# Kingdom of Belgium
## Rating Report

AA- STABLE OUTLOOK

| Credit strengths | Credit challenges |
|---|---|
| • Wealthy and diversified economy<br>• Favourable debt profile and strong market access<br>• Strong external position | • High public debt levels<br>• Fiscal pressures due to ageing population<br>• 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 partially mitigate risks stemming from high public debt levels and rising funding costs.

**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 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% | aaa | EUR [+1] | -1/3 | AA- |
| Public Finance Risk | | 20% | bbb- | | 0 | |
| External Economic Risk | | 10% | a | | +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 Ratings' 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 | Negative rating-change drivers |
|---|---|
| • Public debt is placed on a firm downward trajectory<br>• Economic growth outlook improves over the medium-term | • Fiscal outlook deteriorates resulting in further increase in public debt<br>• Economic growth outlook weakens over the medium-term<br>• Political instability constrains effective policymaking |

### 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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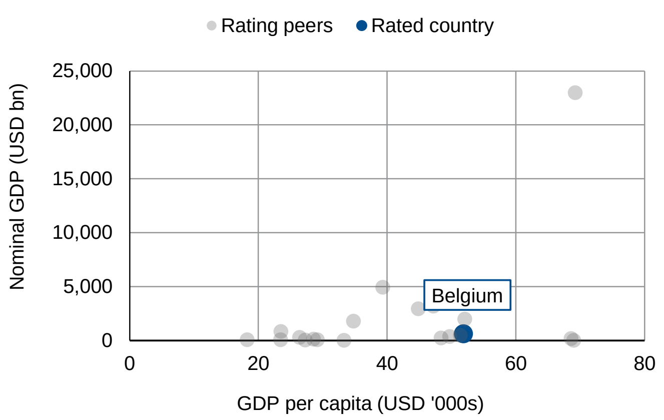
## Domestic Economic Risks

- **Growth outlook:** After robust quarterly growth of 0.5% of GDP in 2022 Q1 driven by strong momentum in private demand, economic activity slowed in 2022 Q2 (+0.2% of GDP quarter-on-quarter), primarily due to a contraction in business investment. We expect growth to slow down further in the second half of the year, as high energy prices hit the private sector. At the same time, net exports should suffer from the combined impact of rising nominal energy imports and the deteriorating growth outlook in the euro area. The automatic indexation of wages to prices should alleviate the impact of inflation on household purchasing power, though consumption is still expected to weaken given falling consumer sentiment. 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. We expect annual growth to moderate to 2.2% in 2022 before gradually converging towards the medium-term potential of around 1.2% by 2025.
- **Inflation and monetary policy:** Inflation has risen sharply in recent months and reached 11.3% year-on-year in September 2022 (up 1.3pp from August). This acceleration was primarily driven by high energy and food prices, which contributed for nearly two-thirds of this increase. Core inflation has also increased markedly and stood at 6.2% in September (up 4.6pp from the same month last year). Headline inflation should remain elevated in H2 2022, before gradually subsiding.. While the automatic indexation of wages to prices raises the risk of a wage price spiral compared to its peers, we expect wage-price pressures to remain contained. The ECB's recent 75bps rate hike and end of its net asset purchase should help curb inflationary pressures.
- **Labour markets:** The unemployment rate is moderate, at 5.7% as of Q2 2022, slightly up from the previous quarter (+0.3pp). Domestic employment continues to grow steadily and now stands about 3% above its pre-pandemic levels. The employment rate remains weak compared to peers, however, at 71.4%, nearly 3pp below the euro area average. The job vacancy rate reached 5% in Q2 2022, one of the highest levels in the EU, reflecting low activity rates and growing skills mismatches challenges.

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

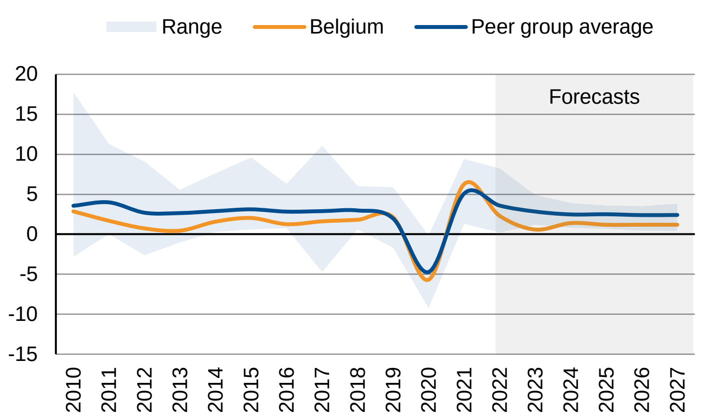
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Growth potential of the economy | Weak | -1/3 | Low and declining growth potential requires policy response |
| | Monetary policy framework | Neutral | 0 | ECB is a highly credible and effective central bank; 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




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

**Real GDP growth**, %




Source: IMF WEO, Scope Ratings forecasts

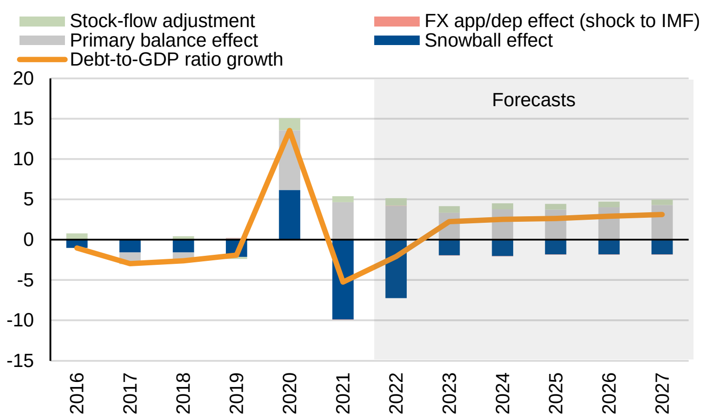
## Public Finance Risks

- **Fiscal outlook:** After a sharp improvement in the general government balance in 2021, to 5.5% of GDP (-3.6pp from the previous year), the fiscal outlook has worsened materially because of the conflict in Ukraine. The sharp rise in inflation is leading to significant upwards pressures on spending, primarily via social and personnel expenditures, while the weakening of growth weighs on revenue. Some temporary measures aimed at supporting the private sector during the crisis have been made permanent, including lower VAT rates for electricity and fuel prices, and will durably weaken the fiscal balance. We thus expect the headline deficit to remain elevated, at 5.0% of GDP in 2022 and to decline only moderately in 2023, to about 4.8%, before trending upwards in subsequent years. This medium-term increase of the budget deficit reflects Belgium's significant structural challenges, which will hinder the fiscal consolidation process, primarily related to the country's adverse demographics, which are expected to push pension and healthcare expenditures to 20.9% of GDP by 2050.
- **Debt trajectory:** After declining to 108.2% of GDP in 2021 (-4.6pps of GDP from 2020) on the back of a robust post-pandemic economic rebound, we expect the debt-to-GDP ratio to moderate further this year, to 105.7%. It should increase again from 2023, however, and trend upwards to around 119% by 2027 due to the combined effect of sustained primary deficits, rising debt servicing costs and modest nominal growth.
- **Debt profile and market access:** Belgium benefits from a favourable debt structure with long public maturities (average maturity of 10.4 years as of August 2022) and a stable investor base. The foreign currency share of debt is at 0% after accounting for swaps. Like peers, financing costs have increased in recent months in line with tightening monetary policies, with yields on benchmark 10-year government bonds rising to 2.4% on average in September 2022 (up from 0% in September 2021). As of September 2022, the Belgian Debt Agency had achieved 80% of its funding target for the year after raising a total of EUR 35.6bn.

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

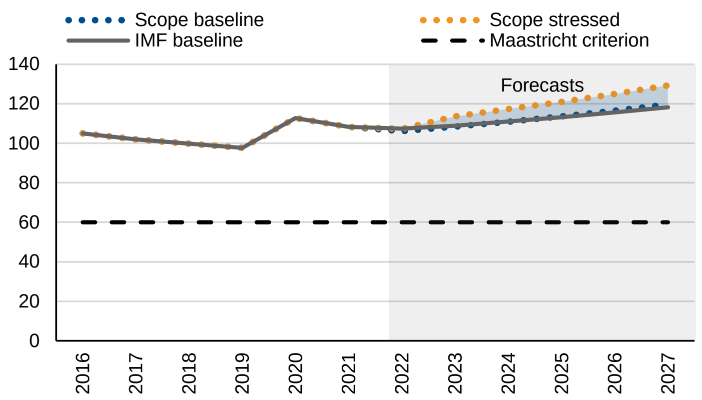
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| bbb- | Fiscal policy framework | Neutral | 0 | Long-term fiscal pressures due to ageing population; imperfect fiscal policy coordination across different government levels |
| | Debt sustainability | 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**, pps of GDP




Source: Scope Ratings forecasts

**Debt-to-GDP forecasts**, % of GDP




Source: IMF WEO, Scope Ratings forecasts

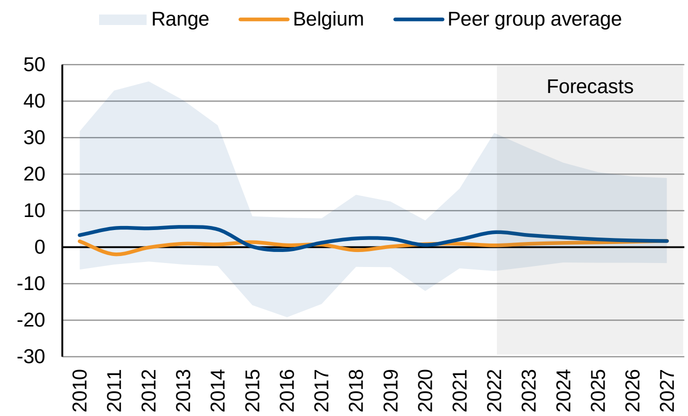
## External Economic Risks

- **Current account:** After a period of small surpluses, averaging at about 0.5% of GDP over 2015-20, Belgium experienced a current account deficit in 2021 of 0.4% of GDP. This deficit widened to 2.9% of GDP in the year to Q2 2022, as result of rising nominal imports, in a context of spiking energy prices and despite robust exports growth. Between January and July 2022, the cumulative trade deficit reached EUR 17.8bn (about 3.5% of GDP), versus a moderate surplus of EUR 0.6bn over the same period last year. Looking ahead, we expect the current account balance to remain negative due to high global energy prices and to the worsening economic outlook among Belgium's key euro area trade partners. The sharp acceleration of inflation and the resulting wage increases represents a material threat to Belgium's competitiveness, adding to the country's long-standing productivity challenges and potentially weighing on the country's current account balance in the long term.
- **External position:** Belgium's external position benefits from its large and increasing net creditor position, with a net international investment position amounting to about 52% of GDP as of Q2 2022, up 5pp from end-2020. Gross external debt is elevated, at about 249% of GDP, but has a stable and favourable composition, being mostly comprised public-sector liabilities and intercompany loans (around 54% of total), with a moderate share of short-term liabilities (27%). In addition, external liabilities related to the Belgian banking sector have declined materially since the Great Financial Crisis, from 63% to 23% of total outstanding external debt between 2007 and 2021.
- **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 Risks***

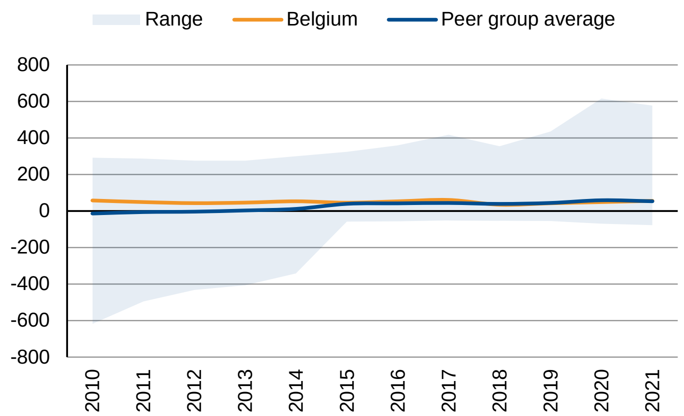
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| a | Current account resilience | Neutral | 0 | Moderate post-crisis current-account deficits reflecting competitiveness challenges; diversified export base |
| | External debt structure | 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

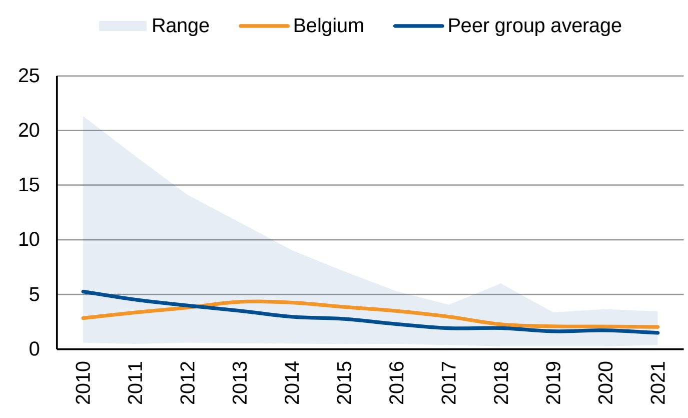
## Financial Stability Risks

- **Banking sector:** The resilience of the Belgian banking sector is underpinned by strong capitalisation and liquidity metrics, as measured by the aggregate Tier-1 (17.9% as of Q1 2022) and liquidity (25.2%) ratios. The aggregate non-performing loan ratio declined to 1.4% in Q1 2022, down from 2.0% in Q4 2019 despite the withdrawal of Covid-19 support measures, reflecting a steady improvement in asset quality. Vulnerabilities could arise from borrowers most impacted by the inflationary environment, however, with exposures to energy-intensive companies representing more than 15% of total banking loans to companies. Profitability, as measured by aggregate return-on-equity, declined to 7.0% in Q1 2022 (down 2pp from the previous quarter) but remains adequate 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 Q1 2022. The debt of non-financial corporates represents about 147% of GDP, having moderated somewhat from 2017 highs of above 170%, albeit remaining well above the euro area average. Risks related to elevated leverage are partially mitigated by the record high level of net financial wealth of Belgian households, which stood above EUR 1,500bn as of end-2021. Additionally, a high share of fixed rate mortgage loans (more than 70%) and regulatory caps on interest rate variability should limit the immediate impact of monetary policy tightening on household balance sheets.
- **Financial imbalances:** Elevated private debt levels and overvalued real estate assets prices represent key financial stability risks. The National Bank of Belgium (NBB) estimated that housing prices were overvalued by around 21% in 2021. 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. Looking ahead, we expect housing market dynamics to moderate, as a result of rising mortgage rates and of the weakening economic outlook. Risks of a sharp price correction are partially mitigated by high household wealth.

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

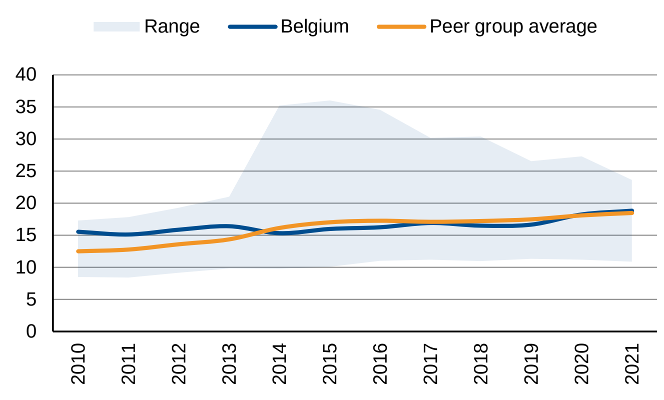
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Banking sector performance | Neutral | 0 | Strong capitalisation, asset quality and liquidity buffers; expected recovery in profitability from rising interest rates |
| | Banking 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**, % of total loans




Source: IMF, Scope Ratings

**Tier 1 ratio**, % of risk-weighted assets




Source: IMF, Scope Ratings

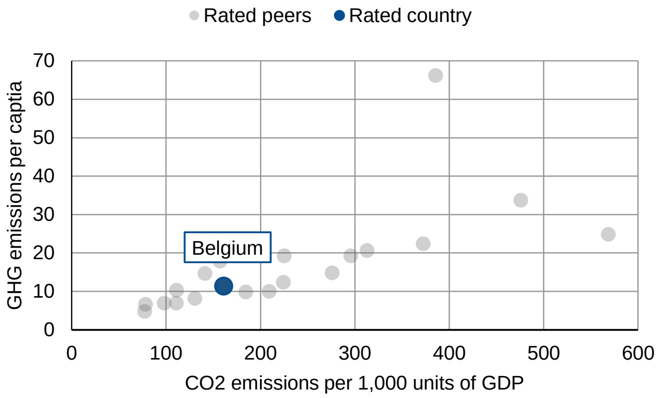
## ESG Risks

- **Environment:** With 11.4 million tons in 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 (36%) and natural gas (30%). The share of renewable energy in total energy supply doubled between 2010 and 2020, from 6% to 12%, 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 announced its intention to postpone their phase out to 2035. Nonetheless, the planned closure of the Doel 3 reactor was made effective in September 2022, further raising Belgium's energy imports dependency.
- **Social:** Labour force participation is markedly weaker than peers, at 70% as of 2022 Q2, 4.6pp below the EU 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 but 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 almost complete standstill, a new federal government coalition was formed in September 2020. Scope expects policy making in Belgium to remain constrained, ahead of the 2024 general elections and in view of 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***

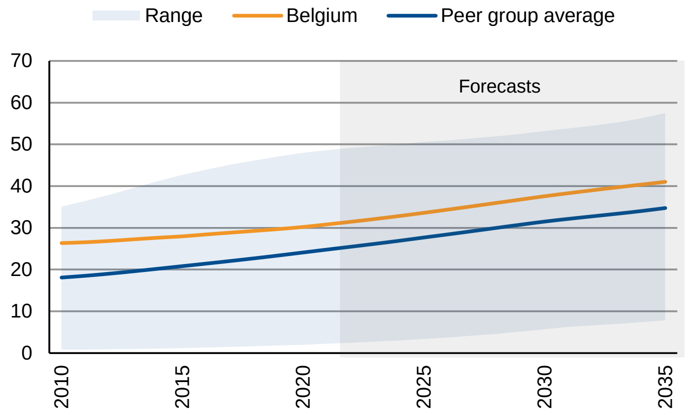
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| a | Environmental factors | Neutral | 0 | High reliance on fossil fuel imports, slow progress towards climate neutrality objectives, meaningful transition risks |
| | Social factors | 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 |

**Emissions per GDP and per capita**, $mtCO_2e$



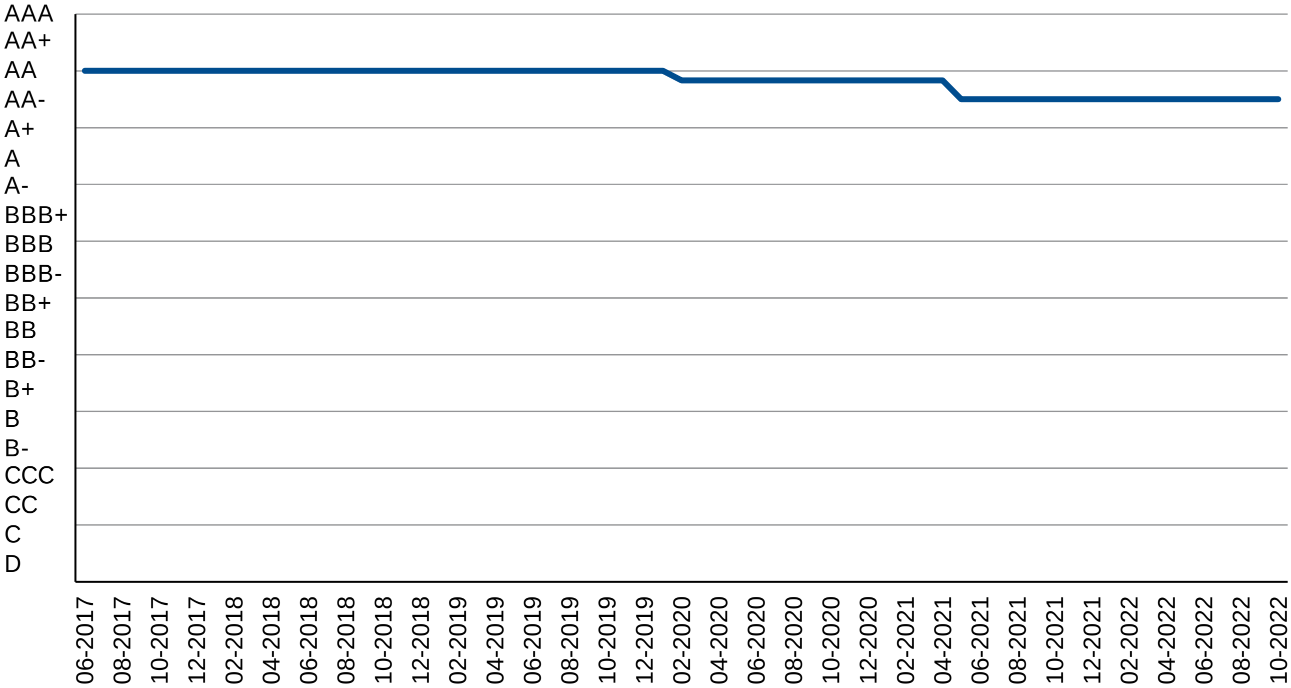

Source: European Commission, Scope Ratings

**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 in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

| Peer group* |
|---|
| Czech Republic |
| Estonia |
| France |
| Japan |
| Lithuania |
| Malta |
| Slovenia |

*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. The metrics and sources for the data presented here are in line with Scope's Sovereign Rating Methodology and may differ from national statistics.

| Pillar | Core variable | Source | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|
| Domestic Economic | GDP per capita, USD '000s | IMF | 44,274 | 47,683 | 46,733 | 45,255 | 51,875 |
| | Nominal GDP, USD bn | IMF | 502.6 | 543.5 | 535.3 | 521.4 | 600.0 |
| | Real growth, % | IMF | 1.6 | 1.8 | 2.1 | -5.7 | 6.3 |
| | CPI inflation, % | IMF | 2.2 | 2.3 | 1.2 | 0.4 | 3.2 |
| | Unemployment rate, % | WB | 7.1 | 6.0 | 5.4 | 5.6 | 6.4 |
| Public Finance | Public debt, % of GDP | IMF | 102.0 | 99.9 | 97.7 | 112.8 | 108.3 |
| | Interest payment, % of revenue | IMF | 4.0 | 3.6 | 3.4 | 3.4 | 2.8 |
| | Primary balance, % of GDP | IMF | 1.4 | 1.0 | -0.2 | -7.4 | -4.7 |
| External Economic | Current account balance, % of GDP | IMF | 0.7 | -0.8 | 0.2 | 0.8 | 0.9 |
| | Total reserves, months of imports | IMF | 0.7 | 0.6 | 0.7 | 0.8 | 0.9 |
| | NIIP, % of GDP | IMF | 59.5 | 33.3 | 41.3 | 47.8 | 54.6 |
| Financial Stability | NPL ratio, % of total loans | IMF | 3.0 | 2.3 | 2.1 | 2.1 | 2.0 |
| | Tier 1 ratio, % of RWA | IMF | 16.1 | 16.4 | 16.0 | 16.5 | 18.1 |
| | Credit to private sector, % of GDP | WB | 65.1 | 68.1 | 69.9 | 75.8 | - |
| ESG | $CO_2$ per EUR 1,000 of GDP, $mtCO_2e$ | EC | 174.3 | 172.6 | 167.1 | 150.9 | - |
| | 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 | 28.9 | 29.3 | 29.7 | 30.2 | 30.8 |
| | Composite governance indicators* | WB | 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 11/10/2022 | 24.8 |

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