REPUBLIC OF AUSTRIA
Rating Analysis - 7/9/12
Debt: EUR238.4B

EJR Sen Rating(Curr/Prj) A/ BBB+
EJR CP Rating: A1
EJR's 1 yr. Default Probability: 1.8%

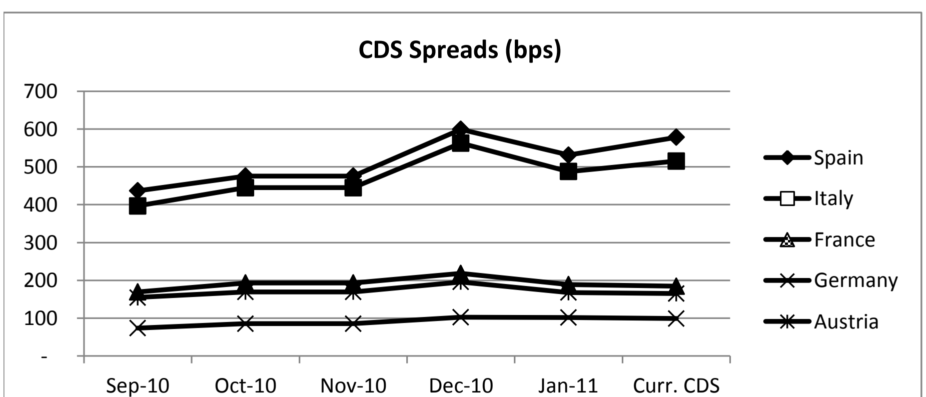
Same story - like Germany and The Netherlands, Austria is among the European Union's top economy. However, Austria has been shouldering the burdens of other EU countries and their banks via its exposure to the EFSF and indirectly via the ECB. The country's debt to GDP of 79.4% as of 2011 (expect near 85% for 2012) and a deficit to GDP near 3.0%, are weak and are understated due to exposures to the EU periphery and the Netherland's financial institutions. Unemployment was near 8% and will probably increase as many EU countries implement austerity measures. Other positives were the EUR9.4B balance of trade surplus and the EUR10.6B current account surplus as of the end of 2011. Inflation is near 2.1% currently (per Statistik Austria) but is up from 0% in 2009 and will probably rise with monetization.

The markets have cheered the decision to provide EUR100B directly to Spain's banks and to forego seniority for bailout funds. However, the market provides few gifts; the northern European countries will absorb the cost of providing support. Furthermore, with Spain's and probably Italy's seeking support from the EFSF and ESM, two major economies will switch from providers to users of funds. Our view is that the longer the euro crisis continues, the lower the ultimate recoveries. We are downgrading to "A" with a negative watch.

	Annual Ratios (source for past results: IMF)					
INDICATIVE CREDIT RATIOS	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	73.4	77.6	79.4	85.2	90.6	96.5
Govt. Sur/Def to GDP (%)	-4.1	-4.5	-2.6	-6.1	-5.8	-5.6
Adjusted Debt/GDP (%)	73.4	90.2	91.4	97.0	102.2	107.9
Interest Expense/ Taxes (%)	10.2	9.7	9.4	9.2	9.9	10.2
GDP Growth (%)	-0.9	2.7	0.7	2.0	2.0	1.2
Foreign Reserves/Debt (%)	2.9	1.5	1.9	1.8	1.6	1.5
Implied Sen. Rating	A	BBB+	BBB+	BBB+	BBB	BBB

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*
Government Of Canada	AAA	33.0	-4.5	34.0	14.1	1.9	A+
Federal Republic Of Germany	AAA	78.3	-5.2	88.7	11.4	2.0	BB+
French Republic	AA+	82.5	-5.2	106.6	9.5	1.2	BB
Republic Of Italy	BBB+	113.2	-3.9	124.4	16.7	-0.5	B
Kingdom Of Spain	BBB+	64.2	-8.5	77.8	12.3	0.3	BB+



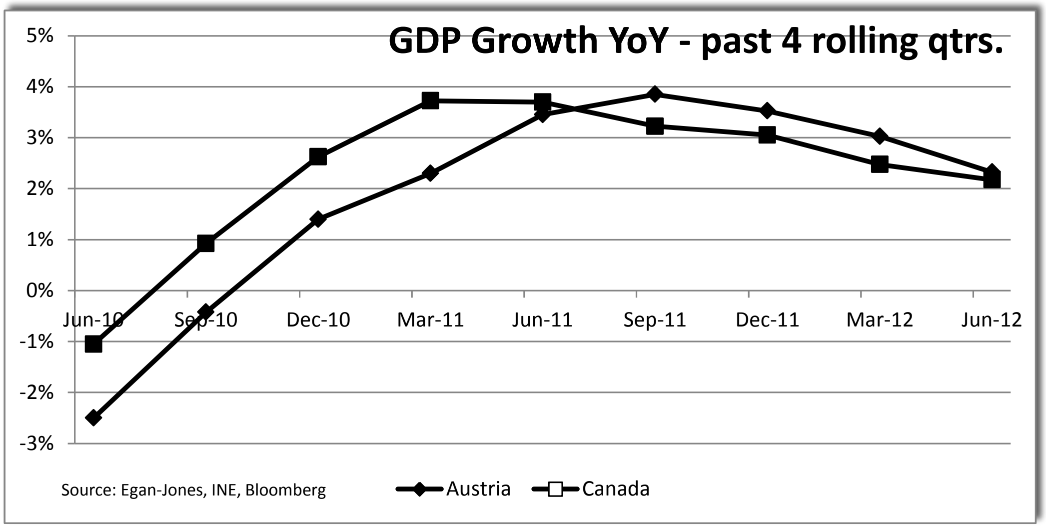
Country (EJR Rtg*)	Current CDS	Targeted CDS
Spain (CC)	578	3,000
Italy (B)	515	1,200
France (BBB-)	185	400
Germany (A-)	99	120
Austria (BBB+)	165	200

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

Economic Growth

From an economic perspective, Austria has historically been among the strongest EU countries with growth near 2% for the June 2012 period, which is respectable in moribund Europe. The recent decline in the euro will help the major exporters in the Netherlands such as the manufacturers, auto suppliers and pharmaceutical firms. However, imports will cost more and the economies of other EU countries are likely to remain weak and the Netherlands will be expected to contribute support.

As can be seen from the below chart, the Netherland's recent GDP growth has more or less tracked 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. Our major concern is the growth of the weaker EU countries and Austria's exposure.



Fiscal Policy

Austria's deficit to GDP of 2.6% is better than any other peers. However, over the last several fiscal years (that is from 2008 through 2011), total sovereign revenues rose a total of 5.6% while expenses rose a total of 9.7%, thereby increasing its debt to GDP. Austria spent to support citizens as a result of the 2008 slowdown. As can be seen from the chart at right, Austria's debt to GDP was 79.4% which is high and understated due to its indirect support to Greece, Spain and other weak countries.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr CDS Spreads
Austria	2.6	79.4	168
Canada	4.5	33.0	N/A
Germany	5.2	78.3	102
France	5.2	82.5	189
Italy	3.9	113.2	488
Spain	8.5	64.2	531

Sources: Bloomberg and IFS

Unemployment

The Netherland's unemployment rate of 8.2% is somewhat high for a top-tier country. As can be seen from the chart, Belgium is at the lowest rate of the peer countries and declined by 50 basis points from 2010 to 2011. For the more recent periods, Germany's unemployment rate has been near 6.7%. With the moderate unemployment rates relative to other EU countries, Austria might need to undertake fiscal stimulus measures.

Unemployment (%)	2010	2011
Austria	8.2	8.2
Canada	7.6	7.5
Germany	7.4	6.8
France	9.6	9.8
Italy	8.3	9.1
Spain	20.3	22.9

Source: Intl. Finance Statistics

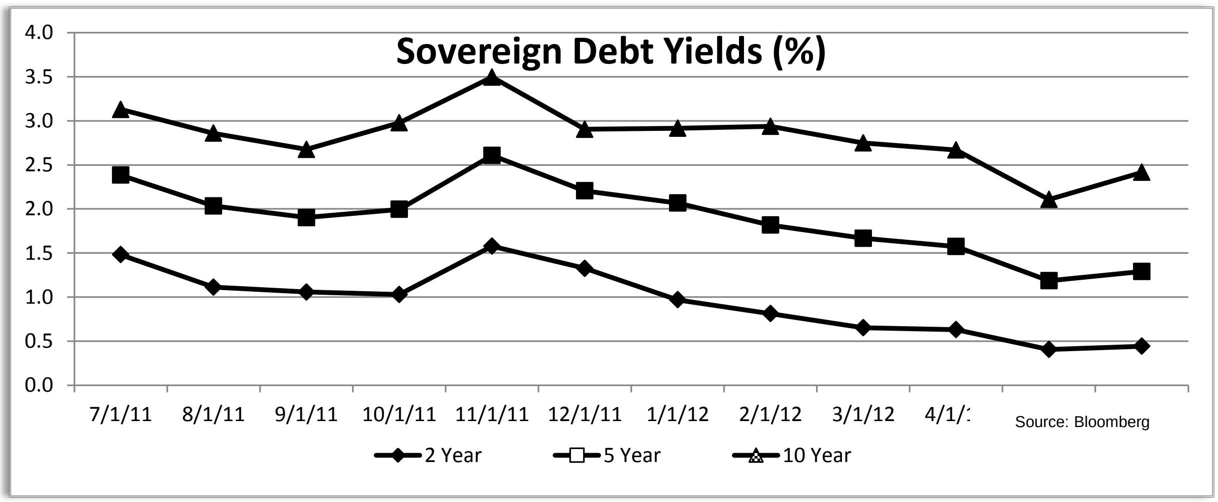
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. Germany has significant exposure to its banking sector because the bank's large aggregate size measured in assets The top five banks have assets equal to 143% of GDP, vs. 124% for Germany, and 477% for the UK, which is at the high end. Our concern is that Austrian support for weaker EU banks will be at the detriment of Austrian state finances. Watch Finland's actions regarding EMU membership.

Bank Assets (billions of local currency)	Assets	Cap/ Assets %
ERSTE GROUP BANK	210	7.2
RAIFFEISEN INTL	147	7.4
OEST VOLKSBANKEN	41	1.2
OBERBANK AG	17	7.0
VORARLBERG LAN-P	14	4.3
Total	429	
EJR's est. of cap shortfall at 10% of assets less market cap		36
Austria's GDP		300

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 Austria belongs in the top-tier of credit quality given its exposure 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 32 (1 is best) is strong.

The World Bank's Doing Business Survey*	2012 Rank	2011 Rank	Change in Rank
Overall Country Rank:	**32**	**28**	**-4**
Scores:			
Starting a Business	134	127	-7
Construction Permits	76	72	-4
Getting Electricity	21	21	0
Registering Property	35	32	-3
Getting Credit	24	21	-3
Protecting Investors	133	131	-2
Paying Taxes	82	81	-1
Trading Across Borders	25	25	0
Enforcing Contracts	9	9	0
Resolving Insolvency	21	19	-2

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

Economic Freedom

As can be seen below, Austria is above average in its overall rank of 70.3 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom

World Rank 70*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**70.3**	72.8	-2.5	64.3
Trade Freedom	**87.2**	87.6	-0.4	74.8
Fiscal Freedom	**50.5**	50.3	0.2	76.3
Government Spending	**15.4**	28.0	-12.6	63.9
Monetary Freedom	**82.2**	82.9	-0.7	73.4
Investment Freedom	**80.0**	80.0	0.0	50.2
Financial Freedom	**70.0**	70.0	0.0	48.5
Property Rights	**90.0**	90.0	0.0	43.5
Freedom from Corruption	**79.0**	79.0	0.0	40.5
Labor Freedom	**78.1**	78.2	-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

	Peer	Issuer	Base Case	
Income Statement	**Median**	**Average**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	1.7	5.4	**2.0**	**2.0**
Social Contributions Growth %	1.4	4.6	**2.0**	**2.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	5.0	0.9	**0.9**	**0.9**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	2.0	4.7	**2**	**1.2**
Compensation of Employees Growth%	2.0	1.3	**1.8**	**1.8**
Use of Goods & Services Growth%	5.3	0.9	**0.9**	**0.9**
Social Benefits Growth%	1.6	1.8	**1.8**	**1.8**
Subsidies Growth%	(3.8)	7.2		
Other Expenses Growth%	(1.2)	(1.2)	**(1.2)**	**(1.2)**
Interest Expense	0.0	3.2	**3**	
Balance Sheet				
Currency and Deposits (asset) Growth%	(36.0)	0.0		
Securities other than Shares LT (asset) Growth%	(7.2)	2.0	**2.4**	**2.4**
Loans (asset) Growth%	7.5	6.2	**2.0**	**2.0**
Shares and Other Equity (asset) Growth%	(2.0)	(4.4)	**2.0**	**2.0**
Insurance Technical Reserves (asset) Growth%	3.0	0.0		
Financial Derivatives (asset) Growth%	0.0	126.4	**2.0**	**2.0**
Other Accounts Receivable LT Growth%	3.0	3.9	**1.6**	**1.6**
Monetary Gold and SDR's Growth %	0.0	0.0	**2.0**	**2.0**
Other Accounts Payable Growth%	(2.9)			
Currency & Deposits (liability) Growth%	2.5	0.0		
Securities Other than Shares (liability) Growth%	7.6	6.1	**2.0**	**2.0**
Loans (liability) Growth%	3.1	14.2	**4.0**	**4.0**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	(17.1)	**1.0**	**1.0**
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	75,665	77,874	82,087	83,729	85,404	87,112
Social Contributions	45,614	46,579	48,724	49,699	50,693	51,707
Grant Revenue	0	0	0	0	0	0
Other Revenue	12,689	13,318	13,445	13,566	13,688	13,811
Other Operating Income	0	0	0	0	0	0
Total Revenue	133,969	137,771	144,256	146,993	149,784	152,629
Compensation of Employees	27,170	27,806	28,166	28,673	29,190	29,715
Use of Goods & Services	12,876	12,897	13,016	13,136	13,257	13,379
Social Benefits	70,234	72,595	73,915	75,259	76,628	78,021
Subsidies	9,887	10,013	10,738	10,739	10,740	10,741
Other Expenses	24,099	26,652	26,325	26,325	26,003	26,003
Grant Expense	0	0	0	0	0	0
Depreciation	3,545	3,655	3,719	3,719	3,719	3,719
Total Expenses excluding interest	137,924	143,603	145,141	157,852	159,537	161,579
Operating Surplus/Shortfall	-3,955	-5,832	-885	-10,858	-9,753	-8,950
Interest Expense	7,708	7,560	7,717	7,717	8,446	8,868
Net Operating Balance	-11,663	-13,392	-8,602	-18,575	-18,199	-17,818

Base Case
ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)	12,395	12,830				
Securities other than Shares LT (asset)	7,677	7,707	7,864	8,053	8,246	8,444
Loans (asset)	24,009	24,172	25,671	26,184	26,708	27,242
Shares and Other Equity (asset)	41,676	46,183	44,154	45,037	45,938	46,857
Insurance Technical Reserves (asset)				0	0	0
Other Accounts Receivable LT	6,443	6,914	7,187	7,302	7,419	7,538
Monetary Gold and SDR's						
Additional Assets		(793)	14,625			
Total Financial Assets	92,709	97,646	100,934	88,038	89,802	91,601
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)				0	0	0
Securities Other than Shares (liability)	169,392	185,864	197,220	201,164	205,188	209,291
Loans (liability)	30,206	33,814	38,614	57,189	75,388	93,206
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	2,610	1,788	1,483	1,498	1,513	1,528
Other Liabilities	2,049	2,290	2,525	(14,330)	(14,330)	(14,330)
Liabilities	204,257	223,756	239,842	245,521	265,483	285,101
Net Financial Worth	(111,548)	(126,110)	(138,908)	(157,483)	(175,682)	(193,500)
Total Liabilities & Equity	92,709	97,646	100,934	88,038	89,802	91,601

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