UNITED STATES (GOVT OF)

Rating Analysis - 7/16/11

EJR Sen Rating(Curr/Prj) AA+/ N/A
EJR CP Rating: A1+
EJR's 1 yr. Default Probability: 0.5%

Real GDP increased at an annualized rate of 4.0% in Q1 2011, following an increase of 3.5% rise in the prior quarter. Personal consumption expenditures, exports, and nonresidential fixed investment contributed positively to growth during the quarter. Meanwhile, imports rose sharply. In the March 2011 quarter, trade in goods and services resulted in a deficit of $562B, many because of the high price of petroleum. However, the major factor driving credit quality is the relatively high level of debt and the difficulty in significantly cutting spending. We are taking a negative action not based on the delay in raising the debt ceiling but rather our concern about the high level of debt to GDP in excess of 100% compared to Canada's 35%. Nonetheless, since the US's debt is denominated in dollars, a hard default is unlikely.

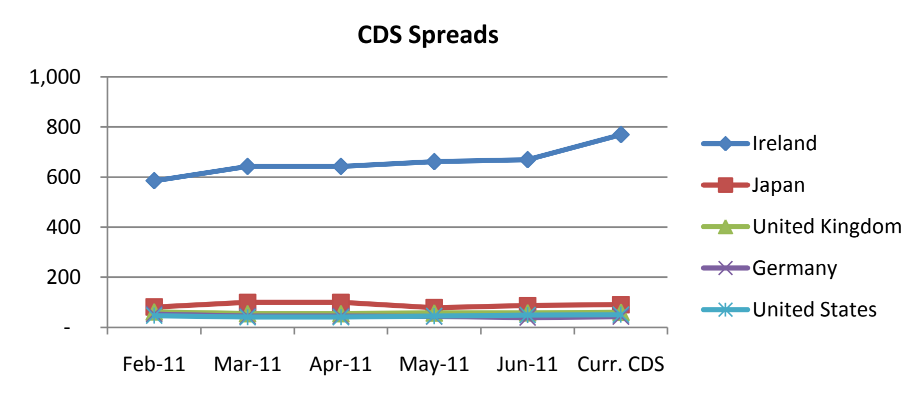
Yields on 10-year treasury notes have fallen to their lowest since early February 2010 as concerns in Europe have shifted investors out of risky assets.

Annual Ratios

INDICATIVE CREDIT RATIOS	Jun-09	Jun-10	Jun-11	PJun-12	PJun-13	PJun-14
Debt/ GDP (%)	85.7	99.3	107.1	104.8	102.8	100.8
Govt. Sur/Def to GDP (%)	-10.3	-8.6	-4.4	-4.0	-4.0	-4.0
Adjusted Debt/GDP (%)	86.2	99.9	107.7	105.4	103.3	101.3
Interest Expense/ Taxes (%)	19.7	21.8	22.3	22.7	23.1	23.6
GDP Growth (%)	-2.6	2.9	2.2	2.2	2.0	2.0
Foreign Reserves/Debt (%)	0.3	0.3	0.3	0.3	0.3	0.3
Implied Sen. Rating	AA+	A	A-	A	A	A

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	40.0	50.0	60.0	80.0	120.0	150.0
Govt. Sur/Def to GDP (%)	5.0	3.0	0.5	-2.0	-5.0	-9.0
Adjusted Debt/GDP (%)	45.0	55.0	65.0	85.0	125.0	155.0
Interest Expense/ Taxes (%)	7.0	9.0	12.0	15.0	22.0	26.0
GDP Growth (%)	5.0	4.0	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*
United Kingdom	AAA	100.2	-11.4	123.2	10.3	-4.9	B
Federal Republic Of Germany	AAA	88.4		96.3			BB+
Government Of Canada	AAA	18.3	-5.5	18.3	14.3	0.3	A-
Japan	AA-	271.0	-8.7	277.6	14.6	-1.5	CC+
Republic Of Ireland	BBB+	92.3	-32.4	106.7		-0.2	BB-



Country (EJR Rtg*)	Current CDS	Targeted CDS
Ireland(BB)	769	400
Japan(BB+)	91	333
United Kingdom(AA)	61	30
Germany(AA)	43	30
United States(AA+)	50	28

* Projected Rating

Economic and Budgetary Challenges

The United States' market-oriented economy is the world's largest. As of 2009, GDP totaled $14,256.3 billion, or 24.61% of the world economy. The country's average GDP per capita of $46,436 ranks 8th worldwide. Services account for more than 70% of activity in the advanced economy. The U.S. is also the world's largest producer of manufactured goods and fourth-largest producer of agricultural goods.

Advanced estimates reveal that real GDP increased by an annual rate of 3.2% in the fourth quarter of 2010, reflecting positive contributions from personal consumption expenditures, exports, and nonresidential fixed investment. The gains were offset by a negative contribution from private inventory investment. In the third quarter, real GDP increased 2.6%.

Overall, real GDP increased 2.9% in 2010 after having contracted 2.6% in 2009. The yearly increase was due in large part to increases in private inventory investment, exports, person consumption expenditurs (PCE), nonresidential fixed investment, and federal government spending, as reported by the Bureau of Economic Analysis. Economic growth is expected to remain moderate this year and next with growth of 3.1% and 2.8% in 2011 and 2012, respectively.

CBO's Economic Projections for Calandar Years 2010 to 2021

	Estimated	Forecast		Annual	
	Jul-05	2011	2012	2013-2016	2017-2021
Calendar Year Average					
Nominal GDP (Percentage Change)	3.8	3.7	4.4	5.1	4.4
Unemployment Rate (Percent)	9.6	9.2	8.2	5.3	5.2
Interest Rates (Percent)					
Three-month Treasury bill rate	0.1	0.3	1.1	3.6	4.4
Ten-year Treasury note rate	3.2	3.4	3.8	4.7	5.4
Fourth Quarter to Fourth Quarter (Percentage Change)					
Real GDP	2.5	3.1	2.8	3.4	2.4
PCE Price Index	1.4	1.2	1.3	1.7	2.0
Core PCE Price Index	1.0	1.0	1.2	1.6	2.0
Consumer Price Index	1.2	1.3	1.3	2.0	2.3
Core Consumer Price Index	0.6	0.9	1.2	1.9	2.2

Source: Congressional Budget Office, CBO Summary - The Budget and Economic Outlook: Fiscal Years 2011 to 2021 (January 2011), Page 3.

Growing Federal Deficit

The US recorded a budget deficit of $1.4 trillion in 2009 and $1.3 trillion in 2010, representing 10.0% and 8.9% of the country's output, respectively. The current figures are the largest since 1945. If current laws remain unchanged, including those pertaining to taxes and spending policies, the CBO projects the federal budget will show a deficit of close to $1.5 trillion, or 9.8% of GDP, in 2011. This is roughly $200 billion greater than the federal deficit recorded in 2010.

CBO Projections: Deficits and Surpluses, Billions of US Dollars

	Jul-08	**Jul-09**	**Jul-10**	**Jul-11**	**2012-2016**
Total Revenues	2,228	2,555	3,090	3,442	16,570
Total Outlays	3,708	3,655	3,794	3,975	20,117
Total Deficit	**-1,480.00**	**-1,100.00**	**-704.00**	**-533.00**	**-3,547.00**
Percentage of GDP	-9.8	-7.0	-4.3	-3.1	-4.1

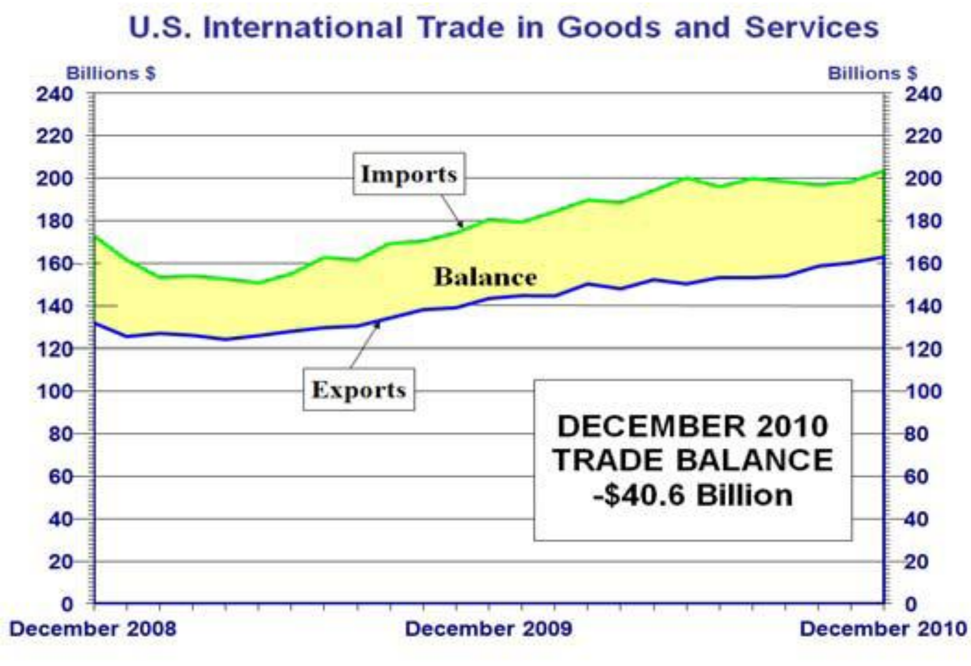
Source: Congressional Budget Office

(1) Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2010).

The CBO attributes the staggering deficit to weak revenues and elevated spending associated with the economic downturn and the policies implemented in response to it[1]. In response to the growing imbalance, the US government has announced plans to halve its deficit by 2013, a feat which the IMF argues will require significant adjustments to US fiscal policy in order to meet. In the meantime, the accumulating deficit will only add to the country's federal debt, which currently stands at over $14 trillion.

Trade in Goods and Services: Growing Deficit Reaches 3 Month High
In December 2010, imports in the amount of $203.5 billion exceeded exports of $163 billion, resulting in an overall trade deficit of $40.6B. The deficit was up from $38.3 billion the month prior. Exports during the month were $2.8 billion more than November exports of $160.1 billion. Imports were $5.1 billion more than November imports of $198.5 billion. On an annual basis, the overall deficit increased $3.5 billion with exports up $19.6 billion, or 13.7%, and imports up $23.1 billion, or 12.8%.

In the last month of the year, the goods deficit increased $2.3 billion from the month prior to $53.6 billion while the services *surplus* remained nearly unchanged at $13 billion. Exports of goods reportedly increased $2.8 billion to $116.6 billion while imports of goods increased $5.1 billion to $170.1 billion. Exports and imports of services remained virtually unchanged at $46.4 billion and $33.4 billion, respectively.



Source: U.S. Census Bureau; U.S. Bureau of Economic Analysis.

CPI Increases, Gasoline Index Up
The consumer price index for all urban consumers (CPI-U) increased 0.5% in December on a seasonally adjusted basis. The index increased by an overall 1.5% in the twelve months through December as compared to a 2.7% increase in 2009 (NSA). Overall, inflation remains quite low in the U.S.

Gasoline prices have accounted for much of the movement in the CPI over the last year. In December, a sharp 8.5% rise in the gasoline index accounted for about 80% of the corresponding seasonally adjusted CPI-U increase. Throughout the year as a whole, a *deceleration* in the gasoline index contributed to much of the CPI slowdown as gasoline prices increased 13.8% after having risen 53.5% in 2009.

The index for all items less food and energy also decelerated in 2010 as compared to the year prior. The index rose by a mere 0.8% in 2010 after having increased 1.8% in 2008 and 2009. The Bureau of Labor Statistics notes that the gain is the smallest such YoY increase in the history of the index. The CBO has forecast inflation to remain very low in 2011 and 2012 before averaging no more than 2.0% between 2013 and 2016.

Significant Fall In Unemployment

In January 2011, US unemployment fell by 0.4% to 9.0% while the number of unemployed persons decreased by about 600,000 to 13.9 million. The number of long-term unemployed (those jobless for 27 weeks or longer) edged down to 6.2 million and accounted for 43.8% of the unemployed. Employment increased in manufacturing and in retail trade but was down in construction and in transportation and warehousing. Levels in most other major industries remained little changed.

Like growth in output, employment in the US is expected to recover slowly. The economy is forecast to add approximately 2.5 million jobs annually from the years 2011 through 2016 as slight recovery continues. The unemployment rate is expected to end 2011 at 9.2% before falling to 8.2% in 2012 and 7.4% in 2013.

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Assumptions for Projections

	Peer	Issuer	Base Case	
Income Statement	**Median**	**Average**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	0.0	(21.2)	**3.0**	**3.0**
Social Contributions Growth %	0.0	(1.9)	**1.0**	**1.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	0.0	32.6	**2.0**	**2.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	0.0	(12.0)	**2**	**2.0**
Compensation of Employees Growth%	2.3	7.5	**1.0**	**1.0**
Use of Goods & Services Growth%	1.0	4.4	**4.4**	**4.4**
Social Benefits Growth%	0.1	15.5	**2.0**	**2.0**
Subsidies Growth%	0.0	18.3		
Other Expenses Growth%	62.8	62.8	**2.0**	**2.0**
Special Items (millions $)	0.0	0.0		
Balance Sheet				
Currency and Deposits Growth%	(24.6)	0.0		
Securities other than Shares LT Growth%	16.8			
Loans Growth%	5.1	0.0		
Shares and Other Equity Growth%	1.0	0.0		
Insurance Technical Reserves Growth%	0.0	0.0		
Financial Derivatives Growth%	(56.3)	0.0		
Other Accounts Receivable LT Growth%	0.0	0.0		
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Accounts Payable Growth%	0.0	NMF		
Currency & Deposits Growth%	(24.6)	0.0		
Securities Other than Shares Growth%	16.8	0.0		
Growth%	0.0	0.0		
Loans Growth%	5.1	0.0		
Insurance Technical Reserves Growth%	0.0	0.0		
Financial Derivatives Growth%	(50.0)	0.0		
Addl debt. (1st Year) million USD	0.0	0.0		

Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS $)

	Jun-08	Jun-09	Jun-10	PJun-11	PJun-12	PJun-13
Taxes	1,664,460	1,475,970	1,163,100	1,197,993	1,233,933	1,270,951
Social Contributions	945,014	972,367	953,470	963,005	972,635	982,361
Grant Revenue	0	0	0	0	0	0
Other Revenue	71,166	82,915	109,916	112,114	114,357	116,644
Other Operating Income	1	1	1	1	1	1
Total Revenue	2,680,640	2,531,250	2,226,490	2,273,113	2,320,925	2,369,957
Compensation of Employees	379,649	403,835	433,979	438,319	442,702	447,129
Use of Goods & Services	374,905	431,514	450,302	469,908	490,368	511,718
Social Benefits	1,265,410	1,402,650	1,620,170	1,652,573	1,685,625	1,719,337
Subsidies	47,250	49,811	58,941	58,947	58,953	58,959
Other Expenses	16,411	89,880	146,358	91,678	149,285	93,511
Grant Expense	476,329	498,017	600,632	612,645	624,898	637,395
Depreciation	106,251	113,245	117,694	117,694	117,694	117,694
Total Expenses	2,666,205	2,988,952	3,428,076	3,441,763	3,569,524	3,585,744
Operating Surplus/Shortfall	14,435	-457,702	-1,201,586	-1,168,650	-1,248,599	-1,215,787
Interest Expense	315,559	291,167	253,962	266,660	279,993	293,993
Net Operating Balance	-301,124	-748,869	-1,455,548	-1,435,310	-1,528,592	-1,509,780

ANNUAL BALANCE SHEETS (MILLIONS $)

ASSETS	Jun-08	Jun-09	Jun-10	PJun-11	PJun-12	PJun-13
Currency and Deposits						
Securities other than Shares LT						
Loans						
Shares and Other Equity						
Insurance Technical Reserves				0	0	0
Financial Derivatives						
Other Accounts Receivable LT				0	0	0
Monetary Gold and SDR's						
Additional Assets	0	0	0	0	0	0
Total Financial Assets				0	0	0
LIABILITIES						
Other Accounts Payable						
Currency & Deposits				0	0	0
Securities Other than Shares						
Loans				1,435,311	1,435,311	1,435,311
Insurance Technical Reserves						
Financial Derivatives						
Other Liabilities				(0)	(0)	(0)
Liabilities				1,435,310	2,963,902	4,473,682
Net Financial Worth				(1,435,310)	(2,963,902)	(4,473,682)
Total Liabilities & Equity				0	0	0

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.

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