GOVERNMENT OF CANADA

Rating Analysis - 8/26/13
Debt: CAD553.6B

*EJR Sen Rating(Curr/Prj) AA+/ AA+
*EJR CP Rating: A1+
EJR's 5 yr. Default Probability: 0.5%

Some challenges - Canada has benefited from a relatively low population and a high level of natural resources, but faces risks. Over the past four years, GDP has grown an average of 9%, while debt has grown an average of 7%. As a result debt to GDP has declined from 30.6% to 28.9%. The major issue confronting Canada, and the other commodity-rich countries, is how to adjust to an end to the commodity boom cycle whereby demand and margins for commodities weaken.

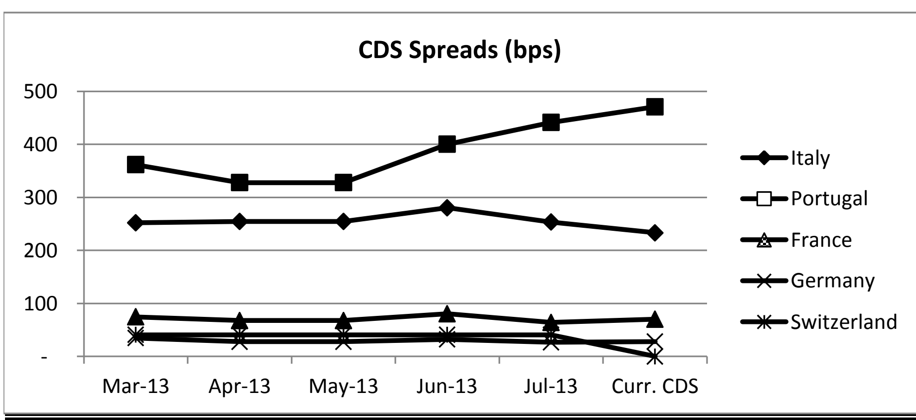
Unlike the US, Canada did not experience a real estate lending bubble in 2007 and 2008 because the country's banking industry is highly consolidated and lending was more carefully controlled. Development of Canada's tar sands and fracking should asset in maintaining reasonably high exports.

Canada's deficits as a % of GDP have been in the area of 2.5% for recent periods, which is modest compared to other developed countries. Additional positives are the relatively low inflation rate of 1.2%, the moderate jobless rate of 7.1%, and the ease of doing business. The major challenge to the country are weaker commodity prices. We are slipping our rating.

	Annual Ratios (source for past results: IMF)					
CREDIT POSITION	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	29.9	28.4	28.9	35.6	43.1	50.6
Govt. Sur/Def to GDP (%)	-5.2	-4.0	-3.2	-2.1	-2.7	-2.6
Adjusted Debt/GDP (%)	29.9	28.8	29.3	36.0	43.5	51.0
Interest Expense/ Taxes (%)	13.3	13.9	13.3	12.9	15.8	16.2
GDP Growth (%)	4.2	2.1	0.8	2.3	2.3	2.5
Foreign Reserves/Debt (%)	11.5	11.3	12.5	9.9	8.1	6.9
Implied Sen. Rating	AA+	AA+	AA+	AA+	AA+	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*
Swiss Confederation	AAA	19.2	0.7	28.2		1.4	AA+
Federal Republic Of Germany	AAA	83.7	0.2	93.2	11.1	0.3	BB+
French Republic	AA+	91.9	-4.8	115.0	9.7	-0.3	BB-
Republic Of Italy	BBB	125.8	-3.0	136.4	16.7	-2.8	B
Portugal Republic	BB	118.5	-6.4	127.1	13.0	-3.8	B+



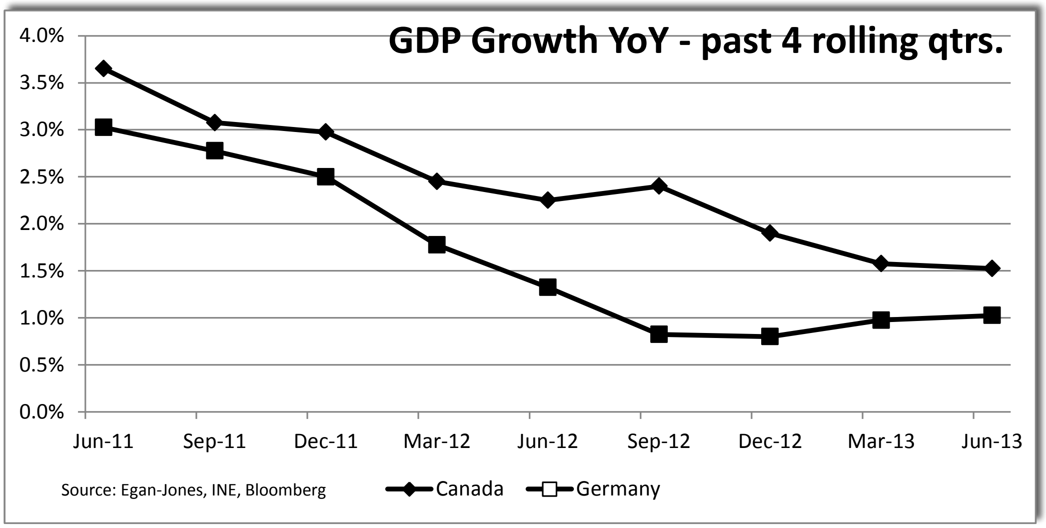
Country (EJR Rtg*)	Current CDS	Targeted CDS
Italy (C+)	233	4,300
Portugal (CCC+)	471	1,500
France (BBB)	70	300
Germany (A-)	28	120
Switzerland (AA+)		40

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

Economic Growth

Canada is the world's 11th largest economy in terms of GDP (per the IMF), with GDP totaling US$1.8T in the most recent periods. A large portion of the economy's growth has been geared to the commodities sector which has wakened over the past couple of years. As can be seen below, Canada's growth has slowed, although it remains stronger than Germany.

Regarding economic growth over the next couple of years, we expect the factors which have helped the country over the past decade will continue to drive growth. Additionally, we expect the housing industry will become a major contributor to growth over the next couple of years.



Fiscal Policy

Like most countries, Canada is running a deficit; the deficit to GDP is 3.2%. Debt to GDP is in the area of 29%, which is better than most other sovereign countries. From 2008 to 2011, total sovereign revenues rose 7.6% while total expenses rose 14.9%; the country had to spend to support citizens as a result of the 2008 slowdown. Watch for an increase in deficits as a result of rising interest rates.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Canada	3.2	28.9	N/A
Switzerlanc	(0.7)	19.2	41
Germany	(0.2)	83.7	27
France	4.8	91.9	64
Italy	3.0	125.8	254
Portugal	6.4	118.5	441

Sources: Bloomberg and IFS

Unemployment

Canada's unemployment rate has long mirrored the United States. As can be seen from the chart at right, Canada is near the median of the peer countries although for a top-notch credit, unemployment is high. For the more recent periods, the country's unemployment rate has been near 7.1%. We expect Canada will follow the US in experiencing a slight decline in unemployment over the next couple of quarters.

Unemployment (%)	2011	2012
Canada	7.5	7.1
Switzerlanc	3.0	3.3
Germany	6.8	6.9
France	9.8	10.5
Italy	9.3	11.4
Portugal	14.0	16.9

Source: Intl. Finance Statistics

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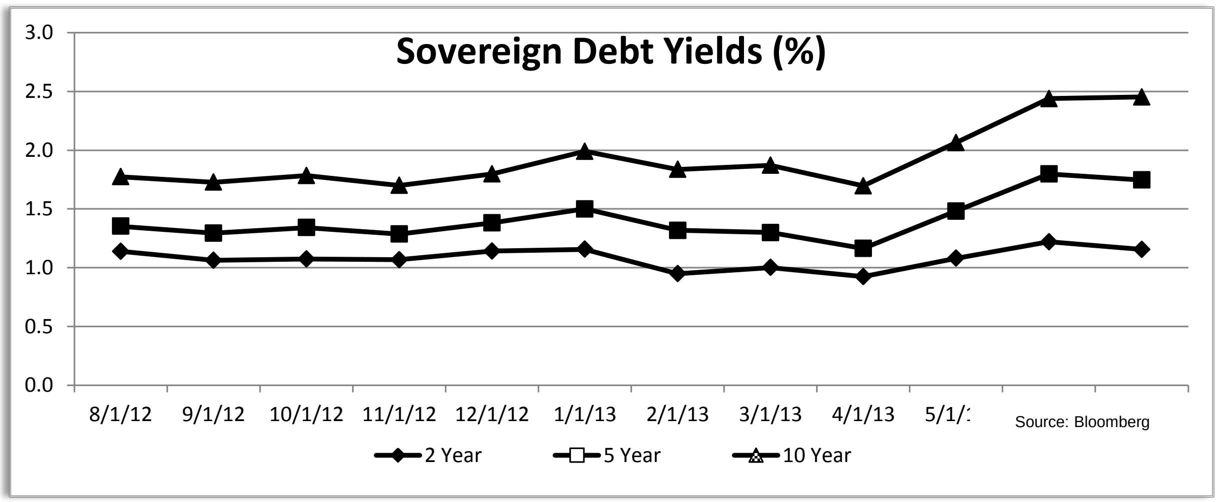
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. Canada has moderate exposure to its banking sector because the banks' small aggregate size measured in assets. The top five banks have assets equal to 168% of GDP versus 477% for the UK (which is at the high end) and 116% for Germany. However, unlike many of the European banks, most Canadian banks are well-capitalized.

Bank Assets (billions of local currency)	Assets	Cap/ Assets %
ROYAL BANK OF CA	825	5.6
TORONTO-DOM BANK	811	6.0
BANK OF NOVA SCO	668	6.2
BANK OF MONTREAL	525	5.7
CAN IMPL BK COMM	393	4.3
Total	3,223	
EJR's est. of cap shortfall at 10% of assets less market cap		7
Canada's GDP		1,913

Funding Costs

The theme for many of the sovereign borrowers has been a rise in funding costs as a result of threats to end quantitative easing. As can be seen in the below graph, the bond yields for 10 year debt has risen but remained below 2.5%. Additionally, unlike many other developed country sovereigns, Canada does not have exposure to the weaker EU countries via the ECB.



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 34 (1 is best, 183 worst) is strong.

The World Bank's Doing Business Survey*	2012 Rank	2011 Rank	Change in Rank
Overall Country Rank:	**34**	**32**	**-2**
Scores:			
Starting a Business	27	23	-4
Construction Permits	52	46	-6
Getting Electricity	42	40	-2
Registering Property	146	147	1
Getting Credit	53	52	-1
Protecting Investors	82	79	-3
Paying Taxes	53	53	0
Trading Across Borders	27	25	-2
Enforcing Contracts	8	8	0
Resolving Insolvency	43	46	3

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

Economic Freedom

As can be seen below, Canada is above average in its overall rank of 79.9 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom
World Rank 80*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**96.6**	96.4	0.2	64.3
Trade Freedom	**87.9**	88.1	-0.2	74.8
Fiscal Freedom	**79.2**	78.0	1.2	76.3
Government Spending	**41.7**	52.7	-11.0	63.9
Monetary Freedom	**77.3**	78.8	-1.5	73.4
Investment Freedom	**75.0**	75.0	0.0	50.2
Financial Freedom	**80.0**	80.0	0.0	48.5
Property Rights	**90.0**	90.0	0.0	43.5
Freedom from Corruption	**89.0**	87.0	2.0	40.5
Labor Freedom	**81.8**	81.7	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

Income Statement	Peer Median	Issuer Average	Base Case Yr 1&2	Base Case Yr 3,4,5
Taxes Growth%	4.9	6.9	**3.0**	**3.0**
Social Contributions Growth %	1.4	6.2	**3.0**	**3.0**
Grant Revenue Growth %	0.0	3.6	**3.6**	**3.6**
Other Revenue Growth %	5.0	5.2	**3.0**	**3.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.9	6.5	**3.8**	**3.4**
Compensation of Employees Growth%	(34.7)	3.4	**3.4**	**3.4**
Use of Goods & Services Growth%	1.2	2.6	**2.6**	**2.6**
Social Benefits Growth%	1.7	3.2	**3.2**	**3.2**
Subsidies Growth%	(6.1)	(0.9)		
Other Expenses Growth%	2.1	2.1	**2.1**	**2.1**
Interest Expense	0.0	11.2	**11.2**	
GDP Growth%			**2.3**	**2.5**
Currency and Deposits (asset) Growth%	6.0	0.0		
Securities other than Shares LT (asset) Growth%	(1.5)	(0.7)	**1.5**	**1.5**
Loans (asset) Growth%	14.4	2.2	**2.2**	**2.2**
Shares and Other Equity (asset) Growth%	(0.8)	10.2	**10.2**	**10.2**
Insurance Technical Reserves (asset) Growth%	2.8	0.0		
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	0.5	2.3	**2.3**	**2.3**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.0			
Currency & Deposits (liability) Growth%	0.0	2.0	**2.0**	**2.0**
Securities Other than Shares (liability) Growth%	5.3	12.0	**8.4**	**8.4**
Loans (liability) Growth%	0.0	4.1	**4.1**	**4.1**
Insurance Technical Reserves (liability) Growth%	0.0	2.6	**2.6**	**2.6**
Financial Derivatives (liability) Growth%	0.0	0.0		
Addl debt. (1st Year) billion CAD	0.0	0.0		

Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (BILLIONS CAD)

	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Taxes	430	437	467	481	495	510
Social Contributions	75	76	81	83	86	88
Grant Revenue	3	3	4	4	4	4
Other Revenue	115	124	130	134	138	142
Other Operating Income	0	0	0	0	0	0
Total Revenue	623	640	682	702	723	745
Compensation of Employees	211	217	224	232	240	248
Use of Goods & Services	152	158	162	166	170	174
Social Benefits	132	135	139	143	148	153
Subsidies	21	24	24	24	24	24
Other Expenses	47	51	52	53	54	55
Grant Expense	3	3	4	4	4	4
Depreciation	51	54	58	58	58	58
Total Expenses excluding interest	617	642	662	680	698	717
Operating Surplus/Shortfall	6	-2	19	22	25	28
Interest Expense	57	61	62	62	78	82
Net Operating Balance	-51	-63	-43	-40	-53	-54

Sources: Historical - IMF, Projections - EJR

Base Case

ANNUAL BALANCE SHEETS (BILLIONS CAD)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)						
Securities other than Shares LT (asset)	104	101	100	101	103	104
Loans (asset)	256	261	267	272	279	285
Shares and Other Equity (asset)	292	318	350	386	425	468
Insurance Technical Reserves (asset)				0	0	0
Other Accounts Receivable LT	160	153	156	160	163	167
Monetary Gold and SDR's						
Additional Assets	48	47	57			
Total Financial Assets	860	878	930	976	1,027	1,082
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	5	5	5	6	6	6
Securities Other than Shares (liability)	988	1,068	1,195	1,295	1,404	1,521
Loans (liability)	42	45	47	87	141	195
Insurance Technical Reserves (liability)	216	223	229	234	240	247
Financial Derivatives (liability)						
Other Liabilities	386	405	443	384	384	384
Liabilities	1,637	1,746	1,919	2,006	2,110	2,219
Net Financial Worth	(777)	(868)	(989)	(1,030)	(1,083)	(1,137)
Total Liabilities & Equity	860	878	930	976	1,027	1,082

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.