

European Month-end Index Projections

Month-end changes supportive for Bunds

- **European Government Bond Index (EGBI):** The EGBI will extend by around 0.04 at month-end. This is historically large for the month of August. The month-end changes should be most supportive for Germany and least supportive for France. This is largely because Germany was the biggest issuer this month, even after adjusting for market-cap.
- **Curve split:** We expect index changes to be supportive for the 10yr sector of Italy. The changes should also put flattening pressure on 2s10s part of the BTP curve.
- **Update on EMU inflation-linked index changes:** There was no change to the composition of the index during the fixing month. Therefore, the modified duration of the EMU ILSI index will remain unchanged at month-end.

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Figure 1. EGBI: Projected month-end duration change

| EGBI Effective Duration | | | Largest Duration changes over last year | | |
|-------------------------|---------------|---------------------|-----------------------------------------|---------|-------------------------|
| Aug Index | Sep Index (e) | Duration Change (e) | Minimum | Maximum | Average Absolute Change |
| 6.38 | 6.41 | 0.037 | 0.01 | 0.15 | 0.06 |

Source: Citi Research

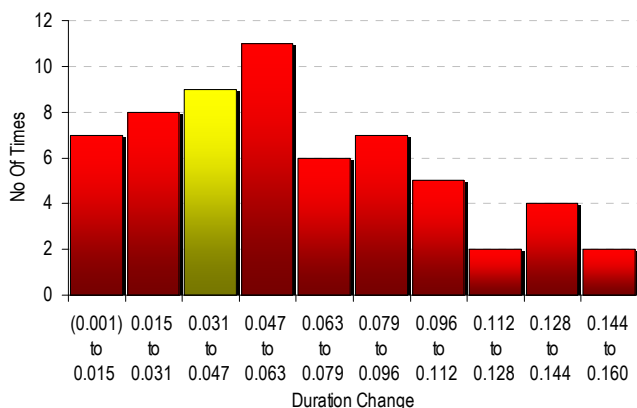
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EGBI changes supportive for Bunds

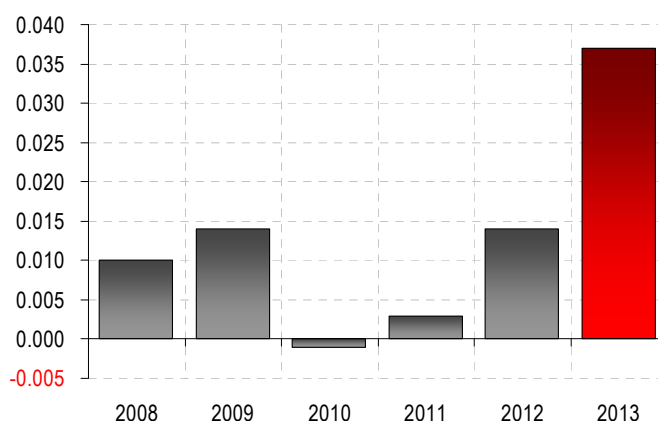
We project the effective duration of the EGBI to increase by 0.037 at the end of August (Figure 1)¹. This change will be the largest August change in the last 6 years (Figure 3).

Figure 2. Five-year distribution of month-end EGBI changes



Source: Citi Research

Figure 3. End-August EGBI changes over the last 5 years



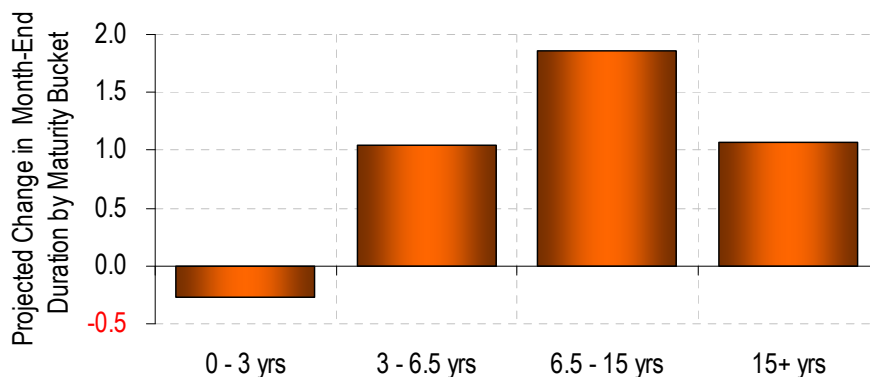
Source: Citi Research

Curve breakdown of projected August EGBI changes

Support for the 10yr sector

The curve breakdown of the projected weighted duration changes points to support for the 10yr sector. The changes should put flattening pressure on 2s10s (Figure 4).

Figure 4. End-August Projected Index Changes by Curve Sector (Weighted Duration)



Source: Citi Research

Bonds dropping out of the EGBI at the end of August

€27bn of the BTP 4.25% Aug14 drop out of the EGBI at the end of August

Issuance over the fixing period, 26 July to 26 August, will be eligible for inclusion in the index at the end of August. On the other hand, bonds that fall below 1 year of residual maturity on the last calendar day of the month are excluded from the index. The only bond dropping out of the EGBI this month is BTP 4.25% Aug14 (€27.25bn).

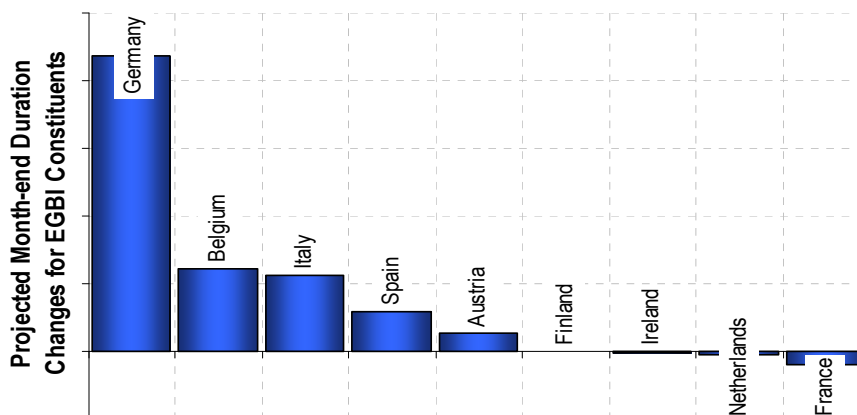
¹ Based on Citi supply estimates. Supply is the main driver of duration projections, but other factors, e.g., yield level and curve shape, also affect the calculations and are subject to change.

Projected changes very supportive for Germany

Projected changes very supportive for Germany

Figure 5 shows that at a country level, Germany is in line to benefit the most from the projected index extensions. This is largely because Germany was the biggest issuer this month, even after adjusting for market-cap. Weighted-duration changes should be marginally negative for France.

Figure 5. Germany likely to benefit the most from end-August changes (weighted duration)



Source: Citi Research

Significant duration extension projected in Italy GBI

Detailed analysis of the changes

Figure 6 shows detailed analysis of end-August EGBI changes. Among the individual country indices that make up the EGBI, we expect the Italian index to extend by its second largest amount in a year. To the extent that domestic Italian investors move to match this benchmark this should provide some support for BTPs at the margin.

For EGBI portfolios, it is the weighted duration change that is most relevant². On this metric, Germany is projected to extend the most.

Figure 6. Breakdown of end-August EGBI projections

| 22-Aug-13 | Aug Index | | Sep Index* | | Projected Change | | | Duration change range over last year (unweighted) | | | | |
|-------------|------------------|----------|-------------------|----------|---------------------------|---------------|-----------------|---------------------------------------------------|------|-------------------------|----------------------|--------------------------|
| | % weight in EGBI | Duration | % weight in Index | Duration | Weighted Dur Change X 100 | Weight Change | Duration Change | -ve | +ve | Average Absolute Change | Duration 5yr Z-Score | Weighted Dur 5yr Z-Score |
| | | | | | | | | | | | | |
| Germany | 20.6 | 6.70 | 20.9 | 6.71 | 2.18 | 0.30 | 0.01 | (0.05) | 0.13 | 0.06 | (0.93) | 0.83 |
| Italy | 23.1 | 6.06 | 22.7 | 6.20 | 0.57 | (0.43) | 0.14 | 0.00 | 0.17 | 0.07 | 1.01 | (0.63) |
| France | 23.9 | 6.69 | 23.9 | 6.69 | (0.10) | (0.01) | 0.00 | (0.04) | 0.17 | 0.07 | (0.80) | (0.97) |
| Spain | 12.0 | 5.48 | 12.0 | 5.47 | 0.30 | 0.08 | (0.01) | (0.06) | 0.17 | 0.07 | (0.61) | (0.85) |
| Belgium | 6.5 | 6.65 | 6.5 | 6.67 | 0.61 | 0.06 | 0.03 | (0.04) | 0.36 | 0.07 | (0.32) | 0.36 |
| Netherlands | 6.4 | 6.79 | 6.4 | 6.79 | (0.03) | (0.00) | 0.00 | (0.10) | 0.36 | 0.08 | (0.45) | (0.76) |
| Ireland | 1.9 | 5.28 | 1.9 | 5.28 | (0.01) | (0.00) | 0.00 | (0.03) | 0.35 | 0.05 | (0.18) | (0.39) |
| Austria | 4.1 | 6.90 | 4.1 | 6.91 | 0.13 | 0.01 | 0.01 | (0.04) | 0.62 | 0.13 | (0.37) | (0.20) |
| Finland | 1.6 | 6.11 | 1.6 | 6.11 | (0.01) | (0.00) | 0.00 | (0.03) | 0.55 | 0.10 | (0.53) | (0.46) |

Source: Citi Research

*Projected

² Weighted duration of a country is calculated as (market value of that country) * (effective duration) / (total market value of the EGBI). This is very significant for an EGBI portfolio as he will try to keep it unchanged through rebalancing at the month-end (within the bounds of his mandate).

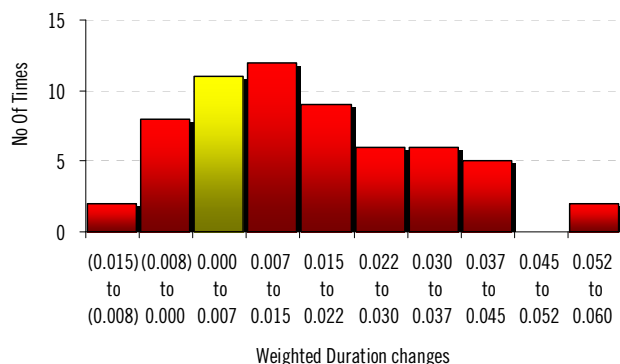
Putting projected country changes in perspective

Support for 10yr Italy

Below we show the distributions of weighted duration changes and the curve splits of the projected changes. As the 5yr distributions show (charts on the left below), projected changes at the end of August are generally close to median.

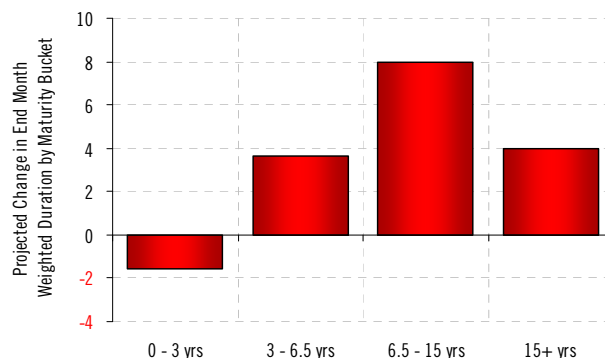
Looking at the curve split (charts on the right) we expect index changes to be supportive for 10yr Italy. The changes should also put flattening pressure on 2s10s Italy.

Figure 7. Italy: Distribution of month-end duration changes over the last five years (weighted duration)



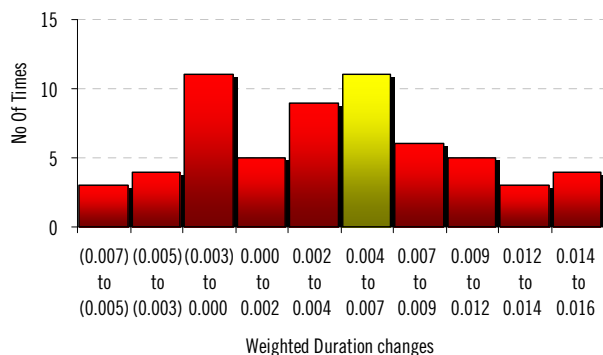
Source: Citi Research

Figure 8. Italy: Maturity split of projected index changes (weighted duration)



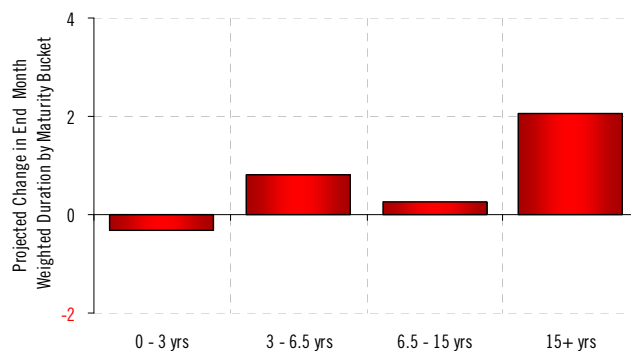
Source: Citi Research

Figure 9. Belgium: Distribution of month-end duration changes over the last five years (weighted duration)



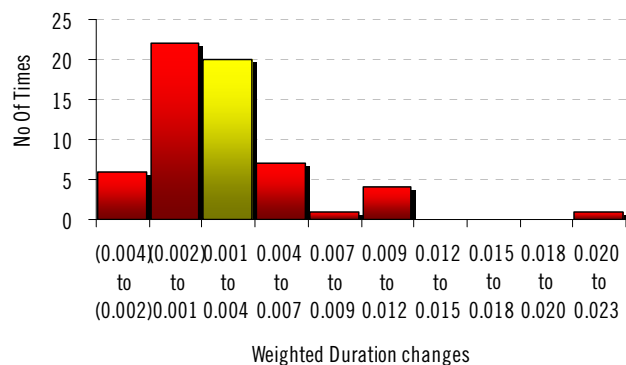
Source: Citi Research

Figure 10. Belgium: Maturity split of projected index changes (weighted duration)



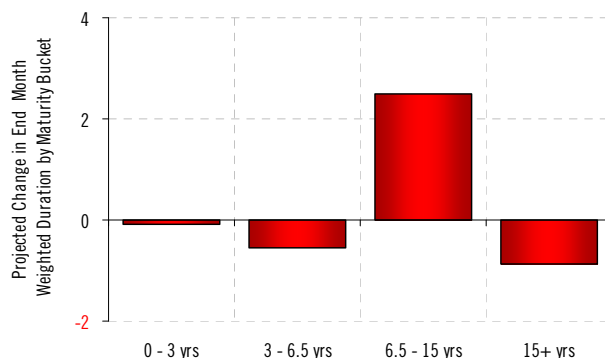
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Figure 11. Austria: Distribution of month-end duration changes over the last five years (weighted duration)



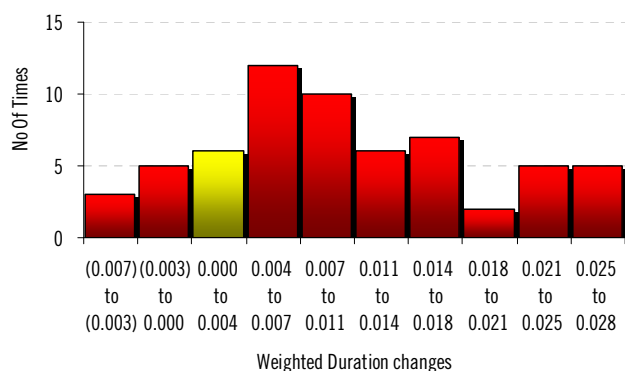
Source: Citi Research

Figure 12. Austria: Maturity split of projected index changes (weighted duration)



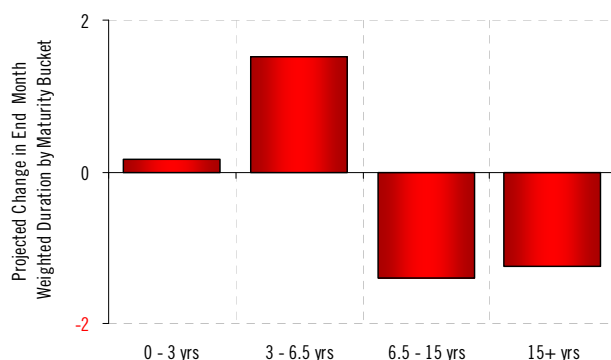
Source: Citi Research

Figure 13. Spain: Distribution of month-end duration changes over the last five years (weighted duration)



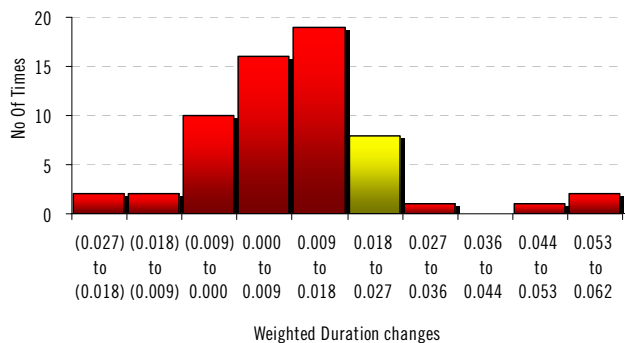
Source: Citi Research

Figure 14. Spain: Maturity split of projected index changes (weighted duration)



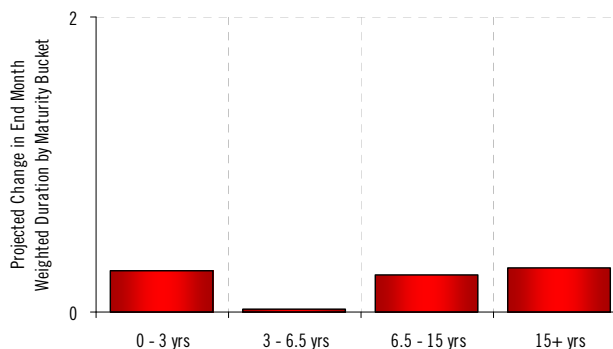
Source: Citi Research

Figure 15. Germany: Distribution of month-end duration changes over the last five years (weighted duration)



Source: Citi Research

Figure 16. Germany: Maturity split of projected index changes (weighted duration)



Source: Citi Research

Appendix A-1

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