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Rating Object	Rating Information	
UNITED KINGDOM	Assigned Ratings/Outlook: **AA /stable**	Type: Follow-up Rating, unsolicited
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: 02-06-2017 Rating Renewal: 29-03-2019 Rating Methodologies: "Sovereign Ratings"	

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Rating Action

Neuss, 29 March 2019

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "AA" for the United Kingdom (UK). Creditreform Rating has also affirmed the United Kingdom's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AA". The outlook is stable.

Key Rating Drivers

1. Large and wealthy economy characterized by an excellent business environment set against moderate medium-term growth perspectives stemming from weak private investment, stalling labor productivity, and high household debt

2. Sovereign continues to exhibit a very high quality in its institutional framework, but lack of political consensus in ongoing Brexit negotiations exposes the economy to extraordinarily high economic, fiscal, and political uncertainties; baseline scenario continues to be that of a delayed Brexit deal followed by a transition period

3. Track record of expenditure-based budget consolidation and expectation of sharply narrowing headline deficit in FY18/19; but fiscal consolidation should slow down in view of rising expenditure pressures and political commitments to adopt further tax relief measures

4. Elevated debt-to-GDP and interest-to-revenue ratio should improve only slowly; fiscal sustainability risks mitigated by favorable redemption profile and strong demand for government debt due to Sterling's reserve currency status

5. Persistently high current account deficits leave the UK with elevated susceptibility to a reversal of capital flows; risks somewhat tempered by large external assets and the currency sensitivity of the NIIP

Reasons for the Rating Decision

Our credit assessment continues to reflect strong economic and political institutions, as well as the Bank of England's (BoE) demonstrated track record of prudent and effective monetary policy-making through multiple economic cycles.

Assessing the World Bank's latest edition of the Worldwide Governance Indicators (WGIs), the UK's performance compares well with similarly-rated peers. Regarding the WGI voice and accountability, which captures the transparency of policymaking and citizens' participation rights, the country was placed at rank 15 out of 209 economies – standing on par with the median of our AA-rated sovereigns. Furthermore, the UK outperforms most similar peers when it comes to the perception of the extent to which public power is exercised for private gain (rank 12), and the quality of its legal framework (rank 16). The same holds true with regard to the sub-indicator government effectiveness, although the quality of policy formulation and implementation appears to have weakened somewhat in recent years, with the UK slipping from rank 16 to 20 in 2015-17.

The fact that the British government was unable to conclude on a withdrawal agreement with Brussels and push it through parliament after almost two years of negotiations corroborates our view that policy implementation has become more challenging in light of a deepening political divide, an increasingly polarized social climate, and the Prime Minister's lack of a parliamentary majority.

In Nov-18, PM May and the EU concluded on a draft withdrawal agreement, including a post-Brexit transition period until December 2020 and details on the settlement of the UK's financial obligations. Moreover, the agreement guarantees EU and British citizens their existing residency rights and provides a solution to keep the Irish border open. However, the negotiated proposal was rebuffed by several cabinet members and the parliament. Four ministers resigned over withdrawal agreement, claiming that the deal does not honor the result of the referendum and threatens the integrity of the UK.

More importantly, PM May failed to secure a parliamentary majority for the deal, as it was rejected twice by the House of Commons. As we understand, parliament voted down the draft agreement mainly due to the terms of the so called backstop solution, which was designed to keep the Irish border open if the UK and the EU fail to reach a trade agreement. According to the proposed withdrawal agreement, Northern Ireland would stick to some rules of the EU single market, if another solution cannot be found by the end of the transition period in December 2020. A single customs territory between the EU and UK would apply from the end of the transition period unless and until a subsequent agreement becomes applicable. Exiting the backstop would need to be agreed jointly by the UK and EU. Brexiteers in the House of Commons argue that the proposed backstop could leave the UK tied indefinitely to the EU. In particular, the Democratic Unionist Party (DUP), which is supporting May's minority government, and the European Research Group, a group of about 70 Tory MPs, strongly oppose the terms of the backstop. Meanwhile, the European Commission has reiterated its position and ruled out any time limitations or unilateral exit options from the backstop.

At the same time, the House has spoken out against the UK leaving the EU without an agreement, calling on May to apply to the EU for a postponement of the current withdrawal date on 29 March. On 20 March, May applied for a "technical" postponement of three months until 30 June. The European Council, in turn, agreed to an extension until 22 May 2019, provided the withdrawal agreement is approved by the House by 29 March.

Otherwise, the exit date may be postponed to 12 April 2019, under the condition that UK authorities indicate a way forward.

Our baseline scenario continues to be that of a delayed Brexit deal, i.e. a conclusion on May's deal or a similar deal, followed by a transition period, which ensures greater continuity for corporates, consumers, and policy-makers alike – thereby cushioning cliff effects and enabling a relatively smooth adjustment to a post-Brexit world. While we believe that a 'short extension' until 22 May 2019 may be feasible, a 'longer-term delay', which could happen if the House cannot agree on a way forward before 12 April, appears not unlikely – probably implying a participation in the election of EU Parliament. Even a new referendum or snap elections may not be ruled out in that case.

Even if a deal will eventually be passed, we believe that Brexit will continue to absorb significant administrative and political capacities over the coming years. In our view, shifting back political decision-making from Brussels to the UK will require building up knowledge and staff at the national level. Apart from that, more than 40 bilateral EU trade agreements and a large number of international agreements such as those on air transport, fisheries, and legal cooperation will cease to apply to the UK after its EU exit. The UK intends to replicate these agreements as far as possible, but negotiations have proven to be rather complex and time-consuming. As of Mar-19, only a small fraction of the EU's currently applicable trade agreements have been replaced, according to the Department for International Trade.

The sovereign's credit rating continues to be underpinned by the economy's strong macroeconomic performance. Our macroeconomic assessment reflects the UK's very large and prosperous economy buoyed by a competitive business environment and well-performing labor markets. These credit strengths are set against robust but slowing trend growth and elevated private sector debt.

In our view, the size of its economy coupled with high wealth levels continue to enhance the UK's economic resilience against external shocks. According to IMF estimates, the UK is the fifth largest economy in the world (2018: USD 2.81tr) and exhibited a per capita income of USD 45,643 (PPP terms) in 2018, which compares favorably to an EU-28 median of USD 39,387. As compared with its AA-rated peers, British per capita GDP is broadly on par with France (USD 45,601) and Finland (USD 46,559), but there is a considerable gap towards Austria (USD 52,224) and Belgium (USD 48,179).

High levels of wealth are a result of the UK's flexible product and labor markets, its well-educated workforce, and a strong presence of high value-added activities in the domestic economy. While economic output (8.9% of GDP) and employment (7.9%) in the manufacturing sector compare relatively low by European standards in Q3-18 (EU-28: 14.6 and 13.8%), the share of high value-added services is disproportionately high. Apart from the financial sector (6.1%), ICT (5.9%), and business services (11.4%) contribute a significantly higher share to GDP than in the EU-28 as a whole (4.3, 4.6, and 10.1%).

In general, the competitiveness of the country's private corporate sector benefits from sound economic policy-making, low taxes, and a business-friendly administrative and regulatory environment. The World Bank's latest Doing Business report confirms this

view, attesting the UK to display one of the most business-friendly environments in the world and to be the second best performer in the EU-28 (rank 9/190 economies), with only Denmark scoring better (rank 3). The World Bank highlights, in particular, the ease of getting construction permits (rank 17/190), conditions for startups (19), and the quality of the insolvency framework (14).

Notwithstanding that the UK has exhibited a track record of solid economic growth since the Global Financial Crisis, we note that trend growth has gradually decelerated over recent years. Averaging at 2.4% per year, the UK enjoyed the highest growth among G7 countries in 2013-15, before growth eased to 1.8% in 2016 and 2017 respectively and further moderated to 1.4% last year. Thus, the UK not only recorded its lowest growth rate since 2012 (1.4%) in 2018, but also one of the lowest among the EU-28 member states. A sharp deceleration in economic activity towards the end of the year particularly weighed on growth last year. Having expanded by 0.4 and 0.6% q-o-q in Q2 and Q3-18 respectively, the British economy nearly stagnated in the final quarter of the year (+0.2%). It is worth noting that the slowdown in economic activity would have been even more pronounced in the absence of vividly rising inventories. As highlighted by survey data, the risk of a border gridlock caused by a no-deal Brexit led British manufacturers to significantly ramp up their stockpiling efforts towards the end of the year. As a result, increasing inventories boosted GDP growth by 0.3 p.p. in 2018 (2017: -0.5 p.p.)

By contrast, both net exports and domestic demand softened compared to 2017. Although private consumption remained the key driver of real GDP growth, contributing 1.1 p.p. to the economic expansion (2017: 1.4 p.p.), household spending growth eased from 2.2 (2017) to 1.9% last year as inflationary pressures continued to weigh on real wage growth. After having contracted by 0.4% in 2017, average weekly earnings returned to positive growth last year. Thanks to accelerating nominal wage growth and receding CPI inflation, real wages picked up in the second half of 2018. Still, purchasing power gains were rather limited, with real wages expanding by a modest 0.7%. Unlike in previous years, dissaving did not provide any tailwinds to private consumption. The household savings rate, which had trended downwards since 2015, appears to have bottomed out in 2018. In Q3-18 the savings rate posted at 4.3%, slightly above the historical low marked in Q1-17 (3.3%).

While consumption held up relatively well, 2018 saw a significant weakening in investment activity. As evidenced by survey indicators, capital spending in the corporate sector was held back by Brexit-induced uncertainties regarding a future trade agreement with the EU. Following an increase of 3.5% in 2017, gross fixed capital formation stalled (+0.0%) as business and dwellings investment showed a weaker performance than in the year before. Residential investment growth decelerated sharply from 7.6 to 2.2%, partly mirroring slower growth in house prices and capacity constraints in the construction sector. More importantly, spending on machinery and equipment turned negative. Despite favorable financing conditions and high corporate profitability indicated by a net rate of return at 12.6% in Q3-18 (1997-2018: 12.0%), business investment contracted in each quarter for the first time since 2009, falling by 0.9% on the year (2017: +1.5%).

Meanwhile, net exports made a slightly negative contribution to GDP growth (-0.2 p.p.). Decelerating from 5.6 and 5.2% in 2017, import (+0.8%) and export (+0.2%) volumes stayed almost flat. While softer import dynamics came on the back of moderating domestic demand, gradually abating tailwinds from the Sterling's depreciation in the aftermath of the Brexit referendum and sector-specific issues in the automotive industry partly explain the weak export performance. Drawing on SMMT data, the number of exported cars fell by 7.3% y-o-y reflecting model changes, the introduction of new WLTP emission test procedures, and a weaker economic backdrop in European and Asian key markets. Sustained growth in external demand for cars from the US (+5.3%) and Japan (+26.0%) was not enough to offset sharply decreasing car exports to China (-24.5%) and the EU (-9.6%).

Looking ahead, we expect the British economy to further lose steam, anticipating GDP growth of 1.2 and 1.3% in 2019 and 2020 respectively, with domestic demand remaining the main driver. To be sure, this forecast is contingent on the materialization of our baseline scenario, implying an orderly Brexit (see above). At this stage, both soft and hard data indicate that weakness in economic activity persisted at the beginning of 2019. In January, the rolling three-month growth rate remained at a low 0.2% (Oct-Dec: +0.2%), while the composite PMI fell to 50.3 points, corresponding to the lowest level since the post-referendum drop in July 2016 (47.6 points).

A sustained weakness in industrial and construction output at the beginning of the year underpins our view that a rebound in investment is rather unlikely until we see greater clarity on the terms of the UK's EU departure. Furthermore, current levels of capacity utilization do not point to increasing capacity constraints in the manufacturing sector. At the beginning of the year, capacity utilization was broadly aligned with its long-term average (Q1-19: 81.4% vs. 1980-2018 avg. 80.4%), after having trended downward throughout 2018. Against this background, we believe that the BoE's decision to put further rate hikes on hold will only have limited impact on corporates' propensity to invest. After its 25bp rate hike last August, the BoE's Monetary Policy Council (MPC) decided to keep the bank rate unchanged at 0.75% at its February meeting. Moreover, the MPC voted to maintain the stock of government and investment-grade corporate bonds at GBP 435bn and 10bn respectively. In view of softening global growth prospects and intensifying Brexit uncertainty, we expect the BoE to maintain its accommodative monetary policy stance. Currently, market expectations signal that the next interest rate hike should occur not before Q4-19.

External demand should remain muted over the coming two years, as uncertainty about the UK's future trade relationship with the EU is likely to persist beyond March 2019 and economic growth in the country's main trading partners should lose momentum. At the same time, imports should grow at a moderate pace as we anticipate no meaningful recovery in domestic demand.

Alongside sluggish growth in headline investment and external demand, we anticipate only moderately rising private consumption over the next two years. With the deadline for the UK's departure from the EU ticking closer, there are signs that Brexit-related uncertainty is increasingly spreading to private households. The European Commission's con-

sumer confidence indicator steadily deteriorated in the second half of 2018 and hit a new post-referendum low in January 2019. However, data also showed that the slump was primarily fueled by fears related to the UK's economic prospects rather than consumers' concerns about their personal finances. In general, household spending should be supported by high levels of employment and rising real disposable incomes. The implementation of tax relief measures (see below), a minimum wage hike entering into effect in April 2019, and further easing inflationary pressures should bolster consumers' purchasing power. Nevertheless, the overall increase in private consumption should be limited by low savings and high leverage of households. Although the debt-to-disposable income ratio somewhat decreased from 129.4 to 128.8% in the year to Q3-18, it is still high by European standards and remains significantly above the levels seen in economies of similar size such as France (94.6%) and Germany (84.8%).

While near term growth forecasts for 2019/20 are already subject to elevated uncertainty, it is even more difficult to gauge the economy's medium-term growth prospects at the current junction. The eventual terms of a future UK-EU agreement will have a significant impact on trade, migration, and foreign direct investment inflows, and thus on GDP growth. Notwithstanding these issues, sluggish productivity growth in recent years has been weighing on the UK's growth potential. Despite labor productivity in the UK being significantly below the levels in France and Germany, growth has been very modest over the last decade. Since 2007, labor productivity per hour worked increased by a mere 2.7%, against 7.6% and 6.2% in Germany and France respectively. Weak productivity growth may be partly explained by the shift in the economy towards sectors with lower productivity but also by the prolonged weakness in investment activity. The UK's private as well as its public investment stood structurally below EU-28 levels in the recent past. While private investment accounted for 14.3% of 2018 GDP in the UK, the private sector in the EU-28 as a whole exhibited an investment-to-GDP ratio of 17.6%.

To boost productivity, authorities are following a multi-pronged approach. Firstly, the government incentivizes higher private investment by granting tax deductions. Among others, the current budget includes a temporary increase in the annual investment allowance applying in 2019-20, and a permanent building allowance. Secondly, the administration plans to ramp up public spending on transport infrastructure, housing, and R&D via the National Productivity Investment Fund (NPIF). Established in 2017, the fund plans to spend GBP 37bn over the next five years in areas that are important for economic growth. Starting in FY 19/20, over GBP 20bn of NPIF funds are envisaged for upgrading the country's transport infrastructure and supporting housing construction. Furthermore, the NPIF is making GBP 7bn available for R&D, including promoting R&D in new technologies such as artificial intelligence and digital manufacturing. In general, the implementation of these measures should bode well for productivity growth, although their eventual impact on productivity is hard to assess as of now.

Given the already tight labor market conditions, raising labor productivity appears even more important going forward. In general, the British labor market continued to reflect the economy's high degree of flexibility, with unemployment declining for the seventh consecutive year. In 2018, the unemployment rate dropped from an already low 4.4% (2017)

to 4.1% on the back of enduring employment growth. After employment increased by 1.0% in 2017, growth came in at 1.2% last year, suggesting increasing labor supply pressures. In the light of already high activity rates and a decline in net migration, the potential for further employment gains appears limited. Following record-high net migration of +336,000 in the year ending June 2016, overall net migration appears to have stabilized on lower levels in 2017 (+277,000) and 2018 (+283,000). It is noteworthy that the decline observed since the 2016 referendum was entirely driven by slowing net migration of EU citizens. While still adding to the population, EU net migration has fallen by almost 70% from +196,000 (year ending Jun-16) to +57,000 (year ending Sep-18) more recently. Thus, net migration from the EU fell to the lowest level in a decade.

Turning to the sovereign's fiscal performance, we note that the situation of public finances has significantly improved in recent years. From 10.0% of GDP in FY09/10, the budget deficit steadily decreased to 2.1% of GDP in FY17/18. Budget consolidation was predominantly expenditure-based with the government's expenditure-to-GDP ratio falling by 6.5 p.p. over this period.

In the current fiscal year, the headline deficit should have narrowed sharply to 1.2% of GDP on the back of sustained spending containment and vividly growing tax receipts. Tax outturn data in the year up to Jan-19 was strong, with total receipts increasing by 4.5% y-o-y. Our expectation is underpinned by the Office for Budgetary Responsibility's (OBR) recently lowered estimate on net borrowing. Improvements shaping the fiscal outlook mainly result from stronger-than-expected tax revenue growth. According to OBR, receipts from the self-assessed income tax and national insurance contributions surprised on the upside in the first ten months of FY18/19 as wage growth gradually picked up. Also, revenue forecasts for national insurance contributions and the capital gains tax experienced modest upward revisions. In addition, lower-than-anticipated debt service costs contributed to the recent improvement in fiscal projections. Mirroring easing RPI inflation, which determines interest coupons of index-linked gilts, interest spending is now forecast to reach GBP 38.4bn, down from GBP 41.2bn in the Autumn Budget of 2018.

With respect to the next fiscal year, we expect a slightly higher headline deficit of 1.4% GDP as the fiscal policy stance is set to become more expansionary. Total costs of policy measures included in the Chancellor of the Exchequers Autumn Budget add up to GBP 15.1bn or approx. 0.7% of GDP in FY19/20, with the bulk (GBP 10.9bn) contributing to higher expenditures. Alongside a GBP 0.8bn in increase in defense spending, the government plans to scale up welfare expenditures significantly in order to improve health infrastructure and the quality of care. Accordingly, funds allocated to social care and the National Health Service are set to rise by a combined GBP 8.1bn. Also noteworthy is that departments receive an additional GBP 0.5bn to prepare for Brexit in 2019-20 on top of the GBP 1.5bn already announced for that year. On the revenue side of the budget, favorable dynamics should carry over into FY19/20 although we anticipate growth in tax receipts and social security contributions to lose momentum, mirroring slowing job creation and moderate economic growth. Moreover, the introduction of tax relief measures will curb the expansion of state revenues going forward. Effective from Apr-19, the personal income tax allowance will increase by a GBP 650 to GBP 12,500 and the higher rate

threshold will be lifted to GBP 50,000 (up from 46,350). Meanwhile, excise taxes on alcohol and fuel will remain frozen at their current levels.

Notwithstanding the fact that the British government is stepping up efforts on contingency planning, we believe that a disorderly Brexit remains the biggest budgetary risk in the medium term. Under a no-deal scenario, we believe that the British government would temporarily boost public spending to support the domestic economy. At the same time, tax revenues in particular from the financial sector (approx. 11% of total tax receipts) could be seriously dented, should a large number of financial institutions decide to relocate their operations. This would probably result in a further increase of the government's interest-to-revenue ratio.

However, even in the event of a smooth departure from the EU, we expect budget consolidation to become more challenging in the coming years. Having one of the lowest corporate tax rates among developed nations, the government confirmed plans to cut the CIT-rate further from 19 to 17% in 2020. On the other hand, there are already signs of increasing spending pressures. In our view, the latest budget, as well as recently adopted policy measures, were already shaped by the government's commitment to ensure more inclusive growth. For instance, higher healthcare spending, which had been a cornerstone of the pro-Brexit campaign, will remain the government's top priority well beyond FY19/20. According to the five-year NHS settlement from Jun-18, funds allocated to healthcare will rise by another GBP 20.3bn per year by the end of FY23/24, equivalent to an average annual increase of 3.4% in real terms. More recently, the government announced the launch of a GBP 1.6bn "Stronger Towns Fund for England", mainly targeted at deprived communities in Northern England and the Midlands.

Against the backdrop of slowing growth and increasing spending pressures, government debt should remain elevated in the medium term. We anticipate general government gross debt (Maastricht definition), which stood at 85.3% of GDP in FY17/18, to stabilize at this level in the current fiscal year before gradually declining towards the 80%-mark by FY 23/24. Hence, the UK's debt affordability metrics should remain weaker than those of its AA-rated peers for the foreseeable future. According to Eurostat data, the UK's debt-to-revenue and interest-to-revenue ratio have somewhat improved in the year ending Q3-18, but standing at 219.7 and 6.4% both metrics are still the highest among our AA-rated sovereigns. We note, however, that debt sustainability risks are tempered by the Sterling's reserve currency status, the UK's deep and liquid government bond markets, and a favorable maturity profile. At the end of 2018, the average weighted maturity of central government debt posted at a high 15.2 years, equivalent to the longest average maturity across G7-countries.

Regarding its external position, the British economy continues to exhibit elevated external funding needs due to relatively high and persistent current account deficits. Hence, the economy remains susceptible to changes in foreign investor sentiment. After the UK had run the smallest current account deficit in six years in 2017 (3.3% of GDP), the current account appears to have weakened again more recently. In the first nine months of the year, the current account balance slipped to -4.4% of GDP mainly due to a deteriorating trade in services and primary income balance. In particular, exports of manufacturing

services and intellectual property performed relatively weak, which fell by 13.9 and 18.0% y-o-y respectively. Meanwhile, the primary income balance weakened from -1.2 (2017) to -1.7% of GDP in in the first three quarters of the year. Falling net foreign direct investment (FDI) earnings were the main contributor to the worsening primary income balance. Net earnings on FDI more than halved to 10.7bn in the year up to Q3 (Jan-Sep-17: GBP 24.2bn), driven by an increase in the profits generated by overseas investors on their UK FDI.

Risks associated with the UK's sustained current account deficits are somewhat tempered by sizeable external assets (Q3-18: GBP 5.8tr excl. MFIs) and the currency composition of its net international investment position (NIIP). As pointed out by the IMF, the economy's external assets have a higher foreign currency exposure than its liabilities. Thus, the sharp depreciation of the Sterling vis-à-vis the US dollar and the euro in the aftermath of the Brexit referendum explains a large part of the NIIP improvement from -20.1 (2015) to -8.1% of GDP in 2017. Mirroring limited exchange rate movements in 2018, the NIIP remained broadly stable at -6.0% of GDP in the third quarter.

Turning to developments in the banking sector, we note that the government has continued to put financial crisis legacies behind it since our last review. In Jun-18, the state reduced its direct financial sector exposure by selling a 7.7% (GBP 2.5bn) stake in Royal Bank of Scotland. Moreover, new ring-fencing requirements effective from Jan-19 force banks with retail deposits in excess of GBP 25bn to separate their retail and investment banking operations. This should lower the need for large-scale government bail-outs going forward.

Nevertheless, we continue to regard the UK's banking sector as a contingent liability risk for the government budget given its significant size. Including three systemically important financial institutions (HSBC, Barclays and Standard Chartered), the banking sector featured an asset-to-GDP ratio of 434.6% in Q3-18 (ECB data). To be sure, financial soundness indicators signal that the UK's banking sector is in good shape. We consider the asset quality of British banks to be high and their capital buffers to be sufficient. The CET1-ratio saw a further increase to 15.1% in Q3-18 (EBA data; Q3-17: 14.6%); concurrently British banks reported an NPL ratio of only 1.4%, one of the lowest in the EU-28 (average 3.4%). The generally high resilience of British banks was also confirmed by the results of the BoE's latest stress test (Nov-18). BoE analysis also showed the major UK banks would be resilient to a disorderly Brexit scenario.

Meanwhile, European and national regulators continued with their contingency planning to prevent financial market disruptions in the event of a hard Brexit. In Nov-18, the British parliament passed legislation to allow "temporary permissions and recognition regimes". These will allow UK households and businesses to continue to access financial services provided by EU firms. In the same vein, European regulators acted to ensure that EU counterparties could continue to clear derivatives at UK central counterparties for a limited period of time should the UK leave the EU without a withdrawal agreement in place. On Feb-19, ESMA authorized three central counterparties established in the UK to continue serving their European clients in the event of a hard Brexit.

While lending to NFCs has expanded moderately throughout 2018, consumer lending continued to grow vividly. Monthly 12-month growth of net consumer credit has decelerated since the end of 2016, but it still came in at a high 6.4% in Jan-19 (Jan-18: 9.3%). Although there are no signs of a weakening credit quality of consumer loans at this stage, growth in consumer credit should be monitored closely. At the same time, secured lending to individuals (i.e. mortgages) sustained growth rates in the 3-4% range. That said, growth in the outstanding volume of secured lending was broadly in line with that of house prices. On the back of lower migration and an increasingly uncertain economic outlook, growth in house prices lost further momentum last year. Drawing on HM Land Registry data, the y-o-y increase in house prices averaged at 7.0% per month in 2016, before it decelerated to 4.5% in 2017 and further moderated to 3.3% last year. In particular, growth was dragged down by price developments in London. Home prices in London, which exhibited double-digit growth rates in the run-up to the Brexit referendum, slightly decreased with yearly rates averaging at -0.4% per month in 2018 (2017: +2.2%). Notwithstanding the recent moderation in price growth, the future trajectory of house prices should be followed closely in view of already stretched balance sheets of private households, and a continuing deterioration in affordability indicators. Judging by OECD data, both the price-to-income and the price-to-rent ratio reached their highest levels since Q1-08, standing 22.3 and 25.7% above their long-term average (1995-2018) in Q3-18.

Rating Outlook and Sensitivity

Our Rating outlook on the long-term sovereign rating of “AA” is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – will remain fundamentally unchanged in the next 12 months.

We could consider a downgrade if the GDP growth falls significantly short of our expectations. A disorderly Brexit continues to represent the key risk to the short-term outlook. According to BoE estimates, leaving the EU without a transition period may lead to a contraction of real GDP by up to 8%. In the medium term, we believe that a failure in negotiations with the EU on a comprehensive trade agreement, which also covers trade in services, presents the most important downside risk to the British economy. In general, the rating could come under downward pressure if it became apparent that the eventual agreement had negative effects on productivity and the economic outlook, e.g. prompted by significantly lower FDI inflows as well as the implementation of overly restrictive immigration policies. A downgrade of our rating could also occur if key fiscal metrics show signs of a material deterioration. Fiscal policies targeted towards cushioning a potential “post-Brexit” slump in domestic demand by additional government expenditure may lead to fiscal backtracking, resulting in a further increase of already high government debt levels.

Conversely, we could raise our sovereign rating if medium-term growth turns out to be substantially higher than in our baseline scenario, or if public finances improve on a sustainable basis, thus resulting in a steeper-than-anticipated downward trend of general government debt.

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Ratings*

Long-term sovereign rating	AA /stable
Foreign currency senior unsecured long-term debt	AA /stable
Local currency senior unsecured long-term debt	AA /stable

*) Unsolicited

Economic Data

	2013	2014	2015	2016	2017	2018e	2019e
Real GDP growth	2.0	2.9	2.3	1.8	1.8	1.4	1.2
GDP per capita (PPP, USD)	39,449	41,066	42,145	43,013	44,292	45,643	47,042
CPI inflation rate, y-o-y change	2.6	1.5	0.0	0.7	2.7	2.5	2.0
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	81.1	81.4	81.0	81.2	81.3	n.a.	n.a.
Fiscal balance/GDP	-5.6	-4.8	-3.9	-2.3	-2.1	-1.2	-1.4
Current account balance/GDP	-5.1	-4.9	-4.9	-5.2	-3.3	n.a.	n.a.
External debt/GDP	318.4	310.6	288.7	309.2	312.2	n.a.	n.a.

Source: International Monetary Fund, World Bank, Eurostat, OBR, own estimates

*) Fiscal years, i.e. calendar year 2013 ⇔ FY13/14, etc.

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	02.06.2017	AA /stable
Monitoring	30.03.2018	AA /stable
Monitoring	29.03.2019	AA /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. HM Treasury participated in the credit rating process as the authorities commented on a draft version of this report. Thus, the report represents an updated version which was augmented in response to the factual remarks of HM Treasury. The rating outcome as well as the related outlook remained unchanged.

The rating was conducted on the basis of CRAG´s “Sovereign Ratings” methodology in conjunction with its basic document “Rating Criteria and Definitions”. CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document “Rating Criteria and Definitions” is published on the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

To prepare this credit rating, CRAG has used following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, Office for National Statistics, Bank of England, HM Treasury, Office for Budget Responsibility, SMMT, IHS Markit, HM Land Registry.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s “Sovereign Ratings” methodology. The main arguments that were raised in the discussion are summarized in the “Reasons for the Rating Decision”.

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

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