United Kingdom
Rating Report

AA
STABLE OUTLOOK

Credit strengths

- Strong institutional framework
- Large, wealthy and diversified economy
- High degree of financing flexibility
- Robust debt profile

Credit challenges

- Weakening fiscal and economic outlooks
- Weak external position with persistent current account deficit
- Prolonged uncertainties surrounding the post-Brexit UK-EU trade relationship

Rating rationale:

Strong institutional framework: The UK benefits from robust financial supervisory, economic and monetary governance frameworks. This strong institutional support allows for swift reactions to crises, notably in September 2022 during an episode of market turmoil involving pension funds.

Large, wealthy and diversified economy: The UK economy proved broadly resilient to the Covid-19 shock, with output edging close to pre-pandemic level by late 2021. While the economic outlook has since weakened materially, comparatively high wealth and a very diversified economic base remain significant resilience factors.

High degree of financing flexibility: Despite the heightened volatility in gilt markets last year, the country significantly benefits from its access to deep domestic capital markets and sterling's status as a reserve currency.

Robust debt profile: The UK benefits from a high average debt maturity of 14.7 years. Around one-fifth of government debt is indexed to inflation, which led to a rapid temporary rise in debt servicing costs in 2022.

Rating challenges include: i) the country's weakening fiscal and economic outlook; ii) a weak external position with a persistent current account deficit; and iii) the prolonged uncertainties surrounding the post-Brexit UK-EU trade relationship.

United Kingdom's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aa+	GBP [+1]	+2/3	AA
Public Finance Risk		20%	bb-		+1/3	
External Economic Risk		10%	Ccc		-1/3	
Financial Stability Risk		10%	aaa		+2/3	
ESG Risk	Environmental Factors	5%	a-		+1/3	
	Social Factors	7.5%	bb+		0	
	Governance Factors	12.5%	aaa		0	
Indicative outcome			**a+**		**+2**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

- Significant improvement of the fiscal outlook including a stable downward trajectory of public debt in the medium term
- Reduction of external vulnerabilities

Negative rating-change drivers

- Protracted fiscal deterioration leading to weaker debt sustainability
- Growth outlook weakening significantly over the medium term
- Increase in external vulnerabilities or challenge to sterling's reserve currency status

Ratings and Outlook

Foreign currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

Lead Analyst

Eiko Sievert
+49 69 6677389-79
e.sievert@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

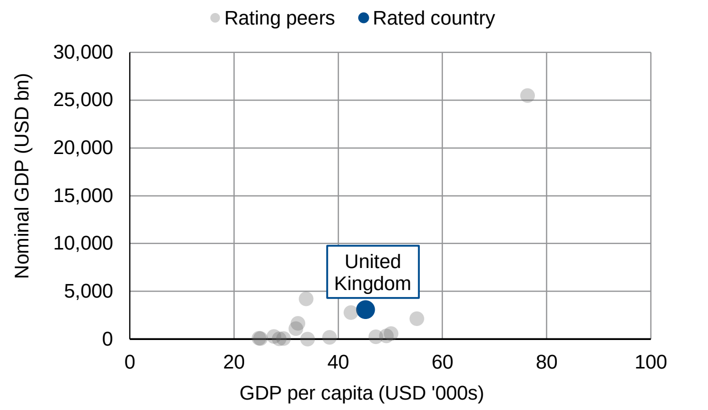
Domestic Economic Risks

- **Growth outlook**: After displaying broad resilience in H1 2022, the economic momentum stagnated in H2 2022, with quarterly growth rates falling by 0.1% in Q3 and rising by 0.1% in Q4. This primarily reflects a slowdown in private demand, amid declining real incomes and rapidly tightening borrowing conditions. By end-2022, UK GDP remained 0.6% below pre-pandemic levels, pointing to a lag in its recovery relative to European peers. We expect growth will remain subdued over the medium term due to the adverse impact of persistent inflationary pressures and high interest rates. After reaching 4.1% in 2022, we expect real growth to slow down to 0.2% in 2023, before gradually rising to its long-term potential, which we estimate at around 1.5% per year.
- **Inflation and monetary policy**: CPI inflation has stabilised at very high levels and stood at 10.1% YoY in March 2023. Similarly, core inflation remained stable from the previous month, at 6.2%. Moving forward, we expect headline inflation to moderate thanks to base effects, a fall in the price of imported goods and declining domestic demand. This decline should only be gradual in view of persistent underlying price pressures driven in part by tight labour markets and the continued feed-through of higher energy prices to the broader economy. The Bank of England has rapidly tightened monetary policy since December 2021, raising the Bank rate to 4.5% by May 2023. The Bank also continued its planned quantitative tightening by stopping re-investments in February 2022 and actively selling bonds from November 2022.
- **Labour market**: Labour market dynamics have remained robust despite the slowing economic momentum, with the unemployment rate close to historical lows (3.8% as of January). The employment rate, at 75.8%, counts among the highest in the peer group. Declining job vacancies (-14.5% YoY in February) and decelerating nominal wage growth point to some moderation in labour market tightness, although vacancy rates remain well above pre-pandemic levels. We expect the unemployment rate to increase slightly over the next two years, averaging 3.9% this year and 4.0% in 2024.

Overview of Scope's qualitative assessments for the United Kingdom's *Domestic Economic Risks*

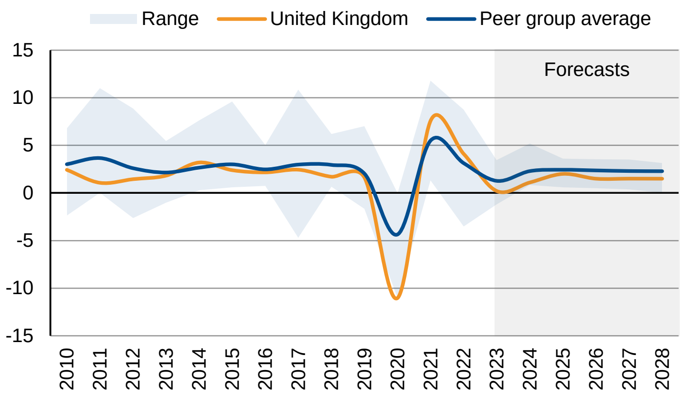
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Growth potential of the economy	Neutral	0	Moderate growth potential compared with peers
	Monetary policy framework	Strong	+1/3	Highly credible and effective central bank; independent monetary policy
	Macro-economic stability and sustainability	Strong	+1/3	Diversified economy and flexible labour market; strong institutional framework has supported quick recoveries following recent shocks

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

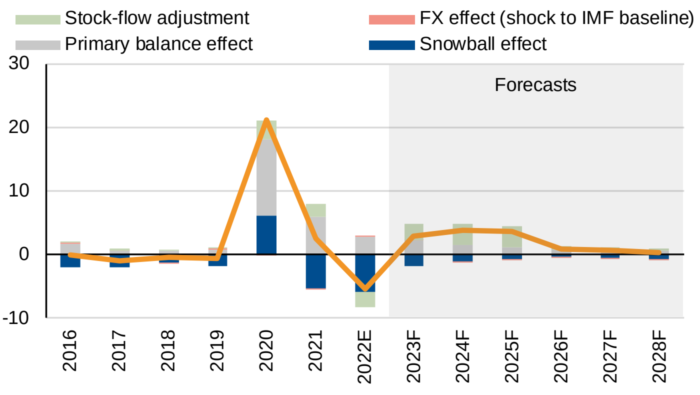
Public Finance Risks

- **Fiscal outlook**: The general government deficit narrowed to 6.3% of GDP in 2022, down 2 pp YoY but remaining well above pre-pandemic levels of below 3%. The improvement was driven by robust revenue growth outweighing spending pressures stemming from the energy crisis (amounting to GBP 41.2 bn in the year to March 2023, about 1.7% of GDP) and rising debt service costs. Much of the additional headroom against the government's fiscal targets was used to provide further energy support measures for businesses and households, capital allowances for qualifying business investments, measures aimed at increasing labour market participation, higher defence spending and fuel duty freezes. Looking ahead, we expect the UK's fiscal deficit to improve only gradually, declining to 5.6% in 2023 and 5.0% in 2024, before stabilising at a high level of around 4.0% of GDP over a forecast horizon ending in 2028.
- **Debt trajectory**: The debt-to-GDP ratio declined to 102.6% last year in a context of high inflation and lower fiscal deficits, down 5.5 pp from 2021 albeit remaining well above its 2019 level of around 85%. We expect debt to be on an upward trend from 2023, increasing to 105.5% this year and reaching around 115% by 2028 amid persistent high primary deficits, moderate nominal growth and elevated borrowing costs. Ageing-related contingent liabilities pose a long-term challenge to the debt trajectory as also reflected in IMF estimates for the net present value of healthcare and pension spending changes at nearly 68% of GDP over 2022-2050.
- **Market access**: The UK benefits from strong market access, with an exceptionally long average debt maturity (14.7 years as of end-2022) compared to peers. Despite the gradual process of quantitative tightening, the Bank of England remains the largest holder of gilts (around one-third of total). Interest rates have stabilised in recent months after increasing sharply since H2 2021 amid rising inflation and tightening monetary policy and following a temporary jump in September 2022 in response to the previous government's mini-budget. The yield on 10-year government bonds averaged about 3.6% in April 2023, broadly stable from the beginning of the year. Over a quarter of government gilts are indexed to retail-price inflation, which led to a sharp temporary rise in interest payments in 2022 with the interest burden rising from 5.9% of revenues in 2021 to 9.1% in 2022.

Overview of Scope's qualitative assessments for the United Kingdom's *Public Finance Risks*

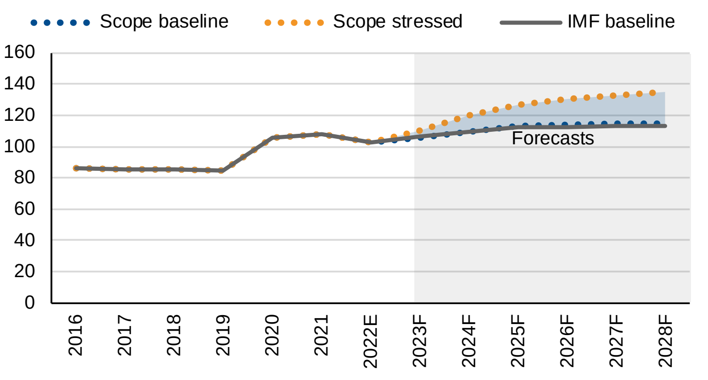
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Fiscal policy framework	Neutral	0	Renewed commitment to budgetary discipline, but revised fiscal framework could weaken future fiscal discipline
	Debt sustainability	Neutral	0	Debt expected to gradually increase, but still in line with most peers
	Debt profile and market access	Strong	+1/3	Excellent government market access, long average debt maturity, significant debt held by central bank, high share of index-linked government debt

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

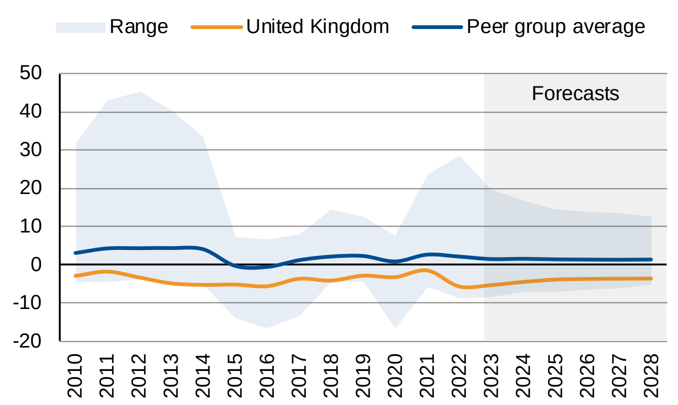
External Economic Risks

- **Current account:** The UK has a track record of running a sizable current account deficit, averaging 3.5% of GDP over 2017-2019, well above peer countries. After moderating temporarily during the pandemic, amid lower domestic demand and robust services exports, the current account deficit widened again to 3.8% of GDP in 2022 as a result of a record-high deficit in the trade of goods balance (10.3% of GDP), primarily reflecting the impact of soaring nominal energy imports. Subdued economic growth in the UK's main trading partners will weigh on export dynamics over the medium term. We therefore expect the current account balance to remain large, negative and recover only gradually over the coming years, in line with IMF forecasts, which estimates the current account deficit will average 4.0% of GDP over 2023-2028.
- **External position:** The external debt-to-GDP ratio stood at about 293% as of end-2022, close to pre-pandemic averages. Short-term liabilities make up just over 70% of the external debt stock and more than half of external liabilities are owed by financial institutions. A significant share of foreign currency-denominated liabilities represents a degree of exchange rate risk. The net international investment position (NIIP) is moderate, at -11% of GDP as of end-2022. It narrowed sharply in Q3 2022 to -4.5% as a result of a short-term depreciation of Sterling against other currencies, though this largely reversed in Q4 as Sterling strengthened against most major currencies.
- **Resilience to shocks:** International reserves held by the UK are typically low. Holdings of gross reserves increased in 2009 and 2021, with the allocation of Special Drawing Rights by the IMF, a rise in the value of gold and a government provision of GBP 72bn for additional financing that ended in April 2020. The sterling's status as a reserve currency largely shields the country from external short-term shocks. The share of global reserves held in GBP has moderately increased in recent decades, from 2.7% in 2000 to 4.9% as of end-2022, supporting our view that it will retain its status in the foreseeable future.

Overview of Scope's qualitative assessments for the United Kingdom's *External Economic Risks*

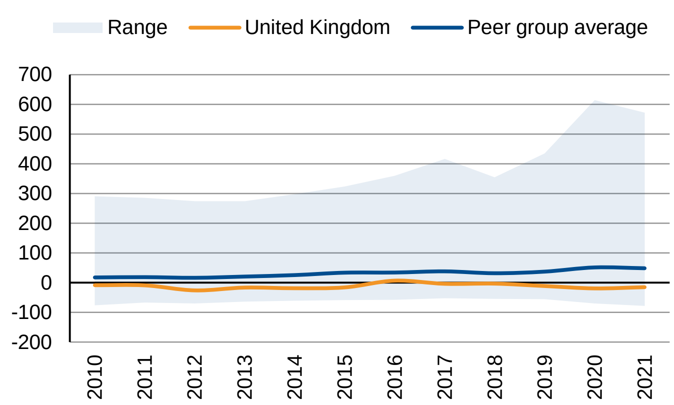
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Weak	-1/3	Expectations of persistent wide current account deficit
	External debt structure	Weak	-1/3	High external debt, with high foreign currency composition
	Resilience to short-term external shocks	Strong	+1/3	Sterling as a reserve currency shields against short-term external shocks; track record of effective institutional responses to recent shocks

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

Financial Stability Risks

- **Banking sector:** The UK banking sector's resilience is underpinned by favourable capital and liquidity positions, as reflected in a Tier 1 ratio of 18.4% and liquidity ratio (comparing liquid assets with short-term liabilities) of 35.4% as of end-2022. Asset quality is strong, with the NPL ratio remaining below 1%. We expect NPLs to increase in the medium term as a result of the rapid rise in interest rates, persistent cost pressures and the weak economic outlook. While asset quality is likely to deteriorate, we expect higher interest rates to support banks' lending margins. Despite falling somewhat in 2022, profitability remains robust relative to pre-pandemic averages, as reflected in an aggregate return-on-equity of 7.6% in Q4 2022 (up from 3.7% in Q4 2019). To further build bank resilience in light of the more challenging economic outlook, the Financial Policy Committee maintained the counter-cyclical capital buffer rate in its September meeting at 2%, effective from July 2023.

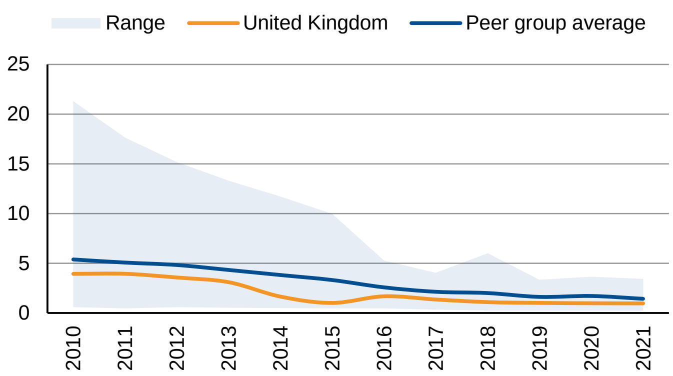
- **Private debt:** Private sector debt is high but stands below pre-pandemic levels with aggregate household debt at 85% of GDP as of end-2022 and debt to non-financial corporations at 70%. Persistent inflationary pressures and high lending rates are weighing on households' balance sheets and increase their vulnerability to future shocks. Despite having declined in recent years, aggregate debt service paid by households remains high when compared with peers, at 8.5% of income. The Bank of England estimates that around 70% of owner-occupier mortgagors will experience an increase in their mortgage payments by 2025, reflecting the impact of rising mortgage rates. Small and medium-sized businesses will be impacted significantly faster as most of their loans tend to be on variable rates.

- **Financial imbalances:** Residential real estate market activity slowed markedly in 2022 as a result of rapidly rising interest rates and weakening economic activity. However, mortgage costs have eased somewhat in early 2023 and Nationwide's house price index increased moderately in April 2023 (up 0.5% from March) after seven consecutive months of decline, though the number of mortgage approvals remains around one-third below pre-pandemic levels. Although we expect further price corrections over the medium term, the downturn is unlikely to rival the global financial crisis as household finances remain on a stronger footing and mortgage contracts since 2008 better reflect borrower risk profiles.

Overview of Scope's qualitative assessments for the United Kingdom's *Financial Stability Risks*

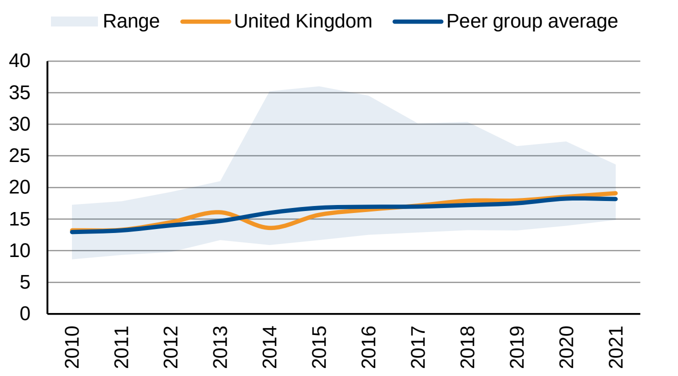
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Strong	+1/3	Banking-system capitalisation remains sound, low NPLs, good profitability
	Banking sector oversight	Strong	+1/3	Sophisticated financial regulatory system and strong macro-prudential governance framework
	Financial imbalances	Neutral	0	High private debt levels, high asset valuations and sharp rise in cost of borrowing

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

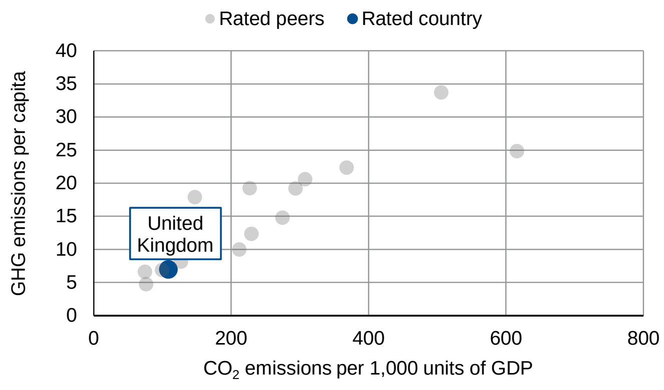
ESG Risks

- **Environment:** The UK is committed to reaching net zero carbon emissions by 2050. According to the independent Climate Change Committee, the Net Zero Strategy is an ambitious but achievable vision towards carbon neutrality. Over 1990-2021, the UK reduced its carbon emissions by 42%, the sharpest decrease among G7 countries. The country almost doubled the share of its energy supplied from low carbon sources in recent decades, from 9.9% in 2000 to 19.5% in 2021. To support further decarbonation and raise the country's energy independence, the government aims to reach a 95% low-carbon electricity mix by 2030, including through significant investments in wind and nuclear energy. The UK is exposed to the effects of climate change, specifically flooding, water-supply shortages and risks to health from high temperatures. While some estimates suggest a moderate impact on the UK's economic output in the long run, a high degree of uncertainty remains.
- **Social:** The labour force participation rate is high relative to peers at 78.9% as of January 2023, despite having declined somewhat compared to pre-pandemic averages. Challenges relate to comparatively high income inequality, reflected in a higher Gini coefficient compared with peer countries and high poverty rates. We expect the current pressures on real wages will aggravate income inequality, thereby raising the risk of social exclusion and increasing the need for government support to households.
- **Governance:** The UK benefits from mature institutions under parliamentary democracy, although its institutional strength has been tested since the 2016 EU referendum. The implementation of the Windsor Framework should favour a more stable and predictable policy environment, following a period of tensions surrounding the Northern Ireland protocol. Despite the more stable, predictable and constructive policy environment under Rishi Sunak, the Conservative party suffered significant losses during the May 2023 local elections in England. The next general elections are set to be held no later than January 2025.

Overview of Scope's qualitative assessments for the United Kingdom's *ESG Risks*

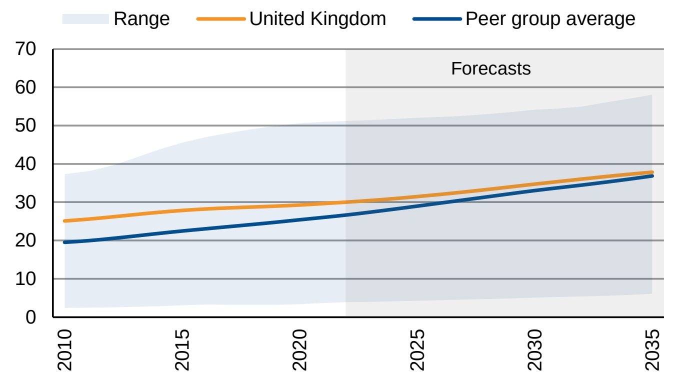
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Environmental factors	Strong	+1/3	Ambitious commitment to carbon neutrality by 2050; low carbon intensity compared with peers
	Social factors	Neutral	0	Substantial social safety nets; challenges include high income inequality, elevated poverty rates compared with peers and the risk of social exclusion
	Governance factors	Neutral	0	Resilient institutional framework, but elevated political uncertainty and ongoing domestic and international Brexit-related challenges

Emissions per GDP and per capita, $mtCO_2e$



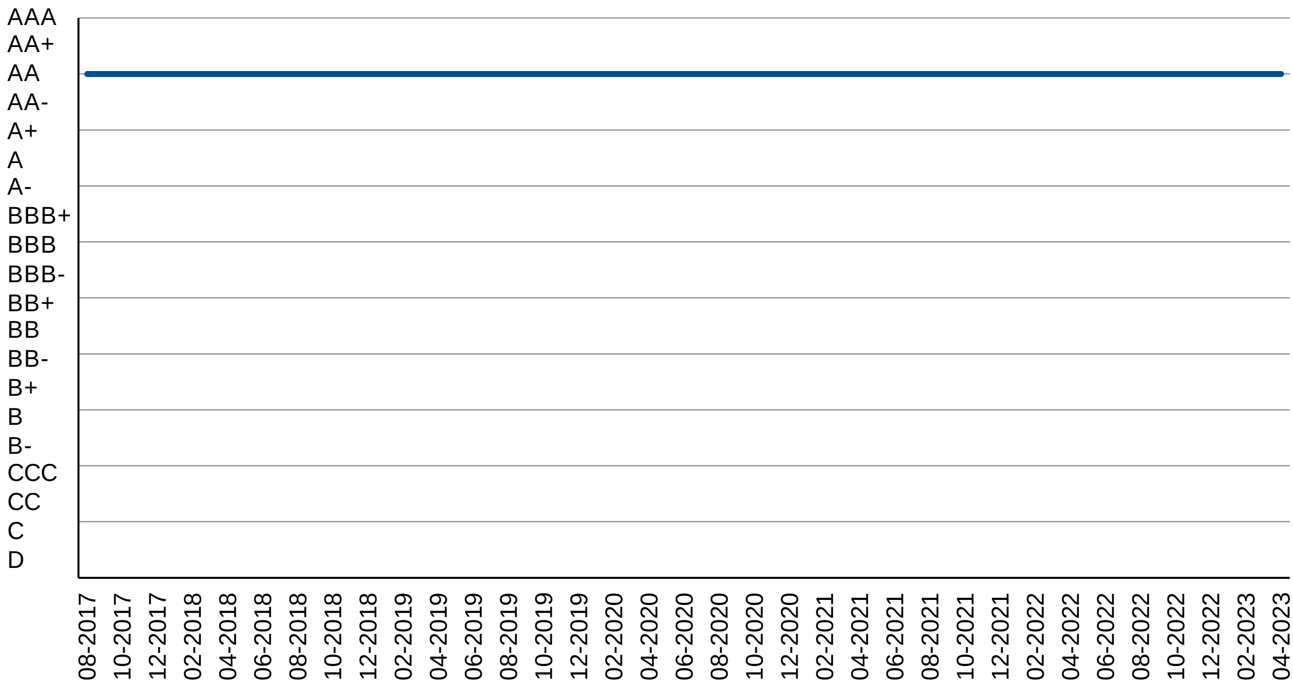
Source: European Commission, Scope Ratings

Old-age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Belgium
Czech Republic
Estonia
France
Japan
Lithuania
Malta
Slovenia
United States

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022	2023
Domestic Economic	GDP per capita, USD '000s	IMF	43.4	42.8	40.3	46.4	45.3	46.4
	Nominal GDP, USD bn	IMF	2,881.8	2,858.7	2,706.5	3,123.2	3,070.6	3,158.9
	Real growth, %	IMF	1.7	1.6	-11.0	7.6	4.0	-0.3
	CPI inflation, %	IMF	2.5	1.8	0.9	2.6	9.1	6.8
	Unemployment rate, %	WB	4.0	3.7	4.5	4.8	-	-
Public Finance	Public debt, % of GDP	IMF	85.2	84.5	105.6	108.1	102.6	106.2
	Interest payment, % of revenue	IMF	4.5	3.8	2.9	5.9	9.1	6.4
	Primary balance, % of GDP	IMF	-0.5	-0.9	-12.0	-6.0	-2.7	-3.3
External Economic	Current account balance, % of GDP	IMF	-4.1	-2.8	-3.2	-1.5	-5.6	-5.2
	Total reserves, months of imports	IMF	1.6	1.7	2.1	2.0	-	-
	Net international investment position, % of GDP	IMF	-2.9	-11.0	-19.1	-14.9	-10.6	-
Financial Stability	NPL ratio, % of total loans	IMF	1.1	1.0	1.0	1.0	-	-
	Tier 1 ratio, % of risk-weighted assets	IMF	17.0	17.7	17.2	18.4	17.3	-
	Credit to private sector, % of GDP	WB	133.7	132.3	146.6	-	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	121.8	116.1	111.0	108.7	-	-
	Income share of bottom 50%, %	WID	20.3	20.4	20.4	20.4	-	-
	Labour-force participation rate, %	WB	77.7	78.0	-	-	-	-
	Old-age dependency ratio, %	UN	28.8	29.0	29.3	29.7	30.0	30.5
	Composite governance indicators*	WB	1.3	1.4	1.3	1.3	-	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 19 May 2023	19.11

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30 31 58 14

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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