S&P Global Ratings

RatingsDirect®

Canton of Zurich

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This report does not constitute a rating action.

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Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
The Swiss economy remains largely resilient to eurozone macroeconomic challenges.	A significant increase in tax revenue collection and higher Swiss National Bank (SNB) dividend payouts will lead to a surplus after capital accounts in 2022.
The Canton of Zurich's economic situation remains strong, and we expect it to expand in line with the Swiss average.	A shortfall in SNB dividends will pressure cantons' financials in 2023.
Zurich anchors Switzerland's financial sector and remains the highest net contributor to the national equalization system.	Prudent financial management should limit adverse budgetary effects over our forecast horizon.
	Moderate debt and exceptional liquidity will allow the canton to finance transitory deficits.

The Canton of Zurich's creditworthiness remains exceptional, thanks to a very strong economy, sound management, and low debt. The rating is supported by the resilient and very strong economic foundation of the canton, which operates in an extremely predictable and supportive institutional framework. S&P Global Ratings believe that the canton will post a surplus after capital accounts in 2022. In contrast, we think the canton will face some budgetary challenges in 2023, such as an assumed shortfall of SNB dividends as well as a potential one-off compensation payment to its municipalities for costs accrued from operating children and youth homes.

Nevertheless, in our opinion, the very strong cantonal financial management should prudently manage current macroeconomic challenges and expenditure-side pressures. The canton's moderate debt level and exceptional liquidity position will allow it to finance manageable deficits in our forecast.

Outlook

The stable outlook on the Canton of Zurich reflects our view of its prudent financial management and the limited effects of the current economic slowdown in Switzerland. The still-strong economy, with low unemployment, moderate inflation, and continuous GDP growth, will support the canton's revenue generation, offsetting potential negative effects from additional budgetary challenges, such as a potential shortfall of SNB dividends.

Downside scenario

We could lower the rating on the Canton of Zurich if the current financial position weakens, resulting in a structural deterioration of its budgetary position and a worsening of the liquidity and debt positions. Additionally, we could lower the rating if Zuercher Kantonalbank (AAA/Stable/A-1+) has to call on the canton for substantial support, with a meaningful impact on the canton's finances.

Rationale

The canton has strong fundamentals that should allow it to withstand adverse financial effects from current macroeconomic developments.

Switzerland's economy remains very resilient, despite geopolitical headwinds from the Russia-Ukraine conflict and the ensuing macroeconomic slowdown in the eurozone. S&P Global Ratings projects real GDP growth of 2.4% in 2022 and a slower but still positive 1.1% in 2023, before recovering to 1.6% and 1.4% in 2024 and 2025, respectively. Although current inflation is high by Swiss standards and above the SNB's target range, it will likely peak at moderate levels in an international comparison of 3.1% in 2022 and 2.6% in 2023. With an estimated national GDP per capita of about $95,000 in 2022, Switzerland remains one of the world's strongest economies.

In this context, Zurich stands out, with a per capita GDP at about 120% of the national average, as the country's largest business hub. We also view positively that the unemployment rate in the canton is well below the national average. Although the financial industry dominates the Canton of Zurich's economic structure, we view this sector as broad and highly diversified, with commercial and investment banking, wealth-management activities, and a strong insurer presence. Trade, information technology, real estate, health, and education also contribute a substantial share to the service sector's value added, so we do not see a concentration risk. The canton's economy has been resilient thanks to its diversity, especially the strong fundamentals of the financial sector.

Our ratings on Zurich are supported by our view of the Swiss institutional framework for cantons as extremely predictable and supportive. Changes to the system are infrequent. When any are proposed, they are tested well in advance, and are subject to approval by the cantons before being implemented. The Canton of Zurich continues to contribute the highest share to Switzerland's cantonal equalization system, thanks to its economic strength. In 2022, the canton's contribution was Swiss francs (CHF) 492.5 million, about 29% of Swiss cantons' overall CHF 1.6 billion contribution.

In our opinion, the canton's financial management is highly sophisticated, including conservative and excellent liquidity and debt management. This positions the canton well for financial challenges ahead in 2023, such as an expected shortfall of SNB dividends and a potential one-off payment to its municipalities as compensation for the costs of operating children and youth homes. We currently do not expect any major changes to the canton's financial policies, given the strong cantonal financial framework, which requires the government to present consolidation measures on expenditure for the next budget and financial planning if it deviates negatively from institutionalized requirements for medium-term balanced income statements. The Canton of Zurich has managed several consolidation programs in the past, primarily by implementing cost-saving measures, which is why we expect the cantonal government and parliament would be highly likely to follow a similar process in case of need.

Temporary deficits in our forecast can be comfortably covered by slight increases in debt

We believe that the canton will outperform its 2022 budget significantly, posting an operating surplus of 6.8% alongside a marginal surplus after capital accounts. The better financial performance can be primarily attributed to significantly higher-than-budgeted tax collections and elevated profit distributions from the SNB. However, we forecast weaker margins from 2023, and deficits after capital accounts over the forecast horizon. We currently assume that there will be no profit distribution from the SNB in 2023, following the bank's reported balance-sheet loss of CHF142 billion in the first nine months of 2022, the continued deterioration in global markets, rising interest rates, and based on the asset composition of the SNB's balance sheet. Furthermore, the canton will potentially have to bear additional compensation costs stemming from a court ruling against it, originally filed by two municipalities. Next year will also see a substantial increase in personnel costs, driven by inflation-induced salary adjustments and staff additions, which will also affect subsequent budget years. This will pressure the canton's budgetary performance in 2023 but be partly compensated by the higher tax collection assumed in our forecast. However, we expect the canton to maintain its tight financial management policies, financing increasing expenditure with higher revenue.

We expect the canton's tax-supported debt to increase to about 40% of consolidated operating revenue by 2024, since it will need to finance the moderately negative balances after capital accounts. Although the canton engaged in short-term borrowing in recent years, we believe that this will no longer be used to cover debt service and deficits. We continue to view financing conditions for Swiss cantons as excellent, particularly for the Canton of Zurich. Our view on the canton's debt is, however, burdened by its ownership of Zuercher Kantonalbank (AAA/Stable/A-1+). Although the bank has solid creditworthiness, given its very large size compared to the cantonal budget, any potential requirement of financial support could be material for the canton. However, we currently see the likelihood that such support would be needed as very remote.

In our view, the Canton of Zurich's liquidity position is exceptionally strong in an international comparison, primarily based on its access to the deep Swiss franc money and bond markets. The canton has internal guidelines for minimum liquidity, which we expect it will generally follow. However, we currently see some leeway in its liquidity position, which we expect the canton will utilize to cover the deficits we anticipate over our forecast period. After relatively high maturities in 2020 and 2021, the canton only has moderate long-term maturities due over our forecast horizon. Our liquidity assessment also takes into consideration the Canton of Zurich's committed credit line and its strong access to the broad Swiss capital market. We believe the canton can cover its financing requirements by accessing the market with long- and short-term debt instruments. It has a track record of strong demand for its issues, even in periods of market turbulence.

Canton of Zurich Selected Indicators

Mil. CHF	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenue	15,971	16,292	18,321	17,656	17,752	17,675
Operating expenditure	14,743	15,118	16,819	16,460	17,675	17,379
Operating balance	1,227	1,174	1,501	1,196	77	296
Operating balance (% of operating revenue)	7.7	7.2	8.2	6.8	0.4	1.7
Capital revenue	33	88	79	82	83	84
Capital expenditure	1,116	1,256	1,236	1,230	1,269	1,309
Balance after capital accounts	145	6	344	48	(1,109)	(929)
Balance after capital accounts (% of total revenue)	0.9	0.0	1.9	0.3	(6.2)	(5.2)
Debt repaid	1,400	1,651	1,094	600	450	210
Gross borrowings	1,470	2,049	875	200	1,000	1,100
Balance after borrowings	221	405	(10)	(351)	(549)	(25)
Direct debt (outstanding at year-end)	5,908	6,319	6,100	5,700	6,250	7,140
Direct debt (% of operating revenue)	37.0	38.8	33.3	32.3	35.2	40.4
Tax-supported debt (outstanding at year-end)	5,920	6,331	6,100	5,700	6,250	7,140

Canton of Zurich Selected Indicators

Tax-supported debt (% of consolidated operating revenue)	37.1	38.9	33.3	32.3	35.2	40.4
Interest (% of operating revenue)	0.5	0.3	0.3	0.4	0.4	0.4
Local GDP per capita ($)	102,131.7	102,622.1	110,145.7	113,753.9	115,487.8	118,121.9
National GDP per capita ($)	83,826.9	85,327.7	91,619.0	94,662.0	96,113.4	98,310.2

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. CHF--Swiss franc. $--U.S. dollar.

Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1
Budgetary performance	2
Liquidity	1
Debt burden	3
Stand-alone credit profile	aaa
Issuer credit rating	AAA

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "**Methodology For Rating Local And Regional Governments Outside Of The U.S.**," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct.10, 2022. A free interactive version is available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, Nov. 3, 2022
- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022,
- Cantons Will Likely Withstand Temporary Instability Of Swiss National Bank Profit Distributions, Aug. 17, 2022
- Switzerland, Aug. 15, 2022
- Local Government Debt 2022: Can German, Austrian, And Swiss Borrowing Volumes Continue Their Post-COVID Normalization?, April 6, 2022
- Zuercher Kantonalbank, Nov. 19, 2021

Ratings Detail (as of November 14, 2022)*

Zurich (Canton of)	
Issuer Credit Rating	AAA/Stable/--
Senior Unsecured	AAA
Issuer Credit Ratings History	
10-May-1994	AAA/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.