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:	26-08-2016 19-05-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 19 May 2023

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.

Key Rating Drivers

1. Belgium's economy recovered strongly from the pandemic and has held up reasonably well since the onset of the Russian war against Ukraine, as evidenced by positive quarterly real GDP growth rates up to this year's first quarter; despite slowing momentum, we forecast real GDP to expand solidly this year before picking up moderately in 2024 amid abating headwinds; we believe that private consumption will be the main growth engine in the near term, benefiting from wage indexation and Belgium's healthy labor market

2. We remain constructive on medium-term growth prospects for Belgium's very prosperous and highly productive economy; underlying growth should be supported by significant R&D expenditure and innovation capacity, while underperforming labor participation is likely to benefit from labor market reforms; high debt levels in our view continue to weigh on the private sector's risk-bearing capacities, and we will closely follow Belgium's cost competitiveness in light of its wage indexation framework

3. Very strong institutional set-up and vast benefits from the sovereign's membership in the EU and EMU; the division of competencies across the various layers of government remains challenging with a view to government effectiveness, whilst the 7-party-coalition adds to complexity in terms of coherent policy-making; that said, the swift reaction to the energy crisis and progress on implementing fiscal and labor market reforms pays testament to the state's ability to act

4. Fiscal sustainability remains the sovereign's main credit weakness, as indispensable measures to shield the Belgian economy from the energy crisis entailed further adverse repercussions to stretched fiscal metrics; we expect the headline deficit to remain elevated in the near term, while the already high public debt ratio should continue to edge up gradually over the medium term; fiscal risks are tempered by sound economic fundamentals, a favorable debt profile as a result of sound debt management, and debt affordability, which we expect to remain generally high, irrespective of a gradual rise in debt servicing costs; we assess the headway being made with regard to fiscal reforms as positive, not

least related to pensions, as ageing costs represent another factor weighing on medium- to long-term fiscal sustainability

5. External risks remain remote, since Belgium exhibits sizable external buffers, as mirrored by its very high, positive net international investment position (NIIP); we expect the current account to move closer to balance over the medium term after having been pushed it into deficit on the back of higher energy prices

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Sound economic fundamentals in our view remain a cornerstone of the sovereign's very high creditworthiness. The overall strong macroeconomic performance profile is buttressed by very high per capita income and productivity levels as well as favorable labor market conditions, as reflected by strong employment growth and declining unemployment. While tightening financial conditions will act as a drag on growth, we expect medium-term growth perspectives to remain robust. The cross-currents stemming from the geopolitical context emanating from Russia's invasion of Ukraine should curb economic activity in the near term via softer growth in Belgium's main trading partners and high inflation, but subside gradually. Although Belgium exhibits a relatively high share of energy-intensive industries, its energy imports from Russia are moderate. High R&D spending, as well as its status as an innovation leader, should foster Belgium's potential growth. The country's comparatively low labor participation rate increased more recently and should be boosted by ongoing as well as envisaged labor market reforms. The wage indexation mechanism caters for robust household spending, but could weigh on Belgian cost competitiveness going forward. High private sector debt continues to pose risks to medium-term growth prospects.

The Belgian economy continued to recover strongly last year. After the pandemic-related slump in 2020 (-5.4%) and the sharp rebound in 2021 (6.3%), Belgium's real GDP grew by 3.2% in 2022. With this, Belgium outperformed our forecast from June 2022 (2.3%) by a wide margin, withstanding the shock posed by the Russian war against Ukraine and the energy crisis, although economic activity tailed off during the second half of last year, primarily due to high inflation and tightening financial conditions.

Output expansion was mainly driven by private consumption, which increased markedly by 4.1% in 2022 (2021: 5.5%). Household spending thus contributed 2.0 p.p. to real GDP growth, being driven by strong employment growth (see below) and, particularly in the first half of 2022, release of pent-up demand amidst the winding down of Covid-restrictions. Growth in consumption was also supported by a drawdown on savings, as mirrored by a decline in the savings ratio (17.0% to 13.3% in 2021-22, National Bank of Belgium, NBB), as well as aid measures to shield households from the adverse impact from the energy crisis and high inflation. Public consumption added another 0.8 p.p. to 2022 growth.

Meanwhile, fixed investment contracted by 0.8% as investment activity suffered from economic uncertainty as well as from rising funding costs and commodity prices. Export growth outpaced

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[1] This rating update takes into account information available until 12 May 2023.

that of imports, leading to a positive growth contribution by net external trade (0.2 p.p.). On the whole, last year's economic growth was broadly in line with that of the euro area (EA), which expanded by 3.5% in 2022, but we note that Belgium's five-year average stood well above the euro area's reading over the period 2018-22 (1.6% vs. 1.2%).

Robust real GDP growth translated into a significant increase in real GDP per capita, which we regard as one of the sovereign's key rating strengths. Drawing on IMF estimates, Belgium's per capita income jumped to USD 63,070 in 2022 (PPP terms, current prices), up by 9.7% and in line with Germany (USD 63,816), whilst surpassing AA-peers such as France (USD 56,426) and Finland (USD 58,651).

We anticipate that growth of the Belgian economy will slow over the next two years, forecasting real GDP growth of 1.1% for this year and a slight uptick to 1.4% in 2024. Having said this, and drawing on our latest set of forecasts for 2023, we expect Belgium's economy to expand not only at a faster rate than the euro area overall (2023e: 0.8%), but also as compared to key trading partners such as Germany (2023e: 0.2%). Our expectation is underpinned by the latest flash estimates, according to which Belgium posted a quarterly real GDP growth of 0.4% q-o-q in Q1, whereas euro area growth was close to stagnating (0.1%, Eurostat). Hence, Belgium was able to avoid a technical recession, having featured positive quarterly growth rates since the Russian invasion of Ukraine, further underscoring the resilience of Belgium's economy.

Looking forward, growth should be entirely driven by domestic demand, while net exports are likely to make a negative contribution, given our expectation of softening global trade volumes more generally, and the fact that economic growth in Belgium's main trading partners (Germany, Netherlands, France) is about to decelerate. These three neighboring economies account for approx. 52% of Belgium's exports. At the same time, import growth should soften to a lesser extent in view of solid, albeit weakening, domestic demand.

We assume that household spending will be the main growth engine this year and next, benefiting from wage indexation, receding inflationary pressures, favorable labor market conditions and, concurrently, gradually improving consumer confidence. The annual rate of change in HICP inflation dropped to its lowest level since mid-2021 this April. Following six consecutive declines, headline inflation stood at just 3.3% (EA, Mar-22: 6.9%), down from its peak of 13.1% in Oct-22. To be sure, core inflation rates are still high, adversely impacting real incomes, and in turn households' purchasing power.

That being said, core inflation (excl. energy, food, alcohol and tobacco) appears to have plateaued more recently, having stagnated at 6.3% over the last three months. Arguably more importantly, Belgium's wage indexation mechanism will lend vital support to wages and social benefits, and thus to private consumption. With indexation for a third of people employed in the private sector having come into force in January 2023, we expect spending to receive a significant boost alongside dwindling headline inflation.

Furthermore, the government has implemented measures to support households via targeted and untargeted measures, such as the energy package (Nov-22 to Mar-23) and the permanent reduction of VAT on electricity and gas (see also below), which will lead to a significant relief for the household balance sheets. NBB expects the households' purchasing power to rise by approx. 6% in 2023-25.

Accordingly, consumer sentiment has brightened rapidly over recent months, after having plummeted to multi-decade lows in Sep/Oct-22. The European Commission's (EC) consumer sentiment indicator in March improved to its highest reading since the onset of the Russian invasion of Ukraine, underscoring our view that household spending will increasingly gain strength over the next quarters. By the same token, retail sales have so far made a good start in 2023, edging up by 0.9% and 1.2% m-o-m in January and February, respectively.

In addition, Belgium's healthy labor market will likely remain a key support for private consumption, as we expect it to remain resilient. Unemployment decreased on an annual basis, having fallen from 6.3% to 5.6% in 2021-22, standing below the euro area overall (6.7%, LFS-adj.). Judging by high-frequency data, monthly unemployment ticked up to 5.9% this March (Mar-22: 5.4%), but remained low, and we expect it to continue hovering around levels observed over recent quarters. Belgium displayed strong, albeit slowing, employment growth more recently, coming in at 1.8% and 1.4% y-o-y in Q3- and Q4-22, respectively. Employment growth should continue to moderate in line with easing economic activity, but challenges in recruiting—as highlighted by very high job vacancy rates (Q4-22: 4.5%, EA: 3.1%)—should motivate firms to hoard labor going forward.

As regards investment activity, we expect fixed investment to expand moderately in 2023, being dragged down by the still prevalent, but slowly receding, adverse repercussions from the Ukraine war. That said, we anticipate headwinds, namely high uncertainty and difficulties in sourcing due to friction in global supply chains, to continue to fade going forward, resulting in a stronger pick-up in gross fixed capital formation next year. Meanwhile, high factor costs (labor, raw materials), as well as rising funding costs following rapidly tightening monetary policy, are set to weigh on business investment, the latter presumably more strongly in 2024 due to lags in monetary transmission, in particular concerning housing investment.

Corroborating our view, sentiment in manufacturing seems to have bottomed out. Whilst remaining depressed overall, soft data from Q1 saw improvements in surveyed demand and employment expectations, as well as new orders and export expectations. At the same time, capacity utilization continued to decline at the start of 2023, having dropped further below the long-term average, boding ill for expansion investment.

Public investment will significantly aid overall investment. Drawing on Ministry of Finance intelligence from the recently published Stability Program 2023 (SP23), the government intends to ramp up public gross fixed capital formation markedly, by 10.6% in 2023 and 7.4% in 2024. More generally, we think that investment tied to the EU's Recovery and Resilience Facility and the related national Recovery and Resilience Plan will facilitate investment growth over the medium term, ultimately boosting Belgium's underlying growth.

In this vein, we highlight Belgium's innovation-friendly economy, which we view essentially as supportive for its growth performance further afield. As a case in point, Belgium is deemed as a European innovation leader according to the EC's European Innovation Scoreboard. Likewise, Belgium is attested to feature high quality in human capital and research as well as pronounced business sophistication by the World Intellectual Property Organization, being ranked at 26th place out of 132 economies on the Global Innovation Index 2022 overall. Tying in with this, Belgium's business expenditure on research and development is tremendously high, coming in at 2.4% of GDP in 2021, corresponding to the highest reading in the EU27.

Further elements aiding the overall constructive medium-term outlook pertain to Belgium's high productivity levels, with nominal labor productivity per person posting roughly 31% above the EU27 total (2022, Eurostat data), a comparatively large and rising share of high-technology products in total exports (2021: 17%, Eurostat), and its overall favorable non-cost competitiveness, e.g., as underscored by rank 21 out of 63 economies world-wide on the IMD World Competitiveness Yearbook 2022 (2021: rank 24).

Against this backdrop, Belgium's underlying growth should remain above that of the euro area as a whole, with its potential growth rate estimated at 1.7% and 1.6% in 2023 and 2024 as compared to 1.1% and 1.3% in the euro area, respectively (EC intelligence). Gradually rising labor participation is likely to support the Belgian economy's medium- to long-term prospects. Labor participation, whilst still sub-par from a euro area perspective (EA: 74.6%), has increased over the years, having gone up from 69.1% in 2019 to 70.5% in 2022. As elaborated in the recent National Reform Program 2023, the government is implementing several labor market reforms geared towards fostering flexibility and training, which should raise labor market participation further out. The same applies to the envisaged increase in the retirement age.

Medium-term growth prospects remain somewhat constrained by a relatively high level of private indebtedness, limiting the private sector's shock-absorbing potential to some extent. Household debt to disposable income stood at about 107% of GDP in Q3-22 (ECB data), representing one of the higher ratios among EU members, having continued to trend upward over recent years. Loans to private households for house purchases accounted for more than half of the outstanding bank credit to the private sector (private households and NFCs) in Feb-23 (56.5%, ECB data). While also comparing high in the European context, corporate debt measured against GDP has been decreasing over the last few years, standing at 97.8% as of Q4-22 (Q4-21: 107.1% of GDP).

While the sovereign continues to display a relatively strong competitive position with a view to the sophistication of its exports and non-cost factors, we would also flag some risks entailed by deteriorating cost competitiveness on the back of Belgium's wage indexation framework, potentially representing the flip side of the scheme's stabilizing effect on private consumption through strong wage growth.

Hence, we would pay closer attention to the development of Belgium's share in the global export market going forward. Judging by latest available data referring to 2021 (Eurostat), the respective share was stable compared to the preceding year (1.87%), while exhibiting a marked increase vis-à-vis the pre-pandemic year 2019, largely driven by a higher share of service exports. That said, trade data is likely somewhat distorted by the pandemic phase. Drawing on real unit labor costs (AMECO data), Belgium still compared relatively favorably against its main European trading partners in a medium- to longer-term comparison (2022 vs. 2017/2012), albeit less so when considering a shorter period (2022 vs. 2021).

Institutional Structure

We continue to regard the sovereign's credit rating as buttressed by its very strong institutional framework, benefiting from substantial advantages linked to deep integration into the EU and the euro area, as well as to being host to major EU institutions and the NATO headquarters. In particular, as a small, open economy, Belgium can reap the benefits from having access to the large EU Single Market with its common standards, alongside availability of broad and deep capital markets and use of the euro *as a reserve currency. Belgium's complex political governance structure, in our view, presents some counterweight to these strengths, given that the structure tends to lengthen the government formation process and presents challenges to effective policymaking, thus potentially leading to delays in the implementation of reforms. However, we believe that reform progress on important structural challenges, swift policy action and crisis management in response to the pandemic, as well as the energy price shock, pays testament to the government's effectiveness and ability to act.*

Generally, the World Bank's Worldwide Governance Indicators (WGI), our preferred measure for assessing the quality of a sovereign's institutional framework, continue to underscore Belgium's very strong institutional set-up. Regarding the four WGI pillars on which we chiefly focus, the sovereign's respective ranks remain broadly in line with the median of our AA-rated sovereigns, displaying slightly better performance than the median over all euro area members.

Having said that, and tying in to some extent with the abovementioned challenging domestic political backdrop, we note that the WGI 'government effectiveness', which among others refers to the perceived quality of policy formulation and implementation, has continued to deteriorate over recent years. Exhibiting a relative rank of 36 out of 209 economies when it comes to this indicator (AA median rank 29), referring to the year 2021, we observe that this was Belgium's weakest result since inception of the WGIs in 1996.

While being in line with the AA-median regarding 'voice and accountability' (rank 21 out of 209, EA median rank 26), i.e., the extent to which citizens are able to participate in selecting their government, as well as freedom of expression, of association, and a free media, we note a declining tendency as well. Concerning 'rule of law' (25 out of 209, EA median rank: 32) and 'control of corruption' (23/209, EA median: 42), the sovereign's relative ranks have remained rather stable over the last few years.

Turning to initiatives to further strengthen Belgium's institutional quality, among others drawing on the EC's Rule of law report (Jul-22), the process of enhancing the level of digitalization in the justice system is ongoing, as are measures to tackle shortages of human resources in this area, including targeted investments. Apart from these, new rules the appointment of judges are being developed.

Scope to improve remains with regard to an overall strategy on combating corruption. In this context it is also worth mentioning the recent GRECO report on the issue of preventing corruption. This third interim compliance report published in Sep-22 suggests that there has been little progress since the second compliance report (Mar-21) in terms of preventing corruption regarding parliament, whereas the report stresses advancements regarding judges and prosecutors in this respect. Overall, six out of 15 recommendations in the Fourth Evaluation Round were deemed implemented or dealt with satisfactorily.

The recently presented pension reform proposals by the pensions minister (Feb-23), partly amending agreed plans in Jul-22, may constitute a decisive step forward with a view to Belgium's tapping the RRF facility after initial pre-financing in 2021. Protracted domestic political debate over this reform and lack of agreement with the EC seems to play a part in Belgium's having refrained from requesting this first tranche so far. Disbursement thereof is partly linked to a pension reform targeting improvements in the financial and social sustainability of the pension system. The current reform proposals, inter alia, aim at lowering age-related costs by linking the minimum pension to the length of a career, by abolishing a bonus to those working beyond the retirement age, and by harmonizing pensions between the public and the private sector.

Another recent reform proposal, also linked to ultimately putting efforts to improve public finances onto firmer ground, concerns the tax system, with the respective proposal targeting a reduction of labor taxation at the expense of wealth and consumption, and partly funded by the introduction of the global minimum tax (pillar 2) in Belgium. Both reform proposals have to undergo the political process, and we will continue to monitor developments in this respect. The government reportedly plans to hold a formal vote on the tax reform proposal this summer, and to let the reform enter into force from 1 January 2024. That said, we recall that federal and regional elections will have to be held in the first half of 2024, potentially increasing incentives for various parties to engage in heavier opposition to current proposals, which may result in some implementation delays.

Commitment to fostering the green transition remains high, although there remains scope to improve in terms of ecological innovation, as suggested by a rank in the lower third among the EU countries as regards the EC's respective index in 2022, being hampered by challenges posed by complexities in coordination of the various government layers.

The government strives to reduce carbon emissions by 55% by 2030 and to reach climate neutrality by 2050. The upcoming draft National Climate Energy Plan is to be submitted to the EC before end of June 2023. While authorities maintain the goal of terminating the use of nuclear power, its phasing out was pushed back last year to 2035 as regards the newest nuclear power plants in light of the energy crisis. The Hydrogen Strategy aims to make Belgium a hub for the import and transit of green hydrogen. Apart from setting incentives to develop hydrogen transport infrastructure, development of a climate-neutral steel plant using green hydrogen energy is envisaged as well.

Indeed, greenhouse gas emissions per head stood at a comparatively high 10.0 tons in 2021 (EU: 7.9 tons). Tying in with that, Belgium's overall share of energy from renewable sources only came to 13.0% as of 2021, well below the EU level (21.8%), primarily due to trailing most EU countries when it comes to renewable energy used for heating/cooling. Nevertheless, compared to 2019, the 2021 total share of renewables constitutes a marked increase from 2019 (+3.1 p.p.).

Fiscal Sustainability

Belgium's credit profile remains impacted by risks to fiscal sustainability associated with an elevated debt level, notwithstanding last year's improvement, and with age-related costs putting pressure on public finances. Acknowledging a formalized commitment to fixed and variable fiscal efforts, episodes of fiscal slippages during the last decade the past call for, in our view, caution from a rating perspective. The recent quick succession of economic shocks meant a setback to the previously gradually falling path of the public debt ratio. Reform proposals currently undergoing the political process could result in some improvement of public finances in the medium-to-longer term, if fully and timely implemented. At this stage, we consider a sustainable downward trend in the debt ratio unlikely over the medium term, but would emphasize that the sovereign has been able to significantly lower its public debt ratio multiple times over the past decades. Sound debt management, a benign debt structure and high, albeit prospectively less favorable, debt affordability continue to act as mitigating factors concerning fiscal risks, as do the sound economic fundamentals elaborated above.

On the back of the further unwinding of pandemic measures and robust economic growth, Belgium's general government deficit decreased to -3.9% of GDP last year, representing a marked and stronger decline than we had estimated in our last review (Jun-22). Total revenue rose by

8.8%, driven by strongly increasing tax revenue in light of continued economic expansion and mounting net social contributions amid favorable labor market developments. At the same time, general government expenditure climbed by 5.7%, a more pronounced increase than in 2021 (2.8%), partly driven by significantly expanding public wages, and despite receding subsidies.

Drawing on data from the recent SP23, the budgetary impact of Covid-19-related measures came to roughly EUR 4.14bn in 2022, while measures to cushion adverse effects of soaring energy prices amounted to roughly EUR 5.9bn last year. Concerning the current fiscal year, the Belgian authorities envisage the impact of pandemic measures to dwindle to about EUR 881mn, and deficit-relevant energy support to decrease to roughly EUR 3.6bn. Adding to this year's expenditure, the government also takes into account an estimated budgetary effect of approximately EUR 1.3bn to accommodate refugees from Ukraine and to deal with the consequences of flooding over recent years.

Given the unpredictable developments around the war in Ukraine and related economic reverberations, uncertainty around estimates concerning public finances remains pronounced. Wage indexation in the public sector contributes to this as well. At this stage, also given the expected slowdown in GDP growth, we expect the headline deficit to widen to about -5.2% of GDP in 2023, and to moderate to about -4.4% of GDP next year amid some acceleration of economic growth and the assumption of further receding energy support measures. Agreement on pension policies increasing confidence in fiscally sustainable costs of the pension system would unlock RRF funds in the short term. Uncertainty is also added to by assumed dampening economic effects due to the ongoing monetary policy tightening cycle, as well as by the upcoming election in 2024, which may entail risks in terms of missing fiscal targets.

As per the coalition contract, the Belgian authorities envisage a fixed fiscal effort of 0.2% of GDP per year until 2024 (entity I). In addition, drawing on the 2023 budget review, a variable fiscal effort, which is generally linked to expected economic growth, is to amount to 0.1% of GDP in 2023 and 0.3% of GDP in 2024 (SP23). With a view to medium-term fiscal prospects, we note that the government envisages lowering the headline deficit to below 3% of GDP in 2026, which would take into account further fiscal efforts over the years to 2026. Whilst assessing this commitment to fiscal sustainability as positive, we would view this consolidation path as ambitious at the current juncture.

Uncertainty around the medium-term fiscal outlook—although with a more positive connotation—also relates to the abovementioned efforts to reform pensions and the tax system in order to address age-related cost pressures. The ultimate design of the current draft proposals, however, is yet to be agreed in the political process, making it too early to formulate a conclusion at this point in time. More generally, we view the enhanced role of spending reviews as a positive development with a view to fiscal policymaking.

Belgium's public debt ratio compares unfavorably with the median debt-to-GDP of our AA-rated universe, as well as of the euro area as a whole, although the Kingdom's debt level dropped significantly by 4.0 p.p. to 105.1% of GDP in 2022 on the heels of a decline by 2.9 p.p. a year earlier, due to the lower deficit and the strongly expanding nominal economic output. Given our expectations for the headline balance and GDP growth this year and next, we project Belgium's debt ratio to edge up to about 106.0% of GDP in 2023, and drift upwards to 106.9% of GDP in 2024.

Contingent liabilities in the form of public guarantees amount to an overall maximum of 23.8% of GDP, according to the SP23, with about half of this related to Covid-19 guarantees. While these appear high and have increased compared to data provided by the preceding stability program, it has to be noted that the estimated take-up was still comparatively moderate, at 6.8% of GDP. Focusing on guarantees to the financial sector by the federal level, we note that 3.5 p.p. out of a maximum of 8.0% of GDP were taken up.

Belgium's banking sector, which occupies a middle-range position among the EU members regarding total assets-to-GDP (Q3-22: 223.5% of GDP), continues to give a sound impression. The sector also showed resilience in the face of an episode of market tension over failing banks in the US and the struggles of a major Swiss bank. Measured by return on assets, the banking sector has been more profitable than banks in the EU on average of late, while important metrics such as the CET1 and the NPL ratios (Q4-22: 18.1% and 1.5%, respectively, EBA data) point to a comfortable capital buffer and high asset quality, respectively.

Likely starting to mirror the turning financial, credit, and property cycle, outstanding bank credit to the private sector has more or less stalled in absolute terms lately, with the annual increase in lending to NFCs moderating to 5.9% as of Feb-23 (Feb-22: 8.7% y-o-y) and the annual rate of outstanding credit to households for house purchases slightly down to a still dynamic 7.1%. Given elevated levels of private sector indebtedness (see above), we will continue to monitor further developments against the backdrop of assumed more adverse economic effects from tighter monetary policy. House prices are on the retreat: According to Eurostat data, the annual rate of change of Belgian house prices was down to +4.7% in Q4-22, while respective data provided by the OECD even point to a decline by 4.7% y-o-y as of Q4-22. At the end of March 2023, NBB decided to maintain the countercyclical capital buffer rate at 0% for Q2-23.

With regard to the longer term, unfavorable projections for age-related spending continue to weigh on fiscal sustainability, but may be at least partly tackled by the tabled structural reforms mentioned above. In its 2022 annual report, the Study Committee on Ageing (CEV, Jul-22) had estimated that social expenditure, the vast majority of which is accounted for by pensions and health care, would reach a maximum of 29.7% of GDP in 2049, corresponding to an increase of approximately 5.2 p.p. compared to the reference year 2019.

Alongside Belgium's sound economic fundamentals and robust medium-term growth prospects, we continue to view very sound debt management and high debt affordability as key mitigating factors with respect to fiscal risks. The average life of the debt portfolio increased to 10.37y as of Mar-23 (2022: 10.32y), counting among the longest in the euro area. Contrary to the majority of EU members, the sovereign's interest rate payments continued to decline in 2022, posting a fall by 1.7% y-o-y and amounting to a modest 1.5% of GDP. Due to further increasing market interest rates, however, interest costs are likely to rise over the coming years. The yield on 10-year Belgian government bonds stood at 3.0% as of 28-Apr-23 (weekly data), up by almost 1.5 p.p. in an annual comparison. Over the same period, the Bund spread widened by a modest 11bp to 69bp.

We currently expect two more interest rate hikes by the ECB this year following the decision in May-23, presumably by 25bp each, while we consider a first lowering unlikely to occur before 2024. For the time being, the ECB will continue to reinvest the principal payments from maturing securities purchased under the Pandemic Emergency Purchase Program (PEPP) until at least the end of 2024, whereas a gradual winding down of the Asset Purchase Program (APP) portfolio began in March 2023, with an initial monthly portfolio reduction of EUR 15bn until June 2023.

The ECB expects to discontinue the reinvestments under the APP as of July 2023, corresponding to an accelerated shrinking of its balance sheet.

Foreign Exposure

We continue to assess external risks as limited, despite some vulnerabilities associated with Belgium's status as a small, open economy. The sovereign remains in a pronounced net international creditor position, with its current account partly subject to volatility associated with activities of multinational enterprises (MNEs). While a return to a current account surplus may take some time in light of persisting uncertainties around energy market developments due to the war in Ukraine and the ongoing green transformation, we expect the current account deficit to at least moderate in the near term amid receding energy prices.

Having exhibited an average surplus of 0.3% of GDP over the five years to 2021, Belgium's current account balance swung into a pronounced deficit last year (-3.6% of GDP) as the goods trade balance (-3.2% of GDP, 2021: 0.8%) and, to a lesser extent, the service trade balance (-0.7% of GDP, 2021: 0.3%) recorded deficits. Higher energy prices, but also a decline in the export of Covid-19 vaccines, had a larger impact on the goods trade balance, while rebounding transport and travel activities weighed on the services balance. Looking ahead, the current account deficit should diminish over the medium term, while we flag some risks related to the abovementioned risks to Belgium's cost competitiveness and export performance.

Meanwhile, Belgium's highly positive NIIP amounted to 53.6% of GDP in 2022, signaling extensive external buffers. The NIIP decreased by 10.3 p.p. as compared to a year before, mainly due to a lower net positive position regarding portfolio investment on the back of valuation effects and due to the effect of sanctions against Russia on the net position regarding other investment. Nevertheless, Belgium's NIIP-to-GDP ratio represents one of the largest net creditor positions among the EU members, with large gross asset and liability positions partly linked to the presence of the MNEs.

Rating Outlook and Sensitivity

Our rating outlook for the Kingdom of Belgium's long-term credit ratings is negative, continuing to reflect in particular uncertainty over medium-term fiscal developments, against the backdrop of the recent accumulation of crises and remedial government measures to alleviate related adverse effects, as well as of pending implementation of structural reforms to improve public finances.

We could consider a negative rating action if efforts to lower the deficit fail, and conviction over a more persistent deteriorating trend of the public debt ratio from its already elevated level takes center stage. A markedly more negative medium-term outlook for economic growth, possibly amid further escalation of the war in Ukraine and/or stronger negative effects on the global economy, may be part of such a scenario, as may be failure to timely implement tangible reform measures aimed at reducing age-related costs.

Conversely, we could lift the sovereign's outlook or ratings if confidence in a positive trend regarding fiscal metrics prevails, possibly reinforced by a marked improvement in medium-term growth prospects on the back of fading adverse effects related to the war in Ukraine and timely progress in implementing structural reforms to strengthen public finances and potential growth.

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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

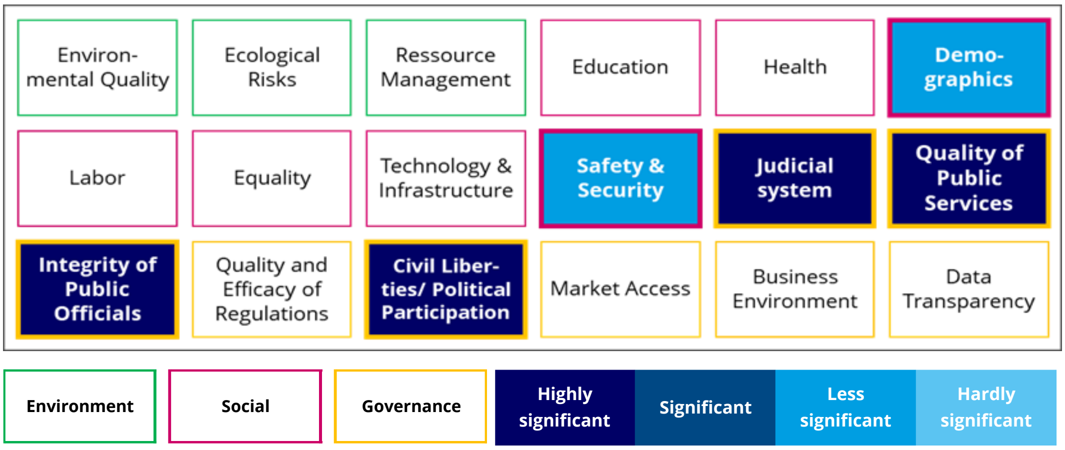
ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

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.

ESG Factor Box



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 exert 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 on public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022e	2023e
Macroeconomic Performance							
Real GDP growth	1.6	1.8	2.3	-5.4	6.3	3.2	1.1
GDP per capita (PPP, USD)	50,727	52,660	54,534	51,980	57,485	63,070	65,501
Credit to the private sector/GDP	90.9	93.0	93.6	97.6	94.1	91.2	n/a
Unemployment rate	7.2	6.0	5.5	5.8	6.3	5.6	n/a
Real unit labor costs (index 2015=100)	98.7	98.7	98.3	100.8	97.9	96.6	100.5
World Competitiveness Ranking (rank)	23	26	27	25	24	21	n/a
Life expectancy at birth (years)	81.6	81.7	82.1	80.8	81.9	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.3	1.4	1.4	1.4	1.3	n/a	n/a
WGI Control of Corruption (score)	1.4	1.5	1.5	1.5	1.5	n/a	n/a
WGI Voice and Accountability (score)	1.3	1.3	1.3	1.3	1.3	n/a	n/a
WGI Government Effectiveness (score)	1.3	1.3	1.1	1.1	1.1	n/a	n/a
HICP inflation rate, y-o-y change	2.2	2.3	1.2	0.4	3.2	10.3	4.0
GHG emissions (tons of CO2 equivalent p.c.)	10.7	10.7	10.6	9.6	10.0	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	-0.7	-0.9	-2.0	-9.0	-5.5	-3.9	-5.2
General government gross debt/GDP	102.0	99.9	97.6	112.0	109.1	105.1	106.0
Interest/revenue	4.6	4.1	4.0	3.9	3.4	3.1	n/a
Debt/revenue	198.7	194.3	195.5	224.4	218.6	211.7	n/a
Total residual maturity of debt securities (years)	9.1	9.6	10.1	10.2	10.7	10.9	n/a
Foreign exposure							
Current account balance/GDP	0.7	-0.9	0.1	1.1	0.4	-3.6	n/a
International reserves/imports	6.4	5.9	6.8	8.4	7.9	6.6	n/a
NIIP/GDP	56.0	34.3	40.9	46.7	63.9	53.6	n/a
External debt/GDP	258.0	247.4	257.6	268.8	258.4	240.0	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
Monitoring	17.06.2022	AA/ negative
Monitoring	19.05.2023	AA /negative

Regulatory Requirements

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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, IMD Business School, National Bank of Belgium, Statbel, Belgian Debt Agency, Ministry of Finance, ERMG, Federal Planning Bureau, High Council of Finance, CEV.

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 the event 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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