FRENCH REPUBLIC

Rating Analysis - 6/14/12
Debt: EUR1,993.9B

EJR Sen Rating(Curr/Prj) BBB+/ BBB-
EJR CP Rating: A1
EJR's 1 yr. Default Probability: 2.3%

Disastrous trend and the worst has yet to come. Over the past four fiscal years, the Republic of France's debt has grown by an average of 11% per annum from EUR1.4T to EUR2.0T. Meanwhile, FYE GDP rose by an average of 1% from EUR1.89T as of 2007 to EUR1.99T as of 2011. As a result, debt to GDP rose from 73% in 2007 to 99.9% in 2011 and is well over 100% currently. As the EU growth slows, and France's unemployment rises, budget pressures will rise. An item which is hard to quantify but is a growing concern is the health of France's banks; the assets of the five largest banks equal 282% of France's GDP. Given France's propensity for supporting its banks, France might soon be confronting a substantial additional liability.

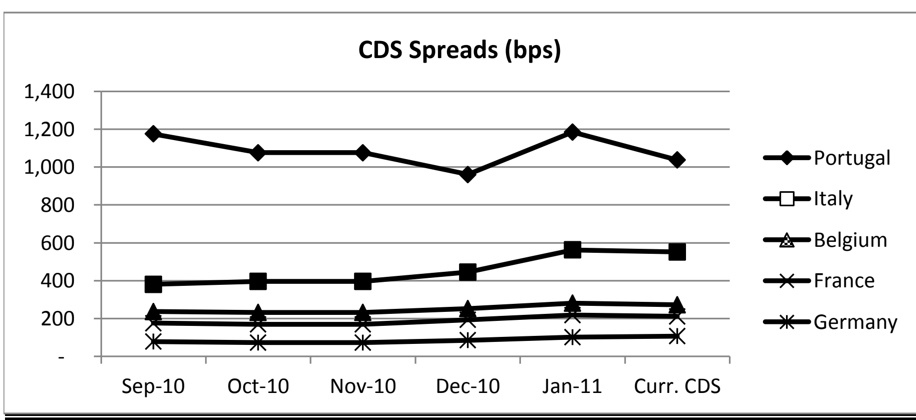
For the most part, over the past 18 months France has been exempted from the rise in funding costs. However, as the crisis evolves, we expect that France will be pressured. The deterioration in France's credit metrics combined with the needed supported for France's banks are likely to pressure the country. A major catalyst is likely to be charges for the weakened periphery countries. Hollande will be under pressure to keep campaign promises which will ultimately hurt credit quality.

Annual Ratios (source for past results: IMF)

INDICATIVE CREDIT RATIOS	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	91.0	95.7	99.9	112.2	123.2	146.1
Govt. Sur/Def to GDP (%)	-7.5	-7.1	-5.2	-6.7	-7.1	-7.8
Adjusted Debt/GDP (%)	91.0	121.9	125.3	137.5	148.4	171.2
Interest Expense/ Taxes (%)	9.6	9.5	10.0	9.9	11.1	11.5
GDP Growth (%)	-1.0	1.8	1.2	0.5	0.5	0.4
Foreign Reserves/Debt (%)	1.3	1.0	1.4	1.2	1.1	0.9
Implied Sen. Rating	BBB+	BBB	BBB	BBB	BBB-	BBB-

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	45.0	55.0	75.0	85.0	95.0	145.0
Govt. Sur/Def to GDP (%)	4.0	1.0	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	40.0	50.0	60.0	80.0	120.0	150.0
Interest Expense/ Taxes (%)	7.0	9.0	12.0	15.0	22.0	26.0
GDP Growth (%)	4.0	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	25.0	20.0	15.0	12.0	9.0	7.0

PEER RATIOS	S&P Sen.	Debt as a % GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Government Of Canada	AAA	32.7	-5.0	34.0	14.1	1.9	A+
Federal Republic Of Germany	AAA	80.0	-5.2	90.6	11.4	2.0	BB
Kingdom Of Belgium	AA	96.9	-3.7	96.9	11.9	1.2	BB
Republic Of Italy	BBB+	115.7	-3.9	127.3	16.7	-0.5	B+
Portugal Republic	BB	101.4	-4.2	112.4	13.0	-2.9	BB-



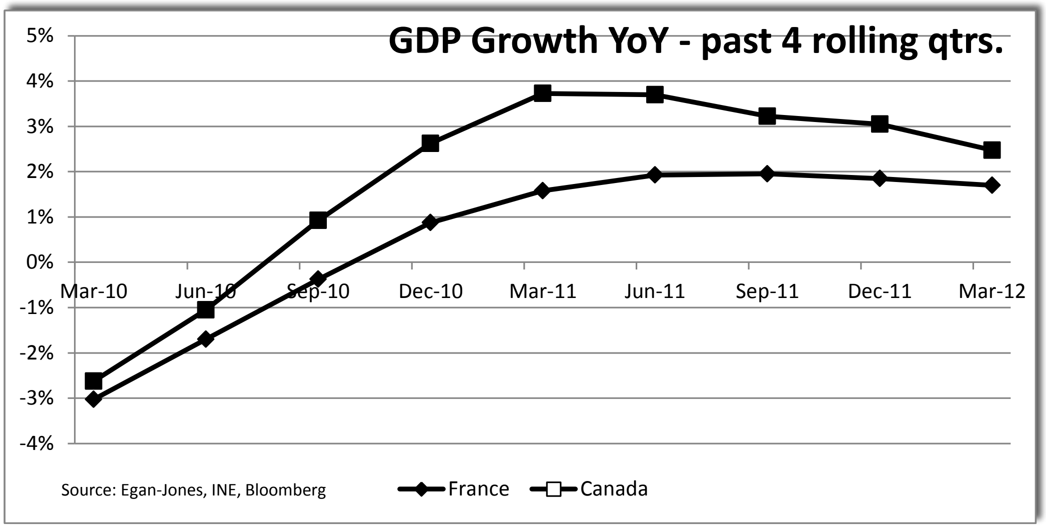
Country (EJR Rtg*)	Current CDS	Targeted CDS
Portugal (CCC+)	1,037	1,500
Italy (B)	552	1,200
Belgium (BBB-)	273	400
France (BBB-)	211	400
Germany (A+)	108	80

* Projected Rating
* EJR's targeted CDS based on rating

Economic Growth

The country was hobbled by the global financial crisis of 2007, eviscerating the nation's GDP and causing the economy to enter into a recession during the third quarter of 2008. As seen below, growth has been tepid at less than 2% over the last couple of quarters. We expect GDP to drop over the next couple of years.

France's rolling four quarter GDP growth has been near 2% over the past year per the below chart; in contrast, another top-tier credit, Canada has consistently grown faster than France. The major concern about France's economic growth is that the problems of Italy, Spain, and Portugal will make it more difficult for France. Additionally, the low and aging population will further constrain growth.



Fiscal Policy

France's deficit to GDP of 5.2% is in line with the other peer countries. Over the last couple of full fiscal years (that is 2009 through 2011), total sovereign revenues rose 4.6% while total expenses rose 2.3%. However, interest expense rose 8.3% As can be seen from the chart to the right, France's Debt-to-GDP at 84.3% is close to Portugal's 88.6%. France will have difficulty implementing substantive budget cuts and therefore debt is likely to grow and the likely response will probably be monetization.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr CDS Spreads
France	5.2	84.3	219
Canada	5.0	30.5	#N/A
Germany	5.2	78.8	102
Belgium	3.7	91.1	282
Italy	3.9	112.4	563
Portugal	4.2	88.6	1,185

Source: Bloomberg using yr end data other than CDS data

Unemployment

While Spain has 24% unemployment, France's is a more modest rate of 9.8%. As of the first quarter of 2012, the unemployment rate increased to 10.2% (per Eurostat). The high unemployment rate is driving social benefit payments. Economic weakness in France makes it difficult to substantially reduce unemployment over the next couple of years. Watch changes in labor policies.

Unemployment (%)	2010	2011
France	9.6	9.8
Canada	7.6	7.5
Germany	7.4	6.8
Belgium	7.6	7.2
Italy	8.3	9.1
Portugal	11.1	14.0

Source: Intl. Finance Statistics

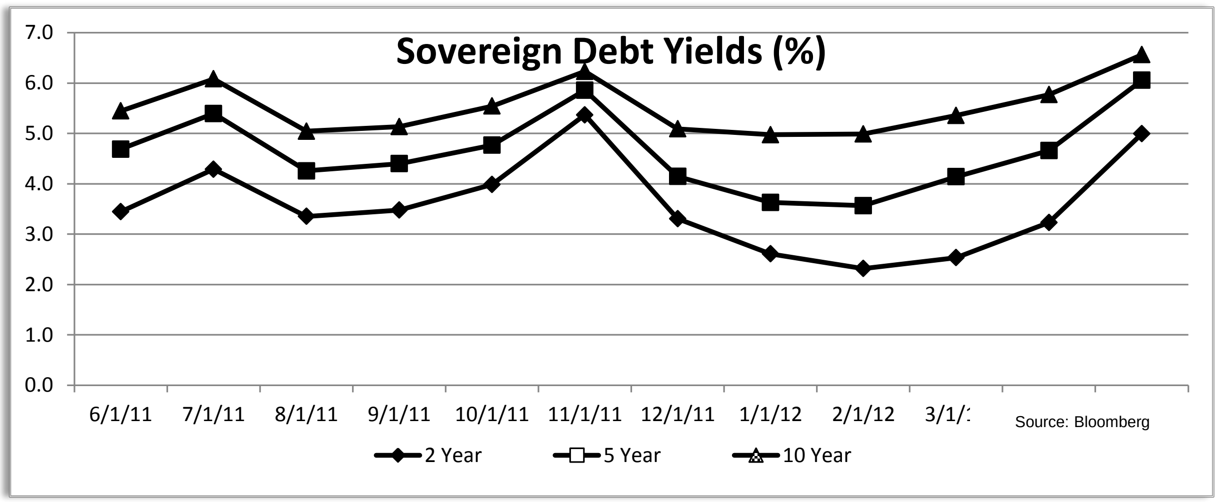
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. France has significantly more exposure to its banking sector because the bank's aggregate size measured in assets The top five banks have assets equal to 282% of GDP compared to 125% for Germany. France will be expected to provide substantial financial support to its banks over the next couple of quarters because of charges associated with a weakening in the periphery countries.

Bank Assets (billions of local currency)	Assets	Cap/ Assets %
BNP PARIBAS	1,965	4.4
CREDIT AGRICOLE	1,724	2.9
SOC GENERALE	1,181	4.3
NATIXIS	508	4.2
CREDIT INDUS COM	242	4.1
Total	5,620	
EJR's est. of cap shortfall at 10% of assets less market cap		507
France's GDP		1,996

Funding Costs

With the waning of the LTRO and weakening credit metrics, France has seen a rise in its funding costs over the past couple of months. As can be seen in the below graph, the bond yields declined since Nov. 2011, but have risen recently. France will be exposed for the support provided to the peripheral countries via the ECB and EFSF.



Ease of Doing Business

A major factor for growing the economy is the ease of doing business and the economic freedom; although not the sole factor for determining economic growth, a country which makes it easy for businesses to operate and provides a reasonably free environment to conduct business has a good chance for growth. The chart on the right indicates that with an overall rank of 29 (1 is best) is strong.

The World Bank's Doing Business Survey*	2012 Rank	2011 Rank	Change in Rank
Overall Country Rank:	**29**	**26**	**-3**
Scores:			
Starting a Business	25	22	-3
Construction Permits	30	31	1
Getting Electricity	62	59	-3
Registering Property	149	147	-2
Getting Credit	48	45	-3
Protecting Investors	79	74	-5
Paying Taxes	58	55	-3
Trading Across Borders	24	26	2
Enforcing Contracts	6	6	0
Resolving Insolvency	46	45	-1

* Based on a scale of 1 to 183 with 1 being the highest ranking.

Economic Freedom

As can be seen below, France is above average in its overall rank of 63 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom

World Rank 63*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**83.7**	85.6	-1.9	64.3
Trade Freedom	**82.1**	82.6	-0.5	74.8
Fiscal Freedom	**53.8**	52.3	1.5	76.3
Government Spending	**5.3**	16.4	-11.1	63.9
Monetary Freedom	**82.3**	83.7	-1.4	73.4
Investment Freedom	**55.0**	55.0	0.0	50.2
Financial Freedom	**70.0**	70.0	0.0	48.5
Property Rights	**80.0**	80.0	0.0	43.5
Freedom from Corruption	**68.0**	69.0	-1.0	40.5
Labor Freedom	**51.6**	51.4	0.2	61.5

*Based on a scale of 1-100 with 100 being the highest ranking.

**The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).

Source: The Heritage Foundation & Wall Street Journal

Assumptions for Projections

	Peer	Issuer	Base Case	
Income Statement	**Median**	**Average**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	4.9	7.6	**1.0**	**1.0**
Social Contributions Growth %	1.4	4.2	**1.0**	**1.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	12.1	3.5	**1.0**	**1.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.8	5.9	**1**	**0.5**
Compensation of Employees Growth%	2.7	1.5	**1.5**	**1.5**
Use of Goods & Services Growth%	4.0	0.4	**0.4**	**0.4**
Social Benefits Growth%	1.7	3.0	**2.0**	**2.0**
Subsidies Growth%	(3.8)	(9.4)		
Other Expenses Growth%	(3.7)	(3.7)	**2.0**	**2.0**
Interest Expense	0.0	2.7	**3**	
Balance Sheet				
Currency and Deposits (asset) Growth%	(3.5)	0.0		
Securities other than Shares LT (asset) Growth%	5.0	(1.5)	**2.0**	**2.0**
Loans (asset) Growth%	14.4	19.1	**2.0**	**2.0**
Shares and Other Equity (asset) Growth%	(1.7)	(8.8)	**2.0**	**2.0**
Insurance Technical Reserves (asset) Growth%	3.6	2.8	**2.8**	**2.8**
Financial Derivatives (asset) Growth%	0.0	10.4	**0.5**	**0.5**
Other Accounts Receivable LT Growth%	3.0	7.3	**1.0**	**1.0**
Monetary Gold and SDR's Growth %	0.0	0.0	**2.0**	**2.0**
Other Accounts Payable Growth%	2.4			
Currency & Deposits (liability) Growth%	2.5	30.3	**2.0**	**2.0**
Securities Other than Shares (liability) Growth%	5.3	9.3	**1.0**	**1.0**
Loans (liability) Growth%	3.1	(4.0)	**0.5**	**0.5**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	104.1	**1.0**	**1.0**
Addl debt. (1st Year) million EUR	0.0	0.0		

Base Case
ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)

	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Taxes	479,188	499,229	537,238	542,610	548,036	553,517
Social Contributions	353,474	360,441	375,682	379,439	383,233	387,066
Grant Revenue	0	0	0	0	0	0
Other Revenue	96,160	97,911	101,298	102,311	103,334	104,367
Other Operating Income	0	0	0	0	0	0
Total Revenue	928,822	957,581	1,014,218	1,024,360	1,034,604	1,044,950
Compensation of Employees	254,315	259,427	263,418	267,470	271,585	275,763
Use of Goods & Services	104,799	110,625	111,062	111,501	111,941	112,383
Social Benefits	479,490	495,980	511,087	521,309	531,735	542,370
Subsidies	31,700	33,445	30,301	30,304	30,307	30,310
Other Expenses	119,478	120,208	115,786	122,612	118,102	125,064
Grant Expense	0	0	0	0	0	0
Depreciation	49,471	51,146	52,680	52,680	52,680	52,680
Total Expenses excluding interest	1,007,553	1,037,386	1,054,033	1,105,876	1,116,350	1,138,571
Operating Surplus/Shortfall	-78,731	-79,805	-39,815	-81,516	-81,746	-93,621
Interest Expense	46,056	47,210	53,672	53,672	60,588	63,617
Net Operating Balance	-124,787	-127,015	-93,487	-135,188	-142,334	-157,238

Base Case
ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)	57,429	36,753				
Securities other than Shares LT (asset)	46,525	48,196	47,451	48,400	49,368	50,355
Loans (asset)	35,699	38,822	46,223	47,147	48,090	49,052
Shares and Other Equity (asset)	416,008	423,303	386,178	393,902	401,780	409,815
Insurance Technical Reserves (asset)	1,148	1,182	1,215	1,249	1,284	1,320
Other Accounts Receivable LT	178,849	183,734	197,149	199,120	201,112	203,123
Monetary Gold and SDR's						
Additional Assets	3,649	6,877	59,608			
Total Financial Assets	740,547	741,096	740,285	692,292	704,119	716,163
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	23,808	23,238	30,271	30,271	30,271	30,271
Securities Other than Shares (liability)	1,340,840	1,442,729	1,576,629	1,592,395	1,608,319	1,624,402
Loans (liability)	208,428	226,248	217,286	458,438	675,724	1,134,162
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	108	469	957	967	976	986
Other Liabilities	147,343	155,910	169,733	(0)	(0)	(0)
Liabilities	1,720,527	1,848,594	1,994,876	2,082,071	2,236,232	2,405,514
Net Financial Worth	(979,980)	(1,107,498)	(1,254,591)	(1,389,779)	(1,532,113)	(1,689,351)
Total Liabilities & Equity	740,547	741,096	740,285	692,292	704,119	716,163

Sovereign Rating Methodology

Egan-Jones takes the perspective of the investor as its primary point of view when developing the ratings it issues for sovereigns. Therefore, in the case of sovereign ratings, we attempt to take a more holistic view of credit quality to include not only analytic comparisons of various sovereign issuers but also the impact on our quantitative and qualitative analyses by current global, sovereign, governmental and market events, including the effects of government investments in speculative, volatile or other high risk investment products. For example, many sovereign issuers have taken on significant exposures of major financial institutions over the past several years. Hence, we calculate the under-funding of financial institutions and include this amount in the total indebtedness of sovereigns. (We use a base assumption that no country can afford to allow its major banks to fail and therefore we believe that there will almost always be an intervention by either a host or allied nation should financial institutions or markets require support at some measurable level.)

Generally we devise modeling calculators and do an analysis that examines the debt load of a country with respect to its GDP and other economic indicators. The analysis is then adjusted to reflect the outlook on a myriad of factors that reflect the firm’s overall view of the sovereign debt and the quality of the country’s ability to meet and thrive under such load. Some of the qualitative factors that impact our ultimate assessment of credit quality such as the flexibility, stability and overall strength of the economy, ease of tax collection, acceptance of contract law, ease of doing business, and prospects for future growth and health. The non quant issues are generally subjective and a moving target, so each rating of a sovereign may differ because of the non-quantitative nuances being addressed. Note, debt levels for many sovereign issuers have increased over the past decade and has accelerated recently, effecting the implied ratings.

Nota Bene

History has proven that defaults on domestic public debt do occur. In fact, seventy out of three hundred twenty defaults since 1800 have been on domestic public debt (1). Egan-Jones does not view a country's ability to print its own currency as a guarantee against default. Additionally, Egan-Jones generally views cases of excessive currency devaluation as a de facto default.

1. "This Time Is Different: Eight Centuries of Financial Folly", Reinhart & Rogoff, p.111, 126