S&P Global Ratings

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COVID-19: Swiss Banking Sector To Remain Resilient

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Key Takeaways

- Swiss banks' profitability and asset quality will deteriorate this year, but we expect credit losses to remain contained because of the superior financial strength of both households and corporates in Switzerland.
- In response to the pandemic-induced recession this year, Swiss policy responses should support a swift recovery and ultimately help to protect domestic banks' credit metrics.
- We anticipate only few, if any negative rating actions for banks in Switzerland over the next few quarters.
- We could take a more negative view of the Swiss banking sector if the recovery proves to be substantially weaker than we expect or delayed, the housing market weakens dramatically, or we see an increase in serious money-laundering cases in Switzerland that would destabilize its banking sector.

S&P Global Ratings believes that Swiss banks' profitability and asset quality will deteriorate amid the recession triggered by the coronavirus pandemic. However, we think Swiss banks will remain resilient and see limited risk to their financial profiles under our base scenario. Switzerland is facing a deep recession in 2020 and in response, the government has launched sizable aid packages to support households and companies.

Swiss banks are entering this recession from a position of strength in our view, reflecting their currently clean balance sheets and capitalization that remains among the strongest in a global context. Swiss banks--like most banks in Europe--have turned into better-capitalized, better-funded, and more-liquid banks since the global financial crisis, and we think they have been even subject to even more conservative regulatory standards than most peers. Despite margin pressure on core products amid the backdrop of low interest rates, they have reported solid operating performances from domestic operations over the last decade, benefitting from overall sound efficiency. We also do not foresee a rise in liquidity risk for the Swiss banking sector because we think most banks can rely on a stable depositor base with strong on-balance-sheet liquidity buffers. We expect the strongest banks could benefit from a flight to quality during extreme economic conditions, which happened during the last crisis.

We expect the two largest lenders, UBS and Credit Suisse, to remain resilient in the wake of the pandemic. We do see some pockets of risk including their exposure to leveraged loans but take comfort from their diversified business mix that includes large wealth management operations and well-collateralized credit exposures. We also believe healthy capital and liquidity positions at both banks are significant mitigants (see "UBS Ratings Affirmed On Expected Resilience To Economic Effects Of COVID-19; Outlook Remains Stable" and "Credit Suisse AG Affirmed At 'A+' On Expected Resilience To COVID-19 Effects; Outlook Stable").

There are six reasons why we believe that the Swiss banking sector will remain resilient despite pandemic-related headwinds. In our view they positively differentiate the Switzerland's banking sector from most peers:

- The expectation of a relatively milder economic downturn followed by a strong recovery,
- One of the wealthiest household sectors globally and a strong social safety net resulting in sufficient financial buffer,
- Stable domestic housing market,
- A crisis-proof corporate sector,
- A domestic customer portfolio dominated by well-collateralized mortgage loans, and
- Moderate tech disruption risk in retail banking after the pandemic.

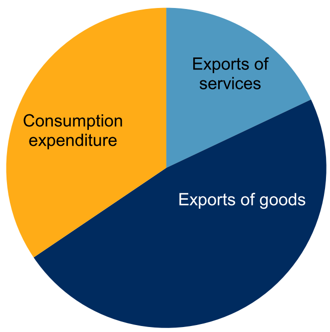
The Economy Is Set To Rebound

We assume a U-shaped recovery in our base scenario for the Swiss economy. Switzerland is in the middle of a deep recession and we forecast a 6.5% drop in GDP this year. This is less severe than the 7.3% decrease we project for the eurozone. For next year, we expect a strong recovery in GDP of 6.3% in 2021 and 4% in 2022, again exceeding our expectations for the eurozone at 5.6% and 3.7% (see "Europe Braces For A Deeper Recession In 2020," published on April 20, 2020). We think Switzerland's economy will rebound swiftly due to its competitive and innovative economy with a skilled workforce und low unemployment. Today, the spread of coronavirus in Switzerland appears to be under control. The gradual loosening of lockdown measures will promote the revival of domestic economic activity and consumption. Although Switzerland is a small, open economy that relies heavily on exports that have dropped this year, we expect the larger proportion of more resilient industries, including the pharmaceutical sector, to provide relative stability (see chart 1).

Chart 1a

Half Of Swiss GDP Related To Exports Of Goods...

GDP composition

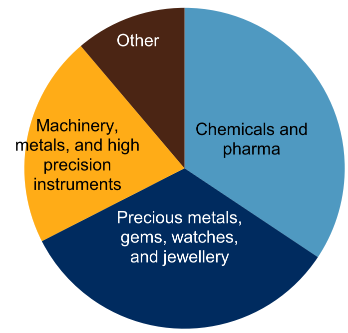


Sources: Swiss Statistics Office, S&P Global Ratings. Data as of year-end 2019.

Chart 1b

...With High Reliance On Less Cyclical Goods

Share of exported goods by type



Sources: Swiss Statistics Office, S&P Global Ratings. Data as of year-end 2019.

We see Swiss support measures as broad, substantial, and rapidly deployed (see chart 2). The major components consist of federal guarantees on credits extended by banks to corporates experiencing stress. Banks are able to refinance these extensions through unlimited liquidity facilities at the central bank (see table 1). The Swiss financial regulator, FINMA, provides further relief for banks in the application of certain regulatory requirements including deactivation of the countercyclical buffer. These measures are complemented by schemes designed to support employment during the pandemic, including an expansion of the short working-hours scheme that has proven successful during the global financial crisis (see table 1) and that we consider as generous in international comparison. Overall, we expect unemployment to increase only slightly and return to pre-pandemic levels after 2022. This will help to restart the economy over the coming months and limit the severity of second-round shocks to domestic demand.

Table 1

Examples Of Swiss Pandemic Countermeasures

Loan guarantee programs
COVID-19 Credit Program: Interest-free and fully government-guaranteed loan up to CHF500,000 or 10% of annual revenue aimed primarily at SMEs. Uses a highly standardized process with minimal paperwork; no credit assessment through banks required. A similar program targeted particularly at start-ups with risk sharing between federal government and cantons has been initiated as well.
COVID-19 Credit Plus: Aimed at larger SMEs and corporates with liquidity needs between CHF0.5 million and CHF20 million. Loans under this program carry a 85% guarantee by the Swiss government and bear an interest of 0.5% on the guaranteed portion.
Monetary policy support and regulatory relief
Unlimited COVID-19 refinancing facility under which banks can pledge governmental and cantonal guaranteed loans as collateral to draw liquidity.
The countercyclical capital buffer intended for the residential mortgage market has been deactivated.
FINMA is also: temporarily allowing the exclusion of central bank deposit in calculating leverage ratio; granting relief in market risk modeling and delayed the implementation of margin requirements for over-the-counter derivatives; and granting temporary exemptions to banks for the identification of anti-money laundering to allow digital loan and client onboarding.
Employment support programs
The existing short working-hours program has been extended; employees are now eligible for support of up to six months and 80% of foregone labor income.
Income losses for self-employed due to government-imposed interruption in operations lockdown and all employees with income losses due to closed childcare institutions are eligible for a compensation up to CHF196 per day for 10 to 30 days.
Other measures
Penalty interest on late payments of sales and consumption taxes as well as import duties lowered to zero until year-end.
Tax offices advised to grant tax deferrals to corporates with liquidity needs.
Relaxation of corporates' requirements to notify insolvency courts of overindebtedness.
All debt foreclosures put on hold during March. The Swiss government introduced a three-month debt moratorium for which SMEs can apply at their local insolvency court (opt-in rather than blanket moratorium), which can be extended up to three months.

CHF--Swiss franc. SMEs--Small and midsize enterprises. Source: FINMA, S&P Global Ratings, Swiss National Bank, Federal Council.

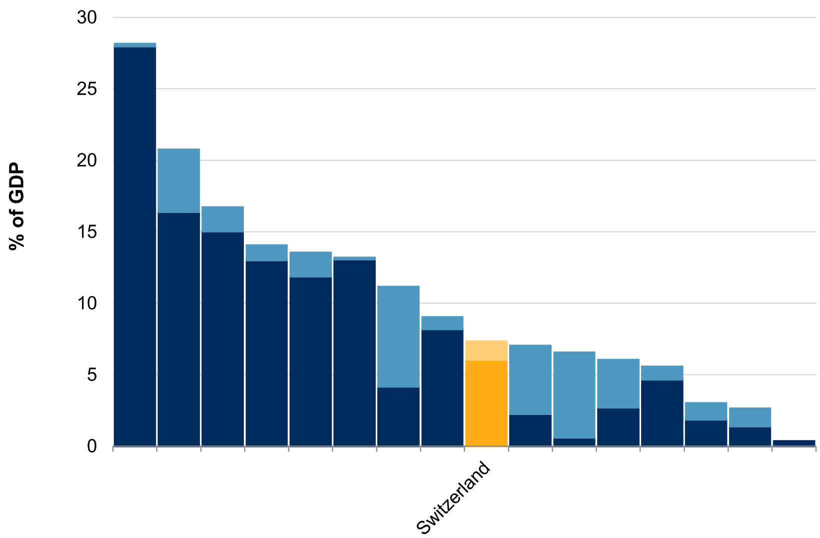
Additional programs from individual cantons flank these measures. For example, the largest canton of Zurich provides an additional CHF425 million for guarantees for SMEs with up to 250 employees. Overall, we estimate the size of initial aid packages put in place by the federal government at about 7% of Swiss GDP and total cantonal support at about 0.5% of GDP, and more may be added. We note positively that the Swiss guarantee programs efficiently make use of existing banking infrastructure that allows for swift support of troubled corporates.

We assess support measures for both the corporate and household sector as sound. We do not yet observe significant numbers of applications for COVID-19 debt moratoriums. However, we expect them to somewhat lag applications for other government support measures and to start rising moderately. Finally, if necessary, we consider the Swiss government to have sufficient fiscal headroom for additional substantial economic stimulus packages, highlighted by a net government debt-to-GDP ratio that ranks among the lowest in Europe.

Chart 2

Estimated Size Of Initial Swiss Support Package In Mid Field Relative To European Peers

But material fiscal headroom available for further stimulus if needed



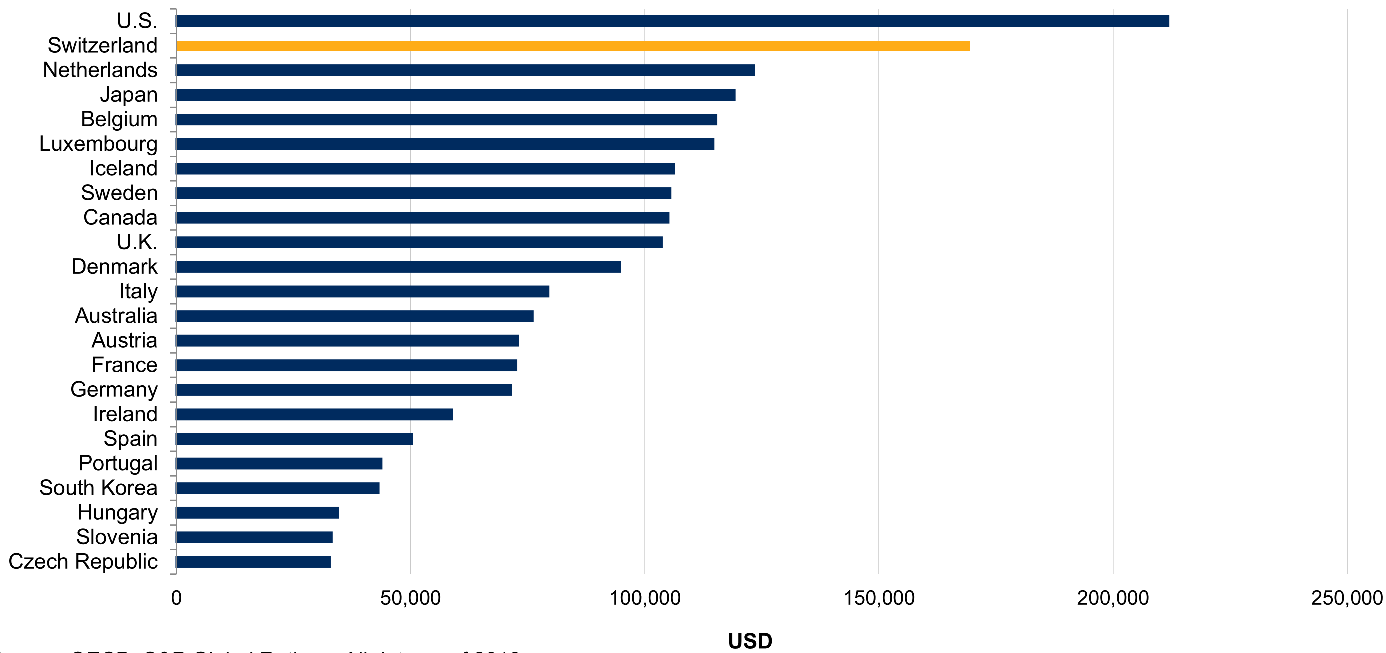
Data as of end April 2020. Guarantees in dark; direct cash injections bright. Highlighed: Switzerland. Excludes support for unemployment insurance for short work hours program. Source: Global Ratings.

A Very Wealthy Household Sector

In our view, households in Switzerland are financially stronger than in many other peer countries (US$81,717 GDP per capital as of year-end 2019). Compared with peers', the household sector's indebtedness looks high. However, it is purely a reflection of the tax system, which allows the deduction of interest from income tax and therefore incentives mortgage holders to amortize little. At the same time, the Swiss accumulate significant wealth by investing their funds widely including in the various pillars of the Swiss pension system to repay mortgages close to retirement. Overall, most importantly, the country's net wealth position per inhabitant ranks among the top globally (see chart 3), with a broad distribution among the population. Financial assets (about double the size of its debt) and other resources to service debt obligations of Swiss inhabitants did slightly suffer because of recent market turbulence, but we do not anticipate any constraints in the population's debt capacity.

Chart 3

Wealthy Households Have Material Buffer To Absorb The COVID-19 Effects
Household net wealth per inhabitant



Source: OECD, S&P Global Ratings. All data as of 2018.

The unemployment rate slightly increased recently from very low levels but the Swiss social safety net in place is strong and will mitigate short-term effects from higher unemployment on the population's debt capacity, in our view.

The Housing Market Should Hold Up

For 2020, we expect nominal house prices to decline in most European markets with the exception of Switzerland, where we still project slight growth of 0.5% (see "Government Job Support Will Stem European Housing Market Price Falls," published on May 15, 2020), supported by the country's job support schemes and through supportive Swiss National Bank policy that keeps rates ultralow. In line with our expectation for a recovery in 2021 and 2022 we forecast Swiss house prices will grow a moderate 1.5% and 2.4%, which remain below the growth rates we observed before the pandemic (see chart 4). The sensitivity of Swiss house prices to the expected material drop in GDP for 2020 remains low, which we believe will significantly limit future credit risk on residential mortgage loans.

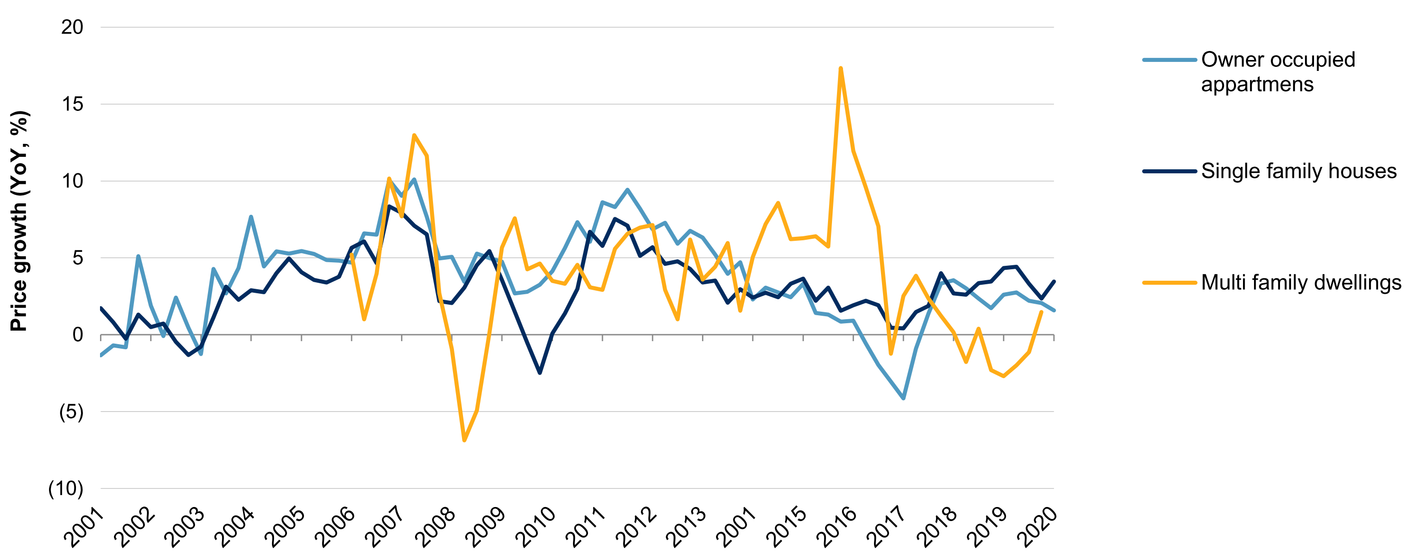
We believe the pandemic-induced downturn could kick off a reduction of moderate structural imbalances in the Swiss housing sector in the medium to long term. In our assessment of economic imbalances in Switzerland, we consider affordability risks in the owner-occupied segment, measured by historical price-to-income and price-to-rent ratios, as material and further increasing over the last decade. However, in our view, the residential investment property segment (estimated 30% of market) poses the major risk. Even before the pandemic, we observed signs of a decline in prices that led the regulator to enforce stricter underwriting rules for investments in multifamily housing that remain still in place today.

We expect a slowdown in price growth in single-family housing and owner-occupied apartment segments compared with previous years' growth that could reduce imbalances over time. The countercyclical capital buffer intended for the residential mortgage market has been lifted already. In our view, these segments will not heat up further and we believe there is limited downside risk. The number of transactions has collapsed during the lockdown and demand will remain weak for some time. However, for prices to drop materially would require a significant rise in unemployment that we consider as unlikely as of today.

That said, we do not expect improvements in the investment property segment in the near term, particularly as long as rates remain in negative territory. The search for yield and a lack of investment alternatives led to strong construction activity in the past. We see a risk of rising oversupply, highlighted by already increasing vacancy rates in rural areas, reflecting a slowdown in immigration numbers and a trend toward urbanization within Switzerland. While considered unlikely as of today, this could signal a broader decline in prices over the coming years. However, in line with the Swiss Bankers Association's minimum standards for mortgage financing (self-regulation), we note that Swiss banks must apply a number of strict underwriting rules. For instance, they include haircuts on property values and the calculation of the applicants' financial burden from mortgages (limited to 33% of gross income) based on a rate materially above market (up to 5%). In the investment property segment, for instance, the rules require a minimum amount of equity financing of 25% based on conservatively calculated collateral and amortization down to 67% over the first 10 years.

Chart 4

House Price Growth Has Been Muted For Years
Prices remain high on an absolute level



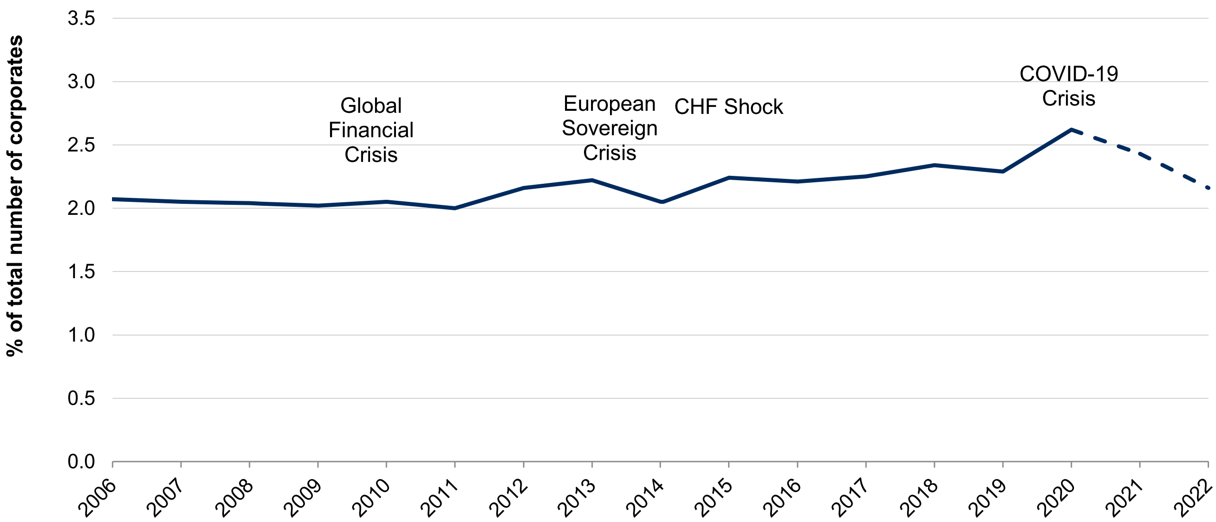
YoY--Year-on-year. Source: S&P Global Ratings, Wuest Partner, Swiss National Bank.

The Proven Strength Of The Corporate Sector

We think the Swiss corporate sector has proven its resilience to external shocks in the past, and we consider it as significantly stronger than that of other countries. There has been nearly no increase in corporate bankruptcies during recent crises, particularly following the global financial crisis and sovereign debt crisis in 2008 and 2012, respectively, or following idiosyncratic events such as the strong Swiss franc appreciation after the SNB abandoned its exchange rate floor against the euro in 2015 (see chart 5).

Chart 5

Swiss Corporates Performed Well During Past Crises
Initiated bankruptcy proceedings

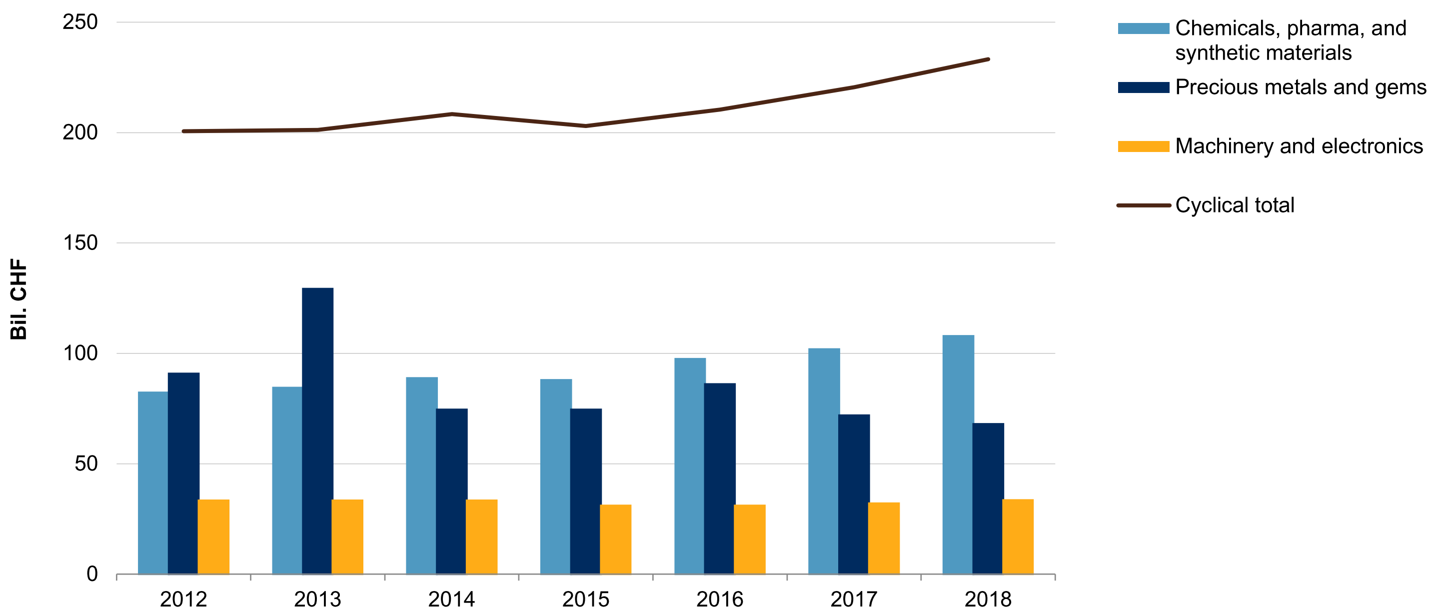


Source: Swiss Statistics Office; S&P Global Ratings. S&P Global Ratings' forecast for 2019-2022.

Exports have proved relatively price-insensitive also because of the high share of less cyclical industries including pharmaceutical and chemicals (see chart 6). We also believe the Swiss corporate sector will be able maintain its relative strength over the coming years, reflecting that Switzerland remains among the top countries in competiveness and innovation rankings globally.

Chart 6

Stable Exports Through The Cycle
Swiss exports saw no lasting effect of after CHF Shock in 2015



Source: Swiss Customs Office, S&P Global Ratings. Cyclical Totals excludes exports of precious metals, gems, objects of art and antiquities.

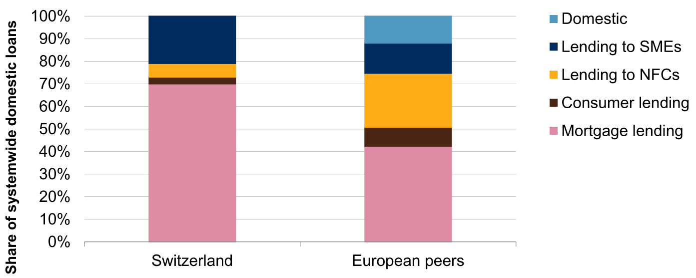
We also take comfort that the banks' reported nonperforming loans have been very low for many years, which also positively reflects on the corporate sector's resilience, in our view. Due to its competitiveness, Switzerland's corporate sector will be less affected by the economic downturn in 2020, and we expect the number of corporate defaults to increase more moderately in 2020 and 2021 than for the peer countries.

Residential Mortgage Loans Dominate Most Banks' Customer Portfolios

We expect Swiss banks' asset quality will deteriorate from historical low levels, but credit losses to remain moderate in an international comparison. Most Swiss banks have an exclusive domestic focus, with customer loan portfolios dominated by collateralized residential mortgage loans (with an average 55% loan to value ratio by our estimate) and loans to small to midsize enterprises (SMEs) that are also often collateralized by real estate. Unsecured corporate loans and, particularly, more cyclical consumer loans play a rather limited role in most Swiss banks' portfolios. Among European peers, Switzerland ranks among the countries with the highest share of collateralized lending (see chart 7).

Chart 7a

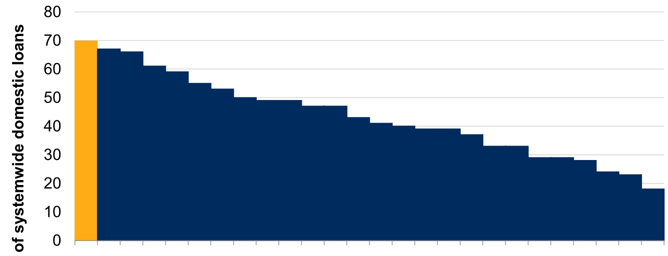
Swiss Domestic Loans Tilted Toward Lower-Risk Asset Categories
Loan book split relative to average over 25 European peer countries



NFCs--Nonfinancial corporations. SMEs--Small and midsize enterprises. Source: S&P Global Ratings.

Chart 7b

Mortgage Financing In Switzerland More Important Than Among Any European Peers

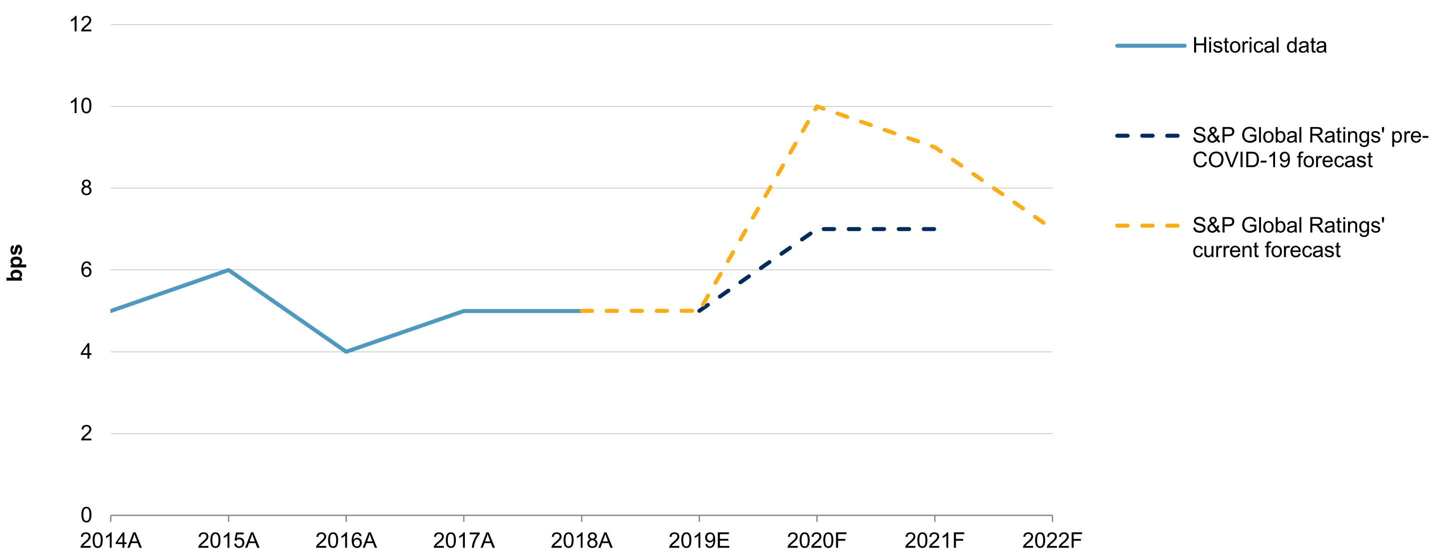


Note: The yellow bar refers to Switzerland. Sources: S&P Global Ratings.

This supports our view that asset quality will remain robust in the wake of the pandemic, with credit loss increases on domestic loans being less severe than for many peers (see chart 8). We particularly expect stable performance in mortgage loans but increasing credit losses in unsecured lending.

Chart 8

Swiss Banks' Credit Losses Expected To Increase From Historically Low Levels
Credit losses as % of total loans



A--Actual. bps--Basis points. E--Estimate. F--Forecast. Sources: S&P Global Ratings, FINMA.

Moderate Tech Disruption Risk For Swiss Banks On The Horizon

The pandemic has triggered a quick shift to remote working and serving customers through an online or mobile application in many areas of the business world, and therefore is likely to accelerate digital transition. We believe it will also fuel the trend toward digital banking and away from branch banking. This will likely result in accelerated branch closures to reflect increasing customer demand toward digital channels in a number of countries. However, we consider the risk that Swiss banks could be subject to major tech disruption and quickly lose ground against tech players, including international big techs or challenger banks, as moderate. We consider Swiss banks to be in a relative better position than many of their international peers. We consider as protective, in the short to medium term, the population's customer loyalty and limited presence of foreign players and international challenger banks due to high barriers of entry. We also think that Swiss banks are technologically well equipped, which allows them to react quickly enough to a sudden digital shift (see "Tech Disruption In Retail Banking: Swiss Banks Are In No Rush To Become Digital Frontrunners, published on Feb. 13, 2020).

What Could Change Our Positive View Of The Sector?

We expect the Swiss banking system will remain resilient in our base scenario that includes a strong rebound in GDP in 2021 and 2022 after a sharp correction in 2020. At this point, the ratings on most Swiss banks continue to have a stable outlook (see table 2) as they have sufficient room within their ratings to absorb a moderate deterioration in credit metrics. Today, we do not anticipate broad negative rating actions, including negative outlook revisions. Rating actions on individual banks could occur where we expect a bank's metrics to move durably outside our parameters for the rating. This could include higher-than- anticipated credit losses impairing a bank's capitalization or implying a less risk-averse stance than we assume in our ratings today. We also note that in many cases our rated Swiss banks benefit from explicit guarantees provided by their strong public owners. This implies that even if a bank's stand-alone credit quality were to worsen moderately, for a number of banks we would expect our current issuer credit rating remain supported by additional support through the guarantors.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

We could take a more negative view of the Swiss banking sector, for instance if:

- The recovery is substantially weaker than we now expect or is delayed, potentially triggered by a second coronavirus wave in Switzerland or the EU, its main trading partner, or if countermeasures are found to be less effective than expected.
- A severe drop in the residential housing market translates into high credit losses on domestic mortgage loans.
- A crash in the domestic commercial real estate (CRE) market that spreads to the Swiss economy, resulting in higher risk for the banking sector. We have already observed a moderate decline in "asking rents" (the list price) for retail and industrial space that could further accelerate in the wake of the pandemic. However, we also note that price growth in the CRE

market has been relatively low over the past few years, and that this segment plays a rather limited role in most banks' customer portfolios.

- We see a renewed increase in serious money-laundering cases in Switzerland, which could lead us to question Swiss banks' market discipline and our view of the effectiveness of FINMA's efforts in this area. We consider Switzerland's compliance with highest anti-money-laundering standards as crucial for the stability of its banking sector.

Table 2

Rating Components For Rated Swiss Financial Institutions

	Core opco long-term ICR/outlook	Business position	Capital & earnings	Risk position	Funding & liquidity	Group SACP/SACP	Type of support	No. of notches of support	Holdco long-term ICR/ outlook
Major Swiss banks									
Aargauische Kantonalbank	AA/Stable	Adequate	Very Strong	Adequate	Avg/Strong	a+	GRE	2	N/A
Bank J. Safra Sarasin AG	A/Stable	Moderate	Very Strong	Adequate	Avg/Adequate	a	N/A	N/A	N/A
Banque Cantonale de Genève SA§	A+/Positive	Adequate	Strong	Adequate	Avg/Adequate	a	GRE	2	N/A
Banque Cantonale Vaudoise	AA/Stable	Adequate	Strong	Adequate	Avg/Strong	a	GRE	3	N/A
Basellandschaftliche Kantonalbank	AA/Stable	Adequate	Very Strong	Adequate	Avg/Strong	a+	GRE	2	N/A
Basler Kantonalbank	AA+/Stable	Adequate	Very Strong	Moderate	Avg/Strong	a	GRE	4	N/A
Cembra Money Bank AG§	A-/Negative	Weak	Very Strong	Adequate	Below Avg/Adequate	bbb+	N/A	N/A	N/A
Credit Suisse Group AG*	A+/Stable	Adequate	Strong	Moderate	Avg/Adequate	a-	ALAC	2	BBB+/Stable
Glarner Kantonalbank	AA/Stable	Moderate	Very Strong	Adequate	Below Avg/Adequate	a-	GRE	4	N/A
Graubuendner Kantonalbank	AA/Stable	Adequate	Very Strong	Adequate	Avg/Strong	a+	GRE	2	N/A
Luzerner Kantonalbank	AA/Stable	Adequate	Very Strong	Adequate	Avg/Adequate	a+	GRE	2	N/A
Migros Bank AG	A/Stable	Moderate	Very Strong	Adequate	Avg/Strong	a	N/A	N/A	N/A
PostFinance AG	AA+/Stable	Adequate	Very Strong	Moderate	Above Avg/Strong	a+	GRE	3	N/A
Schwyzer Kantonalbank	AA+/Stable	Adequate	Very Strong	Adequate	Avg/Strong	a+	GRE	3	N/A
UBS Group AG*	A+/Stable	Strong	Strong	Moderate	Avg/Adequate	a	ALAC	1	A-/Stable
Zuercher Kantonalbank	AAA/Stable	Strong	Very Strong	Adequate	Avg/Strong	aa-	GRE	3	N/A

GRE--Government Related Entitiy. ALAC--Additional loss-absorbing capacity. ICR--Issuer credit rating. N/A--Not applicable. SACP--Stand-alone credit prole. In each case the anchor is 'a-'. *These scores reflect the group credit profile construct. §Cembra Money Bank AG: We include a positive comparable notch adjustment within its ratings construct. Banque Cantonale de Genève SA: We include a negative comparable notch adjustment within its ratings construct Source: S&P Global Ratings.

Related Research

- Bulletin: Potential Revision To Glarus' Cantonal Bank Law Could Lead To Downgrade Of Swiss-Based Glarner Kantonalbank, June 12, 2020
- How COVID-19 Is Affecting Bank Ratings: June 2020 Update, June 11, 2020
- Bulletin: Proposed Legal Framework For PostFinance Could Lead To Downgrade In The Future, June 10, 2020
- Credit Suisse AG Affirmed At 'A+' On Expected Resilience To COVID-19 Effects; Outlook Stable, May 26, 2020
- European Short-Time Work Schemes Pave The Way For A Smoother Recovery, May 20, 2020
- UBS Ratings Affirmed On Expected Resilience To Economic Effects Of COVID-19; Outlook Remains Stable, May 20, 2020
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- Switzerland-Based Cembra Money Bank Affirmed At 'A-/A-2' Amid Economic Impact Of COVID-19; Outlook Remains Negative, May 5, 2020

How COVID-19 Risks Prompted European Bank Rating Actions, April 29, 2020

- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers, April 1, 2020
- Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Feb 21, 2020
- Tech Disruption In Retail Banking: Swiss Banks Are In No Rush To Become Digital Frontrunners, Feb. 13, 2020
- Swiss Cantonal Banks: Ratings As High As The Alps, Jan 31, 2019
- Banking Industry Country Risk Assessment: Switzerland, Nov 20, 2019

This report does not constitute a rating action.