S&P Global
Ratings

RatingsDirect®

Canton of Zurich

November 22, 2021

PRIMARY CONTACT

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

SECONDARY CONTACT

Thomas F Fischinger
Frankfurt
49-693-399-9243
thomas.fischinger
@spglobal.com

This report does not constitute a rating action.

Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
--We expect the Canton of Zurich's economic recovery to be in line with previous assumptions.	--Prudent financial management will limit adverse budgetary effects over our forecast horizon.
--Although we expect economic growth to be slightly below national levels in 2021, we think the canton's overall economic situation remains solid.	--We assume revenue recovery to be in line with economic recovery in 2021 and stable in 2022.
--Continuously high dividend reserves at SNB point to additional payouts for Swiss cantons in coming years.	--Comfortable debt and liquidity positions will allow for financing of small deficits.
--Additional costs from road law and the additional benefits act have been integrated into financial planning and will pose no additional risk.	

The rating on the Canton of Zurich (AAA/Stable/--) remains exceptional in a national and international context. This is mainly thanks to very strong underlying financial indicators and a very strong track record of financial management, as well as an extremely predictable and supportive institutional framework. In our assessment, we take into consideration that the canton has a very strong economic background, showing significant resilience to the COVID-19 pandemic. The canton is able to consolidate budgetary challenges in its year-end results and therefore keep a stable financial position, demonstrated by both an exceptional liquidity position and a moderate debt burden.

Outlook

The stable outlook on the Canton of Zurich reflects our view of the canton's prudent financial management. We think strong economic recovery and additional SNB dividend payouts, as well as constructive use of debt and liquidity positions, will result in rising revenues, offsetting potential negative effects stemming from additional budgetary challenges such as the road law and additional benefits act (ZLG).

Downside scenario

We could lower the rating on the Canton of Zurich if the current financial position substantially weakened, resulting in a severe and structural deterioration of the canton's budgetary position and an ensuing worsening of the liquidity and debt positions. Additionally, we could lower the rating if Zuercher Kantonalbank (AAA/Stable/A-1+) had to call on the canton for substantial support.

Rationale

Economic recovery and tax revenue recovery is stabilizing the canton's budgetary position.

The pandemic had a pronounced negative effect on economic levels in Switzerland, including the Canton of Zurich, in 2020, but we do not expect significant long-lasting negative effects on tax revenue going forward. We expect national economic recovery will be 3.55% in 2021. Although the canton's recovery might be slightly weaker than the Swiss national average this year, we expect the canton's overall economic situation to return to pre-pandemic levels. Whereas we previously assumed that adverse economic effects would translate into a considerable negative impact on revenue for the canton in 2021 and 2022, we are now seeing only moderate effects in 2021, which could also be the case in 2022. This is partly due to higher-than-expected tax inflows and the additional dividend payout of the Swiss National Bank (SNB).

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 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 do not see a concentration risk. The canton's economy has been resilient thanks to its diversity, especially owing to the strong fundamentals of the financial sector and value-added production from the teleworking segment.

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 came into effect in 2020. The Canton of Zurich continues to contribute the highest share to Switzerland's cantonal equalization system, thanks to its economic strength. Despite a slight net reduction in 2021 due to increased compensation for socioeconomic effects, the canton's contribution amounted to Swiss francs (CHF) 499.6 million, about 29% of Swiss cantons' overall total CHF1.7 billion contribution.

In September 2020, the road law and the 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 toward municipal roads, while the ZLG will raise the cantonal share to 70% from 44% to support pension recipients.

In our opinion, the cantonal administration is highly sophisticated, including conservative and excellent liquidity and debt management. 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 plan 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.

Minor upticks of debt will cover slight deficits after capital accounts in our base case.

We expect the economic recovery and subsequent tax revenue increases, as well as highly likely additional dividend payouts by SNB--which currently allows for up to 6x dividend payouts if the SNB dividend reserve is sufficiently high--to result in higher-than-expected revenue over our forecast horizon. Given the specifics of the Swiss taxation system, comprising advance tax payments in the current and possibly a delay of up to two years to settle tax bills, we still assume a moderate negative base impact on tax levels for 2021 and 2022. In terms of expenditure, the effect of cantonal tax reform is fully implemented in the canton's budgets, which is also true for the additional pressure stemming particularly from the road law and the ZLG, which will come into full effect in 2022 and limit budgetary recovery post-pandemic. However, we expect the canton to maintain its tight financial management position and finance increasing expenditure with higher revenue, without resorting to structural debt financing of operational costs.

The slightly negative budgetary performance, as shown by small deficits after capital accounts over our forecast horizon, will affect the Canton of Zurich's liquidity and debt. We still anticipate tax-supported debt--which is only slightly higher than direct debt--will increase to 44% by 2023. We continue to view financing conditions for cantons in Switzerland as excellent, particularly for the Canton of Zurich, which remains able to secure short-term borrowings at negative rates. We consider the canton able and willing to provide support for its government-related entities, if needed, for recapitalization, for example. The Canton of Zurich's debt assessment is mainly burdened by its ownership of Zuercher Kantonalbank, for which potential additional financial support would pose a significant financial risk for the canton. However, we currently see no likelihood that it will need to provide such support.

We continue to view the Canton of Zurich's liquidity as exceptionally strong, primarily based on its access to the deep Swiss franc money and bond market. A negative interest-rate environment continues to prevail in Switzerland, linked to the SNB's monetary policy. The canton has an internal guideline 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 to use intra-year to manage the cash balance and potentially small deficits. After relatively high maturities in 2020 the canton only has moderate long-term maturities coming 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. The canton is a preferred debtor in Swiss capital markets, so we think the canton can easily cover its financing requirements by accessing the market with long- and short-term debt instruments focusing on investor needs.

Canton of Zurich Selected Indicators

Mil. CHF	2018	2019	2020	2021bc	2022bc	2023bc
Operating revenue	15,479.0	15,970.6	16,292.0	16,830.0	16,822.0	17,003.0
Operating expenditure	14,460.0	14,743.3	15,117.9	16,160.0	16,485.0	16,622.0
Operating balance	1,019.0	1,227.4	1,174.1	670.0	337.0	381.0
Operating balance (% of operating revenue)	6.6	7.7	7.2	4.0	2.0	2.2
Capital revenue	46.5	33.1	88.2	93.0	62.0	75.0
Capital expenditure	1,064.2	1,115.7	1,256.1	1,170.0	1,130.0	1,153.0
Balance after capital accounts	1.3	144.8	6.3	(407.0)	(731.0)	(697.0)
Balance after capital accounts (% of total revenue)	0.0	0.9	0.0	(2.4)	(4.3)	(4.1)
Debt repaid	1,640.0	1,400.0	1,651.0	875.0	750.0	900.0
Gross borrowings	1,657.0	1,470.0	2,049.0	875.0	1,325.0	1,450.0
Balance after borrowings	42.2	220.7	404.9	(405.0)	(155.0)	(150.0)
Direct debt (outstanding at year-end)	5,714.0	5,907.8	6,319.0	6,319.0	6,894.0	7,444.0
Direct debt (% of operating revenue)	36.9	37.0	38.8	37.6	41.0	43.8
Tax-supported debt (outstanding at year-end)	5,726.0	5,919.5	6,330.5	6,330.5	6,905.5	7,455.5
Tax-supported debt (% of consolidated operating revenue)	37.0	37.1	38.9	37.6	41.1	43.9
Interest (% of operating revenue)	0.6	0.5	0.3	0.5	0.4	0.4
Local GDP per capita ($)	107,190.8	105,877.5	108,009.4	116,121.3	115,848.1	116,128.7
National GDP per capita ($)	86,083.1	85,029.6	86,756.5	93,277.1	93,065.3	93,299.4

Canton of Zurich Selected Indicators

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 to 6
Economy	1 to 5
Financial management	1 to 5
Budgetary performance	1 to 5
Liquidity	1 to 5
Debt burden	1 to 5
Stand-alone credit profile	e.g. bbb
Issuer credit rating	e.g. BBB

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, April 12, 2021; 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Related Research

- Institutional Framework Assessment: Swiss Cantons, Jan. 14, 2021
- Bulletin: Swiss National Bank Higher Payout To Government Offers Budgetary Relief, Feb. 3, 2021
- Local Government Debt 2021: COVID Aftershocks Push German And Austrian LRGs Into Heavy Borrowing, March 25, 2021
- Local Government Debt 2021: The Pandemic Takes More Of The Shine Off Large Developed Regions' Credit Quality, March 25, 2021
- Local Government Debt 2021: Global Borrowing To Hit $2.25 Trillion, March 25, 2021
- Zuercher Kantonalbank, Dec. 10, 2020

Ratings Detail (as of November 19, 2021)*

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.