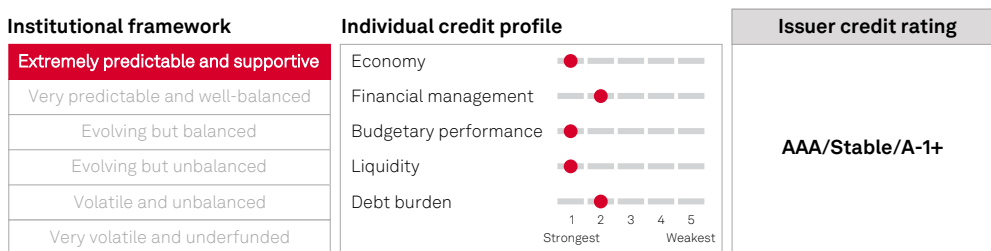


# Canton of Aargau

June 17, 2024

This report does not constitute a rating action.

## Ratings Score Snapshot



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## Credit Highlights

### Overview

#### Credit context and assumptions

The ratings on Aargau will continue to benefit from the strengths of the institutional framework and the very strong and resilient national economy.

Thanks to solid revenue growth and tight financial policies, Aargau's overall financial performance will remain strong over 2024-2026.

We assume the canton's financial management will further reduce its debt burden.

#### Base-case expectations

We expect operating margins to remain positive in 2024-2026, even if we consider budgetary pressure related to increasing healthcare costs.

Aargau will maintain its exceptional liquidity position, thereby sustaining the capacity to cover its debt service multiple times.

Aargau's projected debt burden indicators will remain low in national and international comparisons.

**S&P Global Ratings thinks Aargau benefits from a strong economy and supportive institutional framework.** We expect the cantonal tax base to remain resilient over the 2024-

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2026 forecast horizon. This, together with additional transfers from the equalization system, will partially offset the absence of the Swiss National Bank (SNB) profit distribution and higher operating expenditure.

**We assume Aargau's financial management will continue to act with fiscal discipline.** We project Aargau will post small surpluses after capital accounts, even after factoring in higher spending pressures associated with increased transfers. We expect the cantonal management to exercise financial discipline and implement the necessary measures in the event of spending rates outpacing revenues, as it has demonstrated in previous years by reducing expenditure.

**Aargau's ample cash reserves will allow it to continue reducing debt over the next two years.** We project Aargau's direct debt burden will continue to decrease while retaining ample levels of liquidity over the coming years. We also project that tax-supported debt will stay below 30% of consolidated operating revenue.

## 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

Despite challenging macroeconomic conditions, we forecast that Switzerland's real GDP growth will accelerate to 1.0% in 2024 and 1.4% by 2025, from 0.7% in 2023. We project that Aargau's GDP per capita, in line with the national growth rate, will expand 1% to approximately \$77,000 in 2024. This is very strong in an international comparison despite Aargau's GDP per capita being at only 80% of the Swiss average. Furthermore, Aargau's unemployment rate of 2.5% in first-quarter 2024 is only slightly above the national average of 2.3%, demonstrating a robust and enduringly dynamic economy. Higher-than-expected tax collection in the first half of 2024--which is projected to partially offset the anticipated lack of SNB dividend payout in 2024--points to the local economy's wellbeing. The canton benefits from its geographical proximity to Basel and Zurich, two important Swiss economic centers. Furthermore, Aargau is comparatively more industrially oriented than the average Swiss canton, with pharmaceuticals, chemicals, electrical, and engineering being the most important economic sectors. Aargau is one of the cantons that could benefit from the OECD minimum tax rate in Switzerland. However, we think the effect will be neutral, as the funds will be transferred to municipalities or spent to improve the attractiveness of the canton.

### Aargau's budgetary performance will likely remain robust and direct debt should decline further

From 2024-2026, various budgetary pressures will reduce Aargau's surpluses relative to historical levels. Nevertheless, we expect fiscal performance to remain strong, with operating

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margins above 5% and surpluses after capital accounts. We base our projection on the lack of SNB profit distributions in 2024 and 2025, the 2025 tax law revision, and an increase in subsidization for medical insurance premia for the less affluent, which will burden the canton from 2025. The tax law revision, part of the canton's strategy 2022-2030 aimed at enhancing its appeal as a residential and business hub, will be implemented in phases. The first set of measures will take effect in 2025, followed by additional revisions in 2027. These changes include a reduction in wealth taxes and increased deductibility of third-party childcare and work-related education and training costs. Our forecast also incorporates wage increases in various sectors due to inflation, which is declining but remains uncertain because of various geopolitical risks.

Consequently, we project Aargau's direct debt level will remain low and continue to decrease to below 10% of adjusted operating revenue and that the tax-supported debt will remain below 30% of consolidated operating revenue over the medium term. Our assessment of tax-supported debt includes the direct debt and debt of specific government-related entities, most importantly the cantonal hospital Aarau. The canton abstains from using foreign currency debt, swaps, and derivative instruments, reflecting its conservative debt-management policies, which is supportive of the canton's creditworthiness, in our view.

Our overall assessment of Aargau's debt burden as low factors in the canton's contingent liabilities. Aargau's main exposure relates to Aargauische Kantonbank, which is 100%-owned by the canton and benefits from a statutory cantonal guarantee. The bank's balance sheet is almost 7x the canton's budget; however, we regard the likelihood of the guarantee being called as very low. Additional contingent liability exposure mainly comes from cantonal hospital Baden and Aargau's 28% stake in energy generation and trading group Axpo, which is now positioned to make dividend payments.

Aargau's liquidity is exceptionally strong and very comfortably covers the next 12 months of debt service. In addition to cash and money market deposits, which we expect will remain high, the canton maintains contractually committed credit lines of Swiss franc (CHF) 300 million. We project Aargau's liquid assets will enable it to repay debt redemptions of CHF100 million in 2025 and CHF45 million in 2026 while maintaining exceptional liquidity. 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	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenue	5,707	5,747	5,555	5,655	5,767	5,943
Operating expenditure	5,039	5,260	5,133	5,297	5,502	5,588
Operating balance	668	487	421	357	264	355
Operating balance (% of operating revenue)	11.7	8.5	7.6	6.3	4.6	6.0
Capital revenue	83	78	53	60	78	84
Capital expenditure	319	290	483	271	315	311
Balance after capital accounts	433	276	(9)	147	27	127
Balance after capital accounts (% of total revenue)	7.5	4.7	(0.2)	2.6	0.5	2.1
Debt repaid	250	160	49	0	100	45
Gross borrowings	125	49	0	--	--	--
Balance after borrowings	308	165	(58)	147	(73)	82
Direct debt (outstanding at year-end)	850	739	690	690	590	545
Direct debt (% of operating revenue)	14.9	12.9	12.4	12.2	10.2	9.2

**Canton of Aargau Selected Indicators**

Tax-supported debt (outstanding at year-end)	1,291	1,259	1,167	1,420	1,530	1,695
Tax-supported debt (% of consolidated operating revenue)	20.4	19.7	18.7	22.4	23.8	25.6
Interest (% of operating revenue)	0.2	0.2	0.2	0.2	0.2	0.2
Local GDP per capita (\$)	70,403.2	70,266.9	75,349.6	77,332.7	N/A	N/A
National GDP per capita (\$)	93,068.3	92,920.2	99,640.8	102,264.2	N/A	N/A

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.

**Canton of Aargau--Rating Component Scores**

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 8, 2024. An interactive version is available at <http://www.spratings.com/sri>

**Related Criteria**

## Canton of Aargau

- 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, Mar 05, 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 04, 2024
- Local And Regional Governments' Workarounds Are Running Out Of Time, Dec 06, 2023
- Institutional Framework Assessment: Swiss Cantons, May 23, 2023

## Ratings Detail (as of June 14, 2024)\*

### Aargau (Canton of)

Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured	AAA

### Issuer Credit Ratings History

16-Dec-2022	<i>Foreign Currency</i>	AAA/Stable/A-1+
18-Jun-2021		AA+/Positive/A-1+
20-Jul-2018		AA+/Stable/A-1+
16-Dec-2022	<i>Local Currency</i>	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.

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