SWISS CONFEDERATION

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ACRA revised the ratings of the Swiss Confederation (hereinafter, Switzerland, or the country) under the international scale in January 2022. As of the publication of this report, the issuer had the following ratings:

- Long-term foreign currency credit rating at AAA and local currency credit rating at AAA;
- Short-term foreign currency credit rating at S1+ and local currency credit rating at S1+.

The outlooks on the long-term foreign currency credit rating and the local currency credit rating are Stable.

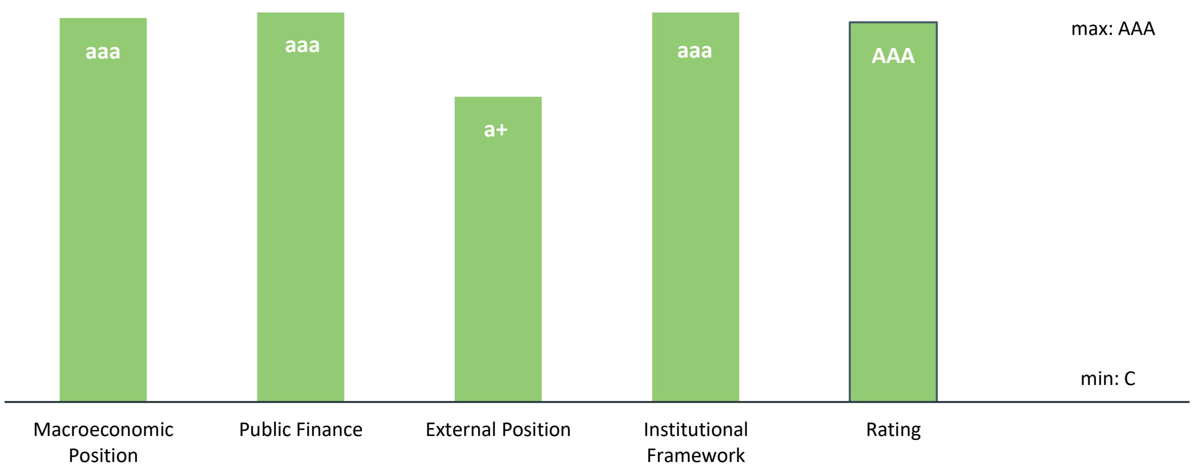
Positive rating assessment factors

- Very high level of wealth.
- Developed, diversified, innovative and competitive national economy.
- Moderate level of public debt and large domestic financial market.
- Strong banking sector with high level of resiliency to various shocks.
- Comparatively strong external position.
- Developed institutional base.

Negative rating assessment factors

- High level of private debt.
- Large size of the banking sector, which may potentially become a source of contingent liabilities for the government.

Long-term foreign currency credit rating structure



KEY ASSESSMENT FACTORS

The AAA long-term sovereign ratings of Switzerland are based on the final scores of the following analytical blocks: Macroeconomic Position — aaa, Public Finance — aaa, External Position — a, and Institutional Framework — aaa.

MACROECONOMIC POSITION

The final score of the Macroeconomic Position analytical block is aaa, which is one notch higher than the core score of aa+.

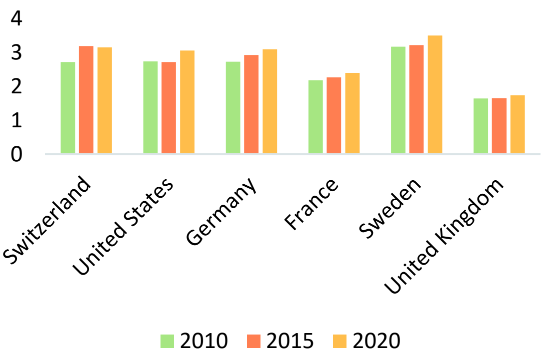
Core score factors. ACRA expects Switzerland's real GDP to grow by 3.5% in 2021 and 2.9% in 2022 after a 2.5% contraction in 2020. Targeted measures undertaken by the national government proved to be effective during the pandemic (e.g. no widespread closures in the manufacturing sector), while globally strong exports (chemicals, jewelry and pharmaceuticals), a low share of contact-intensive sectors in services, well-developed healthcare, and the strong capital buffers of households and financial institutions helped minimize the negative impact related to COVID-19 containment measures. The downside risks to GDP growth projections in 2022 are diminishing considerably due to the rising share of vaccinated individuals — as of February 6, 2022, around 69% of the population had received two or more doses of a COVID-19 vaccine. Therefore, the probability of further lockdowns and other restrictions on economic activity in 2022 are comparatively low in Switzerland, although the Omicron variant, as well as other possible mutations, impose some additional risks. Thus, the national economy is likely to perform at its potential level after 2022, which is around 1.8%, although some scarring from the pandemic (e.g. higher unemployment and a protracted recovery of the service sector) may also be reflected in the upcoming GDP growth rates.

Considering the prolonged history of deflation and external appreciation pressure on the Swiss franc, the policy rate is likely to stay at its current level of -0.75% in the near future, which is the lowest in the world. Unlike central banks in other major economies, the Swiss National Bank (SNB) is likely to preserve its accommodative stance, unless inflation surpasses 2%, which is the upper limit of the inflation corridor. ACRA expects average annual inflation to stay within the 0–2% range and be around 0.5–1% in the upcoming years, considering the determination of the Swiss authorities to keep it under strict control, as well as rising energy prices and growing inflation globally.

Modifiers. The core score of aa+ was upgraded to aaa thanks to specific features of the Swiss economy, which are not captured by the core score factors, in particular Switzerland's innovative capacity and competitive advantages. The country's developed, diversified, innovative and competitive economic structure places it ahead of its peers in terms of GDP per capita. Its national economy has been consistently ranked among the top in terms of competitiveness internationally and there is significant investment in R&D, which has been over 3% of GDP over the past decade. Switzerland's strongest sectors include financial services, pharmaceuticals, jewelry and chemicals, which have proved to be competitive internationally and resilient to economic shocks, thus shielding the national economy in times of crisis.

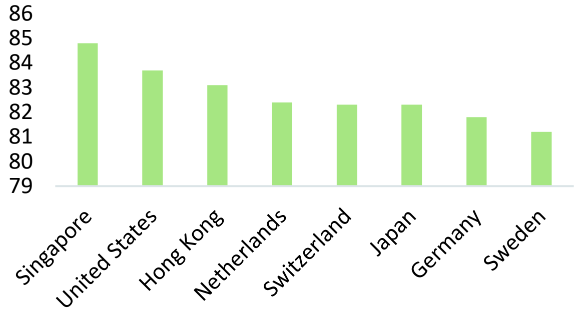
No other modifiers were applied in this block.

Figure 1. Switzerland has some of the highest R&D spending in Europe and globally, % of GDP



Source: World Bank

Figure 2. Switzerland among its peers in terms of the Global Competitiveness Index in 2019



Source: World Economic Forum

PUBLIC FINANCE

The final score of the Public Finance analytical block is aaa, which is the same as the core score of aaa.

Core score factors. Stable GDP growth of around 2% over the last decade and a constantly positive budget balance in the years prior to the coronavirus pandemic allowed the general government consolidated debt to GDP ratio to be maintained at around 40% with a declining trend. By the end of 2021, due to anti-crisis measures in 2020 and 2021, public debt rose to more than 42% of GDP, according to ACRA's estimates. According to the fiscal rule, which is applicable at federal budget level, a certain level of deficit is possible during times of recession. This was the case for the years 2020 and 2021 due to pandemic-related circumstances. The rule mandates that deficits in years of recession should be followed by surpluses during periods of economic growth. Therefore, additional spending in recession years is to be amortized in the following years, when public debt is expected to return to its pre-pandemic level.

Taking into account the fiscal rule, ACRA expects that the budget balance will be close to 0% of GDP in the years following 2021, and gradually move into positive territory, unless the national economy experiences new unexpected economic shocks. In ACRA's view, potential risks to the budget balance stemming from pension liabilities are mitigated by the recent reforms of the first pillar pension system approved by the country's parliament at the end of 2021, which entail increasing the pension age of women to 65 and imposing additional value added tax to cover higher pension expenditures.

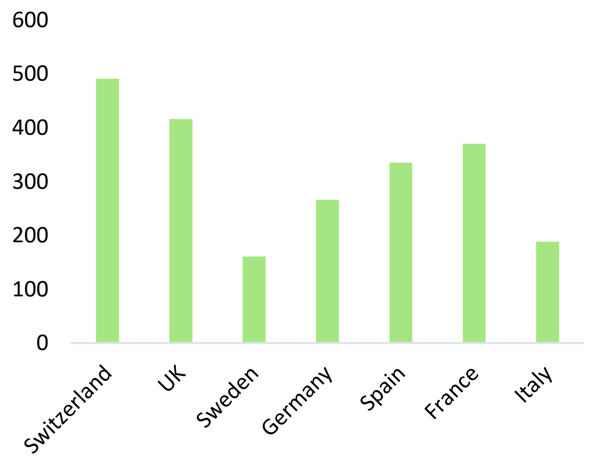
Based on Switzerland's GDP per capita, the country falls into the category of sovereigns where ACRA's methodology puts the emphasis overwhelmingly on interest payments as opposed to debt load. With interest payments at less than 1% compared to budget revenues, Switzerland scores the highest on the debt burden criterion. Moreover, external public debt is very low at around 7% of the total, while debt denominated in foreign currency is expected to be 0.3% of the total in 2021, indicating low susceptibility to external shocks. Moreover, non-residents have been gradually decreasing their share due to low interest rates, which have been in negative territory for a prolonged period of time.

Modifiers. Notwithstanding the highest scores for the core part of the model, Switzerland receives two positive and one negative adjustments to the core part, which solidifies its place in the "aaa" category for the Public Finance analytical block. The first positive adjustment refers to the current fiscal rule framework (the so-called debt brake), which prevents federal expenditure from growing faster than trend line revenue and is designed to prevent chronic deficits in order to control the level of public debt. Since its introduction in 2001, it has proven to be very successful and has allowed the country to gradually decrease its debt to GDP ratio from around 57% in the same year to around 40% in 2019.

The second positive adjustment takes into account the large domestic market, which provides a deep pool for the government's borrowing needs. The size of the Swiss banking sector is close to 400% of GDP, while the size of the whole financial sector, which also includes investment funds, insurance corporations, pension funds and other financial intermediaries, is around 1,100% of GDP. Therefore, the necessity to turn to external creditors is limited, which is also reflected by the small share of external public debt — 7.7% of total government debt. Moreover, the level of borrowing is likely to gradually decrease after surging in 2020–21 as stipulated by the national fiscal rule — according to the IMF World Economic Outlook's forecast, it will stand at around 38.3% of GDP in 2026, as compared to 42.7% in 2021, thus exhibiting a downward trend of a 10% decrease over the next five years.

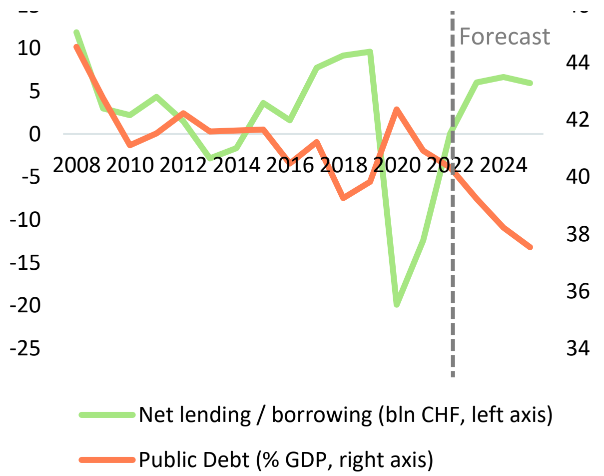
The single negative adjustment refers to the sheer size of the banking sector, the potential problems of which may have a large impact on the sovereign. An additional concern is related to the high level of private sector indebtedness (580% of GDP in Q2 2021), which in the case of the corporate sector is not balanced by corresponding assets. However, strict banking sector supervision and the high quality of assets and strong capital buffers (e.g. non-performing loans stood around 0.7% of total gross loans in Q2 2021, while the Tier 1 capital ratio was around 19%) make the probability of worst-case scenarios rather low. The recent cases of Archegos and Greensill, when Credit Suisse absorbed losses without external support, proved the resiliency of major national financial institutions, while even stricter supervision of national regulators ensures lower probability of similar cases in the future.

Figure 3. The weight of the Swiss banking sector in the national economy is one of the largest among European countries, % of GDP



Sources: IMF 2020 FSI

Figure 4. Switzerland's budget balance was in positive territory before 2020 and is likely to return there after 2021, thus reducing public debt



Source: Swiss Federal Finance Administration

EXTERNAL POSITION

The final score of the External Position analytical block is a, which is one notch higher than the core score of a-.

Core score factors. The core score of this analytical block is supported by the very strong current account, import cover and low volatility of the national currency. The score is dragged down by the negative net investment position of the private sector and low diversification index compiled by UNISTAD. As the current account was around 7% over the last five years before 2020 (when the pandemic began), ACRA expects it to return to its pre-pandemic levels and stay at around 7% of GDP in 2022–2023.

The positive current account along with periodic SNB interventions in the foreign exchange market helped the country accumulate a significant amount of international reserves and reach 29 months of import cover by the end of 2021, which is also due to the SNB's sizable interventions in 2020 to keep the national currency exchange rate under control amid appreciation.

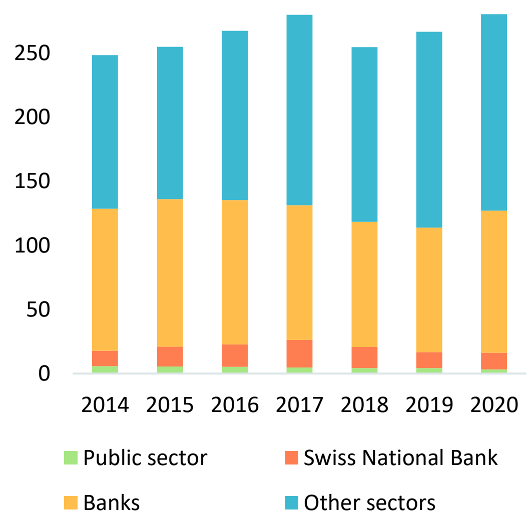
Without taking into account the liabilities of the public sector and the international reserves of the SNB, which, according to ACRA's estimates, amounted to about 137% of GDP the net international investment position of the private sector was negative at -32% of GDP by the end of 2021. This could be explained by the fact that Swiss residents have become reluctant to acquire assets abroad since the 2008 crisis, while foreign investors consider Switzerland to be a "safe haven" and have been investing in the country on an increasing scale, thus creating upward pressure on the national currency. The latter became evident during 2020, when a large number of foreign investors turned to Switzerland as an attractive investment destination due to its safety and stability amidst turmoil in the world economy.

The majority of external liabilities belong to financial corporations (39%), non-financial companies (28%) and intercompany lending (28%), while public external debt is insignificant at around 1% of the total. It is also noteworthy that the bulk of external debt is rather short-term (57% as of Q3 2021), which might lead to higher refinancing needs.

Switzerland's low export diversification factor can be explained by the specifics of the index calculation. The highest value of the index is assigned to the export structure of the country, which mimics the global export structure. Due to the concentration of the Swiss economy on a limited number of industries, the country's index is low. ACRA acknowledges the limitation of the index and assigns a positive modifier to rectify the situation.

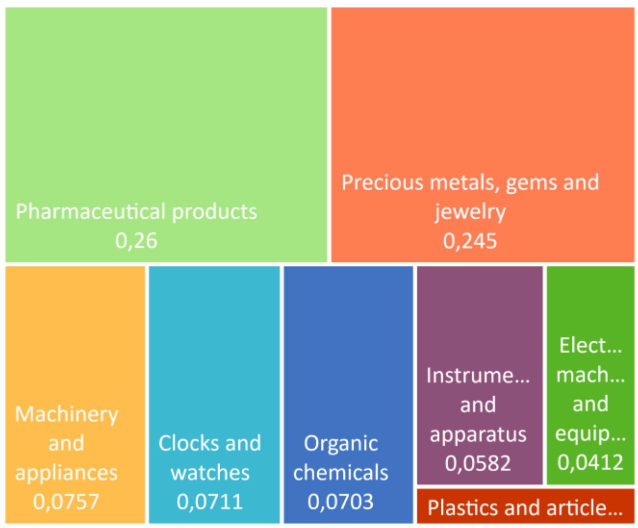
Modifiers. One positive modifier in the External Position analytical block reflects ACRA's position on Switzerland's high competitiveness of exports sectors despite the limited number of types of products the country exports.

Figure 5. Banks and the private sector are major external borrowers, % of GDP



Source: SNB, % of GDP

Figure 6. Switzerland's major export items are high value-added products that are competitive in international markets



Source: The Observatory of Economic Complexity, 2019

INSTITUTIONAL FRAMEWORK

The final score of the Institutional Framework analytical block is aaa, which is the same as the core score of aaa.

Core score factors. Institutional factors are above average on the global scale ACRA uses to assess countries, and one of the highest among countries with the same level of creditworthiness. In ACRA's view, Switzerland can still be considered to be a "safe haven" with a high level of trustworthiness in public institutions and the authorities and high quality of public governance. However, the recent developments in negotiations between Switzerland and the EU over the framework agreement, which were halted until November 2021, when it was agreed that the dialog should be restarted in 2022, create some uncertainty about country's future relationship with its major European partners.

Modifiers were not applied for this block.

KEY MACROECONOMIC INDICATORS

	2017	2018	2019	2020	2021F	2022F
GDP, CHF bln	693.7	719.3	727.2	706.2	**735.6**	760.0
GDP, USD bln	705.2	735.7	732.5	752.7	**804.8**	804.8
GDP, real growth	1.7	2.9	1.2	-2.5	**3.5**	2.9
GDP, real growth of developed economies	2.5	2.3	1.7	-4.5	**5.1**	3.6
Inflation, average annual %	0.5	0.9	0.4	-0.7	**0.5**	0.8
General government budget balance, % of GDP	1.1	1.3	1.3	-2.8	**-2.1**	-0.3
General government debt, % of GDP	41.2	39.3	39.8	42.4	**42.8**	41.7
General government interest payments, % of GDP	0.4	0.3	0.3	0.3	**0.3**	0.3
External general government debt, % of general government debt	11.4	10.8	10.5	7.7	**6.6**	5.9
Current account, % of GDP	5.9	5.3	4.9	1.2	**7.2**	7.5

KEY ASSUMPTIONS

- An end to lockdowns in 2022.
- Continued cooperation with the EU.

POTENTIAL OUTLOOK OR RATING CHANGE FACTORS

A negative rating action may be prompted by:

- Potentially serious financial shock for Switzerland's banking sector associated with a sudden deep price correction in the real estate market.
- Negative scenario of developments in the negotiations between Switzerland and the EU associated with higher trade costs and impeded cooperation in other spheres.

REGULATORY DISCLOSURE

The sovereign credit ratings have been assigned to the Swiss Confederation under the international scale based on the Methodology for Credit Rating Assignment to Sovereign Entities under the

International Scale and the Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities.

The sovereign credit ratings of the Swiss Confederation were published by ACRA for the first time on September 10, 2019. The sovereign credit ratings and their outlooks are expected to be revised within 182 days following the publication date of the press release on the sovereign credit rating revision as per the Calendar of sovereign credit rating revisions and publications.

The sovereign credit ratings are based on information from publicly available sources and ACRA's own databases. The sovereign credit ratings are unsolicited. The Swiss government did not participate in the credit rating assignment.

In assigning the credit ratings, ACRA used only information, the quality and reliability of which was, in ACRA's opinion, appropriate and sufficient to apply the methodologies.

ACRA provided no additional services to the Swiss government. No conflicts of interest were discovered in the course of the sovereign credit rating assignment.

Calculation chart for Switzerland as of January 11, 2022

Indicator/ adjustment/ modifier	UoM	Period	Weight	Value	Rating/ Score	Rating/ Score after adjustments	Modifier score	Rating after modifiers
Macroeconomic Position					**aa+**		**2**	**aaa**
CORE PART			25%		**3.45**			
Income level	USD	2021F	35%	87 226.81	**1**			
Economic growth	y-o-y	[2014-2023F]	10%	-0.361	**11**			
Size of economy	USD bln	2021E	35%	804.78	**4**			
Inflation	y-o-y	[2019-2023F]	20%	0.29	**3**			
MODIFIER PART								
Potential economic growth							0	
Quality and sustainability of economic growth							2	
Efficacy of structural economic policy and recent structural reforms							0	
Efficacy of monetary policy							0	
Public Finance					**aaa**	**aaa**	**3**	**aaa**
CORE PART			25%		**2.34**	**2.34**		
Debt burden			60%		**1.73**	**1.73**		
General government gross public debt	% of revenues	2021E		123.44	**5**			
Weight of public debt		2021E	49.4%	18.33				
Interest payments	% of revenues	2021E		0.87	**1**	**1**		
Weight of interest payments		2021E	10.6%	81.67				
Preferential government borrowing	% of GDP	2021E		-		**0**		
Fiscal balance	% of GDP	[2020-2022F]	10%	- 1.73	**10**			
External public debt	% of GDP	2021E	30%	2.83	**1**			
Foreign currency public debt	% of GDP	2021E		0.14		**0**		
Public debt in global international reserves	%	2021E		0.29		**0**		
General government gross public debt	% of GDP	2021E		42.76		**0**		
MODIFIER PART								
Sovereign wealth funds							0	
Contingent liabilities and the risk of their materialization							-1	
Debt sustainability and access to markets and funding sources							2	
Fiscal policy framework and fiscal flexibility							1	

External Position						**a-**	**a-**	**1**	**a**
CORE PART			25%			**7.2**	**7.2**		
Current account	% of GDP	[2020-2022F]	10%	5.29		**1**			
Import cover	months	2021E	15%	29.22		**1**	**1**		
Reserve currency		2021E					**0**		
International investment position	% of GDP	2021E	15%	32.31	-	**11**			
Export diversification	index	2021E	35%	0.64		**13**			
Currency volatility	ratio	[2012-2021E]	25%	5.26		**3**			
MODIFIER PART									
Balance of payments vulnerability								1	
External debt sustainability								0	
Currency regime stability								0	
Institutional Framework						**aaa**		**0**	**aaa**
CORE PART			25%			**1.00**			
Political stability	index	2021E	33%	136.67		**1**			
Government benevolence and effectiveness	index	2021E	33%	187.94		**1**			
Human capital quality	index	2021E	33%	344.18		**1**			
MODIFIER PART									
Political instability and recent political decisions								0	
Involvement in geopolitical conflicts, exposure to geopolitical risks								0	
Willingness to pay								0	
RATING						**AA+**	**AA+**		**AAA**
FINAL (after adjustments for boundary values and data uncertainty)									AAA
FINAL (after adjustments for boundary values, data uncertainty, and risk of adverse events)									AAA
Defaulter type									0
Number of years since last default									0
Final score with limitation (cap)									No Cap
FINAL RATING (after cap)									**AAA**
Outlook									Stable
Status									-
Short-term rating									S1+

The Analytical Credit Rating Agency (ACRA) was founded in 2015, with its 27 shareholders representing major Russian corporate and financial institutions and its authorized capital exceeding RUB 3 bln. ACRA's main objective is to provide the Russian financial market with high-quality rating products. Methodologies and internal documents of ACRA are developed in compliance with Russian legislation and with regard to global rating industry best practices.

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