

# Basel-City (Canton of)

11/08/2021

This report does not constitute a rating action.

## Credit Highlights

### Overview

#### Credit context and assumptions

The Canton of Basel-City (Basel-City)'s very wealthy economy and sound budgetary performance contribute to its position as one of only a few contributors to the Swiss fiscal equalization system.

--Basel-City will presumably achieve a surplus after capital accounts again in 2021, but slightly weaker results in the years to come.

--The diversified and very wealthy economy will digest the economic and social turmoil of the pandemic.

--Basel-City is one of the few net contributors to the very predictable and supportive institutional framework for Swiss cantons.

#### Base-case expectations

The canton's prudent financial management aims to keep debt at moderate levels.

--Swiss real GDP is forecast to increase more than 3% in 2021 and 2022, benefiting from restored international trade.

--Basel-City has created sufficient budgetary headroom to digest any drawbacks, should they appear.

#### PRIMARY CONTACT

**Michael Stroschein**  
Frankfurt  
49-693-399-9251  
michael.stroschein  
@spglobal.com

#### SECONDARY CONTACTS

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

**Didre Schneider**  
Frankfurt  
49-69-33-999-244  
didre.schneider  
@spglobal.com

*The ratings reflect the canton's very strong economic fundamentals with very high wealth levels and low unemployment rates.*

Extraordinary high tax revenue from 2019 to 2021, partly as one-offs, helped the canton to offset the financial effects of the COVID-19 pandemic and moderately reduce its debt burden.

*The ratings also benefit from the canton's high flexibility to alter its tax rates if unforeseen developments occur.* However, they take into account the canton's potentially sizable contingent liabilities from its stake in a commercial bank

## Outlook

The stable outlook reflects S&P Global Ratings' view that Basel-City will continue to achieve sound budgetary performance over the next few years, despite pandemic-related economic headwinds. We regard potential deficits after capital accounts as small and temporary

## **Downside scenario**

All other factors remaining equal, we could lower the rating if the canton's management fails to exercise budgetary discipline and loosens its grip on financial performance. In addition, pressure on the ratings would build if the cantonal bank calls upon Basel-City for support. However, we currently view this scenario as unlikely.

## **Rationale**

### **Basel-City will likely witness an economic recovery in 2021 and 2022, but also structural changes in the operating environment**

We expect Switzerland's real GDP to expand 3.2% in 2021 and 3.1% in 2022 (see "Latest European Economic Snapshots Highlight The Continent's Faster-Than-Expected Restart," published Sept. 29, 2021, on RatingsDirect). The local economy performed better than the national average in 2020 due to the canton's focus on life sciences. With an estimated national GDP per capita in excess of \$93,000 in 2021, Switzerland will remain one of the world's strongest economies. As a regional center and economic powerhouse, Basel-City achieves about twice this already very high national average. The canton is home to some of the largest corporations in the pharmaceutical and chemical sectors globally, which have proven relatively resilient during the COVID-19 pandemic. Ongoing diversification within the life science industry limits the canton's exposure to a single subsector or product cycle. Moreover, we observe that the sector's high economic relevance does not seem to cause volatility in the canton's tax revenue. The large number of companies located in Basel-City helped to keep unemployment at a very low 3.4% in September 2021, down by half a percentage point year-on-year. This is, however, slightly higher than the national average of 2.6%. Basel-City's unemployment figures usually follow national trends. The canton attracts a significant number of national and international commuters.

Due to its very favorable economic and financial profile, Basel-City is one of only seven cantonal contributors to the national fiscal equalization system, from which transfers to weaker cantons are made. For 2022, the canton is obliged to pay Swiss franc (CHF) 70 million--equivalent to 1.6% of operating revenue--to the system. Basel-City's reduced contribution compared to previous years reflects adjustments to the system to mitigate the negative effects of the recent Swiss corporate tax reform (TP17 or TRAF; see "Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others?," published Aug. 29, 2018). In short, the reform provides for the discontinuation of certain tax privileges for foreign holding, domiciliary, and mixed companies. Basel-City used to receive considerable taxes from such special-status entities, and therefore is particularly affected by the reform. Parts of the extraordinary tax revenue received from 2019 and 2020, and expected for 2021, relate to companies preparing for the tax system change, with the introduction of so-called patent boxes having particular relevance for Basel-City.

We think the institutional framework for Swiss cantons is well developed and extremely predictable, with major reforms planned far in advance and widely discussed, notably between the federal government and the cantons, and among the cantons themselves. All Swiss cantons currently also benefit from increased payouts by the Swiss National Bank (SNB; for more information see "Swiss National Bank's Higher Payout To Government Offers Budgetary Relief," published Feb 12, 2021).

In our opinion, the canton's management has created enough financial headroom to deal with both the corporate tax reform and the COVID-19 pandemic. The canton regularly outperforms its budgetary plans, thanks to usually better-than-planned tax revenue and tight expenditure control. We view the canton's transparency as superior to that of peers, since it publishes interim results twice a year. We also note that the canton enjoys high flexibility to alter its tax rates if unforeseen developments arise. Compared with national peers, Basel-City has the additional flexibility to alter municipal revenue if necessary.

Due to tax collection and assessment mechanics, we understand the COVID-19-induced 2.4% decline in Swiss real GDP in 2020 will still hit 2021 revenue. Tax is mostly collected through prepayments that are invoiced based on the previous year's profits or personal income, and only finally settled in the following year, creating a lag. Although the canton benefited from a series of positive one-off effects from 2019 to 2021, we expect that future performance will be structurally weaker than the outstandingly high results, with surpluses after capital accounts, achieved in recent years.

**Multiple one-offs have helped Basel-City achieve budgetary surpluses and debt reduction, but margins may weaken**

For 2021, we expect Basel-City to still achieve a small surplus, thanks to the above-mentioned one-off revenue from the corporate tax reform and increased payouts from the SNB. These should more than offset the extra expenditure due to the COVID-19 pandemic. In our forecast beyond 2021, we assume that lower tax revenue than in previous years will reduce the operating surplus to--a still sound--about 8% of operating revenue. Increased capital spending by the canton will lead to small deficits after capital accounts of below 2% of operating revenue in 2022 and 2023, in our view. We note that additional uncertainty following the current second wave of the COVID-19 pandemic might change this forecast, but we think the canton has enough budgetary flexibility to mitigate additional pressure if necessary. We view the potential deficits as a structural change compared with the extraordinarily high surpluses after capital accounts achieved previously.

Thanks to its past budgetary surpluses, the canton has considerably reduced its debt burden and is likely to refrain from debt issuance in 2021. We therefore expect Basel-City's direct debt will continue to decline, before stabilizing at rates above 60% of operating revenue by 2023--a moderate debt burden in a national and international comparison. The canton does not have any outstanding debt denominated in foreign currency.

Basel-City's main contingent liability is Basler Kantonalbank, since the canton legally guarantees almost all the bank's liabilities. In our opinion, Basel-City's creditworthiness could suffer if the bank calls on the guarantee or has to rely on the canton for significant capital contributions. However, we currently view the likelihood of such a scenario as remote. The canton's other contingent

**Canton of Basel-City Selected Indicators**

Mil. CHF	2018	2019	2020	2021bc	2022bc	2023bc
Operating revenue	4,199.9	4,724.4	4,369.9	4,258.8	4,272.5	4,373.8
Operating expenditure	3,672.0	3,810.6	3,999.1	3,914.5	3,967.7	4,039.6
Operating balance	527.9	913.8	370.8	344.3	304.8	334.2
Operating balance (% of operating revenue)	12.6	19.3	8.5	8.1	7.1	7.6
Capital revenue	10.4	9.9	2.6	1.0	1.2	0.0
Capital expenditure	321.3	277.2	349.6	306.3	326.1	410.0
Balance after capital accounts	217.0	646.5	23.8	39.0	(20.1)	(75.8)
Balance after capital accounts (% of total revenue)	5.2	13.7	0.5	0.9	(0.5)	(1.7)
Debt repaid	803.0	450.0	600.0	400.0	525.0	500.4
Gross borrowings	809.0	461.9	0.0	0.0	601.0	576.0
Balance after borrowings	185.4	636.3	(476.1)	(439.2)	0.2	(0.2)
Direct debt (outstanding at year-end)	3,778.0	3,789.5	2,589.5	2,789.1	2,865.1	2,941.1
Direct debt (% of operating revenue)	90.0	80.2	59.3	65.5	67.1	67.2
Tax-supported debt (outstanding at year-end)	3,778.0	3,789.5	2,589.5	2,789.1	2,865.1	2,941.1
Tax-supported debt (% of consolidated operating revenue)	90.0	80.2	59.3	65.5	67.1	67.2
Interest (% of operating revenue)	0.7	0.5	0.4	0.2	0.2	0.3
Local GDP per capita (\$)	208,579.7	205,839.5	192,837.8	225,578.8	225,113.6	225,459.7
National GDP per capita (\$)	86,083.1	85,029.6	86,756.5	93,277.1	93,065.3	93,299.4

## Canton of Basel-City Selected Indicators

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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
Economy	1
Financial management	1
Budgetary performance	1
Liquidity	1
Debt burden	4
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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, Oct. 12, 2021. An interactive version is available at <http://www.spratings.com/sri>

### Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

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- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- COVID-19 Impact: Key Takeaways From Our Articles, Oct. 27, 2021
- Institutional Framework Assessments For International Local And Regional Governments, Oct. 6, 2021
- Latest European Economic Snapshots Highlight The Continent's Faster-Than-Expected Restart, Sept. 29, 2021
- Default, Transition, and Recovery: 2020 Annual International Public Finance Default And Rating Transition Study, Sept. 14, 2021
- Comparative Statistics: European Local And Regional Government Risk Indicators, Sept. 1, 2021
- Switzerland, Aug. 23, 2021
- COVID Aftershocks Push German And Austrian LRGs Into Heavy Borrowing, March 25, 2021
- Local Government Debt 2021: Global Borrowing To Hit \$2.25 Trillion, March 25, 2021
- Swiss National Bank's Higher Payout To Government Offers Budgetary Relief, Feb. 3, 2021
- Institutional Framework Assessment: Swiss Cantons; Jan. 14, 2021
- Basler Kantonbank, Dec. 11, 2020
- Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others?, Aug. 29, 2018

## Ratings Detail (as of November 09, 2021)\*

### Basel-City (Canton of)

Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured	AAA

### Issuer Credit Ratings History

09-Nov-2018	AAA/Stable/A-1+
10-Nov-2017	AA+/Positive/A-1+
16-Jun-2009	AA+/Stable/A-1+

\*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.

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