31 March 2023 | Sovereign and Public Sector

Kingdom of Belgium
Rating Report

AA- STABLE OUTLOOK

Credit strengths

- Wealthy and diversified economy
- Favourable debt profile and strong market access
- Strong 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 has 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 partially mitigate risks `stemming from high public debt levels and rising funding costs.

Sound external position: High net international investment assets, with diversified export destination markets across Europe and competitive exporting industries help mitigate external risks. Still, Belgium's external position faces several challenges related to adverse trends in competitiveness, including rising labour costs and weak productivity growth.

Rating challenges include: i) elevated 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		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic economic risk		35%	aa+	EUR [+1]	-1/3	AA-
Public finance risk		20%	bbb-		0	
External economic risk		10%	bbb+		+1/3	
Financial stability risk		10%	aaa		0	
ESG risk	Environmental factors	5%	bbb		0	
	Social factors	7.5%	b+		0	
	Governance factors	12.5%	aaa		-1/3	
Indicative outcome		**aa-**			**0**	
Additional considerations					**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment 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 Rating Methodology. Source: Scope Ratings

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

- Fiscal consolidation is achieved, placing public debt on a downward trajectory
- Economic growth outlook improves over the medium-term

Negative rating-change drivers

- Economic growth momentum weakens over the medium-term
- Fiscal deficits remain large and underpin further increases in public debt
- Political instability re-emerges and leads to policy inertia

Ratings and Outlook

Foreign currency

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

Local currency

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

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Bloomberg: RESP SCOP

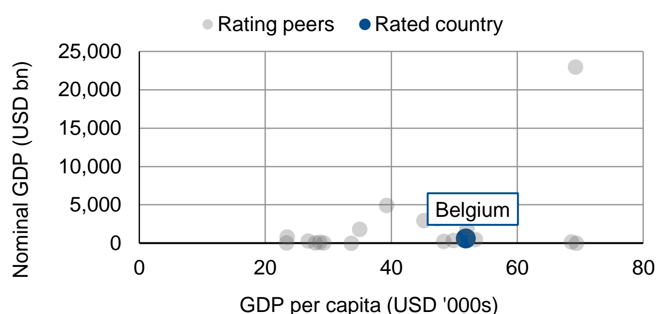
Domestic economic risk

- **Growth outlook:** After remaining broadly resilient in the first half of the year, economic growth decelerated in the second half of the year, with consecutive QoQ real GDP growth rates of 0.2% and 0.1% in Q3 and Q4 2022 respectively. This slowdown primarily reflects elevated price pressures, high uncertainty and tightening funding conditions on investment, while soaring energy prices weighed on manufacturing output. At the same time, the automatic indexation of wages to consumer prices, robust labour market dynamics and government support measures shielded household consumption from much of the energy price shock. After reaching 3.1% in 2022, we expect annual growth to weaken to 0.8% in 2023, due to muted contributions from investment and net exports. GDP growth should then pick up to 1.6% in 2024 and gradually converge towards the medium-term potential of about 1.2% in subsequent years. Long-term challenges to the growth outlook relate to Belgium's declining productivity growth which, combined with rising labour costs threatens to erode the competitiveness of Belgium's trade-oriented economy.
- **Inflation and monetary policy:** After rising sharply from H2 2021, headline inflation has declined markedly over recent months to 5.4% (HICP, YoY) in February 2023, down from peaks of 13.1% in October 2022, primarily reflecting the decline in global energy prices. At the same time, core inflation has continued to increase, up to 6.3% in February, pointing to the broadening of domestic price pressures amid robust nominal wage growth. Moving forward, we expect headline inflation to continue to decline from the combined impact of base effects, a more favourable external environment and tighter monetary policy, while the decline of core inflation should be more gradual. The ECB has increased its main policy rate by a cumulative 350bps since July 2022, bringing the deposit facility to 3.0%, its highest level since 2008.
- **Labour markets:** Labour market dynamics remained strong in 2022, despite the slowdown in economic growth in the second half of the year. Net job creation reached a historical high (+100,400) while the unemployment rate is moderate, at 5.8% as of January 2023. The Belgian job vacancy rate remains one of the highest in the EU, at 4.5%, reflecting persistently low activity rates and growing skills mismatches. The government has recently put forward a tax reform aimed at alleviating the tax burden on labour and reducing work disincentives, which should support its target of lifting the employment rate to 80% by 2030, from 72% presently.

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

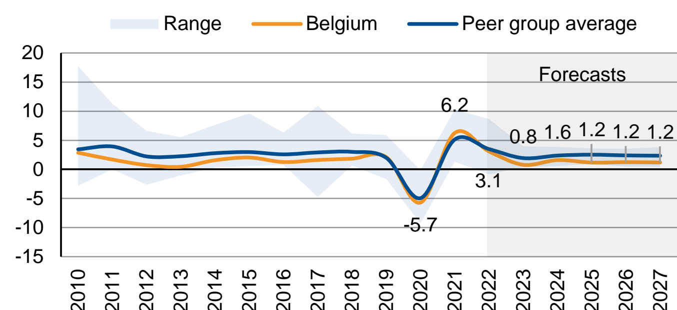
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Growth potential of the economy	Weak	-1/3	Low and declining growth potential requires policy response
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank; effective policy framework and transmission over the cycle
	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 '000s



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

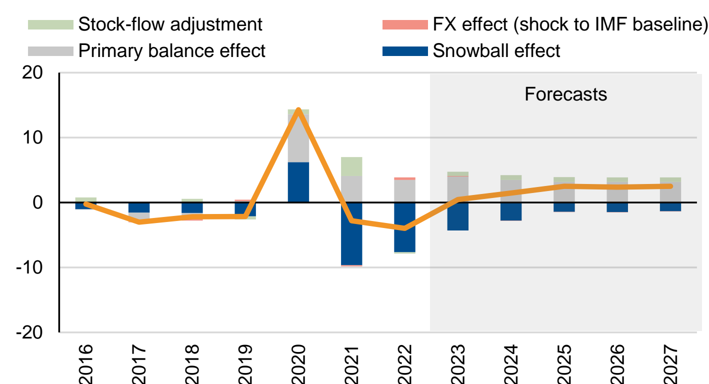
Public finances risk

- **Fiscal outlook:** The general government deficit declined to 3.9% of GDP in 2022, from 5.6% in 2021, thanks to the withdrawal of pandemic-era support measures and to the continued rebound in economic activity. This improvement came despite significant spending pressures resulting from fiscal measures aimed at alleviating the impact of the energy crisis on the private sector (amounting to about 1.3% of GDP) and the impact of inflation on social and personnel expenditures. We expect the headline budget deficit to widen again in 2023 to about 5.5% of GDP, among of the highest within the euro-area, given slowing economic growth, large public investment and continued energy support measures. It should then stabilise at an elevated level, averaging at about 5.1% of GDP over 2024-27. This medium-term view is underpinned by rising interest payments, higher defence spending, and significant structural spending pressures, challenges primarily related to the country's adverse demographics, which are expected to push pension and healthcare expenditures up by 3.5pps to 21.3% of GDP by 2050.
- **Debt trajectory:** The debt-to-GDP ratio declined to 105.0% in 2022, from 109.2% in 2021, on the back of a continued recovery in economic output and elevated inflation. We expect it to remain broadly stable in 2023 before resuming an increasing trajectory from 2024 onwards, trending upwards to around 115% by 2027. This increase in debt is primarily driven by sustained primary deficits, rising debt servicing costs and modest nominal growth, which will likely conflict with EU fiscal framework requirements.
- **Debt profile and market access:** Belgium benefits from a favourable public debt structure with long maturities (average maturity of 10.5 years as of end-2022), a stable investor base and no exposure to foreign currency risk after accounting for swaps. Like peers, financing costs have increased in recent months in line with tightening global funding conditions, with yields on benchmark 10-year government bonds rising to 2.96% on average in February 2023 (up from 0.56% in February 2022). As of March 2023, the Belgian Debt Agency had achieved about 35% of its funding target after raising a total of EUR 16.5bn.

Overview of Scope's qualitative assessments for Belgium's *Public Finances Risk*

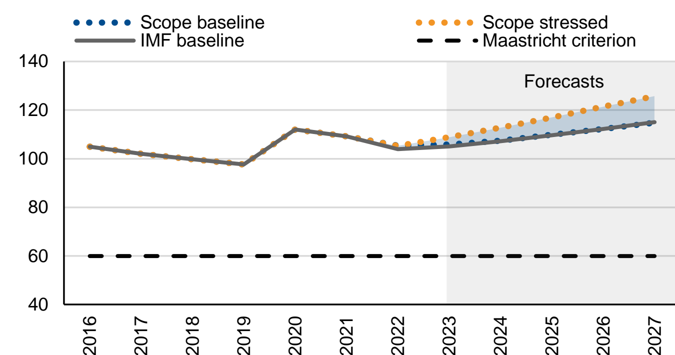
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Fiscal policy framework	Neutral	0	Long-term fiscal pressures due to ageing population; challenging fiscal policy coordination across different government levels
	Debt sustainability	Weak	-1/3	High and increasing public-debt levels, set to remain on an upward trajectory
	Debt profile and market access	Strong	+1/3	Low interest-payment burden, high average debt maturity, strong market access

Contributions to changes in debt levels, pp of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

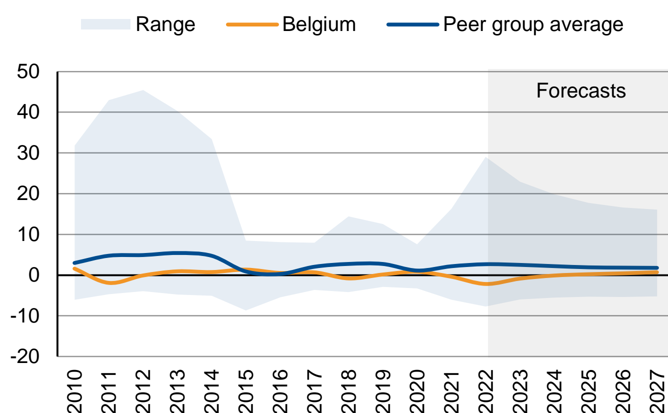
External economic risk

- **Current account:** After a period of small surpluses, averaging at about 0.3% of GDP over 2016-21, the Belgian current account balance swung to a deficit in 2022, estimated at 4.9% of GDP. This primarily resulted from a sharp deterioration of the trade balance, amid soaring nominal energy imports and lower vaccine exports. Looking ahead, we expect the headline current account deficit to moderate only gradually, from the combined impact of weaker demand among euro area neighbours in the near-term and persistent, sizable fiscal deficits. Challenges to Belgium's current account balance in the long-term stem from weak productivity gains as well as from the growth of labour costs, which has outpaced that of the country's main trading partners due in part to the automatic indexation of wages on inflation.
- **External position:** Belgium's external position benefits from its large net creditor position, with a net international investment position amounting to 58% of GDP as of Q3 2022. Gross external debt is elevated, at around 250% of GDP, but has a stable and favourable composition, being mostly comprised of public-sector liabilities and intercompany loans (around 54% of total), with a moderate share of short-term liabilities (32%). In addition, external liabilities related to the Belgian banking sector have declined materially since the Great Financial Crisis, from 63% to 31% of total outstanding external debt between 2007 and 2022.
- **Resilience to shocks:** 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 Risk*

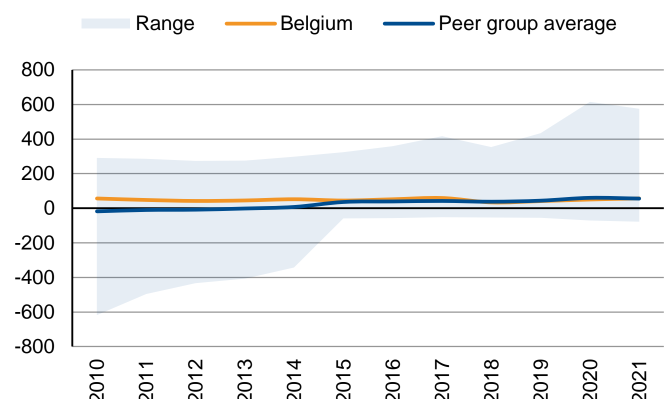
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Current account resilience	Neutral	0	Post-crisis current-account deficits reflecting competitiveness challenges; diversified export base
	External debt structure	Strong	+1/3	Comfortable positive net international investment position; risks related to a large external debt stock offset by favourable debt structure
	Resilience to short-term external shocks	Neutral	0	Euro-area membership shields against short-term external risks

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

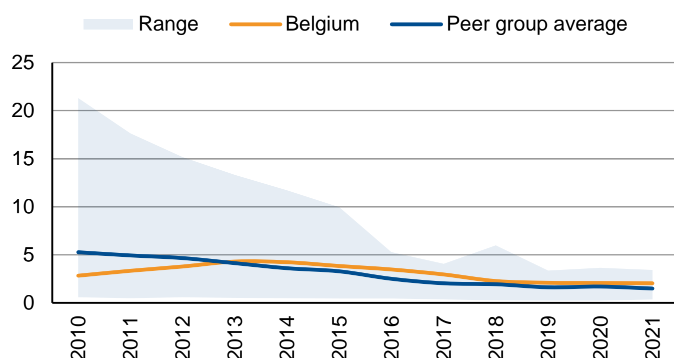
Financial stability risk

- **Banking sector:** The resilience of the Belgian banking sector is underpinned by strong capitalisation and liquidity, as measured by the aggregate Tier-1 (18.9% as of Q3 2022) and liquidity coverage (178.8%) ratios. The aggregate non-performing loan ratio is low, at 1.4% as of Q3 2022, down from 2.0% in Q4 2019, reflecting a steady improvement in asset quality. Vulnerabilities could arise from borrowers most impacted by inflation and the cooling of the housing market, however, which could require the build-up of additional provisions. The aggregate return on equity stands at 9.0%, indicating adequate profitability relative to peers and pre-pandemic averages.
- **Private debt:** Household debt is elevated, albeit broadly in line with the euro area average, at 61% of GDP as of Q3 2022. The debt of non-financial corporates represents about 139% of GDP, having moderated from 2017 highs of above 170% but remaining well above the euro area average. Risks related to elevated leverage are partially mitigated by the overall high net financial wealth of Belgian households (amounting to more than 220% of GDP) as well as to their elevated holdings of liquid assets, which exceeds the level of aggregate mortgage debt. Additionally, a high share of fixed rate mortgage loans (more than 70%) and regulatory caps on interest rate variability should soften the immediate impact of monetary policy tightening on household balance sheets.
- **Financial imbalances:** Elevated private debt levels and overvalued real estate assets prices pose some financial stability risks. The National Bank of Belgium (NBB) estimated that residential real estate (RRE) prices were overvalued by around 13% in 2022. The NBB's roll out of mortgage measures from 2020, including caps on loan-to-value ratios, led to a tightening of lending standards and an improvement in the credit risk of new loans. In February 2022, the European Systemic Risk Board assessed macroprudential measures to be partially appropriate and partially sufficient, indicating the need for further policy actions to address outstanding risks. RRE market dynamics have decelerated in recent months, in a context of rising lending rates and weakening economic momentum. Nevertheless, risks related to a sharp price correction are partially mitigated by high household wealth and the introduction of a sectoral systemic risk buffer against housing-related exposure for lenders in May 2022.

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

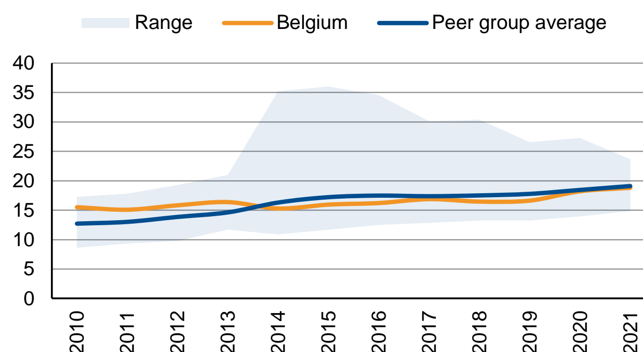
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Strong capitalisation, asset quality and liquidity buffers; post-pandemic recovery in profitability supported by rising interest rates
	Banking sector oversight	Neutral	0	Robust oversight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

Non-performing loans (NPLs), % of total loans



Source: World Bank, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

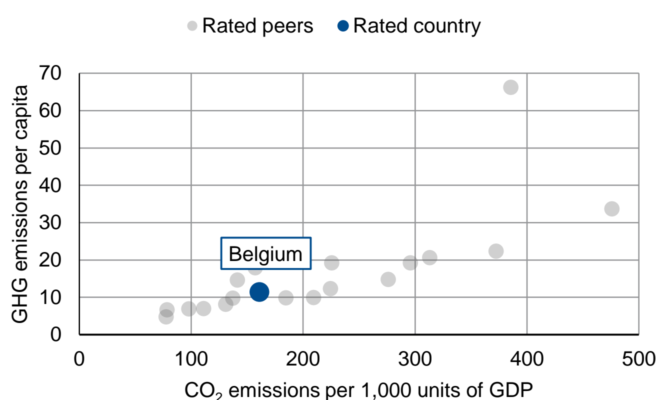
ESG risk

- **Environment:** With 11.4MtCO2ein greenhouse gas emissions per capita in 2018, the Belgian economy is relatively more carbon intensive than European peers and accounts for 3.3% of total EU emissions. Belgium's energy consists mostly of imported fossil fuels, primarily oil (35%) and natural gas (27%). The share of renewable energy in total energy supply doubled over 2012-21, from 6% to 13%, but remains among the lowest in the EU. The European Commission assesses Belgium's National Energy and Climate Plan to be unambitious as regards its contribution to renewable energy. Over 50% of electricity consumption needs are covered by the country's seven nuclear reactors, which were initially scheduled to close between 2022 and 2025. Following the breakout of the Ukraine war and the subsequent jump in global energy prices, the government postponed the phase out of several nuclear reactors until 2035. Nevertheless, the planned closures of the Doel 3 and Tihange 2 reactors were made effective in recent months, further raising the country's energy imports dependency.
- **Social:** Labour force participation is markedly weaker than peers, at about 71% of population aged 15 to 64, 4pp below the euro area average. Belgium suffers from stark regional inequalities, with GDP per capita levels at 205%, 120% and 87% of the EU average in the Brussels, Flemish and Walloon regions, respectively. Demographic trends are unfavourable with the UN projecting the old-age dependency ratio to rise from 32.5% in 2019 to 51.8% in 2060, broadly in line with peers, weighing structurally on public finances and economic growth over the long-term.
- **Governance:** The elevated political fragmentation and polarisation 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 an almost complete standstill, a new federal government coalition was formed in September 2020. We expect policy making in Belgium to remain constrained, ahead of the 2024 general elections and in view of the broad range of views within the current 'Vivaldi' coalition, which comprises seven political parties.

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

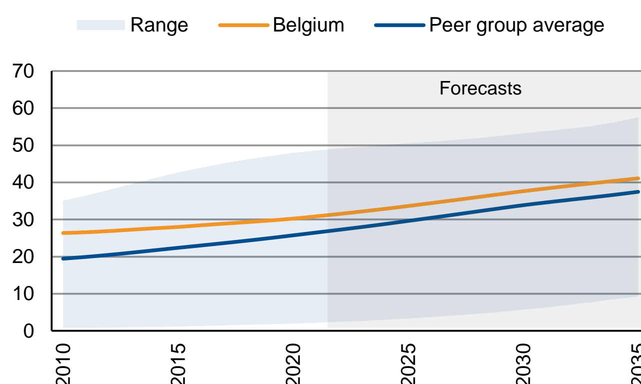
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Environmental factors	Neutral	0	High reliance on fossil fuel imports, slow progress towards climate neutrality objectives, meaningful transition risks
	Social factors	Neutral	0	Strong social safety nets; skills mismatches and persistent regional inequalities are challenges; weak demographic trends
	Governance factors	Weak	-1/3	Political fragmentation and polarisation constrain effective policy-making; fragile government coalition poses risks of another political stalemate

CO_2 emissions per GDP, $mtCO_2e$



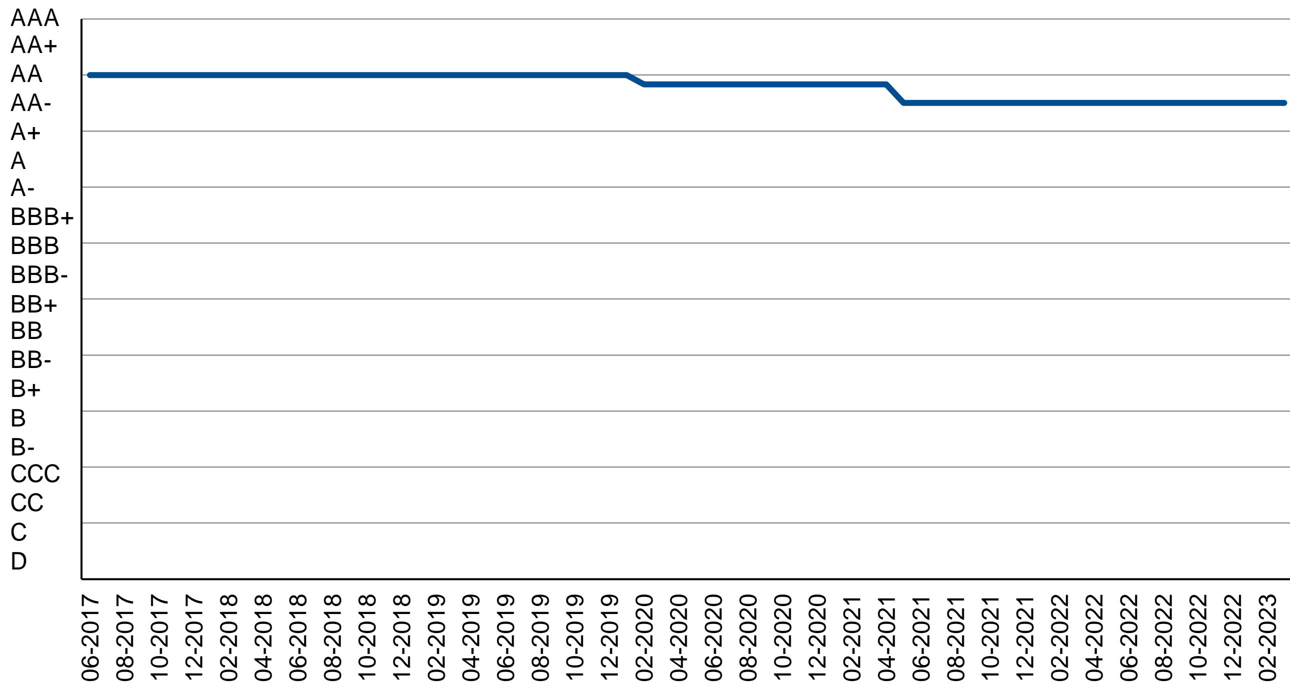
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or adjacent categories, with Scope's core variable scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Austria
Czech Republic
Estonia
France
Japan
Lithuania
Malta
Slovenia
United Kingdom
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 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the core variable scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021	2022
Domestic economic	GDP per capita, USD '000s	IMF	44.3	47.7	46.7	45.2	51.8	50.6
	Nominal GDP, USD bn	IMF	502.6	543.6	535.4	521.3	599.1	589.5
	Real growth, %	IMF	1.6	1.8	2.1	-5.7	6.2	2.4
	CPI inflation, %	IMF	2.2	2.3	1.2	0.4	3.2	9.5
	Unemployment rate, %	WB	7.1	6.0	5.4	5.6	6.4	-
Public finance	Public debt, % of GDP	IMF	102.0	99.8	97.7	112.8	108.4	103.9
	Interest payment, % of revenue	IMF	4.0	3.6	3.4	3.4	2.9	2.2
	Primary balance, % of GDP	IMF	1.4	1.0	-0.2	-7.4	-4.1	-3.6
External economic	Current account balance, % of GDP	IMF	0.7	-0.8	0.2	0.8	-0.4	-2.2
	Total reserves, months of imports	IMF	0.7	0.6	0.7	0.9	0.9	-
	NIIP, % of GDP	IMF	59.5	33.2	41.1	50.6	57.3	-
Financial stability	NPL ratio, % of total loans	IMF	3.0	2.3	2.1	2.1	2.0	-
	Tier 1 ratio, % of risk-weighted assets	IMF	16.1	16.4	16.0	16.5	18.1	18.4
	Credit to private sector, % of GDP	WB	65.1	68.1	69.8	75.3	-	-
ESG	CO_2 per EUR 1,000 of GDP, mtCO_2e	EC	174.5	172.6	168.1	161.2	160.4	-
	Income share of bottom 50%, %	WID	21.2	20.4	20.4	20.4	20.4	-
	Labour-force participation rate, %	WB	68.1	68.6	69.1	-	-	-
	Old-age dependency ratio, %	UN	28.8	29.2	29.7	30.0	30.4	31.0
	Composite governance indicators*	WB	1.2	1.2	1.2	1.2	1.2	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 3 March 2023	20.5

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