Subnational Debt 2024: Switzerland

Resilient budget surpluses should enable further deleveraging

S&P Global Ratings

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This report does not constitute a rating action

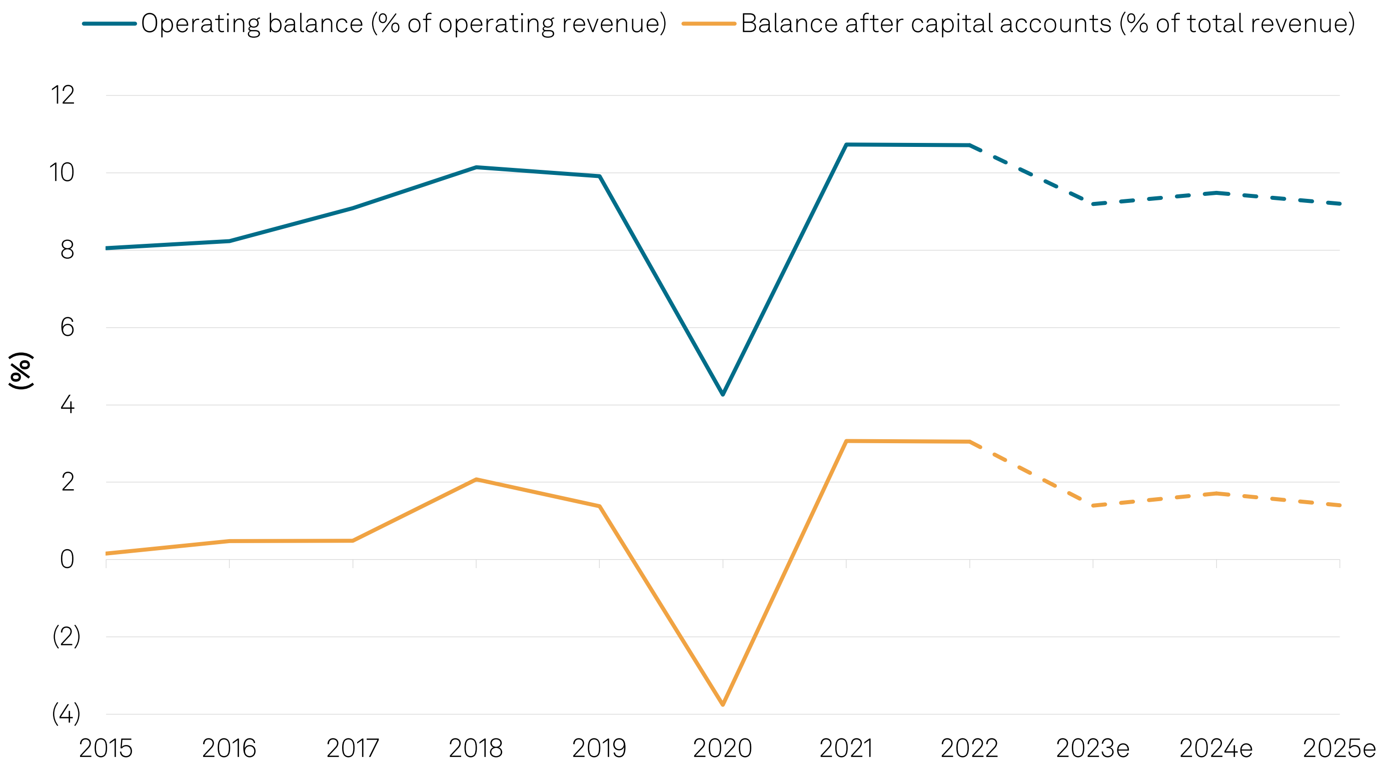
Key Takeaways

- Swiss local and regional governments' (LRGs) sound budgetary performance is supported by comparatively low cost-inflation and a resilient economy that should enable continued net debt repayments in 2024 and 2025.
- Surpluses could, however, shrink due to reduced profit distributions from the Swiss National Bank (SNB) and pending, potentially costly legislative initiatives at the national level.
- S&P Global Ratings forecasts Swiss LRG annual gross borrowing of about CHF13 billion in each of 2024 and 2025. That includes CHF3.0 billion-CHF3.5 billion of new bonds, annually, with the new issue volume capped by LRGs' robust liquidity and limited bond maturities during the period.
- LRG’s interest expense will gradually follow rising market yields, though in-place fixed-rate financing should mean the effective average portfolio interest rate will only marginally exceed 1% by 2025.
- Swiss LRGs issued CHF305 million of "digital" distributed-ledger based securities in 2023. We expect utilization of innovative instruments--including green and social bonds--will continue at a limited scale.

Strong Budgetary Performance Should Reduce LRG Borrowing Needs

Resilient surpluses, but likely lower than over 2021-2022

Budget balance of Swiss LRGs



Source: Swiss Federal Statistics Office, S&P Global Ratings.

- We forecast Swiss LRGs will, on aggregate, remain in surplus in 2024 and 2025, thereby limiting new borrowing needs. Key factors are:
  - Comparatively benign cost inflation.
  - Resilient tax revenue growth due to a robust economy that doesn't need stimulus packages.
- LRG surpluses could be smaller than during the extraordinarily strong 2021 and 2022 because:
  - Swiss National Bank (SNB) profit distributions are no longer elevated.
  - National legislative initiatives could increase cantons' costs related to medical insurance premium subsidies and childcare.
- OECD minimum tax rate implementation will benefit selected cantons (and hence the sector on aggregate). However, resultant cash flows are unlikely to be evident prior to 2026.

Deleveraging Is Expected To Continue

However, the pace of Swiss LRGs debt reduction might slow

Swiss LRGs' outstanding debt, gross borrowing, and repayments

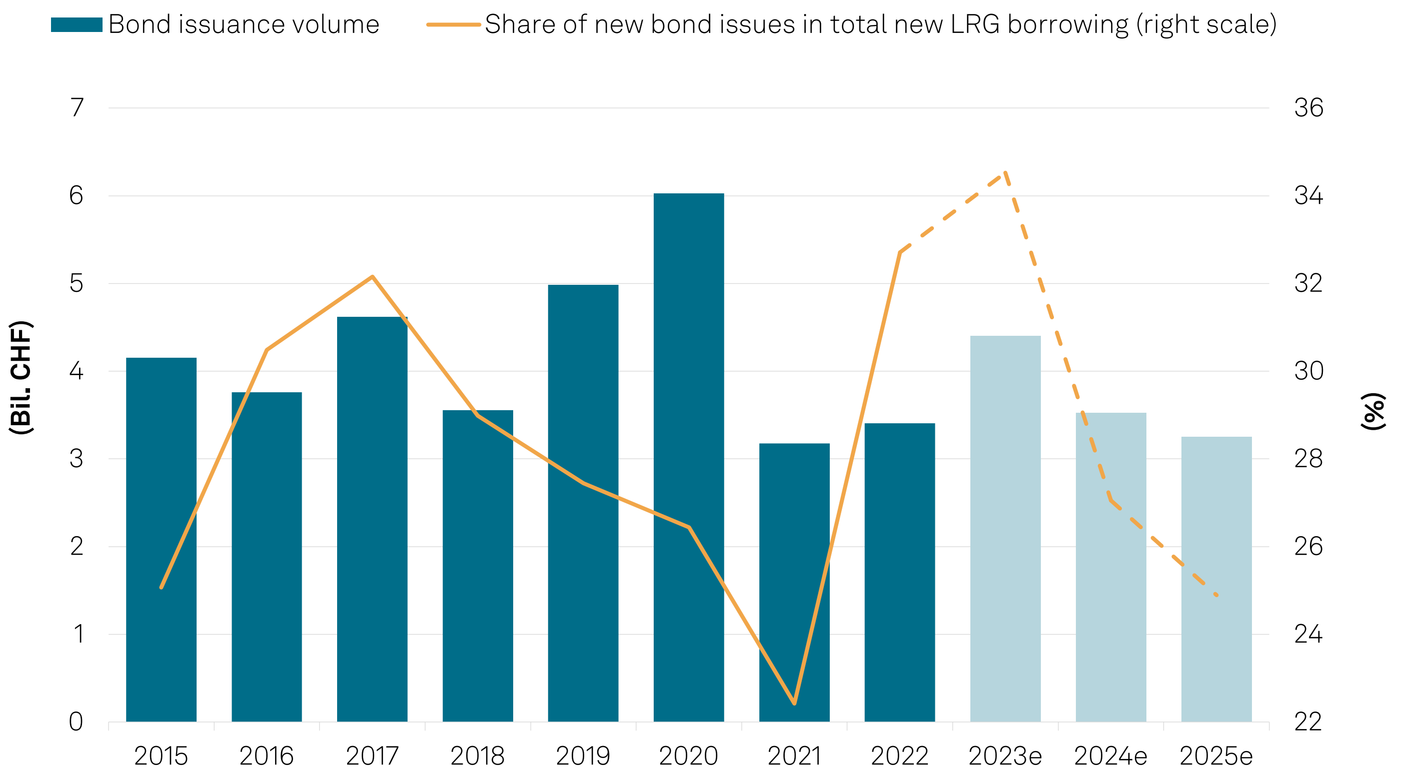
CHF--Swiss franc. e--Estimate. LRG--Local and regional government. Sources: Swiss Federal Statistics Office, S&P Global Ratings.

- We expect recent deleveraging of Swiss LRGs to continue, albeit at slower pace than in 2022 when excess cash funded a material part of the repayments.
- Net debt repayments over 2023-2025 are likely to be financed largely with concurrent budgetary surpluses.
- We anticipate annual gross borrowing over 2023-2025 of about CHF13 billion, compared to maturities of CHF15 billion- CHF16 billion over the same period.
- That balance of borrowing and maturities means total outstanding debt at Swiss LRGs is likely to fall to just above CHF90 billion by 2025.

Annual Bond Issuance Is Likely To Be CHF3.0 billion-CHF3.5 Billion

Maturities and anticipated net repayments point to limited new bond issuance

Swiss LRG bond issuance volumes



CHF--Swiss franc. e--Estimate. LRG--Local and regional government. Sources: Swiss Federal Statistics Office, S&P Global Ratings.

- At CHF44 billion per end of 2023, Swiss LRG-issued bonds account for about 45% of the sector's total outstanding debt.
- For 2024-2025, we anticipate muted new issuance activity of CHF3.0 billion-CHF3.5 billion per annum from Swiss LRGs. That reflects:
    - Strong liquidity position at the cantons we rate.
    - An anticipated sector surplus.
    - Limited upcoming bond maturities.
- We expect loan-based funding will prove to be the predominant "background noise" in the market (providing cover for seasonal liquidity swings) and that the share of bonds in gross borrowing could drop back to about 25%.

Cantons And Cities Use The Swiss LRG Bond Market

Measured by outstanding amounts, both government tiers are active issuers

Split of outstanding Swiss LRG bonds by issuer type, year-end 2023

CHF--Swiss franc. Sources: Bloomberg, S&P Global Ratings.

- Swiss LRG bond issuance is not the exclusive preserve of regional governments, unlike in Germany, for example.
- The cities of Zurich and Bern have issued more bonds than most cantons, while numerous smaller municipalities have one, or very few, small bonds outstanding.
- Bond issuance directly by cantons' hospitals (or for hospitals but through LRGs' budgets) is a recent sector development.
- Given healthcare infrastructures' ongoing funding requirements we expect that trend will continue. Basel-City's large hospital refurbishment project is a good example of that funding demand.

Largest Individual Swiss LRG Bond Issuers

Urban centers dominate issuer ranking

Largest cantonal issuers

1. Republic and Canton of Geneva
Rating: AA/Positive/--
Amount outstanding: CHF8,825 million
Amount issued in 2023: No new issuance

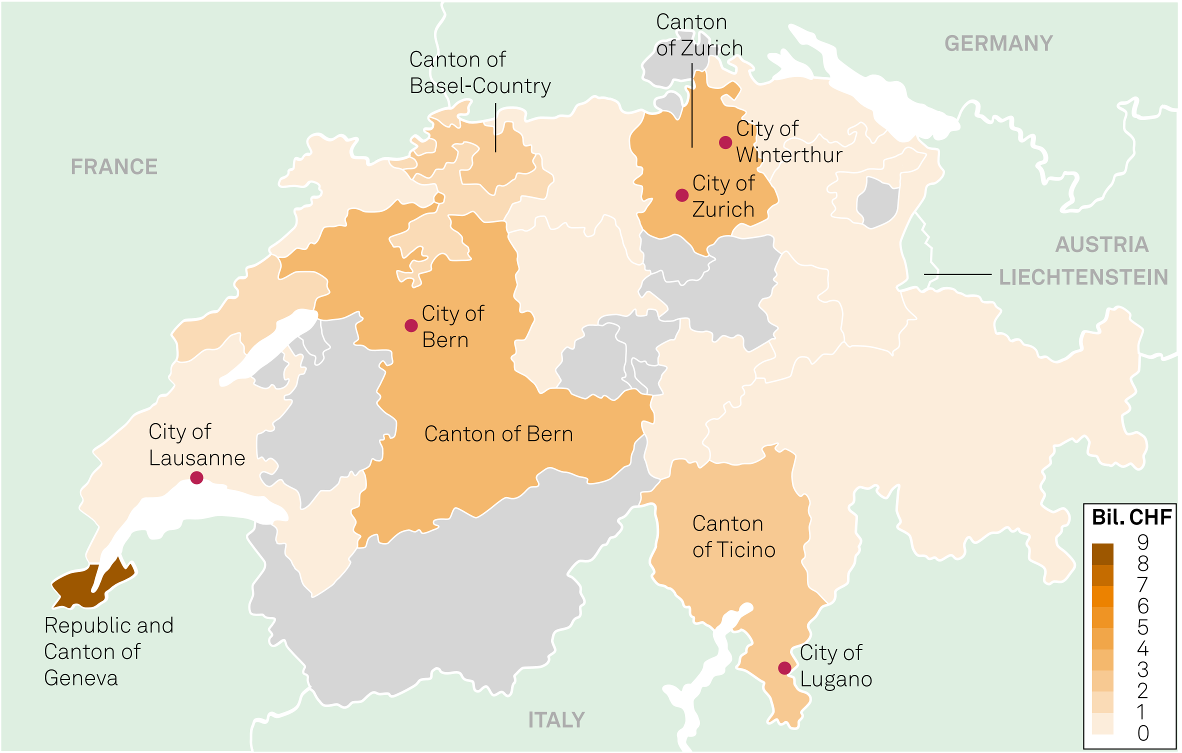
2. Canton of Zürich
Rating: AAA/Stable/--
Amount outstanding: CHF3,840 million
Amount issued in 2023: CHF100 million

3. Canton of Bern
Rating: Not rated
Amount outstanding: CHF3,325 million
Amount issued in 2023: CHF200 million

4. Canton of Ticino
Rating: Not rated
Amount outstanding: CHF2,325 million
Amount issued in 2023: CHF500 million

5. Canton of Basel-Country
Rating: AAA/Stable/A-1+
Amount outstanding: CHF2,250 million
Amount issued in 2023: No new issuance

Bonds outstanding as of end-2023



Largest municipal issuers

1. City of Zürich
Rating: AAA/Stable/A-1+
Amount outstanding: CHF5,425 million
Amount issued in 2023: CHF1,185 million

2. City of Bern
Rating: Not rated
Amount outstanding: CHF2,750 million
Amount issued in 2023: CHF655 million

3. City of Lausanne
Rating: AA-/Stable/--
Amount outstanding: CHF1,800 million
Amount issued in 2023: CHF300 million

4. City of Winterthur
Rating: Not rated
Amount outstanding: CHF1,210 million
Amount issued in 2023: CHF125 million

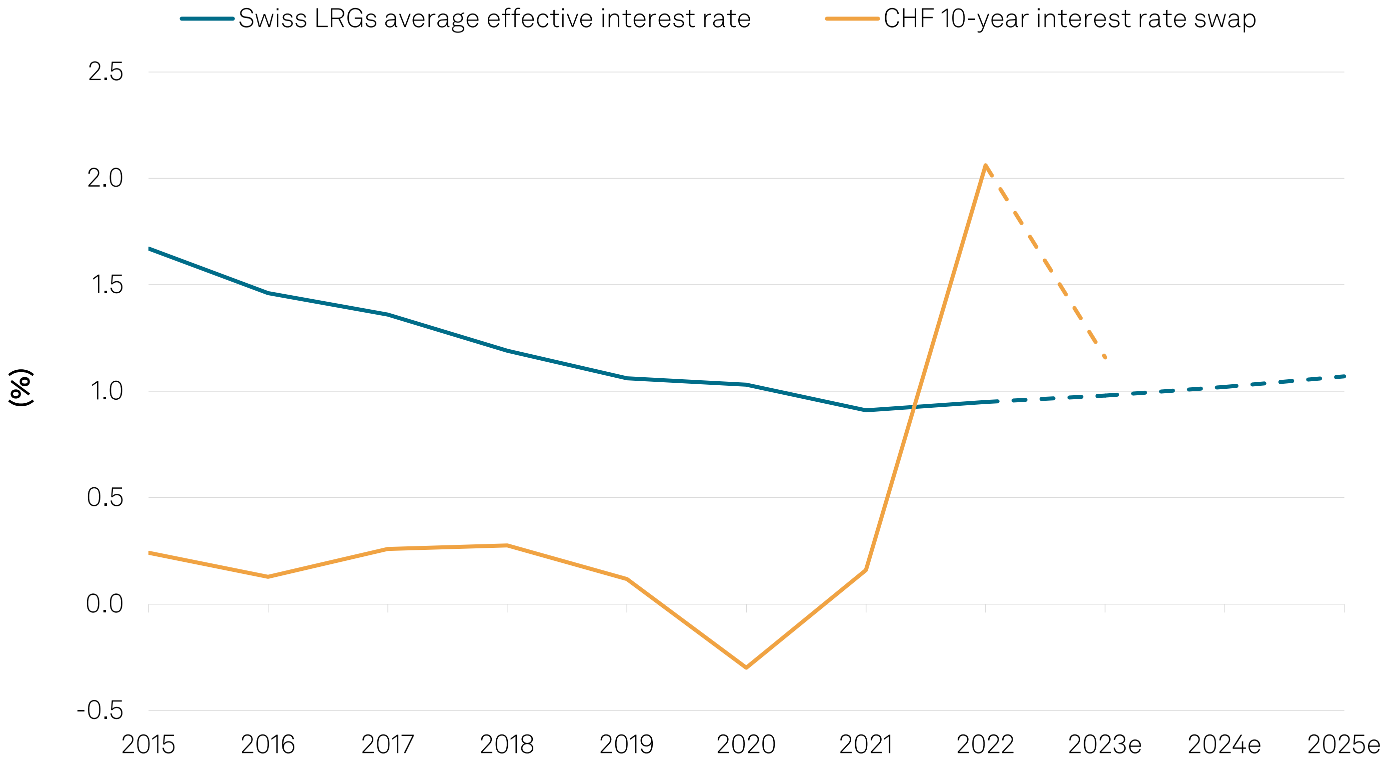
5. City of Lugano
Rating: Not rated
Amount outstanding: CHF890 million
Amount issued in 2023: CHF100 million

CHF--Swiss franc. Sources: Bloomberg, S&P Global Ratings.

Effective Interest Rates Will Rise, But Only Gradually

Benefitting from long-term debt at low fixed rates, Swiss LRGs‘ interest cost should remain fairly stable

Estimated average effective interest rate of Swiss LRGs



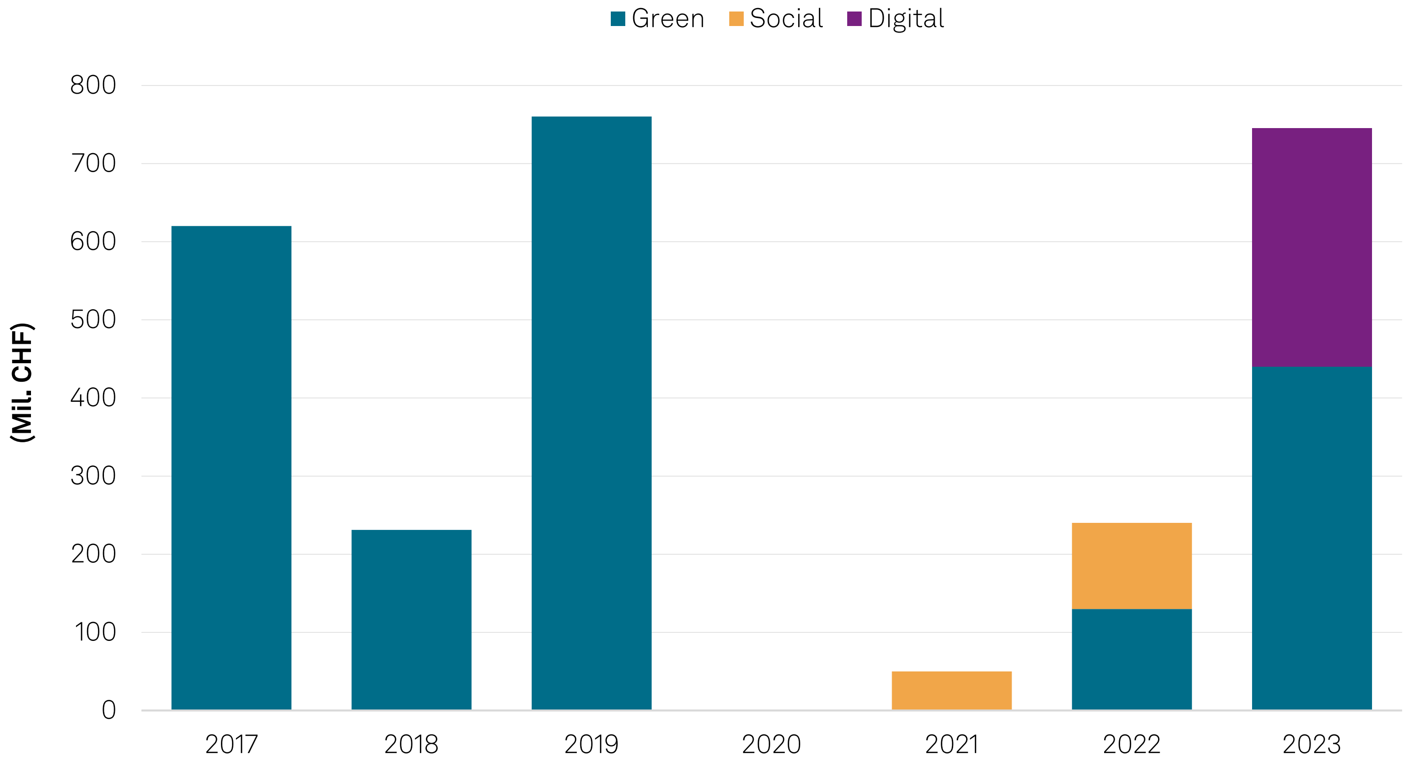
CHF--Swiss franc. e--Estimate. LRG--Local and regional government. Sources: Bloomberg, S&P Global Ratings.

- We expect Swiss LRGs' average portfolio interest rate to be 1.1% by 2025, up from 0.9% in 2022.
- Swiss market yields have risen sharply from the negative values seen as recently as 2022.
- However, we anticipate rising rates will only gradually and manageably effect LRGs' budgetary performance because:
  - An estimated 90%-plus of Swiss LRG debt is fixed rate, while long average tenors limit refinancing. Outstanding bonds' weighted average life was about 11 years as of end-2023.
  - Market yields are still low by international standards.
  - We estimate average LRG indebtedness to be a moderate 58% of operating revenue.

Swiss LRGs Utilize Innovative Funding Tools

Swiss LRGs' first fully-digital bonds were placed in 2023, joining earlier green and social bond innovations

Green, social, and digital bond issuance by Swiss LRGs



CHF--Swiss franc. LRG--Local and regional government. Sources: Bloomberg, S&P Global Ratings.

- Swiss LRGs placed their first "digital" (distributed ledger-based) bonds in 2023, adding to their earlier innovative adoption of green and social bonds.
- The digital bonds were issued by the cantons of Basel-City and Zurich, and the City of Lugano.
- Settlement of the Basel-City and Zurich bonds can occur through a digital Swiss franc, made available by the Swiss National Bank (SNB) to financial institutions participating in a pilot scheme.
- The three digital LRG issues raised a total CHF305 million, with the relatively small amounts reflecting the products' ongoing testing by Swiss LRGs.
- We consider the LRGs willingness to test technological and regulatory innovations in a controlled environment (as part of the SNB pilot) to be positive.

Identifiable Key Risks

Despite a robust fiscal position, structural challenges exist

Escalation of geopolitical risks

- Heightened geopolitical tensions could weigh on budgetary performance via:
  - Reduced economic activity.
  - Supply chain disruptions.
  - Inflation spikes impacting cost.
- Should efforts to stimulate economic growth be required they could strain budgets due to foregone tax revenues or direct costs.

Increasing healthcare costs

- Healthcare cost are a long-term, multidimensional issue for LRGs:
  - General demographic shifts are increasing "consumer" numbers.
  - Cantons share per-patient treatment costs.
  - Hospitals require capital expenditure for upgrades and refurbishments.
  - A national referendum seeking to boost health insurance premium subsidies for low-income households could strain cantonal budgets if passed.

Demographic trends/EU-relations

- Switzerland faces a challenge to attract enough skilled workers amidst an aging population and already existing labor shortages.
- If (limited) immigration fails to offset an insufficient birth-rate then economic output and tax revenue growth may suffer.
- Failure to (re-)negotiate supportive agreements with the EU could exacerbate existing economic constraints.

Related Research

- Subnational Debt 2024: Fiscal Policy Differences Influence Borrowing In Developed Markets, March 4, 2024
- Subnational Debt 2024: France, Adaptability Will Remain Key Amid Sluggish Growth, March 4, 2024
- Subnational Debt 2024: Spain (Debt Absorption Scenarios): All could benefit, with some more than others, March 4, 2024
- Subnational Debt 2024: Australian States' Debt Rift Deepens, Feb. 29, 2024
- Subnational Debt 2024: Canadian Local And Regional Governments Are Running Fast To Stay In Place, Feb. 29, 2024
- Subnational Debt 2024: Chinese Governments Reach Their Limits; Other Emerging Markets Taper Borrowing, Feb. 29, 2024
- Subnational Debt 2024: Focus on debt sustainability, Feb. 29, 2024
- Subnational Debt 2024: Germany, Subdued Fiscal Performance Suggests Borrowing Will Rebound, Feb. 29, 2024
- Subnational Debt 2024: Global LRGs Can Handle Rising Interest Expenses, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Subnational Debt 2024: Spain: Lower borrowings, but bond issuances recover, Feb. 29, 2024
- Subnational Debt 2024: Switzerland, Resilient Budget Surpluses Should Enable Further Deleveraging, Feb. 29, 2024
- China City Governments Risk Falling Into A Debt Trap, Feb. 20, 2024

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