Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information			
KINGDOM OF BELGIUM	Assigned Ratings/Outlook: **AA /stable**		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 28-06-2019 "Sovereign Ratings" "Rating Criteria and Definitions"	

Rating Action

Neuss, 28 June 2019

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 stable.

Contents

Key Rating Drivers

1. Economy continues to display a very high degree of wealth and productivity; solid GDP growth should remain in place in 2019/20, mainly buttressed by healthy household spending, while dragged down by increasing external headwinds; modest medium-term growth prospects and high private sector debt weigh on macro-performance
2. Despite persisting governance challenges stemming from its complex structure of government, sovereign is characterized by a strong institutional setup and enjoys extensive benefits from its integration in the EU; increasing political fragmentation and expectation of lengthy coalition formation
3. Budget deficit continued to narrow in 2018, largely driven by one-offs; we expect headline deficit to increase in 2019/20, as implementation of tax shift measures and corporate tax reform should weigh on revenues, while there is significant uncertainty regarding timing of coalition formation and consolidation plans of incoming government
4. Vulnerability stemming from very high but slowly declining government debt, somewhat tempered by prudent debt management; medium-term risks related to debt consolidation arising from age-related costs and challenges pertaining to the implementation of fiscal framework
5. Limited external risks in light of a broadly balanced current account and a net international investment position which is among the highest in the EU-28

Reasons for the Rating Decision

The Kingdom of Belgium's very high creditworthiness mainly reflects its favorable institutional and macroeconomic performance profile as well as solid external metrics, somewhat balanced by elevated fiscal sustainability risks.

Macroeconomic Performance

The sovereign's credit rating continues to be underpinned by the economy's favorable macroeconomic performance profile, incorporating high levels of wealth and productivity, as well as stable economic growth underpinned by a recovering labor market. These strengths are set against modest growth prospects and elevated private sector debt.

First and foremost, Belgium's prosperous and highly productive economy continues to support the sovereign's rating. Belgium exhibits the second-highest GDP per capita among our AA-rated sovereigns and the 25th highest in the world. At the latest count, GDP per capita was estimated at USD 48,245 in PPP terms (2018). Thus, Belgian per capita income was below the Austrian level (USD 52,137), but well above Finland (USD 46,430), France (USD 45,775), and the UK (USD 45,705).

High per capita income is the result of productivity levels well in excess of the European average. As measured by nominal labor productivity per person employed, Belgium is a European frontrunner in terms of productivity. Nominal labor productivity per person in Belgium stood 28.9% above the weighted EU-28 average in 2017, with only Luxembourg (+60.6%) and Ireland (+87.1%) posting stronger productivity metrics. It is also noteworthy that all NACE activities contribute to Belgium's productivity edge. As indicated by Eurostat data, Belgian gross value added per person employed stood 35.5% above the EU average in the service sector last year – in construction (+50.6%) and industry (+58.5%), the productivity gap was even wider. More generally, we consider the Belgian economy to be diversified. At the end of 2018, the sectoral composition of gross value added in the Belgian economy closely resembled that of the EU-28 as a whole, with services accounting for three quarters (77.0%) of total output and the industrial sector for 16.7% (EU-28: 73.4; 19.4%).

Belgium has displayed a track record of moderate but stable economic growth in recent years. Between 2015 and 2017, annual growth rates oscillated in a narrow band between 1.5 and 1.7%. However, developments in 2018 suggest that the Belgian economy has lost some momentum. As real GDP growth eased from 1.7 to 1.4% in 2017-18, output expanded at the slowest pace since 2014 (1.3%) and growth also lagged behind the euro area as a whole (+1.9%) for the fifth consecutive year.

Weakening net exports were the main reason behind the economic slowdown observed in 2018. The growth contribution of net exports fell from 0.7 p.p. in 2017 to a modest 0.3 p.p. in 2018. While import growth decelerated from 4.3 to 3.3%, backed by solid domestic demand, the moderation in export dynamics was more pronounced. In real terms, export growth softened from 5.0 (2017) to 3.6% in 2018. Given its high degree of trade openness (trade-to-GDP ratio 2018: 175.6%), the weaker macroeconomic backdrop in the global economy, intensifying trade tensions, and fears of a disorderly Brexit negatively impacted Belgium's export performance.

Domestic demand remained the key driver of real GDP growth, contributing 0.7 p.p. to the economic expansion (2017: 1.2 p.p.). Private consumption retained its growth momentum and expanded by 1.0% (2017: 1.1%), though this increase can be considered as rather lackluster from both a historical and European perspective. We believe that comparatively soft private consumption is partly explained by the implementation of the new WLTP emission standard, weakening consumer sentiment towards the end of the year, as well as by subdued real wage dynamics. Although nominal wages and salaries in the business economy stepped up a gear and expanded by 2.2% y-o-y, up from 1.9% in 2017, the increase was not large enough to offset inflationary pressures. Mainly due to higher energy and food prices, HICP inflation remained at an elevated 2.3% in 2018 (2017: 2.2%), weighing on households' purchasing power. Moreover, consumption faced headwinds from the decision by households to save a larger share of their disposable income amidst a gradually weakening macroeconomic outlook. The savings ratio thus edged up from 11.4% in Q4-17 to 11.7% in the fourth quarter of 2018, the highest reading since Q4-15.

Contrarily, growth in gross fixed capital formation picked up in 2018. Following an expansion of 1.8% in 2017, investment rose by a healthy 2.9% last year, whereby stronger investment activity was observed across all economic sectors. Despite rising external uncertainties, private investment increased by 2.7% y-o-y (2017: +2.3%). Mainly due to the local electoral cycle, public investment experienced the strongest growth since 2009 (+11.0%) and rose from 2.3 to 6.8% in 2017-18. Also, dwellings investment returned to growth last year. After having stagnated in 2017, households' capital expenditures posted a moderate increase of 1.8%.

We expect a further deceleration of economic activity, with real GDP growth clocking in at 1.2% in 2019 and 2020 respectively, as net exports should increasingly drag on growth, not entirely compensated by strengthening domestic demand.

Most importantly, external demand should be dented by the cyclical slowdown in Belgium's key export markets Germany, France, and the Netherlands (42.9% of total exports). Also, multiple issues weigh on global trade (e.g. Brexit, US trade policies), whereas tailwinds from improving cost competitiveness should gradually abate. Partly driven by wage containment measures, real unit labor costs (ULC) dropped by 3.8% in 2013-17, comparing favorably with a 1.9% decrease in the euro area over this period. As flagged by 2018 data, however, ULC adjustment has come to a halt, with real compensation per employee (+0.8%) outpacing labor productivity growth (+0.1%). It thus remains to be seen whether recent gains in cost competitiveness can be sustained in light of the expected acceleration of wage growth (see below). Concurrently, imports should decelerate to a lesser extent than exports in view of the prospective strengthening in domestic demand.

Slowing net exports should coincide with still solid but gradually moderating investment growth. While public investment at the local level should normalize after an extraordinary strong 2018, we believe that NFCs will become more hesitant to invest in new equipment in a context of persisting economic uncertainty and the projected pick-up in wage costs, which may weigh on profitability. There are, however, indications that support our expectation of a 'soft landing' of investment. Despite slowing external demand, capacity utilization remained broadly stable in the year to Q2-19 and it is still running slightly above its long-term average (1985-2018: 79.6%). Apart from that, benign financing conditions should provide additional support to investment. Reflecting a more cautious economic outlook, the ECB decided to postpone monetary policy normalization further. At its June meeting, the governing council decided to keep the refinancing rate at its present level at least through the first half of 2020.

Against the background of increasing uncertainties surrounding the near-term prospects for external demand and investment, private consumption is set to play an even more important role in 2019/20 than in previous years. Currently, hard and soft indicators suggest a recovery of consumer spending from its rather lackluster performance in 2017/18. Retail turnover (excl. motor vehicles) appears to be gaining traction, as April saw the strongest expansion since November 2017 (+1.6%). In addition, there are increasing signs that consumer confidence has bottomed out. After a pronounced weakening in the final quarter of 2018, the European Commission's Consumer Confidence Indicator improved for the fourth consecutive month this May. In general, household spending should be supported by enduring employment growth and rising real disposable incomes in 2019/20. Alongside an automatic cost of living adjustment under the Belgian wage-indexation mechanism at the beginning of 2019 (2.16%), the next stage of the tax shift and sustained nominal wage growth in an increasingly tight labor market should boost consumers' purchasing power. In the same vein, consumption should be buoyed by receding inflation. HICP inflation, which posted at 2.4% in Q1-19, should decline in the second half of the year. Mirroring base effects from lower energy prices, we expect inflation to moderate to 1.7% on an annual basis. As a result, the real disposable income of households, and in turn consumption, should grow more vividly than in 2018.

Stronger consumer spending should be facilitated by the ongoing recovery in the Belgian labor market. Last year, the unemployment rate fell to 6.0%, down from 7.1% in 2017 – the lowest level since Eurostat started to compile harmonized unemployment data in 1987. Decreasing unemployment was accompanied by the fifth consecutive year of job creation. Employment growth showed no signs of slowing down, coming in at 1.3% (2016: +1.3%; 2017: +1.4%). Favorable labor market dynamics carried over into Q1-19 as the unemployment rate continued on its downward trajectory (5.8%), while employment saw another increase of 1.5% y-o-y. Nevertheless, large regional disparities, skill mismatches, and a low participation rate continue to present challenges to the labor market. Standing at 68.6% in 2018, the labor participation rate (15-64y) was not only lower than in the euro area (73.5%) as a whole, but also significantly lower than in neighboring countries such as France (71.9%), Germany (78.6%), and the Netherlands (80.3%). In particular, labor market participation of the young population, as well as of low-skilled individuals, is disproportionately low in Belgium. In 2018 the participation rate of the age group 15-24y (29.6%) was among the lowest in the euro area (average 40.1%); the same applied to individuals with less than lower secondary education (35.5% vs. EA-19: 46.3%). Even though these figures suggest that there remains considerable untapped labor supply in the Belgian economy, job vacancies are persistently high, pointing to significant skill mismatches. Since the end of 2016, the vacancy ratio has notably increased from 3.5 to 4.4% in Q4-18, which compares high to 2.4% in the EA-19.

We acknowledge that Belgian authorities have already gone a long way to smooth the functioning of the labor market and address its shortcomings. Among others, the government revised the wage-setting mechanism, removed some early retirement incentives, and lowered the labor tax wedge, which remained the highest in the EU-28 (2018: 52.7%, average earners). While these reforms mainly focused on lowering labor costs to restore cost competitiveness, authorities have recently stepped up their efforts to foster labor market inclusiveness. In July 2018, the government concluded on the 'Jobs Deal'. In particular, the policy package aims to tackle skills shortages in certain professions through training and retraining by granting fiscal incentives, tightening eligibility for pre-pension benefits, and provide stronger incentives to take up work. Yet, some parts of the Jobs Deal legislation are still pending due to the break-up of the government last December (see below). Meanwhile, the implementation of educational reforms has been progressing. Under the so-called Pact for Excellence, various reforms pertaining to schooling and the vocational training system entered into effect in 2018. To make the education system more inclusive and to lower dropout rates, additional measures such as free pre-primary schools and better staffing in early childhood education will enter into effect by the end of 2019.

Notwithstanding that the Belgian economy should experience solid growth in the near term, medium-term growth prospects appear less favorable. Weak public investment and subdued productivity growth continue to hamper the economy's growth potential. As highlighted by AMECO data, the investment-to-GDP ratio of the public sector has been consistently lower than in the euro area since 2000. Although spending on public investment ticked up to 2.4% of GDP last year (2017: 2.2% of GDP) this still compares low to a public investment ratio of 2.7% GDP in the euro area. Authorities appear to be aware of the importance of stronger investment activity to enhance productivity. Belgian authorities envisage stimulating productivity growth by the gradual implementation of the National Pact for Strategic Investments (NPSI). In September 2018, central and regional governments concluded their consultations and presented their priorities. With the participation of the private sector, the government envisages to invest approx. EUR 150bn by 2030 across six thematic areas - namely digitization, cyber security, education, healthcare, energy, and transport.

Likewise, boosting competition in the service sector may have positive knock-on effects on productivity growth. According to the 2018 edition of the OECD's Product Market Indicators, regulatory barriers to firm entry and competition are still comparatively high in retail and professional services. Among others, Belgium's regulatory requirements for architects, estate agents, and accountants remain among the most restrictive in the OECD. Admittedly, 2018 witnessed some progress regarding the liberalization of regulated professions, with Flanders and Wallonia lifting the qualification requirements for several craft professions.

We also see persisting challenges when it comes to non-cost competitiveness. The most recent editions of the World Economic Forum's Global Competitiveness Report and the World Bank's Doing Business Report both attest Belgium to have a generally favorable business environment, ranking the sovereign 21out of 140 and 45 out of 190 countries respectively. However, Belgium receives lower scores than its AA-rated peers Finland, the UK, and

France in both assessments, with extensive labor market regulations, high taxes, and infrastructure quality being cited as main weaknesses.

Institutional Structure

Our assessment continues to reflect the sovereign's strong institutional setup, and extensive political and economic benefits associated with Belgium's integration in multi- and supranational structures such as NATO, the EMU, and the EU. Being a small, open economy, Belgium is highly integrated into European value chains and therefore benefits from the Single Market and the euro's reserve currency status. At the end of last year, intra-EU exports made up for 69.5% (services) and 70.0% (goods) of total exports. The share of domestic value added embodied in foreign final demand stood at a high 38.9% (2015, OECD TiVA data).

According to the World Bank, Belgium outperforms the euro area median by a considerable margin on most Worldwide Governance Indicators (WGIs). The sovereign achieves very high scores with regard to democratic participation and the perception of corruption, ranking 11th and 22nd out of 209 economies respectively, comparing favorably with EA-19 median ranks of 27 and 41. Regarding the WGI government effectiveness, which captures the quality of policy formulation and implementation, Belgium was placed at rank 32, broadly on par with the EA-19 median (33). However, Belgium fares worse than most of its AA-rated peers. More importantly, the quality of public services appears to have weakened more recently, as Belgium achieved a significantly higher score on government effectiveness two years before (corresponding to rank 24/209). It has to be emphasized that we still view Belgium's institutional framework as strong. Notwithstanding, the further development of government effectiveness requires close attention – in particular, whether the gap towards the AA median (rank 23) continues to widen.

In general, we see institutional quality as somewhat constrained by the complex governance system including three regions and three communities. These entities have been given extended powers over the last decades, most recently enshrined in the Sixth State Reform. Responsibilities are widely spread across the different layers of government and sometimes shared, potentially impeding efficient policy-making. Challenges to the governance framework are compounded by an increasing political divide along lingual and regional borders.

The political situation has become more complex since our last review, as the Flemish N-VA left the governing coalition, which thus lost its majority. Moreover, federal elections held on 26 May 2019 resulted in a more fragmented and polarized parliament, with twelve parties elected to the Chamber of Representatives, none of which won more than 16% of the seats. While the traditional parties lost seats in both regions, we observed a resurgence of the far-right Vlaams Belang in Flanders, as well as gains for the far-left PTB/PVDA and the green Ecolo party in Wallonia. As of December 2018, PM Michel is heading a caretaker government until a new government is formed. We expect a lengthy and tedious process of government formation.

While the structural reforms of the past four years have had a positive impact on economic activity, the labor market, and the business environment, we are less confident that the reform momentum will be sustained going forward. In fact, we expect the implementation of far-reaching reforms to stall in the near term.

Fiscal Sustainability

The sovereign's credit rating continues to be constrained by high general government debt levels and repeated fiscal slippages. Nevertheless, we acknowledge that significant headway was made with regard to fiscal consolidation in recent years, as the budget deficit narrowed from 3.1 to 0.8% of GDP in 2013-17. With 0.7% of GDP, the headline balance surprised on the upside last year, coming in slightly lower than in the previous year and significantly outperforming the government's target of 1.0% outlined in the in the 2018 Stability Program. The favorable performance was a result of stronger-than-expected revenue growth. On the back of solid GDP growth, current tax revenues (including PIT- and CIT-receipts) expanded by 3.5%. More importantly, the revenue side of the budget benefited from changes to corporate taxation introduced in 2017, leading to strongly increasing advance payments. Drawing on data from the Ministry of Finance, advance payments edged up by EUR 2.45bn in 2018 (+18.6%), which was considerably above initial expectations (EUR 2.0bn). Hence, the increase in advance payments explained more than half of the overall increase in current taxes. At the same time, net social security contributions continued to grow at a moderate pace (+2.2%), aided by sustained employment growth.

With regard to recent trends in spending, government expenditure picked up notably rising by 3.1% in 2018 (2017: 1.6%). The increase in primary spending, which we regard as a better indicator to assess the underlying fiscal effort, was even stronger. Excluding interest payments, government outlays rose by 3.5%, outpacing nominal GDP growth (+2.6%) for the first time since 2013. Above all, higher expenditures on social benefits and investment boosted primary spending. Mainly on account of vividly growing capital expenditures at the local and municipal level in the run-up to the 2018 local elections, public investment growth almost doubled from 5.1 (2017) to 10.0% in 2018.

Looking ahead, we expect some weakening in the sovereign's budgetary position. As of now, we see the headline deficit to widen to 1.3 and 1.4% of GDP in 2019 and 2020 respectively. In particular, the one-off boost from corporate tax advance payments, which had buoyed revenues over the last two years, should eventually taper off. There are already signs of an imminent slowdown in early tax payments. Over the first four months of 2019, corporate taxes paid in advance increased by a moderate 3.2% y-o-y (Jan-Apr-18: +42.9%). In addition, further tax cuts applying to personal income, entering into effect at the beginning of the year, should weigh on revenues. Under the next stage of the "tax shift", the tax-free allowance was lifted from EUR 7,430 to EUR 8,860, the 40%-income tax bracket was expanded, and the tax work bonus for low-wage workers increased. From 2020 onwards, the new corporate tax regime foresees further tax relief for enterprises. The CIT-rate, which had already been cut from 34 to 29.6% in 2018, will be lowered to 25%, effective from next year. It has to be mentioned that the outgoing government submitted a request for a temporary deviation from the adjustment path towards its medium-term budget target under the structural reform clause, which was eventually approved by the European Commission.

We note that fiscal uncertainty has increased since our last review. Belgium is currently led by a caretaker government not enjoying full budgetary powers, following the break-up of the four-party governing coalition in December 2018 (see above). Hence, the timing of a coalition formation and the shape of a coalition agreement are subject to high uncertainty – as are prospective consolidation plans of the incoming government. At the same time, fiscal risks are somewhat mitigated by the fact that the 2018 budget was rolled over to 2019, and the caretaker government operates under a provisional twelfths ruling, with new spending measures having to be endorsed by Parliament.

Against the backdrop of slowing growth and increasing budgetary pressures, government debt should remain elevated in the medium term. Having peaked at 107.5% of GDP in 2014, the Belgian debt-to-GDP ratio gradually decreased to 103.4% of GDP in 2017 before falling to 102.0% of GDP last year. Nevertheless, debt levels still compare unfavorably with similarly-rated peers. Among our AA-rated sovereigns, Belgium's debt-to-GDP ratio remains the highest, while the country's debt-to-revenue ratio of 197.4% was only exceeded by the UK (218.3%) at the end of last year. Thus, sharply rising interest rates – not accompanied by stronger growth or higher inflation – could pose a risk to Belgium's medium-term fiscal sustainability.

Still, we believe that debt should remain on a downward trajectory over the coming years, gradually nearing the 100%-mark by 2020, while debt affordability has improved over the last couple of years, with the interest-to-revenue ratio having diminished to 4.4% in 2018 (2017: 4.8%, 2013: 6.3%). In general, interest and refinancing risks should be somewhat mitigated by prudent debt management operations. The weighted average maturity (WAM) of government debt was extended from 9.29 (end of 2017) to 9.62 years at the end of 2018. With regard to 2019, we note that the Belgian Debt Agency is set to maintain its current strategy, keeping the WAM above 9 years, while limiting the 12-month refinancing and refixing risk to 17.5%. What is more, Belgium continues to demonstrate its ability to issue debt at very long tenors. Following the issuance of a 10-year bond with a coupon of 0.9%, Belgium issued a 30-year bond with a coupon of 1.7% in January 2019. Although the ECB has terminated net purchases under its PSSP, sustained demand from reinvestments should help to keep yields on long maturities at very low levels for the foreseeable future.

In the medium term, an ageing population and difficulties related to an effective implementation of the current fiscal framework may put fiscal sustainability at risk. In 2017, Belgium's age-related expenditures amounted to a high 27.6% of GDP (EU-28 median: 21.3%). Additionally, the old-age dependency ratio of 28.6% was slightly lower than in the EU-28 (29.9%), pointing to a relatively generous pension system. According to the European Commission's 2018 Ageing Report, spending pressures will further intensify over the coming decade. Age-related costs in Belgium are estimated to rise by 2.1 p.p. of GDP up to 2030, the second highest increase in the EU-28. To safeguard pension sustainability, Belgium's outgoing government adopted several legislative changes pertaining to the pension system during its term. Among others, authorities legislated a stepwise increase in the pension age from 65 to 67 years by 2030, strengthened supplementary pension schemes, and introduced a partial pension, entering into effect in July 2019. In the longer term, the government envisaged the introduction of a points-based pension system. However, in view of strong union opposition and the complex outcome of the federal elections (see above), a swift implementation of far-reaching changes to the pension system appears rather unlikely.

Furthermore, challenges related to the fiscal framework increase the risk of budget overruns. Flanders is currently undertaking steps to evaluate certain expenditure items as part of the budgetary process, but on the central government level Belgium still lacks regular spending reviews. In addition, the budgetary coordination process between the federal, regional and municipal governments remains challenging. Unlike in 2018, when all subordinated entities approved the consolidation path outlined in the Stability Program, the Concertation Committee only took note of the medium-term budgetary targets this year. In general, the federal government has limited powers to enforce fiscal targets at the regional and local levels. Given that these entities account for a significant share of general government spending, overspending at the regional or local level could derail the fiscal consolidation process.

By contrast, we believe that the banking sector carries no immediate risk to public finances, as we consider Belgian banks to be sound in terms of asset quality and capital buffers. The CET1 capital ratio was broadly stable at 16.9% in the year to Q4-18 (Q4-17: 17.1%) and remained well above the EU-28 level (16.9%). At the same time, asset quality continued to improve, with non-performing loans representing only 2.3% of total loans outstanding (Q4-17: 2.6%; EU average 3.2%). On the other hand, profitability remained relatively weak. Banking taxes, strong competition, and a high reliance on interest income (Q4-18: 65.6% of total operating income) continue to squeeze bank earnings in the current low-interest environment. Regarding the planned privatization of the government's 30% stake in Belfius Bank, we notice that the outgoing government announced putting the initial public offering on hold in September 2018.

While the banking sector appears healthy at the moment, risks associated with vividly growing credit to the private sector warrant close monitoring. As in the years before, credit growth continued to outpace the expansion in total economic output in 2018. Drawing on ECB data, the credit-to-GDP ratio edged up from 87.5 (Q1-14) to 92.8% at the beginning of 2018 before it further increased to 95.0% in Q1-19. This increase was in particular driven by rapid loan growth. In the twelve months to April 2019, NFC and mortgage loan growth averaged at 9.1% and 8.5% y-o-y, comparing high with most euro area members. According to the National Bank of Belgium's most recent Financial Stability Report, there are signs that banks have further eased mortgage lending standards to offset lower interest margins. Between 2014 and 2018, the share of new housing loans carrying LTV-ratios of above 80% has gradually risen from 41% to 53%. In addition, a large proportion (over 20%) of new mortgages originated over this period came with stretched DSTI-ratios above 50%, implying that borrowers have to spend more than half of their monthly income to service their debt. In our view, the recent relaxation of lending standards coupled with a large and growing exposure to the domestic real estate market renders banks vulnerable to a significant drop in house prices. To be sure, the recent development in real estate prices does not indicate an emerging housing bubble. In 2018 real house prices expanded by a moderate 1.0% y-o-y, while the 3y-growth rate posted at 3.7%.

The dynamic lending activity pushes household debt up. Since Q4-13, the debt-to-disposable-income ratio of Belgian households has risen by some 10 p.p., reaching 106.2% of GDP end-of-2018. In the euro area as a whole, households slightly reduced their leverage from 97.1 to 94.7% of disposable income between Q4-13 and Q4-18. Thus, trends in household debt in Belgium and the euro area continued to diverge last year. Regarding the corporate sector, we acknowledge that debt levels are somewhat biased by significant inter-company loans. However, even on a consolidated basis, non-financial corporate debt amounted to a high 128.3% of GDP in 2018 (2017: 127.4% of GDP), thus remaining among the highest in Europe.

Foreign Exposure

Risks arising from Belgium's external position appear contained at the moment. Belgium's current account has been close to balance over the last decade, averaging at -0.4% of GDP in 2008-18. Last year, however, we observed a deterioration of the economy's current account, mainly due to a weaker trade in services balance. While the trade in goods balance remained stable at 0.1% of GDP, the services balance turned negative, edging down from 0.9% of GDP in 2017 to -1.1% of GDP in 2018. As a result, the economy operated at a current account deficit of 1.3% of GDP, following a surplus of 0.7% of GDP in 2017. Going forward, we expect that the current account deficit will widen somewhat, largely driven by the weaker exports and robust import growth.

The country continues to exhibit a highly positive, albeit declining net international investment position (NIIP). Down from 57.0 and 52.4% of GDP in 2016 and 2017 respectively, Belgium's NIIP fell to 43.9% of GDP last year. As illustrated by BoP data, this development was largely driven by a significant decline in foreign direct investment assets and to a lesser extent by the accumulation of external debt. On a net basis, foreign direct investment halved from 21.2 (2016) to 10.8% of GDP (2018) over the last two years. Meanwhile, the economy remains a net external creditor to the rest of the world although its net external debt has been edging closer to balance in recent years. In 2018, net external debt stood at -6.8%, down from -14.2% and -29.2% of GDP in 2017 and 2016 respectively. In this context, we note that fluctuations in external debt levels are partly explained by funding activities of MNEs residing in Belgium. As highlighted by IMF data, approx. a quarter (26.7%) of Belgium's external debt can be attributed to inter-company lending, which we regard as a relatively stable source of funding, while long-term government bonds account for another 22.6% of external debt. Thus, we believe that refinancing risks are somewhat tempered by the composition of the external debt stock.

Rating Outlook and Sensitivity

Our Rating outlook on Belgium's sovereign ratings is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – will remain fundamentally unchanged in the next twelve months.

We could consider lowering Belgium's ratings or the related outlook if medium-term growth slowed significantly due to a deceleration of economic activity in the country's key trading partners. Other risks stemming from the external environment could be the fallout from rising protectionism or a disorderly Brexit, which is not our baseline scenario. Furthermore, GDP growth could also take a hit in the event of a sharp correction in housing prices, which would negatively affect private consumption and the lending capacity of the banking sector. Our AA rating could also come under pressure if we observe significant fiscal slippages, a further deterioration in governance indicators, or if the new government, which has yet to be formed, backtracks on structural reforms.

We could raise our credit ratings if the Belgian economy expands at a higher-than-expected rate over the medium term. In the same vein, faster-than-projected progress on fiscal consolidation and debt reduction could lead to upward pressure on our ratings.

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Ratings*

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

*) Unsolicited

Economic Data

	2013	2014	2015	2016	2017	2018	2019e
Real GDP growth	0.2	1.3	1.7	1.5	1.7	1.4	1.2
GDP per capita (PPP, USD)	42,258	43,430	44,424	45,281	46,755	48,245	49,480
HICP inflation rate, y-o-y change	1.2	0.5	0.6	1.8	2.2	2.3	1.7
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	80.7	81.4	81.1	81.5	81.6	n.a.	n.a.
Fiscal balance/GDP	-3.1	-3.1	-2.4	-2.4	-0.8	-0.7	-1.3
Current account balance/GDP	-0.3	-0.9	-1.0	-0.6	0.7	-1.3	n.a.
External debt/GDP	244.9	258.9	259.0	279.3	258.4	241.3	n.a.

Source: International Monetary Fund, Eurostat, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	26.08.2016	AA- /stable
Monitoring	28.07.2017	AA- /positive
Monitoring	01.06.2018	AA /stable
Monitoring	28.06.2019	AA /stable

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.

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 ac-counts, 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.

The rating was conducted on the basis of CRAG´s "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". 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 the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

To prepare this credit rating, CRAG has used 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, National Bank of Belgium, Statbel, Belgian Debt Agency, Ministry 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.

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