FRENCH REPUBLIC

Rating Analysis - 2/25/13

Debt: EUR1,717.0B

*EJR Sen Rating(Curr/Prj) BBB/ BBB

*EJR CP Rating: A2

EJR's 5 yr. Default Probability: 2.0%

Disastrous trend and the worst has yet to come. Over the past three fiscal years, the Republic of France's debt has grown 30.2% from EUR1.32 trillion to EUR1.72 trillion. Meanwhile, FYE GDP rose merely 3.3% from EUR1.93 trillion as of 2008 to EUR1.95 trillion as of 2011. As a result, debt to GDP rose from 61.8% in 2008 to 86.0% in 2011 and is near 95% currently. As the EU growth slows, and France's unemployment rises (projected to rise to 10.7%), budget pressures will rise. An item which is hard to quantify but is a growing concern is the health of France's banks; the assets of the five largest banks equal 288% of France's GDP and France is likely to provide additional support for its banks.

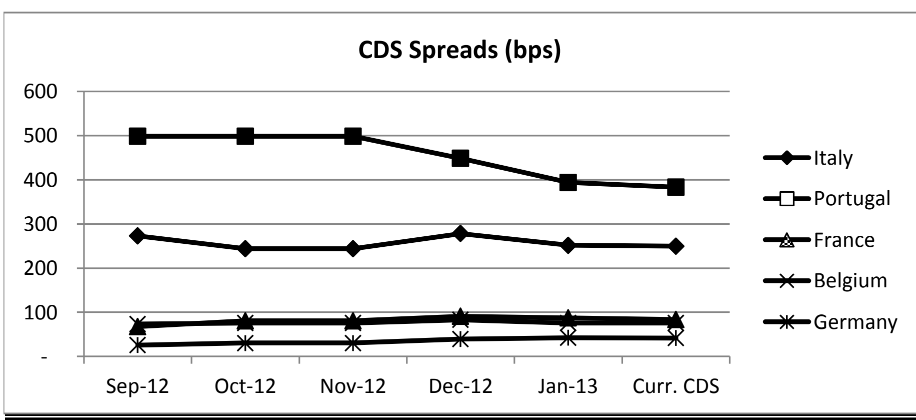
As a result of the ECB's measures, along with other EU countries, France has been exempted from the rise in funding costs. However, the deterioration in France's credit metrics combined with the needed supported for France's banks are likely to pressure the country. We expect that France will be forced to make major adjustments over the next couple of years in an effort to stoke growth and stem unemployment. A likely catalyst is the continued troubles in the EU's southern countries. Additionally, Hollande's policies are unlikely to spur growth. We are downgrading.

Annual Ratios (source for past results: IMF)

INDICATIVE CREDIT RATIOS	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	79.2	82.4	86.0	91.0	95.4	99.4
Govt. Sur/Def to GDP (%)	-7.5	-7.1	-5.2	-4.2	-3.8	-3.1
Adjusted Debt/GDP (%)	79.2	106.8	109.7	113.6	116.9	120.0
Interest Expense/ Taxes (%)	9.5	9.4	9.7	10.6	11.3	11.4
GDP Growth (%)	1.8	1.1	-0.3	-1.0	-1.0	-0.7
Foreign Reserves/Debt (%)	1.3	1.7	1.2	1.1	1.0	0.9
Implied Sen. Rating	BBB	BBB-	BBB-	BBB-	BBB-	BB-

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	31.2	-3.5	31.9	14.1	1.3	A+
Federal Republic Of Germany	AAA	81.3	-0.8	91.2	11.1	0.4	BB
Kingdom Of Belgium	AA	102.0	-3.7	102.0	11.9	-0.4	BB
Republic Of Italy	BBB+	120.6	-3.9	131.3	16.7	-2.7	B
Portugal Republic	BB	107.0	-4.4	115.1	13.0	-3.8	BB-



Country (EJR Rtg*)	Current CDS	Targeted CDS
Italy (C+)	250	4,300
Portugal (CCC+)	383	1,500
France (BBB)	83	300
Belgium (BBB-)	76	400
Germany (A-)	42	120

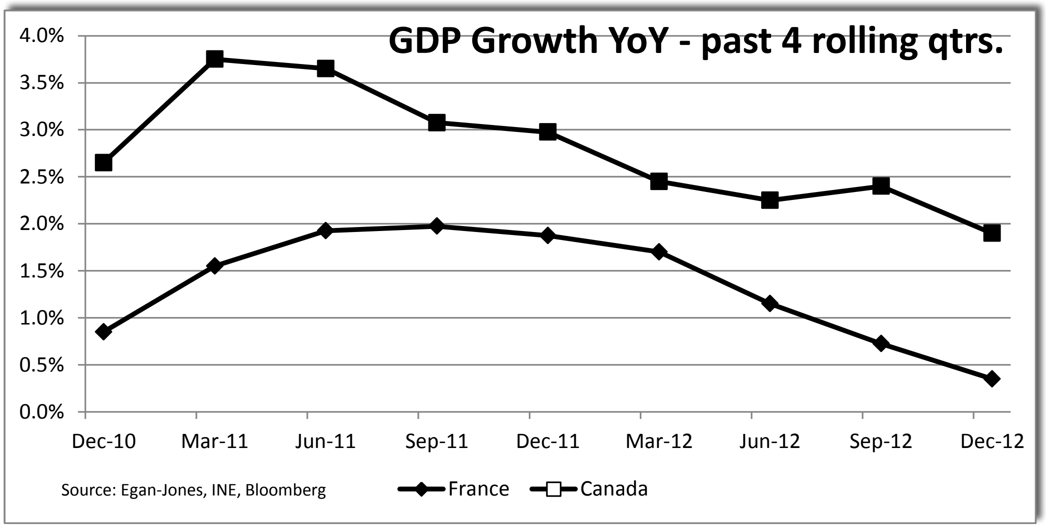
* Projected Rating

* EJR's targeted CDS based on rating

Economic Growth

Economic growth has been anemic, averaging less than 2% on an annualized basis. The annualized GDP growth was a mere .3% YoY (.1% on a real basis per the World Factbook). The austerity measures and increased taxes are likely to further imperil growth. Wages continue to stagnate because of the high unemployment, while costs on every-day items continue to rise. A major prospective concern is the tepid economic growth and an overhang from the rising sovereign debt and high taxes.

As can be seen from the below chart, over the past couple of years GDP growth has slipped. With the rise in debt to GDP, increased taxes, austerity measures, and problems with its southern and eastern neighbors, it is unclear how France will be able to enhance growth in the near term.



Fiscal Policy

France's deficit to GDP is in line with the other peer countries. Over recent full reported fiscal years (that is 2008 through 2011), total sovereign revenues rose an average of 5.1% while total expenses rose an average of 10.5%. As can be seen from the chart at right, France's Debt-to-GDP at 84% is in line with peers, but the deficit is a concern, especially with the low growth. (French debt held by the ECB might not be included.) France is attempting to reduce spending and raise taxes although France's tax rates currently are among the highest in Europe. Note, at EUR52B, France's int exp is a growing concern.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
France	5.2	86.0	87
Canada	3.5	N/A	N/A
Germany	0.8	81.3	42
Belgium	3.7	102.0	76
Italy	3.9	120.6	252
Portugal	4.4	107.0	394

Sources: Bloomberg and IFS

Unemployment

As can be seen in the chart at the right, France's unemployment has risen over the last two years and is among the highest for its peers. With the EU's continued malaise, any relief from unemployment will take time. Additionally, the high unemployment makes it difficult for the country to employ austerity measures without increased unrest. The socialistic policies of Hollande are likely to exacerbate unemployment.

Unemployment (%)	2011	2012
France	9.8	10.3
Canada	7.5	7.1
Germany	6.8	6.9
Belgium	7.1	7.5
Italy	9.2	10.6
Portugal	14.0	16.9

Source: Intl. Finance Statistics

Banking Sector

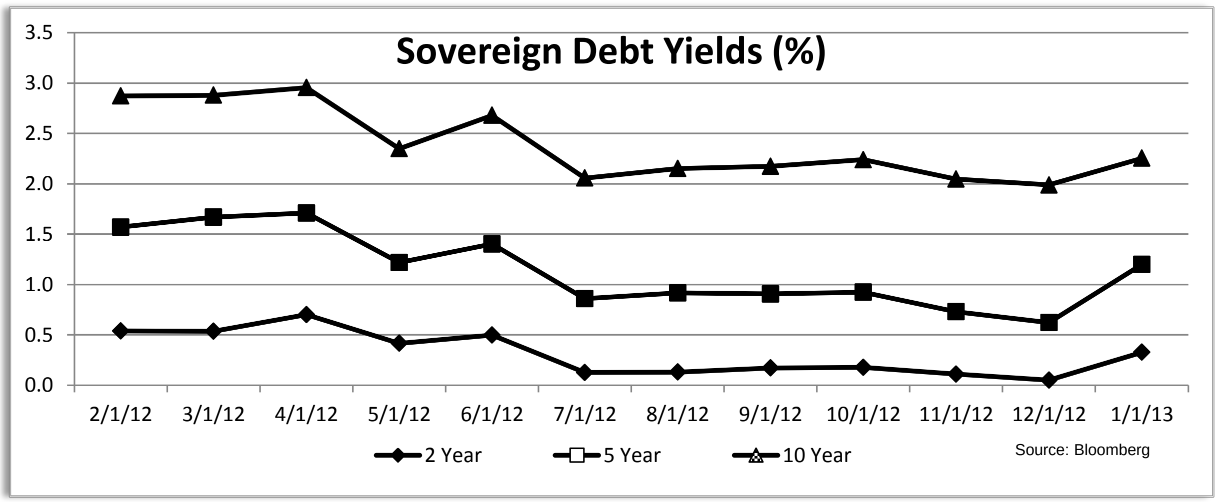
History has shown that country and bank obligations are linked during times of economic distress. France has significantly more exposure to its banking sector because the banks' high agreggate size measured in assets; the top five banks have assets equal to 282% of GDP compared to 125% for Germany. France will be expected to provide additional support to its banks over the next couple of years because of the weakness in the periphery countries.

Bank Assets (billions of local currency)

	Assets	Cap/ Assets %
BNP PARIBAS	1,907	5.0
CREDIT AGRICOLE	1,842	2.5
SOC GENERALE	1,251	4.3
NATIXIS	508	4.2
CREDIT INDUS COM	233	4.1
Total	5,741	
EJR's est. of cap shortfall at 10% of assets less market cap		472
France's GDP		1,995

Funding Costs

Despite weakening credit metrics, France has seen a significant decline in its funding costs over the past couple of years because of extraordinary measures of the ECB. As can be seen in the below graph, the ten year debt yield has declined from near 3.0% to below 2.5% and the 2 year yield is below .5%. Our concern is that funding costs will rise over the next couple of years and further pressure federal budgets.



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) is strong. France has slipped a bit over the past year.

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, France is above average in its overall rank of 63.2 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom
World Rank 63*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**83.7**	85.6	-1.9	64.3
Trade Freedom	**82.1**	82.6	-0.5	74.8
Fiscal Freedom	**53.8**	52.3	1.5	76.3
Government Spending	**5.3**	16.4	-11.1	63.9
Monetary Freedom	**82.3**	83.7	-1.4	73.4
Investment Freedom	**55.0**	55.0	0.0	50.2
Financial Freedom	**70.0**	70.0	0.0	48.5
Property Rights	**80.0**	80.0	0.0	43.5
Freedom from Corruption	**68.0**	69.0	-1.0	40.5
Labor Freedom	**51.6**	51.4	0.2	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	7.9	**4.5**	**4.5**
Social Contributions Growth %	1.4	4.1	**4.0**	**4.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	12.3	2.0	**5.0**	**5.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.8	5.9	**5.0**	**4.5**
Compensation of Employees Growth%	2.7	1.6	**3.0**	**3.0**
Use of Goods & Services Growth%	4.0	(2.3)	**2.0**	**2.0**
Social Benefits Growth%	1.7	3.1	**4.0**	**4.0**
Subsidies Growth%	(3.7)	(8.6)		
Other Expenses Growth%	2.7	2.7	**2.7**	**2.7**
Interest Expense	0.0	3.1	**3.5**	**3.7**
GDP Growth%			**(1.0)**	**(0.7)**
Currency and Deposits (asset) Growth%	0.0	30.4	**4.1**	**4.1**
Securities other than Shares LT (asset) Growth%	5.0	(1.5)	**2.3**	**2.3**
Loans (asset) Growth%	14.4	19.1	**4.5**	**4.5**
Shares and Other Equity (asset) Growth%	(1.7)	(8.7)	**2.0**	**2.0**
Insurance Technical Reserves (asset) Growth%	3.6	2.8	**2.8**	**2.8**
Financial Derivatives (asset) Growth%	0.0	10.4	**4.5**	**4.5**
Other Accounts Receivable LT Growth%	3.0	7.3	**4.5**	**4.5**
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%	2.4			
Currency & Deposits (liability) Growth%	2.5	30.4	**4.5**	**4.5**
Securities Other than Shares (liability) Growth%	5.3	9.3	**6.5**	**6.5**
Loans (liability) Growth%	3.1	(4.0)	**0.5**	**0.5**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.3	104.1	**5.9**	**5.9**
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	479,349	500,910	540,637	564,966	590,389	616,957
Social Contributions	353,745	360,958	375,906	390,942	406,580	422,843
Grant Revenue	0	0	0	0	0	0
Other Revenue	94,858	96,382	98,287	103,201	108,361	113,779
Other Operating Income	0	0	0	0	0	0
Total Revenue	927,952	958,250	1,014,830	1,059,109	1,105,330	1,153,579
Compensation of Employees	254,157	259,422	263,670	271,580	279,728	288,119
Use of Goods & Services	104,763	112,036	109,514	111,704	113,938	116,217
Social Benefits	480,022	495,617	511,207	531,655	552,921	575,038
Subsidies	31,310	32,337	29,558	29,561	29,564	29,567
Other Expenses	86,750	86,829	89,214	89,214	91,665	91,665
Grant Expense	0	0	0	0	0	0
Depreciation	49,560	51,279	53,644	53,644	53,644	53,644
Total Expenses excluding interest	1,006,562	1,037,520	1,056,807	1,087,359	1,121,460	1,154,250
Operating Surplus/Shortfall	-78,610	-79,270	-41,977	-28,249	-16,129	-671
Interest Expense	45,754	46,956	52,598	60,094	66,767	70,105
Net Operating Balance	-124,364	-126,226	-94,575	-88,343	-82,896	-70,776

Sources: Historical - IMF, Projections - EJR

Base Case
ANNUAL BALANCE SHEETS (MILLIONS EUR)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)	23,808	23,148	30,181	31,403	32,675	33,999
Securities other than Shares LT (asset)	46,525	48,196	47,451	48,519	49,610	50,727
Loans (asset)	35,699	38,822	46,223	48,303	50,477	52,748
Shares and Other Equity (asset)	413,935	421,160	384,567	392,258	400,104	408,106
Insurance Technical Reserves (asset)	1,148	1,182	1,215	1,249	1,284	1,320
Other Accounts Receivable LT	178,849	183,734	197,149	206,021	215,292	224,980
Monetary Gold and SDR's						
Additional Assets	37,270	20,482	29,427			
Total Financial Assets	738,474	738,953	738,674	759,752	781,556	804,114
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	23,808	23,148	30,181	30,181	30,181	30,181
Securities Other than Shares (liability)	1,340,840	1,442,729	1,576,477	1,678,780	1,787,722	1,903,733
Loans (liability)	208,428	226,201	217,239	305,582	388,478	459,254
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	108	469	957	1,013	1,072	1,135
Other Liabilities	147,343	155,910	169,983	88,702	88,702	88,702
Liabilities	1,720,527	1,848,457	1,994,837	2,104,258	2,208,958	2,302,291
Net Financial Worth	(982,053)	(1,109,504)	(1,256,163)	(1,344,506)	(1,427,402)	(1,498,178)
Total Liabilities & Equity	738,474	738,953	738,674	759,752	781,556	804,114

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