Canton of Zurich

November 20, 2023

Primary contact

Stefan Keitel
Frankfurt
49-693-399-9254
stefan.keitel
@spglobal.com

Secondary contact

Michael Stroschein
Frankfurt
49-693-399-9251
michael.stroschein
@spglobal.com

This report does not constitute a rating action.

Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
The Swiss economy will remain robust despite challenging economic conditions globally.	Zurich's higher-than expected tax collection in 2023 will allow it to reduce its tax multiplier by one percentage point without triggering substantial budgetary deterioration.
The Canton of Zurich (Zurich) continues to host Switzerland's main financial industry leaders and remains the highest net contributor to the national equalization system.	High tax revenue will also help cushion the shortfall of Swiss National Bank (SNB) profit distribution in 2023 and potentially in 2024, and allow the canton to maintain its competitive financial position.
Prudent financial management will limit adverse budgetary effects over our forecast horizon and maintain moderate debt levels and exceptional liquidity.	Given a court ruling against Zurich, which requires the canton to reimburse its municipalities for residential costs for young people, we expect a temporary deterioration of budgetary performance, which the canton should be able to finance with its ample cash reserves.

S&P Global Ratings believes that very strong financial management will prudently manage expenditure-side pressures and maintain the canton's low debt and very strong liquidity position. Zurich's creditworthiness continues to benefit from a very strong and resilient economic position, coupled with Switzerland's extremely predictable and supportive institutional framework. We assume that the canton's budgetary performance will weaken temporarily from 2023 before returning to solid indicators with balanced budgets after 2025. The budgetary pressures primarily stem from the missing SNB profit distribution for potentially longer than 2023, higher costs from inflation, and a court ruling against Zurich that requires a reimbursement to its municipalities for costs accrued for housing children and young people. The canton can finance small deficits in the next two-to-three years with the ample cash reserves it accumulated during the pandemic. As a result, its debt burden will remain low, while its liquidity position will remain solid due to still-ample cash reserves and uninterrupted access to bank lending and capital market.

We think the canton will maintain its strong financial position and allow for moderate tax cuts to strengthen its fiscal base. In our opinion, the moderate tax cut of one percentage point the canton is planning from 2024 onwards seem manageable, especially considering the higher-than-expected tax revenue in 2023, which is likely to have a base effect on future tax collection.

Outlook

The stable outlook on Zurich reflects our view that the canton's prudent financial management will allow it to navigate expenditure headwinds in a way that will leave its overall financial position largely unaffected. The still-strong economy, with low unemployment and strong tax collection, will provide sufficient buffer.

Downside scenario

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

Rationale

Despite economic challenges, the canton's economic foundation remains robust and underpins its financial resilience

The Canton of Zurich benefits from its position of Switzerland's financial and economic center. With an estimated national GDP per capita of Swiss franc (CHF) 99,500 in 2023 Switzerland remains one of the world's strongest economies. Even in this context, however, Zurich stands out, with a per capita GDP at about 120% of the national average. Despite weaker macroeconomic conditions globally, Switzerland's economy remains very resilient due to its diversified economic structure. After strong growth of 2.6% in 2022, we expect the Swiss economy to modestly expand by 0.6% in 2023 before accelerating to 1.2% and 1.4% in 2024 and 2025, respectively. Unemployment in the canton is usually below the national average at 1.8% at Oct. 31, 2023, compared with 2.0% nationally, according to the Swiss State Secretariat for Economic Affairs.

The local economy in the canton remains diversified despite the strong financial sector, which itself we consider broad with various activities such as commercial and investment banking, wealth-management activities, and a strong insurer presence. Further economic sectors in the canton include trade, IT, real estate, health, and education, which contribute a substantial share to the service sector's value added and limit concentration risk. We think the notable merger between UBS and Credit Suisse, which was completed in June 2023, will have a limited long-term effect on the canton. Layoffs from the merger will most likely be absorbed because we expect the Swiss labor market to remain tight and the canton’s unemployment remains well below the national average. Any potential impact on tax revenue would be temporary and with a lag. Also, UBS will continue Credit Suisse's profitable domestic business, so the complete related tax base will be preserved.

Our ratings on Zurich are supported by the extremely predictable and supportive institutional framework for Swiss cantons. Changes to the system are infrequent. The Canton of Zurich continues to contribute the highest share to Switzerland's national equalization system, thanks to its economic strength. In 2023, its contribution was about CHF497 million, or about 29% of all Swiss cantons' CHF1.7 billion contributions. Two pending national legislative initiatives, one for greater subsidization of health insurance premiums for low-income households and one for cost-free childcare, could theoretically affect the institutional framework's supportiveness for Swiss cantons. However, we think the cantons' representation in the second chamber of the national parliament and the possibility of a referendum can limit the impact for Zurich.

In our view, the canton's financial management is highly sophisticated, including conservative and prudent liquidity and debt management. Financial results for 2022 outperformed the budget largely due to higher-than-expected tax revenue, which now provides fiscal headroom for the canton to navigate the budgetary challenges such as the lack of profit distribution from SNB, higher operating costs due to inflation, and compensation for the costs of operating children and youth homes in 2023 and thereafter. We do not expect any major changes to Zurich'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 has managed several consolidation programs, primarily by implementing cost-saving measures, which is view as a strong track record and commitment to stick to conservative financial policies.

Sound financial buffers will help the canton finance its temporary budgetary deficits with limited debt accumulation

After posting strong financial results in 2022, on higher-than-budgeted tax collections and elevated SNB profit distribution, we expect the canton's operating margins to soften from 2023 with moderate deficit after capital accounts. We attribute the weaker budgetary performance to a shortfall in profit distributions from SNB; higher inflation-fueled operating expense, especially in personnel costs; and compensation costs from a court ruling against the canton, originally filed by two municipalities. We think the canton will be able to finance the small deficits after capital accounts with its ample cash reserves accumulated during the pandemic and potentially limited debt accumulation. The adverse factors should be short-to-medium-term, without long-lasting effects on the cantonal finances. We expect the canton to return to balanced budgets after 2025.

On the other hand, the continuously high tax revenue from the very strong tax base will allow Zurich to cover additional structural tax measures such as the planned and accounted for reduction in the cantonal tax multiplier (to 98% from 99%) and the profit tax for companies (to 6% from 7%). We believe that these measures will temporarily burden the canton’s revenue but will strengthen its economy and tax base structurally, thereby supporting its financial position.

Due to structurally solid budgetary performance, we expect Zurich to maintain a low debt burden. The canton reduced its debt stock to about 30% in 2022 from 38% in 2020 due to much higher-than-expected revenue. We project Zurich's tax-supported debt to stay at about 37% of consolidated operating revenue in 2025, since the canton will need to finance the moderately negative balances after capital accounts in our base-case scenario. Although the canton engaged in short-term borrowing in recent years, we think this will no longer be used to cover debt service and deficits structurally, but rather remain a tool to smooth over short periods of low revenue during the year. Our view on the canton's debt is remains burdened by our assessment of the canton's ownership of Zuercher Kantonalbank as a contingent liability. Although the bank has solid creditworthiness, its very large size compared to the cantonal budget turn any potential requirement of financial support into a substantial financial burden for the canton. However, we see the likelihood that this support would be needed as very remote.

Our overall assessment of Zurich's liquidity position remains exceptionally strong in an international comparison, primarily based on its access to the deep Swiss franc money and bond markets as well as its committed credit lines. It has a proven track record of strong demand for its issues, even in periods of market turbulence, and employs internal guidelines for minimum liquidity, which we expect it will generally follow. We anticipate the canton will partially cover the projected deficits after capital accounts (over the forecast period) from its existing reserves. Additional financing requirements could be addressed by accessing the market with long- and short-term debt issuances. After relatively high maturity levels in 2020 and 2021, the canton only has moderate long-term maturities due over our forecast horizon.

Canton of Zurich Selected Indicators

Mil. CHF	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenue	16,292	18,321	18,317	18,256	18,305	18,594
Operating expenditure	15,118	16,819	16,970	17,720	17,779	17,997
Operating balance	1,174	1,501	1,347	536	526	597
Operating balance (% of operating revenue)	7.2	8.2	7.4	2.9	2.9	3.2
Capital revenue	88	79	65	83	88	86
Capital expenditure	1,256	1,236	1,078	1,269	1,309	1,351
Balance after capital accounts	6	344	334	(650)	(695)	(668)
Balance after capital accounts (% of total revenue)	0.0	1.9	1.8	(3.5)	(3.8)	(3.6)
Debt repaid	1,651	1,094	1,178	600	700	700
Gross borrowings	2,049	875	645	1,000	1,200	1,200
Balance after borrowings	405	(10)	(158)	(240)	(181)	(164)
Direct debt (outstanding at year-end)	6,319	6,100	5,567	5,967	6,467	6,967
Direct debt (% of operating revenue)	38.8	33.3	30.4	32.7	35.3	37.5
Tax-supported debt (outstanding at year-end)	6,331	6,100	5,567	5,967	6,467	6,967
Tax-supported debt (% of consolidated operating revenue)	38.9	33.3	30.4	32.7	35.3	37.5
Interest (% of operating revenue)	0.3	0.3	0.3	0.4	0.4	0.4
Local GDP per capita ($)	102,622.1	111,579.7	111,285.9	119,195.7	120,565.5	118,860.2
National GDP per capita ($)	85,568.2	93,080.2	92,869.0	99,467.7	100,611.1	99,187.4

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.

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. 9, 2023. A free 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
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Credit Conditions Europe Q4 2023: Resilience Under Pressure Amid Tighter Financial Conditions, Sept. 26, 2023
- Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening, Sept. 25, 2023

- Switzerland 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 11, 2023
- Institutional Framework Assessment: Swiss Cantons Benefit From Autonomy And Robust Checks And Balances, May 23, 2023
- Zuercher Kantonalbank, Nov. 22, 2022

Ratings Detail (as of November 15, 2023)*

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.