

# REPUBLIC OF FINLAND

Rating Analysis - 6/16/17

\*EJR Sen Rating(Curr/Prj) AA/ AA

\*EJR CP Rating: A1+

EJR's 3 yr. Default Probability: 1.0%

Over the last 8 quarters, the YoY nominal GDP growth rate of Finland fluctuated between 1.5% and 2.5%. The overall trend shows that Finland's economy is slowly recovering. Meanwhile, the debt-to-GDP ratio increased from 64.3% in 2012 to 75.9% in 2016.

Finland's overreliance on the forestry and telecommunication sectors continues to be a major concern for the economy, and the sluggish GDP growth makes Finland more volatile to external demands. However, with the gradual recovery of EU and the stabilization of major industries, we are expecting GDP growth to be maintained in the range of 2.0% to 2.5%. Another concern for Finland is its aging population. The birth rate has been falling for years and the government appears not to have any effective policies to stop the trend. The aging labor market will cause serious issues in the long term. Over the last a couple of years, Finland improved its government deficit and the growth of sovereign debt. We expect Finland to keep this slow recovery in the foreseeable future. Affirming.

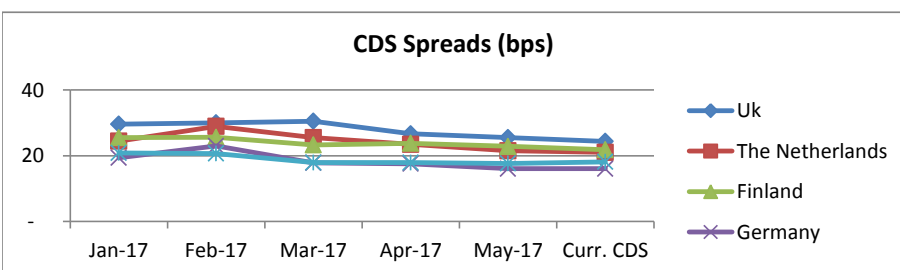
## Annual Ratios (source for past results: IMF)

CREDIT POSITION	2014	2015	2016	P2017	P2018	P2019
Debt/ GDP (%)	71.7	74.9	75.9	76.7	77.0	76.9
Govt. Sur/Def to GDP (%)	-2.5	-2.4	-1.7	-1.2	-0.8	-0.3
Adjusted Debt/GDP (%)	71.7	74.9	75.9	76.7	77.0	76.9
Interest Expense/ Taxes (%)	3.9	3.7	3.4	3.4	3.3	3.3
GDP Growth (%)	1.1	2.0	2.2	2.3	2.3	2.3
Foreign Reserves/Debt (%)	3.7	3.5	3.7	3.6	3.5	3.4
Implied Sen. Rating	AA	AA-	AA	AA	AA	AA

## INDICATIVE CREDIT RATIOS

	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	100.0	115.0	130.0	145.0	170.0	200.0
Govt. Sur/Def to GDP (%)	2.5	0.5	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	95.0	110.0	125.0	140.0	160.0	190.0
Interest Expense/ Taxes (%)	9.0	12.0	15.0	22.0	26.0	35.0
GDP Growth (%)	3.5	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	3.0	2.5	2.0	1.5	1.0	0.5

PEER RATIOS	Other NRSRO Sen.	Debt as a % of GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Federal Republic Of Germany	AAA	76.5	0.6	76.5	5.9	3.3	AA
Kingdom Of Denmark	AAA	52.1	-0.2	52.1	2.9	1.9	AA+
Kingdom Of Sweden	AAA	60.2	2.1	60.2	1.1	4.7	AA+
Kingdom Of The Netherlands	AA+	75.8	0.3	75.8	4.6	3.0	AA-
United Kingdom	AA	123.2	-2.1	123.2	9.0	4.1	A

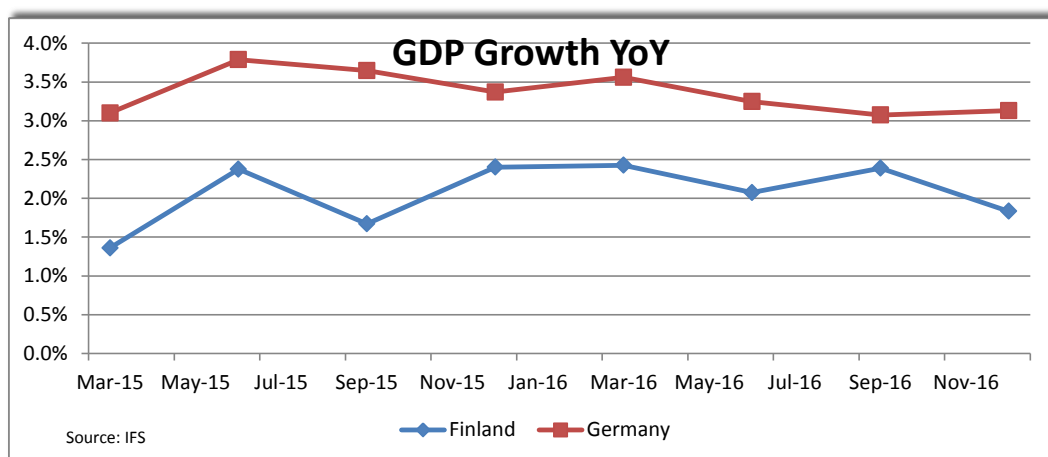


Country	CDS
Uk	24
The Netherlands	21
Finland	22
Germany	16
Denmark	18

**Economic Growth**

Recent performance indicates that the GDP growth continues, albeit at a slower rate. Given the absence of any significant government action to boost the economy, we are expecting the growth rate to remain at the current level for the foreseeable future.

As can be seen in the chart below, Finland's YoY GDP growth (nominal) fluctuated around 2% during 2015 and 2016, while Germany sustained its GDP growth above 3%. The overall trend of Finland's GDP growth shows that the country is gradually recovering. However, the speed is still low, even for an advanced economy like Finland.



**Fiscal Policy**

Finland's deficit-to-GDP ratio of 1.66% is within a normal level while its 75.93% debt-to-GDP ratio is strong by international standards, indicating a very low likelihood that Finland will default on its debt in the foreseeable future. Finland has improved its deficit over the last 2 years, by efforts such as limiting employee benefits. Meanwhile, the debt-to-GDP ratio had been increasing over years (using the debt market value). As the government is still running a deficit, we expect Finland's debt size will grow slightly in the next couple of years.

	Surplus-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Finland	-1.66	75.93	21.87
Germany	0.65	76.47	16.07
Denmark	-0.16	52.10	18.13
Sweden	2.13	60.22	19.12
The Netherla	0.26	75.84	21.03
Uk	-2.06	123.25	24.37

Sources: Thomson Reuters and IFS

**Unemployment**

Finland's unemployment rate improved from 9.4% in 2015 to 8.8% in 2016. The number is slightly higher than its peers, which may to some degree offset the government's efforts to improve the deficit. Another issue for Finland is its aging population. As the number of births remains low, the government needs to make adjustments in the labor market.

Unemployment (%)	Unemployment (%)	
	2015	2016
Finland	9.40	8.80
Germany	4.60	4.10
Denmark	6.20	6.20
Sweden	7.40	6.90
The Netherla	6.90	6.00
Uk	5.37	4.90

Source: Intl. Finance Statistics

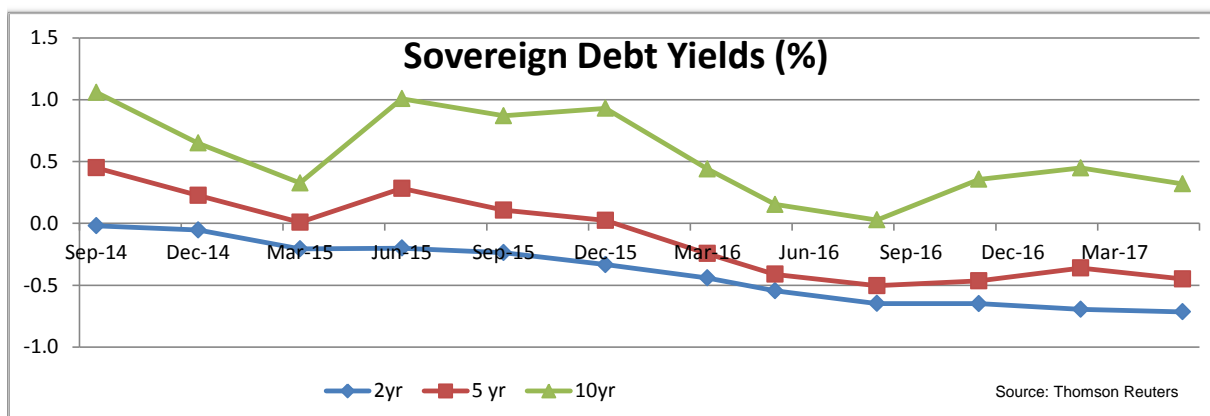
**Banking Sector**

The majority of Finland's banks had a good capital ratio and passed the EU stress tests in 2016. The size of its banking sector is relatively small compared to the overall economy. If the banks experienced capital shortfalls, the central government has the wherewithal to provide support. Detailed analysis on Finland's banking system is not conducted due to the high percentage of private banks and limited data.

Bank Assets (billions of local currency)		
	Assets	Mkt Cap/ Assets %
Aktia Bank	9.49	2.57
ALBAV FH Equity	5.14	1.77
<b>Total</b>	<b>14.6</b>	
EJR's est. of cap shortfall at 10% of assets less market cap		1.1
Finland's GDP		214.1

**Funding Costs**

Although the 10-year sovereign debt yield increased a little in late 2016, the overall yields have dropped a lot since 2014. As can be seen in the chart, the 2-year and 5-year debt yield have decreased to and remained negative. In December 2016, the ECB extended the QE programme to the end of 2017. We are expecting the low sovereign debt yields to persist in the foreseeable future.



**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 13 (1 is best, 189 worst) is extremely strong.

The World Bank's Doing Business Survey*			
	2017	2016	Change in
	Rank	Rank	Rank
<b>Overall Country Rank:</b>	<b>13</b>	<b>10</b>	<b>-3</b>
<b>Scores:</b>			
Starting a Business	28	33	5
Construction Permits	40	27	-13
Getting Electricity	18	16	-2
Registering Property	20	20	0
Getting Credit	44	42	-2
Protecting Investors	70	66	-4
Paying Taxes	13	17	4
Trading Across Borders	33	32	-1
Enforcing Contracts	30	30	0
Resolving Insolvency	1	1	0

\* Based on a scale of 1 to 189 with 1 being the highest ranking.

**Economic Freedom**

As can be seen below, Finland is above average in its overall rank of 74.0 for Economic Freedom with 100 being best.

<b>Heritage Foundation 2017 Index of Economic Freedom</b>				
<b>World Rank 74.0*</b>				
	<b>2017</b>	<b>2016</b>	<b>Change in</b>	<b>World</b>
	<b>Rank**</b>	<b>Rank</b>	<b>Rank</b>	<b>Avg.</b>
<b>Property Rights</b>	<b>90.6</b>	<b>90.0</b>	<b>0.6</b>	<b>52.2</b>
<b>Government Integrity</b>	<b>90.0</b>	<b>89.0</b>	<b>1.0</b>	<b>42.4</b>
<b>Judicial Effectiveness</b>	<b>82.7</b>	<b>N/A</b>	<b>N/A</b>	<b>44.4</b>
<b>Tax Burden</b>	<b>66.6</b>	<b>66.5</b>	<b>0.1</b>	<b>77.3</b>
<b>Gov't Spending</b>	<b>0.0</b>	<b>0.8</b>	<b>-0.8</b>	<b>63.0</b>
<b>Fiscal Health</b>	<b>77.3</b>	<b>N/A</b>	<b>N/A</b>	<b>66.3</b>
<b>Business Freedom</b>	<b>90.2</b>	<b>90.7</b>	<b>-0.5</b>	<b>64.8</b>
<b>Labor Freedom</b>	<b>53.4</b>	<b>53.7</b>	<b>-0.3</b>	<b>59.4</b>
<b>Monetary Freedom</b>	<b>85.1</b>	<b>81.9</b>	<b>3.2</b>	<b>76.3</b>
<b>Trade Freedom</b>	<b>87.0</b>	<b>88.0</b>	<b>-1.0</b>	<b>75.9</b>

\*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

**Credit Quality Driver: Taxes Growth:**

REPUBLIC OF FINLAND has grown its taxes of 2.7% per annum in the last fiscal year which is disappointing. We expect tax revenues will grow approximately 2.8% per annum over the next couple of years and 2.8% per annum for the next couple of years thereafter.

**Credit Quality Driver: Total Revenue Growth:**

REPUBLIC OF FINLAND's total revenue growth has been less than its peers and we assumed a 2.5% growth in total revenue over the next two years.

Income Statement	Peer Median	Issuer Avg.	Assumptions	
			Yr 1&2	Yr 3,4,5
Taxes Growth%	5.5	2.7	2.8	2.8
Social Contributions Growth %	4.5	3.9	4.2	4.2
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	0.0	NMF		
Other Operating Income Growth%	0.0	(2.0)		
Total Revenue Growth%	4.9	2.1	2.5	2.3
Compensation of Employees Growth%	2.7	(0.9)	1.0	1.0
Use of Goods & Services Growth%	1.5	3.7	3.8	3.8
Social Benefits Growth%	1.8	2.0	1.5	1.5
Subsidies Growth%	4.2	(5.8)	2.0	2.1
Other Expenses Growth%	0.0			
Interest Expense	1.8	1.4	2.0	
Currency and Deposits (asset) Growth%	0.0	0.0		
Securities other than Shares LT (asset) Growth%	0.0	0.0		
Loans (asset) Growth%	3.8	(3.8)	(3.8)	(3.8)
Shares and Other Equity (asset) Growth%	4.3	8.6	8.6	8.6
Insurance Technical Reserves (asset) Growth%	0.0	(4.8)	2.0	2.0
Financial Derivatives (asset) Growth%	0.0	0.0		
Other Accounts Receivable LT Growth%	10.1	(5.0)	(5.0)	(5.0)
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%	43.7	5.2	5.2	5.2
Securities Other than Shares (liability) Growth%	(0.1)	3.4	2.4	2.4
Loans (liability) Growth%	(1.4)	(0.5)	0.5	0.5
Insurance Technical Reserves (liability) Growth%	0.0	(45.6)	3.0	3.0
Financial Derivatives (liability) Growth%	0.0	(65.4)	(10.0)	(10.0)
Additional ST debt (1st year)(millions EUR)	0.0	0.0		

**ANNUAL INCOME STATEMENTS**

Below are REPUBLIC OF FINLAND's annual income statements with the projected years based on the assumptions listed on page 5.

	ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)					
	2013	2014	2015	2016	P2017	P2018
Taxes	62,889	63,845	65,195	66,971	68,846	70,774
Social Contributions	25,902	26,288	26,942	27,989	29,165	30,389
Grant Revenue						
Other Revenue						
Other Operating Income	22,816	22,663	21,511	21,087	21,087	21,087
Total Revenue	111,607	112,796	113,648	116,047	119,098	122,250
Compensation of Employees	29,128	29,166	29,054	28,800	29,088	29,379
Use of Goods & Services	23,438	23,626	22,677	23,519	24,413	25,340
Social Benefits	43,928	45,885	47,469	48,411	49,137	49,874
Subsidies	2,697	2,689	2,832	2,669	2,723	2,777
Other Expenses				6,579	6,579	6,579
Grant Expense						
Depreciation	7,167	7,266	7,326	7,354	7,501	7,651
Total Expenses excluding interest	113,126	115,521	116,255	117,332	119,441	121,601
Operating Surplus/Shortfall	-1,519	-2,725	-2,607	-1,285	-343	649
Interest Expense	<u>2,560</u>	<u>2,492</u>	<u>2,432</u>	<u>2,277</u>	<u>2,323</u>	<u>2,369</u>
Net Operating Balance	-4,079	-5,217	-5,039	-3,562	-2,665	-1,720

**ANNUAL BALANCE SHEETS**

Below are REPUBLIC OF FINLAND's balance sheets with the projected years based on the assumptions listed on page 5.

	<b>ANNUAL BALANCE SHEETS</b>					
	<b>(MILLIONS EUR)</b>					
<b>Base Case</b>	2013	2014	2015	2016	P2017	P2018
<b>ASSETS</b>						
Currency and Deposits (asset)	14,743	13,097	2,177	17,667	17,667	17,667
Securities other than Shares LT (asset)						
Loans (asset)	31,222	31,347	30,878	29,716	28,598	27,522
Shares and Other Equity (asset)	141,608	156,892	162,280	176,161	191,229	207,587
Insurance Technical Reserves (asset)	84	176	44,184	42,054	42,895	43,753
Financial Derivatives (asset)						
Other Accounts Receivable LT	6,698	9,452	9,325	8,857	8,412	7,990
Monetary Gold and SDR's						
<b>Other Assets</b>					2,205	2,205
Additional Assets	<u>44,695</u>	<u>45,771</u>	<u>18,795</u>	<u>2,205</u>		
<b>Total Financial Assets</b>	239,050	256,735	267,639	276,660	291,007	306,723
<b>LIABILITIES</b>						
<b>Other Accounts Payable</b>						
Currency & Deposits (liability)	614	752	831	874	874	874
Securities Other than Shares (liability)	94,004	107,848	113,226	117,061	119,836	122,678
Loans (liability)	25,550	27,530	30,549	30,407	33,072	34,792
Insurance Technical Reserves (liability)	84	138	79	43	44	46
Financial Derivatives (liability)	-1,039	-1,003	-1,941	-672	-605	-544
Other Liabilities	<u>11,962</u>	<u>11,519</u>	<u>12,746</u>	<u>14,674</u>	<u>14,674</u>	<u>14,674</u>
<b>Liabilities</b>	131,175	146,784	155,490	162,387	179,399	196,835
<b>Net Financial Worth</b>	<u>107,875</u>	<u>109,951</u>	<u>112,149</u>	<u>114,273</u>	<u>111,608</u>	<u>109,888</u>
<b>Total Liabilities &amp; Equity</b>	239,050	256,735	267,639	276,660	291,007	306,723

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**Comments on the Difference between the Model and Assigned Rating**

We consider a one or less "notch" difference between in the recent results and therefore we have used our best judgement in making adjustments which are reflected in the results for the projected ratings. We have assigned a rating of "AA" whereas the ratio-implied rating for the most recent period is "AA"; the median rating for the peers is significantly higher than the issuer's rating.

**Changes in Indicative Ratios**

We have not made any adjustment in the indicative ratios at this time.



**SEC Rule 17g-7(a) Disclosure**

Below are the disclosures as required by Paragraph (a) of Rule 17g-7.

**1. The symbol in the rating scale used to denote the credit rating categories and notches within categories and the identity of the obligor, security, or money market instrument as required by Paragraph (a)(1)(ii)(A) of Rule 17g-7:**

For the issuer REPUBLIC OF FINLAND with the ticker of 1306Z FH we have assigned the senior unsecured rating of AA. There are three notches in our rating categories (e.g., A-, A, and A+) other than those deep into speculative grade; for CC, C, and D there are no notches.

**2. The version of the procedure or methodology used to determine the credit rating as required by Paragraph (a)(1)(ii)(B) of Rule 17g-7:**

We are using the methodology available in our Form NRSRO Exhibit #2 dated May 10, 2015 available via [egan-jones.com](http://egan-jones.com) under the tab at the bottom of the page "Methodologies".

**3. The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7:**

The credit rating assigned reflects our judgement regarding the future credit quality of the issuer. Regarding the specific assumptions used, please refer to page 3 of this Rating Analysis Report.

**4. The potential limitations of the credit rating as required by Paragraph (a)(1)(ii)(D) of Rule 17g-7:**

Our rating pertains solely to our view of current and prospective credit quality. Our rating does not address pricing, liquidity, or other risks associated with holding investments in the issuer.

**5. Information on the uncertainty of the credit rating as required by Paragraph (a)(1)(ii)(E) of Rule 17g-7:**

Our rating is dependant on numerous factors including the reliability, accuracy, and quality of the data relied used in determining the credit rating. The data is sourced from publicly-available 10Q and 10K statements, quarterly reports, 8K filings, earnings reports, and other similar sources. In some cases, the information is limited because of issues such as short operating histories, the lack of reported data, a delay in reporting data, restatements, inaccurate accounting, and other issues. Such shortcomings are not always readily apparent. EJR aims to identify such shortcomings and make adjustments using its best judgement.

**6. Whether and to what extent third-party due diligence services have been used in taking the rating action as required by Paragraph (a)(1)(ii)(F) of Rule 17g-7:**

EJR does not utilize third-party due diligence services.

**7. How servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating as required by Paragraph (a)(1)(ii)(G) of Rule 17g-7:**

Servicer or remittance reports normally pertain to structured finance issuers; this report does not pertain to a structured finance issuer (EJR is not an NRSRO for structured finance or sovereigns/ municipal issuers). Regarding surveillance, the minimum time period for corporation issuers is normally one year.

**8. A description of the data that were relied upon for the purpose of determining the credit rating as required by Paragraph (a)(1)(ii)(H) of Rule 17g-7:**

EJR uses 10Q and 10K statements, quarterly reports, 8K filings, earnings reports, and other similar sources for ratings on publicly-traded issuers. In the case of private issuers, EJR relies on information provided mainly by issuers.

**9. A statement containing an overall assessment of the quality of information available and considered in the credit rating as required by Paragraph (a)(1)(ii)(I) of Rule 17g-7: The information is generally high quality and readily avail.****10. Information relating to conflicts of interest as required by Paragraph (a)(1)(ii)(J) of Rule 17g-7:**

This rating is unsolicited.

**11. An explanation or measure of the potential volatility of the credit rating as required by Paragraph (a)(1)(ii)(K) of Rule 17g-7:**

Our rating aims to assess the probability of the payment of obligations in full and on-time. Factors which affect such probability, and in turn our rating, include changes in the operating performance of the issuer, changes in capital structure, and merger and acquisition events.

**12. Information on the content of the credit rating as required by Paragraph (a)(1)(ii)(L) of Rule 17g-7:**

Regarding the historical performance of the credit rating, our rating transition matrix is available in our Form NRSRO, exhibit 1. The expected probability of default and the expected loss in the event of default is listed on the first page of this report.

**13. Information on the sensitivity of the credit rating to assumptions as required by Paragraph (a)(1)(ii)(M) of Rule 17g-7:**

Below is a summary of the impact of the 5 assumptions which independently would have the greatest impact on our "ratio-implied rating":

	Assumptions			Resulting Ratio-Implied Rating		
	Base	Optimistic	Pessimistic	Base	Optimistic	Pessimistic
Taxes Growth%	2.8	6.8	(1.2)	AA	AA	AA
Social Contributions Growth %	4.2	7.2	1.2	AA	AA	AA
Other Revenue Growth %		3.0	(3.0)	AA	AA	AA
Total Revenue Growth%	2.5	4.5	0.5	AA	AA	AA
Monetary Gold and SDR's Growth %	5.0	7.0	3.0	AA	AA	AA

**14. If the credit rating is assigned to an asset-backed security, a description of: (i) the representations, warranties, and enforcement mechanisms available to investors; and (ii) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities, as required by Paragraph (a)(1)(ii)(N) of Rule 17g-7:**

This credit rating is not assigned to an asset-backed security.

**ATTESTATION FORM**

In compliance with the US Securities and Exchange Commission (SEC) Rule 17g-7(a), the Egan-Jones analyst who published the report is responsible for the rating action and to the best knowledge of the person:

- 1) No part of the credit rating was influenced by any other business activities,
- 2) The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated, and
- 3) The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

**Analyst Signature:**

*Mike Huang*

Mike Huang  
Rating Analyst

**Today's Date**

June 16, 2017

**Reviewer Signature:**

*Caroline Ding*

Caroline Ding  
Rating Analyst

**Today's Date**

June 16, 2017

## **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.*