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 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%	a-		+1/3	
	Governance Risk	10%	aaa		0	
Overall outcome		**aaa**		**0**	**+1**	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and 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 GmbH

Outlook and rating-change drivers

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

Positive rating-change drivers

- N/A

Negative rating-change drivers

- Financial stability risk materialising with significant negative implications for economic growth and public finances
- Deterioration in policy predictability and/or deterioration in relations with the EU, leading to trade disruptions and significant and lasting economic repercussions

Ratings and Outlook

Foreign and local currency

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

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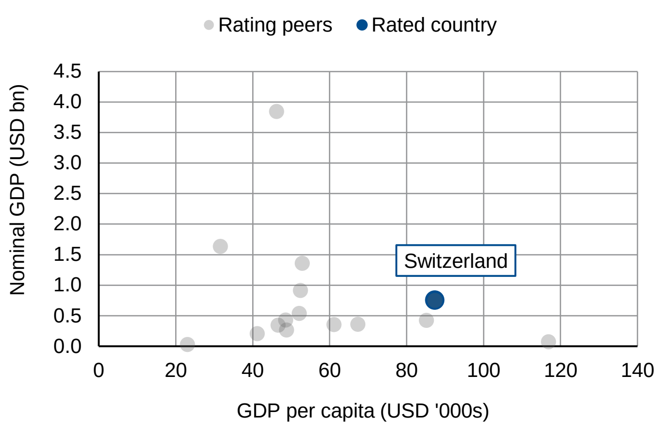
Domestic Economic Risks

- **Growth outlook:** Switzerland's credit profile benefits from its wealthy and highly competitive economy. Real growth averaged 1.9% from 2015-19 and Switzerland ranked third globally in the Observatory for Economic Complexity's economic complexity index in 2019, highlighting the economy's very high level of sophistication and diversification. In 2020, due to the outbreak of the Covid-19 pandemic, real GDP declined by a relatively moderate 2.5%, compared to a 6.4% decline in the euro area. The recovery in 2021 has been robust and quarterly output reached its pre-crisis level in Q2 2021. We expect real GDP growth of 3.5% in 2021, followed by 2.7% in 2022 and 2.0% in 2023. Due to the robust recovery and effective policy response during the crisis, we revise our potential GDP growth estimate to around 1.6%.
- **Inflation and monetary policy:** Inflation has historically been very low in Switzerland due to structural factors and deflationary pressures stemming from Swiss franc appreciation making imports relatively cheaper. Inflation averaged around 0% from 2015 to 2020. In 2021, higher energy prices led to more elevated CPI increases, at 1.5% YoY in December 2021, and averaging 0.6% over the full year. Yet these increases are still modest compared to very high inflation in peer economies such as Germany. The Swiss National Bank has maintained its expansionary monetary policy, with a 0.75% interest charge on banks' sight deposits, and significant foreign exchange interventions to stem safe-haven appreciation pressures on the Swiss franc in 2020 and 2021. Consequently, the Swiss National Bank's balance sheet has increased to CHF 1.06trn at end-2021, up from CHF 0.86trn at the end of 2019.
- **Labour market:** The Swiss labour market performed robustly during the Covid-19 crisis. The unemployment rate returned to its pre-crisis level of 2.3% in January 2022, from a peak of 3.5% in May 2020. Total employment reached its pre-crisis level of around 5.15m persons at the end of the third quarter 2021. Labour market outcomes are supported by the Swiss economy's low reliance on industries affected by pandemic containment measures, a high adaptability to telework, and a short-time work scheme, which covered 1.08m persons (around 21% of total employment) at its peak in April 2020.

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

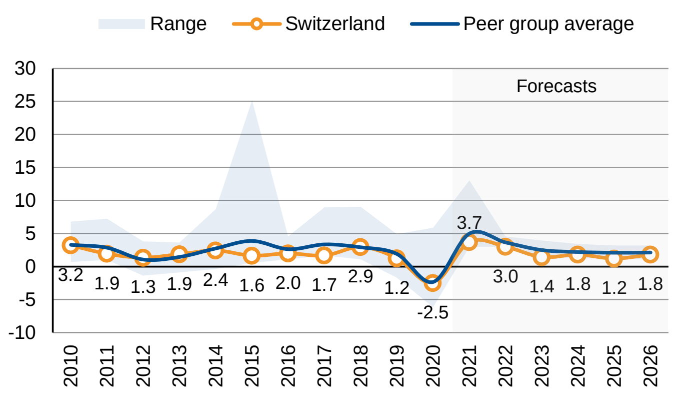
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential
	Monetary policy framework	Neutral	0	Swiss National Bank is a credible central bank. Flexibility is relatively constrained due to sensitivity of FX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

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

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. The main crisis support measure was a swiftly implemented short-time work scheme, which cost CHF 10.8bn in 2020 and CHF 4.5bn in 2021. CHF 800m has been budgeted for the scheme in 2022. The aggregate cost of CHF 16bn represents approximately 41.2% of total budgeted crisis measures of CHF 39bn for 2020-22, representing 5.5% of 2020 GDP. Other crisis tools include grants to businesses affected by pandemic containment measures – extended to end-2022 – amounting to CHF 6.8bn, or 17.4% of the total fiscal response. These measures, along with lower tax revenues, resulted in budget deficits of 2.8% of GDP in 2020 and an estimated 1.7% of GDP in 2021. We expect the 2022 general government budgetary result to be broadly balanced, driven by a phase out of support measures and higher tax revenues.

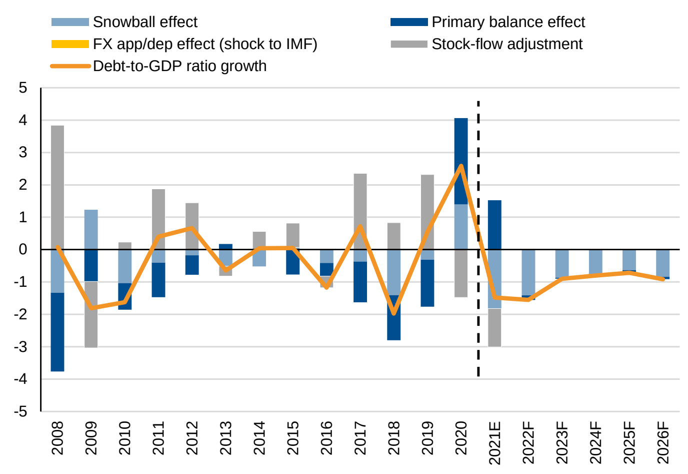
- **Debt trajectory:** General government debt, as defined by the IMF, declined to an expected 40.9% of GDP in 2021 from 42.4% in 2020, and we project a continued decline to 36.0% in 2026. Switzerland's general government debt ratio of 42.4% in 2020 compares favourably to a 50% average of sovereign peers. In our view, Switzerland retains significant fiscal space.

- **Market access:** The Swiss Confederation's market access is very strong. Issuance in 2020 carried an average negative 0.4% interest rate, and marketable debt has a ten year average maturity. The country had sizeable cash buffers of CHF 12.8bn available at the end of 2020, down from CHF 23.5bn in 2019, due to drawdowns that helped finance the crisis response.

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

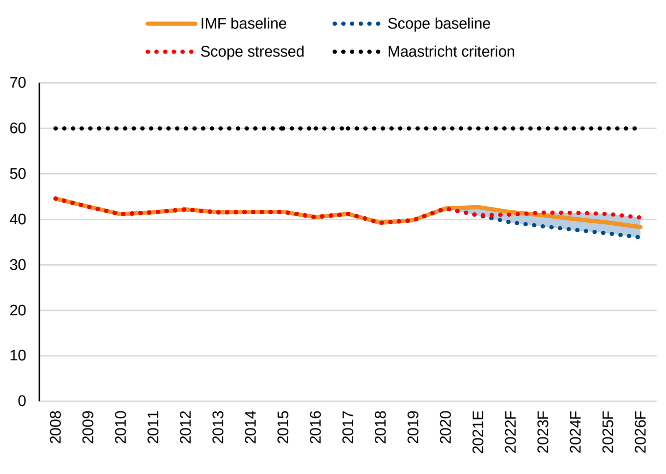
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Fiscal policy framework	Strong	+1/3	Stringent, constitutionally anchored fiscal rules, track record of prudent and stable fiscal policies
	Debt sustainability	Neutral	0	Moderate public-debt levels, strong commitment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

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

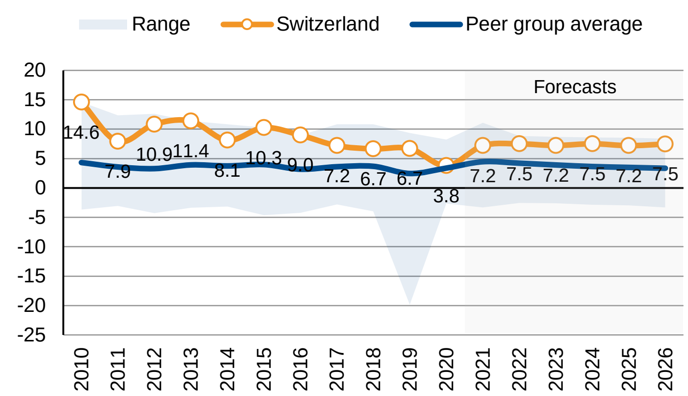
External Economic Risks

- **Current account:** Switzerland's ratings benefit from high and recurrent 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. In the third quarter of 2021, the current account surplus amounted to CHF 24.4bn, or 13% of third-quarter nominal GDP. Switzerland's current account resilience is underpinned by highly specialised, price-insensitive exporting industries, such as pharmaceuticals, which made up around 39% of goods exports in 2020.
- **External position:** Switzerland's robust external position is underpinned by a high net international investment position of 115.3% of GDP at the end of September 2021, up from 72.2% in 2015. External debt of 292% of GDP in Q3 2021 is relatively high. Most external debt is held by non-monetary financial institutions (113% of GDP at Q3 2021), followed by other sectors, including non-financial corporations (80%). Most external debt is short-term and concentrated on the non-monetary financial institution sector.
- **Resilience to shocks:** The Swiss franc is considered a safe haven currency, and the Swiss National Bank holds large foreign currency investments of CHF 966bn in December 2021, or 130.5% of expected 2021 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. We expect a broadly constructive Swiss-EU relationship going forward. This is underpinned by not only the rejection in 2020 of a popular initiative that would have ended free movement of persons between Switzerland and the EU, but also the importance as respective trade partners.

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

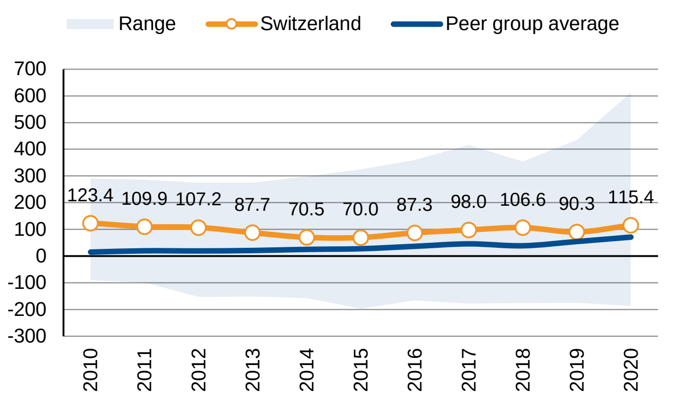
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Strong	+1/3	Large and persistent current account surpluses, reflecting a competitive external sector and a substantial share of price-insensitive exports
	External debt structure	Neutral	0	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, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

Financial Stability Risks

- **Banking sector:** The Swiss banking system is very large (total assets of CHF 3.8trn, or 522% of GDP at the end of September 2021), 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. They also face structural profitability issues.

  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.

  Second, domestically active banks face increasing scrutiny of their mortgage lending, as underpinned by a recent increase in minimum down payments for mortgages for investment property. Finally, system-wide capitalisation remains comfortable (CET1 ratio of 18.8% in Q3 2021) and the non-performing loan ratio was 0.7% of aggregate loans in Q3 2021.

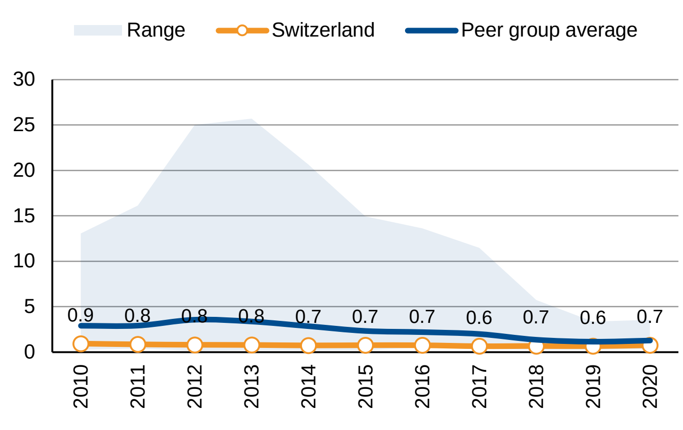
- **Private debt:** Private sector debt is elevated at around 278% of GDP as of Q2 2021, the highest such ratio among peers. Household debt was 132% of GDP, representing mostly mortgage loans. This is offset by high household wealth estimated at 404% of GDP in 2020.

- **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-2020, prices for single-family dwellings were 5.4% higher than a year earlier (5.1% for apartments). These YoY rates increased to 8.3% and 6.7%, respectively, in the third quarter of 2021. Mortgage lending growth was 3.2% in 2020, in line with previous years.

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

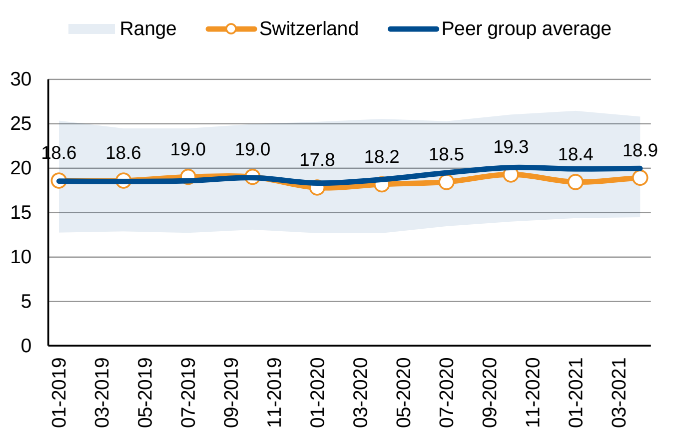
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Banking sector performance	Weak	-1/3	Well-capitalised and liquid banking sector with strong asset quality, but bank profitability remains structurally weak
	Banking sector oversight	Neutral	0	Effective financial policymaking 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, gradual build-up of imbalances in the real estate market due to low interest-rate environment

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

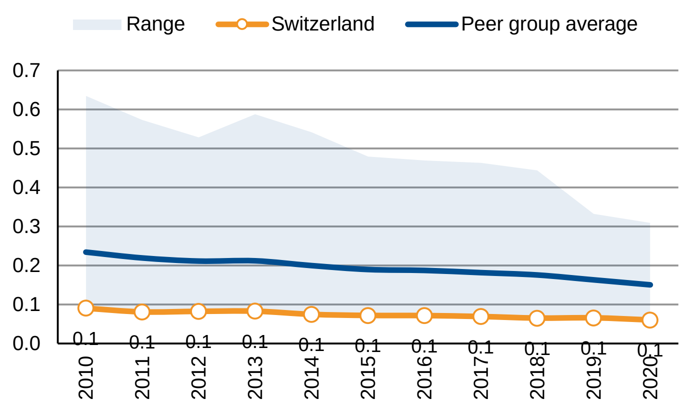
ESG Risks

- **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. 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 (8.7% of the population affected by income poverty in 2019) 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 2020), 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*

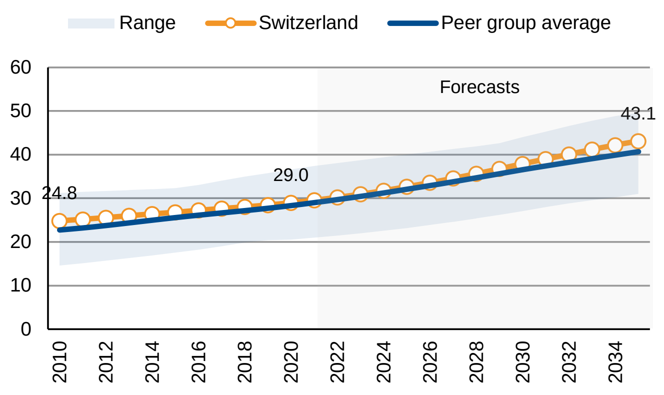
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental risks	Neutral	0	Transition risk mitigated by a robust regulatory framework, including a carbon levy of CHF 130/ton of CO_2, and considerable public expenditure
	Social risks	Strong	+1/3	Very high human 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, MTCO2e



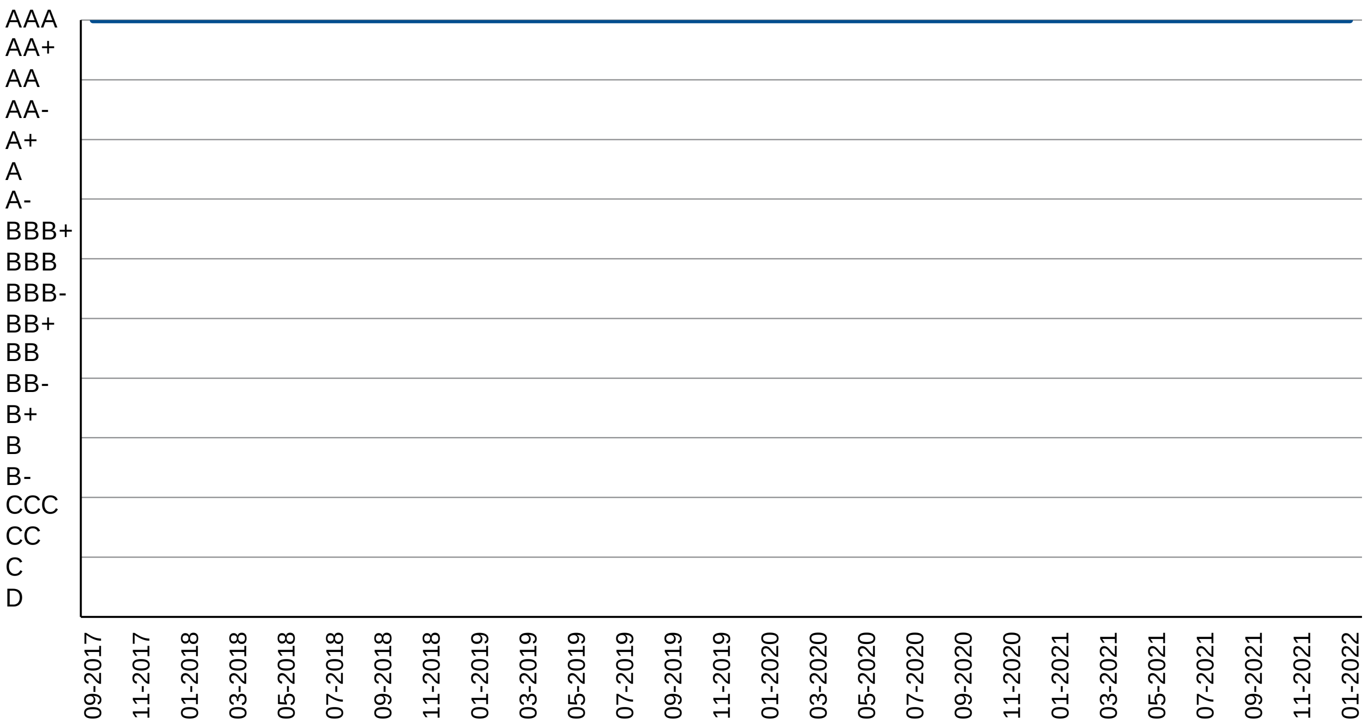
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



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.

Peer group
Austria
Denmark
Estonia
Finland
Germany
Ireland
Luxembourg
Switzerland
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 29) 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	93.5	98.8	102.0
Nominal GDP, USD bn	695.4	704.8	736.1	732.5	751.9	810.8	862.8	898.0
Real growth, %[1]	2.0	1.7	2.9	1.2	-2.5	3.5	2.7	2.0
CPI inflation, %	-0.4	0.5	0.9	0.4	-0.7	0.4	0.6	0.8
Unemployment rate, %[1]	3.3	3.1	2.5	2.3	3.1	3.0	2.5	2.4
Public Finance Risk								
Public debt, % of GDP[1]	40.5	41.2	39.2	39.8	42.4	40.9	39.3	38.4
Interest payment, % of government revenue	0.5	0.4	0.4	0.4	0.5	0.5	0.4	0.4
Primary balance, % of GDP[1]	0.4	1.3	1.4	1.5	-2.7	-1.5	0.1	0.0
External Economic Risk								
Current account balance, % of GDP	9.0	7.2	6.7	6.7	3.8	7.2	7.5	7.2
Total reserves, months of imports	15.2	17.1	15.4	17.4	22.2	-	-	-
NIIP, % of GDP	87.3	98.0	106.6	90.3	115.4	-	-	-
Financial Stability Risk								
NPL ratio, % of total loans	0.7	0.6	0.7	0.6	0.7	-	-	-
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	237.6	246.8	239.3	256.2	269.6	278.3	-	-
ESG Risk								
CO^2 per EUR 1,000 of GDP, MTCO2e	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 and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: Bank for International Settlements, European Commission, IMF, United Nations Conference on Trade & Development, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 17 February 2022	7

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