S&P Global
Ratings

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Research Update:

Swiss Canton of Solothurn Upgraded To 'AAA' On Improving Financials; Outlook Stable

May 3, 2024

Overview

- We assume that the Canton of Solothurn will contain expenditure growth and post strong financial performance over the next few years.
- We expect Solothurn's government to implement a cost-savings package from 2025.
- We also assume that Solothurn will continue reducing its debt burden.
- We therefore raised our long-term rating on Solothurn to 'AAA' from 'AA+' and affirmed our 'A-1+' short-term ratings. The outlook is stable.

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Rating Action

On May 3, 2024, S&P Global Ratings raised its long-term issuer credit rating on the Swiss Canton of Solothurn to 'AAA' from 'AA+'. The outlook on the long-term rating is stable. At the same time, we affirmed the 'A-1+' short-term issuer credit rating on Solothurn.

Outlook

The stable outlook reflects our view that Solothurn's financial performance will improve over 2024-2026, partly owing to a cost-savings package we expect it to implement. At the same time, we assume the canton will continue to gradually reduce debt.

Downside scenario

We could lower the rating on Solothurn if we were to observe a structural deterioration in financial performance that has potential to bring the canton's current debt reduction to a stop.

Rationale

We think that the Canton of Solothurn will reinforce its tight financial policy with a cost-savings package starting in 2025. This, combined with revenue growth picking up again, should yield further improvements in the canton's financial performance from an already strong base. With operating margins above 5% of operating revenue and small surpluses after capital accounts, Solothurn will be able to sustain its excellent financial performance while continuing to reduce debt. We view this prudent financial management as supportive of the rating.

The rating on Solothurn continues to benefit from a supportive institutional framework for Swiss cantons, as well as the country's very strong and resilient economic foundation. In our view, Solothurn's liquidity position is exceptional, with liquid assets and contracted funding well above 120% of debt service over the next 12 months. Furthermore, the canton will have access to short-term financing and planning to refinance the next long-term debt maturity of Swiss franc (CHF) 100 million at the end of 2024.

The planned cost-savings package will help offset the impact of canceled dividend payouts from the central bank

We expect the Swiss economy to pick up slightly with an estimated GDP growth of 1.0% in 2024, mainly in the second half of the year, and 1.4% in 2025. This uptick is mainly based on increasing demand for Swiss exports, but also from higher investments supported by interest rate cuts and the general attractiveness of the Swiss market. With GDP per capita of an estimated $105,600 in 2024, Switzerland remains one of the wealthiest economies globally. Solothurn's GDP per capita stands at only 82% of the national average, but it continues to be very high in an international comparison. Considering the economic structure of Solothurn, we think regional GDP growth should stay broadly in line with the Swiss average. Also, the canton's unemployment rate remains very low at about 2.2%; this in turn fuels the canton's strong tax base.

In our view, cost-cutting efforts effectively got the canton through multiple adverse revenue effects and inflation-related expenditure pressures last year. The canton experienced lower tax revenue due to tax cuts following a referendum held in 2022. We estimate that, without that referendum, the canton would likely have seen moderate tax revenue growth. In addition, the Swiss National Bank's (SNB's) dividend payouts to the cantons were cancelled in 2023, causing a revenue shortfall of CHF128 million for Solothurn. Since the authorities do not expect any SNB dividend payouts in 2024 or 2025, Solothurn's cantonal government decided to initiate a cost-savings package that will be finalized in 2024, and it will gradually implement the package over 2025. We project the package will cut the canton's expenditure by about 1.0% in 2025 and up to 2.5% annually in 2026-2028. This, paired with increasing tax revenue, should enable Solothurn to deliver stronger financial results over the coming years.

We continue to assess the institutional framework for Swiss cantons as extremely predictable and supportive. The Swiss institutional system provides Solothurn with a reliable source of revenue through its resource equalization scheme, and it allows the canton to benefit from positive developments in Switzerland's economic centers.

A return to balanced budgets will spur further deleveraging

Inflation-induced expenditure growth and adverse revenue effects squeezed Solothurn's operating balance to 3.2% of operating revenue in 2023 from an operating surplus of 10.9% in

2022. Also in 2023, the canton posted a small deficit of 0.6% revenue after capital accounts, after reporting a surplus of 7.3% in 2022. The most significant part of the CHF194 million difference stems from the canceled CHF128 million in SNB dividend payouts. Although we expect another year without dividend payouts, we think Solothurn will return to almost the same level of operating revenue in 2024 as in 2022. At the same time, we expect moderate operating expenditure growth of 1.8% in 2024, after general inflation and higher operating expenditure for social transfers and subsidies increased spending by 3.4% in 2023. We therefore expect the canton to return to an operating balance of 4.6% of operating revenue and balanced budgets at about 0.5% of total revenue in 2024.

Although we do not anticipate dividend payouts from SNB over 2024-2025, we think there will be a minimum payout in 2026. This, alongside the cost-savings, will elevate operating margins to comfortably above 5% operating margins and sustain balanced budgets after capital accounts.

Solothurn repaid its 2023 long-term debt maturity of CHF100 million without long-term refinancing, but it subsequently increased short-term borrowing to CHF170 million from roughly CHF50 million previously. That said, we expect the canton will be able to reduce short-term debt levels throughout 2024. We also expect Solothurn to fully refinance its CHF100 million long-term maturity in December 2024. We expect the canton will move toward a tax-supported debt to operating revenue ratio of roughly 64% in 2026, compared with 91% in 2020, and a peak of 105% in 2017. We believe that the canton will continue its steady debt reduction path, following the one-off debt-financed full capitalization of the cantonal pension fund in 2014. Since all of Solothurn's debt is denominated in Swiss francs, 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. Contrary to other Swiss cantons, we currently see no elevated financial risk for Solothurn from cantonal hospitals, which we understand are all financially well endowed. The canton is closely monitoring the financial performance of its hospital sector.

We view the liquidity situation of Solothurn as supportive for the rating. The canton benefits from short-term financing available via bank facilities to bridge liquidity gaps in times of low cash inflows, which the it uses especially at year end. The canton's revenue and expenditure follow a predictable pattern that facilitates liquidity planning. Considering this, alongside the canton's strong access to Switzerland's deep and liquid capital markets, we assess the overall liquidity position of the canton as exceptional.

Key Statistics

Table 1

Canton of Solothurn Selected Indicators

Mil. CHF	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenues	2,396	2,489	2,369	2,449	2,500	2,570
Operating expenditures	2,207	2,219	2,294	2,335	2,374	2,418
Operating balance	189	271	75	113	126	152
Operating balance (% of operating revenues)	7.9	10.9	3.2	4.6	5.0	5.9
Capital revenues	7	3	5	7	8	20
Capital expenditures	84	92	93	108	116	134

Table 1

Canton of Solothurn Selected Indicators (cont.)

Mil. CHF	2021	2022	2023	2024bc	2025bc	2026bc
Balance after capital accounts	112	181	(13)	12	18	38
Balance after capital accounts (% of total revenues)	4.6	7.3	(0.6)	0.5	0.7	1.4
Debt repaid	385	200	150	270	200	50
Gross borrowings	200	50	170	150	200	50
Balance after borrowings	(72)	33	8	(108)	18	38
Direct debt (outstanding at year-end)	1,880	1,730	1,750	1,630	1,630	1,630
Direct debt (% of operating revenues)	78.5	69.5	73.9	66.6	65.2	63.4
Tax-supported debt (outstanding at year-end)	1,896	1,746	1,761	1,641	1,641	1,641
Tax-supported debt (% of consolidated operating revenues)	79.1	70.1	74.3	67.0	65.6	63.8
Interest (% of operating revenues)	0.8	0.8	0.8	0.9	1.0	1.0
Local GDP per capita (single units)	69,576	72,485	73,166	74,264	75,526	76,659
National GDP per capita (single units)	85,061	88,647	89,480	90,823	92,369	93,755

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.

Ratings Score Snapshot

Table 2

Canton of Solothurn Ratings Score Snapshot

Key rating factors	
Institutional framework	1
Economy	1
Financial management	2
Budgetary perfomance	1
Liquidity	1
Debt burden	3
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, April 8, 2024. 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

- Subnational Debt 2024: Fiscal Policy Differences Influence Borrowing In Developed Markets, March 5, 2024
- Subnational Debt 2024: Switzerland, Resilient Budget Surpluses Should Enable Further Deleveraging, Feb. 29, 2024
- Switzerland, Feb. 13, 2024
- Sorry, Cantons: No Profit Distributions From The SNB In 2024 And Possibly 2025, Jan. 4, 2024
- Local And Regional Governments' Workarounds Are Running Out Of Time, Dec. 6, 2023
- Institutional Framework Assessment: Swiss Cantons, May 23, 2023

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
Solothurn (Canton of)		
Issuer Credit Rating	AAA/Stable/A-1+	AA+/Positive/A-1+
Senior Unsecured	AAA	AA+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.