

**RATING ACTION COMMENTARY**

# **Fitch Revises Outlook on Flemish Community to Negative on Sovereign Rating Action; Affirms at 'AA'**

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Fitch Ratings - Paris - 17 Mar 2023: Fitch Ratings has revised the Outlook on the Flemish Community's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) to Negative from Stable and affirmed the IDRs at 'AA'. Fitch has also affirmed the Short-Term Foreign-Currency IDR at 'F1+'. A full list of rating actions is below.

Under applicable credit rating agency (CRA) regulations, the publication of local and regional government reviews is subject to restrictions and must take place according to a published schedule, except where it is necessary for CRAs to deviate from this schedule in order to comply with the CRAs' obligation to issue credit ratings based on all available and relevant information and disclose credit ratings in a timely manner.

Fitch interprets these provisions as allowing us to publish a rating review in situations where there is a material change in the creditworthiness of the issuer that we believe makes it inappropriate for us to wait until the next scheduled review date to update the rating or Outlook/Watch status. The next scheduled review date for Fitch's rating on the Flemish Community is 9 June 2023, but Fitch believes that developments for the Flemish Community warrant such a deviation from the calendar and our rationale for this is set out in the first part (High weight factors) of the Key Rating Drivers section below.

In this case, the deviation was caused by the revision of Belgium's Outlook to Negative from Stable on 10 March 2023 (see "Fitch Revises's Outlook to Negative; Affirms at 'AA-'").

## **KEY RATING DRIVERS**

The rating action reflects the following key rating drivers and their relative weights:

### **HIGH**

The revision in Outlook reflects that on the Belgian sovereign. Fitch considers that the Flemish Community may not be rated more than one notch above the Belgium state (AA-/Negative). As a result, a downgrade of the sovereign would be reflected on the ratings of the Flemish Community, hence the Negative Outlook.

The Flemish Community's Standalone Credit Profile (SCP) is 'aa+', two notches above the rating of Belgium, and the entity meets the conditions for it to be rated above the sovereign, including institutional recognition and large financial and fiscal autonomy. In Fitch's view, the Flemish Community would have the ability to continue servicing its debt despite a default of the sovereign in some scenarios, which is reflected in the one-notch rating difference with the sovereign.

However, Fitch also believes that a sharp deterioration in sovereign finances would likely have an impact on the Flemish Community, and that a default of the sovereign would have a significant impact on the Flemish Community, including a sharp increase in its cost of borrowing, although it would not necessarily lead to an immediate default by the Flemish Community itself. Fitch also considers that the Flemish Community has a large incentive to support the federal government due to the importance of the services provided by the latter to the population, including unemployment benefits. This explains why we consider that the Flemish Community may not be rated more than one notch above the sovereign.

### **LOW**

The derivation of the SCP is unaffected by the rating action and remains 'aa+'.

For key rating drivers see the latest published rating action commentary for Flemish Community (Fitch Affirms Flemish Community at 'AA'; Outlook Stable, published on 8 July 2022).

## **DERIVATION SUMMARY**

The Flemish Community's 'aa+' SCP reflects a combination of a 'Stronger' risk profile and debt sustainability assessed in the upper end of the 'a' category under Fitch's rating case. The IDR is one notch above the rating of Belgium and reflects Fitch's view that in some scenarios the Flemish Community would have the ability to continue servicing its debt, despite a default of the sovereign.

## **KEY ASSUMPTIONS**

Qualitative assumptions and assessments and their respective weigh in the rating decision:

Risk Profile: 'Stronger', unchanged with low weight;

Revenue Robustness: 'Stronger', unchanged with low weight;

Revenue Adjustability: 'Stronger', unchanged with low weight;

Expenditure Sustainability: 'Stronger'; unchanged with low weight;

Expenditure Adjustability: 'Midrange'; unchanged with low weight;

Liabilities and Liquidity Robustness: 'Stronger', unchanged with low weight;

Liabilities and Liquidity Flexibility: 'Stronger', unchanged with low weight;

Debt sustainability: 'a', unchanged with low weight;

Support (Budget Loans): 'N/A', unchanged with low weight;

Support (Ad Hoc): 'N/A', unchanged with low weight;

Asymmetric Risk: 'N/A', unchanged with low weight;

Sovereign Cap: 'AA', lowered with high weight;

Sovereign Floor: 'N/A', unchanged with low weight.

Quantitative assumptions - Issuer Specific

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. The key assumptions for the scenario include for 2022-2026:

- Operating revenue growth on average at 3.2% a year; unchanged with low weight;
- Operating spending growth on average at 2.5% a year; unchanged with low weight;
- Net capex on average at close to EUR5.4 billion a year; unchanged with low weight;
- Apparent cost of debt (consolidated level) at 2.4%; unchanged with low weight.

Quantitative assumptions - sovereign related (note that no weights are included as none of these assumptions was material to the rating action)

Figures as per Fitch's sovereign actual for 2021 and forecast for 2024, respectively:

- GDP per capita (US dollar, market exchange rate): 51,121; 50,828;
- Real GDP growth (%): 6.1; 1.6;
- Consumer prices (annual average % change): 2.3; 3.3;
- General government balance (% of GDP): -5.6; -4.8;
- General government debt (% of GDP): 109.2; 107;
- Current account balance plus net FDI (% of GDP): -3.1; -4.2;
- Net external debt (% of GDP): 17.8; 39.4;
- IMF Development Classification: DM
- CDS Market Implied Rating: AA

## **RATING SENSITIVITIES**

**Factors that could, individually or collectively, lead to positive rating action/upgrade:**

An upgrade of the Flemish Community's ratings is unlikely. The Outlook would be revised back to Stable if the Outlook on the sovereign was revised to Stable, all other things remaining unchanged.

**Factors that could, individually or collectively, lead to negative rating action/downgrade:**

A downgrade of Belgium would also be reflected on the Flemish Community's ratings. The Flemish Community's Long-Term IDRs may be downgraded if its payback ratio exceeds 12x on a sustained basis in our rating case. This could happen if GDP growth in the coming years is lower than that in our rating case.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **ISSUER PROFILE**

The Flemish Community is a federated entity of the Belgian state, combining the responsibilities of a region, such as economy, and that of a community, such as welfare and education. It has a population of 6.6 million, representing 58% of the national population.

## **Sources of Information**

Discussion Note

Committee date: 16 March 2023

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Flemish Community's ratings are linked to Belgium's.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			PRIOR ⚡
Flemish Community	LT IDR	AA Rating Outlook Negative		AA Rating Outlook Stable
		Affirmed		
	ST IDR	F1+	Affirmed	F1+
senior unsecured	LC LT IDR	AA Rating Outlook Negative		AA Rating Outlook Stable
		Affirmed		
	LC ST IDR	F1+	Affirmed	F1+
senior unsecured	LT	AA	Affirmed	AA
senior unsecured	ST	F1+	Affirmed	F1+

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[International Local and Regional Governments Rating Criteria \(pub. 03 Sep 2021\)](#)  
(including rating assumption sensitivity)

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Flemish Community

EU Issued, UK Endorsed

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