The United Kingdom of Great Britain and Northern Ireland

Rating Results

Long-term Local Currency：AAA_i

Long-term Foreign Currency：AAA_i

Outlook：Negative

Previous Results

Long-term Local Currency：AAA_i

Long-term Foreign Currency：AAA_i

Outlook：Stable

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Rating Opinion

On June 23, 51.9% of the voters voted "leave" in the United Kingdom European Union membership referendum ("Brexit"), pointing to the prospect of the UK breaking with the European Union. In consideration of the impacts, explicit or implicit, probably caused by a Brexit, the United Ratings has adjusted the outlook for the UK, from Stable to Negative, but maintaining the UK's sovereign ratings in both local and foreign currencies at AAA_i.

The existing high-level sovereign rating of the UK is determined by many factors, such as the stable constitutional monarchy system, mature government replacement mechanism, exceptional public policy effectiveness, economic strength and the long-lasting role of London as an international financial center. All these factors help the UK withstand risks. However, the United Ratings has observed that (1) the Brexit vote is impairing the predictability of the UK's public policy and the effectiveness of its government; (2) uncertainties surrounding the UK's economic and trade relations with the EU and the UK's domestic politics are increasing; (3) short-term declines in business confidence are likely to result in decreases in domestic investment and consumption, which may reverse the favorable trend of the UK's economic recovery and growth since the global financial crisis; (4) the financial sector is significantly impacted by the referendum result and the local currency has depreciated substantially, so that the role of London as one of the world financial centers may be challenged; (5) public budget deficit is probably rising higher than expected, thus the pubic budget burden will increase. In view of the above-stated points, the United Ratings believes that the sovereign rating of the United Kingdom faces the possibility of downgrading.

Rationale for Outlook Adjustment

The Brexit vote greatly amplified the UK's political risk. The Conservative Party has been further fragmented. The resignation of Prime Minister David Cameron, who has firmly favored the UK remaining in the EU, makes the appointment of future cabinet members uncertain. In addition, the majority of the voters in Scotland and Northern Ireland strongly wished to stay in the EU, which is likely to lead to their separation from the UK. In a certain period of time, these factors will exacerbate the UK's political frailties, impacting the predictability and stability of its policies. In the short to medium term in particular, the UK risks a certain degree of political volatility.

Uncertainties of the negotiation between the UK and the EU on the UK's departure increase the probability of the country's political and economic changes. Under Article 50 of the Lisbon Treaty, the UK and the EU will engage in a two-year-long negotiation. The central question will be: to what extent the UK could maintain its access to the EU single market. In the medium and long term, this will be an important factor that affects the UK's economic performance in the future. Whether the EU will give the UK the benefits of the EU common market currently enjoyed by Switzerland or Norway or will adopt some other pattern that brings a higher market barrier to the UK is highly uncertain. As of the end of 2015, 44% of the UK's exports went to the EU single market, 15.3% to the US, and 6.3% to China. Therefore, the UK's relationship with the EU is still critical. On the other side, in order to avoid Brexit's knock-on effect, the EU is very likely to take a hard line in the negotiation, while the UK is reluctant to accept the free flow of people in exchange of favorable trade terms. For this reason, the entire negotiation process appears to be full of uncertainties and could be further delayed.

The Brexit vote has a negative impact on the UK's financial sector. The total assets of the UK's financial sector are 4.5 times its GDP, and the assets belonging to foreign banks account for about 50% of the total bank assets. Under the existing financial regulatory regime, financial institutions set up in the UK may provide services to clients in all EU member states. Over the years, this has attracted many foreign investors to the UK's financial sector, exploiting its established financial infrastructure and human resources to expand their business in Europe. At the same time, the role of London as an international financial center is also consolidated. If the UK leaves the EU, a large part of the capital from the European Continent is likely to return to Europe, some organizations or some of their functions may withdraw from Europe, and London can hardly keep its status as a Euro transaction center. Part or all of these adverse possibilities mentioned above, if realized, will seriously impact the UK's financial sector. Because of the uncertainties of the negotiation between the UK and the EU on their economic relations, the attractiveness of the UK's financial sector will decline, the position of London as the second largest international financial center will be eroded, and the ability to attract FDI and external funding could deteriorate.

The soaring uncertainties with regard to the business environment and diminishing confidence in investment could reverse the UK's current economic recovery and growth, leading to increasing unemployment. Following the global financial crisis, the UK stood out among the developed world with a healthy recovery. Its GDP growth rate reached 2.2% in 2015, much higher than that of the Euro Zone and Japan, roughly on a par with the US. Nonetheless, the Brexit vote has brought great uncertainty to the country's investment environment. Some investors at home and abroad would take a wait-and-see attitude, and consumer sentiment may be affected to some degree. The gains in exports from the pound's devaluation are insufficient to offset the losses mentioned above. As a result, the economic recovery will inevitably fall in the short term: GDP growth is expected to decline to 1.6% in 2016 and 1.1% in 2017, considerably lower than the average of 2.4% in the past three years. Furthermore, the United Ratings has also noted that property prices in the UK, in particular in London, has been rising in recent years, above the highest level when the 2008 global financial crisis broke out. There has been much talk about bubbles in the real estate sector. Whether the result of the referendum would shake confidence in the real estate market and lead to greater economic volatility bears watching.

To alleviate economic slowdown and stimulate growth, the UK government may increase public investment and government spending. We forecast that the UK's public budget deficit will increase for some time in the future, and the government debt level will surge slightly. After the global financial crisis, the Cameron Government has been committed to fiscal consolidation by cutting government expenditure. Fiscal expenditure in 2015 as a percentage of GDP fell 5.6 percentage points from 2010. Correspondingly, fiscal deficit declined to 4.4% from 9.66%. However, this process will change as a result of the Brexit vote. On the one hand, the economic downturn and especially the impact on the financial sector would result in slower growth of tax revenue. On the other hand, change of government may perhaps prompt adjustments of fiscal policy. The possibility of the introduction of a stimulus plan by the new government can't be ruled out. If so, the contraction of fiscal deficit may slow down and government debt will continue to rise slightly.

Rationale for Maintaining Sovereign Ratings

The UK's parliamentary system has a long history and has survived many domestic and international political and economic shocks, showing its resilience and capability to resist risk and helping maintain the UK's domestic peace and political stability. Although the Brexit vote could ignite complicated political fighting, it won't threaten the stability of the constitutional system itself. In addition, if the UK breaks away from the EU, the UK government would be able to handle the immigration and refugee problems more independently.

The UK has a large-scale, structurally diverse, and healthy economy. Moreover, its well-developed financial sector has displayed outstanding capability to absorb shocks of risky events. After the global financial crisis, the UK's fiscal and monetary policies have shown excellent effectiveness, and accordingly, its economic recovery was able to outpace other similar economies. Brexit's short-term impacts on the UK economy are inevitable. In the long run, however, the UK will be able to gain greater independence and flexibility, shed the constraints of the EU agreements and regulations, and improve regulatory performance and economic efficiency.

In conclusion, the fundamentals that underpin the sovereign rating of the UK are likely to successfully control credit risk brought by the referendum in a manageable range. The United Ratings decides to maintain the UK's sovereign rating in local and foreign currencies at AAA_i. Of course, we have already noted that the decisive factors that affect the sovereign rating of the UK are its economic problems, such as industrial hollow-out, decreasing labor productivity, and a highly leveraged private sector, etc. Solutions to these problems depend on the UK government's policy and its ability to govern and whether its negotiation with the EU will be successful. In view of the uncertainties brought by the Brexit vote, the United Ratings decides to adjust the outlook rating for the UK, and will closely track various developments and make any necessary rating actions accordingly.

Key Indicators of the Sovereign Rating for the United Kingdom

	2011	2012	2013	2014	2015	2016f	2017f
GDP（billion USD）	2597.1	2640.3	2714.8	2993.8	2850.1	2738.0	2833.0
GDP per Capita（USD）	41408.8	41813.7	42713.2	46777.6	44230.0	42210.0	43400.0
GDP Growth Rate（Real）	2.0	1.2	2.2	2.9	2.2	1.6	1.1
Inflation Rate	4.2	2.7	2.0	0.5	0.2	0.7	1.2
Total Credit/GDP	49.8	52.4	58.9	110.5	110.6	113.3	109.3
Growth Rate of Domestic Debt	-2.9	-2.3	-3.3	-3.1	0.3	0.9	0.4
M2 Growth Rate	-3.1	0.1	0.7	-0.1	0.7	0.9	1.3
Fiscal Balance of Governments/GDP	-7.7	-9.9	-5.6	-5.6	-4.4	-3.4	-3.0
Interest Payment of Governments/GDP	3.2	2.9	2.9	2.7	2.3	2.1	2.0
Gross General Government Debt/GDP	81.8	85.3	86.2	88.2	89.2	90.1	90.7
Balance of Current Account/GDP	-1.7	-3.3	-4.5	-5.1	-5.1	-5.2	-4.7

Source: Sovereign Rating Database of United Ratings. "f" stands for forecasts.