S&P Global Ratings

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# Aargau (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 |
| --- | --- |
| The ratings on Aargau will continue to benefit from the strengths of the national and local economy and the institutional framework. | We anticipate operating margins will soften slightly, reflecting financial aid to support a hospital, an absence of profit distribution from the Swiss National Bank (SNB), and higher inflation. |
| Aargau's budgetary performance will weaken, but only temporarily and this doesn't represent a deviation from prudent financial policies. | Despite supporting its cantonal hospital, Aargau will retain its exceptional liquidity position, which covers several times its debt service. |
| In our view, the canton's financial management will avoid increasing the debt burden despite ongoing challenges. | Aargau's projected debt burden indicators will remain low in national and international comparison. |

**Aargau's economy benefits from the canton's diversified and strong national and local economy**. The canton's unemployment rate remains very low at 2.2% in April 2023. We believe its strong diversified local economy adds resilience, particularly to tax flows.

**We believe Aargau's financial management will continue to act with fiscal discipline.** The projected moderate deficits after capital accounts for 2023-2025 mainly result from provision of financial aid to cantonal hospital Aarau, a lack of profit distribution from the SNB, and elevated inflation by Swiss standards.

**Aargau's ample cash reserves will allow it to face budgetary pressures without recourse to debt over the medium term.** Despite projected deficits, we project Aargau's debt burden will continue to decrease while retaining ample levels of liquidity over the coming years. We also believe that tax-supported debt will stay below a low 30% of consolidated operating revenue, an appropriate level for the rating.

# Outlook

The stable outlook on Aargau reflects our expectation that the canton will maintain solid budgetary performance over the medium term, as well as cautious use of liquidity and debt, offsetting volatility on budgetary performance.

## Downside scenario

We could lower the rating if cantonal management fails to exercise budgetary discipline and loosens its grip on financial performance, leading to material debt accumulation, for instance as a result of higher investment programs or further capital injections to cantonal hospitals. In addition, pressure on the ratings would build if the cantonal bank called upon Aargau for support.

# Rationale

### Aargau benefits from a strong economy and supportive institutional framework

The canton benefits from a resilient tax base and strong local economy. Although we project Aargau's local GDP per capita will reach only about 80% of the national average, at about $76,300 in 2023, this remains very strong internationally. In addition, Aargau's unemployment rate of just 2.2% in April 2023, which is marginally above the Swiss national average of 2.0%, shows a resilient economy that, so far, remains dynamic. The canton benefits from its proximity to Basel and Zurich, two important Swiss economic centers. Aargau is also comparatively more industrially focused than the average Swiss canton, with pharmaceuticals, chemicals, electrical, and engineering being the most important economic sectors. Despite tax reductions approved in recent years, tax revenue has increased, which reflects a dynamic economy and resilient base.

Aargau will likely benefit from the planned implementation of the OECD minimum tax rate in Switzerland from 2024. If the proposed revenue split of 75:25 between cantons and the central government is adopted, the canton might gain additional revenue in the short term. That said, the effects on competitiveness in the medium term are yet to be seen, but we believe that financial planning will be balanced between maintaining competitiveness and solid tax collection.

The canton's policy response to a more difficult economic environment will be a key determinant of the rating trajectory. We consider that the projected expenditure increases are a result of external pressures and not a deviation from fiscal discipline. Going forward, and considering healthy fiscal results in recent years, we expect some saving measures to be implemented if inflation moves higher or additional support for cantonal hospitals is needed.

Switzerland's still-pending reform of the subsidization scheme for medical insurance premiums for the less affluent could burden the canton with an additional Swiss franc (CHF)70 million (€75 million) in 2024, equivalent to almost 3x the projected operating balance in 2024. However, in our view, the cantons' representation in the second chamber of parliament and the possibility of a referendum gives them sufficient power to prevent extremely detrimental legislative changes.

### We project Aargau's financial management will continue to act with fiscal discipline despite budgetary pressures

From 2023, we expect slightly softer, albeit sound, operating margins than in previous years and modest deficits after capital accounts. This mainly reflects inflation, which is currently high by Swiss standards, no SNB profit distribution (at least in 2023, but possibly also in 2024), the CHF240 million financial aid to cantonal hospital Aarau, approved in May 2023 in the cantonal parliament, equivalent to 4.2% of projected operating revenue in 2023. The need for support is a consequence of an impairment test, which required adjustments in the value of assets in the same amount. Higher construction costs for a new complex, staff shortages, and heavily regulated healthcare tariffs, prevent the hospital from operating at full capacity to recover fixed costs. Aargau's staff costs will also increase in 2023, driven primarily by additional personnel required to care for and teach refugees. For the 2023 budget, the government council proposed an average wage increase of 1.6% for cantonal employees and 1.8% for teachers.

Aargau's already-low debt burden will continue to decrease in our view. We project the canton's tax-supported debt will remain below 30% over the medium term. Our assessment of tax-supported debt includes the direct debt and debt of specific government-related entities, most importantly from cantonal hospital Aarau. Next to financial aid in 2023, we include in the forecast a debt-financed investment plan. We note that the canton abstains from using foreign currency debt, swaps, and derivative instruments, reflecting its conservative debt-management policies.

Our overall assessment of Aargau's debt burden as low factors in the canton's contingent liabilities. Aargau's main exposure relates to Aargauische Kantonalbank, which is 100%-owned by the canton and benefits from a statutory cantonal guarantee. Although the bank's balance sheet is more than 6x the canton's budget, we nevertheless regard the likelihood of the guarantee being called as very low. Further contingent liability exposure mainly comes from cantonal hospital Baden and Aargau's 28% stake in energy generation and trading group Axpo, which currently holds a credit line with the federal government of CHF4 billion and additional credit lines with different banks of CHF6 billion to ensure sufficient liquidity amid uncertainty in energy markets. As long as Axpo maintains the credit line with the federal government, the canton will not benefit from payment of dividends. We currently don't anticipate any crystallization of contingent liabilities from these companies.

Aargau's liquidity is exceptionally strong and covers the next 12 months of debt service several times. In addition to cash and money market deposits, which we expect will remain high, the canton maintains contractually committed credit lines of CHF300 million. Its liquid assets and no long-term debt maturities in 2023 and 2024 allow Aargau to finance projected deficits without increasing its debt burden. The canton's proven access to bond-market financing represents an additional positive factor in our liquidity assessment.

### Canton of Aargau Selected Indicators

| Mil. CHF | 2020 | 2021 | 2022 | 2023bc | 2024bc | 2025bc |
|---|---|---|---|---|---|---|
| Operating revenue | 5,269 | 5,707 | 5,747 | 5,607 | 5,615 | 5,887 |
| Operating expenditure | 4,717 | 5,039 | 5,260 | 5,433 | 5,591 | 5,684 |
| Operating balance | 551 | 668 | 487 | 175 | 24 | 203 |
| Operating balance (% of operating revenue) | 10.5 | 11.7 | 8.5 | 3.1 | 0.4 | 3.5 |
| Capital revenue | 92 | 83 | 78 | 70 | 79 | 88 |
| Capital expenditure | 358 | 319 | 290 | 489 | 274 | 274 |

## Canton of Aargau Selected Indicators

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance after capital accounts | 286 | 433 | 276 | (244) | (172) | 16 |
| Balance after capital accounts (% of total revenue) | 5.3 | 7.5 | 4.7 | (4.3) | (3.0) | 0.3 |
| Debt repaid | 390 | 250 | 160 | 49 | 0 | 100 |
| Gross borrowings | 250 | 125 | 49 | 0 | 0 | 0 |
| Balance after borrowings | 146 | 308 | 165 | (293) | (172) | (84) |
| Direct debt (outstanding at year-end) | 1,000 | 850 | 739 | 690 | 690 | 590 |
| Direct debt (% of operating revenue) | 19.0 | 14.9 | 12.9 | 12.3 | 12.3 | 10.0 |
| Tax-supported debt (outstanding at year-end) | 1,457 | 1,291 | 1,259 | 1,410 | 1,610 | 1,710 |
| Tax-supported debt (% of consolidated operating revenue) | 25.0 | 20.4 | 19.7 | 22.6 | 25.7 | 26.2 |
| Interest (% of operating revenue) | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Local GDP per capita ($) | 67,284.2 | 72,217.0 | 72,240.0 | 76,315.9 | 77,473.3 | 77,465.4 |
| National GDP per capita ($) | 85,327.7 | 91,619.0 | 91,684.0 | 96,855.6 | 98,325.9 | 98,323.7 |

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 | 1 |
| Liquidity | 1 |
| Debt burden | 2 |
| 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 10, 2023. 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

- Institutional Framework Assessment: Swiss Cantons Benefit From Autonomy And Robust Checks And Balances, May 23, 2023
- Economic Outlook Eurozone Q2 2023: Rate Rises Weigh On Return To Growth, March 27, 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
- Global Ratings List: International Public Finance Entities 2023, Jan. 9, 2023
- Aargauische Kantonalbank Upgraded To 'AA+' On Similar Action On Canton of Aargau; Outlook Stable, Dec. 19, 2022
- Cantons Will Likely Withstand Temporary Instability Of Swiss National Bank Profit Distributions, Aug. 17, 2022

## Ratings Detail (as of June 16, 2023)*

| | |
|---|---|
| **Aargau (Canton of)** | |
| Issuer Credit Rating | AAA/Stable/A-1+ |
| Senior Unsecured | AAA |
| **Issuer Credit Ratings History** | |
| 16-Dec-2022 | AAA/Stable/A-1+ |
| 18-Jun-2021 | AA+/Positive/A-1+ |
| 20-Jul-2018 | 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.