Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information		
KINGDOM OF BELGIUM	Assigned Ratings/Outlook: **AA /negative**		Type: Monitoring, Unsolicited
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	30-09-2016 18-06-2021 “Sovereign Ratings” “Rating Criteria and Definitions”	

Rating Action

Neuss, 18 June 2021

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of “AA” for the Kingdom of Belgium. Creditreform Rating has also affirmed Belgium’s unsolicited ratings for foreign and local currency senior unsecured long-term debt of “AA”. The outlook is negative.

Contents

Key Rating Drivers

1. Strong macroeconomic performance profile featuring high income per capita and a high level of productivity; long-running streak of stable GDP growth prior to the outbreak of Covid-19, paired with low unemployment; elevated and further rising private debt and low productivity growth remain factors weighing on the medium-term growth outlook, while well-targeted implementation of reforms as envisaged in the Recovery and Resilience Plan (RRP) should help to foster productivity growth
2. Scope of the pandemic-induced recession comparable to that of the euro area as a whole, although the labor market has proved somewhat more robust so far; while support measures seem to have been effective in maintaining employment, developments will have to be monitored once aid measures are withdrawn; although still subject to unusually high uncertainty, we expect a strong economic recovery in 2021/22
3. Very strong institutional framework buttressed by deep and fruitful EU/EMU integration; while formation of a new government in the past fall should be conducive to implementing the state’s reform agenda, some concern over government stability and effective decision-making remains, given obvious challenges to cohesive policy-making of a 7-party coalition and the multiple and moderately-coordinated layers of government
4. Already elevated public debt ratio surged to high levels on which it is likely to plateau in the medium term; while fiscal pressure stemming from aging-related costs remains in place, and the net effect of the envisaged pension reform is unclear, fiscal risks are balanced to some degree by sound debt management and strengthening debt affordability; we assess announced medium-term fiscal consolidation strategy as positive
5. External risks appear limited in light of Belgium’s highly positive net international investment position (NIIP) and a current account hovering close to a balanced position over recent years; current account should continue to show a moderate deficit in the near term

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Belgium's strong macroeconomic performance profile is buttressed by a comparatively high per-capita income, a high level of productivity, and a long-running streak of stable economic growth along with low unemployment before the onset of the corona crisis. Starting from a favorable position and backed by effective support measures, the Belgian labor market has so far proved comparatively robust in this crisis. Elevated and further rising private sector indebtedness and low labor participation may constrain the medium-term growth outlook to some extent and balance these strengths somewhat, as do subdued real labor productivity growth and some room to improve in terms of its business environment.

Following an average annual real GDP growth rate of 1.7% in 2015-19, slightly behind the average growth rate recorded for the euro area (EA: 1.9%), the Covid-19 pandemic caused the steepest fall in Belgium's economic output since the Second World War last year. Still, the 6.3% GDP decline was markedly smaller than we had estimated in last year's review, and was broadly on par with the GDP decline witnessed in the euro area as a whole (-6.5%). Mirroring the typical pattern in this crisis, private consumption led the contraction, falling by 8.7% and taking 4.5 p.p. off GDP growth. Gross fixed capital formation (GFCF) posted a similarly strong and broad-based decline (-6.9%), contributing a negative 1.7 p.p., also as construction virtually came to a standstill during the first lockdown. Net exports posed a drag as well, erasing a further 0.3 p.p. from the final growth outturn. While the severe recession caused Belgium's GDP per capita to shrink to USD 51,096 in 2020 (PPP terms, IMF, 2019: USD 54,265), the economy continues to boast a significantly higher per-capita income than most of its AA-peers in our rating universe (2020 median: USD 46,062).

Given that Belgium is a very open economy, illustrated by one of the highest trade-to-GDP ratios in the EU (2020: 160.7%), and as such particularly vulnerable to global economic shocks, the 2020 downturn in exports turned out relatively mild (4.6%, EA: -9.3%, Eurostat), with regard to both goods exports and services exports. Notwithstanding a higher concentration on services than the euro area overall, Belgium's economy is ultimately well diversified, which has acted as a stabilizing factor in this crisis. Services in the category 'other business services' account for the largest part of service exports (2020: 37.7%, BoP data), and have posted a smaller decline than services exports overall (-5.3% vs. -6.6%). Moreover, ICT services exports rose by 1.9%, contrasting with the 8.1% decline in the important transport sector (share of 20.2%). The drop in goods exports, meanwhile, was softened by the increase in exports of chemical products, accounting for close to a third of goods exports (2020: 29.0%) and rising by 5.2% y-o-y.

Although the economy had to battle a third wave of coronavirus infections and deal with a temporary sharp lockdown, GDP in the first quarter of 2021 expanded against the preceding quarter, coming in stronger than in the euro area economy, which recorded a drop. From an initially reported 0.6%, the q-o-q rate was revised up to 1.0% (EA: -0.3%). The expansion was backed by rebounding domestic demand, with some positive distorting effects on investment linked to

[1] This rating update takes into account information available until 14 June 2021.

ship transactions. With that, real GDP was still 3.9% below its level in Q4-19, comparing favorably against the euro area (Q1-21 vs. Q4-19: -5.1%).

Thus far, sentiment indicators point to continued positive growth in Q2-21. Overall business confidence improved for a sixth consecutive month in May, reaching its highest level since March 2011. Business sentiment in the manufacturing sector has been well above pre-crisis levels for some time now, climbing further in May. Consumer confidence has been recovering as well, displaying a leap in May amid the lifting of some restrictions. From 8 May, schools and non-essential shops were allowed to open, and bars and restaurants were able to offer outdoor service. From 9 June, indoor service was able to resume, along with some relaxation regarding sports and cultural events.

Against the backdrop of a lower number of infection cases (14-day cumulative rate of 182 as of week 22) and well-advancing immunization against Covid-19, the stage is thus set for yet more vivid economic activity in the second half of the year, as 62.1% of the population have received a first dose as of week 24, and 34.4% have been fully vaccinated (EU: 53.8% and 29.7%, respectively). The recovery will likely be driven by a release of pent-up domestic and foreign demand, corroborated by accommodative monetary policy which contributes to ongoing benign funding conditions. That said, judging by a recent survey presented by the Economic Risk Management Group (ERMG) on 1 June, supply shortages both with regard to filling vacancies in some areas and regarding inputs such as commodities or intermediate goods, may become more of an issue, driving up input costs and leading to wage pressure in some areas. Supply constraints are perceived particularly in wholesale trade, but also in construction and industry, with shortages in supply and transport being given as the dominating factors behind this.

Apart from plenty of forced savings at their disposal, household spending should be supported by the relatively benign labor market development in this pandemic, on the back of the temporary employment scheme and the replacement income for the self-employed, which prevented worse and which were extended to the end of June. In the second half of 2020, the monthly minimum wage level was lifted by 2.0%. Given surfacing labor shortages, wages may start to see more pronounced increases in some industries where vacancies are difficult to fill.

The Belgian labor market was in a strong position when the crisis hit, and the unemployment rate increased by a mere 0.2 p.p. to 5.6% in 2020, remaining significantly below the euro area level (2020: 7.8%, LSF-adj., Eurostat), and well below the average rate over the five years prior to the outbreak of coronavirus (2015-19: 7.0%). The monthly average dropped from an intermediate high at 6.5% in Aug-20 to 5.3% in Apr-21. Employment developments also proved more resilient than in the euro area, virtually stagnating in 2020 (EA: -1.6%, national accounts, domestic concept), as the Covid-19 shock was largely absorbed via the number of hours worked which dropped by 5.7% last year. Employment started to rise again in the second half of last year, and, contrary to the euro area, continued to do so in Q1-21 (0.1% q-o-q, EA: -0.3%).

While the effective use of the temporary unemployment scheme is well below the peak seen in the first infection wave (Mar-21: 11% of private salaried employment, Apr-20: 36%, ERMG), it remains elevated as measured against the highest level recorded during the global financial crisis. We still see some risks that, if fiscal support is phased out, the number of bankruptcies may experience a steeper rise with negative consequences for the labor market, although the insolvency law was adapted in March 2021 to simplify and flexibilize procedures in order to smooth the transition when moratoria expire at the end of June 2021.

Thanks to government support, the number of bankruptcies in 2020 was considerably below the 2019 level, and about 30% below the 10-year average (2020: 7,203, avg. 2010-19: 10,223, Statbel). However, monthly figures showed a yearly increase by roughly 56% in Apr-21. Concurrently, we observe that the use of moratoria had receded to 2.1 % for companies and 0.4 % for mortgage borrowers by the end of April 2021, from 13% of outstanding business loans and 6% of outstanding mortgage loans at the end of September 2020, according to NBB.

Gross fixed capital formation, which continued its recovery starting from Q3-20 and which exceeded its pre-pandemic level by 0.3% in this year's first quarter, should benefit from favorable financing conditions, the ongoing global recovery, as well as from prospective impulses from the EU's Recovery and Resilience Facility (RRF). Grants via this instrument will amount to EUR 5.925bn, or about 1.3% of 2020 GDP. As Belgium trails the euro area as a whole as regards public investment, this may represent a unique chance to narrow the gap and improve prospects for higher productivity growth and, ultimately, higher potential growth. The gradual reduction of the country's nominal corporate income tax rate from 33% to 25% in 2017-20 should be supportive as well. However, bearing in mind some supply bottlenecks, it seems conceivable that some investment plans may have to be delayed somewhat.

Against the backdrop of the accelerating international economic recovery as palpable progress in the vaccination campaign, prospects for Belgian exports are brightening up, possibly leading to a small positive contribution of net trade to GDP growth this year. Beyond this year, this contribution should turn negative, as the recovery in domestic demand is likely to result in a marked rise in imports.

For 2021 as a whole, we expect real GDP to expand by 5.3% before moderating to 3.4% in 2022. Near-term risks remain linked to the evolution of virus mutations and, associated with this, the effectiveness of the vaccination campaign. As suggested above, some supply constraints related to labor and production factors may have to be mentioned here as well.

Belgium's competitiveness seems to have held up reasonably well more recently, judging by its slightly increasing global export market share, which stood at 1.88% in 2020 (2019: 1.77%), corresponding to its highest reading since 2011. The improvement was largely driven by the services side. As pointed out above, Belgium continues to display a high level of nominal labor productivity per hour worked, exceeding that of the EU-27 by 33.2% (2019, Eurostat), although we observe that this difference has decreased over the last few years.

Growth of real labor productivity has been weaker than that of the euro area in the recent past, although the picture is more mixed when comparing Belgium with its main European trading partners in this respect. As illustrated by AMECO data, lower real compensation per employee, as compared to the euro area overall, seems to have made up for shortcomings in terms of productivity growth. Overall, real unit labor costs grew somewhat more vividly than in the euro area in 2020 (+3.5% vs. +2.6%), but saw a more favorable development over a longer-term horizon (0.0% vs. 1.9% in 2011-20).

Recalling the latest available World Bank's Doing Business ranking for 2019, at rank 46 out of 190 economies Belgium's performance is perceived as weaker than that of its AA-rated peers in our rating universe, suggesting there is some room to step up non-price competitiveness.

Looking beyond the short term, we continue to flag some factors posing constraints to Belgium's medium-term outlook. Elevated and further rising indebtedness of the private sector harbors limited risk-bearing capacities, although we acknowledge likely distortions with regard to NFC debt due to strong MNE presence and associated inter-group lending, which complicates the interpretation of available data somewhat. NFC debt stood at 135.4% of GDP in Q4-20, up by 15.4 p.p. against Q4-19. Household debt to disposable income, already at a relatively high level prior to the pandemic amid a firm upward trend since 2002, had climbed to 107.5% by Q4-20 (Q4-19: 106.1%). However, the very high net financial wealth of Belgian households (254.2% of GDP in 2020) may serve a risk buffer.

Low labor participation, at 68.6% of the total population one of the lowest in the euro area (2020, EA: 73.0%) poses some downside risks to underlying growth. While potential growth has been estimated to hover above euro area levels for most of the time since euro inception, it is projected to broadly match the euro area level in 2021 and 2022 (1.1% and 1.4%, EA: 1.0% and 1.4%, AMECO). Notwithstanding, the government is committed to increase activity and employment rate, setting the ambitious goal of reaching an employment rate of 80% by 2030, essentially focusing on a better inclusion of older workers. To this end, policy-makers plan to incentivize a longer work life via the envisaged pension reform (see below).

Furthermore, Belgium's job vacancy rate was one of the highest in the EU already before the corona crisis, hinting at persistent matching challenges. This year's first quarter saw the highest share of vacancies in the ICT sector (7.1%), followed by scientific activities & administrative services (5.6%), and construction (5.5%). A further declared goal of the government is to reduce the tax burden on labor. Despite having declined markedly since 2015, Belgium still displayed the highest tax wedge regarding single workers in the OECD in 2020, posting at 51.5% (2019: 52.3%, OECD average: 34.6%).

Medium-term growth prospects also seem dampened somewhat by comparatively low public investment, which in Belgium averaged 2.5% of GDP in 2011-20, thus moving below the average in the euro area (2.8%). However, the government aims to step up investment decisively, planning for GFCF to the tune of 3.0% and 2.8% of GDP in 2021/22, whilst targeting 4% for 2030, not least in an effort to increase productivity growth. According to the government's National Recovery and Resilience Plan (NRRP), roughly 88% is envisaged to be directed towards enhancing the economy's capital stock. Taking into account the public expenditure financed by RRF grants, Belgium's Federal Planning Bureau reckons that the average annual effect of the NRRP on real GDP could be around 0.14% in 2021-26, with the largest boost likely to occur next year. However, bearing in mind Belgium's status as a very open economy, positive spillover effects from a similar impetus in fellow EU member states could add to that, as could planned reforms and investment by the federal government and the Belgian regions.

Institutional Structure

We continue to view the sovereign's very strong institutional framework as a credit strength. This assessment is corroborated by the extensive advantages the small open economy can draw from its deep integration in the euro area and the EU, which also entails the international role of the capital as host to the headquarters of major EU institutions as well as NATO. Acknowledging effective action to manage the most acute phase of the corona crisis and its economic and health consequences, we consider the complex political governance structure with its potential to prolong government formation, complicate decision-making, and hamper reform efforts, as a factor persistently weighing on our otherwise favorable assessment of the sovereign's institutional quality. With diverging interests to *take into account, government stability may again prove challenging, raising some concern over efficient policymaking as regards having to deal with the aftermath of the crisis, and in view of significant reform ambitions as laid out in the NRRP.*

The latest vintage of the World Bank's Worldwide Governance Indicators (WGIs), concerning the year 2019, confirms the mostly very positive impression of Belgium's institutional set-up with a view to the WGIs to which we pay special attention. The indicators pertaining to rule of law (BE: rank 25 out of 209 economies, AA rating peers: 23, EA: 33) and control of corruption (rank 19/209, AA: 20, EA: 42) move largely in line with the median of our AA-rated sovereigns, and well above the euro area level. In terms of voice and accountability, Belgium is even perceived to perform markedly better than the AA-median (rank 10/209, AA: 20, EA: 26). Mirroring the complex government structure and the related challenges that come with it, perception of the quality of policy formulation and implementation has deteriorated further. With regard to the WGI government effectiveness, the sovereign now occupies rank 41, down from relative rank 35 and constituting the worst assessment since inception of the WGIs in 1996. We note that the government envisages a state reform that is to take effect in 2024, aiming at more autonomy for the regions.

Whilst echoing good performance with regard to the extent to which agents have confidence in and abide by the rules of society, the European Commission's (EC) 2020 Rule of Law report also mentions a few shortcomings in Belgium's judiciary, e.g. shortages in human and financial resources, and a lack of consistent data on the efficiency of the system. Despite acknowledging some progress e.g. regarding recruitment and training of substitute judges, as well as concerning corruption prevention with regard to members of parliament, the latest GRECO report, published in May 2021, highlights substantial room to improve with regard to its recommendations.

Following several failed attempts to form a new government, the so-called Vivaldi coalition consisting of seven parties including liberals, greens, Socialists of both large language groups, as well as the Flemish Christian democrats led by the incoming PM Flemish Liberal Alexander de Croo and holding 88 of the 150-seat House of Representatives, finally took office from 1 October 2020. The last election took place on 26 May 2019, following the collapse of the former government on 9 December 2018, highlighting the above-mentioned challenges.

Besides further propping-up of the health sector, the government agreement presented on 30 September 2020 contains further economic stimulus, an intended tax reform which also includes digital taxation, as well as an envisaged pension reform. In November 2020, the government adopted a multi-annual plan to gradually increase minimum social security and social assistance benefits towards the at-risk-of-poverty-threshold, to take place each January over a 4-year period starting from 2021. With regard to the intended broad tax reform spanning taxation of labor, property, and consumption, we gather that at the beginning of June 2021 a broad-based dialogue also involving social partners, interest groups and citizens was launched, highlighting the consensus-orientated approach of Belgian policy-making.

As per the NRRP, the remodeling of the economy towards an environmentally more sustainable path, while enhancing social inclusion and achieving a higher degree of digitalization, will be structured along five major strings, namely: (i) climate, sustainability and innovation, (ii) digital transformation, (iii) mobility, (iv) social inclusion and community, (v) economy of the future and productivity. While EUR 3.4bn is to be directed to sustainable projects, EUR 1.85bn is earmarked for projects concerning digitalization. More than EUR 1bn is to go towards increasing the energy efficiency of public buildings and social housing. Investing in new energy technologies includes

EUR 450mn for an offshore energy island in the North Sea by 2025. Enhancing green mobility is to be a further cornerstone, with EUR 1.3bn dedicated to pedestrian and bicycle ways, greener and more efficient bus, metro, and tram infrastructure, and to drive forward electrification of road transport including provision of charging infrastructure. One important focus of investment concerning the digital transformation will be modernization of public services, but also 5G-technology and cybersecurity.

Turning to environmental issues, we observe that Belgium as of 2019 was among those EU countries emitting a high volume of greenhouse gas (GHG) emissions per capita, at 10.6 tons (EU-27: 8.4). Regarding the EC's eco-innovation index, the sovereign moves below the EU average, occupying the 16th position among the 27 EU members, based on an index score of 85, having inched up from 82 in 2016. The overall share of energy from renewable sources has gone up from 8.8% to 9.9% between 2016 and 2019, corresponding to less than half the share observed for the EU-27 in 2019 (19.7%), with the proportion of renewables in electricity as well as in heating/cooling comparing rather low in particular. The authorities have issued the target of reducing GHG emissions by 55% compared to 1990 levels by 2030 and to reach carbon neutrality by 2050. A commitment to phase out nuclear power by 2025 remains in place.

Fiscal Sustainability

The Covid-19 pandemic has reversed developments with regard to the elevated - although gradually shrinking – public debt ratio we observed before the outbreak of the pandemic, thus aggravating our concerns pertaining to fiscal sustainability weighing on our credit assessment. Repeated fiscal slippages in the past add to such concerns, although we consider the recent formation of a government coalition and presentation of a medium-term consolidation path as part of the Stability Program as credit positive. Fiscal risks are mitigated by high and increasing debt affordability in view of low financing costs, and a very favorable debt profile as a result of sound debt management.

Having to provide substantial support to cushion the fallout from this crisis, along with the sharp temporary contraction in economic activity, put a halt to gradually improving public finance metrics as seen over the last few years. The pandemic caused Belgium's general government deficit to surge to 9.4% of GDP last year (2019: -1.9% of GDP), more pronounced than in the euro area as a whole (-7.2% of GDP), but ultimately lower than envisaged in October's DBP21 (10.7% of GDP). Of this deficit, the federal level accounted for 7.2 p.p., while communities and regions shouldered 2.4 p.p.

The drastic increase in the negative general government balance was mainly driven by soaring spending (+9.1%), while the 4.5% decline in total revenues was comparatively tame, buffered by only mildly shrinking net social benefits (-1.2%) and income tax revenue (-4.2%), as the labor market proved rather robust given the severity of the recession, and as employment support schemes seemed effective. Taxes on production and imports decreased to a larger extent (-6.2%). With total government revenue falling less than GDP, the respective ratio thus rose by 0.4 p.p. to 50.6% of GDP compared to 2019.

The Belgian authorities on all levels stepped up to provide fiscal support with a budgetary effect of about EUR 17.5bn in 2020 (3.9% of GDP, Debt Agency), with the largest portion (EUR 9.1bn) directed to the support of families, mainly temporary unemployment benefits, and bridging support to the self-employed. Support to enterprises totaled 7.4bn, while 5.8bn was put towards managing the health crisis. The federal government provided two guarantee schemes for credit lines and new loans from banks to businesses, with the first scheme covering loans granted between March and December 2020, having been extended beyond October 2020 as initially intended. The second scheme was implemented in June 2020, and ultimately extended beyond the end of last year, to end of June 2021.

For the year 2021, authorities envisaged further corona-related measures with a direct impact of about EUR 13bn (2.7% of our estimated 2021 GDP). However, some measures including temporary unemployment and the bridging right for the self-employed, were extended in May to the end of September 2021, thus adding to the budgetary impact. More permanent measures would include wage increases for workers in the health care sector, additional spending on education, and the envisaged increase in the minimum pension (DBP21). In its coalition agreement of 30 September, the government also aims at a comprehensive tax reform, including simplification of the personal income tax system and reducing the burden on labor. In order to pursue its social, security and competitiveness agenda, the government envisages structural measures in the amount of EUR 3.2bn by 2024. Steps have already been taken to bring relief to families by extending the tax reduction for childcare and introducing a tax-free allowance supplement for dependent persons. Against this backdrop, we expect the headline deficit to rise to about 7.0% of GDP this year. Amidst phasing-out of supportive measures and ongoing, although normalizing, economic growth, we assume the deficit to narrow to about 4.5% of GDP in 2022.

With regard to the medium term, the government expects net borrowing to fall to a still elevated -3.7% of GDP by 2024 (SP21). Against this background, we have to emphasize that the government announced a medium-term fiscal consolidation plan. As presented in the majority agreement, the underlying medium-term term projection takes into account a fixed budgetary effort of 0.2% of GDP per year between 2021 and 2024. Moreover, a variable effort dependent on the economic performance is introduced, with its scope to be determined each year with the draft budget. For 2021, this effort will be zero, overturning the initially envisaged 0.2% of GDP in the original budget over doubts that the Belgian economy would not sufficiently recover this year. We view the government’s ambition and concrete proposals as a positive factor. Still, we would still flag some caution in view of ongoing uncertainty related to the variable effort, also illustrated by changing the initially suggested scope of it for 2021.

At 98.1% of GDP, the sovereign’s debt-to-GDP ratio was already rather elevated in the year prior to the outbreak of corona, representing the second-highest among our AA-rated sovereigns. In light of the high deficit and decreasing economic output, Belgium’ general government debt rose to 114.1% of GDP in 2020. In light of another estimated high deficit this year, we expect the public debt ratio to edge down to 113.7% of GDP and remain close to that level in the following year (113.8% of GDP).

EU funding sources such as RRF or SURE (EUR 7.8bn, Debt Agency) should help to alleviate some of the fiscal pressure. Apart from that, benign financial market conditions which we expect to remain in place for the time being, thanks to continued accommodative monetary policy, also constitute a mitigating factor to existing fiscal risks. The Eurosystem’s cumulative asset purchases under the PSPP and the PEPP have totaled EUR 89.7bn and EUR 36.1bn as of May 2021. Overall, the official sector (including foreign official) held 30% of Belgian government debt as of Q3-20 (IMF data).

Interest expenses have fallen by another 5.5% in 2020 (2019: -4.3%), leaving the interest-to-GDP ratio stable at 2.0% (3.9% of total revenue). Moreover, the Belgian Debt Agency plans to extend the already high minimum average life of the debt portfolio (2020: 9.0y) by a further 0.25y in

2021. According to monthly ECB data, at 10.77y Belgium featured the second-highest average weighted maturity of its debt portfolio among the EU countries after Austria as of Apr-21, thus suggesting low refinancing risks, despite the elevated debt level.

Further out, we expect fiscal pressure from age-related costs to mount. Drawing on updated data from the Aging Report 2021, age-related expenditure totaled 25.6% of GDP in 2019, which represents one of the highest ratios among the EU members and is projected to rise by 2.0 p.p. by 2030 (EU: 1.4 p.p.), mainly driven by pension spending. The overall impact of the planned pension reform, which is to lift the minimum pension but tries to incentivize a longer work life, appears uncertain at this stage. We will follow developments closely.

As opposed to the onset of the global financial crisis, Belgium's banking sector was in a much stronger position when the current health crisis struck. In terms of size, the sector moves in the middle ranks among the EU countries, boasting relatively comfortable capitalization levels and a high asset quality. While the CET-1 ratio increased by 1.5 p.p. to 18.1% in the year up to Q4-20, which is well above the EU average (15.9%, EBA), the NPL ratio remained stable at 2.0% when comparing Q4-20 with Q4-19, also more favorable than the EU average (2.6%, EBA). The release of the countercyclical capital buffer, which before the outbreak of coronavirus had been activated, provided about EUR 2bn in capital to the banking sector. Reactivation is not envisaged before 2022.

This being said, we monitor developments regarding stage 2 loans, whose share has climbed to 11.4% of total loans and advances in Q4-20 (EU: 9.1%). Moreover, in combination with already high household debt levels, a stronger rising number of insolvencies - and thus higher unemployment - could have negative consequences for servicing household debt. After displaying double-digit percentage changes over 2020, mortgage lending stood at a still dynamic 8.6% y-o-y in Mar-21. Credit growth to households overall moderated to 7.7% in Mar-21 (11.1% in Mar-20). House prices, which in Q1-20 had been dented, likely in connection with the removal of mortgage tax relief in the Flanders region, have resumed rising, with the annual growth rate accelerating from 4.8% in Q4-19 to 5.7% in Q4-20.

Further to contingent liabilities, public guarantees provided by the federal level amounted to 11.15% of GDP in 2020, of which 2.11 p.p. were in connection with the corona crisis. The estimated take-up stood at 6.73% as of 1 January 2021. Guarantees provided by Flanders and Wallonia added 1.84% of GDP to that.

Legacies from the global financial crisis remain visible in more or less pronounced stakes which the state holds in various financial institutions (BNP Paribas, Dexia, Belfius , Ethias), although in terms of guarantees at present only the guarantee scheme for Dexia is still active, with exposure having declined. Out of a EUR 43.7bn maximum state guarantee for Dexia (of an overall guarantee amounting to EUR 85bn), Belgium's exposure stood at EUR 25.56bn as of 7 June, down from EUR 31.12bn at the end of 2019. It is foreseen that this scheme will be replaced by a new guarantee scheme from 2022, with the stake Belgium holds falling to a maximum of EUR 39.75bn. We understand that the parliamentary process to adopt the respective law is currently under way.

Foreign Exposure

As a small and very open economy, the sovereign is potentially vulnerable to external shocks and the international environment. However, such risks appear limited in light of Belgium's highly positive NIIP *and a current account hovering close to a balanced position over recent years. To an extent, the current account balance is affected by - at times large - movement regarding the trade and primary income balances linked to the activity of MNEs. A large part of the increase in net external debt in 2020 can be attributed to intercompany lending.*

2020 saw Belgium's current account balance deteriorate somewhat, displaying a slight deficit of 0.2% of GDP (2019: +0.3% of GDP). Main drivers behind this development were a lower goods surplus (-0.5 p.p. to 0.2% of GDP), as exports experienced a stronger contraction than imports in light of Covid-19 crisis, and a larger negative secondary income balance (-0.3 p.p. to -1.8% of GDP), chiefly due to the EU budget contribution .

Contrary to the preceding two years, the service balance concluded the year 2020 in surplus, mainly on account of considerably reduced travel abroad, which to some degree offset the negative contributions from the goods and secondary income balance on the overall change in the current account position. Looking ahead, we would expect the current account deficit to remain close to that level, with net external trade turning negative whilst the primary and secondary balances should compensate this effect.

Despite some narrowing of the large and positive NIIP in 2020 (-5.7 p.p. to 44.9% of GDP), Belgium remains the largest net creditor among our AA-rated sovereigns and retains one of the largest positive NIIPs in the EU. Last year's decline occurred on the back of a shrinking net positive position regarding direct investment (-11.0 p.p. to 7.5% of GDP) and a net negative position in the 'other investment' category (-8.0 p.p. to -3.0% of GDP

Rating Outlook and Sensitivity

Our rating outlook on Belgium's long-term credit ratings is negative, as we perceive risks to fiscal sustainability dominating in a macroeconomic scenario still subject to a considerable degree of uncertainty, although perspectives of a more stable recovery are improving on the back of progressing vaccinations. We continue to emphasize that the assessment and interpretation of economic developments remains more challenging than under normal circumstances, as is the case for other indicators, in particular from the fiscal realm.

We could consider lowering our ratings if the medium-term outlook falls significantly short of our expectations, or if fiscal metrics fail to improve, with the public debt ratio remaining high over the medium term. A rather short-lived economic recovery and/or significantly deteriorating labor market metrics may be part of such a scenario. Partly related to that, economic and fiscal prospects may be adversely affected if challenges to finding political consensus regarding the concrete implementation of reforms as envisaged in the RRP clouds the medium-term growth outlook.

By contrast, we could consider a positive rating action if economic recovery is stronger than we expect, with no significant or persistent detrimental effects to the labor market and notable reform action lifting underlying growth, or if we see a reversing debt trend and/or convincing signs of a likely sustainable fall in the public debt ratio. Upward pressure would also result from further diminishing debt servicing cost.

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Ratings*

Long-term sovereign rating	AA /negative
Foreign currency senior unsecured long-term debt	AA /negative
Local currency senior unsecured long-term debt	AA /negative

*) Unsolicited

ESG Factors

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook. For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

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ESG Factor Box

Environ-mental Quality	Ecological Risks	Ressource Management	Education	Health	**Demo-graphics**
Labor	Equality	Technology & Infrastructure	**Safety & Security**	**Judicial system**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liber-ties/ Political Participation**	Market Access	Business Environment	Data Transparency

Environment	**Social**	**Governance**	**Highly significant**	**Significant**	**Less significant**	**Hardly significant**

The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Indicators or projections providing insight into likely demographic developments and related costs represent a social component affecting our rating or adjustments thereof. Hence, we regard the ESG factor 'Demographics' as less significant in our ESG framework. What is more, protracted difficulties in government formation due to the complex political structure and strong regional identities would touch upon the social dimension as well, which is reflected among other things by the WGI "Political Stability" and "Government Effectiveness" and would ultimately affect fiscal performance, so that we regard the ESG factor 'Safety and Security' as less significant.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2015	2016	2017	2018	2019	2020	2021e
Macroeconomic Performance							
Real GDP growth	2.0	1.3	1.6	1.8	1.8	-6.3	5.3
GDP per capita (PPP, USD)	46,365	48,680	50,720	52,662	54,265	51,096	53,973
Credit to the private sector/GDP	87.9	90.0	90.9	93.0	94.1	99.4	n/a
Unemployment rate	8.5	7.8	7.1	6.0	5.4	5.6	n/a
Real unit labor costs (index 2015=100)	100.0	98.7	98.7	98.5	98.8	102.3	n/a
Ease of doing business (score)	72.4	72.4	72.2	74.7	75.0	n/a	n/a
Life expectancy at birth (years)	81.1	81.5	81.6	81.7	82.1	80.9	n/a
Institutional Structure							
WGI Rule of Law (score)	1.5	1.4	1.3	1.4	1.4	n/a	n/a
WGI Control of Corruption (score)	1.6	1.6	1.5	1.5	1.6	n/a	n/a
WGI Voice and Accountability (score)	1.4	1.4	1.4	1.4	1.4	n/a	n/a
WGI Government Effectiveness (score)	1.4	1.3	1.2	1.2	1.0	n/a	n/a
HICP inflation rate, y-o-y change	0.6	1.8	2.2	2.3	1.2	0.4	2.0
GHG emissions (tons of CO2 equivalent p.c.)	10.9	10.8	10.7	10.8	10.6	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability							
Fiscal balance/GDP	-2.4	-2.4	-0.7	-0.8	-1.9	-9.4	-7.0
General government gross debt/GDP	105.2	105.0	102.0	99.8	98.1	114.1	113.7
Interest/revenue	5.6	5.3	4.6	4.1	3.9	3.9	n/a
Debt/revenue	205.1	206.9	198.7	194.2	195.5	225.6	n/a
Weighted average maturity of debt (years)	7.9	8.4	9.1	9.6	10.1	10.2	n/a
Foreign exposure							
Current account balance/GDP	1.4	0.6	0.7	-0.8	0.3	-0.2	n/a
International reserves/imports	0.1	0.1	0.1	0.1	0.1	0.1	n/a
NIIP/GDP	45.2	54.5	56.0	35.8	50.6	44.9	n/a
External debt/GDP	255.5	277.1	258.0	242.3	242.6	268.6	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, Statbel, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	30.09.2016	AA- /stable
Monitoring	28.07.2017	AA- /positive
Monitoring	29.06.2018	AA /stable
Monitoring	28.06.2019	AA /stable
Monitoring	26.06.2020	AA /negative
Monitoring	18.06.2021	AA /negative

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party. Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, European Center for Disease Prevention and Control (ECDC), Blavatnik School of Government, National Bank of Belgium, Statbel, Belgian Debt Agency, Ministry of Finance, ERMG, Federal Planning Bureau, High Council of Finance.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

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An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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