UNITED STATES (GOVT OF)

Rating Analysis - 4/5/12
Debt: $14,542.9B, Cash: $750.4B

EJR Sen Rating(Curr/Prj) AA/ AA-
EJR CP Rating: A1+
EJR's 1 yr. Default Probability: 1.2%

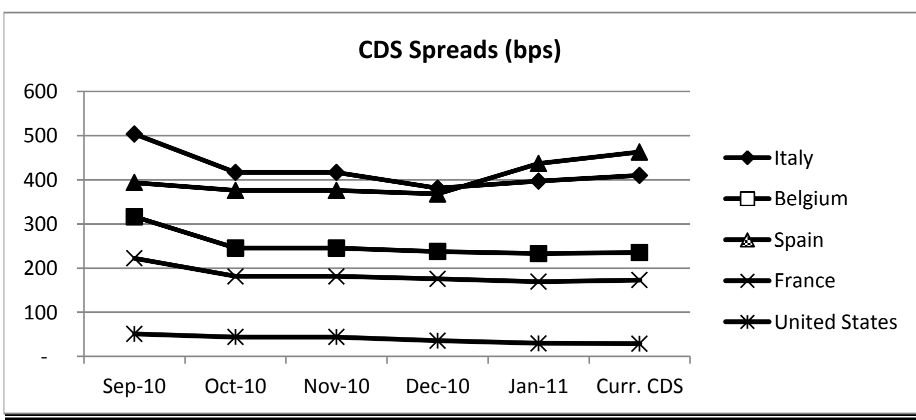
Inflection point - when debt to GDP exceeds 100%, a country's financial flexibility becomes increasingly strained. For the first time since WWII, US debt exceeds 100%. From 2008 to 2010, debt rose a total of 23.6% while GDP rose a total of 1.6%. Unfortunately, with an annual federal budget deficit in the area of $1.4T, debt is likely to reach $16.7T as of the end of 2012 while assuming GDP grows 2.5%, total GDP is likely to reach $15.7T. Therefore, as of the end of 2012, debt to GDP is likely to be in the area of 106%. Assuming the federal deficit for 2013 remains at $1.4T and GDP growth is 2.5%, the total debt will rise to $18.1T and GDP will rise to $16.1T, resulting in debt to GDP of 112%. In comparison, France's and Italy's debt to GDP are 81% and 117% respectively. Regarding efforts to address budget problems, the Super Committee was seeking spending cuts of $1.5T over 10 years or merely $150B per year, and was a failure. Obviously, the current course is not enhancing credit quality. Without some structural changes soon, restoring credit quality will become increasingly difficult.

Yields on 10-year treasury notes have fallen to their lowest since early Feb 2010 with US Federal Reserve's aggressive purchases of US Treasuries. A concern is the rise in interest rates placing higher pressure on the US's credit quality. Excess growth of money supply (i.e., debt monetization) harms creditors and ultimately, the economy. Weak debt reduction efforts force a neg. watch.

	Annual Ratios					
INDICATIVE CREDIT RATIOS	2008	2009	2010	P2011	P2012	P2013
Debt/ GDP (%)	74.9	88.3	99.2	102.6	108.7	114.9
Govt. Sur/Def to GDP (%)	-10.4	-8.6	-8.2	-9.5	-8.7	-9.1
Adjusted Debt/GDP (%)	74.9	88.3	99.2	102.6	108.7	114.9
Interest Expense/ Taxes (%)	14.3	14.6	14.6	13.2	13.6	13.9
GDP Growth (%)	-3.5	3.0	1.7	2.5	2.5	2.5
Foreign Reserves/Debt (%)	0.4	0.4	0.3	0.3	0.3	0.3
Implied Sen. Rating	AA	BBB+	A-	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	33.9	-5.0	57.2	14.1	1.9	A
French Republic	AA+	81.1	-7.1	81.1	9.5	1.3	BB
Kingdom Of Belgium	AA	94.8	-4.1	94.8	11.9	1.0	BB-
Kingdom Of Spain	A	59.5	-9.3	59.9	9.5	0.3	BBB-
Republic Of Italy	BBB+	117.3	-4.6	117.3	15.4	-0.4	B



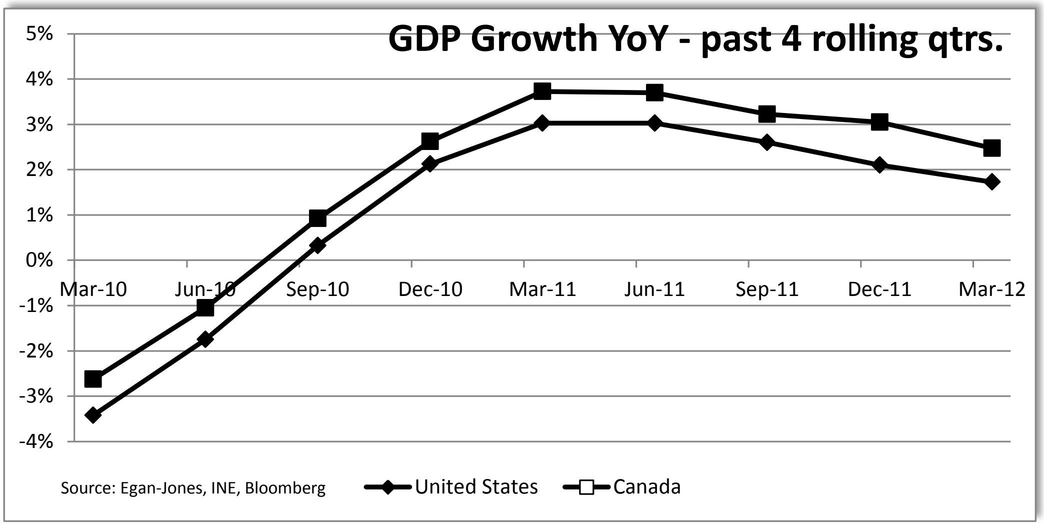
Country (EJR Rtg*)	Current CDS	Targeted CDS
Italy (BB)	410	800
Belgium (BBB-)	235	400
Spain (BBB-)	463	400
France (A-)	173	120
United States (AA-)	29	70

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

Economic Growth

Economic growth has been aenemic, averaging 2% to 2.5% recently. If adjusted for inflation (including energy and commodity costs) economic growth has been at best stagnant, at worst, negative. Attempts at monetary stimulus have had little positive effect on the underlying economy. A major concern continues to be tepid economic growth and an overhang from the pending retirement of the baby boom generation.

As can be seen from the below chart, over the past couple of years GDP growth has been near Canada albeit at a slightly lower pace. although as of the end of 2009 and 2010 growth was negative and below Canada's. A major issue is that if the US is running hefty deficits with an economic recovery and depressed interest rates, the deficits might grow faster under less salubrious conditions.



Fiscal Policy

The US's deficit to GDP of 8.2% is not particularly comforting for a top tier country. Over the last couple of full fiscal years (that is 2008 and 2010), total sovereign revenues declined 2.5% while total expenses rose 11.7%; the country had to spend to support citizens as a result of the 2008 slowdown. As can be seen from the chart to the right, the deficit to GDP for countries such as Spain is 9.3% and the debt to GDP is only 60% for Spain, thereby underscoring the credit concerns.

	Def/ Surplus to GDP	Debt-to-GDP	5 Yr. CDS Spreads
United State	-8.2	96%	30
Canada	-5.0	32%	N/A
France	-7.1	81%	169
Belgium	-4.1	95%	233
Spain	-9.3	60%	437
Italy	-4.6	117%	397

Source: Bloomberg using year end data excluding CDS data

Unemployment

Despite substantial fiscal and monetary stimulus, unemployment in the US has remained stubbornly high. Although over the past four quarters stated unemployment has declined to approximately 8.3%, the economy faces some challenges from EU fiscal and monetary issues. Additionally, a major global growth generator, China, is facing lower growth. Perhaps the major issue is the difficulty in effecting additional substantial fiscal and monetary stimulus given the high debt. Watch unemployment levels post stimulus.

Unemployment (%)

	2009	2010
United Stat	9.6	9.0
Canada	7.6	7.5
France	9.7	9.8
Belgium	7.6	7.1
Spain	20.3	22.9
Italy	8.2	8.8

Source: Intl. Finance Statistics

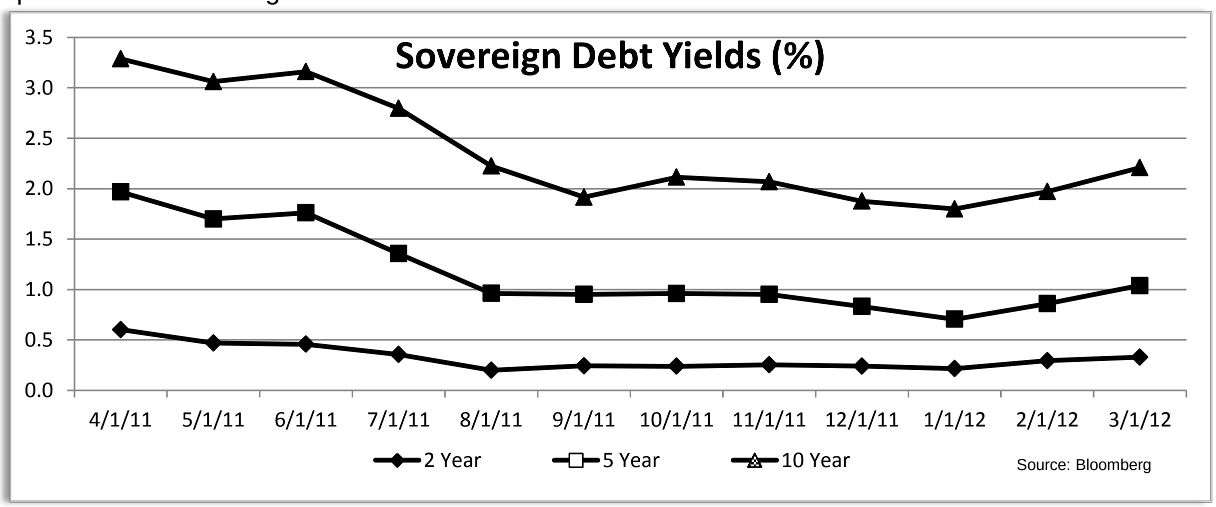
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. The US has significantly less exposure to its banking sector because of the bank's relatively small size; the US's top five banks have assets equal to 54% of GDP compared to 125% for Germany. However, in the case of the US, it is becoming increasingly obvious that quasi-banks, Fannie, Freddie, and the Student Loan units will need substantial federal support.

Bank Total Assets (billions of dollar's)	Assets
JPMORGAN CHASE	2,266
BANK OF AMERICA	2,129
CITIGROUP INC	1,874
WELLS FARGO & CO	1,314
US BANCORP	340
Total	7,923
United States's GDP	14,527

Funding Costs

Despite weakening credit metrics, the US has seen a significant decline in its funding costs over the past couple of years because of "monetary easing" (i.e., the FED's purchasing US Treasury debt) and a flight to quality stemming from the EU credit crisis. As can be seen in the below graph, the ten year debt yield has declined from 3.3% to 2.2% and the 2 year yield is below .5%. Our concern is that funding costs will rise over the next couple of years and further pressure federal budgets.



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 4 (1 is best) is well above average.

The World Bank's Doing Business Survey	2012 Rank	2011 Rank	Change in Rank
***Overall Country Rank**:	**4**	**4**	**0**
****Scores:**			
Starting a Business	13	11	-2
Construction Permits	17	17	0
Getting Electricity	17	16	-1
Registering Property	16	11	-5
Getting Credit	4	4	0
Protecting Investors	5	5	0
Paying Taxes	72	70	-2
Trading Across Borders	20	20	0
Enforcing Contracts	7	7	0
Resolving Insolvency	15	14	-1

* Based on a scale of 1 to 183 with 1 being the highest ranking.
** Based on a scale where 100 is best, 1 is worst.

Economic Freedom

As can be seen below, United States is above average in its overall rank of 10 for Economic Freedom with 100 being best.

Heritage Foundation 2010 Index of Economic Freedom
World Rank: 10*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**91.1**	90.0	1.1	64.3
Trade Freedom	**86.4**	86.4	0.0	74.8
Fiscal Freedom	**69.8**	68.0	1.8	76.3
Government Spending	**46.7**	57.0	-10.3	63.9
Monetary Freedom	**77.2**	77.0	0.2	73.4
Investment Freedom	**70.0**	76.0	-6.0	50.2
Financial Freedom	**70.0**	71.0	-1.0	48.5
Property Rights	**85.0**	85.0	0.0	43.5
Freedom from Corruption	**71.0**	77.0	-6.0	40.5
Labor Freedom	**95.8**	95.8	0.0	61.5

*Based on a scale of 1-179 with 1 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%	4.2	9.0	**3.0**	**3.0**
Social Contributions Growth %	1.4	2.3	**3.0**	**3.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	1.8	3.5	**3.0**	**3.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	3.1	6.8	**3**	**2.5**
Compensation of Employees Growth%	2.0	2.5	`	**3.0**
Use of Goods & Services Growth%	1.8	6.0	**3.0**	**3.0**
Social Benefits Growth%	3.2	6.8	**2.0**	**3.0**
Subsidies Growth%	3.9	(4.0)	**3.0**	**4.0**
Other Expenses Growth%	(25.2)	(25.2)	**2.0**	**2.0**
Interest Expense	0.0	2.7	**3**	
Balance Sheet				
Currency and Deposits (asset) Growth%	(20.6)	26.4	**2.0**	**2.0**
Securities other than Shares LT (asset) Growth%	7.0	(0.8)	**2.0**	**2.0**
Loans (asset) Growth%	7.5	18.3	**3.0**	**3.0**
Shares and Other Equity (asset) Growth%	(1.7)	45.0	**3.0**	**3.0**
Insurance Technical Reserves (asset) Growth%	0.0	10.3	**2.0**	**2.0**
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	0.5	11.3	**3.0**	**3.0**
Monetary Gold and SDR's Growth %	0.0	(1.7)	**3.0**	**3.0**
Other Accounts Payable Growth%	2.4	11.3	**10.0**	**10.0**
Currency & Deposits (liability) Growth%	2.5	(1.1)	**4.0**	**4.0**
Securities Other than Shares (liability) Growth%	5.7	15.0	**4.0**	**4.0**
Loans (liability) Growth%	5.7	18.3	**7.0**	**7.0**
Insurance Technical Reserves (liability) Growth%	0.0	10.3	**10.0**	**10.0**
Financial Derivatives (liability) Growth%	0.0	0.0		
Addl debt. (1st Year) billion USD	0.0	0.0		

Base Case
ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS$)

	Dec-08	Dec-09	Dec-10	PDec-11	PDec-12	PDec-13
Taxes	2,808,140	2,448,097	2,668,146	2,748,190	2,830,636	2,915,555
Social Contributions	992,116	969,016	991,682	1,021,432	1,052,075	1,083,638
Grant Revenue	0	0	0	0	0	0
Other Revenue	285,352	311,664	322,696	332,377	342,348	352,619
Other Operating Income	0	0	0	0	0	0
Total Revenue	4,085,608	3,728,777	3,982,524	4,102,000	4,225,060	4,351,812
Compensation of Employees	1,424,679	1,479,837	1,517,184	1,517,184	1,517,184	1,562,700
Use of Goods & Services	696,673	661,816	701,688	722,739	744,421	766,753
Social Benefits	1,857,886	2,115,980	2,259,479	2,304,669	2,350,762	2,397,777
Subsidies	52,917	59,690	57,329	59,055	60,832	63,272
Other Expenses	202,845	274,827	205,563	280,324	209,674	285,930
Grant Expense	0	0	0	0	0	0
Depreciation	259,621	270,497	278,605	286,963	295,572	307,395
Total Expenses excluding interest	4,441,704	4,802,957	4,962,519	5,170,933	5,178,445	5,383,827
Operating Surplus/Shortfall	-356,096	-1,074,180	-979,995	-1,068,933	-953,385	-1,032,015
Interest Expense	400,244	358,589	390,233	363,574	385,480	404,754
Net Operating Balance	-756,340	-1,432,769	-1,370,228	-1,432,506	-1,338,865	-1,436,769

Base Case
ANNUAL BALANCE SHEETS (MILLIONS$)

ASSETS	Dec-08	Dec-09	Dec-10	PDec-11	PDec-12	PDec-13
Currency and Deposits (asset)	733,367	593,744	750,353	765,360	780,667	796,281
Securities other than Shares LT (asset)	1,226,304	1,323,624	1,313,316	1,339,582	1,366,374	1,393,701
Loans (asset)	634,503	804,717	951,672	980,222	1,009,629	1,039,918
Shares and Other Equity (asset)	157,984	(407,190)	(590,440)	(608,153)	(626,398)	(645,190)
Insurance Technical Reserves (asset)	210,236	227,927	251,297	256,323	261,449	266,678
Other Accounts Receivable LT	659,372	722,976	804,939	829,087	853,960	879,579
Monetary Gold and SDR's	9,344	57,818	56,828	58,533	60,289	62,097
Additional Assets	(210,236)	(227,927)	(251,301)			
Total Financial Assets	3,420,874	3,095,689	3,286,664	3,620,954	3,705,970	3,793,064
LIABILITIES						
Other Accounts Payable	659,372	722,976	804,939	885,433	973,976	1,071,374
Currency & Deposits (liability)	26,551	26,199	25,923	25,923	25,923	25,923
Securities Other than Shares (liability)	9,776,788	11,374,457	13,076,033	13,599,074	14,143,037	14,708,759
Loans (liability)	634,503	804,717	951,672	1,304,876	2,076,657	2,915,849
Insurance Technical Reserves (liability)	210,236	227,927	251,297	276,427	304,069	334,476
Financial Derivatives (liability)						
Other Liabilities	(413,645)	(614,615)	(783,459)	1,469	1,469	1,469
Liabilities	10,893,805	12,541,661	14,326,405	16,093,202	17,517,083	19,040,946
Net Financial Worth	(7,472,931)	(9,445,972)	(11,039,741)	(12,472,247)	(13,811,113)	(15,247,881)
Total Liabilities & Equity	3,420,874	3,095,689	3,286,664	3,620,954	3,705,970	3,793,064

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