Kingdom of Belgium
Rating Report

SCOPE AA- STABLE OUTLOOK

Credit strengths

- Wealthy and diversified economy
- Favourable debt profile and strong market access
- Sound external position

Credit challenges

- High public debt levels
- Fiscal pressures due to ageing population
- Low productivity growth, labour market rigidities and weak business dynamism

Rating rationale:

Wealthy and diversified economy: Belgium benefits from its high wealth levels and diversified economic structure, supported by high value-added services. This underpins resilience to shocks and shields Belgium's open economy from adverse external developments.

Favourable debt profile and strong market access: Government debt is characterised by a long average maturity, a low share of short-term debt and no foreign currency exposures. This robust debt profile combined with strong market access and the ECB's highly accommodative monetary policy stance, partially mitigates risks stemming from high public debt levels.

Sound external position: High net international investment assets combined with diversified destination markets across Europe and the innovativeness and competitiveness of key exporting industries helps to mitigate external risks. Still, Belgium's external position faces a number of challenges related to adverse developments in competitiveness, including rising wages and adverse productivity developments.

Rating challenges include: i) high public indebtedness; ii) substantial fiscal pressures related to an ageing population which weigh on the budget balance and limit prospects for material fiscal consolidation; and iii) structural economic weaknesses in the form of declining productivity growth, lagging business dynamism and labour market bottlenecks.

Belgium's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aaa		-1/3	
Public Finance Risk		25%	bb+		+1/3	
External Economic Risk		10%	a		0	
Financial Stability Risk		10%	aaa		0	AA-
ESG Risk	Environmental Risk	5%	a+		0	
	Social Risk	5%	bbb-		0	
	Governance Risk	10%	aa+		-1/3	
Overall outcome		**a+**		**+1**	**0**	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. In line with this methodology, movements between indicative ratings are not immediate but are executed after analyst review of CVS results. The rating committee approved an implied core variable scorecard (CVS) rating of 'a+'. Source: Scope Ratings GmbH

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- Public debt is placed on firm downward trajectory
- Structural reform strengthens growth outlook

Negative rating-change drivers

- Fiscal outlook deteriorates resulting in increasing public debt trajectory
- Economic growth outlook weakens over the medium-term
- Political instability re-emerges, further hampering effective policymaking

Ratings and Outlook

Foreign and local currency

Long-term issuer rating	AA-/Stable
Senior unsecured debt	AA-/Stable
Short-term issuer rating	S-1+/Stable

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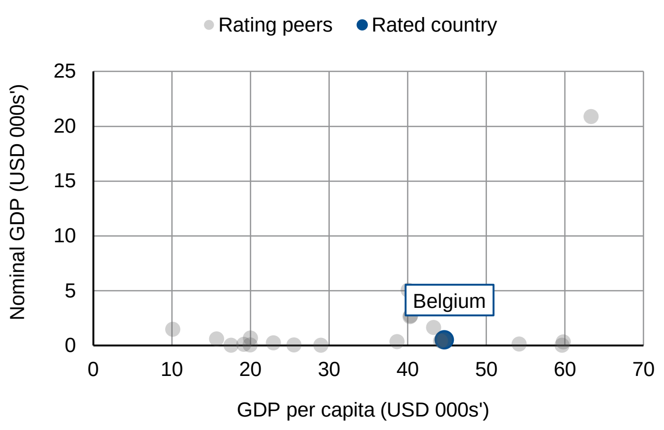
Domestic Economic Risks

- **Growth outlook:** The Covid-19 pandemic led to a historic contraction of Belgium's GDP of 5.7% in 2020. GDP growth rebounded in 2021 mainly driven by higher domestic demand and the recovery in private consumption. We expect annual growth of 5.5% in 2021 followed by a gradual convergence towards the medium-term potential of 1.3% by 2025.
- **Labour market:** The Belgian labour market has performed relatively well despite the Covid-19 pandemic thanks to the widespread implementation of temporary unemployment schemes. The unemployment rate peaked at 6.7% in February 2021 before declining to 6.3% as of September while total employment is already back at pre-crisis levels. However, Belgium's employment rate remains low compared to its peers and reforms are needed to increase labour-force participation, inclusiveness and flexibility.
- **Recovery plan:** Economic recovery will be supported by the government's Recovery Plan which is structured around six pillars including climate and sustainability, digital transformation, innovation and productivity among others. The plan combines large-scale investments and structural reform proposals. It will be financed through the EU Resilience Facility fund, of which Belgium is due to receive around EUR 5.95bn.
- **Structural economic bottlenecks:** The Belgian economy faces long-standing structural challenges which are likely to weigh on future growth absent a forceful policy response. This includes declining productivity growth, labour market rigidities and weak business dynamism which have led to widening competitiveness gaps with key trading partners and pose risks to Belgium's trade-oriented economy.

Overview of Scope's qualitative assessments for Belgium's *Domestic Economic Risks*

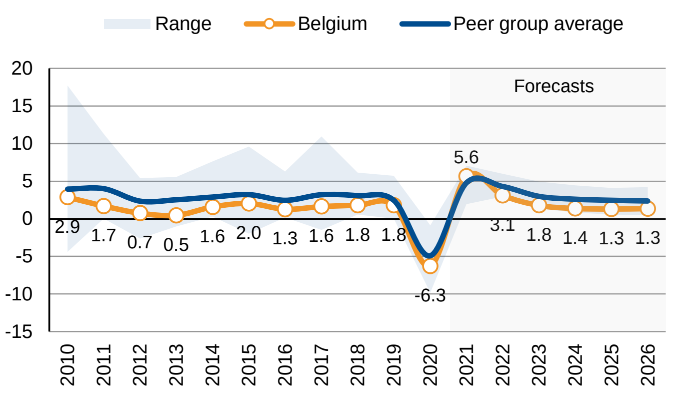
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Weak	-1/3	Low and declining growth potential requires policy response
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank
	Macro-economic stability and sustainability	Neutral	0	Diversified economy supports economic stability; structural pressures on productivity and competitiveness weigh on sustainability

Nominal GDP and GDP per capita, USD thousands



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

Public Finance Risks

- **Fiscal outlook:** The general government deficit widened to 9.4% of GDP in 2020 and is expected to be 7% of GDP in 2021. Wide deficits are the result of the appropriate countercyclical policies implemented by the government to mitigate the economic fallout of the Covid-19 pandemic, which amounted to around 5% of GDP in 2020. We expect deficits to narrow through 2022 as pandemic-related spending is phased out before widening thereafter given upward pressures on social spending weighing on the government's fiscal performance.

  While the Stability and Growth Pact remains suspended until end-2022, any reforms before its re-introduction in 2023, which must be agreed at the European level, are likely to be limited in our view, raising the possibility of excessive deficit procedures over the medium-term.

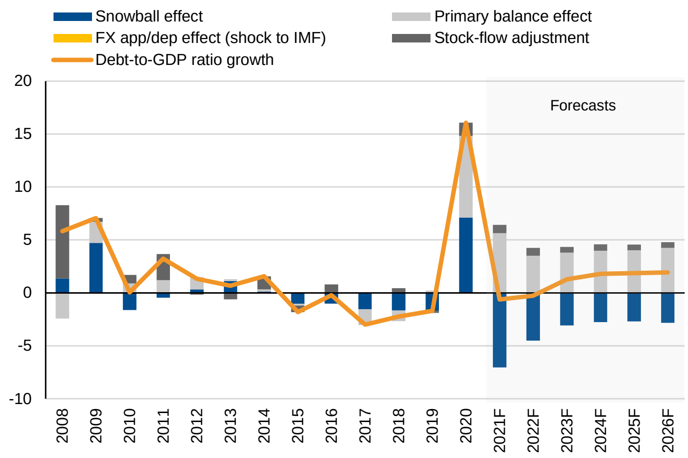
- **Debt trajectory:** The government debt-to-GDP ratio increased by 16.1pps in 2020, reaching 114.1%. While we expect a slight reduction in public indebtedness over 2021-22, supported by the buoyant economic recovery and the associated base effects, we foresee debt to return to an upward trajectory and reach 120% of GDP in 2026, broadly in line with IMF forecasts.

- **Market access:** Belgium benefits from a favourable debt structure with long public maturities (average maturity of 10.2 in September 2021) and a stable investor base. The foreign currency share of debt is at 0% after accounting for swaps. In addition, financing costs are low thanks to the ECB's monetary policies with interest payments relative to revenue expected to stabilise through 2026 despite the marked increase in debt. The Belgian Debt Agency's 2021 funding plan foresees an issuance of EUR 39bn of debt securities. In addition, Belgium received EUR 4.2bn in funding from the EU SURE programme. As of 31 October 2021, 91.4% of the funding plan had been achieved.

Overview of Scope's qualitative assessments for Belgium's *Public Finance Risks*

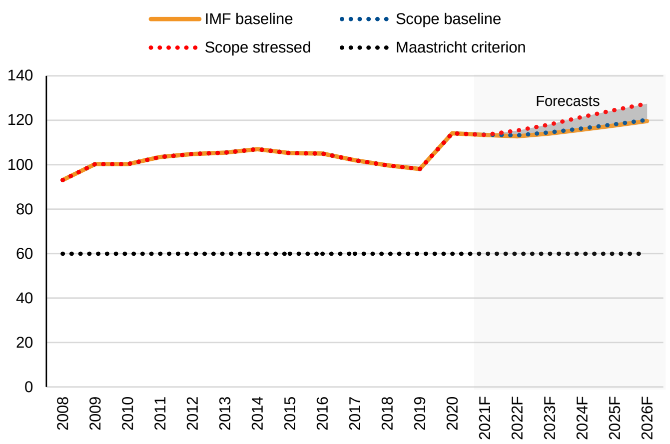
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Fiscal policy framework	Neutral	0	Countercyclical fiscal policies appropriate in the context of the Covid crisis; expected long-term deterioration in fiscal performance
	Debt sustainability	Neutral	0	High and increasing public-debt levels, set to remain on an upward trajectory over the medium-term
	Debt profile and market access	Strong	+1/3	Low and declining interest-payment burden, high average debt maturity, strong market access

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

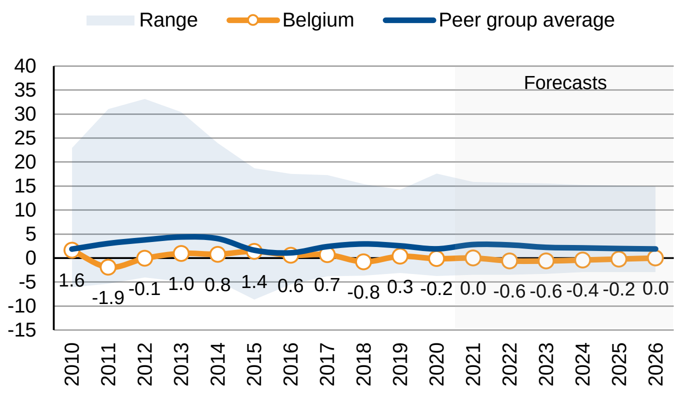
External Economic Risks

- **Current account:** The Covid-19 shock reversed a recent trend of improving current account balances. The current account reached -0.2% of GDP in 2020, versus +0.3% of GDP in 2019. This was driven by lower trade and secondary income balances which were only partially offset by lower energy prices and good performance in pharmaceutical exports. The current account balance is projected to remain moderately negative through 2026 as import growth should outpace export growth given recovery in domestic demand. Deteriorating competitiveness in Belgium could lead to a further weakening in the current account if left unaddressed.
- **External liabilities and assets:** Belgium's external position benefits from its large net creditor position with the net international investment position remaining at a high level of 48.4% of GDP in 2020 according to IMF figures. Gross external debt stood at 252% of GDP as of June 2021 is well above the euro area average (122.9% of GDP) and is mostly made up of government and banking sector debt.
- **Euro as global reserve currency:** Belgium, along with all euro area members, benefits from the euro's status as a global reserve currency, significantly mitigating risks to external shocks.

Overview of Scope's qualitative assessments for Belgium's *External Economic Risks*

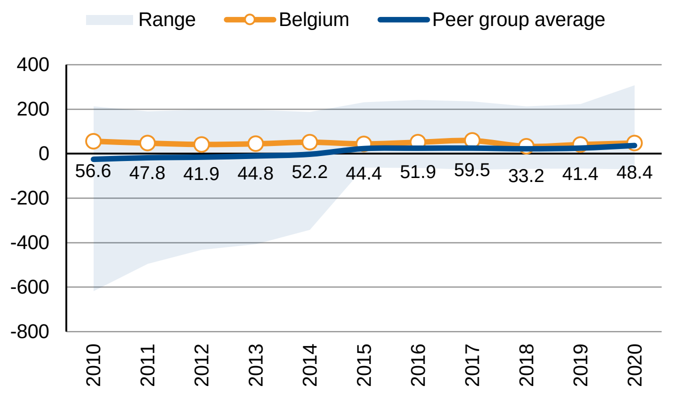
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Current account resilience	Neutral	0	Post-crisis moderate current-account deficits reflecting competitiveness challenges; diversified export base
	External debt structure	Neutral	0	Large external debt stock, but significant external assets
	Resilience to short-term shocks	Neutral	0	Euro-area membership shields against short-term external risks

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

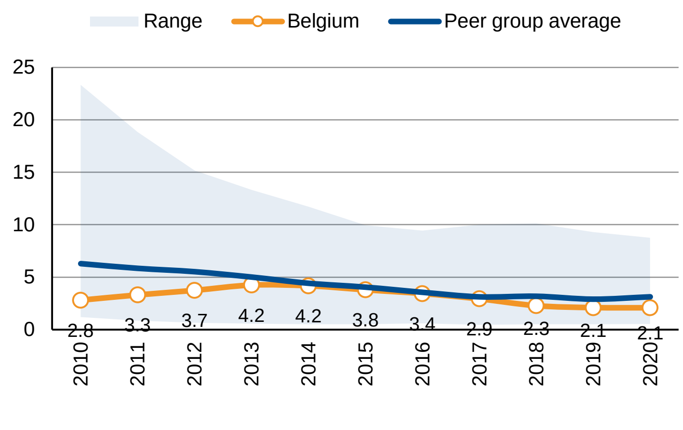
Financial Stability Risks

- **Banking sector:** The Belgian banking sector demonstrated its resilience and acted as a shock absorber during the Covid-19 pandemic, on the back of strong financial positions entering the crisis. The banking sector's tier 1 ratio was at 18.1% in Q1 2021, well above minimum requirements, and the NPL ratio did not worsen during the crisis, falling to 1.9% from 2.1% in 2020. The liquidity position is comfortable, with liquidity coverage levels of 188% in Q2 2021 up from 143% pre-crisis.
- **Private debt:** Leverage in the private sector has increased in recent years, especially for households, driven by buoyant credit growth. Household debt increased by 14.9pps of GDP between 2009 and 2020 to 67.2% of GDP. Risks associated with this leverage are mitigated by households' financial assets which outweigh their liabilities. However, wealth is unevenly distributed and highly indebted households risk entering a more fragile situation in the event of a reduction in income.
- **Housing market:** Residential property prices increased by 5.8% in nominal terms in 2020. The increase in prices occurred despite the slower rise in household incomes in the current crisis and the end of the mortgage relief scheme in the Flemish Region, two factors that would tend to depress property price growth. As a result, the National Bank of Belgium estimates the residential property market to be overvalued by 14.1% as of 2020. Overvalued real estate assets – which account for a sizeable share of financial sector portfolios – combined with elevated private debt levels present pockets of financial stability risks.

Overview of Scope's qualitative assessments for Belgium's *Financial Stability Risks*

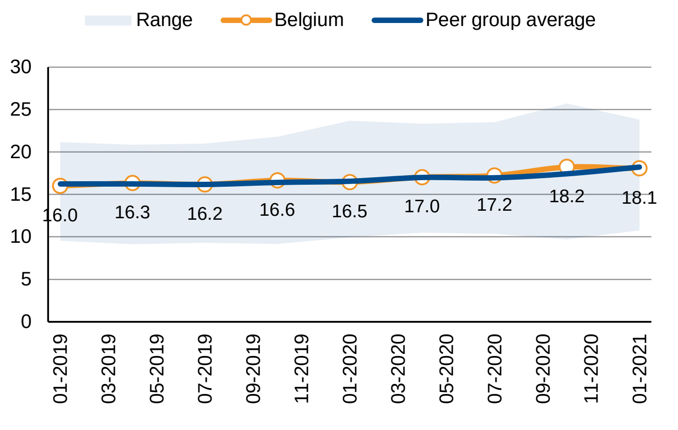
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Strong capitalisation, asset quality and liquidity buffers; low interest rates pose profitability challenges
	Banking sector oversight	Neutral	0	Robust oversight under the National Bank of Belgium and the ECB as part of Banking Union
	Financial imbalances	Neutral	0	Elevated private debt levels and rising housing market vulnerabilities; large household financial wealth

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

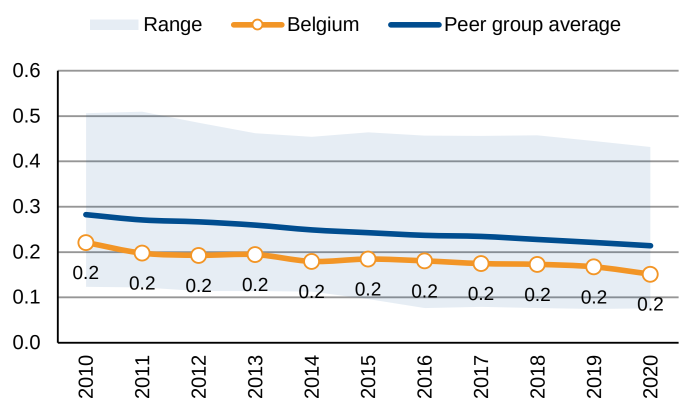
ESG Risks

- **Environment:** With 9.0 mtCO²e emissions per capita in 2019, the Belgian economy is relatively more carbon intensive than peers and accounts for 3.3% of total EU 27 emissions. The government recovery plans foresee large scale investments to support the green transition, including EUR 1bn in energy efficient renovation of residential and public buildings, EUR 540m in novel low carbon energy technologies and EUR 920m in sustainable transport. Still, the European Commission deems Belgium's National Energy and Climate Plan to be unambitious as regards its contribution to renewable energy. Over 50% of electricity is generated by the seven nuclear reactors, which are scheduled to close between 2022 and 2025, putting upwards pressure on emissions and increasing the fiscal cost for Belgium's transition towards a carbon-neutral economy. The pending European Commission decision on the classification of nuclear energy as a sustainable energy source is likely to impact the government's decision on whether to keep some plants open and inform our view of Belgium's transition risks
- **Social**: Labour force participation is weaker than peers with activity rates of 69.8% as of June 2021. Belgium suffers from regional inequality, with a regional GDP per capita in Brussels of EUR 64k versus EUR 38k in the Flemish Region and only EUR 27k in Wallonia. Demographic trends are unfavourable with the old-age dependency ratio expected to rise from 32.5% in 2019 to 51.8% in 2060, broadly in line with peers but weighing structurally on public finances and economic growth over the long-term.
- **Governance:** Rising political fragmentation and polarisation in the context of Belgium's complex political system weigh on the country's ability to design and implement policies at the national level. After Belgium was run by a caretaker government for almost two years during which national policy making was at almost complete standstill, a new federal government coalition was formed in September 2020. Looking ahead, Scope expects policy making in Belgium to remain constrained given the broad range of views among the coalition partners which comprise seven political parties.

Overview of Scope's qualitative assessments for Belgium's *ESG Risks*

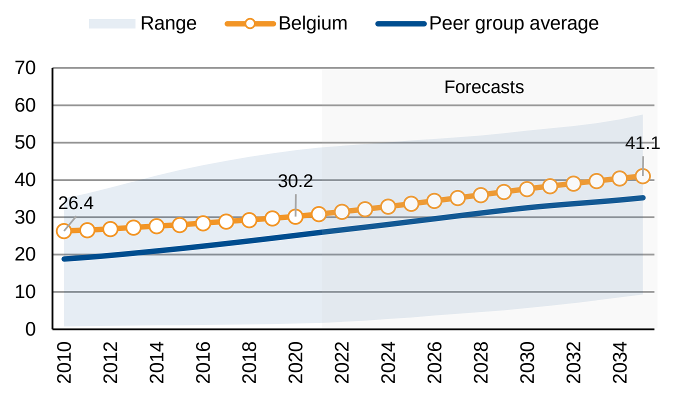
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Environmental risks	Neutral	0	Emissions-reduction plans in line with Effort Sharing Regulation; meaningful transition risks
	Social risks	Neutral	0	Strong social safety nets; skills mismatches and persistent regional inequalities are challenges
	Institutional and political risks	Weak	-1/3	Political fragmentation and polarisation constrain effective policy-making; fragile government coalition poses risks of political stalemate

CO2 emissions per GDP, mtCO2e



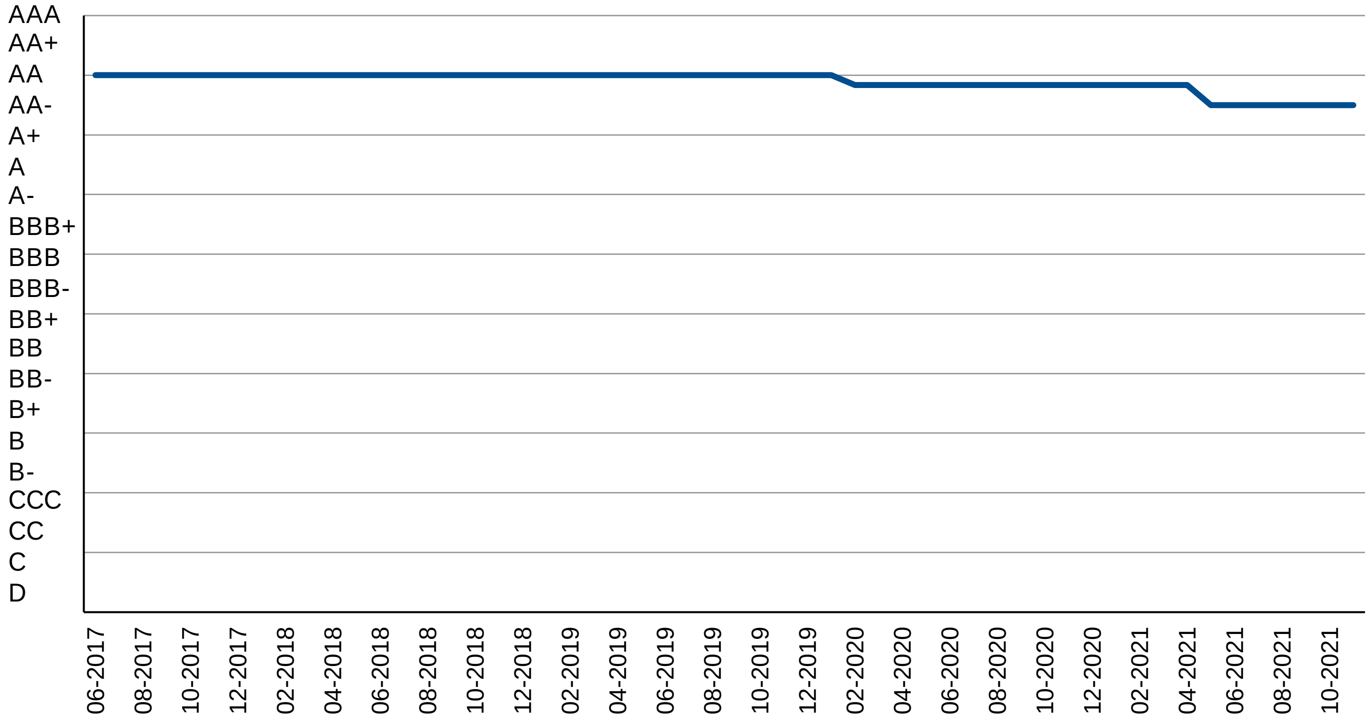
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard.

Peer group*
Belgium
Czech Republic
France
Japan
Latvia
Lithuania
Malta
Poland
Russia
Slovakia
Slovenia
United States

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021F	2022F
Domestic Economic Risk							
GDP per capita, USD 000s'	42.1	44.3	47.7	46.6	44.7	50.4	53.5
Nominal GDP, USD bn	475.9	502.6	543.9	533.3	514.9	581.8	619.2
Real growth, %[1]	1.3	1.6	1.8	1.8	-5.7	5.5	3.0
CPI inflation, %	1.8	2.2	2.3	1.2	0.4	2.4	2.2
Unemployment rate, %[1]	7.8	7.1	6.0	5.4	5.6	6.3	6.1
Public Finance Risk							
Public debt, % of GDP[1]	105.0	102.0	99.8	98.1	114.1	114.1	113.5
Interest payment, % of government revenue	4.7	4.0	3.6	3.4	3.3	2.8	2.2
Primary balance, % of GDP[1]	0.0	1.4	1.0	-0.2	-7.7	-5.6	-3.5
External Economic Risk							
Current account balance, % of GDP	0.6	0.7	-0.8	0.3	-0.2	0.0	-0.6
Total reserves, months of imports	0.6	0.7	0.6	0.7	0.8	-	-
NIIP, % of GDP	51.9	59.5	33.2	41.4	48.4	-	-
Financial Stability Risk							
NPL ratio, % of total loans	3.4	2.9	2.3	2.1	2.1	-	-
Tier 1 ratio, % of risk weighted assets	16.2	16.9	16.5	16.6	18.2	18.1	-
Credit to private sector, % of GDP	63.4	65.1	68.0	70.1	76.7	-	-
ESG Risk							
CO^2 per EUR 1,000 of GDP, mtCO^{2}e	180.3	174.3	172.6	167.1	150.9	-	-
Income quintile share ratio (S80/S20), x	4.2	4.2	4.1	-	-	-	-
Labour force participation rate, %	67.7	68.1	68.6	69.1	-	-	-
Old age dependency ratio, %	28.4	28.9	29.3	29.7	30.2	30.8	31.5
Composite governance indicator[2]	1.3	1.2	1.2	1.2	1.1	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 10 November 2021	12.3

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