S&P Global
Ratings

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Research Update:

Canton of Zurich 'AAA' Ratings Affirmed; Outlook Stable

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Overview

- We view the Canton of Zurich (Zurich-Canton) as Switzerland's economic center, which allows it to make high contributions to the cantonal equalization system.
- We forecast that Zurich-Canton's budgetary performance will weaken, owing to a cut in the corporate tax rate and increased capital expenditure, but that management will maintain good financial indicators.
- We are affirming our 'AAA' ratings on Zurich-Canton.
- The outlook is stable.

Rating Action

On Nov. 22, 2019, S&P Global Ratings affirmed its 'AAA' long-term issuer credit rating on the Swiss Canton of Zurich (Zurich-Canton). The outlook is stable.

We also affirmed our 'AAA' issue rating on Zurich's senior unsecured debt.

Outlook

The stable outlook reflects our expectation that Zurich-Canton's financial management will successfully keep forecast deficits under control, maintain a sufficient level of liquidity, and limit debt uptake. We believe that the canton will weather the effects of the corporate tax reform and increased capital program without significant drawbacks to its budgetary performance, liquidity, or debt.

Downside scenario

We could lower the rating if Zurich-Canton loosens its grip on budgetary performance because of the corporate tax reform and its increased capital program and reduces its liquidity levels, which would reflect a weaker commitment to maintaining sound financial indicators beyond our base-case horizon through 2021. Additionally, we could lower the rating if Zuercher Kantonalbank (AAA/Stable/A-1+) were to call upon the canton for substantial support. However, we currently view these scenarios as unlikely.

Rationale

Zurich-Canton is Switzerland's economic powerhouse. It is therefore a major contributor to Switzerland's equalization system enshrined in the excellent institutional framework. We expect budgetary performance to weaken in the next few years because of the implementation of the cantonal corporate tax reform and an increased capital spending program, with moderate deficits after capital accounts. However, we assume that the canton's financial management will maintain both its grip on budgetary execution and benchmark financial indicators. A reduction of liquidity and moderate increase in debt will help finance forecast deficits, in our opinion.

Zurich-Canton's economy is a bellwether for the Swiss economy

Zurich-Canton's economy contributes 21% to the Swiss GDP, and, therefore, impacts the overall economic outlook for Switzerland. Its GDP per capita is roughly 20% above the Swiss average. Although its economic structure is dominated by the financial industry, we view this sector as broad and highly diversified with commercial and investment banking, wealth management activities, and a strong presence of insurance companies. However, trade, information technology, real estate, health, and education also contribute a substantial share to the service sector's value added, so we don't see a concentration risk for Zurich-Canton's economy.

Zurich-Canton contributes the highest share to Switzerland's cantonal equalization system, thanks to its economic strength. It is slated to provide Swiss franc (CHF) 584.1 million in 2020, 32.4% of Swiss cantons' total CHF1.8 billion overall contributions. We view the Swiss institutional framework for cantons as extremely predictable and supportive, since the impact of any of the infrequent changes is tested well in advance and cantons have to approve such changes before they can be implemented. A slightly amended new national equalization system comes into effect as of 2020 with minor changes from the previous one.

Cantonal parliament elections in March 2019 led to a slight majority of center and center-left parties (particularly green parties). The cantonal executive government elections confirmed the right and center-right majority, but it was less pronounced. However, we do not expect any major changes to the canton's financial policies, given the strong cantonal financial framework requiring balanced accrual income statements over an eight-year horizon (three actual years and five forecast years). Negative deviations require the government to present consolidation measures on expenditure for the next budget and financial plan; these measures must aim for a return to balanced income statements. In the two prior decades, Zurich-Canton has managed several consolidation programs, primarily by implementing cost-saving measures, which is why we expect that the cantonal government and parliament would be highly likely to follow a similar process. In our opinion, the cantonal administration is highly sophisticated, applying state-of-the-art management tools and including conservative and excellent liquidity and debt management.

Budgetary performance will weaken, but financial indicators will remain reasonable

We expect Zurich-Canton's budgetary performance to weaken from 2019-2023 and that it will report deficits after capital accounts of 3.5% on average, in contrast to the recorded surpluses after capital accounts of 0.9% in 2016-2018. For 2019-2020, the canton budgeted higher capital spending to construct cantonal police headquarters and a court complex. As of 2021, the cantonal tax reform comes into play, introducing a reduction of the corporate tax to 7% from 8%, as well as additional tax exemptions, such as higher amortization of research and development expenses (up to 150% of actual expense) and revenue from patent fees. Although Zurich-Canton will receive partial compensation from the federal government for these revenue losses, the net effect of the cantonal corporate tax reform will hit its budget by CHF180 million.

We predict slightly better budgetary performance than Zurich-Canton does because actual results have often exceeded those budgeted. And we think the canton will continue to strictly manage its budget, thanks to its budgetary flexibility being quite high in both a domestic and an international context. Zurich-Canton's pension fund is fully funded, with a coverage ratio of 102.2% as of Oct. 31, 2019, which therefore does not affect financial flexibility or burden the canton with additional operating expense.

Negative budgetary performance will affect both Zurich-Canton's liquidity and debt. We expect that it will cover part of the deficits by raising new debt in capital markets. The canton has repaid substantial amounts of debt in recent years, and created room for new funding requirements. We anticipate tax-supported debt, which is only slightly higher than direct debt, will moderately increase to 42% by 2021. Financing conditions for cantonal borrowers in Switzerland are excellent, in particular for Zurich-Canton, which was able to secure some borrowings at negative rates, depending on maturities. Zurich-Canton's debt assessment is burdened by its portfolio of government-related entities (GREs), particularly its ownership of Zuercher Kantonalbank, whose balance sheet is roughly 10x Zurich-Canton's operating revenue. We would expect that the canton is able and willing to provide support for its GREs, if needed, for example for recapitalization. However, we currently see no likelihood that it will need to provide such support.

A negative interest-rate environment currently prevails in Switzerland, linked to the monetary policy of the Swiss National Bank. Zurich-Canton aims to avoid negative interest payments on its deposits. The canton has an internal guideline for minimum liquidity, which we expect it will generally follow. This guideline will, however, allow a drain on its cash positions, which are at present about twice as high as the guideline requires. In 2020, Zurich-Canton has higher maturities falling due, meaning its debt-service coverage will drop in this specific year. But we expect it will improve again to nearly full cash coverage. In our assessment, we also include Zurich-Canton's committed credit line and its strong access to the broad Swiss capital market. Zurich-Canton is a preferred debtor in Swiss capital markets, and so we think that the canton can easily cover its financing requirements by accessing the market with long- and short-term debt instruments focusing on investor needs.

Key Statistics

Table 1

Canton of Zurich Selected Indicators

	--Fiscal year ending Dec. 31--					
(Mil. CHF)	**2016**	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**
Operating revenues	14,597	15,000	15,479	15,611	16,308	16,265
Operating expenditures	13,620	14,004	14,460	14,875	15,496	15,788
Operating balance	978	996	1,019	736	812	477
Operating balance (% of operating revenues)	6.7	6.6	6.6	4.7	5.0	2.9

Table 1

Canton of Zurich Selected Indicators (cont.)

	--Fiscal year ending Dec. 31--					
(Mil. CHF)	2016	2017	2018	2019bc	2020bc	2021bc
Capital revenues	56	41	47	37	56	86
Capital expenditures	729	959	1,064	1,280	1,303	1,092
Balance after capital accounts	304	78	1	(507)	(435)	(529)
Balance after capital accounts (% of total revenues)	2.1	0.5	0.0	(3.2)	(2.7)	(3.2)
Debt repaid	500	1,200	905	550	1,150	175
Gross borrowings	50	1,725	981	800	1,450	675
Balance after borrowings	119	647	101	(250)	(168)	(26)
Direct debt (outstanding at year-end)	5,737	5,638	5,714	5,964	6,264	6,764
Direct debt (% of operating revenues)	39.3	37.6	36.9	38.2	38.4	41.6
Tax-supported debt (outstanding at year-end)	5,749	5,650	5,726	5,976	6,276	6,776
Tax-supported debt (% of consolidated operating revenues)	39.4	37.7	37.0	38.3	38.5	41.7
Interest (% of operating revenues)	0.7	0.7	0.6	0.5	0.5	0.6
Local GDP per capita (CHF)	93,742	94,351	96,814	98,469	100,449	102,638
National GDP per capita (CHF)	78,568	78,917	80,700	82,087	83,747	85,580

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. CHF--Swiss franc. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Canton of Zurich 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, 2019. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Summary: Switzerland, Aug. 23, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Local Government Debt 2019: Slower Debt Reduction For German States And Little Change For Swiss And Austrian LRG Debt, March 1, 2019
- Banking Industry Country Risk Assessment: Switzerland, Nov. 30, 2018
- Public Finance System Overview: Swiss Cantons, Nov. 20, 2018
- International Public Finance Rating Trends: German, Austrian, And Swiss Local And Regional Governments, Oct. 22, 2018
- Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others?, Aug. 29, 2018

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Zurich (Canton of)	
Issuer Credit Rating	AAA/Stable/--
Senior Unsecured	AAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.