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Zurich (Canton of)

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Table Of Contents

Zurich (Canton of)

Key Rating Factors

Issuer Credit Rating
AAA/Stable/--

Credit context and assumptions	Base-case expectations
• We expect that the resilient budgetary performance for the Canton of Zurich (Zurich-Canton) will mitigate COVID-19-related impacts, thanks to the strong fundamentals of its diversified industrial sector. • Budgetary performance will weaken over the forecast horizon due to tax revenue shortfalls and expenditures related to the pandemic, as well as additional strain from the corporate tax reform and the outcomes of other recent referendums. • Zurich-Canton anchors Switzerland's financial sector and remains the highest net contributor to the cantonal equalization system.	• Zurich-Canton's revenue structure is not as sensitive as international peers', thanks to the Swiss tax system and resilient economy, with a particularly healthy financial sector. • Expenditures will continue to be burdened by COVID-19 fallout, the corporate tax reform, and additional referendum decisions. • The canton should be able to easily cover expected deficits via strong capital market access and exceptional financial management.

Outlook

S&P Global Ratings' outlook on Zurich-Canton is stable. It reflects our expectation that the canton's financial management will keep budget deficits under control, maintain sufficient liquidity, and limit debt uptake, despite the COVID-19-induced economic recession. Additional headwinds stem from the corporate tax reform, the capital program, and other referendum decisions.

Downside scenario

We might lower the rating if Zurich-Canton's financial position eroded significantly because of costly financial policies. A material liquidity deterioration, reflecting weaker financial indicators, could also weigh on the rating. Additionally, we could lower the rating if Zuercher Kantonalbank (AAA/Stable/A-1+) were to call upon the canton for substantial support.

Rationale

We expect the COVID-19 pandemic will trigger a pronounced GDP contraction in Switzerland in 2020. Given that Zurich-Canton is the country's economic and financial center, its downturn and economic recovery will likely move in line with the sovereign's. However, we expect that Zurich-Canton's economy will remain resilient thanks to its diversity, especially owing to the strong fundamentals of the financial sector and value-added production from the teleworking segment.

The immediate COVID-19-related challenges to Switzerland's tax revenue are somewhat cushioned by the time lag introduced through tax collection and assessment mechanics, which will diffuse tax shortfalls and the general impact on budgetary performance in 2020 and 2021. In our view, the expected fiscal recovery in the canton after 2022 will likely be muted by the Swiss corporate tax reform and the recently passed referenda on transferring expenditures from municipalities to the canton under the road law, and additional benefit acts.

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 manageable increase in debt will help finance forecast deficits, in our view.

Economic resilience and strong financial mangement will support Zurich-Canton's recovery path

Although Zurich-Canton's economy, in line with Switzerland's, will suffer from the pandemic, it's relative diversity and wealth levels, in an international context, will offset the damage. We currently project a 4.3% real GDP contraction in 2020, followed by a rebound of 3.9% in 2021, similar to the Swiss economy.

Though the financial sector dominates Zurich-Canton's financial landscape, we view the cantonal economy as broad and highly diversified, with commercial and investment banking, wealth-management activities, and a strong insurance presence. Zurich-Canton's GDP per capita outweighs the national GDP per capita of US$85,500 by about 20%. Due to the canton's industry mix, the coronavirus has not hit the local economy as hard as peers'. For example, while the services-related sector suffered greatly in the first half of the year, the financial industry has not experienced material repercussions.

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 ahead of implementation. Zurich-Canton is the highest contributor to the cantonal equalization system. So far this year, Zurich-Canton has provided Swiss franc (CHF) 584.1 million, accounting for 32.4% of the overall CHF1.8 billion contribution in Switzerland. In August, the road law and additional benefits act (ZLG) were approved by referendum. Both will burden the cantonal budget and relief municipal budgets. The road law will extend funds for construction and maintenance towards municipal roads, whereas ZLG will raise the cantonal share to 70% from 44% to support low-income people and disability pension recipients.

In our opinion, the slight left-wing majority in the cantonal parliament and the slight right-wing majority in the canton's executive government have not impeded a very strong financial management or a sophisticated administration. The strong cantonal financial framework demands balanced accrual income statements over an eight-year horizon (three actual years and five forecast years). Negative deviations require the government to present expenditure consolidation measures for the next budget and a financial plan to return to balanced accounts. In the past, Zurich-Canton has managed several consolidation programs, primarily by implementing cost-saving measures. We currently view the introduction of similar cost-savings as a likely scenario once the effects of the pandemic subside.

Higher spending needs will debilitate the canton's budgetary performance, but liquidity and debt levels will remain intact

We forecast Zurich-Canton's budgetary performance to be hit by tax shortfalls and higher expenditures caused by the pandemic, especially in 2020 and 2021. COVID-19 fallout will look somewhat different for Swiss cantons than for international peers though, due to the specifics of Swiss taxation, comprising advance tax payments in the current and possibly two down payments, or returns after tax-filing in following years. We believe that Zurich-Canton's revenue shortfalls will be compensated by higher payouts (4x than budgeted in 2020) from the Swiss National Bank (SNB). Furthermore, the cantonal tax reform comes into play completely in 2021, 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. Overall, however, tax revenue growth will remain intact and losses will be temporary. In our view, Zurich-Canton's budgetary flexibility is quite high in both the domestic and international context. This is especially advantageous, given the needed leeway for potential operating or capital expenditure cuts following the pandemic. Its pension fund's coverage ratio recovered to 98.4% at end-October from 91.5% at end-March 2020.

Zurich-Canton's widening deficit will hurt both liquidity and debt. That said, we expect that the canton will cover the larger part of the deficits by raising new debt in capital markets and, to a smaller degree, with liquidity. The maturity peak of CHF1.15 billion in 2020, elevated short-term debt levels, and higher financing requirements will raise tax-supported debt to 51% by 2022. 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 believe that the canton is able and willing to provide support for its GREs, if needed, for recapitalization, for instance.

We view Zurich-Canton's liquidity as exceptionally strong, primarily based on its preferred debtor of the Swiss franc money and bond market. The canton has an internal guideline for minimum liquidity, which we expect it will generally follow. Still, this guideline will enable a drain on its cash positions, which are currently about twice as high as the guideline requires. As Zurich-Canton has higher maturities falling due this year, the debt-service coverage will drop significantly in 2020 but we expect this to recover once the effects of the pandemic subside. Our calculation of the canton's debt service coverage ratio over the next 12 months also includes a committed credit line, alongside its solid cash position. Given its sound standing in capital markets, we believe the canton could easily fund 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 ends Dec. 31--					
(Mil. CHF)	**2017**	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	15,000	15,479	15,971	16,109	16,048	16,285

Table 1

Canton of Zurich Selected Indicators (cont.)

	--Fiscal year ends Dec. 31--					
(Mil. CHF)	**2017**	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**
Operating expenditures	14,004	14,460	14,743	15,496	15,814	16,106
Operating balance	996	1,019	1,227	613	234	179
Operating balance (% of operating revenues)	6.6	6.6	7.7	3.8	1.5	1.1
Capital revenues	41	47	33	56	92	100
Capital expenditures	959	1,064	1,116	1,153	1,161	1,155
Balance after capital accounts	78	1	145	(484)	(835)	(876)
Balance after capital accounts (% of total revenues)	0.5	0.0	0.9	(3.0)	(5.2)	(5.3)
Debt repaid	1,200	1,640	1,400	1,850	1,400	1,400
Gross borrowings	1,725	1,657	1,470	2,350	2,100	2,100
Balance after borrowings	647	42	221	(17)	(132)	(174)
Direct debt (outstanding at year-end)	5,638	5,714	5,908	6,408	7,108	7,808
Direct debt (% of operating revenues)	37.6	36.9	37.0	39.8	44.3	47.9
Tax-supported debt (outstanding at year-end)	5,650	5,726	5,920	6,845	7,545	8,245
Tax-supported debt (% of consolidated operating revenues)	37.7	37.0	37.1	42.5	47.0	50.6
Interest (% of operating revenues)	0.7	0.6	0.5	0.5	0.5	0.6
Local GDP per capita (single units)	95,608	98,467	98,752	93,923	97,840	101,137
National GDP per capita (single units)	81,764	84,219	84,466	80,338	83,713	86,553

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.

Ratings Score Snapshot

Table 2

Canton of Zurich Ratings Score Snapshot

Key rating factors	**Scores**
Institutional framework	1
Economy	1
Financial management	1
Budgetary perfomance	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. 12, 2020. 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Nov. 5, 2020
- Switzerland 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug 21, 2020
- Canton of Zurich 'AAA' Ratings Affirmed; Outlook Stable, May 22, 2020
- COVID-19 Will Test The Financial Flexibility Of LRGs In Germany, Switzerland, And Austria, April 27, 2020
- Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- Economic Research: COVID-19 Macroeconomic Update: The Global Recession Is Here And Now, March 17, 2020
- Swiss Cantons Will Receive Greater Payouts From SNB, But Will It Last?, March 3, 2020
- Local Government Debt In Germany, Switzerland, And Austria for 2020, March 2, 2020
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug 19, 2019

Ratings Detail (As Of November 20, 2020)*	
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.

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