

SWISS CONFEDERATION

Rating Analysis - 7/23/13
Debt: CHF138.6B

*EJR Sen Rating(Curr/Prj) AAA/ AA+
*EJR CP Rating: A1+
EJR's 9 yr. Default Probability: 0.5%

Safe Harbor - while a credit quality storm rages in Europe, like the alps, Switzerland stands above the others. As can be seen below, the country maintains a debt to GDP of merely 23%, a level which has declined over the past couple of years as a result of budget surplus. (Note, financials are dated.) With strong positions in pharmaceuticals, baking, watchmaking, tourism, and a highly educated labor force, unemployment for the most recent quarter was merely 2.9% or approximately one tenth of that realized by Spain. Low taxes and apt regulation are likely to continue to stoke growth. GDP growth has been modest recently, but has exceeded most other countries in Europe. Unlike most sovereign credits, Switzerland's foreign reserves of CHF434B exceed the country's debt near CHF130B.

The major challenge facing the country is the weak condition of the EU; while the banking sector is likely to benefit slightly from reduced funding costs, such gains are offset by weaker growth and contortions conducted by its central bank in an attempt to maintain a balance with the euro. Additionally, if Italy and/ or Spain continue to slide, Switzerland is likely to experience some fallout. Nonetheless, Switzerland remains strong and we are affirming. The large size of the banking sector is also a concern although most is asset mgt.

Annual Ratios (source for past results: IMF)

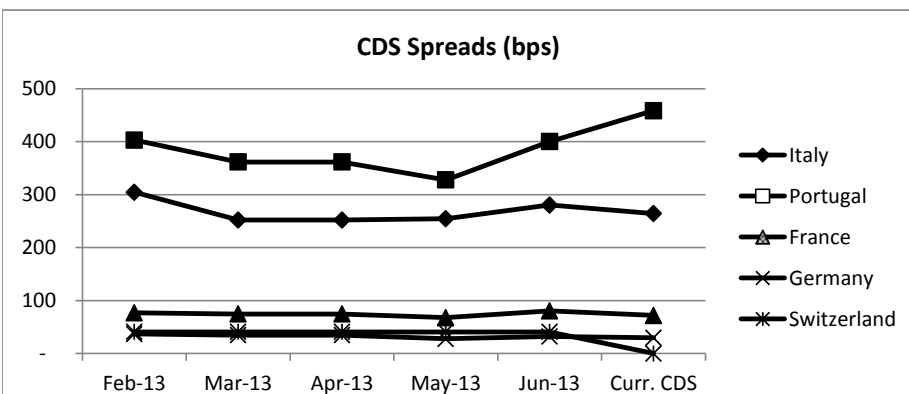
CREDIT POSITION	2008	2009	2010	P2011	P2012	P2013
Debt/ GDP (%)	26.3	22.1	23.4	22.7	22.1	21.5
Govt. Sur/Def to GDP (%)	0.3	0.5	0.7	0.7	0.6	0.5
Adjusted Debt/GDP (%)	26.3	30.8	32.5	31.8	31.2	30.6
Interest Expense/ Taxes (%)	5.3	4.7	4.5	2.8	2.7	2.8
GDP Growth (%)	3.6	0.7	1.4			0.0
Foreign Reserves/Debt (%)	69.6	148.7	183.4	189.3	196.3	202.6
Implied Sen. Rating	AA+	AA+	AA+	AAA	AAA	AA+

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 % of GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Government Of Canada	AAA	29.5	-3.2	30.1	14.1	0.8	A+
Federal Republic Of Germany	AAA	83.7	0.2	93.3	11.1	0.3	BB+
French Republic	AA+	91.9	-4.8	115.5	9.7	-0.3	BB-
Republic Of Italy	BBB	125.8	-3.0	136.8	16.7	-2.8	B
Portugal Republic	BB	118.5	-6.4	127.7	13.0	-3.8	B-



Country (EJR Rtg*)	Current CDS	Targeted CDS
Italy (C+)	264	4,300
Portugal (CCC+)	459	1,500
France (BBB)	72	300
Germany (A-)	30	120
Switzerland (AA+)		40

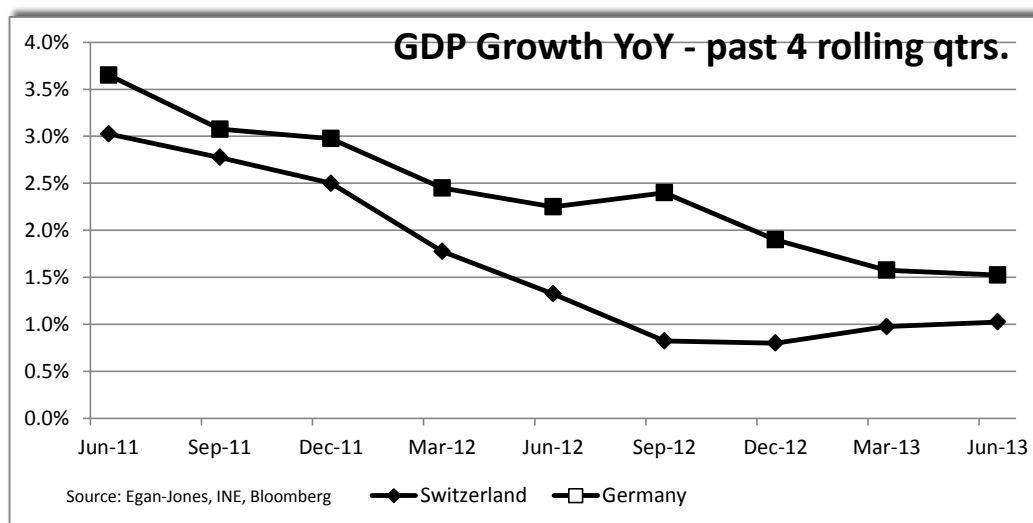
* Projected Rating
* EJR's targeted CDS based on rating

* Note, non-NRSRO rating. Copyright Egan-Jones Ratings Co.; no secondary distribution.

Economic Growth

Like most of Europe, Switzerland has experience tepid growth over the recent past although any growth is stellar in moribund Europe. The euro remains extremely strong relative to the yen, thereby hurting major exporters. As can be seen from the below chart, Switzerland's GDP has decline since June 2011 and recent GDP growth has remained weaker than Germany's. We expect the GDP growth for 2013 to be positive but slower than 2012. Perhaps the more relevant factor is the growth of the weaker EU countries.

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



Fiscal Policy

Unlike most countries, Switzerland is running a surplus; the surplus to GDP of .7% which is better than most other countries in Europe. From 2007 to 2010, total sovereign revenues declined .3% while total expenses rose 4%; the country had to spend to support citizens as a result of the 2008 slowdown. As can be seen from the chart at right, Switzerland's debt to GDP was merely 23.4% using IFS and Bloomberg data.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Switzerl.	(0.7)	23.4	41
Canada	3.2	29.5	N/A
Germany	(0.2)	83.7	32
France	4.8	91.9	80
Italy	3.0	125.8	281
Portugal	6.4	118.5	400

Sources: Bloomberg and IFS

Unemployment

Switzerland's unemployment rate has long been among the lowest in Europe. As can be seen from the chart at right, Switzerland is at the lowest rate of the peer countries although it rose 30 bps from 2011 to 2012. For the more recent periods, Switzerland's unemployment rate has been near 2.9%. With the low unemployment rates relative to other EU countries, Switzerland is not under a great deal of pressure to employ fiscal stimulus measures.

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

Source: Intl. Finance Statistics

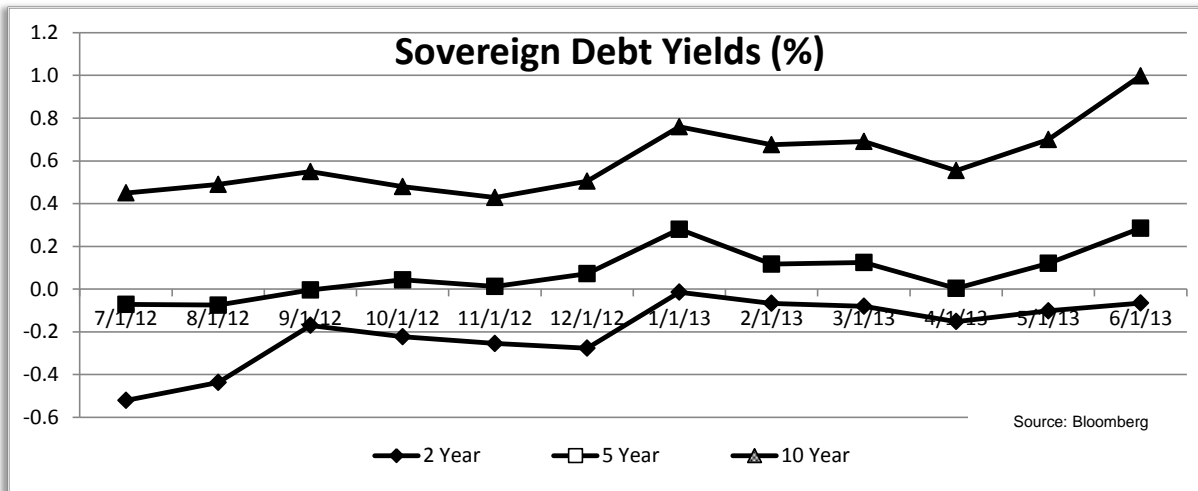
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. Switzerland has significantly exposure to its banking sector because the bank's large aggregate size measured in assets. The top five banks have assets equal to 387% of GDP versus 477% for the UK and 116% for Germany. The major positive is that a large portion of the country's banking business is best described as asset management rather than the usual lending business.

Bank Assets (billions of local currency)		
	Assets	Cap/ Assets %
UBS AG-REG	1,259	4.0
CREDIT SUISS-REG	924	4.6
BANQUE CANTO-REG	40	6.6
BASLER KANTON-PC	39	8.0
BERNER KANTO-REG	26	-
Total	2,289	
EJR's est. of cap shortfall at 10% of assets less market cap		54
Switzerland's GDP		592

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 for 10 year debt has remained below 1%. Additionally, unlike Germany, Switzerland 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	2011	Change in
	Rank	Rank	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, Switzerland is above average in its overall rank of 81.1 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom				
World Rank 81*				
	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	77.9	80.2	-2.3	64.3
Trade Freedom	90.0	90.0	0.0	74.8
Fiscal Freedom	67.9	68.4	-0.5	76.3
Government Spending	65.8	69.3	-3.5	63.9
Monetary Freedom	84.4	83.8	0.6	73.4
Investment Freedom	80.0	80.0	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	87.0	90.0	-3.0	40.5
Labor Freedom	87.9	87.8	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	Issuer	Base Case	
	Median	Average	Yr 1&2	Yr 3,4,5
Taxes Growth%	4.9	1.0	1.5	1.5
Social Contributions Growth %	1.4	0.4	1.0	1.0
Grant Revenue Growth %	0.0	(2.9)	0.5	0.5
Other Revenue Growth %	6.8	1.1	1.4	1.4
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.9	0.9	0.9	0.8
Compensation of Employees Growth%	1.6	2.8	1.0	1.0
Use of Goods & Services Growth%	4.0	(2.4)	1.0	1.0
Social Benefits Growth%	1.7	3.3	3.3	3.3
Subsidies Growth%	(6.1)	(19.6)		
Other Expenses Growth%	46.3	46.3	1.3	1.3
Interest Expense	0.0	3.9	2.5	2.5
GDP Growth%				
Currency and Deposits (asset) Growth%	6.0	5.0	1.4	1.4
Securities other than Shares LT (asset) Growth%	(1.5)	4.3	1.8	1.8
Loans (asset) Growth%	14.4	3.7	1.5	1.5
Shares and Other Equity (asset) Growth%	(0.8)	(13.7)	2.0	2.0
Insurance Technical Reserves (asset) Growth%	2.8	0.0		
Financial Derivatives (asset) Growth%	0.0	192.6	1.5	1.5
Other Accounts Receivable LT Growth%	3.0	4.3	1.5	1.5
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%	0.9			
Currency & Deposits (liability) Growth%	2.5	5.0	5.0	5.0
Securities Other than Shares (liability) Growth%	7.3	(0.3)	(0.2)	(0.2)
Loans (liability) Growth%	(0.6)	1.4	1.4	1.4
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	43.2	2.0	2.0
Addl debt. (1st Year) million CHF	0.0	0.0		

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Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS CHF)

	Dec-08	Dec-09	Dec-10	PDec-11	PDec-12	PDec-13
Taxes	122,610	121,188	122,366	124,201	126,064	127,955
Social Contributions	37,133	38,142	38,286	38,669	39,056	39,447
Grant Revenue	129	162	157	158	159	160
Other Revenue	28,154	27,499	27,810	28,185	28,566	28,952
Other Operating Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Revenue	188,027	186,991	188,620	191,214	193,845	196,513
Compensation of Employees	42,674	43,308	44,538	44,983	45,433	45,887
Use of Goods & Services	21,975	22,555	22,018	22,239	22,461	22,686
Social Benefits	60,526	64,295	66,437	68,651	70,938	73,302
Subsidies	24,360	23,893	19,198	19,200	19,202	19,204
Other Expenses	9,787	11,229	16,430	16,643	16,860	17,079
Grant Expense	129	162	157	153	148	144
Depreciation	<u>11,590</u>	<u>11,529</u>	<u>11,877</u>	<u>11,877</u>	<u>11,877</u>	<u>11,877</u>
Total Expenses excluding interest	171,040	176,971	180,655	183,745	186,919	190,178
Operating Surplus/Shortfall	16,986	10,020	7,965	7,469	6,927	6,335
Interest Expense	<u>6,489</u>	<u>5,738</u>	<u>5,470</u>	<u>3,465</u>	<u>3,358</u>	<u>3,526</u>
Net Operating Balance	10,497	4,282	2,494	4,004	3,569	2,809

Sources: Historical - IMF, Projections - EJR

Base Case

ANNUAL BALANCE SHEETS (MILLIONS CHF)

	Dec-08	Dec-09	Dec-10	PDec-11	PDec-12	PDec-13
ASSETS						
Currency and Deposits (asset)	9,304	9,082	9,536	9,665	9,795	9,927
Securities other than Shares LT (asset)	22,513	17,452	18,195	18,522	18,856	19,195
Loans (asset)	28,401	25,394	26,341	26,736	27,138	27,545
Shares and Other Equity (asset)	108,640	120,969	104,380	106,468	108,597	110,769
Insurance Technical Reserves (asset)				0	0	0
Other Accounts Receivable LT	42,883	41,730	43,510	44,163	44,825	45,498
Monetary Gold and SDR's						
Additional Assets	16,330	23,450	21,604			
Total Financial Assets	229,172	238,359	224,393	227,997	231,666	235,402
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	9,304	9,082	9,536	9,536	9,536	9,536
Securities Other than Shares (liability)	136,485	123,730	123,322	123,038	122,754	122,471
Loans (liability)	94,018	91,614	92,860	88,856	85,287	82,478
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	<u>513</u>	<u>575</u>	<u>823</u>	<u>840</u>	<u>856</u>	<u>873</u>
Other Liabilities	<u>46,715</u>	<u>48,822</u>	<u>49,792</u>	<u>53,664</u>	<u>53,664</u>	<u>53,664</u>
Liabilities	<u>287,034</u>	<u>273,822</u>	<u>276,333</u>	<u>275,934</u>	<u>276,034</u>	<u>276,961</u>
Net Financial Worth	<u>(57,862)</u>	<u>(35,463)</u>	<u>(51,941)</u>	<u>(47,937)</u>	<u>(44,368)</u>	<u>(41,559)</u>
Total Liabilities & Equity	229,172	238,359	224,393	227,997	231,666	235,402

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.