

# KINGDOM OF BELGIUM

Rating Analysis - 10/8/13

Debt: EUR375.4B Cash: EUR777.0M

\*EJR Sen Rating(Curr/Prj) BBB/ BBB-

\*EJR CP Rating: A2

EJR's 5 yr. Default Probability: 2.3%

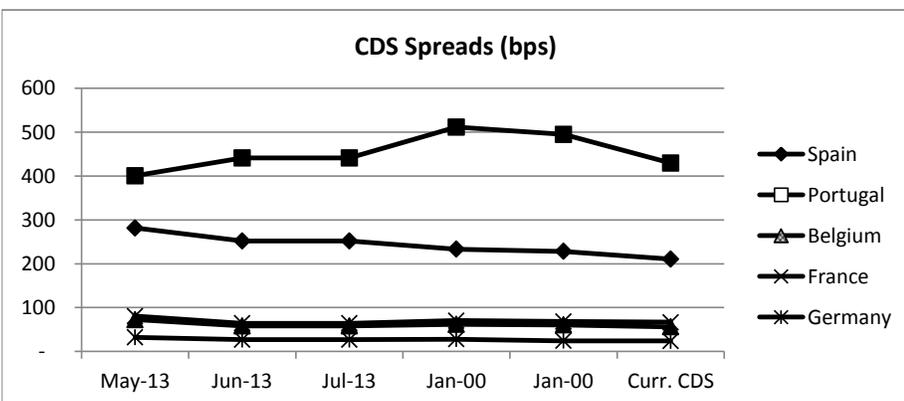
Slightly weaker - over the past three IMF-reported fiscal years (i.e., from 2008 to 2011), Belgium's debt rose at an annual rate of 3.8% while its GDP rose at an annual rate of merely 1.7%. As a result, the country's debt to GDP increased from 94.1% to 101.5%. For 2012, debt rose 3.8% and GDP rose 1.8% with debt to GDP nearing 105%. On the federal government side, the problem has been expenses, including interest expense, rising faster than revenue. Including interest expense, federal government deficit has been in the area of EUR14B per annum over the past couple of years. A major concern should be funding costs; since the ECB's intervention, 5 year rates have been low (i.e., near 1.4%). However, a rise to more normal level would cost Belgium approximately EUR12B.

Regarding GDP growth, rolling four quarter growth has declined from slightly less than 5% as of Sept. 2011 to less than 2% currently. With the slight improvement in Europe, Belgium hopefully will improve over the next couple of years. We envision conditions improving slightly but overall credit quality remaining tenuous. We are issuing a negative watch based on the rise in debt to GDP over the past couple of years.

CREDIT POSITION	Annual Ratios (source for past results: IMF)					
	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	99.8	101.6	101.5	106.3	110.8	114.7
Govt. Sur/Def to GDP (%)	-3.8	-3.7	-3.9	-2.8	-2.6	-2.2
Adjusted Debt/GDP (%)	99.8	101.6	101.5	106.3	110.8	114.7
Interest Expense/ Taxes (%)	13.1	12.1	11.8	9.3	9.4	9.4
GDP Growth (%)	5.5	2.7	1.8	1.5	1.5	1.7
Foreign Reserves/Debt (%)	1.6	1.6	1.6	1.5	1.5	1.5
Implied Sen. Rating	BBB-	BB+	BB+	BB+	BB+	BB-

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	45.0	55.0	75.0	85.0	95.0	145.0
Govt. Sur/Def to GDP (%)	4.0	1.0	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	40.0	50.0	60.0	80.0	120.0	150.0
Interest Expense/ Taxes (%)	7.0	9.0	12.0	15.0	22.0	26.0
GDP Growth (%)	4.0	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	25.0	20.0	15.0	12.0	9.0	7.0

PEER RATIOS	S&P Sen.	Debt	Govt. Surp.	Adjusted	Interest	GDP	Ratio-
		as a %	Def to	Debt/	Expense/	Growth	Implied
		GDP	GDP (%)	GDP	Taxes %	(%)	Rating*
Federal Republic Of Germany	AAA	83.7	0.2	93.2	11.1	0.3	BB+
French Republic	AA+	91.9	-4.8	114.6	9.7	-0.3	BB-
Kingdom Of Belgium	AA	101.5	-3.9	101.5	11.8	1.8	BB-
Kingdom Of Spain	BBB-	82.3	-10.6	93.2	12.3	-2.1	B+
Portugal Republic	BB	118.5	-6.4	127.0	13.0	-3.8	B-



Country (EJR Rtg*)	Current CDS	Targeted CDS
Spain (C)	210	5,000
Portugal (CCC+)	429	1,500
Belgium (BBB-)	56	400
France (BBB)	67	300
Germany (A-)	24	120

\* Projected Rating

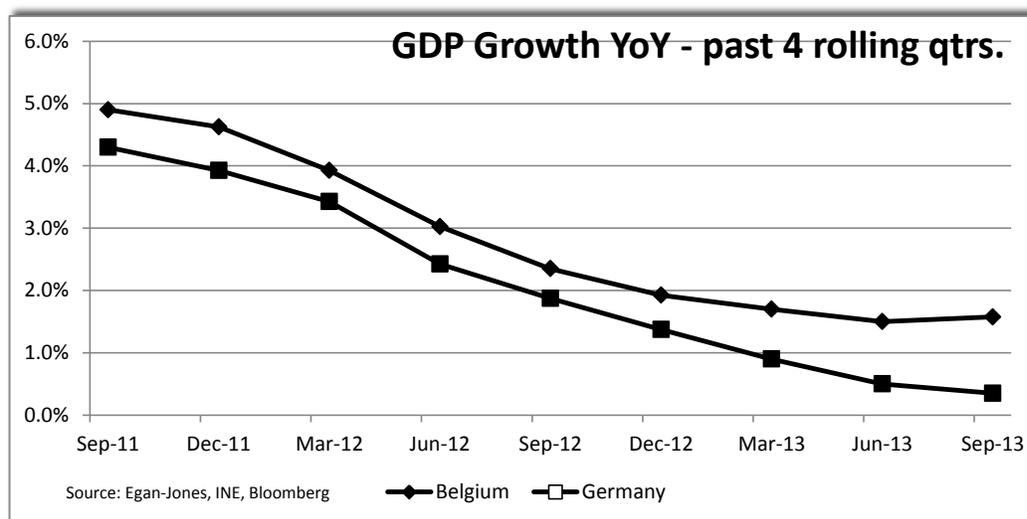
\* EJR's targeted CDS based on rating

\* Note, non-NRSRO rating. Copyright Egan-Jones Ratings Co.; no secondary distribution.

**Economic Growth**

A major driver for sovereign credit quality is the overall growth of the economy, particularly relative to growth in government expenditures. In the case of Belgium, the country has suffered from declines in GDP growth over the past couple of years, from near 5% as of Sept. 2011 to slightly less than 2% currently. As the EU recovers, Belgium's growth should recover although the weakness of the banking sector remains a drag on the economy.

Another factor to consider which might drive growth are the increasingly socialistic policies of France which are likely to drive companies and highly-paid individuals to change domiciles to Belgium. The recent slight rise in GDP is encouraging particularly in the face of weak conditions for most other EU countries.



**Fiscal Policy**

Belgium's deficit to GDP of 3.9% is not comforting and is likely to grow over the next couple of years. The deficit is a concern in light of the country's debt to GDP in excess of 100%. The variable which has changed in sovereign markets has been the intervention of central banks. If there is a growth in the crisis, it will probably focus on Italy, Portugal, and Spain, and the ECB and other quasi-govt units will provide support. Attempts to implement austerity measures and provide real bank relief are likely to fall short and will increase debt.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Belgium	3.9	101.5	61
Germany	(0.2)	83.7	24
France	4.8	91.9	68
Belgium	3.9	101.5	61
Spain	10.6	82.3	228
Portugal	6.4	118.5	495

Sources: Bloomberg and IFS

**Unemployment**

Belgium's unemployment rate of 8.1% is higher than Germany's but lower than others as indicated in the chart at right. Unemployment for the most recent quarter is 8.7%, which is not particularly comforting. The malaise of the EU weighs on credit quality of Belgium; as the southern EU countries slide, Belgium will be pressured from a shift in workers and a relocation of production.

	Unemployment (%)	
	2011	2012
Belgium	7.1	8.1
Germany	6.8	6.9
France	9.8	10.5
Belgium	7.1	8.1
Spain	22.9	26.0
Portugal	14.0	16.9

Source: Intl. Finance Statistics

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Page 3

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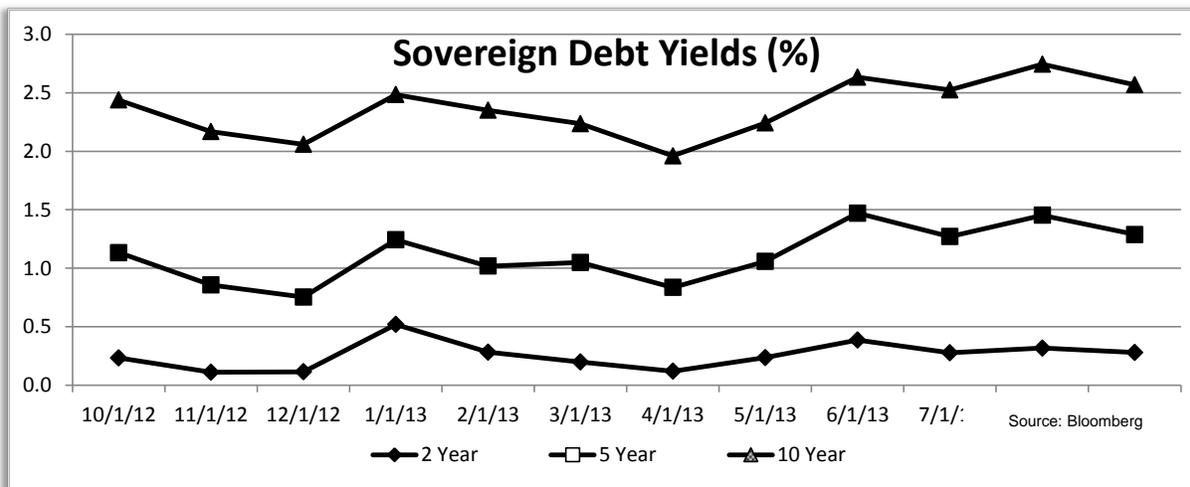
## Banking Sector

Belgium has significantly exposure to its banking because the banks' large aggregate size measured in assets. The top five banks have assets equal to 223% of GDP vs 125% for Germany and 130% for Italy. Belgium has provided financial support to its banks to ameliorate asset quality problems; banks appear to be undercapitalized and equity is severely diluted by reserve shortfalls. However, Belgium's ability to support its banks is minimal.

Bank Assets (billions of local currency)		
	Assets	Cap/ Assets %
DEXIA SA	357	0.9
RHJ INTL	3	22.4
KBC GROEP	257	6.2
BANQ NATL BELGIQ	110	5.1
FORTIS	97	11.1
Total	824	
EJR's est. of cap shortfall at 10% of assets less market cap		-
Belgium's GDP		370

## Funding Costs

As a result of the waning of the ECB's LTRO and weakening credit metrics, Belgium has seen a slight rise in its funding costs over the past couple of months. As can be seen in the below graph, the bond yields have declined since Oct. 2012, but have risen recently. Other EU governments have requested that the ECB, EFSF, and IMF purchase the government's debt. Watch ECB actions to suppress EU funding costs.



## Ease of Doing Business

Major factors for growing the economy are the ease of doing business and the economic freedom; although not the sole factor for determining economic growth, a country which makes it easy for businesses to operate and provides a reasonably free environment to conduct business has a good chance for growth. The chart on the right indicates that with an overall rank of 33 (1 is best, 183 worst) is strong.

The World Bank's Doing Business Survey*			
	2012 Rank	2011 Rank	Change in Rank
<b>Overall Country Rank:</b>	<b>33</b>	<b>31</b>	<b>-2</b>
<b>Scores:</b>			
Starting a Business	44	36	-8
Construction Permits	57	55	-2
Getting Electricity	82	84	2
Registering Property	176	176	0
Getting Credit	70	67	-3
Protecting Investors	19	17	-2
Paying Taxes	75	72	-3
Trading Across Borders	29	30	1
Enforcing Contracts	18	19	1
Resolving Insolvency	7	8	1

\* Based on a scale of 1 to 183 with 1 being the highest ranking.

**Economic Freedom**

As can be seen below, Belgium is above average in its overall rank of 69 for Economic Freedom with 100 being best.

<b>Heritage Foundation 2012 Index of Economic Freedom</b>				
<b>World Rank 69*</b>				
	<b>Rank**</b>	<b>2011 Rank</b>	<b>Change in Rank</b>	<b>World Avg.</b>
<b>Business Freedom</b>	<b>92.3</b>	92.6	-0.3	64.3
<b>Trade Freedom</b>	<b>87.1</b>	87.6	-0.5	74.8
<b>Fiscal Freedom</b>	<b>44.8</b>	41.8	3.0	76.3
<b>Government Spending</b>	<b>12.1</b>	25.0	-12.9	63.9
<b>Monetary Freedom</b>	<b>81.2</b>	82.5	-1.3	73.4
<b>Investment Freedom</b>	<b>80.0</b>	80.0	0.0	50.2
<b>Financial Freedom</b>	<b>70.0</b>	70.0	0.0	48.5
<b>Property Rights</b>	<b>80.0</b>	80.0	0.0	43.5
<b>Freedom from Corruption</b>	<b>71.0</b>	71.0	0.0	40.5
<b>Labor Freedom</b>	<b>71.3</b>	71.0	0.3	61.5

\*Based on a scale of 1-100 with 100 being the highest ranking.

\*\*The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).

Source: The Heritage Foundation & Wall Street Journal

**Assumptions for Projections**

Income Statement	Peer	Issuer	Base Case	
	Median	Average	Yr 1&2	Yr 3,4,5
Taxes Growth%	4.9	4.8	<b>4.8</b>	<b>4.8</b>
Social Contributions Growth %	3.7	5.1	<b>5.0</b>	<b>5.0</b>
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	9.9	16.3	<b>5.0</b>	<b>5.0</b>
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.9	5.6	<b>5.0</b>	<b>4.5</b>
Compensation of Employees Growth%	0.0	4.2	<b>4.0</b>	<b>4.0</b>
Use of Goods & Services Growth%	2.8	2.8	<b>2.8</b>	<b>2.8</b>
Social Benefits Growth%	2.4	5.0	<b>4.8</b>	<b>4.8</b>
Subsidies Growth%	(6.1)	10.4		
Other Expenses Growth%	12.4	12.4	<b>5.0</b>	<b>5.0</b>
Interest Expense	0.0	3.4	<b>2.8</b>	
<b>GDP Growth%</b>			<b>1.5</b>	<b>1.7</b>
Currency and Deposits (asset) Growth%	6.0	0.0		
Securities other than Shares LT (asset) Growth%	(2.2)	0.4	<b>2.4</b>	<b>2.4</b>
Loans (asset) Growth%	30.1	67.8	<b>4.8</b>	<b>4.8</b>
Shares and Other Equity (asset) Growth%	6.3	6.3	<b>6.3</b>	<b>6.3</b>
Insurance Technical Reserves (asset) Growth%	0.0	0.0		
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	7.3	6.6	<b>4.8</b>	<b>4.8</b>
Monetary Gold and SDR's Growth %	0.0	0.0	<b>5.0</b>	<b>5.0</b>
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.0			
Currency & Deposits (liability) Growth%	6.0	6.0	<b>6.0</b>	<b>6.0</b>
Securities Other than Shares (liability) Growth%	8.5	5.7	<b>4.0</b>	<b>4.0</b>
Loans (liability) Growth%	11.1	11.1	<b>11.1</b>	<b>11.1</b>
Insurance Technical Reserves (liability) Growth%	0.0	6.1	<b>2.0</b>	<b>2.0</b>
Financial Derivatives (liability) Growth%	0.0	0.0		
Addl debt. (1st Year) million EUR	0.0	0.0		

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Page 6

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**Base Case****ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)**

	<u>Dec-09</u>	<u>Dec-10</u>	<u>Dec-11</u>	<u>PDec-12</u>	<u>PDec-13</u>	<u>PDec-14</u>
Taxes	96,552	103,377	108,326	113,526	118,975	124,686
Social Contributions	57,230	58,604	61,575	64,654	67,886	71,281
Grant Revenue	0	0	0	0	0	0
Other Revenue	10,064	11,303	13,140	13,797	14,487	15,211
Other Operating Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Revenue	163,847	173,284	183,041	191,976	201,348	211,178
Compensation of Employees	43,485	44,667	46,562	48,425	50,362	52,376
Use of Goods & Services	13,112	13,274	13,649	14,034	14,431	14,838
Social Benefits	85,989	88,417	92,860	97,317	101,988	106,883
Subsidies	7,540	9,191	10,151	10,152	10,153	10,154
Other Expenses	14,473	13,447	15,117	15,873	16,666	17,500
Grant Expense	0	0	0	0	0	0
Depreciation	<u>5,697</u>	<u>5,994</u>	<u>6,338</u>	<u>6,338</u>	<u>6,338</u>	<u>6,338</u>
Total Expenses excluding interest	170,296	174,989	184,676	192,138	199,938	208,089
Operating Surplus/Shortfall	-6,450	-1,705	-1,635	-162	1,411	3,088
Interest Expense	<u>12,641</u>	<u>12,484</u>	<u>12,765</u>	<u>10,511</u>	<u>11,170</u>	<u>11,728</u>
Net Operating Balance	-19,091	-14,189	-14,400	-10,673	-9,759	-8,640

Sources: Historical - IMF, Projections - EJR

**Base Case****ANNUAL BALANCE SHEETS (MILLIONS EUR)**

	<u>Dec-09</u>	<u>Dec-10</u>	<u>Dec-11</u>	<u>PDec-12</u>	<u>PDec-13</u>	<u>PDec-14</u>
<b>ASSETS</b>						
Currency and Deposits (asset)						
Securities other than Shares LT (asset)	759	774	777	796	815	834
Loans (asset)	1,669	2,358	3,957	4,147	4,346	4,555
Shares and Other Equity (asset)	41,477	40,753	43,318	46,044	48,942	52,023
Insurance Technical Reserves (asset)				0	0	0
Other Accounts Receivable LT	15,846	16,156	17,227	18,054	18,920	19,829
Monetary Gold and SDR's						
Additional Assets	9,696	10,684	11,602			
Total Financial Assets	69,447	70,725	76,881	80,643	84,626	88,842
<b>LIABILITIES</b>						
Other Accounts Payable						
Currency & Deposits (liability)	1,279	1,393	1,477	1,477	1,477	1,477
Securities Other than Shares (liability)	290,994	302,959	320,321	333,171	346,536	360,438
Loans (liability)	33,765	35,904	39,874	50,547	60,306	68,946
Insurance Technical Reserves (liability)	<u>539</u>	<u>577</u>	<u>612</u>	<u>624</u>	<u>637</u>	<u>649</u>
Financial Derivatives (liability)						
Other Liabilities	<u>13,544</u>	<u>13,619</u>	<u>14,813</u>	<u>5,713</u>	<u>5,713</u>	<u>5,713</u>
Liabilities	<u>340,121</u>	<u>354,452</u>	<u>377,097</u>	<u>391,532</u>	<u>405,273</u>	<u>418,130</u>
Net Financial Worth	<u>(270,674)</u>	<u>(283,727)</u>	<u>(300,216)</u>	<u>(310,889)</u>	<u>(320,648)</u>	<u>(329,288)</u>
Total Liabilities & Equity	<u>69,447</u>	<u>70,725</u>	<u>76,881</u>	<u>80,643</u>	<u>84,626</u>	<u>88,842</u>

\* Note, non-NRSRO rating. Copyright Egan-Jones Ratings Co.; no secondary distribution.

## **Sovereign Rating Methodology (Non-NRSRO)**

**Scope and Limitations:** Sovereign Issuer Credit Quality Ratings (CQR) are a forward-looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and on time. Sovereigns are assigned two CQRs: a Local-Currency CQR, which reflects the likelihood of default on debt issued and payable in the currency of the sovereign, and a Foreign-Currency CQR, which is an assessment of the credit risk associated with debt issued and payable in foreign currencies.

**Key Rating Drivers:** EJR's approach to sovereign risk analysis is a synthesis of quantitative and qualitative judgments. The quantitative factors EJR uses are:

- Debt in relation to GDP.
- Surplus or deficit in relation to GDP.
- Debt plus potential under-funding of major banks in relation to GDP.
- Interest expense in relation to taxes.
- GDP growth.
- Foreign reserves in relation to debt.

Debt levels for many sovereign issuers have increased at an accelerating rate over the past decade, affecting implied ratings. EJR also considers unemployment levels and funding costs. EJR recognizes that no model can fully capture all the relevant influences on sovereign creditworthiness, meaning that the its sovereign ratings can and do differ from those implied by the rating model. Some of the qualitative factors that impact its ultimate assessment of credit quality include the flexibility, stability and overall strength of the economy, efficiency of tax collection, acceptance of contract law, ease of doing business, trade balances, prospects for future growth and health and monetary policy, and economic freedom. These subjective and dynamic qualitative issues are not captured by the model but affect sovereign ratings

*For additional information, please see Exhibit 2: Methodologies in EJR's Form NRSRO.*