FEDERAL REPUBLIC OF GERMANY

Rating Analysis - 1/18/12
Debt: EUR2,061.8B, Cash: EUR235.3B

EJR Sen Rating(Curr/Prj) AA-/ A+
EJR CP Rating: A1+
EJR's 1 yr. Default Probability: 1.3%

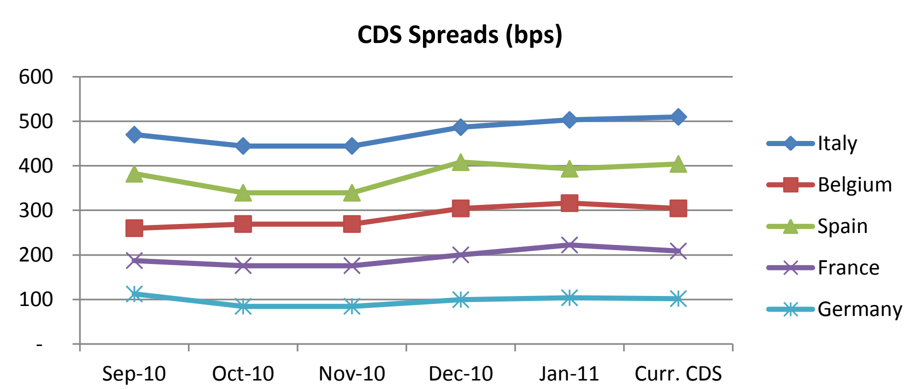
Germany maintains its position as the European Union's top economy. However, Germany has been shouldering the burdens of other EU countries via its exposure to the EFSF and indirectly via the ECB's hefty exposure to the weaker banks and the weaker sovereign credits. The country's debt to GDP of 83% as of 2010 (expect near 86% for 2011) and a deficit to GDP of 4.6% is weak (and getting weaker) for a top-tier country. On the positive side, unemployment was only 6.8% but will probably increase as many EU countries implement austerity measures. Other positives were the positive (EUR133B) balance of trade and the positive (EUR193B) current account as of the end of 2010. Inflation has been fairly moderate at 2%, but we expect an increase as a result of the decline in the euro relative to the dollar.

German chancellor Angela Merkel continues to create tension with EU member states by pushing for ratification of changes to the Lisbon Treaty. The government insists that private investors bear more of the costs of further European bailouts. Note, the cost of the bailouts is likely to be absorbed via increased support for the EFSF, the ESM, the ECB and a rise in the number of euros. The fallout from a likely Greek default needs to be monitored.

	Annual Ratios					
INDICATIVE CREDIT RATIOS	2008	2009	2010	P2011	P2012	P2013
Debt/ GDP (%)	66.7	74.5	83.4	92.1	103.9	116.7
Govt. Sur/Def to GDP (%)	-0.1	-3.2	-4.3	-6.6	-9.5	-10.5
Adjusted Debt/GDP (%)	74.8	82.9	91.5	100.4	112.4	125.4
Interest Expense/ Taxes (%)	11.8	11.6	11.2	11.2	12.0	12.6
GDP Growth (%)	-2.3	3.7	2.6	-2.4	-2.4	-2.2
Foreign Reserves/Debt (%)	1.7	1.5	1.4	1.3	1.1	1.0
Implied Sen. Rating	AA-	BB	BB+	BB	B+	B

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	35.0	45.0	55.0	75.0	115.0	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 (%)	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*
Government Of Canada	AAA	33.0	-5.0	33.0	14.1	2.7	A
French Republic	AA+	78.7	-7.1	96.9	9.5	1.5	BB-
Kingdom Of Belgium	AA	92.3	-4.1	116.4	11.9	1.7	BB
Kingdom Of Spain	A	57.8	-9.3	65.5	9.5	0.8	BB
Republic Of Italy	BBB+	113.8	-4.6	122.1	15.4	0.2	B+



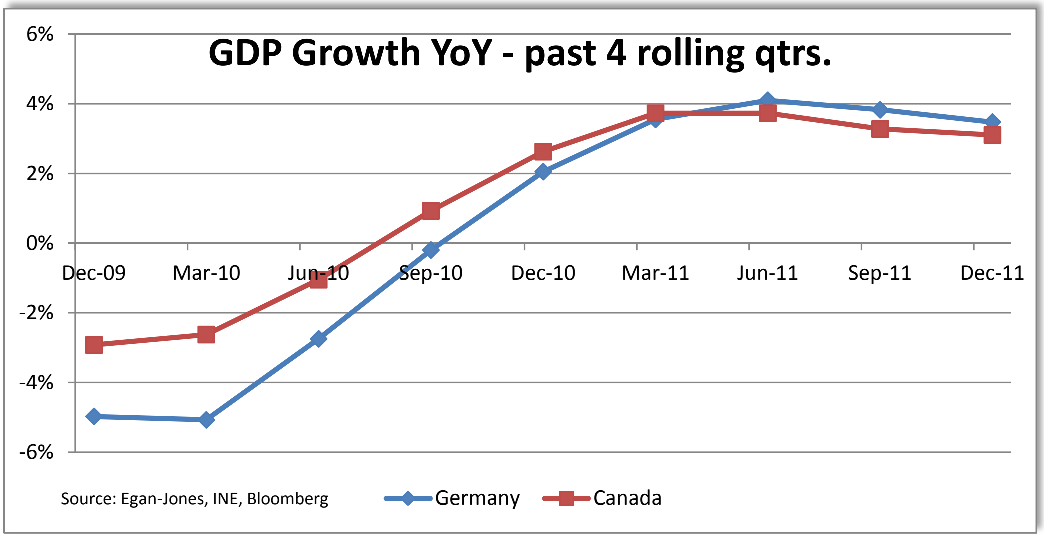
Country (EJR Rtg*)	Current CDS	Targeted CDS
Italy (BB)	510	800
Belgium (BBB-)	305	400
Spain (BBB-)	404	400
France (A-)	209	120
Germany (A+)	102	80

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

Economic Growth

From an economic perspective, Germany is among the strongest EU countries with GDP growth of nearly 4% for the Dec. 2011 quarter, which is stellar in moribund Europe. The recent decline in the euro will help the major exporters in Germany such as the auto manufacturers, chemical and pharmaceutical firms. However, imports will cost more and the economies of other EU countries are likely to remain weak and Germany will be expected to contribute support.

As can be seen from the below chart, Germany's recent GDP growth has been near Canada's although as of the end of 2009 and beginning of 2010 growth was negative and below Canada's. We expect the GDP growth for 2012 to be positive but slower than 2011. Perhaps the more relevant factor is the growth of the weaker EU countries.



Fiscal Policy

Germany's deficit to GDP of 4.3% 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 .8% while total expenses rose 10.4%; the country had to spend to support citizens as a result of the 2008 slowdown. As can be seen from the chart below, Spain's deficit to GDP was 9.3% and its debt to GDP was 114% which are of great concern since Germany will be providing indirect support to Spain and other weak countries.

	Deficit/ to GDP	Debt-to-GDP	5 Yr CDS Spreads
Germany	-4.3	79%	104
Canada	-5.0	31%	#N/A
France	-7.1	79%	222
Belgium	-4.1	92%	316
Spain	-9.3	58%	394
Italy	-4.6	114%	503

Source: Bloomberg

Unemployment

Germany's unemployment rate has long been among the lowest in the Euro zone. As can be seen from the chart at right, Germany is at the lowest rate of the peer countries and declined by 60 basis points from 2009 to 2010. For the more recent periods, Germany's unemployment rate has been near 6.7%. With the low unemployment rates relative to other EU countries, Germany is not under a great deal of pressure to employ fiscal stimulus measures.

Unemployment (%)

	2009	2010
Germany	7.4	6.8
Canada	7.6	7.5
France	9.7	9.7
Belgium	7.6	7.2
Spain	20.3	21.5
Italy	8.3	8.1

Source: Intl. Finance Statistics

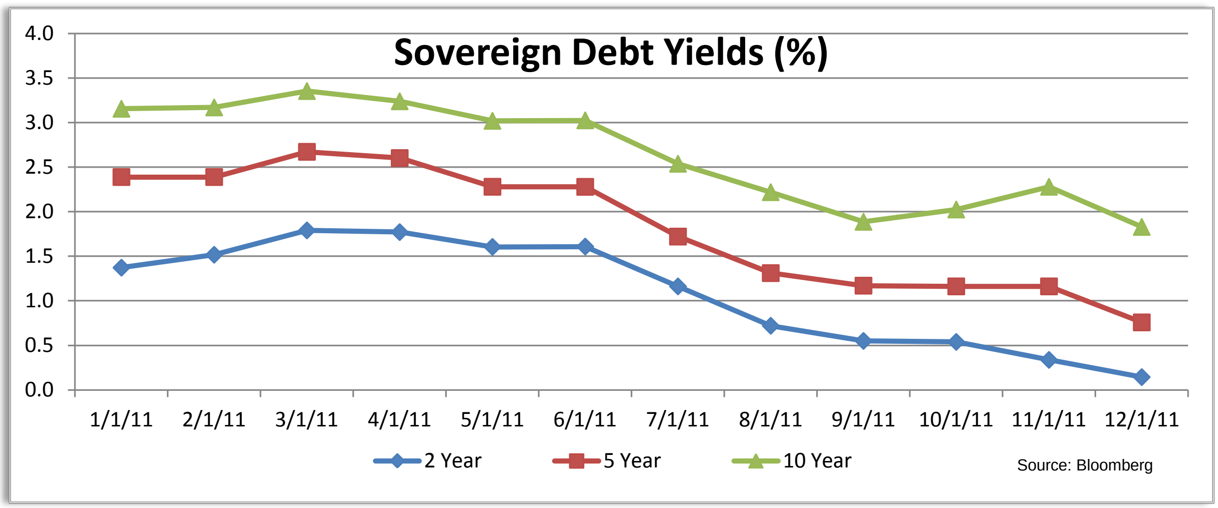
Banking Sector

Germany has significant exposure to its banking sector but it is relatively manageable; the United State's bank assets to GDP is 62% for its top six banks whereas for Germany it is near 120% for its top five banks. We expect the Republic of Germany will be forced to provide significant additional support for its banks directly and via the ECB.

Bank Total Assets (billions of EUR's)	Assets
DEUTSCHE BANK	1,906
COMMERZBANK	754
DEUTSCHE POSTBAN	215
LANDESBANK BERLIN	131
IKB DEUT INDBANK	31
Total	3,038
Germany's GDP	2,472

Funding Costs

The major positive Germany has realized over the past year has been the significant decline in its funding costs. As can be seen in the below graph, the two year debt yield has declined from 2% to near 0 while the 10 year has declined from above 3% to below 2%. Germany has benefited from the flight to quality as concerns increase about the credit quality of Greece, Italy, Portugal and other weak sovereigns. Note, if the strong countries in the EU continue to support the weak countries in a major way, Germany will slip.



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 19 (1 is best) Germany is above average but not outstanding.

The World Bank's Doing Business Survey	2012 Rank	2011 Rank	Change in Rank
***Overall Rank:**	**19**	**19**	**0**
****Scores:**			
Starting a Business	98	89	9
Construction Permits	15	16	-1
Getting Electricity	2	2	0
Registering Property	77	70	7
Getting Credit	24	21	3
Protecting Investors	97	93	4
Paying Taxes	89	85	4
Trading Across Border:	12	13	-1
Enforcing Contracts	8	7	1
Resolving Insolvency	36	35	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, Germany is above average in its overall rank of 26 for Economic Freedom with 1 being best.

Heritage Foundation 2010 Index of Economic Freedom

World Rank: 26*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**90.5**	90.5	0.0	64.3
Trade Freedom	**87.1**	87.5	0.4	74.8
Fiscal Freedom	**61.3**	61.0	-0.3	76.3
Government Spending	**32.2**	43.0	10.8	63.9
Monetary Freedom	**83.5**	83.0	-0.5	73.4
Investment Freedom	**85.0**	85.0	0.0	50.2
Financial Freedom	**60.0**	60.0	0.0	48.5
Property Rights	**90.0**	90.0	0.0	43.5
Freedom from Corruption	**79.0**	79.5	0.5	40.5
Labor Freedom	**41.4**	42.4	1.0	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%	4.9	0.4	**0.1**	**0.1**
Social Contributions Growth %	1.3	2.2	**0.5**	**1.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	1.8	2.3	**0.1**	**0.1**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	3.7	1.3	**(2)**	**(2.2)**
Compensation of Employees Growth%	2.0	2.5	**2.0**	**2.0**
Use of Goods & Services Growth%	1.8	4.5	**4.5**	**4.5**
Social Benefits Growth%	3.2	1.6	**2.0**	**2.0**
Subsidies Growth%	5.5	0.1		
Other Expenses Growth%	27.7	27.7	**27.7**	**25.0**
Interest Expense	0.0	3.0	**3**	
Balance Sheet				
Currency and Deposits (asset) Growth%	(19.7)	19.5	**0.1**	**0.1**
Securities other than Shares LT (asset) Growth%	8.3	217.9	**0.1**	**0.1**
Loans (asset) Growth%	17.6	72.2	**0.1**	**0.1**
Shares and Other Equity (asset) Growth%	(1.7)	3.0	**3.0**	**3.0**
Insurance Technical Reserves (asset) Growth%	0.0	3.3	**3.3**	**3.3**
Financial Derivatives (asset) Growth%	0.0	(719.5)	**(10.0)**	**(10.0)**
Other Accounts Receivable LT Growth%	0.2	0.8	**0.1**	**0.1**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Accounts Payable Growth%	2.4	0.8	**0.8**	**0.8**
Currency & Deposits (liability) Growth%	0.0	(0.3)	**0.5**	**0.5**
Securities Other than Shares (liability) Growth%	5.7	8.9	**6.2**	**6.2**
Loans (liability) Growth%	7.2	41.9	**41.9**	**37.8**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	0.0		
Addl debt. (1st Year) million EUR	0.0	0.0		

Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)

	Dec-08	Dec-09	Dec-10	PDec-11	PDec-12	PDec-13
Taxes	577,330	550,860	553,280	553,833	554,387	554,942
Social Contributions	408,760	409,750	418,680	420,773	422,877	427,106
Grant Revenue	0	0	0	0	0	0
Other Revenue	102,110	105,370	107,790	107,887	107,984	108,081
Other Operating Income	0	0	0	0	0	0
Total Revenue	1,088,200	1,065,980	1,079,750	1,082,494	1,085,248	1,090,129
Compensation of Employees	182,330	189,710	194,540	198,431	202,399	206,447
Use of Goods & Services	106,880	114,750	119,970	125,427	131,133	137,098
Social Benefits	590,270	622,580	632,280	644,926	657,824	670,981
Subsidies	24,620	27,130	27,170	27,173	27,175	27,178
Other Expenses	104,300	111,230	142,070	142,070	181,461	177,522
Grant Expense	0	0	0	0	0	0
Depreciation	41,610	42,380	42,950	42,950	42,950	42,950
Total Expenses excluding interest	1,025,390	1,080,650	1,131,810	1,180,977	1,242,943	1,262,176
Operating Surplus/Shortfall	62,810	-14,670	-52,060	-98,483	-157,694	-172,047
Interest Expense	68,340	63,830	61,880	61,880	66,693	70,028
Net Operating Balance	-5,530	-78,500	-113,940	-160,363	-224,387	-242,075

ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-08	Dec-09	Dec-10	PDec-11	PDec-12	PDec-13
Currency and Deposits (asset)	198,959	196,975	235,290	255,221	255,451	255,681
Securities other than Shares LT (asset)	45,301	49,298	156,734	156,922	157,110	157,299
Loans (asset)	70,614	75,426	129,890	130,020	130,150	130,280
Shares and Other Equity (asset)	209,936	247,695	255,055	262,634	270,438	278,473
Insurance Technical Reserves (asset)	702	726	750	775	800	827
Financial Derivatives (asset)	1,528	2,445	(15,146)	(13,631)	(12,268)	(11,041)
Other Accounts Receivable LT	94,168	99,234	99,996	100,096	100,196	100,296
Monetary Gold and SDR's						
Additional Assets	0	0	0	0	0	0
Total Financial Assets	621,208	671,799	862,569	892,036	901,877	911,815
LIABILITIES						
Other Accounts Payable	94,168	99,234	99,996	100,764	101,538	102,317
Currency & Deposits (liability)	10,516	10,326	10,300	10,300	10,300	10,300
Securities Other than Shares (liability)	1,255,381	1,363,523	1,485,004	1,577,617	1,676,006	1,780,530
Loans (liability)	453,654	460,129	653,132	653,132	788,204	934,918
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)						
Other Liabilities	(90,572)	(95,669)	(96,455)	(6)	(6)	(6)
Liabilities	1,723,147	1,837,543	2,151,977	2,341,807	2,576,035	2,828,048
Net Financial Worth	(1,101,939)	(1,165,744)	(1,289,408)	(1,449,771)	(1,674,158)	(1,916,234)
Total Liabilities & Equity	621,208	671,799	862,569	892,036	901,877	911,815

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