GERMANY

Rating Analysis - 11/22/10
Debt: EUR1,760.5B, Cash: EUR197.1B

EJR Sen Rating(Curr/Prj) AA/ N/A
EJR CP Rating: A1+
EJR's 1 yr. Default Probability: 1.0%

Germany maintains its position as the European Union's top economy in the third quarter. The economy recorded 0.7% growth (3.9% NSA) in Q3 2010 following a record 2.3% growth in Q2 2010. The German government forecasts growth of 1.8% in 2011. Domestic employment was up 0.8% YoY. Unemployment was down -2.8% from the month prior in October, with levels falling below 3M persons for the first time in 18 years. The jobless rate remains at 10.1% and inflation stabilized in October. Both the HICP and CPI rose 1.3% year-on-year and 0.1% on a monthly basis, remaining unchanged from September. The country maintained its trade surplus in October 2010 as exports reached values last seen in October 2008. Exports rose 24.3% YoY while imports rose 17.8% YoY.

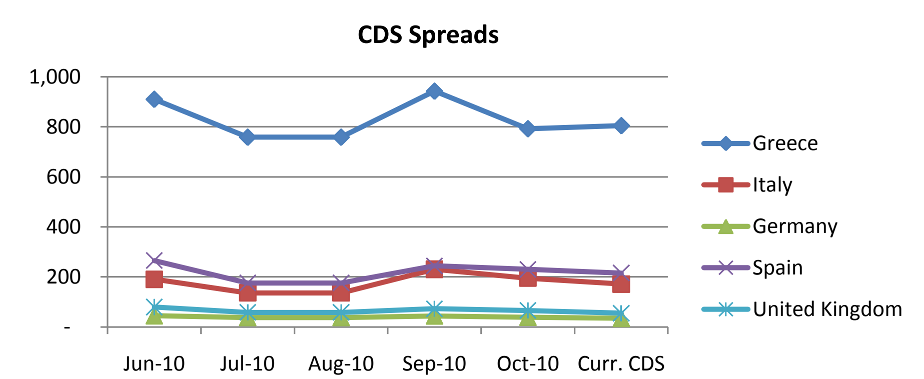
German chancellor Angela Merkel continues to create tension with EU member states by pushing for radification to the Lisbon Treaty. The government insists that private investors bear more of the costs of further European bailouts.

Germany's CDS spreads remain subdued as investors maintain confidence in the economy. We believe Germany's spreads are *undervalued* as German taxpayers bear heavy burdens to the ongoing European bailouts.

	Annual Ratios					
INDICATIVE CREDIT RATIOS	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
Debt/ GDP (%)	61.2	71.6	74.0	76.5	78.1	79.7
Govt. Sur/Def to GDP (%)	0.1	-3.0	-3.3	-3.3	-3.3	-3.3
Adjusted Debt/GDP (%)	67.4	78.4	81.0	83.6	85.3	87.0
Interest Expense/ Taxes %	11.2	10.7	13.7	14.5	14.5	14.6
GDP Growth (%)	-2.0	-2.0	1.0	1.0	1.0	1.0
Foreign Reserves/Debt (%)	1.8	1.2	1.2	1.1	1.1	1.1
Implied Sen. Rating	A+	AA	A+	BBB+	BBB	BBB

INDICATIVE CREDIT RATIOS	B	BB	BBB	A	AA	AAA
Debt/ GDP (%)	120.0	80.0	60.0	50.0	40.0	30.0
Govt. Sur/Def to GDP (%)	-5.0	-2.0	0.5	3.0	5.0	9.0
Adjusted Debt/GDP (%)	125.0	85.0	65.0	55.0	45.0	35.0
Interest Expense/ Taxes %	22.0	15.0	12.0	9.0	7.0	5.0
GDP Growth (%)	-1.0	1.0	2.0	4.0	5.0	6.0
Foreign Reserves/Debt (%)	9.0	12.0	15.0	20.0	25.0	30.0

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	78.4	-3.0	98.6	6.9	-5.0	BB-
Germany	AAA	71.6	-3.0	78.4	10.7	-2.0	BBB
Spain	AA	52.3	-11.1	57.1	9.6	-3.0	BB+
Italy	A+	113.6	-5.3	119.8	15.9	-2.8	B
Greece	BB+	123.0	-15.4	126.2	25.8	-3.2	CCC+



Country (EJR Rtg*)	Current CDS	Targeted CDS
Greece(BB)	805	400
Italy(BBB+)	171	158
Germany(A+)	34	60
Spain(A+)	215	60
United Kingdom(AA)	55	30

* Projected Rating

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Robust Economy

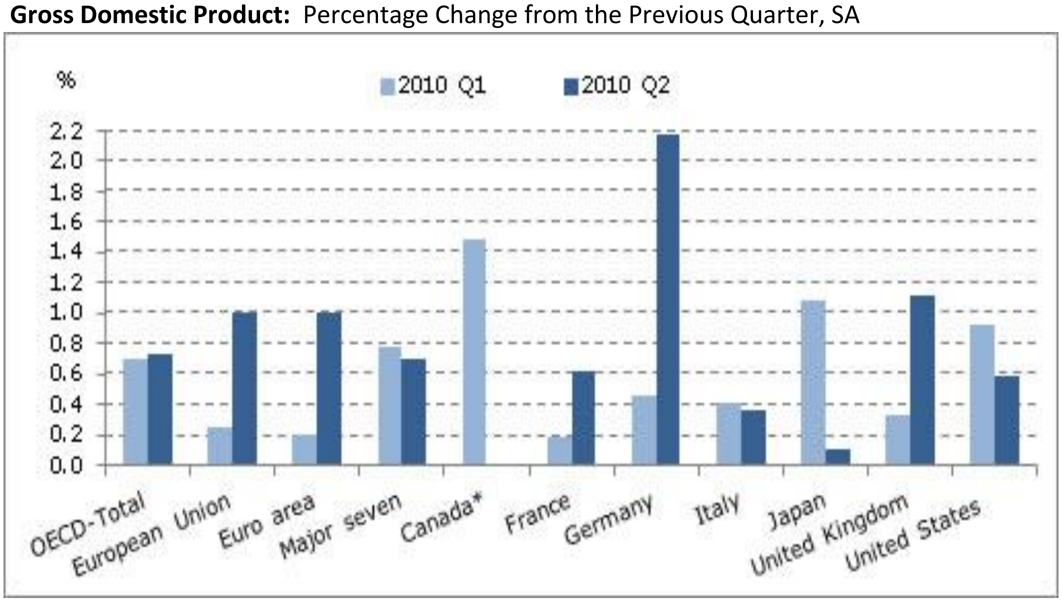
As Europe's largest economy, Germany is a key member of the region's overall economic health as well as its political and defense organizations. In the most recent year, GDP totaled US$3.3 trillion, ranking fourth worldwide in terms of overall value behind only the United States, Japan and China. Meanwhile, GDP per capita, which increased 20% from 1991 to 2009, totaled US$33,733 in terms of purchasing power parity (a 4.7% decline from the year prior), ranking 17th worldwide and trailing many of its EU partners.

While European nations continue to face increased fiscal challenges in the wake of the global financial crisis, Germany's economy has proven itself to be strong. The country has taken a definite pro-austerity stance in dealing with its public finances and statistics have shown economic improvement in recent quarters.

During the recession, Germany's real GDP declined by -6.7%. Meanwhile, OECD nations averaged a decline of -4.8%. The economy emerged from recession in the second quarter of 2009 and posted an average GDP growth rate of 0.5% in the four quarters through Q1 2010. By Q2 2010, GDP grew 2.2% from the previous quarter, marking the country's strongest quarter-on-quarter growth since reunification. At constant prices, Q2 2010 GDP rose by a record 4.9% from the same quarter of 2009.

In recent weeks, the global recovery has slowed as debt-ridden nations across the EU and beyond face increasingly unsustainable fiscal challenges. Germany's economy was directly effected in Q3 2010 as the record growth seen in Q2 2010 slowed to 0.7% growth in the third quarter.

Gross Domestic Product: Percentage Change from the Previous Quarter, SA



Source: *Quarterly National Account* , OECD, August 2010

Debts and Deficits: 'Debt Break' Takes Effect

After having injected billions of euros into the economy through stimulus measures in 2009, the German government implemented new rules for the maximum permissible borrowing by Federal Government and Länder budgets. The rules, known as 'debt break' laws, were designed to steadily reduce Germany's debt-to-GDP ratio. The Länder may no longer show structural deficits following the year 2020. In the case of the Federal Government, net borrowing may not exceed 0.35% of GDP as of the year 2016. The ceiling for structural net borrowing is set to drop steadily from its current position over the course of the 'transitional period' from 2011 to 2015. For the Federal Government, this equates to a consolidation requirement of nearly 60 billion euros or about 10 billion euros per year until the year 2016.

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Following two years with a nearly balanced budget, Germany recorded a deficit of 3.1% of GDP in 2009 as a result of the global financial crisis. Revenues in 2009 fell 2.4% from the year prior while expenditures rose 5.0%. To date, Germany's budget deficit is -3% of GDP. Tax revenues continue to decline.

Trade Balance

Germany has a very export-driven economy that has long benefited from openness to foreign trade and investment. To date, Germany leads in the trade of machinery, vehicles, chemicals and household equipment. Still, due to a lack of natural resources, the economy depends largely on imports as well. The majority of Germany's trade activity is conducted with member EU states. In 2009, European countries accounted for 63% of exports and 71% of imports. Asia is another important market, accounting for 14% of exports and 18% of imports in 2009. America accounted for roughly 10% of export and import trade during the same year.

In Q2 2010, exports in Germany rose 8.2% over the prior quarter (19.1% YoY). Imports grew at a slighly weaker rate of 7% QoQ in the same period (17.8% YoY). The resulting export surplus contributed directly to the record economic growth seen in the quarter.

Unemployment: Relatively Stable

Despite the recent economic downturn, unemployment in Germany has remained relatively stable. Much of the limited impact of the crisis on unemployment can be attributed to large reductions in working time over the recessionary period, during which average hours worked fell by -3.4%.

At the onset of the global recession, Germany's unemployment rate was 7.9%. As of October 2010, unemployment had fallen 0.9% to 7%. In the same period, the average unemployment rate among OECD nations rose 2.8% from a 28-year low of 5.7% at the onset of the recession to 8.5% in the most recently released September 2010 figures (unchanged from August). To date, Germany's unemployment levels remain well below both the euro area and OECD averages.

Inflation & The ECB Limit

Germany's weighted annual rate of inflation averaged 2.5% between 2006 and 2008 before falling to an average 0.3% in 2009. Levels have remaind relatively subdued in FY 2010, having averaged 1.0% YoY growth YTD. The European Central Bank defines price stability as a YoY increase in the HICP of below 2%. The CPI and HICP rose 1.3% YoY in October (0.1% over the month prior), remaining unchanged from September (1). Meanwhile, eurozone inflation rose 1.9% from 1.8% in September.

(1) For inflation measuerd by Harmonized Indices of Consumer Prices (HICP's): Harmonized inflation figures are required under the Treaty on the Functioning of the EU and are designed for international comparison of consumer price inflation.

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Assumptions for Projections

	Peer	Issuer	Base Case	
Income Statement	**Median**	**Average**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	(4.8)	(4.8)	**(4.8)**	**0.5**
Social Contributions Growth %	(1.8)	0.5	**0.5**	**1.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	0.1	0.1		
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	(6.4)	(2.4)	**(2)**	**(1.2)**
Compensation of Employees Growth%	5.2	3.5	**2.0**	**2.5**
Use of Goods & Services Growth%	5.4	5.4	**4.5**	**4.0**
Social Benefits Growth%	8.7	5.5	**5.5**	**5.5**
Subsidies Growth%	2.3	13.8		
Other Expenses Growth%	5.8	5.8	**4.0**	**3.0**
Special Items (millions EUR)	0.0	0.0		
Balance Sheet				
Currency and Deposits Growth%	0.4	(0.9)	**(4.8)**	**0.5**
Securities other than Shares LT Growth%	7.8	7.8	**1.0**	**1.0**
Loans Growth%	2.4	(3.1)	**(3.1)**	**(3.1)**
Shares and Other Equity Growth%	14.8	14.8	**14.8**	**14.8**
Insurance Technical Reserves Growth%	2.8	3.4	**3.4**	**3.4**
Financial Derivatives Growth%	0.0	5.7	**(4.8)**	**(4.8)**
Other Accounts Receivable LT Growth%	8.0	10.1	**(4.8)**	**(4.8)**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Accounts Payable Growth%	9.2	NMF		
Currency & Deposits Growth%	4.5	(1.8)	**0.5**	**0.5**
Securities Other than Shares Growth%	16.3	8.6	**6.0**	**6.0**
Growth%	0.0	0.0		
Loans Growth%	0.8	0.8	**0.8**	**0.8**
Insurance Technical Reserves Growth%	0.0	0.0		
Financial Derivatives Growth%	0.0	0.0		
		0.0		
Addl debt. (1st Year) million EUR	0.0	0.0		

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Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)

	Dec-07	Dec-08	Dec-09	PDec-10	PDec-11	PDec-12
Taxes	580,510	597,370	568,620	541,326	515,343	517,919
Social Contributions	399,830	408,070	410,170	412,281	414,402	418,547
Grant Revenue	0	0	0	0	0	0
Other Revenue	84,980	86,350	86,400	86,400	86,400	86,400
Other Operating Income	0	0	0	0	0	0
Total Revenue	1,065,320	1,091,790	1,065,190	1,039,238	1,013,918	1,001,751
Compensation of Employees	168,380	172,130	178,090	181,652	185,285	189,917
Use of Goods & Services	101,230	106,600	112,360	117,416	122,700	127,608
Social Benefits	596,780	607,380	640,740	675,932	713,057	752,222
Subsidies	27,630	28,020	31,900	31,903	31,906	31,910
Other Expenses	66,440	73,520	77,790	28,313	29,799	23,524
Grant Expense	0	0	0	0	0	0
Depreciation	38,370	39,320	40,050	40,050	40,050	40,050
Total Expenses	998,830	1,026,970	1,080,930	1,075,267	1,122,797	1,165,230
Operating Surplus/Shortfall	66,490	64,820	-15,740	-36,029	-108,879	-163,479
Interest Expense	67,290	67,070	61,080	73,915	74,539	75,168
Net Operating Balance	-800	-2,250	-76,820	-109,944	-183,417	-238,647

ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-07	Dec-08	Dec-09	PDec-10	PDec-11	PDec-12
Currency and Deposits	197,366	198,959	197,109	187,648	178,641	179,534
Securities other than Shares LT	12,970	52,412	56,514	57,079	57,650	58,226
Loans	61,066	73,772	71,497	69,292	67,155	65,084
Shares and Other Equity	201,805	216,527	248,656	285,552	327,924	376,582
Insurance Technical Reserves	678	702	726	751	776	803
Financial Derivatives	1,734	1,576	1,666	1,586	1,510	1,437
Other Accounts Receivable LT	86,292	85,862	94,525	89,988	85,668	81,556
Monetary Gold and SDR's						
Additional Assets	0	0	0	0	0	0
Total Financial Assets	561,911	629,810	670,693	691,896	719,324	763,223

LIABILITIES	Dec-07	Dec-08	Dec-09	PDec-10	PDec-11	PDec-12
Other Accounts Payable	3,628	3,596	4,238	4,238	4,238	4,238
Currency & Deposits	6,934	10,516	10,326	10,326	10,326	10,326
Securities Other than Shares	1,152,720	1,255,370	1,363,530	1,445,765	1,532,960	1,625,414
Loans	427,731	450,769	454,574	502,846	626,496	816,589
Insurance Technical Reserves						
Financial Derivatives						
Other Liabilities	(3)	(1)	2	645	645	645
Liabilities	1,591,010	1,720,250	1,832,670	1,963,820	2,174,665	2,457,211
Net Financial Worth	(1,029,100)	(1,090,440)	(1,161,980)	(1,271,924)	(1,455,341)	(1,693,987)
Total Liabilities & Equity	561,910	629,810	670,690	691,896	719,324	763,223

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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

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