27 January 2023

Sovereign and Public Sector

Swiss Confederation
Rating Report

STABLE OUTLOOK

AAA

Credit strengths

- Wealthy and diversified economy
- Institutional strengths
- Very robust public finances
- Excellent external resilience

Credit challenges

- Financial imbalances, very large banking sector
- Uncertainties about future Swiss-EU trade relations

Rating rationale:

Wealthy and well-diversified economy: Switzerland's ratings are supported by a competitive economy, a highly skilled labour force and institutional strengths including a stable, consensus-oriented, effective policy framework, which, in aggregate, underpin its economic resilience. The Swiss economy has performed robustly in 2022, although growth is slowing due to repercussions of the war in Ukraine on inflation, monetary policy and the real economy.

Prudent fiscal management and low public debt: Solid public finances and the authorities' strong commitment to longer-term debt sustainability remain core credit strengths. This is underpinned by stringent, constitutionally anchored budgetary rules and favourable financing conditions.

Very robust external sector: Switzerland benefits from a significant net external asset position, highly competitive exporting industries and the safe haven status of the Swiss franc.

Rating challenges include: i) a very large banking sector in relation to GDP, posing contingent liability risk to public finances; and ii) imbalances in the real estate market, with high levels of residential overvaluation, after the continued increase in residential property prices since 2020, increasing vulnerability to market corrections. Switzerland's withdrawal from negotiations on the institutional framework agreement with the EU prolongs uncertainty over Swiss-EU near-to-medium-term trade relations. This could have negative effects on the Swiss economic outlook over the longer term.

Switzerland's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aaa	CHF [+0]	+1/3	AAA
Public Finance Risk		20%	aaa		+2/3	
External Economic Risk		10%	aaa		+2/3	
Financial Stability Risk		10%	aa-		-2/3	
ESG Risk	Environmental Factors	5%	aaa		0	
	Social Factors	7.5%	bb+		+1/3	
	Governance Factors	12.5%	aaa		0	
Indicative outcome		**aaa**			**+1**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced over the next 12-18 months.

Positive rating-change drivers

- N/A

Negative rating-change drivers

- Financial stability risks materialise with significant negative implications for economic growth and public finances
- Significant worsening of the economic outlook, for example due to a material deterioration in relations with the EU and trade disruptions

Ratings and Outlook

Foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Lead Analyst

Julian Zimmermann
+49 69 6677389-89
j.zimmermann@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** Switzerland's economy recovered robustly in 2021, growing by 4.2%, after a 2.5% decline in real GDP in 2020 amid the Covid-19 pandemic, but still better than the 6.4% decline observed in the euro area. The recovery was mainly driven by private consumption and net exports. Growth momentum slowed over the first three quarters of 2022, due to weaking external demand and higher energy prices due to repercussions of the full-scale war in Ukraine. Persistent inflationary pressures are likely to continue to curb private consumption, foreign trade and investments. We expect real GDP growth of 2.0% in 2022, 0.6% in 2023 and 1.9% in 2024. Switzerland's real GDP growth potential remains solid at around 1.5% annually.

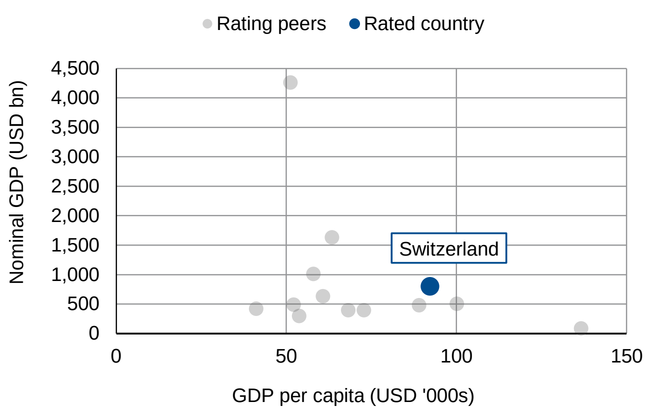
- **Inflation and monetary policy:** After almost a decade of historically very low inflation, Swiss consumer price inflation started to increase from the end of 2021 due to increasing energy prices. CPI inflation rose further over 2022, peaking at 3.5% YoY in August, before slowing down to 2.8% in December, and averaging 2.8% over the full year. Core inflation was more moderate at around 1.7% YoY on average over 2022. To counter inflationary pressures, the Swiss National Bank (SNB) tightened monetary policy and raised its key policy rate by a total of 175bps between June and December 2022 to 1%. The SNB's balance sheet remains large due to high foreign currency investments, although total assets decreased materially from CHF 1.07trn in May 2022 to CHF 883bn in November, reflecting efforts to reduce excess liquidity in the banking sector.

- **Labour markets:** The labour market performed robustly over 2020/22, despite the Covid-19 and energy shocks. Total employment has risen over recent quarters, after having dipped in Q2 2020 due to Covid-19, by around 230,000 persons until Q3 2022, and the unemployment rate stood at a low 1.9% in December 2022. The labour market remains tight and vacancies high with companies experiencing difficulties in recruiting. Amid the economic slowdown we expect the unemployment rate to gradually increase to 2.7% in 2023 and 2.9% in 2024.

Overview of Scope's qualitative assessments for Switzerland's *Domestic Economic Risks*

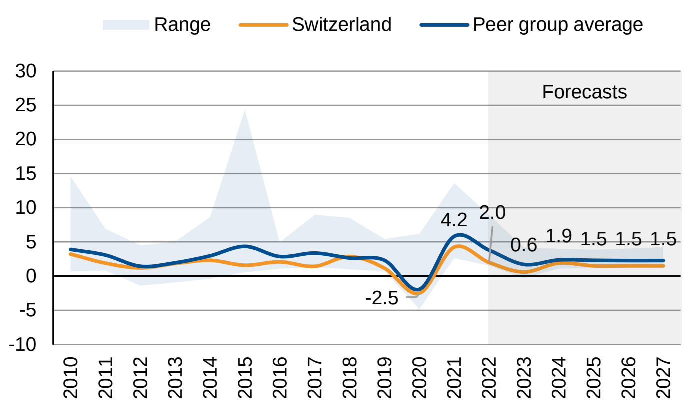
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential, in line with peers
	Monetary policy framework	Neutral	0	Swiss National Bank is a credible central bank. Flexibility is relatively constrained due to sensitivity of FX developments
	Macro-economic stability and sustainability	Strong	+1/3	Very competitive and diversified economy, highly skilled labour force, well-developed infrastructure

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

Public Finance Risks

- **Fiscal outlook:** Switzerland's ratings are further supported by very robust public finances. The central government's debt brake and debt brakes in most cantons call for balanced budgets over the economic cycle. This has resulted in general government budget surpluses averaging 0.9% of GDP over 2015-19. The government's fiscal response to the Covid-19 crisis was effective, targeted and sizeable, with total federal fiscal support of around CHF 40bn between 2020 and 2022. This led to general government deficits of 3.1% of GDP in 2020 and 0.5% in 2021. For 2022, we expect a return to a surplus of around 0.3% of GDP, due to robust revenue and relatively contained expenditure. Public finances in 2023 are expected to benefit from the further withdrawal of Covid-19 measures and continuing growth in tax revenue, especially VAT and direct federal tax. On the other hand, some moderate cost increases are expected, related to housing and integrating Ukrainian refugees and higher defence spending, set to reach 1% of GDP by 2030.

  Overall, fiscal consolidation should progress and we expect very slight, continued general government surpluses in coming years, Still, the absence of SNB dividend pay-outs to the Confederation and the cantons will weigh on the fiscal balance in 2023. Any future SNB dividends and surpluses will be used to reduce Covid-19 debt of CHF 20.3bn at YE 2021.

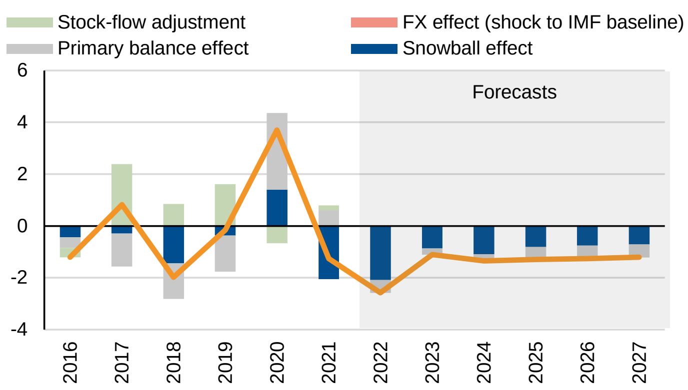
- **Debt trajectory:** The improvement in the general government fiscal balance is accompanied by a decline in the general government debt-to-GDP ratio, which we project to decrease to 38.4% of GDP this year, from 42.1% of GDP in 2021, and to trend towards 33.3% at the end of 2027.

- **Debt profile and market access:** The Swiss Confederation's market access is very strong. The 10-year government bond yield remained negative at -0.4% and -0.2% in 2020 and 2021, respectively, while it gradually increased in 2022, in line with monetary tightening, to 1.1% as of 19 January 2023. A conservative debt profile limits market and interest-rate risks, as bond issues are entirely denominated in Swiss franc, are fixed-rate and have a long average maturity of 10.3 years. Finally, the Confederation had a sizeable cash buffer of CHF 12.6bn at YE 2021.

Overview of Scope's qualitative assessments for Switzerland's *Public Finance Risks*

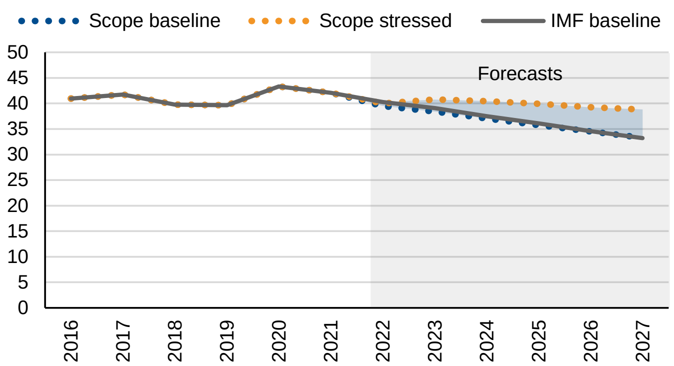
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Fiscal policy framework	Strong	+1/3	Stringent, constitutionally anchored fiscal rules, track record of prudent and stable fiscal policies
	Debt sustainability	Neutral	0	Moderate public debt levels, strong commitment to longer-term debt sustainability
	Debt profile and market access	Strong	+1/3	Highly developed and liquid capital markets supported by Swiss franc's safe-haven status, favourable debt financing costs, long debt maturity

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

External Economic Risks

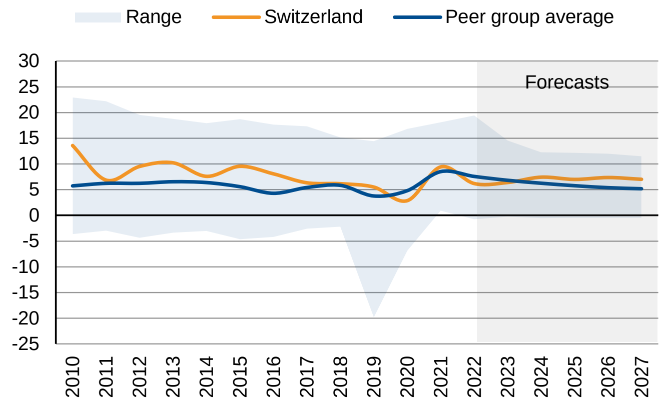
- **Current account:** Switzerland's ratings benefit from high and consistent current account surpluses. These averaged 6.2% of GDP over 2015-19. After a significant contraction to 0.4% of GDP in 2020, the current account surplus recovered to 7.9% of GDP in 2021, boosted by a widening of the goods current account, from 8.6% in 2020 to 13.7% in 2021. The goods trade surplus continued to improve in 2022 and reached 15.9% of GDP in Q3 2022, driving the total quarterly current account surplus to 12.4% of GDP. Switzerland's current account resilience is underpinned by highly specialized, price-insensitive exporting industries, such as pharmaceuticals, which made up around 38% of goods exports in 2021.
- **External position:** Switzerland's robust external position is underpinned by a high net international investment position of 96.5% of GDP as of Q3 2022, slightly below the peak of 131% of GDP in Q1 2021, but in line with pre-pandemic levels. External debt of 285% of GDP in Q3 2022 is relatively high. Most external debt is short-term and held by banks (98% of GDP at Q3 2022), followed by other sectors, including non-financial corporations (35%).
- **Resilience to shocks:** The Swiss franc is considered a safe haven currency, and the SNB holds large foreign currency investments of 104% of estimated 2022 GDP. As a highly open economy, Switzerland is sensitive to global trade shocks and relies on favourable trade relations with its main trading partners, such as the EU. The breakdown of negotiations in May 2021 on the institutional framework agreement with the EU, which was supposed to consolidate existing bilateral trade agreements among the two parties, represents a moderate longer-term risk to the Swiss economic outlook, since lapsing trade arrangements are re-negotiated only on a case-by-case basis and might not all be rolled over.

  A recent re-engagement between a Swiss delegation and the EU is a first positive step in managing future trade relations, although no tangible results have emerged yet. We expect Swiss-EU relations to be maintained in a broadly constructive manner going forward, as reflected by the rejection in 2020 of a popular initiative that would have ended free movement of persons between Switzerland and the EU. Still, downside risks remain.

Overview of Scope's qualitative assessments for Switzerland's *External Economic Risks*

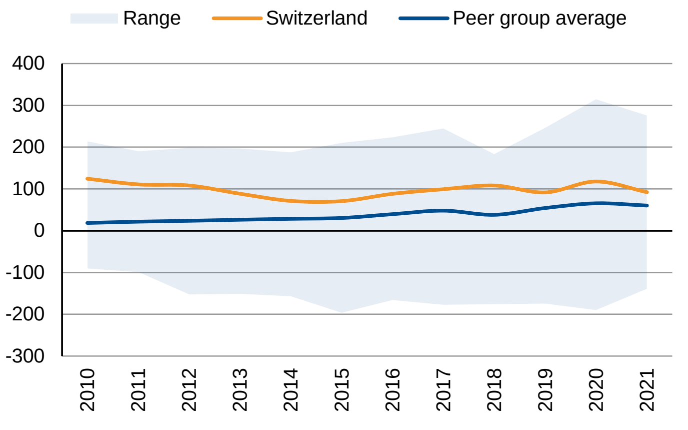
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Strong	+1/3	Persistent current account surpluses, reflecting a competitive external sector and a substantial share of price-intensive exports.
	External debt structure	Neutral	0	Large net external asset position, around two thirds of external liabilities are denominated in local currency
	Resilience to short-term external shocks	Strong	+1/3	Large net external asset position and Swiss franc's safe haven currency status underpin external-sector resilience

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

Financial Stability Risks

- **Banking sector:** The Swiss banking system is very large (total assets of CHF 3.7trn, or 485% of GDP as of Q3 2022), and financial stability risk plays a key role in the country's risk profile. In particular, the two globally active banks UBS and Credit Suisse are very large compared to the Swiss economy (with total assets between 120% and 140% of GDP), due to the global reach of their wealth management and investment banking activities. Capital adequacy improved for the two globally active banks, due to earnings retention and a capital increase at Credit Suisse, in support of its ongoing restructuring efforts. Domestically active banks mostly engage in mortgage lending, which represents around 90% of their loans, increasing sensitivities to real estate repricing and interest rate risks.

  We acknowledge several factors mitigating financial stability concerns. First, UBS and Credit Suisse, as systematically important banks, must comply with 'too big to fail' regulation, requiring them to maintain higher capital and liquidity ratios and recovery and emergency plans. In addition, the Swiss Financial Market Supervisory Authority oversees resolution planning. Both systemic banks disclosed limited net credit exposures to Russia compared to other European banks, for a total of CHF 0.4bn at the end of Q1 2022, mainly consisting of loans, derivatives and trade finance. Losses related to the war in Ukraine were also limited, amounting to CHF 0.1bn for UBS and CHF 0.2bn for Credit Suisse in Q1 2022.

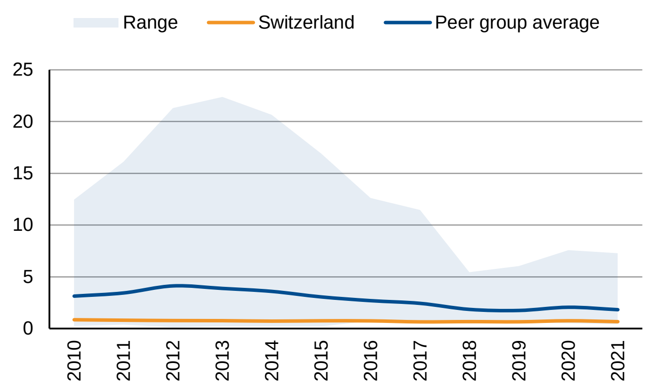
- **Private debt:** Private sector debt is elevated at around 279% of GDP as of Q2 2022, one of the highest ratios among peers. Household debt was 132% of GDP in Q2 2022, representing mostly mortgages. This is offset by household wealth estimated at 415.5% of GDP in 2021.

- **Financial imbalances:** Low interest rates have resulted in a continued increase in residential property prices starting from the second half of 2020. Price increases for single-family dwellings and apartments peaked at 8.8% YoY and 7.5% YoY, respectively, in H1 2022, and have started to decline in H2, reaching 5.5% and 5.2% in Q4 2022, in line with end-2020 levels, as rising rates cool mortgage markets. Banks' mortgage lending grew by 3.3% YoY in October 2022, in line with its long-term trend.

Overview of Scope's qualitative assessments for Switzerland's *Financial Stability Risks*

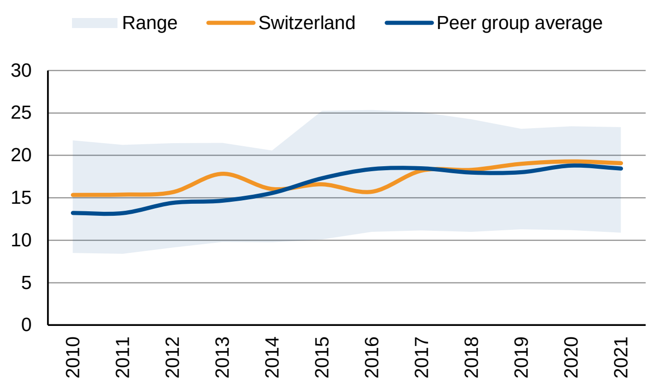
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Financial sector performance	Weak	-1/3	Well-capitalised and liquid banking sector with strong asset quality, but bank profitability remains structurally weaker than in peer countries
	Financial sector oversight	Neutral	0	Effective financial policymaking and stringent regulatory financing requirements mitigate financial system risk
	Financial imbalances	Weak	-1/3	A very large banking sector represent a risk of contingent liabilities, persistent risk of correction in the real estate market

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

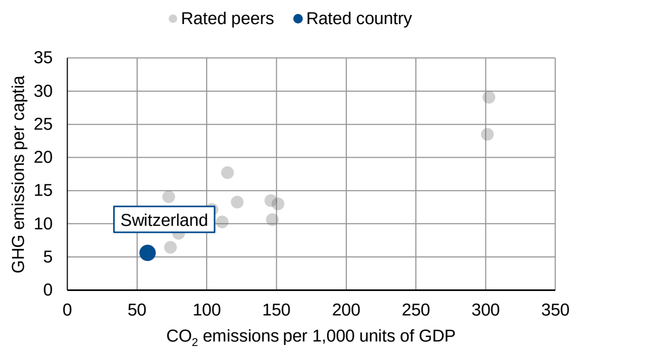
ESG Risks

- **Environment:** Switzerland's environmental risk profile is strong. Natural disaster risks are limited and the economy's carbon intensity (our proxy for transition risk to a greener economic model) is very low. However, the country has a relatively poor performance in terms of its footprint of consumption relative to available biocapacity, given the country's import dependency for many of its natural resources. Switzerland has no natural gas reserves on its territory and no domestic storage capacities, therefore relying entirely on imported natural gas. This represents 15.4% of the country's final energy consumption, of which 47% came from Russia. The rest of the energy mix is mostly composed of fuel and oil products (29.3% and 14.1%, respectively), electricity (26.3%, of which 61.5% is produced via hydropower plants and 28.9% via nuclear power) and renewables (28%), The government is aiming for a 50%-reduction in carbon emissions by 2030 relative to 1990 levels and net carbon neutrality by 2050. Further, the country imposes a carbon levy on fossil fuels, which was increased to CHF 120 per ton of CO_2 (around USD 130) in 2022 from CHF 96 in 2021.
- **Social:** Social outcomes in Switzerland are very strong, reflecting a low risk of poverty (8.5% of the population affected by income poverty in 2020) and strong educational outcomes, as shown by a high share of persons with tertiary education and high average performance in mathematics, reading and sciences according to 2018 PISA results. Challenges relate to first, a high share of part-time labour among women (almost 60% in 2021), reflecting high cost for child-care and high wages, and second, a relatively high unemployment rate among foreigners. In the longer term, an ageing population will make the pension system's first pillar, the AHV system, more costly. A reform of the system to improve long term financial viability was recently approved by parliament, following the approval in September by popular referendum.
- **Governance:** We assess Switzerland's governance as very strong given its excellent institutions, stable political conditions and effective policy making. As a direct democracy, key political issues are decided by popular referenda. The federal council consists of seven members from the four major political parties, each heading one government department, and takes decisions based on consensus. The next general election is scheduled for October 2023.

Overview of Scope's qualitative assessments for Switzerland's *ESG Risks*

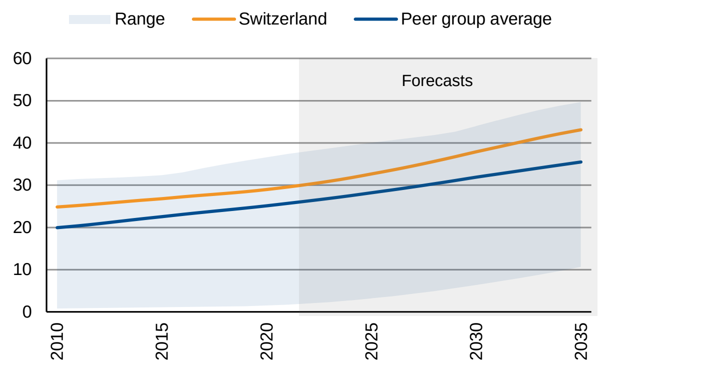
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental factors	Neutral	0	Transition risk mitigated by a robust regulatory framework, including a carbon levy of CHF 130bn of CO2 and considerable public expenditure
	Social factors	Strong	+1/3	Very high human development and employment rate, significant R&D expenditure, high labour market flexibility
	Governance factors	Neutral	0	Stable political environment, institutional effectiveness and a consensus-oriented policy framework; failure to reach institutional framework agreement with the EU creates uncertainty over future EU-Swiss relationship

Emissions per GDP and per capita, $mtCO_2e$



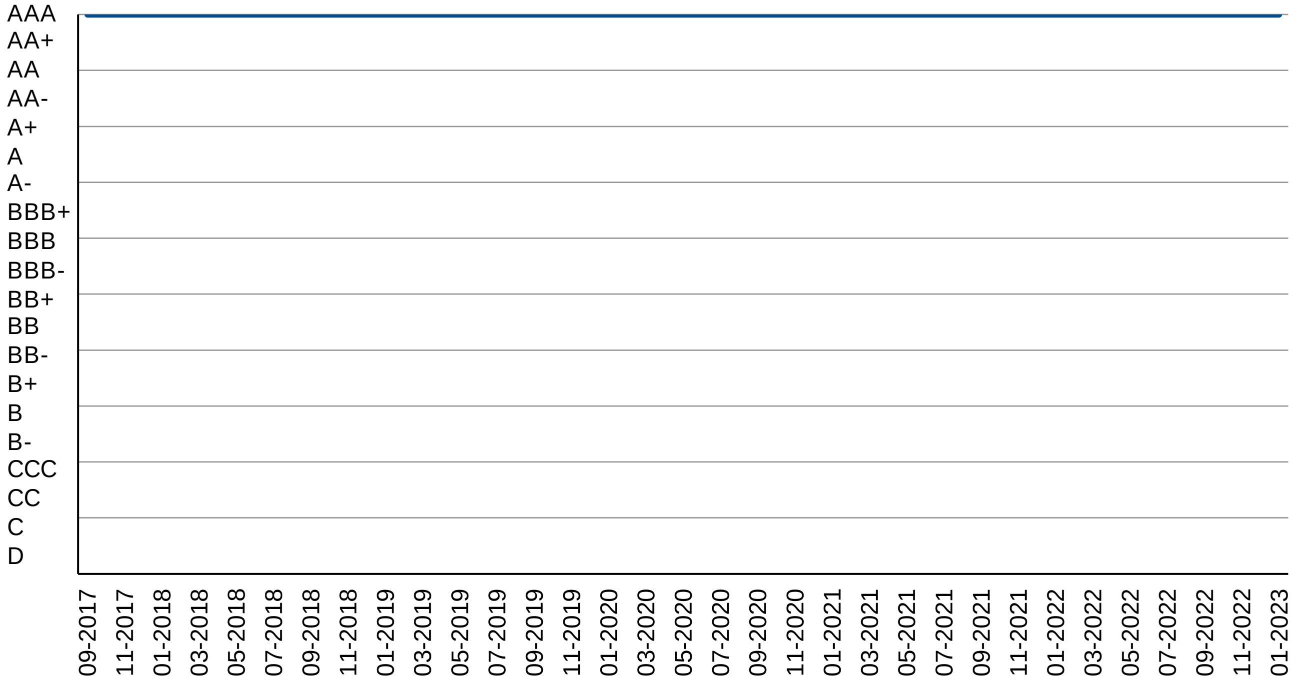
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Denmark
Finland
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021
Domestic Economic	**GDP per capita, USD '000s**	IMF	82,576	85,548	84,476	85,870	92,249
	Nominal GDP, USD bn	IMF	695.3	725.8	721.9	739.0	799.8
	Real growth, %	IMF	1.4	2.9	1.2	-2.5	4.2
	CPI inflation, %	IMF	0.5	0.9	0.4	-0.7	0.6
	Unemployment rate, %	WB	4.8	4.7	4.4	4.8	5.3
Public Finance	**Public debt, % of GDP**	IMF	41.8	39.8	39.6	43.3	42.1
	Interest payment, % of revenue	IMF	0.4	0.3	0.2	0.2	0.4
	Primary balance, % of GDP	IMF	1.3	1.4	1.4	-3.0	-0.6
External Economic	**Current account balance, % of GDP**	IMF	6.3	6.2	5.5	2.9	9.4
	Total reserves, months of imports	IMF	16.8	15.3	16.7	22.0	19.8
	NIIP, % of GDP	IMF	100.3	111.1	94.0	120.2	108.1
Financial Stability	**NPL ratio, % of total loans**	IMF	0.6	0.7	0.6	0.8	0.7
	Tier 1 ratio, % of risk-weighted assets	IMF	18.2	18.3	19.0	19.3	19.1
	Credit to private sector, % of GDP	WB	250.2	242.8	260.7	271.1	275.0
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	68.4	64.4	63.4	57.6	57.0
	Income share of bottom 50%, %	WID	22.7	22.9	22.6	22.6	22.6
	Labour-force participation rate, %	WB	84.0	84.2	84.2	-	-
	Old-age dependency ratio, %	UN	27.6	28.0	28.4	29.0	29.6
	Composite governance indicators*	WB	1.8	1.8	1.7	1.7	1.7

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 25 January 2023	11

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30 31 58 14

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer