

Analyst: Dr Norman Rudschuck, CIIA



Covering an area of 16,844 km², Wallonia is the largest of the three Belgian regions and makes up the southern half of the sovereign territory of Belgium. However, with a population of around 3.6 million people, Wallonia accounts for only around one third of the Belgian population. There are two official languages in Wallonia, which comprises both the French Community of Belgium and the German-speaking Community of Belgium, to which, however, only around 2% of inhabitants in the extreme east of the region belong. The two largest cities in Wallonia are Liège and Charleroi, each with a population of approximately 200,000 inhabitants. In fact, Liège forms the central economic and cultural hub of the region as a whole. However, the capital of Wallonia is Namur, a city of some 110,000 people. Near-permanent conflict has shaped the relationship between Wallonia and its Flemish-speaking, northern neighbour Flanders. The dispute began when the two regions clashed over the official language, although contemporary tensions are above all related to economic issues. While Wallonia assumed the mantle for a flourishing coal and steel industry at the beginning of the 20th century, its northern counterpart, Flanders, was regarded as structurally weak. Following the demise of industry in the 1950s and sluggishly implemented structural reforms in the French-speaking regions of Belgium, the economic strength ratio was reversed to the benefit of Flanders. In recent decades, the areas of responsibility of the regions have been expanded following the implementation of a series of reforms, with the result that today they are administered by the respective local governments on a largely autonomous basis.

Ratings

	Rating	Outlook
Fitch	-	-
Moody's	A2	Negative
S&P	-	-

General information

Outstanding bond volume

EUR 10.7bn

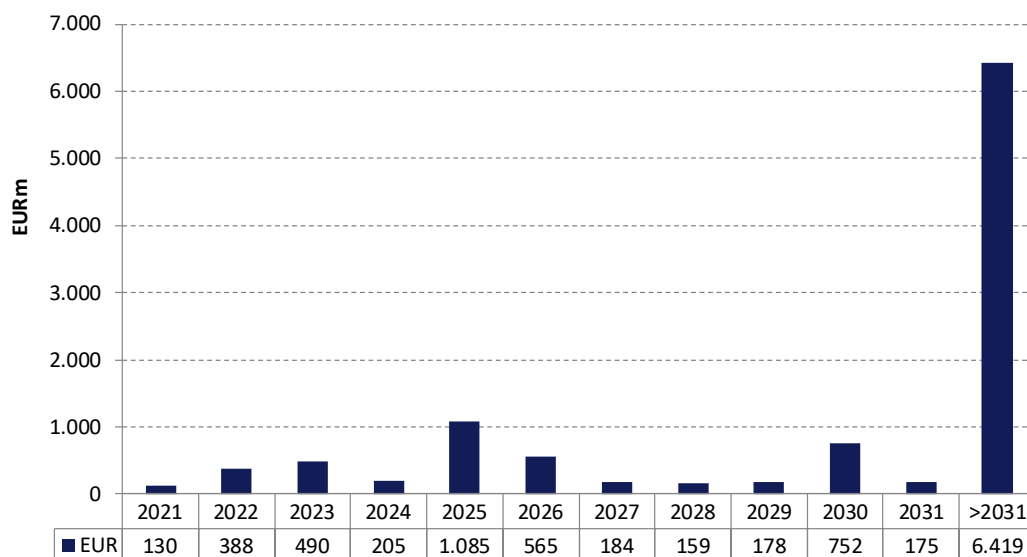
Of which EUR bonds

100%

Bloomberg ticker

WALLOO

Region of Wallonia – outstanding bonds



Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

Funding in Wallonia

Wallonia benefits from good access to diversified funding sources. In 2020, strong demand was recorded for three benchmark bond deals with an overall volume of EUR 3.7bn. Two of these issuances were classified as green bonds. The region has established a debt agency with the aim of optimising its funding strategy. Debt management is based on strict regulations. In this context, securities with a residual term to maturity of less than 12 months and five years may respectively make up a maximum of 15% and 50% of total debt. The share of bonds with a variable rate of interest is capped at 15%, while no diversification in terms of currency is implemented. Overall, WALLOO – as per the Bloomberg ticker – has an outstanding bond volume of EUR 10.7bn.

Rating

Wallonia is rated at A2 by Moody's (with a negative outlook). In December 2020, the outlook for Wallonia was downgraded in view of the uncertainty relating to the further course of the pandemic. In terms of strengths, Moody's highlights the clearly defined responsibilities of the Belgian governance system, in addition to a high degree of fiscal autonomy and efforts aimed at reducing expenditure on the basis of zero-based budgeting. Due to comprehensive fiscal autonomy (sixth state reform 2014) and the fact that 43% of revenues are raised via taxation that can be adjusted by the region, the rating agency attests to the fact that Wallonia boasts extensive leeway in terms of revenues. The establishment of a debt agency is also assessed positively. According to Moody's, the main challenges relate to the regional budget, which has been in deficit for years, rising debts and the weak economic situation compared with other Belgian and similar European regions.

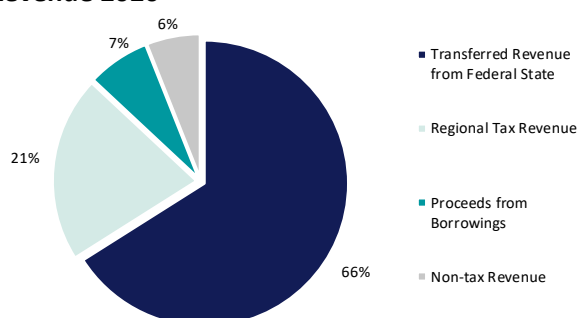
Key economic metrics

The discrepancy between the regions is, among other aspects, today reflected in the unemployment rate, which stood at 13.1% at year-end 2019 (i.e. before the coronavirus crisis) in Wallonia, more than twice as high as Flanders (5.9%). While the economic output of Wallonia was growing steadily by an average of 1.5% p.a. in the years prior to the pandemic, the region is nevertheless still feeling the effects of structural change. It accounts for a share of only around 23% in Belgian GDP, despite making up roughly one third of the population. In 2019, per capita GDP amounted to EUR 27,600, significantly below the Belgian average of EUR 36,600. These days, Wallonia's economic focus is directed towards the service sector to an above-average extent. In 2019, around 79% of all employees worked in this sector. Companies in Wallonia are heavily orientated towards exports, generating an average of 70% of sales via exports over the past few years. The chemicals and pharma industry play the most prominent role here, accounting for 36% of exports overall. More than 50% of sales totalling EUR 48bn were generated from exports to France (29%), Germany (15%) and the USA (8%).

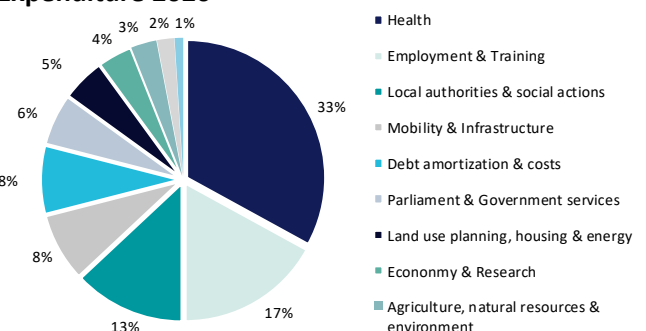
Budget

Deficits have been recorded in the budget of Wallonia each year since 2008. As a result, the debt level has risen continuously. In order to improve this situation, Wallonia started to pursue a policy of zero-based budgeting. This essentially means that expenditure should be continuously reviewed and re-planned from scratch instead of being calculated based on the previous year's budget, as is customary. In addition to savings that should be generated from this, the change in approach aims to improve capital allocation in terms of sustainability. The coronavirus crisis has torn a black hole of some EUR 2bn in the regional budget: expenditure totalled EUR 15.8bn, while revenues came to just EUR 13.8bn. The region is now aiming to raise EUR 3.5bn on the capital market in 2021 to finance this shortfall. The (preliminary) data on revenue and expenditure for the 2020 budget can be broken down as follows:

Revenue 2020



Expenditure 2020



Source: Moody's, Region of Wallonia, NORD/LB Markets Strategy & Floor Research

Regulations

In the SSA segment, we regard the regulatory treatment of exposure as one of the main determinants of the relative attractiveness of an issuer or bond. The method of deriving the risk weighting through CRR, the Commission's decision and CAR therefore confirm the logic of assigning a risk weighting of 0% based on the standard approach. Accordingly, in our opinion, Belgian regions represent interesting alternatives to other issuer groups which benefit from similar regulatory preferential treatment. We also come to the conclusion that Belgian regions benefit from Level 1 classification in the context of the LCR, similar to German Bundeslaender, for example. Preferred status is also awarded within the framework of Solvency II.

Liability mechanism

Interestingly, the Belgian regions enjoy neither horizontal financial equalisation nor an explicit guarantee from the Kingdom of Belgium. Consequently, the state is charged with making corresponding transfer payments at federal level (vertical structure). Tensions between Flanders and Wallonia can be described as significant. It can therefore be stated that no support or liability mechanisms are in place either between the regions and communities or in relation to the federal state. However, Moody's believes it is "highly probable" that the federal government would provide support in the event of payment difficulties – so do we.

Summary of Belgian regions

Risk weighting	0%
LCR classification	Level 1 (EBA list)
NSFR classification	0%
Solvency II classification	Preferred (0%)

Strengths/opportunities

- Savings potential from introduction of zero-based budgeting
- Good market access
- Disciplined debt management

Risks/weaknesses

- High level of unemployment
- Budget deficits recorded each year since 2008
- Political and social conflicts between the regions

Comment

We see Wallonia as a role model among Belgian issuers. Despite the fact that the region's debt level was high even prior to the onset of the Covid-19 crisis and now looks set to rise further due to the pandemic, it is still manageable overall. We also assess the long deficit history as negative, while the below-average economic output compared with other Belgian regions, combined with the high level of unemployment, is another weakness from our perspective. The region continues to suffer from tangible impacts in connection with the structural change related to the former strength of its coal and steel industry. From our point of view, zero-based budgeting is a step in the right direction for the future. The recently established debt agency is definitely a positive development for future economic stability. It would appear that the new government is taking this issue (even) more seriously than was previously the case.

Appendix

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Time of going to press: 09 March 2021 14:45h (CET)

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Breakdown of recommendations (12 months)

Positive: 37%

Neutral: 55%

Negative: 8%

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Issuer / security	Date	Recommendation	Bond type	Cause
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