S&P Global Ratings

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Basel-City (Canton of)

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This report does not constitute a rating action.

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Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
--S&P Global Ratings expects Switzerland to post more benign GDP growth and inflation figures than most neighbors during current macroeconomic challenges.	--Above-budget tax revenue and dividend income should enable Basel-City to post strong results again in 2022, with a small surplus after capital accounts.
--The Canton of Basel-City (Basel-City) additionally benefits from the strong local presence of the pharmaceutical industry, which provides an extremely resilient tax base far in excess of the already very strong Swiss average.	--The weaker general economic backdrop, elevated inflation, recently adopted tax cuts, and planned higher capex will start to weigh on results.
--Basel-City's political leadership has committed to prioritizing climate protection, social cohesion, digitalization, and maintaining the canton's attractiveness as a place for business and residence, which requires additional capital expenditure (capex).	--We therefore anticipate softer operating margins, small deficits after capital accounts, and a minor uptick in the canton's nevertheless still moderate debt burden during 2023-2026.

Basel-City will continue to benefit from an extraordinarily strong local economy. Macroeconomic headwinds appear less severe in Switzerland, while the strong pharmaceutical sector adds resilience, particularly to tax flows.

The canton's financial management will nevertheless need to balance spending priorities with budgetary stability. Higher capex plans and tax cuts leave less room for maneuver and imply small deficits after capital accounts.

An exceptional liquidity position and the moderate debt burden will continue to support our ratings on Basel-City. Despite having used available cash to repay maturing debt, we expect no structural changes to these key parameters.

Outlook

The stable outlook reflects our view that Basel-City will continue to achieve sound budgetary performance over the next few years, despite economic headwinds, initially from the pandemic and now fallout from the Russia-Ukraine war. We regard potential deficits after capital accounts as small and manageable.

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, particularly considering currently elevated economic uncertainties. In addition, pressure on the ratings would build if the cantonal bank calls on Basel-City for support. However, we currently view this scenario as unlikely.

Rationale

Despite current macroeconomic headwinds, Basel-City benefits from a strong and resilient economic and institutional base

Although certainly not immune, we expect Switzerland to be less affected by the current macroeconomic challenges than most other European countries. Aligned with this view, S&P Global Ratings currently forecasts national real GDP growth of 2.4% for 2022. This is expected to slow to 1.1% in 2023, before recovering to 1.6% and 1.4% in 2024 and 2025, respectively. Inflation, even if currently high by Swiss standards, will likely only peak at a comparatively modest value of 3.1% in 2022. We then expect it will level off to 2.6% in 2023 and 1.5% in 2024. The Swiss national unemployment rate of 4.1% at the end of first-half 2022 signals a continuously tight labor market. With an estimated national GDP per capita of about $95,000 in 2022, Switzerland will remain one of the world's strongest economies in any case.

The fundamental strength of Basel-City's local economy arguably exceeds the Swiss average. Some of the largest corporations in the pharmaceutical and chemical sectors globally--such as Roche, Novartis, and Lonza--are headquartered in the canton. Thanks to this, Basel-City's local GDP per capita is more than 200% the national value. The pharmaceutical industry has proven extremely resilient, for example, during the COVID-19 pandemic. It directly and indirectly drives a significant share of the canton's strong tax base. The comparatively higher tax revenue potential makes Basel-City one of only six contributor cantons--out of 26--in the Swiss national fiscal equalization scheme. Basel-City will pay almost Swiss franc (CHF) 118 million into the system in 2023, about 2.5% of adjusted operating revenue.

We consider the institutional framework under which Basel-City and the other Swiss cantons operate as extremely predictable and highly supportive. The supportiveness of the system under extraordinary circumstances was demonstrated through the large volume of federal funds made available to mitigate the economic consequences of the COVID-19 pandemic in 2020 and 2021. However, solidarity can run both ways. For example, we understand that the cantons are together liable for 50% of any losses that the federal government might incur under its new emergency liquidity support scheme for systemically relevant power producers.

We note two outstanding, institutional framework-related, political decisions that, depending on the outcome, could have a material but not yet quantified impact on Basel-City's finances. The first is the split of anticipated additional revenue--resulting from Switzerland implementing the new Organization for Economic Cooperation and Development minimum tax rate--between the cantons and the federation. The second is a national political initiative, currently pending in the Swiss parliamentary system, to cap medical insurance premiums at 10% of an individual's income, with cantonal budgets covering at least part of the cost.

In our view, Basel-City's financial management strategy reflects the political focus on climate protection, social cohesion, and maintaining the canton's attractiveness as a place for business and residence. We observe, for example, a temporary increase in planned capex of about 25% during 2023-2025, particularly for urban development, electrification of the local bus network, new trams, refurbishment of the local sewage treatment plant, and childcare infrastructure. Notably, a recent update of cantonal tax rules combines a cross-the-board reduction of the cantonal income tax rate by 0.75%-points with lower wealth taxes for the mass affluent, and various, more socially oriented, higher deductions for insurance premiums and childcare costs. Altogether, these tax measures are estimated to cost Basel-City CHF112 million, or about 2.5% of operating revenue, a year from 2024.

Although 2022 predicted results exceed budget, margins will likely soften going forward

For 2022, we understand Basel-City is likely outperform its budget by about CHF160 million. This translates into an operating margin above 8% and a small surplus after capital accounts under our cash-focused calculation approach. Chiefly responsible are significantly better-than-budgeted tax collections and elevated profit distributions from cantonal companies and the Swiss National Bank (SNB).

However, we expect softer margins and small deficits after capital accounts from 2023. This reflects current economic headwinds, although tax collections should remain robust. We anticipate, for example, that there will be no profit distribution from the SNB in 2023, after the bank reported a record loss of CHF142 billion for the first nine months of 2022. Furthermore, Basel-City's staff costs will increase markedly in 2023, driven by inflation-induced salary adjustments and additional personnel required to care for, and teach, Ukrainian refugees. From 2024, the above-described, recently adopted tax cuts will likely counteract any macroeconomic normalization and keep margins subdued.

In our view, Basel-City's structural debt burden should remain at about 60% of operating revenue. The canton has used excess cash to retire maturing debt over the past three years. This should cause the relevant ratio of tax supported debt to consolidated operating revenue to bottom out between 2022 and 2023, before expanding slightly again in response to the predicted small deficits. All Basel-City's capital market debt is fixed rate and denominated in Swiss francs. The canton has issued green and social bonds. We note a slightly shorter average tenor than peers but, given the limited amounts, believe that the canton should have no issues refinancing its maturities.

The canton's liquidity position is supported by a committed, CHF900 million credit facility with its majority-owned local lender Basler Kantonalbank (BKB) and access to the deep and liquid Swiss capital market for cantonal borrowers. Although still substantial on average, Basel-City's cash held in bank accounts no longer exceeds the next 12 months' debt service, following utilization of liquid funds for debt repayment.

Basel-City's major contingent liability remains BKB, since the canton legally guarantees almost all the bank's liabilities, and its size exceeds the canton's annual operating revenue by more than a factor of 10. Given the current distortions in the energy market, we additionally note that Basel-City owns a utility company, Industrielle Werke Basel (IWB). Although IWB sells natural gas to local retail clients and still runs two gas-fired heating plants, we note the high share of renewable energy in its energy mix, recently implemented price increases, and the solid balance sheet with a 70% equity ratio.

Canton of Basel-City Selected Indicators

Mil. CHF	2020	2021	2022bc	2023bc	2024bc	2025bc
Operating revenue	4,471	4,510	4,502	4,598	4,628	4,814
Operating expenditure	3,838	4,048	4,125	4,295	4,392	4,515
Operating balance	633	463	377	303	236	298
Operating balance (% of operating revenue)	14.2	10.3	8.4	6.6	5.1	6.2
Capital revenue	13	28	1	1	12	8
Capital expenditure	296	320	325	346	375	416
Balance after capital accounts	350	171	53	(42)	(127)	(109)
Balance after capital accounts (% of total revenue)	7.8	3.8	1.2	(0.9)	(2.7)	(2.3)
Debt repaid	601	408	525	500	350	381
Gross borrowings	0	0	260	617	502	592
Balance after borrowings	(254)	(223)	(268)	(0)	(37)	0

Direct debt (outstanding at year-end)	3,189	2,781	2,516	2,633	2,785	2,996
Direct debt (% of operating revenue)	71.3	61.7	55.9	57.3	60.2	62.2
Tax-supported debt (outstanding at year-end)	3,257	2,870	2,605	2,722	2,874	3,085
Tax-supported debt (% of consolidated operating revenue)	71.8	62.7	57.1	58.4	61.3	63.2
Interest (% of operating revenue)	0.2	0.1	0.2	0.2	0.4	0.7
Local GDP per capita (single units)	193,410	202,539	207,582	212,544	217,198	221,760
National GDP per capita (single units)	80,120	83,726	87,272	89,375	91,166	92,535

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. 10, 2022. 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Credit Conditions Downside Scenario: Recession Risks Deepen, Oct. 12, 2022
- Basler Kantonalbank 'AA+' Rating Affirmed; Stand-Alone Credit Profile Revised To 'a+' On Improved Risk Position, Sept. 22, 2022
- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022
- Cantons Will Likely Withstand Temporary Instability Of Swiss National Bank Profit Distributions, Aug. 17, 2022
- Switzerland, Aug. 15, 2022
- Institutional Framework Assessment: Swiss Cantons, Jan. 14, 2021

Ratings Detail (as of November 03, 2022)*

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.