CANADA

Rating Analysis - 10/13/10
Debt: CAD430.3B, Cash: CAD47M

EJR Sen Rating(Curr/Prj) AAA/ N/A
EJR CP Rating: NR
EJR's 1 yr. Default Probability: 0.0%

Real GDP decreased 0.1% in July, marking the first contraction in growth since August 2009. Growth had slowed prior to July's contraction as Q2 real GDP grew at less than half the pace seen in Q1 (2% annualized growth in Q2 v. 5.8% in Q1. The recent slowdown is believed to be due in large part to the sluggish US economy and reduced demand for Canadian goods on behalf of American consumers. Declines in household spending and a widening trade gap have also been attributing factors. We believe Canada will continue to see modest growth as consumption and manufacturing remain weak.

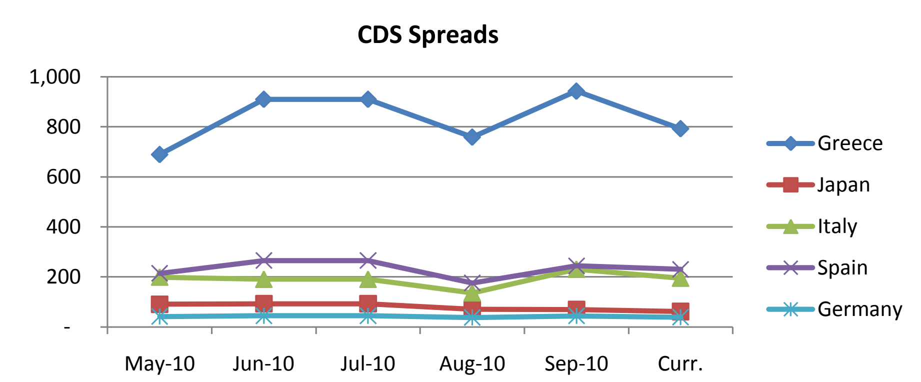
Canada's current account deficit widened in the second quarter due to fewer exports to the US (Canada's largest trading partner). Imports of goods and services totaled C$125.4 billion during the second quarter, exceeding total exports of C$118.6 billion. Trade is expected to lower Canada's economic growth rate by 1.6% this year.

Canada's budget deficit narrowed to C$473M in July from C$5.82B in July 2009 due to higher tax revenues and decreased spending. The total Q2 deficit narrowed to C$7.7B from C$18.3B. Inventories have also improved with Canadian businesses accumulating $13B worth in Q2 following $6B in Q1 (this after four quarters of contraction in 2009). Prices of goods and services produced increased 0.2% in Q2. Personal income increased 1.2%.

	Annual Ratios					
INDICATIVE CREDIT RATIOS	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
Debt/ GDP (%)	23.6	32.1	34.9	38.0	41.1	44.4
Govt. Sur/Def to GDP (%)	0.1	-4.8	-5.3	-5.3	-5.3	-5.3
Adjusted Debt/GDP (%)	23.6	32.1	34.9	38.0	41.1	44.4
Interest/ Taxes %	14.1	14.3	18.7	20.4	22.0	23.8
GDP Growth (%)	1.8	1.7	-1.2	0.3	1.0	1.0
Foreign Reserves/Debt (%)	11.1	9.7	8.9	8.1	7.5	7.0
Implied Sen. Rating	AA+	AA-	AA	AA-	A+	A

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/ 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/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Greece	BB+	115.6	-13.6	118.8	25.8	1.0	BB-
Japan	AA	248.3	-2.7	254.3	14.6	-2.5	BB-
Italy	A+	116.3	-5.3	121.9	15.9	-4.1	B
Spain	AA	53.5	-11.2	57.1	9.6	-2.8	BBB
Germany	AAA	73.5	-3.3	80.3	10.7	-3.0	BBB-



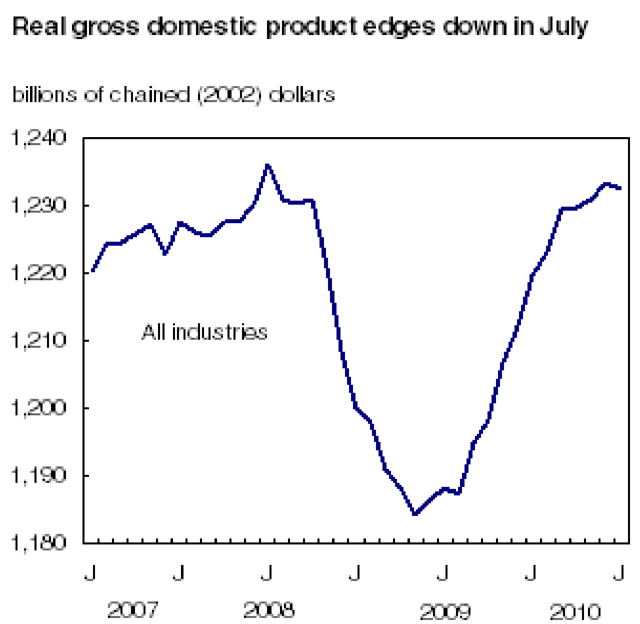
Country (EJR Rtg)	Current CDS	Targeted CDS
Greece (BB)	793	350
Japan (BB+)	62	300
Italy (A)	195	75
Spain (A+)	230	60
Germany (AA)	39	30

Macroeconomic Environment

Canada is the world's 14th largest economy in terms of purchasing power parity, with GDP (PPP) totaling US$1,267bn (or 2.31% of total world GDP contibution) in the most recent year. After experiencing solid economic growth from 1993 through 2007, the economy finally fell into a sharp recession during the third quarter of 2008. The economy has since begun to recover, though modestly in recent months.

The economy grew at an annualized rate of 5.8% during the first three months of 2010. During the second quarter, growth slowed to 2% YoY, almost one third that of the first quarter. Growth continued to slow in July when real GDP contracted 0.1% (monthly), the first monthly decline since August 2009. The decline was due to weaknesses in the manufacturing (-0.7%), construction (-0.5%), and retail (-0.5%) sectors. The Bank of Canada forecasts growth will pick up quickly though modestly, with an annualized economic growth rate of 2.8% in the third quarter and 3.5% for the year. The slowed economic activity is thought in large part to be due to the economic slowdown in the US which has reduced demand for Canadian goods on behalf of the American consumer.

Structurally, the country has seen strong fiscal performance, accompanied by a sound banking system. Moreover, Canada has been successful in utilizing its human resources, providing high education and training. This factor has prepared the country's workforce to adopt the latest technologies for productivity enhancements. This is a strong indication that the solid economic growth seen from Canada over the last decade will continue into the future.



Source: Statistics Canada

Canada's unemployment rate rose in July for the first time in nearly a year, increasing 0.1% to a rate of 8.0%. A gain of 130,000 *part-time* jobs helped to offset a loss of 139,000 *full-time* jobs. Employment decreased in educational services, finance, real estate and leasing while jobs were gained in manufacturing and public administration. Statistics Canada noted virtually no change in the number of public or private sector employees as well as self employed individuals during the month of July. Individuals aged 55 and older expanded into the workforce during July. As a result, the unemployment rate for men and women in this age group increased 0.5% (to 7.1%) and 1.3% (to 6.4%), respectively. Over the past twelve months, workers aged 55 and older have had the fastest rate of employment growth (+5.7%).

Inflation and Interest Rates

The need for ultralow interest rates to stimulate growth has passed, allowing the central bank to lessen the degree of monetary stimulus. The Bank of Canada became the first central bank among G7 nations to increase rates this year when in June the bank raised the target for its key overnight rate 25bps to 0.5%. The bank has since increased the rate by 0.25% twice in two straight meetings, the most recent during the Bank's September 8th rate meeting. The rate currently stands at 1% with the aim of containing inflation as the economy continues to recover from the recession. The Bank is set to meet again on October 19th. The BOC is expected to keep rates at 1%.

Canada's rate of inflation has dropped unexpectedly in recent months. In March, inflation dropped from 1.6% to 1.4% as travel costs returned to pre-Winter Olympic levels. China's rising inflation could trigger a rise in interest rates sooner rather than later to cool economic growth. This could in effect impact Canada's economy by dampening its economic recovery. China is Canada's second largest trading partner after the U.S. and therefore greatly influences commodity prices.

The "Loonie"

The recent strength of the Canadian dollar and desire of investors to be long the currency reflects market confidence in the nation. The CAD currently benefits from the country's small budget deficit as well as continued concerns over the European debt crisis. Furthermore, the proposed cross-border acquisition of Canada's Potash Corp. of Saskatchewan (POT) by Australia's BHP Billiton (BHP) for $43.4 billion has helped the currency as M&A activity historically improves attitudes toward a country. (During the first nine months through September 2010, M&A activity in Canada rose 67% YoY). Though currency strength continues, it has in turn weakened the economy's international competitiveness.

Export-Oriented Economy

With substantial energy sources and vast natural resources, Canada is an export-oriented economy. The country is the world's second-largest exporter of natural gas. Furthermore, Canada claims the largets pool of oil reserves outside of the Middle East. Exports represent roughly one quarter of GDP. Imports of goods and services totaled C$125,409m during the second quarter of 2010, exceeding total exports of C$118,555.00m. Exports of good and services grew for the fourth consecutive quarter, reporting a gain of 1.5%. The main drivers of export growth included exports of automotive products (+12.8%) and exports of machinery and equipment (+6.2%). Imports of good and services grew for the fourth consecutive quarter as well, reporting a gain of 3.9%. The main drivers of import growth included machinery and equipment (+8.7%), industrial goods and materials (+4.9%), and travel services (+6.8%).

Strong Banking Sector

Canada is known for its strong and resilient banking system, arguably the heart of the country's economic strength. For the past two years, the World Economic Forum (WEF) has ranked the banking system as the most sound in the world. Canadian banks are well managed and well regulated. They are also among the best capitalized in the world, exceeding the Bank for International Settelements' (BIS) norms by significant margins. In survey's conducted by Price Waterhouse Coopers (PWC), 85% of Canadians express confience in the Canadian banking system while 91% of Canadians are confident that their deposits are secure.

In the most recent year of reporting, the Canadian banking sector employed 260,000 Canadians, provided financing to 1.2 million small and medium-sized investors, contributed $7.5 billion in taxes paid to tall levels of government, and accounted for approximately 3.8% of GDP (1).
As a result of the strong banking system, Canadian taxpayers have not had to bail out or inject capital into financial institutions, nor has there been a need to set up public entities to buy toxic assets. Canadian consumers benefit from access to affordable and competitive banks

(1) Most recent data, CBA, 2008 & 2009.

while Canadian business owners benefit from the banks' openness for business and availability to provide credit.

Containing the Deficit: Stimulus and Projections

The Canadian government has initiated plans to cut its budget deficit (currently 4.8%) in half when fiscal stimulus ends next year and to nearly eliminate the deficit by 2014/15. Finance Minister Jim Flaherty is confident the plan will succeed if executed as envisioned by the government. The Ministry plans to end fiscal stimulus in March 2011, imposing target measures to lower the rate of spending growth (particularly in defense and international aid), and freezing the salaries and operating budgets of government departments. Currently, the largest chunk of stimulus spending in the country is on infrastructure. The government will not hike taxes to balance the budget. However, previously stated corporate tax cuts will still be imposed.

Business Sophistication

Canada currently ranks 8th out of 183 economies worldwide in The World Bank Group's annual "Doing Business" survey, indicating an extremely business friendly environment. Such an environment is conductive to higher efficiency and production of good and services, which in turn leads to increased productivity and worldwide competitiveness.

Ease of*…	2010 Rank	2009 Rank	Rank Change
Doing Business	**8**	**8**	**0**
Starting a Business	2	2	0
Dealing with Construction Permits	29	28	-1
Employing Workers	17	18	+1
Registering Property	35	32	-3
Getting Credit	30	27	-3
Protecting Investors	5	5	0
Paying Taxes	28	29	+1
Trading Across Borders	38	44	+6
Enforcing Contracts	58	58	0
Closing a Business	4	4	0

Source: The World Bank Group - Doing Business

*Based on a scale of 1 to 183 (countries measured) with 1 being the highest ranking.

Future Projections: Economic Action Plan & Growth Expectations

Canada's Economic Action Plan has been successful thus far. Funds from the program have been committed to over 23,000 projects across the country in an effort to stimulate the economy and put citizens back to work. All of the jobs lost during the recession have now been recouped. To date, the program is on track to deliver a further $22 billion in federal stimulus spending in 2010-2011.

Canada's economy is expected to expand 3% this year, up from previous projections of 2.6% in March. Meanwhile, projections for 2011 growth have fallen from 3.2% to 2.5%.

Canada: Growth Projections - Bloomberg Source: Bloomberg Survey

	2010	2011	2012	2013	2014	2015
Real Growth (Percentage)	3.0	2.5	2.7	2.7	2.6	2.6
Nominal Growth (Percentage)	5.9	4.6	4.9	4.8	4.7	4.7

The government remains focused on winding down stimulus and balancing the budget. Stimulus is expected to end on schedule in March of 2011. By 2014/2015, federal debt as a percentage of GDP is expected to fall to 31.9%. Although Canada's economic recovery is fragile and uncertain, the country is in better shape than others. Whether the government plans to make changes to

Assumptions for Projections

	Peer	Issuer	Base Case	
Income Statement	**Median**	**Average**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	(4.6)	(4.2)	**(0.5)**	**0.5**
Social Contributions Growth %	(0.4)	4.5	**4.0**	**5.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	0.1	(7.8)	**(1.0)**	**(3.0)**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	(2.4)	(3.9)	**(0)**	**0.5**
Compensation of Employees Growth%	4.5	5.1	**5.1**	**5.1**
Use of Goods & Services Growth%	7.5	6.0	**6.0**	**6.0**
Social Benefits Growth%	8.7	8.1	**4.0**	**4.0**
Subsidies Growth%	2.3	5.1		
Other Expenses Growth%	22.4	22.4	**3.0**	**3.0**
Special Items (millions CAD)	0.0	0.0		
Balance Sheet				
Currency and Deposits Growth%	17.5	(22.7)	**(2.0)**	**1.0**
Securities other than Shares LT Growth%	9.9	15.6	**(3.5)**	**(3.5)**
Loans Growth%	2.4	(2.6)	**(2.0)**	**(2.0)**
Shares and Other Equity Growth%	14.8	18.8	**4.0**	**4.0**
Insurance Technical Reserves Growth%	2.8	0.0		
Financial Derivatives Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	10.1	9.5	**2.0**	**2.0**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Accounts Payable Growth%	9.2	NMF		
Currency & Deposits Growth%	1.4	2.1	**2.1**	**2.1**
Securities Other than Shares Growth%	16.3	8.9	**6.2**	**6.2**
Growth%	0.0	0.0		
Loans Growth%	1.7	8.5	**8.5**	**8.5**
Insurance Technical Reserves Growth(%)	0.0	2.3	**2.0**	**2.0**
Financial Derivatives Growth%	0.0	0.0		
		0.0		
Addl debt. (1st Year) million CAD	0.0	0.0		

Base Case
ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS CAD)

	Dec-07	Dec-08	Dec-09	PDec-10	PDec-11	PDec-12
Taxes	439,943	430,502	412,570	410,507	408,455	410,497
Social Contributions	71,824	72,005	75,266	78,277	81,408	85,478
Grant Revenue	0	0	0	0	0	0
Other Revenue	115,766	119,615	110,334	109,231	108,138	104,894
Other Operating Income	0	0	0	0	0	0
Total Revenue	627,533	622,122	598,170	596,375	598,001	600,869
Compensation of Employees	177,609	187,323	196,860	206,883	217,415	228,484
Use of Goods & Services	141,887	152,716	161,838	171,505	181,749	192,605
Social Benefits	115,115	121,573	131,423	136,680	142,147	147,833
Subsidies	16,662	16,930	17,789	17,789	17,789	17,789
Other Expenses	6,018	5,788	7,083	4,634	4,798	4,969
Grant Expense	45,007	43,476	45,710	0	0	0
Depreciation	29,324	32,430	34,479	34,479	34,479	34,479
Total Expenses	531,622	560,236	595,182	571,969	598,378	626,159
Operating Surplus/Shortfall	95,911	61,886	2,988	24,406	-377	-25,290
Interest Expense	63,446	60,676	58,906	76,724	83,276	90,387
Net Operating Balance	32,465	1,210	-55,918	-52,318	-83,653	-115,678

ANNUAL BALANCE SHEETS (MILLIONS CAD)

ASSETS	Dec-07	Dec-08	Dec-09	PDec-10	PDec-11	PDec-12
Currency and Deposits	35,903	60,395	46,704	79,879	78,281	79,064
Securities other than Shares LT	161,993	137,421	158,879	153,318	147,952	142,774
Loans	54,081	54,959	53,522	52,452	51,403	50,374
Shares and Other Equity	96,205	60,060	71,342	74,196	77,164	80,250
Insurance Technical Reserves				0	0	0
Financial Derivatives						
Other Accounts Receivable LT	357,512	484,518	530,497	541,107	551,929	562,968
Monetary Gold and SDR's						
Additional Assets	0	0	0	0	0	0
Total Financial Assets	705,694	797,353	860,944	900,951	906,729	915,430
LIABILITIES						
Other Accounts Payable	331,898	344,616	371,191	371,191	371,191	371,191
Currency & Deposits	4,925	5,098	5,203	5,203	5,203	5,203
Securities Other than Shares	756,754	903,519	984,139	1,045,609	1,110,917	1,180,306
				0	0	0
Loans	21,498	23,045	25,013	25,013	44,767	95,304
Insurance Technical Reserves	203,836	209,308	214,073	218,354	222,722	227,176
Financial Derivatives						
Other Liabilities	(1)	4	1	26,574	26,574	26,574
Liabilities	1,318,910	1,485,590	1,599,620	1,691,944	1,781,374	1,905,753
Net Financial Worth	(613,217)	(688,233)	(738,675)	(790,993)	(874,646)	(990,323)
Total Liabilities & Equity	705,693	797,357	860,945	900,951	906,729	915,430

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