

CareEdge Global assigns Long Term Foreign Currency Rating of AA- (Unsolicited) to the United Kingdom

Credit Profile

The United Kingdom's credit assessment is supported by its large and well-developed financial sector, the status of the Sterling Pound as a reserve currency, as well as its high-quality institutions. It also represents a large, diversified, and competitive economy. However, these strengths are partly offset by relatively subdued economic growth fundamentals in the long-term and a moderate fiscal profile, arising primarily from elevated general government debt levels.

UK's exit from the European Union (EU) in 2020 increased uncertainty about its investment and trade prospects. Agreements like the Northern Ireland Protocol (2021) and the more recent Windsor Framework (2023) signal plan to address these post-Brexit challenges, and their impact remains to be watched.

Strengths

- Large, diversified and competitive economy
- Well-developed financial sector
- Global reserve currency status
- Strong legislative and executive institutions

Weaknesses

- Subdued economic growth outlook
- Elevated general government debt
- High external debt, though arising from its status as a financial centre

Key Monitorables

- The UK's attempts at addressing the challenges emerging from Brexit-related rigidities

Key Rating Drivers

Economic Structure & Resilience

The UK has a nominal GDP of USD 3.3 trillion positioning it as the sixth largest economy globally. It is a high-income economy with a GDP per capita of USD 47020 (2023) in constant purchasing power parity terms (PPP). It represents a well-diversified and competitive economy with a large services sector, contributing to around 70% of the GDP and more than 45% of the total exports.

These strengths are, however, offset by subdued long-term growth fundamentals and weak investment. The economy is projected to grow at 0.7% in 2024 as against the sluggish growth of 0.1% seen last year. However, the projected growth is likely to remain weak compared to the historical average of 2% growth recorded between 2015-2019. Furthermore, in the past the UK has also witnessed a relatively higher

volatility in its economic growth compared to its similarly rated peers. Going ahead, factors such as an ageing population, tighter immigration policies, and subdued labor productivity are likely to be the headwinds for economic growth.

In terms of investment, the UK's gross fixed capital formation (GFCF) at 18.3% of GDP (2023) is seen to be lower than some of its European and similarly rated peers. Brexit induced uncertainty and the pandemic have weighed on the overall investment scenario in the economy.

Fiscal Strength

UK's fiscal assessment is characterized by an elevated level of gross general government debt at 101% of GDP in 2023. IMF projects this burden to increase consistently each year to reach 110% of GDP by 2029, higher in comparison to the pre-pandemic average of 87% (2015-19). It has a higher exposure to inflation indexed bonds, constituting about 25% of their total public debt, increasing the likelihood of higher interest payouts linked to inflation in the near term. Additionally, the UK's increasing older population is likely to keep the committed expenditure towards salaries, pensions, and net social benefits elevated, going forward.

These challenges are offset by risk-mitigating factors such as long-term maturity profile of general government debt, low foreign currency debt, Sterling Pound's global reserve currency status, and access to institutional investors with sufficient market absorption capacity for government securities. Furthermore, its debt affordability measured in terms of interest payments to revenue remained comfortable though elevated relative to its similar rated peers.

External Position & Linkages

The Sterling Pound's reserve currency status represents a key strength for the UK on the external front. The UK's current account balance has historically remained in a deficit, and the deficit is projected to remain elevated, averaging at 3.3% of GDP in the next five years. The UK's external debt is high at 288% of GDP (2023), which must be viewed in the context of London's status as a key international financial center. However, such high external debt increases its susceptibility to changes in investor sentiment. Furthermore, the UK's external funding ratio (defined as the ratio of the country's current account payments and short-term external debt by residual maturity to current account receipts and FDI net inflows) is seen to be the highest among the similar rated peers at 8.1 times (2023) owing to a large quantum of short-term external debt (by residual maturity).

The UK has a highly negative net international investment position at -31.4% of GDP in 2023. Though UK's foreign exchange reserves remain low in terms of months of imports, they are seen to be broadly in line with other advanced economies.

Monetary & Financial Stability

The Sterling Pound is a global reserve currency with a share of 4.9% in the global foreign exchange reserves (2023) and the UK's exchange rate regime is free-floating. These aspects serve as key strengths for the assessment of the UK's monetary pillar.

CPI inflation eased to 7.3% in 2023 from a peak of 9.1% in 2022. It is projected to ease further returning close to the Central Bank's 2% target by 2025. Going ahead, the upside risks to the inflationary scenario emerge from wages and services inflation. The Monetary Policy Committee kept the interest rates unchanged in its September meeting following a 25-basis points rate cut in August this year. However, it highlighted that the monetary policy would remain restrictive until the risks to inflationary pressures have moderated further.

The UK represents a large and well-developed financial sector with banks maintaining a comfortable capital and liquidity position. Furthermore, the asset quality of the banks remain strong with the non-performing loans seen at just 1% of the total gross loans as of Q1 2024.

Institutions & Quality of Governance

The UK benefits from its strong legislative and executive institutions. However, frequent leadership changes in recent years underscore the need for policy continuity, especially in the context of financial market volatility of 2022, which necessitated Bank of England's intervention. The Labour party won a majority in the 2024 general election with Sir Keir Starmer becoming the UK's new Prime Minister.

The recent steps to enhance cooperation with the EU signal commitment towards addressing the post-Brexit issues. However, their impact on fully addressing the post-Brexit rigidities remains a key monitorable going forward.

| United Kingdom – Select Indicators | | | | | | | | | |
|---|-------------|---------|---------|---------|---------|---------|---------|---------|---------|
| | Unit | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 F | 2025 F |
| Economic Indicators | | | | | | | | | |
| Nominal GDP | USD Billion | 2875.0 | 2853.1 | 2699.7 | 3142.3 | 3100.1 | 3344.7 | 3495.3 | 3685.4 |
| GDP Per Capita (Constant-PPP) | USD | 46597.6 | 47106.6 | 42047.6 | 45560.2 | 47181.1 | 47019.7 | 47020.8 | 47544.5 |
| Real GDP Growth | % | 1.4 | 1.6 | -10.4 | 8.7 | 4.3 | 0.1 | 0.7 | 1.5 |
| GFCF/GDP | % | 18.0 | 18.2 | 17.5 | 17.7 | 18.3 | 18.3 | - | - |
| Gross Domestic Savings/GDP | % | 16.8 | 17.0 | 18.2 | 17.8 | 17.1 | 17.4 | - | - |
| Exports (G&S)/GDP | % | 31.6 | 31.6 | 29.7 | 29.6 | 33.4 | 32.2 | - | - |
| Working-Age (15-64) Population (% Share in Total) | % | 63.8 | 63.6 | 63.5 | 63.4 | 63.4 | 63.3 | 63.3 | 63.2 |
| Old-Age (65+) Population (% Share in Total) | % | 18.3 | 18.5 | 18.7 | 18.9 | 19.2 | 19.5 | 19.8 | 20.1 |
| Fiscal Indicators – General Government | | | | | | | | | |
| Fiscal Balance/GDP | % | -2.3 | -2.5 | -13.1 | -7.9 | -4.7 | -6.0 | -4.6 | -3.7 |
| Revenue/GDP | % | 36.6 | 36.3 | 36.8 | 38.0 | 39.7 | 38.6 | 39.5 | 39.9 |
| Expenditure/GDP | % | 38.9 | 38.7 | 49.9 | 45.9 | 44.4 | 44.7 | 44.1 | 43.6 |
| GG Gross Debt/GDP | % | 86.3 | 85.7 | 105.8 | 105.2 | 100.4 | 101.1 | 104.3 | 106.4 |
| GG External Debt (by Creditor)/GG Gross Debt | % | 20.3 | 22.1 | 21.6 | 21.5 | 16.8 | 17.3 | - | - |
| Interest/Revenue | % | 6.8 | 6.0 | 5.4 | 7.3 | 10.9 | - | - | - |
| External Indicators | | | | | | | | | |
| Current Account Balance/GDP | % | -3.9 | -2.7 | -2.9 | -0.5 | -3.1 | -3.3 | -3.2 | -3.5 |
| FDI, Net Inflows/GDP | % | -0.9 | 0.7 | 5.8 | 0.2 | 1.4 | -1.4 | - | - |
| Outstanding FII Liabilities/GDP | % | 139.6 | 159.9 | 174.5 | 162.1 | 128.2 | 133.4 | - | - |
| NIIP/GDP | % | -2.4 | -11.3 | -9.7 | -13.7 | -13.8 | -31.4 | - | - |
| Foreign Exchange Reserves | USD Billion | 171.8 | 172.7 | 177.2 | 193.0 | 176.9 | 177.8 | - | - |
| Import Cover | Months | 2.2 | 2.2 | 2.7 | 2.5 | 1.9 | 1.9 | - | - |
| External Debt/GDP | % | 293.0 | 309.9 | 360.5 | 311.2 | 295.5 | 288.3 | - | - |
| Monetary and Financial Indicators | | | | | | | | | |
| CPI Inflation | % | 2.5 | 1.8 | 0.9 | 2.6 | 9.1 | 7.3 | 2.7 | 2.1 |
| Exchange Rate (Average) | LC per USD | 0.7 | 0.8 | 0.8 | 0.7 | 0.8 | 0.8 | - | - |
| Non-Performing Loans/Total Gross Loans | % | 1.1 | 1.0 | 1.0 | 1.0 | 0.9 | 1.0 | - | - |
| Private debt, loans and debt securities/GDP | % | 157.0 | 155.3 | 173.5 | 163.4 | 150.8 | - | - | - |

Sources: International Monetary Fund, World Bank, Bank for International Settlements, National Sources, CareEdge Global

Note: F - Forecast; PPP – Purchasing Power Parity; GFCF – Gross Fixed Capital Formation; Exports (G&S) – Exports of Goods and Services; GG – General Government; FDI – Foreign Direct Investment; FII – Foreign Institutional Investment; NIIP – Net International Investment Position; Data refers to fiscal/calendar year and actual/estimate as reported by the source; Where general government data is unavailable, central government data is used; Latest available data for 2023

Rating History

| Instrument | Type | Rating | Date |
|---------------|---|--------|-----------------|
| Issuer Rating | Long Term Foreign Currency (Unsolicited) | AA- | October 3, 2024 |

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Criteria Applied

CareEdge Sovereign Rating Methodology

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