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## Swiss Canton of Basel-City Outlook Revised To Positive; 'AA+/A-1+' Ratings Affirmed

### ***Rationale***

On May 30, 2008, Standard & Poor's Ratings Services revised its outlook on the Swiss Canton of Basel-City to positive from stable owing to very good budgetary performance and decreasing debt levels, despite the closing of the unfunded pension gap. At the same time, the 'AA+/A-1+' long- and short-term issuer credit ratings on the canton were affirmed.

The ratings on the Swiss Canton of Basel-City are supported by its budgetary performance with surpluses after capital expenditures, strong economy, contributor position to the Swiss fiscal equalization system, and declining net financial liabilities. These positive factors are offset by the exposure of tax revenues to cyclical developments combined with some economic sector concentration in chemicals and pharmaceuticals, as well as a concentration of its taxpayers as corporations.

We expect the canton's budgetary performance to remain robust in 2008 and in the following years, even after tax reforms are implemented in 2008. In 2007, the cantonal performance deteriorated owing to the transaction for closing the pension gap. After Standard & Poor's made adjustments for the pension-gap-closing transaction, the operating surplus reached a high 15.9% of operating revenues, but the performance after capital expenditure deteriorated to minus 12% of total revenues. In 2008, we expect results to

come close to 2006 figures, because tax revenues partly depend on last year's income and profits, despite a slight weakening in the economy.

The canton, a center of the life-science industry, benefits directly from its strong economy, which is somewhat exposed to the chemical and pharmaceutical industry, but has proved very robust over the past few years. We expect GDP growth to continue above the Swiss average.

The canton continues to be a net contributor to the Swiss fiscal equalization system, even in the new system implemented in 2008. Although the resource index—which is used for calculating the equalization cash flows—improved for Basel-City, the canton still benefits compared with the previous system because its required contributions for equalization are slightly less. Because of a redistribution of responsibilities, expenditure flexibility will increase. The underfunding of the cantonal pension fund was resolved, leading to a fully funded pension fund. Net financial liabilities, which include unfunded pension obligations, could be reduced to 78% from 92% of total revenues by using the canton's excellent liquidity situation in 2007 and by increasing direct debt. Nevertheless, we expect a continuation of the good liquidity situation in 2008, which could allow the canton to further reduce direct debt and net financial liabilities to 63% of total revenues.

The ratings on the canton are constrained by Basel-City's economic sector concentration, which could leave the canton vulnerable to cyclical developments in the chemical and pharmaceutical sector. Fortunately, diversification within this sector diminishes the risk. Furthermore, a high concentration of tax revenues from corporate taxpayers represents some tax-revenue risk, particularly with a relatively high tax-rate level of corporate tax rates in Basel-City and the fierce tax competition among Swiss cantons.

### ***Liquidity***

Basel-City's liquidity situation improved considerably in 2007, allowing the canton to fund the unfunded part of the pension obligations with its own sources. A continuation of the very good liquidity situation is expected in 2008; therefore excess reserves could be used for repaying short-term debt to the pension fund. Even after these transactions, we expect a good, although reduced, liquidity at sufficiently high levels in 2008.

### ***Outlook***

The positive outlook on the canton reflects Standard & Poor's expectation that Basel-City will continue to achieve a budgetary performance with sound operating surpluses and remain close to balance after capital expenditure results. This expectation takes both the tax reform of 2008 and a more demanding cyclical environment into account. The rating could be raised if the canton manages a further debt reduction and if we are optimistic that the tax vulnerabilities will be reduced.

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The outlook could be revised to stable, however, should the canton's financial performance weaken considerably after the tax reform implementation and economic conditions deteriorate.

### ***Ratings List***

	To	From
Issuer credit rating	AA+/Positive/A-1+	AA+/Stable/A-1+

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