

UNITED STATES (GOVT OF)

EJR Sen Rating(Curr/Prj) N/A

Rating Analysis - 11/10/13

Debt: \$15.2B

At the request of the Rating Review Committee, we are withdrawing coverage. Major issues for prospective credit quality are likely to include an analysis of the benefit of the dollar as a reserve currency, the relative burden and the amelioration of the costs associated with entitlement programs, the tenor and future course of extraordinary monetary actions, and the likely growth rate of the economy. A major challenge for most of the developed economies will be addressing the increasing dependency ratio although the growth rate in the US is expected to be stronger than that of other developed countries. Some market observers contend that a country issuing debt in its own currency can never default since it can simply print additional currency. In the case of the US, at times of economic difficulty, the country actually benefits since investors perceive the country as a safe haven. Note, US funding costs are likely to rise as the global economy improves or global monetary easing diminishes. The offset is likely to be stronger revenues with a stronger economy. Perhaps the major event in the US over the next year will be the timing and extent of monetary easing.

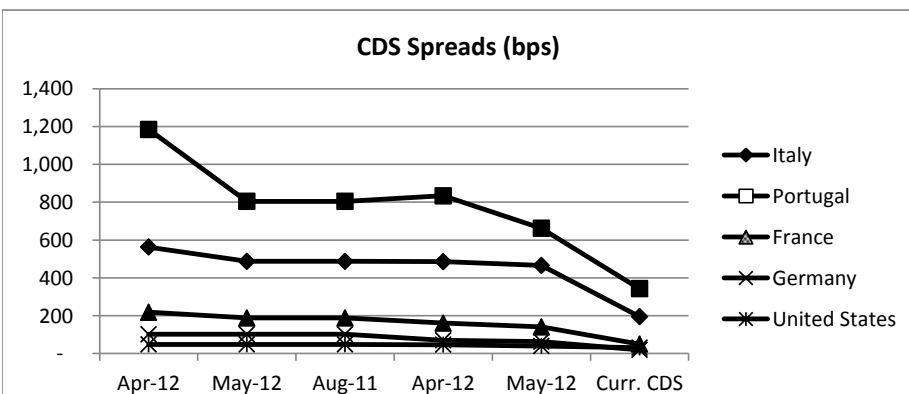
From 2006 to present, the US's debt to GDP rose from 66% to over 100% and will probably continue to rise albeit at a slower rate. Providing some encouragement is the country's dominant position in some of the faster-growing industries such as social media, software, bio-tech, gaming, entertainment, and other services. The below information is primarily from our Sept. 2012 report.

Annual Ratios (source for past results: IMF)

INDICATIVE CREDIT RATIOS	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	88.8	97.1	100.9	106.1	109.8	112.0
Govt. Sur/Def to GDP (%)	-10.4	-8.7	-8.2	-6.8	-5.4	-4.4
Adjusted Debt/GDP (%)	88.8	98.7	102.4	107.6	111.2	113.3
Interest Expense/ Taxes (%)	14.6	14.6	14.7	11.5	12.1	12.2
GDP Growth (%)	-3.1	2.4	1.8	5.3	5.3	5.5
Foreign Reserves/Debt (%)	0.3	0.3	0.3	0.3	0.3	0.3
Implied Sen. Rating	BBB	BBB	BBB	BBB+	BBB+	BB

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 % of GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Government Of Canada	AAA	31.6	-4.5	31.6	14.1	1.9	A+
French Republic	AA+	88.9	-1.0	113.5	9.5	1.9	BB+
Kingdom Of Belgium	AA	102.1	-5.2	102.1	11.9	1.2	BB-
Republic Of Italy	BBB+	120.0	-3.9	130.8	16.7	-0.5	B+
Portugal Republic	BB	106.8	-4.2	117.2	13.0	-3.0	BB-



Country (EJR Rtg*)	Current CDS	Targeted CDS
Italy (C+)	195	4,300
Portugal (CCC+)	343	1,500
France (BBB-)	51	400
Germany (A-)	20	120
United States (N)	31	#N/A

* Projected Rating

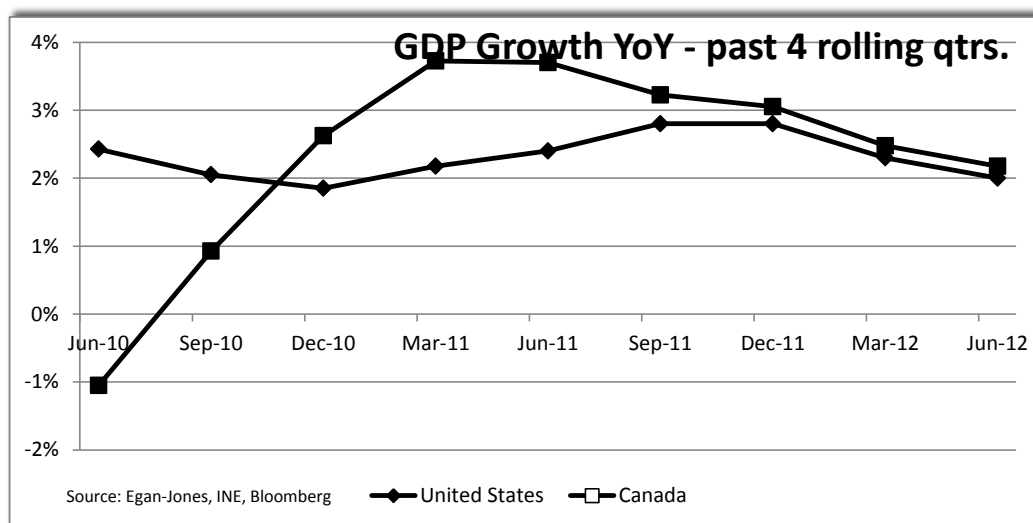
* EJR's targeted CDS based on rating

* Note, non-NRSRO rating. Copyright Egan-Jones Ratings Co.; no secondary distribution.

Economic Growth

Economic growth has been anemic, averaging approximately 2% on an annualized basis. The last annualized GDP growth showed that the US economy near 2.0% YoY but is likely to improve over the next couple of quarters. Monetary stimulus has had helped ease pain immediately after the credit crisis but is now being questioned. Wages in the US continue to be negative on an inflation-adjusted basis. 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 deficits with an economic recovery and depressed interest rates, the deficits might grow faster under less salubrious conditions.



Fiscal Policy

As a carry-over from the 2007-2008 credit crisis, the US has run significant deficits and the national debt over \$16 trillion. Sequestration has resulted in a small reduction in the rate in annual spending growth. Plans to reduce the budget deficit have made progress but probably more is needed. Entitlement spending which accounts for the majority of budgetary expenditures requires extensive reform and without it, the US will have difficulty engaging in meaningful debt reduction.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
U.S.	8.2	100.9	40
Canada	4.5	31.5	N/A
Germany	1.0	81.4	63
France	5.2	88.9	140
Italy	3.9	120.0	466
Portugal	4.2	106.8	662

Sources: Bloomberg and IFS

Unemployment

While unemployment rate was reduced from 9.6% to approximately 7.0%, nearly 400K was eliminated from the work force. The labor participation rate of 63.5% hasn't been this low since the Reagan admin. While the US added 96K jobs in Aug. nearly one third of them were in bars and restaurants. Hopefully employment will make more tangible improvement over the next couple of quarters.

	Unemployment (%)	
	2010	2011
U.S.	9.6	9.0
Canada	7.6	7.5
Germany	7.4	6.8
France	9.7	9.8
Italy	8.3	9.2
Portugal	11.1	14.0

Source: Intl. Finance Statistics

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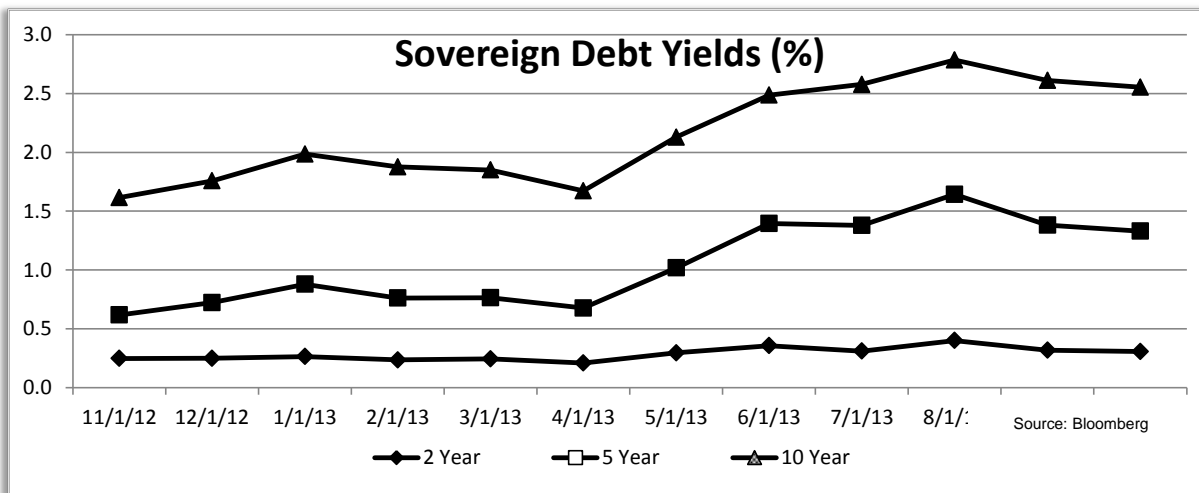
Banking Sector

The US Banking sector has improved. although loan growth rates recorded by some banks have been the result of portfolio acquisitions rather than organic growth. The yield curve in the banking system is more normal and is likely to help returns over the next couple of years. The US banking industry is heavily concentrated with the top six banks in the US accounting for 56% of GDP.

Bank Assets (billions of local currency)		
	Assets	Cap/Assets %
BANK OF AMERICA	2,210	10.7
JPMORGAN CHASE	2,359	8.7
CITIGROUP INC	1,865	10.2
WELLS FARGO & CO	1,423	11.2
GOLDMAN SACHS	939	8.1
Total	8,795	
EJR's est. of cap shortfall at 10% of assets less market cap		65
United States's GDP		16,000

Funding Costs

The US has seen a significant decline in its funding costs over the past four 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. However, as can be seen in the below graph, the ten year debt yield has risen approximately 100bps. Our concern is that funding costs will rise over the next couple of years and further pressure federal budgets.



Ease of Doing Business

Major factors for growing the economy are 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 strong.

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.

Economic Freedom

As can be seen below, United States is above average in its overall rank of 76.3 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom				
World Rank 76*				
	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	91.1	91.0	0.1	64.3
Trade Freedom	86.4	86.4	0.0	74.8
Fiscal Freedom	69.8	68.3	1.5	76.3
Government Spending	46.7	54.6	-7.9	63.9
Monetary Freedom	77.2	77.4	-0.2	73.4
Investment Freedom	70.0	75.0	-5.0	50.2
Financial Freedom	70.0	70.0	0.0	48.5
Property Rights	85.0	85.0	0.0	43.5
Freedom from Corruption	71.0	75.0	-4.0	40.5
Labor Freedom	95.8	95.7	0.1	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	
	Median	Average	Yr 1&2	Yr 3,4,5
Income Statement				
Taxes Growth%	4.2	9.1	5.0	4.0
Social Contributions Growth %	1.4	(6.3)	4.0	3.5
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	6.8	1.2	3.0	3.0
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	3.1	4.6	5	5.5
Compensation of Employees Growth%	2.0	1.0	1.0	1.0
Use of Goods & Services Growth%	4.0	2.9	2.0	3.0
Social Benefits Growth%	2.4	2.4	(1.0)	(0.5)
Subsidies Growth%	2.9	9.6	0.5	1.0
Other Expenses Growth%	(7.0)	(7.0)	1.0	1.0
Interest Expense	0.0	2.8	2	2.3
Balance Sheet				
Currency and Deposits (asset) Growth%	(20.7)	0.0	2.0	2.0
Securities other than Shares LT (asset) Growth%	5.0	(15.2)	2.0	2.0
Loans (asset) Growth%	14.4	11.4	3.0	3.0
Shares and Other Equity (asset) Growth%	(1.7)	21.2	3.0	3.0
Insurance Technical Reserves (asset) Growth%	3.0	7.9	2.0	2.0
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	1.8	(3.3)	3.0	3.0
Monetary Gold and SDR's Growth %	0.0	(3.3)	3.0	3.0
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	2.4	(3.3)	1.0	1.0
Currency & Deposits (liability) Growth%	(1.8)	0.0	4.0	4.0
Securities Other than Shares (liability) Growth%	5.3	8.7	4.0	4.0
Loans (liability) Growth%	5.7	11.4	2.0	2.0
Insurance Technical Reserves (liability) Growth%	0.0	7.9	2.0	2.0
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 (BILLIONS \$)

	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Taxes	2,448	2,668	2,911	3,056	3,209	3,338
Social Contributions	969	992	929	966	1,005	1,040
Grant Revenue	0	0	0	0	0	0
Other Revenue	312	323	327	336	347	357
Other Operating Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Revenue	3,729	3,983	4,166	4,359	4,560	4,734
Compensation of Employees	1,480	1,517	1,532	1,548	1,563	1,579
Use of Goods & Services	662	702	722	736	751	773
Social Benefits	2,116	2,259	2,314	2,290	2,268	2,245
Subsidies	60	57	63	63	63	64
Other Expenses	215	148	138	150	139	151
Grant Expense	0	0	0	0	0	0
Depreciation	<u>270</u>	<u>279</u>	<u>293</u>	<u>295</u>	<u>296</u>	<u>299</u>
Total Expenses excluding interest	4,803	4,963	5,061	5,082	5,080	5,111
Operating Surplus/Shortfall	-1,074	-980	-895	-723	-520	-377
Interest Expense	<u>359</u>	<u>390</u>	<u>428</u>	<u>350</u>	<u>388</u>	<u>407</u>
Net Operating Balance	-1,433	-1,370	-1,324	-1,073	-908	-784

Sources: Historical - IMF, Projections - EJR

Base Case

ANNUAL BALANCE SHEETS (BILLIONS \$)

	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
ASSETS						
Currency and Deposits (asset)				220	225	229
Securities other than Shares LT (asset)	1,324	1,313	1,114	1,137	1,159	1,183
Loans (asset)	797	944	1,052	1,083	1,116	1,149
Shares and Other Equity (asset)	(407)	(590)	(716)	(737)	(759)	(782)
Insurance Technical Reserves (asset)	228	251	271	277	282	288
Other Accounts Receivable LT	723	805	778	802	826	851
Monetary Gold and SDR's	58	57	55	57	58	60
Additional Assets	366	499	265			
Total Financial Assets	3,088	3,279	2,820	3,103	3,172	3,242
LIABILITIES						
Other Accounts Payable	723	805	778	786	794	802
Currency & Deposits (liability)	26	26	26	26	26	26
Securities Other than Shares (liability)	11,374	13,076	14,214	14,783	15,374	15,989
Loans (liability)	797	944	1,052	2,125	3,033	3,817
Insurance Technical Reserves (liability)	<u>228</u>	<u>251</u>	<u>271</u>	<u>277</u>	<u>282</u>	<u>288</u>
Financial Derivatives (liability)						
Other Liabilities	<u>(607)</u>	<u>(789)</u>	<u>(809)</u>	<u>(1,107)</u>	<u>(1,107)</u>	<u>(1,107)</u>
Liabilities	<u>12,542</u>	<u>14,313</u>	<u>15,533</u>	<u>16,889</u>	<u>17,866</u>	<u>18,721</u>
Net Financial Worth	<u>(9,453)</u>	<u>(11,034)</u>	<u>(12,713)</u>	<u>(13,786)</u>	<u>(14,694)</u>	<u>(15,478)</u>
Total Liabilities & Equity	<u>3,088</u>	<u>3,279</u>	<u>2,820</u>	<u>3,103</u>	<u>3,172</u>	<u>3,242</u>

* Note, non-NRSRO rating. Copyright Egan-Jones Ratings Co.; no secondary distribution.

Sovereign Rating Methodology (Non-NRSRO)

Scope and Limitations: Sovereign Issuer Credit Quality Ratings (CQR) are a forward-looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and on time. Sovereigns are assigned two CQRs: a Local-Currency CQR, which reflects the likelihood of default on debt issued and payable in the currency of the sovereign, and a Foreign-Currency CQR, which is an assessment of the credit risk associated with debt issued and payable in foreign currencies.

Key Rating Drivers: EJR's approach to sovereign risk analysis is a synthesis of quantitative and qualitative judgments. The quantitative factors EJR uses are:

- Debt in relation to GDP.
- Surplus or deficit in relation to GDP.
- Debt plus potential under-funding of major banks in relation to GDP.
- Interest expense in relation to taxes.
- GDP growth.
- Foreign reserves in relation to debt.

Debt levels for many sovereign issuers have increased at an accelerating rate over the past decade, affecting implied ratings. EJR also considers unemployment levels and funding costs. EJR recognizes that no model can fully capture all the relevant influences on sovereign creditworthiness, meaning that the its sovereign ratings can and do differ from those implied by the rating model. Some of the qualitative factors that impact its ultimate assessment of credit quality include the flexibility, stability and overall strength of the economy, efficiency of tax collection, acceptance of contract law, ease of doing business, trade balances, prospects for future growth and health and monetary policy, and economic freedom. These subjective and dynamic qualitative issues are not captured by the model but affect sovereign ratings

For additional information, please see Exhibit 2: Methodologies in EJR's Form NRSRO.