S&P Global
Ratings

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Solothurn (Canton of)

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This report does not constitute a rating action.

Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
--The Swiss economy remains resilient against challenging economic conditions.	--Solothurn's tax revenue basis should remain robust and mitigate the impact of the tax reform.
--We believe the Canton of Solothurn's financial management will adhere to tight fiscal policies, and a very good liquidity position will facilitate debt reduction.	--A shortfall in SNB dividends coupled with additional costs stemming from high inflation will pressure cantons' expenditure side in 2023.
--After a record loss in 2022, we currently assume that Swiss National Bank (SNB) will not pay dividends in 2023-2024.	--After strong results in 2022, Solothurn's budgetary performance will hence soften in 2023.

The Canton of Solothurn will face budgetary challenges in 2023. Difficulties will spring from no profit distribution from SNB or increased expenditure due to higher inflation, for example. Last year, however, the canton posted very strong financial results even despite macroeconomic hurdles. Nonetheless, these conditions will persist, likely narrowing the operating balance and leaving only marginal surpluses after capital accounts over the 2023-2026 forecast horizon. We expect the canton's financial management to adhere to its tight fiscal policy and adopt savings measures, if required, to mitigate the budgetary pressures. Furthermore, we assume the canton's tax revenue basis will remain resilient and cushion the impact of the recent tax reform which was approved in a public referendum last year.

We think Solothurn remains committed to reducing its leverage and repaying debt when possible. The canton's liquidity position is still exceptional, with liquid assets falling due before the upcoming long-term debt maturity of Swiss franc (CHF)100 million in 2023. Moreover, in our view, Solothurn's creditworthiness continues to benefit from Switzerland's supportive institutional framework and very strong and resilient economic position.

Outlook

The positive outlook on Solothurn indicates our expectation that the canton will remain committed to a balanced budget with very limited recourse to debt, if any. As a result, its financial position and debt burden may significantly improve to become commensurate with a 'AAA' rating.

Downside scenario

We could revise the outlook to stable if we were to see changes to the canton's revenues that are more significant than currently expected, which could lead to reduced operating surpluses and hamper the debt-repayment strategy.

Upside scenario

We could raise the rating on Solothurn if, in the next 12 months, we were to see a continuation of the strong financial performance similar to pre-pandemic levels and if we observed a lower likelihood of adverse tax measures.

Rationale

Strong financial performance despite macroeconomic obstacles

Switzerland's economy remains resilient against the global economic slowdown and high inflationary pressures. After solid growth of about 2.1% in 2022, the Swiss economy should expand 0.6% in 2023 before accelerating to 1.2% in 2024 and 1.7% in 2025. The expected deceleration in 2023 reflects an uncertain geopolitical environment, higher inflation, and a tighter monetary policy. Given the economic structure of Solothurn, the regional GDP should stay broadly in line with the Swiss average. With an estimated national GDP per capita of about $96,900 in 2023, Switzerland remains one of the strongest economies globally. Although Solothurn's GDP per capita reaches about 81% of the national average, it is markedly higher than that of international peers. Additionally, Solothurn's unemployment rate--just 2.0% in March 2023--is in line with the Swiss national average, supporting our assessment of a robust economy.

We believe that the exceptionally strong tax revenue inflow during the past two-to-three years has strengthened the canton's tax base and facilitated a recovery to pre-pandemic levels as early as 2022. This should cushion the impact of the cantonal counterproposal to the tax initiative ("Jetz si mir draa"), which was approved in the public referendum held on May 15, 2022. The original proposal aimed for a gradual reduction of the income tax burden, for individuals, toward the Swiss average tax rate and would have cost the canton up to CHF130 million annually. The cantonal government therefore countered with a proposal to reduce the tax burden for small- and medium-income households; this was voted in and will cost the canton CHF20 million-CHF30 million annually.

In our view, management is aware of the budgetary challenges, such as the shortfall of SNB dividends and higher costs due to inflation, and we think management will remain prudent. Moreover, we assume management will implement, if needed, proper measures to balance its budgetary performance. It successfully implemented a considerable savings program in 2014, highlighting its commitment to consolidation.

We consider the institutional framework in which all Swiss cantons operate as one of the most predictable and supportive globally. Changes to the system are infrequent. The Swiss institutional system provides Solothurn with a reliable source of revenue through its resource equalization scheme. It also highlights the canton's dependence on developments in

Switzerland's economic centers. In our view, this is not an impediment but rather a supporting factor for the canton's financial performance.

Balanced budgets and a strong liquidity position will help reduce the debt stock

The canton posted an operating surplus of 10.9% and balance after capital accounts of 7.2% in 2022. The strong financial results stem primarily from significantly higher-than-budgeted tax collections, elevated SNB profit distribution, and contained expenditure growth. However, we project the operating margins will somewhat shrink from this year, with minimal but steady surpluses after capital accounts over the forecast horizon. We assume no SNB profit distribution in 2023 and 2024, following a record loss of CHF132 billion in 2022. Furthermore, higher energy prices and inflation will spur additional costs linked to personnel expenditures, goods, and services, among other expense items, straining the canton’s expenditures. However, the robust tax base and resilient economy will help mitigate those pressures, and currently unexpected but possible SNB dividend distributions provide opportunity for further improvements to the canton’s financial position. We expect the canton’s prudent financial management and tighter fiscal policies to maintain balanced budgets despite the economic headwinds.

We anticipate that the canton will gradually reduce its debt over the forecast horizon. In our view, the balanced budgets and very comfortable liquidity position will help net debt repayment in 2023 and potentially in 2024 with very limited recourse to refinancing. For instance, the canton already has short-term liquid assets falling due at the same time of its long-term debt maturity (CHF100 million) in 2023. In our debt assessment, the canton will move toward a tax-supported debt to operating revenue ratio of roughly 65% in 2025, compared with 91% in 2020, and a peak of 105% in 2017. The canton has demonstrated gradual but consistent reduction of its debt stock, which emerged mainly from the one-off full capitalization of the cantonal pension fund following a 2014 public referendum. Since all of Solothurn's debt is denominated in Swiss francs and the management has no intention of amending this policy, the canton's finances do not face foreign exchange rate risk at this time. Unlike other rated Swiss peers, Solothurn does not have a cantonal bank to support. Other contingent financial risks are negligible, stemming from relatively small stakes in private companies, a guarantee for a former waste disposal site, and a small amount of agricultural loans.

We continue to assess Solothurn’s liquidity position as exceptional. The canton has moderate long-term maturities due over our forecast horizon. It has proven access to committed credit lines amounting to CHF260 million with different banks, which helps to bridge liquidity gaps in times of low cash inflows, especially at year-end. The canton's revenue and expenditure follow a predictable pattern that facilitates liquidity planning. Furthermore, the canton has strong access to Switzerland's deep and liquid capital markets, underpinning our liquidity assessment.

Canton of Solothurn Selected Indicators

Mil. CHF	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenue	2,281	2,396	2,489	2,359	2,407	2,447
Operating expenditure	2,126	2,207	2,219	2,273	2,308	2,338
Operating balance	156	189	271	87	99	108
Operating balance (% of operating revenue)	6.8	7.9	10.9	3.7	4.1	4.4
Capital revenue	153	7	3	8	16	13
Capital expenditure	109	84	92	94	108	112
Balance after capital accounts	200	112	181	1	6	9

Canton of Solothurn Selected Indicators

Balance after capital accounts (% of total revenue)	8.2	4.6	7.3	0.0	0.3	0.4
Debt repaid	305	385	200	100	200	200
Gross borrowings	230	200	50	0	150	200
Balance after borrowings	126	(72)	33	(99)	(43)	9
Direct debt (outstanding at year-end)	2,065	1,880	1,730	1,630	1,580	1,580
Direct debt (% of operating revenue)	90.5	78.5	69.5	69.1	65.6	64.6
Tax-supported debt (outstanding at year-end)	2,081	1,896	1,746	1,646	1,596	1,596
Tax-supported debt (% of consolidated operating revenue)	91.2	79.1	70.1	69.7	66.3	65.2
Interest (% of operating revenue)	0.9	0.8	0.8	0.9	0.9	1.0
Local GDP per capita ($)	65,237	68,147	70,866	72,141	73,440	74,688
National GDP per capita ($)	80,120	83,726	87,552	89,215	90,554	91,911

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	2
Budgetary performance	2
Liquidity	1
Debt burden	3
Stand-alone credit profile	aa+
Issuer credit rating	AA+

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, April 10, 2023. Interactive version 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

- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, March 31, 2023
- Subnational Debt 2023: An Easing Burden In Germany, Austria, And Switzerland, March 2, 2023
- Switzerland, Feb. 13, 2023
- Record Loss At Swiss National Bank Wipes Out Profit Distribution To Cantons In 2023 And Jeopardizes 2024 Payment, Jan. 23, 2023
- Institutional Framework Assessment: Swiss Cantons, Jan. 14, 2021

Ratings Detail (as of May 04, 2023)*

Solothurn (Canton of)	
Issuer Credit Rating	AA+/Positive/A-1+
Senior Unsecured	AA+
Issuer Credit Ratings History	
06-May-2022	AA+/Positive/A-1+
01-Dec-2010	AA+/Stable/A-1+
20-Sep-2010	AA/Watch Pos/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.