MOODY'S
INVESTORS SERVICE

SECTOR IN-DEPTH
21 January 2020

TABLE OF CONTENTS

Economic strength: aa1 2
Institutional strength: aa1 3
Susceptibility to event risk: aa 3
Credit conditions: -2 4
Funding conditions: No adjustment 6
Industry structure: No adjustment 6
Appendix: Moody's macro profiles 8
Moody's related publications 10

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Banks - Switzerland

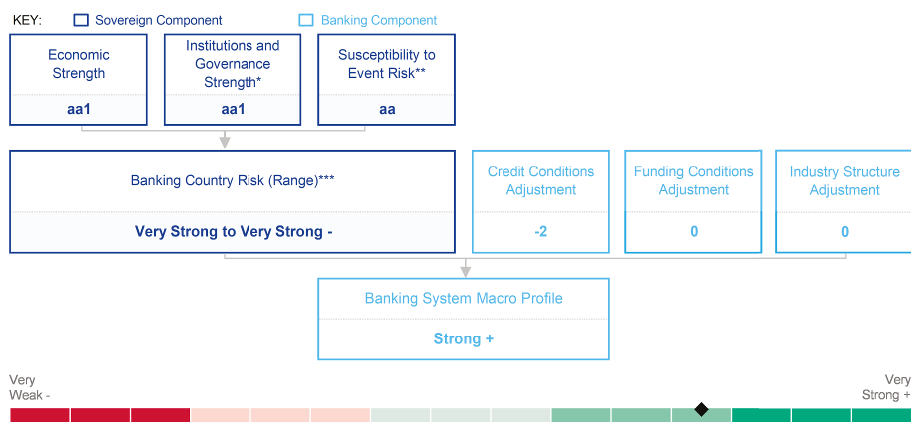
Macro profile – Strong +

Banks in Switzerland (Aaa stable) benefit from operating in an open, well diversified, competitive and highly stable environment characterised by a very high degree of economic, institutional and government financial strength, and very low susceptibility to event risk. Strong financial regulation and the country's long-standing sociopolitical stability provide further support.

We have lowered the macro profile of Switzerland to “Strong +” from “Very Strong -” because of further rising indebtedness of corporates and households to levels among the highest of any economy globally, while continuing to acknowledge some risk-mitigating effects from high wealth. The stronger economic imbalances could increase the potential downside for Swiss banks' asset quality in an adverse scenario.

The Macro Profile also takes into consideration other factors. Despite persistently low and occasionally negative interest rates, funding conditions for Swiss banks continue to benefit from a stable and growing domestic deposit base, as well as good access to liquid covered bond and interbank markets. However, pressure on earnings is unlikely to fade, reflecting banks’ limited ability to improve operating efficiency in a competitive domestic market.

Exhibit
Arriving at Switzerland's macro profile



Note: The macro profile is a rating input used to determine each bank's Baseline Credit Assessment (BCA). It is designed to capture the systemwide factors that are predictive of the propensity of banks to fail. For more information, please consult Moody's Bank Rating Methodology.
Source: Moody's Investors Service

Economic strength: aa1

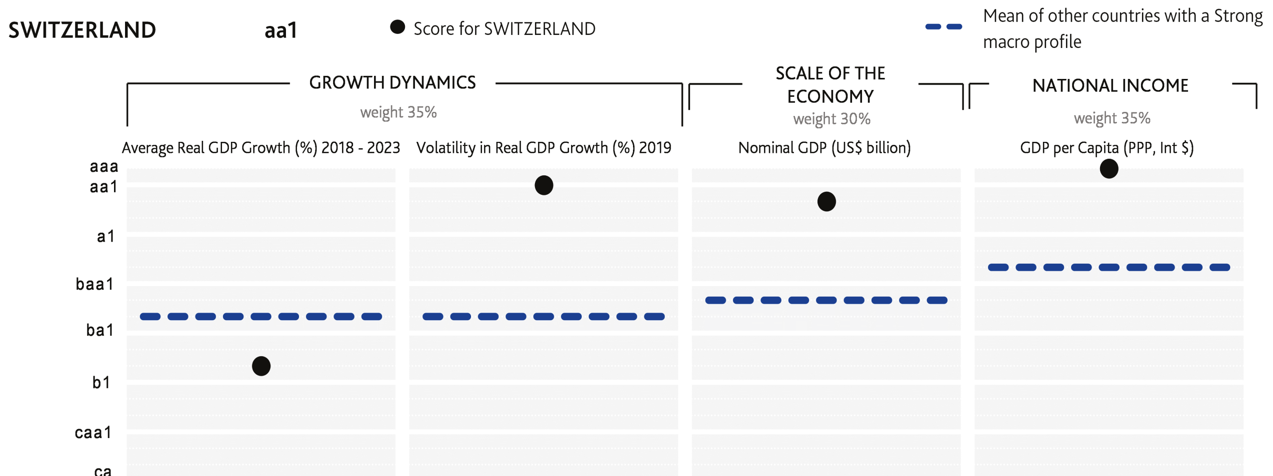
Our “aa1” assessment of Switzerland's economic strength reflects the country's wealth, economic diversity, economic resilience and competitiveness. At the same time, Switzerland's open economy is highly diversified, producing a wide range of high value-added goods and services, spanning electronics, chemicals and financial services. Switzerland also has a long history of fiscal prudence and low inflation, and benefits from a strong net external creditor position on both a flow and stock basis.

Over 2016-18, Switzerland’s growth averaged 2.1%, highlighting the economy's strong international non-price competitiveness and resilience to significant shocks. Despite the Swiss franc's strength, net exports have also contributed to growth, with exports[1] growing 4.4% in 2018 compared with imports[2] growth of 2.5%, both in real terms and on a seasonally adjusted basis

Looking ahead, we expect real GDP growth of 1% in 2020 (after 0.8% in 2019) and 1.3% in 2021, supported by an expansionary fiscal policy in 2020, an accommodative monetary policy and robust private consumption. However, risks are tilted to the downside given the Swiss economy's openness in the context of elevated trade tensions and other uncertainties, such as Brexit.

Amid increasing energy and commodity prices and inflation in Europe, Switzerland's headline inflation rate turned positive in 2017 and hovered around 0.9%-1% in 2018. However, in the first nine months of 2019, price rises averaged 0.5% and fell back into negative territory (-0.25%) in October 2019. We expect inflation to remain positive, but in the lower part of the 0% to 2% Swiss National Bank’s (SNB) implicit inflation target.

Exhibit 2
Economic strength



Source: Moody’s Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

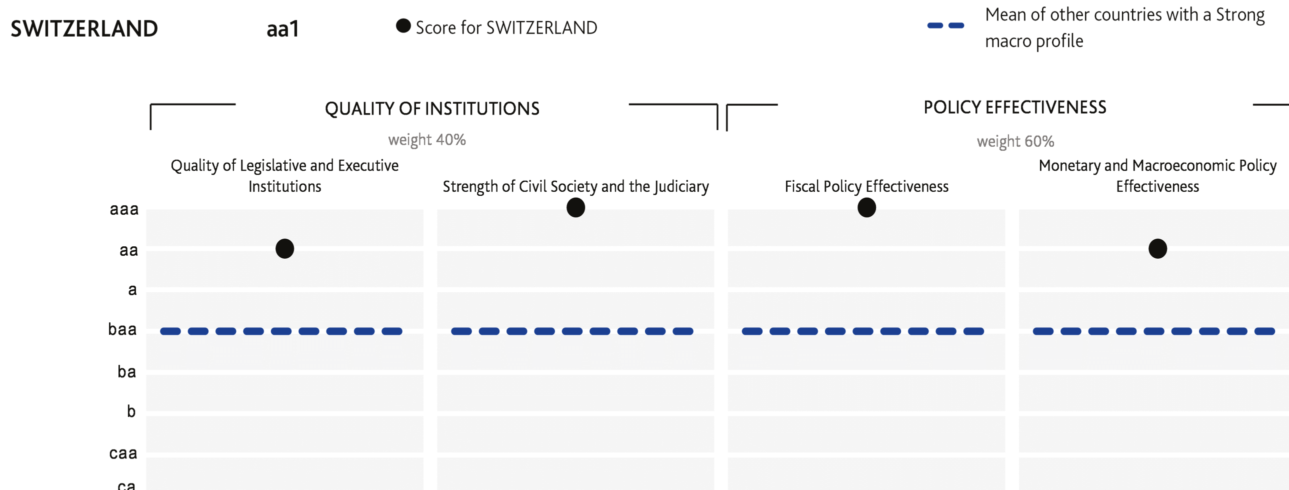
Institutional strength: aa1

Switzerland's institutional strength is among the highest of the countries that we rate. Our assessment is based on the World Bank's Worldwide Governance Indicators, as well as our own measures of policy credibility and effectiveness. Switzerland has a long history of political stability and its institutions are very robust and transparent.

Simple but strong fiscal rules, including a constitutional debt brake in effect since 2003, characterise the Swiss fiscal framework. Compliance with this framework has underpinned the Swiss government's proven track record of achieving and maintaining fiscal surpluses over a number of years. The general government deficit has been either in balance or in surplus over the past decade. Consequently, general government debt fell to 27.6% of GDP in 2018 from over 47.9% of GDP in 2003.

The slow pickup in inflation from negative figures in previous years is challenging the SNB's goal of maintaining sustained positive growth in consumer prices. The ultralow interest-rate environment is likely to remain in place for some time given the latest international developments, namely elevated trade tensions, political uncertainties and an economic slowdown in Europe, as well as recent inflation figures pointing to price growth in the lower part of the SNB's target range. The latter is related to the Swiss Franc's appreciation and muted imported prices, which explain the central bank's willingness to intervene in the foreign exchange market as necessary.

Exhibit 3
Institutional strength



Source: Moody's Investors Service

Susceptibility to event risk: aa

We assess Switzerland's susceptibility to event risk as "aa" because of the government's favourable liquidity, the relative absence of either domestic or geopolitical risks and the long average maturity of its debt, all of which result in very low borrowing requirements. Moreover, consistently large current account surpluses averaging about 10% of GDP in recent years boosted the country's already very large net creditor position with the rest of the world to 128% of GDP as of the end of 2018, strongly reducing external vulnerabilities.

Switzerland's politics have remained stable within its framework of direct democracy. However, it sometimes takes longer to effectively implement new laws, as recurrent referendums test the executive and legislative powers. Popular referendums have occasionally led to tense relationships with Switzerland's trading partners such as the European Union (EU).

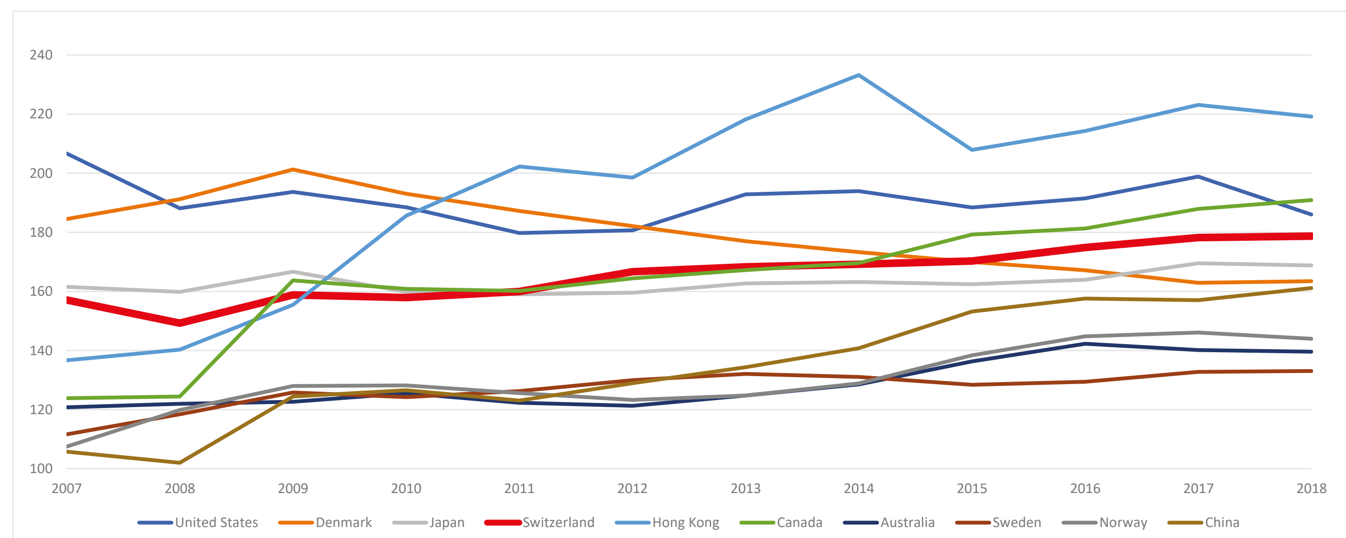
A new referendum on immigration will probably take place in May 2020. Launched by the conservative right SVP-UDC, the initiative seeks to abolish the free movement of people between the EU and Switzerland. Although the proposal is unlikely to pass, the sensitivity of the migration issue will weigh on the political debate. It will also influence the authorities' stance in their protracted negotiations with the EU on the future Switzerland-EU institutional framework agreement.

Credit conditions: -2

Swiss private sector indebtedness is extremely high compared with other European countries; the most recent data show that domestic private sector debt reached about 207% of disposable income has reached a level of close to 180% of GDP and is likely to rise further, while household debt reached around 207% of disposable income; this increasingly implies risks to financial stability. It puts Switzerland alongside the highest leveraged countries globally (as shown in Exhibit 4), and those where leverage is high and rising, such as Canada (Aaa stable) and Australia (Aaa stable), where private sector leverage is also a risk to macro and financial stability.

Ongoing growth in private sector debt-to-GDP from already comparably high levels globally present an increasing risk to Swiss bank's asset quality and profitability. Both the corporate sector as well as private households contribute to the increased economic leverage, while the resilience of borrowers's financials to a serious economic downturn has not been tested at these levels of private sector indebtedness.

Exhibit 4
Swiss private sector debt/GDP is particularly high and rising
Private sector debt/GDP in %



Note: 2017 and 2018 data for Switzerland are Moody's Investors Service forecasts
Sources: Worldbank, Moody's Investors Service

Our assessment also takes account of the rising share of newly granted mortgage loans with high loan-to-income ratios (where the imputed costs[3] exceed one third of gross wage or pension income), which reached a peak of 59% as of 2018. Further, the residential investment property segment is showing signs of imbalances, with a growing share of properties in regions with high vacancy rates and where imputed costs would no longer be covered by rents if interest rates rose to 3%-4%.

Domestic mortgages account for the majority of lending, and house prices increased 51% between 2005 and 2018. Mortgage loans and house prices grew at above average rates for a sustained period until 2015, though house price growth cooled off in 2018 and 2019. This has alleviated some of the concerns over high and rising household leverage and its potential impact on households and the financial system should house prices fall sharply. Overall, the high share of fixed-rate Swiss-franc mortgage loans, low consumer finance activity and a persistently high savings rate mitigate some of the risks of high private-sector credit and its continued growth.

The government is considering ending a tax deduction on mortgage interest for owner-occupiers (and a related tax on imputed rental values), though progress on the legislative initiative is slow and increasingly includes a lot of exceptions, which are likely to limit the potential positive impact on financial stability. At present, Swiss owner-occupiers usually do not pay down their mortgage debt beyond a loan-to-value of 67% as required by the regulator.[4] They benefit from a tax deduction on their mortgage interest, which offsets a tax they must pay on the imputed rent of their home. Instead of amortising their mortgage loans, Swiss homeowners tend to accumulate financial assets. Eliminating the tax deduction on mortgage interest would encourage borrowers to pay off their mortgage loans, pressuring banks' interest income. At the same time, a deleveraging of Swiss households would increase financial stability, a credit positive.[5]

While we believe that the following key factors mitigate some of the risks linked to high and rising indebtedness, we expect the increase in private sector debt to continue as the incentives that underpin the development will remain in place for now.

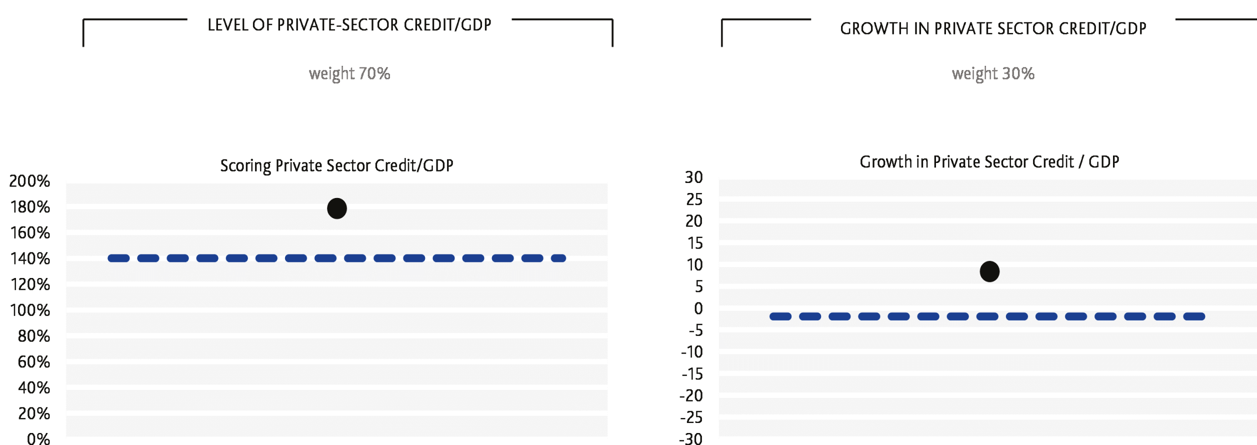
1. Swiss households' financial assets (excluding real estate assets) stood at 375% of GDP in 2018. Moreover liquid financial assets (cash and deposits) cover 98% of financial liabilities. Net of debt, Swiss financial wealth amounted to 244% of GDP in 2018. Further, the pension system, which is partly private sector funded, ensures a broad distribution of net wealth, a key mitigant when it comes to vulnerability at the individual household level. This substantial buffer, partly the result of a high and well dispersed stock of pension assets, reduces the strain that a pronounced slowdown in Swiss property markets could have on Swiss banks' asset quality.

2. The Swiss authorities have implemented a range of macro-prudential policies to increase the banking sector's resilience and cool the housing market. Lending rules have been tightened since mid-2012, including the introduction of a minimum amortisation period and the downpayment of mortgages in cash, which will also apply to the investment property market from 2020. In February 2013, the authorities activated a countercyclical capital buffer requiring banks to hold additional core capital on domestic residential mortgage exposures. The buffer was increased to 2% of risk-weighted exposures as of 30 June 2014 and has been held at that level since.

Exhibit 5

Credit conditions

Strong financial wealth largely mitigates high and rising private sector debt



Source: Moody's Investors Service

Funding conditions: No adjustment

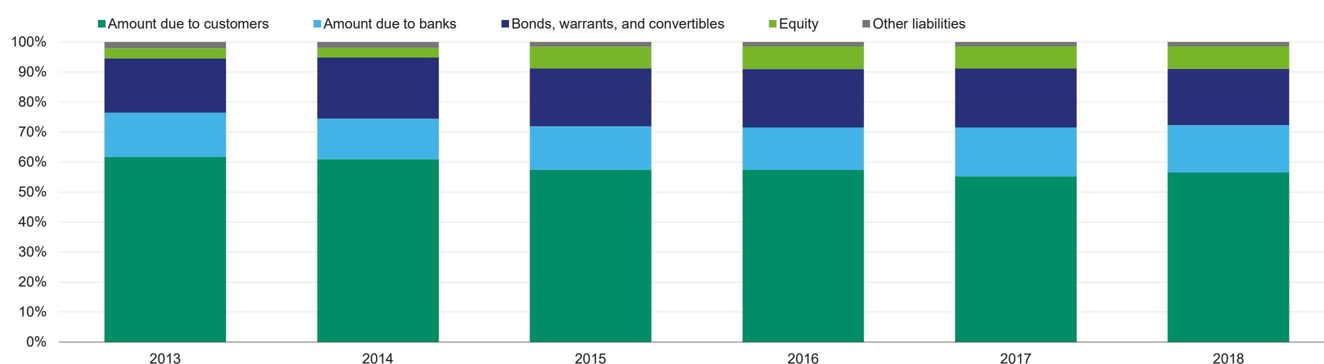
Swiss banks are likely to continue to benefit from growth in client deposits, primarily from domestic sources, reflecting Swiss consumers' stable income and wealth. Domestic customer deposits accounted for approximately two thirds of total domestic liabilities as of 31 December 2018. With a loan to deposit ratio of 90% as of year-end 2018, most Swiss banks' loan books are funded in full by customer deposits, limiting their dependence on market funding. This plays a key role in our positive evaluation of Swiss banks' funding profiles.

Swiss banks' exposure to contractually shorter-term funding sources could put pressure on their funding franchises, particularly if interest rates spike. However, we believe that the domestic covered bond market will remain a sustainable source of funding, given that substantial and as yet untapped collateral is available to compensate for deposit outflows in the event of stress.

Exhibit 6

Swiss banks' funding profile benefits from strong deposit base

Swiss banks' liability structures, 2013-18



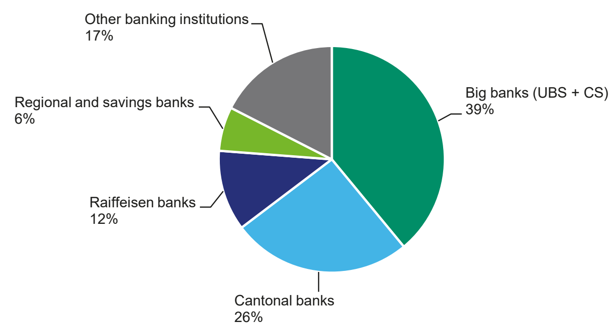
Sources: Swiss National Bank, Moody's Investors Service

Industry structure: No adjustment

Switzerland's two largest banks, UBS AG (Aa2 stable, Aa3 stable, a3[6]) and Credit Suisse AG (A1 positive, A1 positive, baa2), dominate the country's banking system. Their combined loans accounted for 39% of total banking system loans as of 31 December 2018 (see Exhibit 7). The rest of the system is highly fragmented among different banking sectors. The second largest bank category, the cantonal banking sector, collectively held a 26% share as of 31 December 2018.

Domestic banks have a large share in lending, a positive feature of Switzerland's banking system, underscoring the dominance of Swiss banks as providers of financing for the economy without any reliance on shadow banking sectors.

Exhibit 7
Industry structure
Loan market share by banking sector (%, December 2018)



Note: Number of institutions as of year-end 2018
Sources: Swiss National Bank, Moody's Investors Service

Appendix: Moody's macro profiles

North America	Banking Country Risk	Credit Conditions Adjustment	Funding Conditions Adjustment	Industry Structure Adjustment	Macro Profile
BERMUDA	Strong -	0	-2	0	Moderate
CANADA	Very Strong	-3	0	1	Strong +
UNITED STATES OF AMERICA	Very Strong	-1	1	-1	Very Strong -
Western Europe	**Banking Country Risk**	**Credit Conditions Adjustment**	**Funding Conditions Adjustment**	**Industry Structure Adjustment**	**Macro Profile**
ANDORRA	NA	NA	NA	NA	Moderate +
AUSTRIA	Very Strong -	0	0	-1	Strong +
BELGIUM	Very Strong -	-1	0	0	Strong +
CYPRUS	Strong	-4	-1	0	Weak +
DENMARK	Very Strong	-1	-1	0	Strong +
FINLAND	Very Strong -	0	-1	0	Strong +
FRANCE	Very Strong -	-1	0	0	Strong +
GERMANY	Very Strong	0	0	-2	Strong +
GREECE	Weak +	-1	0	0	Weak
IRELAND	Very Strong -	-2	0	0	Strong
ISLE OF MAN	Strong +	0	-1	0	Strong
ITALY	Strong	-1	-1	0	Moderate +
LIECHTENSTEIN	Very Strong -	-1	0	0	Strong +
LUXEMBOURG	Very Strong	-1	0	0	Very Strong -
NETHERLANDS	Very Strong	-1	-1	0	Strong +
NORWAY	Very Strong	-1	-1	1	Very Strong -
PORTUGAL	Strong	-1	-1	0	Moderate +
SPAIN	Strong	-1	0	0	Strong -
SWEDEN	Very Strong	-2	-1	1	Strong +
SWITZERLAND	Very Strong	-2	0	0	Strong +
UNITED KINGDOM	Very Strong -	-1	0	0	Strong +
Asia Pacific	**Banking Country Risk**	**Credit Conditions Adjustment**	**Funding Conditions Adjustment**	**Industry Structure Adjustment**	**Macro Profile**
AUSTRALIA	Very Strong	-2	-1	1	Strong +
BANGLADESH	Weak +	-1	0	-1	Weak -
CHINA	Strong	-2	0	0	Moderate +
HONG KONG	Very Strong -	-2	0	0	Strong
INDIA	Strong -	-2	0	0	Moderate
INDONESIA	Strong -	-1	0	0	Moderate +
JAPAN	Very Strong -	-1	0	-1	Strong
KOREA	Very Strong -	-1	0	-1	Strong
MACAO	Moderate +	-1	0	0	Moderate
MALAYSIA	Strong +	-2	0	0	Strong -
MONGOLIA	Weak -	0	0	0	Weak -
NEW ZEALAND	Very Strong	-1	-1	0	Strong +
PAKISTAN	Weak +	-2	-1	0	Very Weak +
PHILIPPINES	Strong -	-1	0	0	Moderate +
SINGAPORE	Very Strong	-2	0	1	Very Strong -
SRI LANKA	Weak +	-1	0	0	Weak
TAIWAN	Strong +	-1	0	-1	Strong -
THAILAND	Strong -	-1	0	0	Moderate +
VIETNAM	Moderate	-1	0	-1	Weak +
Latin America and the Caribbean	**Banking Country Risk**	**Credit Conditions Adjustment**	**Funding Conditions Adjustment**	**Industry Structure Adjustment**	**Macro Profile**
ARGENTINA	Very Weak +	0	-2	0	Very Weak -
BOLIVIA	Weak	0	0	0	Weak
BRAZIL	Moderate -	0	0	0	Moderate -
CHILE	Strong +	0	0	0	Strong +
COLOMBIA	Strong -	-1	0	0	Moderate +
COSTA RICA	Weak +	0	0	0	Weak +
DOMINICAN REPUBLIC	Moderate -	-1	0	0	Weak +
EL SALVADOR	Weak -	0	0	0	Weak -
GUATEMALA	Weak +	0	-1	0	Weak
MEXICO	Moderate +	0	0	0	Moderate +
PANAMA	Moderate +	0	-1	0	Moderate
PARAGUAY	Moderate -	0	0	0	Moderate -
PERU	Moderate +	0	0	0	Moderate +
URUGUAY	Strong -	0	-1	-2	Moderate -

Central and Eastern Europe	Banking Country Risk	Credit Conditions Adjustment	Funding Conditions Adjustment	Industry Structure Adjustment	Macro Profile
BULGARIA	Moderate +	-2	0	0	Moderate -
CZECH REPUBLIC	Very Strong -	-2	0	0	Strong
CROATIA	Strong -	-2	-1	0	Moderate -
ESTONIA	Strong	0	-1	0	Strong -
HUNGARY	Moderate +	0	-1	-1	Moderate -
LATVIA	Strong -	0	-2	0	Moderate
LITHUANIA	Strong -	0	-1	0	Moderate +
POLAND	Strong +	-1	-1	0	Strong -
ROMANIA	Moderate	0	-1	0	Moderate -
SLOVAKIA	Strong	-1	0	0	Strong -
SLOVENIA	Strong	-1	0	-1	Moderate +
TURKEY	Weak +	0	-3	0	Very Weak +
Commonwealth of Independent States	**Banking Country Risk**	**Credit Conditions Adjustment**	**Funding Conditions Adjustment**	**Industry Structure Adjustment**	**Macro Profile**
AZERBAIJAN	Weak -	0	-1	0	Very Weak +
ARMENIA	Moderate -	0	-1	0	Weak +
BELARUS	Very Weak +	0	0	0	Very Weak +
GEORGIA	Moderate -	0	-1	0	Weak +
KAZAKHSTAN	Moderate -	0	-1	0	Weak +
RUSSIA	Weak +	0	0	0	Weak +
TAJIKISTAN	Very Weak +	0	-1	0	Very Weak
UKRAINE	Very Weak +	0	0	0	Very Weak +
UZBEKISTAN	Weak -	0	0	-1	Very Weak +
Middle East and North Africa	**Banking Country Risk**	**Credit Conditions Adjustment**	**Funding Conditions Adjustment**	**Industry Structure Adjustment**	**Macro Profile**
BAHRAIN	Weak +	0	0	0	Weak +
EGYPT	Weak +	-2	0	0	Weak -
ISRAEL	Very Strong -	-1	0	-1	Strong
JORDAN	Moderate	-2	0	0	Weak +
KUWAIT	Strong -	0	0	0	Strong -
LEBANON	Very Weak	0	0	0	Very Weak
MOROCCO	Moderate -	0	0	0	Moderate -
OMAN	Moderate -	-1	0	0	Weak +
QATAR	Strong +	-2	0	0	Strong -
SAUDI ARABIA	Strong	-2	0	0	Moderate +
TUNISIA	Weak +	-2	-1	0	Very Weak +
UNITED ARAB EMIRATES	Strong +	-2	0	0	Strong -
Sub-Saharan Africa	**Banking Country Risk**	**Credit Conditions Adjustment**	**Funding Conditions Adjustment**	**Industry Structure Adjustment**	**Macro Profile**
ANGOLA	Very Weak +	0	-1	0	Very Weak
COTE D'IVOIRE	Weak +	-2	0	0	Weak -
DEMOCRATIC REPUBLIC OF THE CONGO	Very Weak -	0	0	0	Very Weak -
GHANA	Weak	-2	0	0	Very Weak +
KENYA	Weak	0	0	-1	Weak -
MAURITIUS	Strong	-2	-1	-1	Moderate -
NIGERIA	Very Weak +	0	0	0	Very Weak +
NAMIBIA	Weak +	0	-1	0	Weak
SOUTH AFRICA	Moderate	0	0	0	Moderate
TANZANIA	Weak	-2	0	0	Very Weak +
TOGO	Very Weak +	0	0	0	Very Weak +
UGANDA	Weak -	-1	0	0	Very Weak +

Source: Moody's Investors Service

Moody's related publications

Banking System Outlook and Profile:

- Banking System Outlook – Switzerland: Stable economic activity and strong capital cushion underpin our stable outlook, 3 December 2018
- Banking System Profile: Switzerland, 11 January 2018

Credit Opinion:

- Government of Switzerland – Aaa Stable, 3 December 2019

Country Analysis:

- Analysis: Government of Switzerland, 10 December 2019
- Country Statistics: Government of Switzerland, 3 June 2019

Methodology:

- Banks, 25 November 2019

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Excluding valuables.

2 Excluding valuables.

3 Source: SNB Financial Stability Report, page 21. The imputed costs comprise the imputed interest rate (5%) and maintenance and amortisation costs (1% each).

4 See also "Swiss banks face risk of house price correction but can weather a downturn", 15 March 2018.

5 For more details please refer to our publication "Proposed new laws have potential to change structure of Swiss mortgage market", 15 October 2018

6 The ratings shown in this report are the banks' deposit ratings and senior unsecured debt ratings together with their corresponding outlooks, as well as their Baseline Credit Assessments (BCAs).

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