FEDERAL REPUBLIC OF GERMANY

Rating Analysis - 6/11/12
Debt: EUR2,237.7B

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

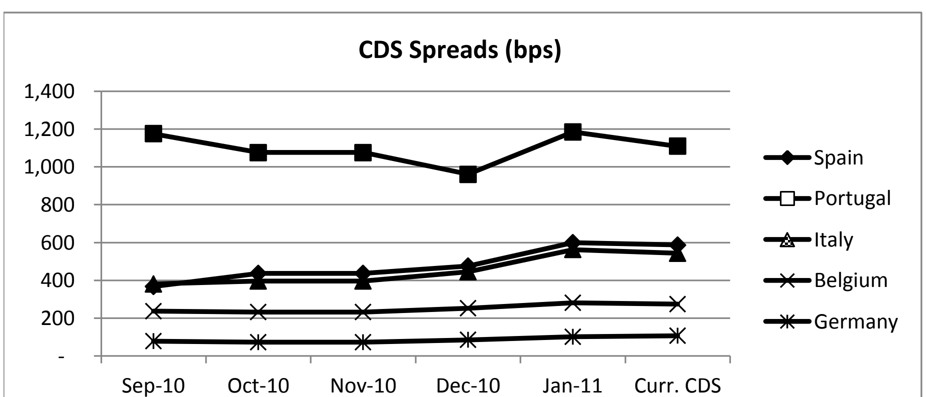
When will Atlas shrug? - Germany has been shouldering the burdens of other EU countries via its exposure to the EFSF and indirectly via the ECB's hefty exposure to the weaker banks and the weaker sovereign credits. The country's debt to GDP of 87% as of 2011; the deficit to GDP of 1.0% is reasonably strong but needs to be adjusted for support for the periphery (Germany shoulders an increasing portion of the periphery's problems that it cannot afford). Unemployment was only 6.8% but will probably increase as many EU countries implement austerity measures. Other positives were the positive (EUR130B) balance of trade and the positive (EUR196B) current account as of the end of 2011. Inflation has been fairly moderate at .9% (per Eurostat). We used the IMF's data for Germany's debt which is 10% great than Eurostat's data.

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 exit needs to be monitored (watch Target 2).

	Annual Ratios					
INDICATIVE CREDIT RATIOS	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	77.4	86.8	87.2	88.5	87.8	88.2
Govt. Sur/Def to GDP (%)	-3.2	-4.3	-1.0	-2.9	-1.0	-1.8
Adjusted Debt/GDP (%)	77.4	86.8	87.2	88.5	87.8	88.2
Interest Expense/ Taxes (%)	11.6	11.2	11.4	11.1	11.2	11.4
GDP Growth (%)	-2.3	3.7	2.0	2.5	2.5	2.2
Foreign Reserves/Debt (%)	1.5	1.2	1.2	1.2	1.2	1.2
Implied Sen. Rating	AA-	A-	A-	A-	A-	A-

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*
Kingdom Of Spain	BBB+	65.2	-8.5	65.6	9.5	0.3	BB+
Republic Of Italy	BBB+	115.0	-5.2	115.0	16.7	-0.5	B
Portugal Republic	BB	100.7	-4.2	100.7	13.0	-2.9	BB-
Kingdom Of Belgium	AA	96.3	-3.7	96.3	11.9	1.2	BB
Kingdom Of Spain	BBB+	65.2	-8.5	65.6	9.5	0.3	BBB-



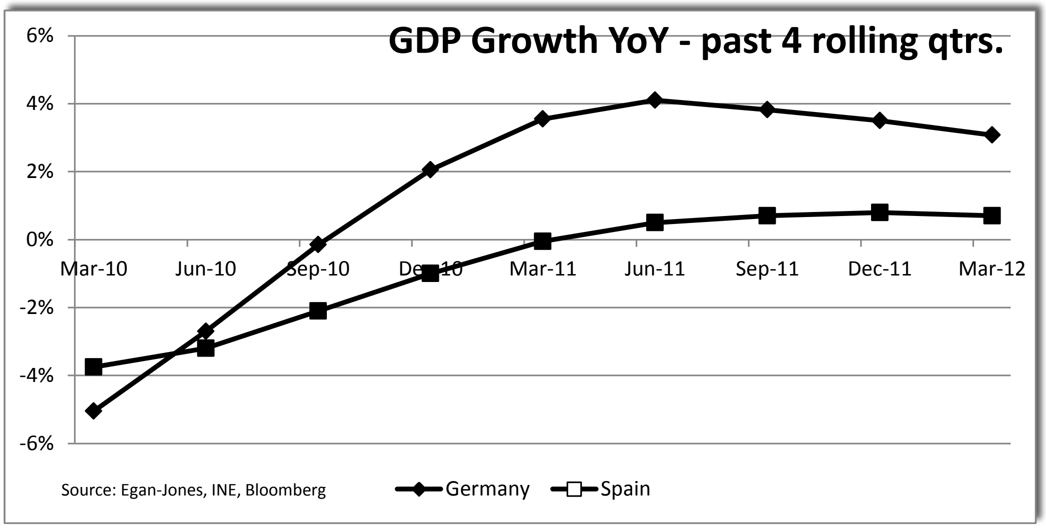
Country (EJR Rtg*)	Current CDS	Targeted CDS
Spain (CCC)	587	2,000
Portugal (CCC+)	1,109	1,500
Italy (B)	543	1,200
Belgium (BBB-)	275	400
Germany (A+)	108	80

* 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 near 3% for the March 2012 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 above Spain although as of the end of 2009 and beginning of 2010 growth was below Spain'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 1.0% is reasonably strong for a top tier country. From 2009 to 2011, total sovereign revenues rose 7% because of tax increases while total expenses rose 2.6%; in prior years the country had to spend to support citizens as a result of the 2008 slowdown. As can be seen from the chart at right, Germany's deficit to GDP was 1.0% (because of tax increases) and its debt to GDP was 80% using Eurostat data. Note, Germany will be providing indirect support to Spain and other weak countries.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr CDS Spreads
Germany	1.0	79.8	102
Spain	8.5	57.3	599
Italy	5.2	112.1	563
Portugal	4.2	88.4	1,185
Belgium	3.7	90.9	282
Spain	8.5	57.3	599

Source: Bloomberg using yr end data other than CDS data

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 2010 to 2011. 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 (%)	2010	2011
Germany	7.4	6.8
Spain	20.3	22.9
Italy	8.3	9.1
Portugal	11.1	14.0
Belgium	7.6	7.2
Spain	20.3	22.9

Source: Intl. Finance Statistics

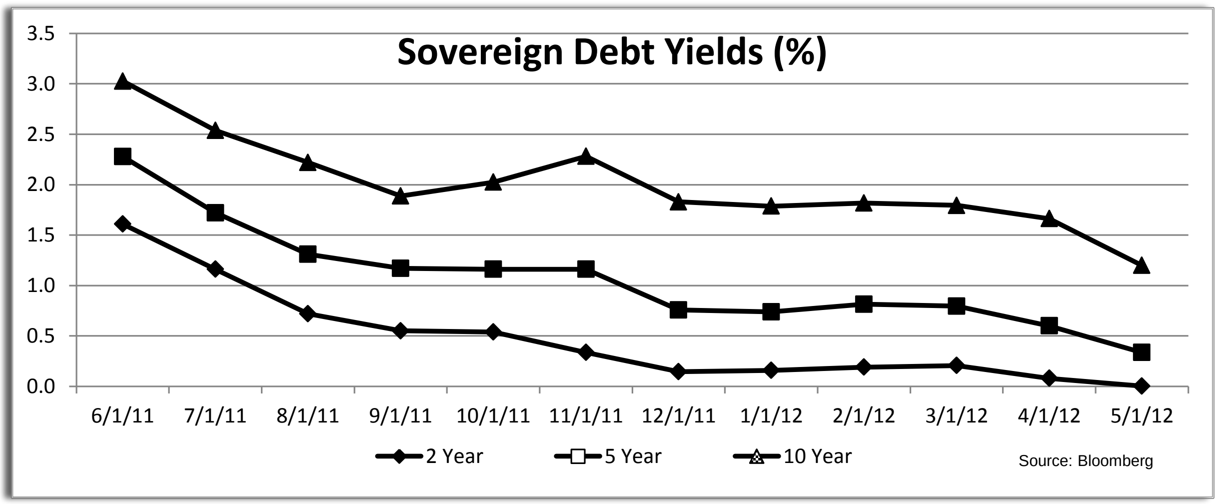
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. Germany has significantly exposure to its banking sector because the bank's large aggregate size measured in assets The top five banks have assets equal to 124% of GDP versus 477% for the UK (which is at the high end). Our major fear is Germany will be expected to provide financial support to weaker EU banks over the next couple of years quarters to ameliorate asset quality problems.

Bank Assets (billions of local currency)	Assets	Cap/ Assets %
DEUTSCHE BANK	2,164	2.5
COMMERZBANK	662	3.7
DEUT. POSTBANK	192	3.0
LANDESBANK BERL.	131	1.8
IKB DEUT INDBANK	31	3.1
Total	3,180	
EJR's est. of cap shortfall at 10% of assets less market cap		273
Germany's GDP		2,567

Funding Costs

A Flight to Supposed Quality - with the problems of the periphery EU countries, capital has migrated to the supposed safe havens. As can be seen in the below graph, the bond yields have plunged particularly since Nov. 2011. A major issue is whether Germany belongs in the top-tier of credit quality given its exposure via the ECB.



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 7 (1 is best) is strong, but has slipped over the past year.

The World Bank's Doing Business Survey*	2012 Rank	2011 Rank	Change in Rank
Overall Country Rank:	**7**	**6**	**-1**
Scores:			
Starting a Business	19	17	-2
Construction Permits	22	20	-2
Getting Electricity	60	54	-6
Registering Property	68	62	-6
Getting Credit	1	1	0
Protecting Investors	10	10	0
Paying Taxes	24	21	-3
Trading Across Borders	13	14	1
Enforcing Contracts	21	22	1
Resolving Insolvency	6	7	1

* Based on a scale of 1 to 183 with 1 being the highest ranking.

Economic Freedom

As can be seen below, Germany is above average in its overall rank of 71 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom
World Rank 71*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**90.5**	89.6	0.9	64.3
Trade Freedom	**87.1**	87.6	-0.5	74.8
Fiscal Freedom	**61.3**	58.5	2.8	76.3
Government Spending	**32.2**	42.7	-10.5	63.9
Monetary Freedom	**83.5**	83.9	-0.4	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**	80.0	-1.0	40.5
Labor Freedom	**41.4**	40.6	0.8	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	
Income Statement	**Median**	**Average**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	6.9	7.0	**3.0**	**3.0**
Social Contributions Growth %	0.6	4.0	**4.0**	**4.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	5.0	12.1	**2.2**	**2.2**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	3.7	6.3	**3**	**2.3**
Compensation of Employees Growth%	(0.7)	2.7	**2.7**	**2.7**
Use of Goods & Services Growth%	1.2	6.4	**3.0**	**3.0**
Social Benefits Growth%	3.2	(0.2)	**2.0**	**2.0**
Subsidies Growth%	2.6	(3.8)		
Other Expenses Growth%	(25.0)	(25.0)	**1.0**	**1.0**
Interest Expense	0.0	3.0	**3**	
Balance Sheet				
Currency and Deposits (asset) Growth%	(3.5)	0.0		
Securities other than Shares LT (asset) Growth%	9.3	(7.2)	**1.5**	**1.5**
Loans (asset) Growth%	17.6	(3.1)	**2.0**	**2.0**
Shares and Other Equity (asset) Growth%	2.1	(2.0)	**2.0**	**2.0**
Insurance Technical Reserves (asset) Growth%	0.0	3.6	**3.6**	**3.6**
Financial Derivatives (asset) Growth%	0.0	0.5	**0.5**	**0.5**
Other Accounts Receivable LT Growth%	0.5	4.1	**3.0**	**3.0**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Accounts Payable Growth%	(4.3)			
Currency & Deposits (liability) Growth%	3.3	6.0	**6.0**	**6.0**
Securities Other than Shares (liability) Growth%	5.3	8.1	**5.7**	**5.7**
Loans (liability) Growth%	18.4	(4.6)	**0.5**	**0.5**
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-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Taxes	550,860	553,280	592,070	609,832	628,127	646,971
Social Contributions	409,750	418,680	435,270	452,517	470,448	489,089
Grant Revenue	0	0	0	0	0	0
Other Revenue	105,370	107,790	120,850	123,509	126,226	129,003
Other Operating Income	0	0	0	0	0	0
Total Revenue	1,065,980	1,079,750	1,148,190	1,185,858	1,224,801	1,265,063
Compensation of Employees	189,710	194,540	199,820	205,243	210,814	216,535
Use of Goods & Services	114,750	119,970	127,670	131,500	135,445	139,508
Social Benefits	622,580	632,280	630,900	643,518	656,388	669,516
Subsidies	27,130	27,170	26,150	26,153	26,155	26,158
Other Expenses	111,230	142,070	106,590	143,491	107,656	144,926
Grant Expense	0	0	0	0	0	0
Depreciation	42,380	42,950	44,150	44,150	44,150	44,150
Total Expenses excluding interest	1,080,650	1,131,810	1,109,130	1,194,055	1,180,608	1,240,794
Operating Surplus/Shortfall	-14,670	-52,060	39,060	-8,197	44,193	24,270
Interest Expense	63,830	61,880	67,660	67,660	70,413	73,934
Net Operating Balance	-78,500	-113,940	-28,600	-75,857	-26,221	-49,664

Base Case

ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)	196,975	235,413		2,493,339	2,493,339	2,493,339
Securities other than Shares LT (asset)	45,036	148,408	137,778	139,845	141,942	144,071
Loans (asset)	73,441	128,312	124,363	126,850	129,387	131,975
Shares and Other Equity (asset)	247,703	303,342	297,290	303,236	309,301	315,487
Insurance Technical Reserves (asset)	726	750	777	805	834	864
Other Accounts Receivable LT	99,460	97,128	101,113	104,146	107,271	110,489
Monetary Gold and SDR's						
Additional Assets			257,409			
Total Financial Assets	665,786	898,239	903,536	3,152,947	3,166,719	3,180,788
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	10,326	10,300	10,913	10,913	10,913	10,913
Securities Other than Shares (liability)	1,362,682	1,480,329	1,600,630	1,691,684	1,787,918	1,889,627
Loans (liability)	460,128	652,444	622,670	622,670	566,429	528,454
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)						
Other Liabilities	(1,833,136)	(2,143,073)	(2,234,213)	2,237,739	2,237,739	2,237,739
Liabilities				4,563,006	4,602,999	4,666,733
Net Financial Worth	(1,170,915)	(1,248,375)	(1,334,203)	(1,410,060)	(1,436,280)	(1,485,944)
Total Liabilities & Equity	(1,170,915)	(1,248,375)	(1,334,203)	3,152,947	3,166,719	3,180,788

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