



Press Release: Rating Action

JCR Affirms AAA Ratings on UK; Outlook Stable

Issuer: United Kingdom (United Kingdom of Great Britain and Northern Ireland)

<i>Issues</i>	<i>Rating</i>	<i>Outlook</i>
FC (Foreign Currency Long-term Senior Debts):	AAA	(Stable)
LC (Local Currency Long-term Senior Debts):	AAA	(Stable)

JCR has affirmed its AAA ratings on the foreign currency and local currency long-term senior debts of the United Kingdom (UK).

The ratings are supported by the country's stable socio-political structure, highly developed open economy, flexible economic policy and its deep capital market of global presence. The outlook of the ratings is stable.

The UK, which had posted uninterrupted positive growth from 1992 to 2008, was hard hit by the global financial crisis from autumn 2008. The economy contracted 4.9% in real GDP terms in 2009. To counter the crisis, the then UK government took decisive measures promptly. The economy had bottomed out in the third quarter of 2009 and has been making a gradual recovery thereafter. Meanwhile, due mainly to these crisis responses, its fiscal position, once relatively in a good shape before the crisis, deteriorated sharply. Its public debt to GDP ratio rose from 44% (net basis) and 56% (gross basis) at the end of March 2009 to 54% and 71% at the end of March 2010, respectively. The current government, which took office in May 2010, is undertaking bold fiscal consolidation measures as a top priority of its policy agenda.

Looking ahead, the UK economy, though unlikely to grow at rates as strong as those seen in the pre-crisis period, is projected to continue a modest recovery on the following grounds: (i) Its financial services industry, highly developed in London as the international capital market, is resilient and may not be easily replaceable; (ii) Net worth of the household sector may likely be sustained as the property prices somewhat stabilize; and (iii) The authorities retain greater flexibility



in its macroeconomic policy management than the members of the European Monetary Union.

Whether the government will accomplish the planned fiscal consolidation rests on its delicate handling in its implementation of fiscal consolidation measures. It will be important for the government (a) to pursue the planned fiscal consolidation, which incorporates certain flexibility to deal with economic uncertainty, (b) to maintain the public support by keeping a balance with the economic and social aspects, and (c) to pay attention to the consistency with other macroeconomic policy measures. JCR views that the UK government possesses the capability to manage such difficult tasks skillfully though we will closely monitor the progress of its fiscal consolidation.

(1) Fiscal and economic situation deteriorated amid severe financial crisis

The UK economy kept positive growth from 1992 through 2008 thanks in part to large inflows of foreign investment under an open and stable business environment. Financial services, among others, attained a phenomenal growth in the City of London, which has reinstated itself as a world's leading international capital market. Meanwhile, the expansion of financial services, accompanied by technological innovation, sent domestic household debts swelling and prices of property and other assets surging. In the autumn of 2008, the global financial crisis began spreading to the UK economy giving rise to credit impairment and liquidity crisis in the banking sector. This resulted in deceleration of credit supply by banks, falls in asset prices, impairment of their loan asset quality and capital adequacy. The slump of demand at home and abroad and the deterioration of domestic employment compounded the situation. The economy contracted in real GDP terms (quarter-on-quarter, seasonally adjusted) for six consecutive quarters since the second quarter of 2008.

In response to these developments, the UK authorities implemented wide-ranging, large-scale policy measures. They put some of the financial institutions in difficulties under government control, in addition to other measures aimed at protecting the financial system, such as liquidity support, capital injections, credit guarantees and asset protection (i.e., loss indemnification). To address the economic difficulties, the monetary authorities implemented a programme of quantitative easing to support nominal demand and improve conditions in credit markets. On the fiscal front, the then government announced a temporary departure from its fiscal rules, facilitating an increase in the fiscal deficit (i.e., public sector net borrowing).

(2) As the economy had bottomed out, the new government launched bold fiscal consolidation

Thanks to the decisive measures to counter the crisis, the economy had bottomed out and has been making a gradual recovery thereafter. The growth momentum of the UK economy may have to be weaker than that in the pre-crisis period mainly because the financial services industry, a key sector in the UK that has contributed strongly to economic growth, is going through major changes in its business environment such as tightened regulations and introduction of the bank levy. However, the



economy is projected to continue a modest recovery on the following grounds: (i) Its financial services industry, highly developed in London as the international capital market, is resilient and may not be easily replaceable; (ii) Net worth of the household sector may likely be sustained as the property prices somewhat stabilize; and (iii) The authorities retain greater flexibility in its macroeconomic policy management than the members of the European Monetary Union.

The country's public finances had, prior to the crisis, retained some room to allow for an expansionary fiscal policy given (a) its relatively small public debt among the major developed countries (44% of GDP in net basis and 56% in gross basis as of the end of March 2009), (b) relatively long maturity of its outstanding debts (13.5 years on the average as of the end of 2009), and (c) its capital markets of global presence. However, the public debt to GDP ratio rose to 54% and 71%, respectively, as of the end of March 2010, with the ratios expected to reach 61% and 78% at the end of March 2011. The government is therefore undertaking bold fiscal consolidation measures as a top priority of its policy agenda. It targets to achieve cyclically-adjusted current balance by the end of the five-year forecast horizon, leaving certain room for public investment expenditures and fiscal flexibility at a time of economic uncertainty. To achieve this, it intends to carry out fiscal consolidation totaling GBP130.5 billion (equivalent to 9% of the projected GDP for 2010/11) over a period from fiscal 2010/11 (from April 2010 to March 2011) to fiscal 2015/16 through expenditure cuts and tax increases with the aim of seeing the public debt to GDP ratio peak by the end of March 2015.

Whether the government will accomplish the planned fiscal consolidation rests on its delicate handling in its implementation of fiscal consolidation measures. It will be important for the government (a) to pursue the planned fiscal consolidation, which incorporates certain flexibility to deal with economic uncertainty, (b) to maintain the public support by keeping a balance with the economic and social aspects, and (c) to pay attention to the consistency with other macroeconomic policy measures. JCR views that the UK government possesses the capability to manage such difficult tasks skillfully though we will closely monitor the progress of its fiscal consolidation.

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The primary rating methods applied to the ratings are posted on JCR's website (<http://www.jcr.co.jp>) "Sovereign, Public Sector Entities and Multilateral Development Bank Rating Methodology." The rating methods are subject to change or addition. However, the changes and additions including those that have been made in the past are posted in chronological order. Please refer to the rating methods above after checking by comparing the date of press release about the ratings with the release date of the rating methods (effective date of each of such rating methods).