UNITED KINGDOM

Rating Analysis - 3/27/13
Debt: GBP1,308.0B

*EJR Sen Rating(Curr/Prj) A+/ A+
*EJR CP Rating: A1
EJR's 5 yr. Default Probability: 1.3%

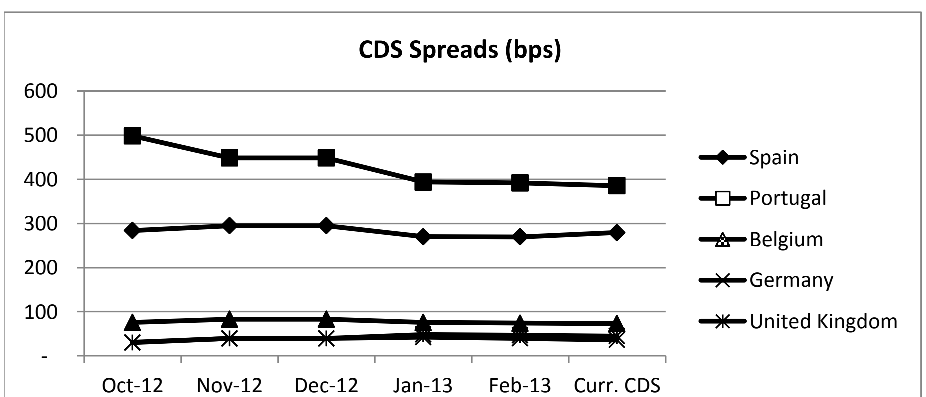
Worse than it appears - per the IMF's IFS, the UK's debt to GDP has rocketed from 49% as of 2007 to 99.7% as of 2011 and for 2014 we believe it is likely to be in excess of 110%. Since 2007, debt grew a total of 119% while GDP rose only 7.4%. The services, particularly banking, is critical to the UK's economy and the industry is requiring taxpayer support to address problem credits.

Re. the balance of payments, imports have exceeded exports by an average of 500B pounds annually over the past several years. The major problems for the UK is that Europe's banking crisis does not appear to be abating as evidenced by the problems of the Cypriot banks. On the fiscal side, the deficit to GDP has declined over the past three years from 11.5% to 8.3%, which is a respectable decline, but is still substantial; the bulk of the deficit reduction was the result of increased taxes. The over-riding concern is whether the country will be able to continue to cut its deficit in the face of weaker economic conditions and a possible deterioration in the country's financial sector. Unfortunately, we expect that the UK's debt/GDP will rise and the country will remain pressed (we are waiting for addl 2012 data). We are downgrading.

	Annual Ratios (source for past results: IMF)					
INDICATIVE CREDIT RATIOS	2009	2010	2011	P2012	P2013	P2014
Debt/ GDP (%)	64.6	78.0	86.3	94.5	102.2	110.4
Govt. Sur/Def to GDP (%)	-11.5	-10.2	-7.8	-6.9	-6.4	-6.8
Adjusted Debt/GDP (%)	64.6	107.7	114.9	122.5	129.5	137.1
Interest Expense/ Taxes (%)	7.0	10.4	11.1	10.4	11.5	11.8
GDP Growth (%)	1.8	0.9	0.2	-0.5	-0.5	0.5
Foreign Reserves/Debt (%)	2.8	2.9	2.9	2.6	2.4	2.2
Implied Sen. Rating	A-	BBB+	BBB	BBB	BBB	B+

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	31.4	-3.5	32.6	14.1	0.8	A+
Federal Republic Of Germany	AAA	81.3	-0.8	91.4	11.1	0.4	BB+
Kingdom Of Belgium	AA	102.0	-3.7	102.0	11.9	-0.4	BB
Kingdom Of Spain	BBB-	68.6	-9.4	82.0	12.3	-1.9	BB
Portugal Republic	BB	107.0	-4.4	115.9	13.0	-3.8	BB-



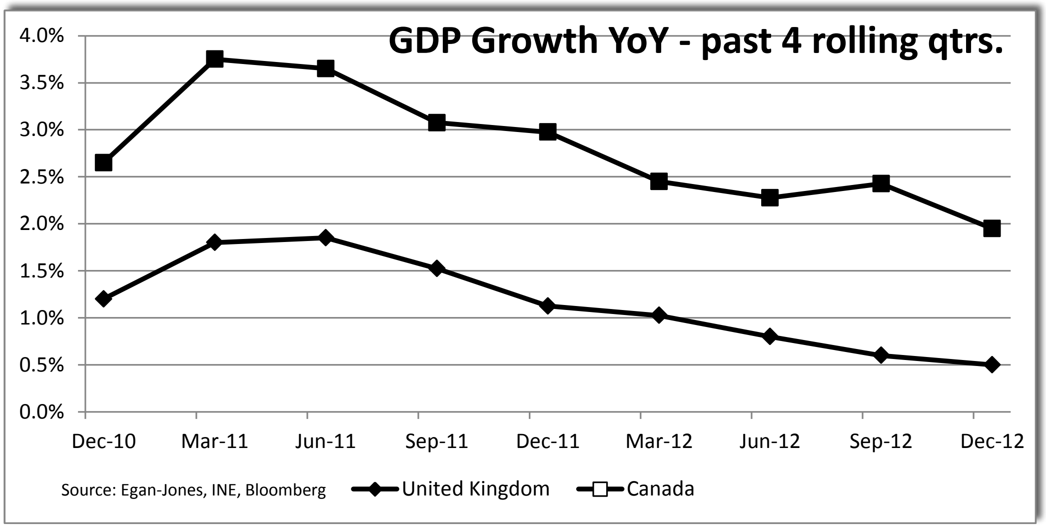
Country (EJR Rtg*)	Current CDS	Targeted CDS
Spain (C)	279	5,000
Portugal (CCC+)	386	1,500
Belgium (BBB-)	73	400
Germany (A-)	36	120
United Kingdom (A+)	45	80

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

Economic Growth

The country was hobbled by the global financial crisis of 2007, harming the nation's GDP and causing the economy to enter into a recession during the third quarter of 2008. As seen below, growth has been tepid at 1% or less over the last couple of quarters. We expect GDP to continue to slip over the next couple of quarters.

As can be seen from the below chart, the UK's rolling four quarter GDP growth has been less than stellar over the past year; the UK is barely growing while Canada has recorded growth near 2%. A large portion of England's economy is geared to the services industry, particularly financial services. The continued weakness in the EU limit's growth in the UK's service economy.



Fiscal Policy

The United Kingdom's deficit to GDP of 7.8% is high and is likely to remain high over the next couple of years. From FYE 2009 through 2011, because of increased taxes, total sovereign revenues rose 9.9% while expenses excluding interest rose 0.8% The major problem for the UK is its high debt to GDP and support needed for its banks. As can be seen from the chart to the right, only Spain has a worse deficit to GDP than the UK. As the UK implements austerity measures and deficits continue, debt to GDP will rise.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
U.K.	7.8	86.3	48
Canada	3.5	31.4	N/A
Germany	0.8	81.3	42
Belgium	3.7	102.0	76
Spain	9.4	68.6	270
Portugal	4.4	107.0	394

Sources: Bloomberg and IFS

Unemployment

The UK's unemployment rate of 8.4% is near the middle of the pack as indicated in the chart at right. However, as of the Jan. 2013 quarter, the rate declined slightly to 7.8%. The weak level of employment will impede the government's attempts to reduce the budget deficit. We expect unemployment to remain high because of the soft conditions in financial services and actions of the EU such as the transaction tax.

Unemployment (%)	2011	2012
United Kin(	8.4	7.8
Canada	7.5	7.1
Germany	6.8	6.9
Belgium	7.1	7.5
Spain	22.9	26.0
Portugal	14.0	16.9

Source: Intl. Finance Statistics

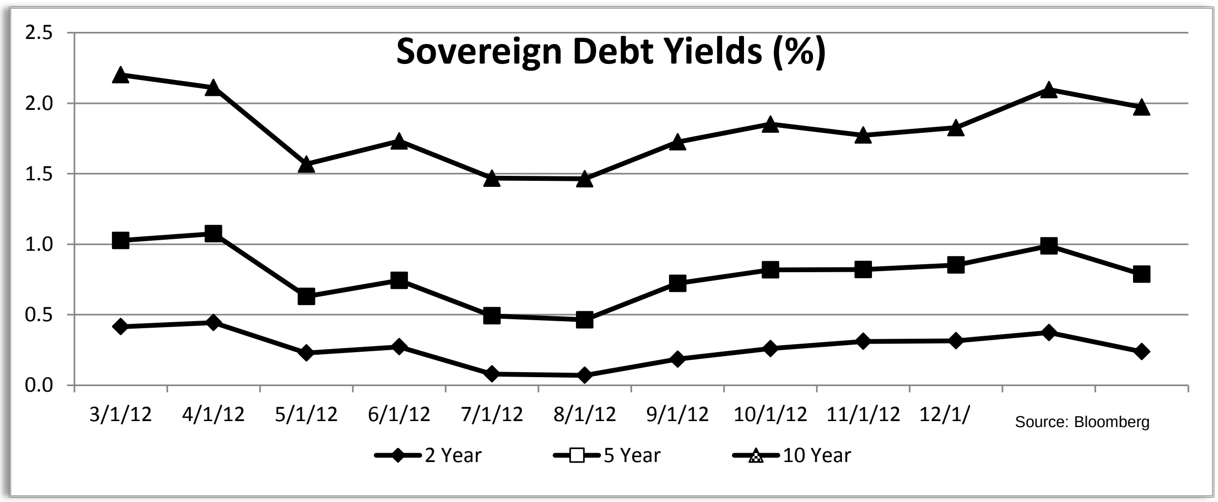
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. The UK has significantly exposure to its banking because the bank's large aggregate size measured in assets. The top five banks have assets equal to 465% of GDP versus 125% for Germany. The UK will probably be expected to provide financial support to its banks over the next couple of years quarters to ameliorate asset quality problems.

Bank Assets (billions of local currency)	Assets	Cap/ Assets %
HSBC HLDGS PLC	2,693	6.8
ROYAL BK SCOTLAN	1,490	4.2
BARCLAYS PLC	1,312	5.4
LLOYDS BANKING	925	4.8
STANDARD CHARTER	637	7.2
Total	7,056	
EJR's est. of cap shortfall at 10% of assets less market cap		435
United Kingdom's GDP		1,516

Funding Costs

A Flight to Quality - with the waning of the ECB's LTRO and weakening of EU credit metrics, the UK's funding costs have risen over the past several months. As can be seen in the below graph, the bond yields have crept up since last August. A major issue is whether the UK belongs in the top-tier of credit quality.



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.

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, United Kingdom is above average in its overall rank of 74.1 for Economic Freedom with 100 being best.

Heritage Foundation 2012 Index of Economic Freedom
World Rank 74*

	Rank**	2011 Rank	Change in Rank	World Avg.
Business Freedom	**94.7**	94.6	0.1	64.3
Trade Freedom	**87.1**	87.6	-0.5	74.8
Fiscal Freedom	**56.4**	52.0	4.4	76.3
Government Spending	**21.5**	32.9	-11.4	63.9
Monetary Freedom	**73.9**	74.9	-1.0	73.4
Investment Freedom	**90.0**	90.0	0.0	50.2
Financial Freedom	**80.0**	80.0	0.0	48.5
Property Rights	**90.0**	85.0	5.0	43.5
Freedom from Corruption	**76.0**	77.0	-1.0	40.5
Labor Freedom	**71.5**	71.2	0.3	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%	4.9	6.0	**2.0**	**2.0**
Social Contributions Growth %	1.4	3.6	**2.0**	**2.0**
Grant Revenue Growth %	0.0	0.0		
Other Revenue Growth %	12.3	(1.7)	**3.0**	**3.0**
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	5.8	4.8	**2.5**	**2.3**
Compensation of Employees Growth%	2.7	(0.2)	**1.0**	**1.0**
Use of Goods & Services Growth%	4.0	(1.8)	**1.0**	**1.0**
Social Benefits Growth%	1.6	3.5	**3.0**	**3.0**
Subsidies Growth%	(3.7)	(12.7)		
Other Expenses Growth%	(10.4)	(10.4)	**2.0**	**2.0**
Interest Expense	0.0	3.8	**3.6**	**3.6**
GDP Growth%			**(0.5)**	**0.5**
Currency and Deposits (asset) Growth%	0.0	5.0	**1.8**	**1.8**
Securities other than Shares LT (asset) Growth%	(2.2)	20.5	**2.4**	**2.4**
Loans (asset) Growth%	30.1	10.0	**2.0**	**2.0**
Shares and Other Equity (asset) Growth%	7.2	1.1	**1.1**	**1.1**
Insurance Technical Reserves (asset) Growth%	0.0	(1.7)	**2.0**	**2.0**
Financial Derivatives (asset) Growth%	0.0	61.5	**2.0**	**2.0**
Other Accounts Receivable LT Growth%	3.4	10.0	**2.0**	**2.0**
Monetary Gold and SDR's Growth %	0.0	6.0	**6.0**	**6.0**
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	2.4			
Currency & Deposits (liability) Growth%	2.8	5.0	**5.0**	**5.0**
Securities Other than Shares (liability) Growth%	7.3	23.2	**4.0**	**4.0**
Loans (liability) Growth%	5.7	6.0	**4.0**	**4.0**
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.0	16.5	**2.6**	**2.6**
Addl debt. (1st Year) million GBP	0.0	0.0		

Base Case
ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS GBP)

	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Taxes	387,072	417,226	442,105	450,947	459,966	469,165
Social Contributions	119,422	123,216	127,624	130,176	132,780	135,436
Grant Revenue	0	0	0	0	0	0
Other Revenue	52,766	49,064	48,211	49,657	51,147	52,681
Other Operating Income	0	0	0	0	0	0
Total Revenue	559,260	589,506	617,940	630,781	643,893	657,282
Compensation of Employees	163,158	168,891	168,616	170,302	172,005	173,725
Use of Goods & Services	190,447	191,546	188,150	190,032	191,932	193,851
Social Benefits	210,934	221,237	228,983	235,852	242,928	250,216
Subsidies	9,363	9,538	8,330	8,331	8,332	8,332
Other Expenses	81,592	68,525	61,374	69,896	62,601	71,293
Grant Expense	0	0	0	0	0	0
Depreciation	13,946	15,129	15,862	15,862	15,862	15,862
Total Expenses excluding interest	669,440	674,866	671,315	690,274	693,660	713,280
Operating Surplus/Shortfall	-110,180	-85,360	-53,375	-59,494	-49,767	-55,998
Interest Expense	26,906	43,241	49,112	47,086	52,877	55,521
Net Operating Balance	-137,086	-128,601	-102,487	-106,580	-102,644	-111,519

Sources: Historical - IMF, Projections - EJR

Base Case
ANNUAL BALANCE SHEETS (MILLIONS GBP)

ASSETS	Dec-09	Dec-10	Dec-11	PDec-12	PDec-13	PDec-14
Currency and Deposits (asset)	127,872	129,464	135,957	138,404	140,896	143,432
Securities other than Shares LT (asset)	29,586	36,860	44,417	45,483	46,575	47,692
Loans (asset)	46,989	52,277	57,513	58,663	59,837	61,033
Shares and Other Equity (asset)	189,912	191,633	193,672	195,733	197,815	199,920
Insurance Technical Reserves (asset)	731	702	690	704	718	732
Other Accounts Receivable LT	64,549	68,247	75,082	76,584	78,115	79,678
Monetary Gold and SDR's	15,701	18,159	19,250	20,407	21,633	22,932
Additional Assets	(41,665)	(77,619)	(71,060)			
Total Financial Assets	432,301	421,001	457,585	467,022	476,675	486,550
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	127,872	129,464	135,957	135,957	135,957	135,957
Securities Other than Shares (liability)	855,803	1,101,386	1,356,817	1,411,090	1,467,533	1,526,235
Loans (liability)	26,167	24,332	25,790	132,370	235,014	346,533
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)		1,850	2,155	2,211	2,269	2,327
Other Liabilities	26,516	28,305	29,273	(15,618)	(15,618)	(15,618)
Liabilities	1,036,358	1,285,337	1,549,992	1,666,009	1,778,306	1,899,700
Net Financial Worth	(604,057)	(864,336)	(1,092,407)	(1,198,987)	(1,301,631)	(1,413,150)
Total Liabilities & Equity	432,301	421,001	457,585	467,022	476,675	486,550

Sovereign Rating Methodology (Non-NRSRO)

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