Swiss Confederation
Rating Report

SCOPE AAA STABLE OUTLOOK

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.

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 global safe haven status of the Swiss franc.

Credit challenges include: i) a very large banking sector in relation to GDP, posing contingent liability risk to public finances; and ii) a gradual build-up of imbalances in the real estate market, supported by the low interest-rate environment and reflecting a continued increase in residential property prices and imbalances between regional price and income developments. 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 scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aaa		+1/3	AAA
Public Finance Risk		25%	aaa		+2/3	
External Economic Risk		10%	aaa		+2/3	
Financial Stability Risk		10%	aa-		-2/3	
ESG Risk	Environmental Risk	5%	aaa		0	
	Social Risk	5%	bbb+		+1/3	
	Governance Risk	10%	aaa		0	
Overall outcome		aaa		0	+1	

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 Scope's view that risks to the ratings are balanced.

Positive rating-change drivers

- N/A

Negative rating-change drivers

- Financial stability risk materializing with significant negative implications for economic growth and public finances
- Significant worsening of the economic outlook, for example due to a significant 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

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Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** Switzerland's credit profile benefits from its wealthy, diversified and highly competitive economy. Real growth averaged 1.9% from 2015-19. Due to the outbreak of the Covid-19 pandemic, real GDP declined by a relatively moderate 2.5% in 2020, below the 6.4% decline in the euro area. The recovery in 2021 has been robust with an annual 3.6% GDP growth rate, driven by consumer spending and favourable foreign trade. After a temporary slowdown in Q4 2021, growth regained momentum in Q1 2022, recording an increase of 2% over the same quarter in the previous year. Direct effects of the Russia-Ukraine war on the economy remain limited, given the low exposure of Swiss trade to these two countries, while indirect effects are higher energy prices and some supply bottlenecks. We expect real GDP growth of 2.4% in 2022, followed by 2% in 2023 and 1.8% in 2024. The country's growth potential remains solid at an estimated 1.6%.

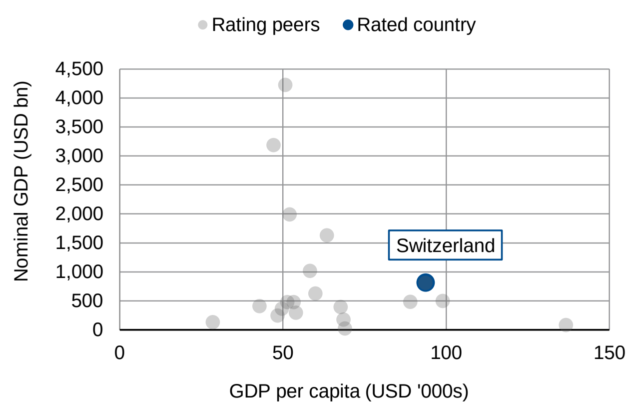
- **Inflation and monetary policy:** Inflation is historically very low in Switzerland, averaging 0% from 2015 to 2020. The CPI started to rise in 2021 and reached 1.5% YoY in December 2021 due to higher energy prices. In 2022, prices have further increased recording a 3.4% YoY rate in June 2022, mainly driven by energy and fuel prices as core inflation rate remained limited at 1.9% YoY. This is moderate compared to levels in euro area economies such as Germany. To counter inflationary pressures the Swiss National Bank (SNB) has accelerated monetary policy tightening in June, with a 50bps hike of the SNB policy rate to -0.25%. This helps to contain inflation also via the strengthening of the Swiss franc, which has appreciated against the Euro by around 5% YTD. The SNB's balance sheet, with total assets of CHF 1.07trn as of May 2022, is large and reflects an accumulation of foreign exchange reserves by selling francs.

- **Labour markets:** The Swiss labour market performed robustly during the Covid-19 crisis, supported by the economy's low reliance on industries affected by the containment measures, high adaptability to telework and the application of short-time work scheme. The unemployment rate has returned to its pre-crisis level of 2.3% already in January 2022, from a peak of 3.5% in May 2020, and continued to gradually decrease to 2.0% in June. Employees on furlough, which amounted to around 21% of the total in April 2020, have declined further throughout Q1 2022, with covered workers declining to 22,000, or 0.4% of total employment in Q1 2022.

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

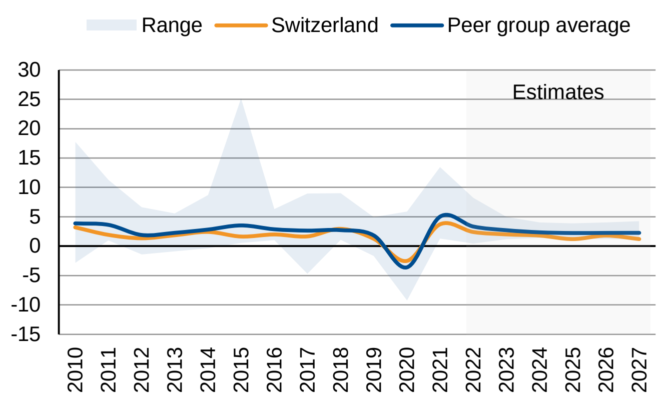
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential
	Monetary policy framework	Neutral	0	Swiss National Bank is a credible central bank. Flexibility is relatively constrained due to sensitivity of FX 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 '000s



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

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

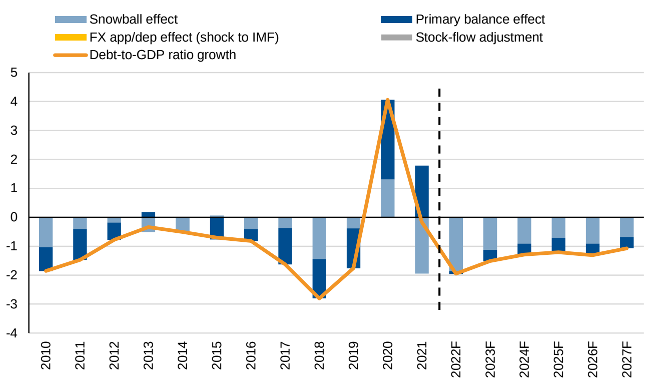
Public Finance Risks

- **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. Total fiscal support amounted to CHF 18bn and CHF 17bn in 2020 and 2021, respectively, with the Confederation bearing more than 80% of the costs in both years. The main measure was a swiftly implemented short-time work scheme, which cost CHF 10.8bn in 2020, CHF 4bn in 2021 and CHF 2.9bn has been budgeted for the scheme in 2022, accompanied by grants to businesses affected by pandemic containment measures, extended to end-2022. General government expenditures for the pandemic are expected to amount to CHF 10bn in 2022. The federal budget 2023 draft budget no longer includes pandemic-related spending, but some moderate cost increases related to housing and integrating Ukrainian refugees. Higher tax revenues on the back of the economic recovery resulted in a lower deficit last year, of 1.9% of GDP compared to 2.8% in 2022. We expect the continued phase-out of Covid-related expenses to bring a further reduction of the fiscal deficit this year, to around 0.1% of GDP. Future surpluses, together with SNB's additional profit distributions, will be used to reduce the Covid-19 debt over the medium-term, now amounting to CHF 30bn.
- **Debt trajectory:** The gradual decrease in the general government headline fiscal deficit is accompanied by a decline in the general government debt-to-GDP ratio, which we project to decrease to 40.2% of GDP this year, from 42.2% of GDP in 2021, and continue to decline afterwards, converging towards 34% by 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 started to increase from January 2022, reaching 0.8% in July. Marketable debt has a ten year average maturity. The country had sizeable cash buffers of CHF 12.6bn available at the end of 2021.

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

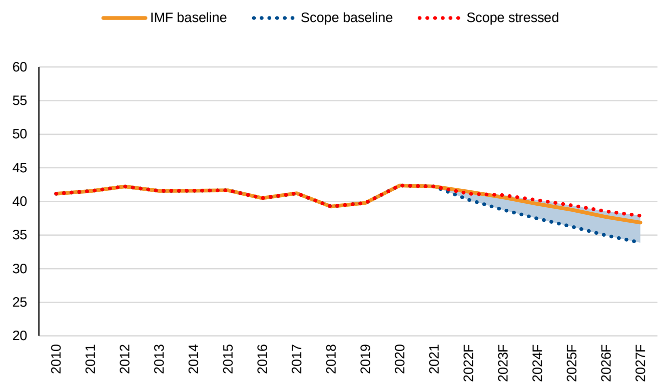
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Fiscal policy framework	Strong	+1/3	Stringent, constitutionally anchored fiscal rules, track record of prudent and stable fiscal policies
	Debt sustainability	Neutral	0	Moderate public-debt levels, strong commitment 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

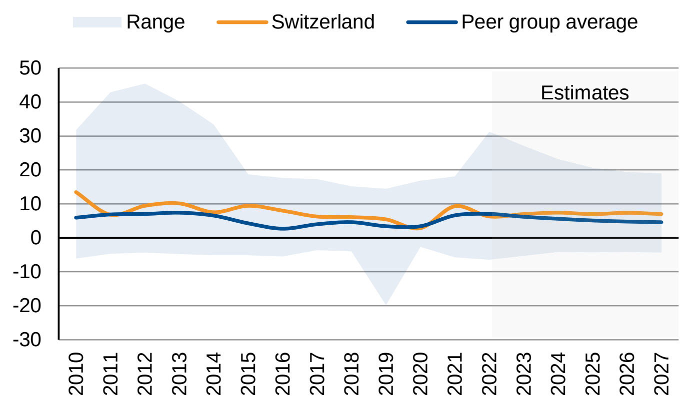
External Economic Risks

- **Current account:** Switzerland's ratings benefit from high and consistent current account surpluses. These averaged 7% of GDP over 2015-19 and narrowed to 2.8% of GDP in 2020 as a service surplus of CHF 800m in 2019 turned to a deficit of CHF 9.3bn in 2020. The trade surplus recovered strongly in 2021 to 9.3% of GDP, boosted by a widening of the goods current account, from 8.2% in 2020 to 13.8% in 2021. Switzerland's current account resilience is underpinned by highly specialised, price-insensitive exporting industries, such as pharmaceuticals, which made up around 38% of goods exports in 2021. Trade exposure to Russia and Ukraine is limited, with less than 2% of total imports and exports related to Russia and less than 0.4% related to Ukraine.
- **External position:** Switzerland's robust external position is underpinned by a high net international investment position of 88% of GDP as of Q1 2022, declining compared to a peak of 124% of GDP in January 2021, but in line with pre-pandemic levels. External debt of 286% of GDP in Q1 2022 is relatively high. Most external debt is short-term and held by banks (113% of GDP at Q1 2022), followed by other sectors, including non-financial corporations (76%).
- **Resilience to shocks:** The Swiss franc is considered a safe haven currency, and the Swiss National Bank holds large foreign currency investments of CHF 959bn in May 2022, or 114% of expected 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 represents a moderate longer-term risk to the Swiss economic outlook, as it complicates the process of establishing future trade agreements. Nevertheless, we expect a broadly constructive Swiss-EU relationship going forward, underpinned by the rejection in 2020 of a popular initiative that would have ended free movement of persons between Switzerland and the EU.

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

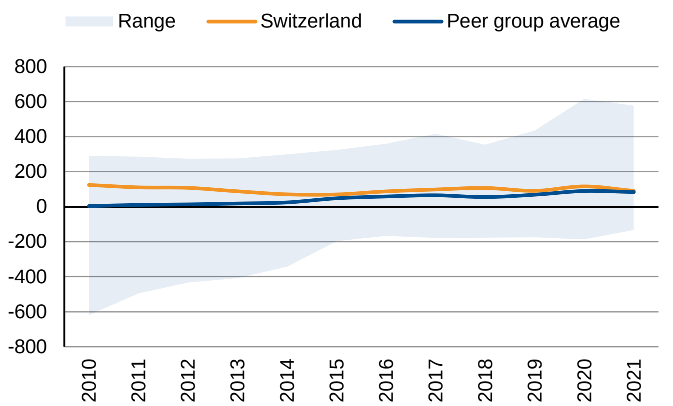
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Strong	+1/3	Large and persistent current account surpluses, reflecting a competitive external sector and a substantial share of price-insensitive exports
	External debt structure	Neutral	0	Large net external asset position, around two thirds of external liabilities are denominated in local currency
	Resilience to short-term 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 GmbH

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings GmbH

Financial Stability Risks

- **Banking sector:** The Swiss banking system is very large (total assets of CHF 3.78trn, or 500% of GDP as of Q1 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 (both with total assets of around 130% of GDP), due to the global reach of their wealth management and investment banking activities. 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. On the back of the economic recovery and pandemic-related support measures, profitability improved in 2021, as well as capitalisation, supported by earnings retention.

  However, 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.

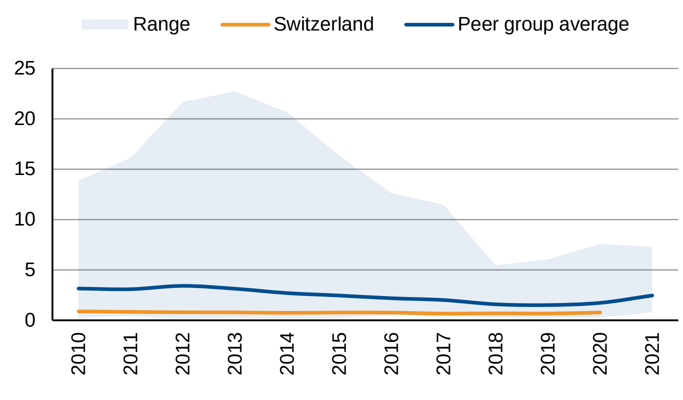
- **Private debt:** Private sector debt is elevated at around 270% of GDP as of Q4 2021, one of the highest ratios among peers. Household debt was 132% of GDP, representing mostly mortgage loans. This is offset by high household wealth estimated at 408% of GDP in 2021.

- **Financial imbalances:** Low interest rates have resulted in a continued increase in residential property prices. Demand for residential property remained high through the Covid-19 pandemic. At end-2021, prices for single-family dwellings were 8.3% higher than a year earlier (6.7% for apartments). These YoY rates increased to 8.7% and 7.5%, respectively, in the first quarter of 2022. Mortgage lending growth was 3.3% in the first half of 2022, in line with previous years. Rising interest rates could lead to a correction in prices and consequently a reduction of vulnerabilities.

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

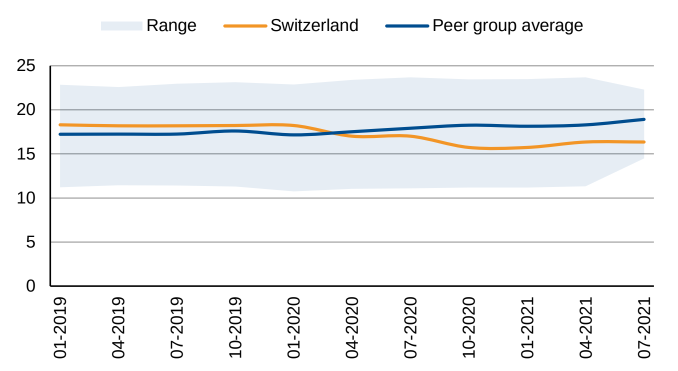
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Banking sector performance	Weak	-1/3	Well-capitalised and liquid banking sector with strong asset quality, but bank profitability remains structurally weak
	Banking sector oversight	Neutral	0	Effective financial policymaking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

Non-performing loans (NPLs), % of total loans



Source: World Bank, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

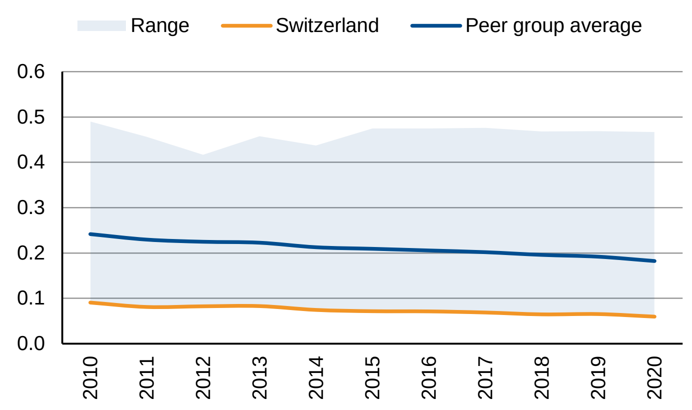
ESG Risks

- **Environment:** Switzerland's environmental risk profile is strong. Natural disaster risks are limited and the economy's carbon intensity (proxy for transition risk to a greener economic model) is very low. However, the country has 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. Energy dependence from Russia is relevant, with 47% of natural gas (representing 12.1% of gross energy consumption) imported from there. The rest of the energy mix is mostly composed of oil and hydropower (34.7% and 31.9%, respectively), nuclear (15.6%) and solar (2.6%). 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 are associated with a high share of part-time labour among women (almost 60% in 2021), reflecting high cost for child-care, but also high wages; and 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. This legislation still needs to be approved by popular referendum.
- **Governance:** Switzerland scores highly on a composite index of six World Bank Worldwide Governance Indicators. This reflects stable political conditions based on consensus-oriented, 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.

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

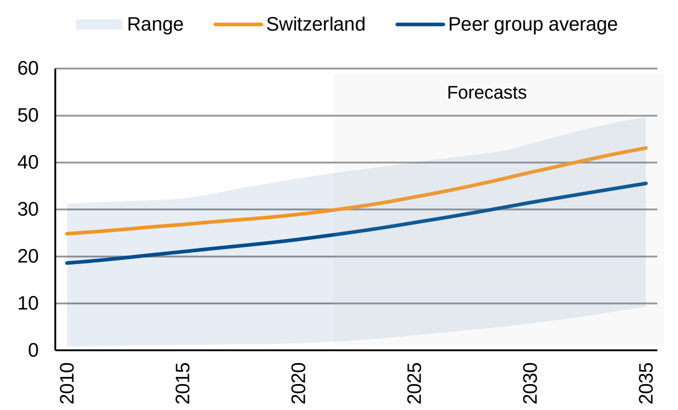
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental risks	Neutral	0	Transition risk mitigated by a robust regulatory framework, including a carbon levy of CHF 130/ton of CO2, and considerable public expenditure
	Social risks	Strong	+1/3	Very high human development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

CO_2 emissions per GDP, $mtCO_2e$



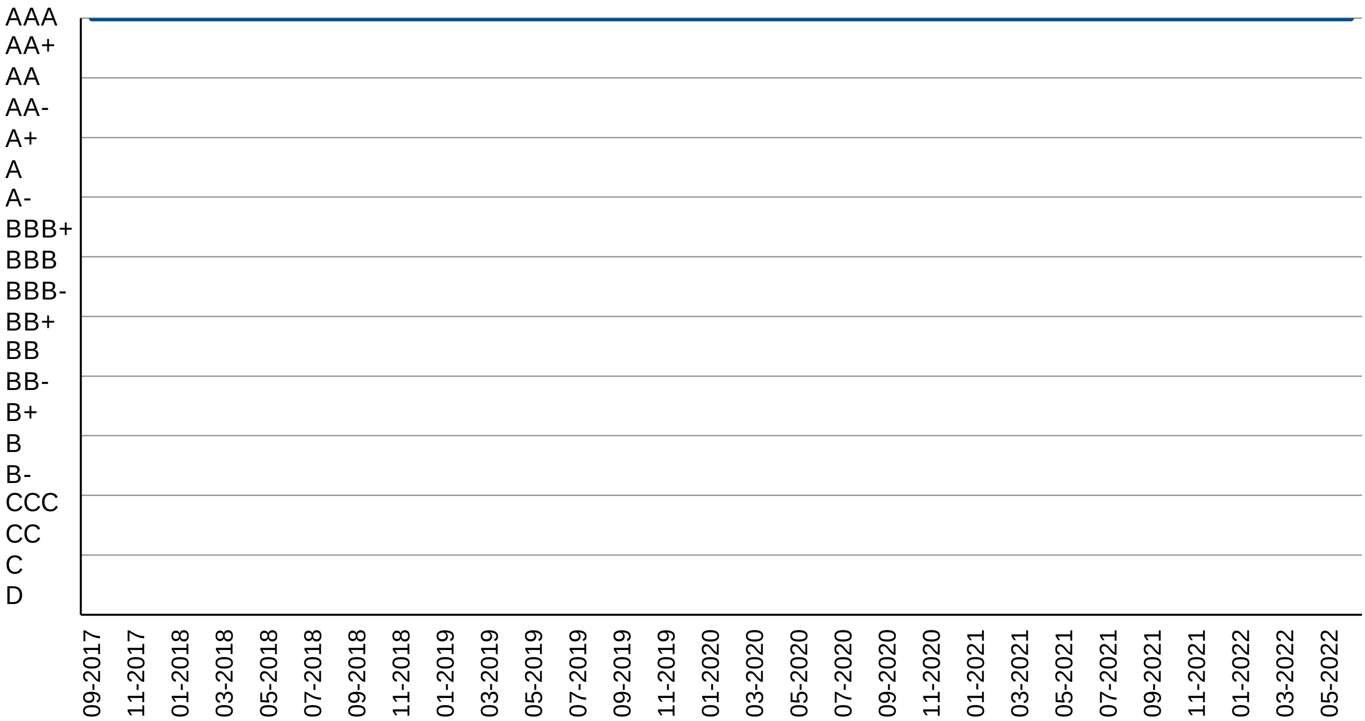
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



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 embedding a methodological reserve-currency adjustment.

Peer group*
Austria
Denmark
Finland
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland
United Kingdom

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 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	83.5	83.7	86.8	85.7	87.4	93.7	96.4	100.9
Nominal GDP, USD bn	695.4	704.7	736.0	732.5	751.7	812.6	842.0	888.2
Real growth, %[1]	2.0	1.7	2.9	1.2	-2.5	3.7	2.4	2.0
CPI inflation, %	-0.4	0.5	0.9	0.4	-0.7	0.6	2.5	1.6
Unemployment rate, %[1]	3.3	3.1	2.5	2.3	3.1	3.0	2.3	2.3
Public Finance Risk								
Public debt, % of GDP[1]	40.5	41.2	39.2	39.8	42.4	42.2	40.2	38.7
Interest payment, % of government revenue	0.5	0.4	0.3	0.2	0.2	0.5	0.4	0.4
Primary balance, % of GDP[1]	0.4	1.3	1.4	1.4	-2.8	-1.8	0.1	0.2
External Economic Risk								
Current account balance, % of GDP	8.0	6.3	6.1	5.4	2.8	9.3	6.3	7.0
Total reserves, months of imports	15.2	17.0	15.5	17.0	22.6	-	-	-
NIIP, % of GDP	87.3	98.0	106.6	90.3	115.4	91.0	-	-
Financial Stability Risk								
NPL ratio, % of total loans	0.7	0.6	0.7	0.6	0.8	-	-	-
Tier 1 ratio, % of risk-weighted assets	15.7	18.2	18.3	19.0	19.3	18.8	-	-
Credit to private sector, % of GDP	168.5	-	-	-	-	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	71.2	68.7	64.7	65.3	59.8	-	-	-
Income quintile share ratio (S80/S20), x	5.4	5.3	5.4	-	-	-	-	-
Labour-force participation rate, %	83.9	84.0	84.2	84.2	-	-	-	-
Old-age dependency ratio, %	27.2	27.6	28.0	28.4	29.0	29.6	30.2	30.9
Composite governance indicator[2]	1.8	1.8	1.8	1.7	1.7	-	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 1 August 2022	11

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