

European Month-end Index Projections

Support for peripheries and Austria

- **European Government Bond Index (EGBI):** We expect the EGBI to extend by 0.11 at the end of January, its largest extension since last January.
- **EGBI curve:** The extension is most supportive for the 10 and 30yr sectors.
- **Individual country impact:** Italy, Austria and Spain are in line to receive the most support from mechanical month-end rebalancing flows. Austria's extension is its largest in the last 5 years.
- **Potential impact on domestic curves:** The projected changes are largely supportive for the long-end. In particular, the changes should support 30yr Netherlands and Austria, and 10yr Germany, France and Belgium.
- **Positioning recommendations based on projected index changes:**
 - Long Spain 10yr, or vs 2yr
 - Netherlands 10s30s flattener

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Figure 1. EGBI: Projected month-end duration change

EGBI Effective Duration			Largest Duration changes over last year		
Jan Index	Feb Index (e)	Duration Change (e)	-ve	+ve	Average Absolute Change
6.43	6.54	0.11	0.01	0.14	0.06

Source: Citi Research

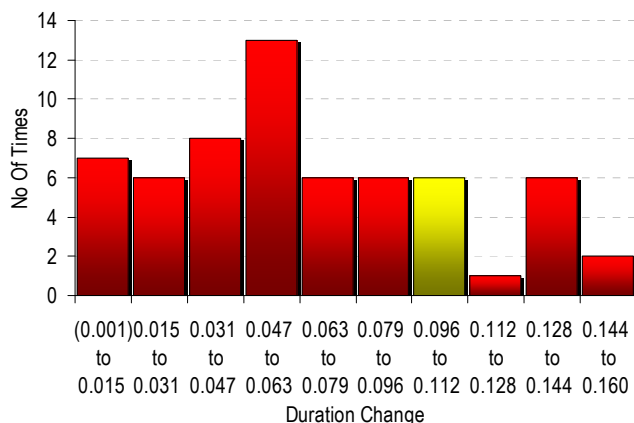
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Projected EGBI Changes

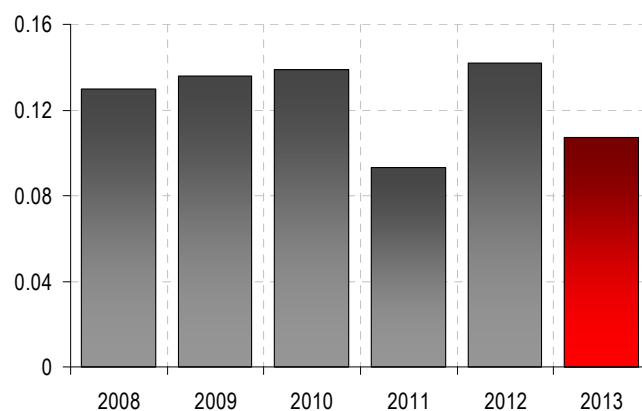
We project the EGBI to extend by 0.11 at the end of January¹, its largest extension since January last year. January extensions always tend to be large however.

Figure 2. Five-year distribution of month-end EGBI changes shows significant extension this month



Source: Citi Research

Figure 3. But it is in line with previous end-of-January extensions



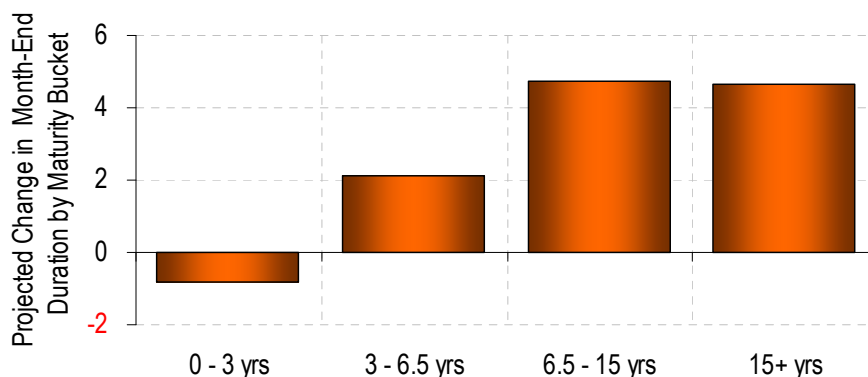
Source: Citi Research

Curve breakdown of projected January EGBI changes

Flattening pressure from long end support and absence of support for the front end

We expect support for the 10 and 30yr areas of the curve, which should exert some flattening pressure at the margin (Figure 5).

Figure 5. End-January Projected Index Changes by Curve Sector (Weighted Duration)



Source: Citi Research

Figure 4. Bonds dropping out of the EGBI at the end of January

Country	Bond	Outstanding Amount (€ bn)
Germany	Bund 4.25% Jan14	24
France	BTAN 2.5% Jan14	28
Ireland	Gilt 4% Jan14	8
Netherlands	DSL 1% Jan14	15
Total		74

Source: Citi Research

4 bonds drop out of the EGBI at the end of January

€74bn of bonds will drop out of the EGBI as their residual maturity falls below 1 year as of the last calendar day of the month (Figure 4). These bonds are in Germany, France, Ireland and the Netherlands.

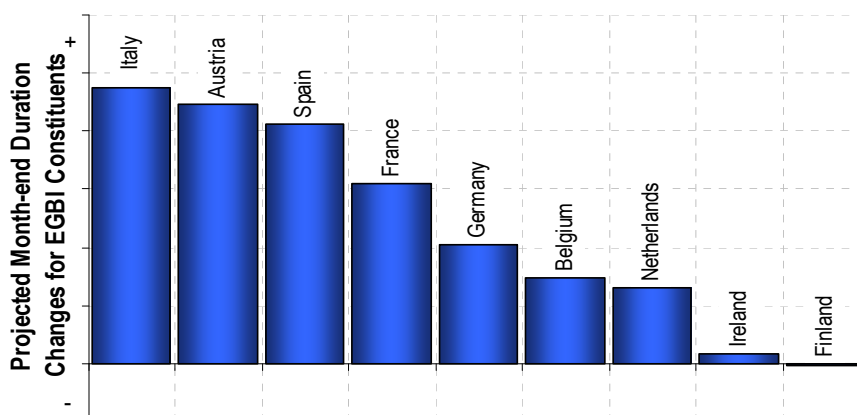
¹ Based on Citi supply estimates. Supply is the main driver of duration projections, but other factors, e.g., yield level and curve shape, also affect the calculations and are subject to change.

Projected changes most supportive for Italy, Spain and Austria

Projected changes most supportive for Italy

As Figure 6 shows, Italy and then Spain stand to benefit the most from month-end rebalancing flows in peripheral space. In the core, the main beneficiary should be Austria, followed by France.

Figure 6. End-January projected weighted duration changes supportive of Italy, Austria and Spain



Source: Citi Research

Austria to extend by its largest in 5yrs

On an *unweighted* duration basis, Austria, Ireland and the Netherlands are projected to extend the most within the EGBI. The large extension in Austria is largely due to the RAGB 3.8% Jan62 becoming eligible for the index².

For investors tracking the EGBI, however, it is the weighted duration change that matter, and on this basis Italy, Austria and Spain are projected to extend the most. The extension in Austria is the largest in the last 5 years (Figure 11) and with a z-score of 5.5.

The increase in the weighted duration of Italy and Spain is mainly due to increases in their weight within the index rather than an increase in their duration (Figure 7).

Figure 7. Breakdown of end-January EGBI projections

22-Jan-13	Jan Index		Feb 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	21.6	6.82	21.3	6.95	1.03	(0.25)	0.13	(0.05)	0.13	0.07	1.03	0.01
Italy	22.9	6.15	23.2	6.16	2.37	0.33	0.01	(0.02)	0.18	0.08	(0.88)	0.45
France	24.1	6.78	23.8	6.93	1.54	(0.28)	0.14	(0.04)	0.16	0.07	1.22	(0.03)
Spain	10.8	5.27	11.2	5.27	2.07	0.39	0.00	(0.06)	0.16	0.07	(0.49)	1.30
Belgium	6.5	6.84	6.6	6.87	0.74	0.07	0.03	(0.04)	0.44	0.09	(0.26)	0.51
Netherlands	6.6	6.75	6.4	7.10	0.65	(0.23)	0.35	(0.10)	0.36	0.09	2.21	0.32
Ireland	1.9	5.13	1.8	5.48	0.08	(0.11)	0.36	(0.02)	0.51	0.05	1.43	(0.22)
Austria	4.2	6.66	4.3	7.05	2.23	0.09	0.39	(0.04)	0.62	0.07	2.85	5.48
Finland	1.5	5.81	1.5	5.81	(0.01)	(0.00)	0.00	(0.03)	0.45	0.09	(0.46)	(0.46)

Source: Citi Research

*Projected

² The RAGB 62s crossed the eligibility threshold of €2.5bn for EGBI with a €0.55bn tap on 8 January.

Summary of pressures on individual country curves from the projected index changes

Summary of pressures on individual country curves³

Figure 8 summarises the pressures on individual country curves from the projected index changes. Green arrows indicate support for prices relative to other points on the respective domestic curves (and red arrows point to downward price pressure). Double arrows indicate particularly strong pressure on that part of the domestic curve. White/transparent arrows indicate weaker price pressures. The underlying detail is shown below in Figure 9 to Figure 22.

Figure 8. Summary of price pressures on individual domestic curves

	2yr	5yr	10yr	30yr	
Germany			↑		Germany
Netherlands				↑↑	Netherlands
France			↑		France
Austria				↑↑	Austria
Belgium			↑	↑↓	Belgium
Spain			↑	↑↓	Spain
Ireland	↓	↑↑	↑↑		Ireland
	2yr	5yr	10yr	30yr	

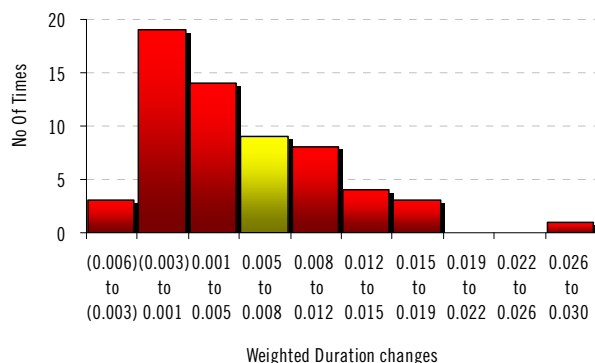
Source: Citi Research

Support on domestic curves:
- 30yr Netherlands and Austria
- 10yr Germany, France and Belgium

Putting projected country changes in perspective

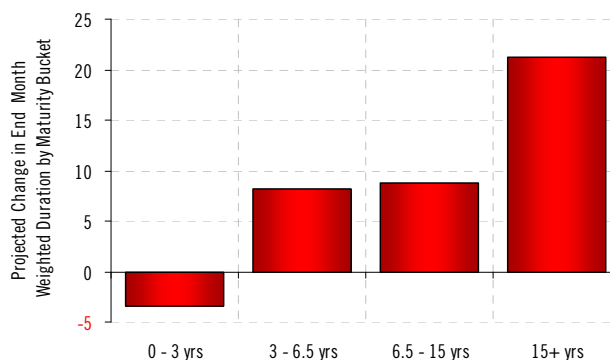
Below we show the distributions of weighted duration changes and the curve splits of the projected changes. From a historical perspective, the extension in Austria is the most notable (Figure 11). The projected changes are mainly supportive for the long-end, in particular, 30yr Netherlands and Austria. Projected changes should also support 10yr Germany, France and Belgium and the belly of the Irish curve.

Figure 9. Netherlands: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



Source: Citi Research

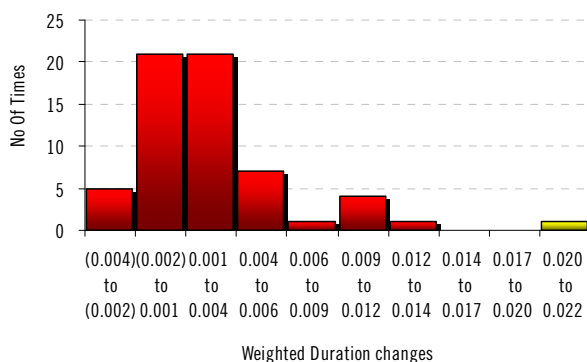
Figure 10. Netherlands: Maturity split of projected index changes (weighted duration) shows potential 10s30s flattening pressure



Source: Citi Research

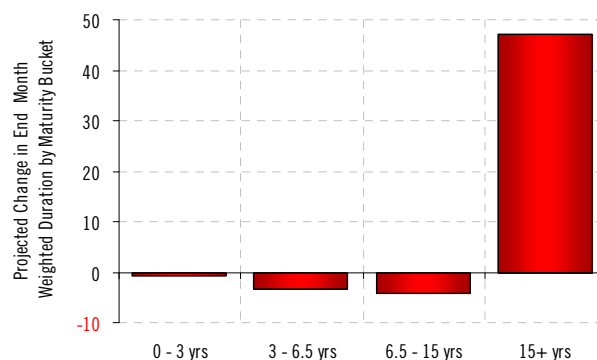
³ Note that all these changes are on the domestic curve only, and should not be viewed as necessarily indicating cross-market opportunities.

Figure 11. Austria: Largest Weighted Duration change in 5 years



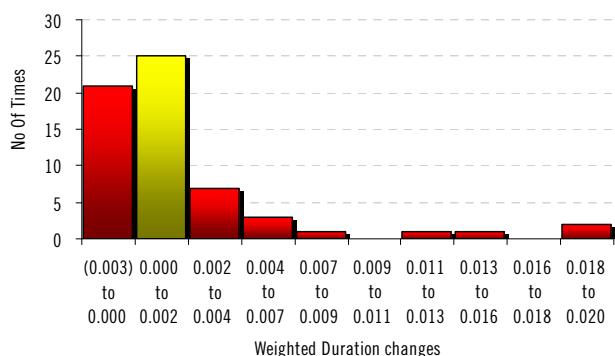
Source: Citi Research

Figure 12. Austria: End-January extension largely concentrated in the long-end



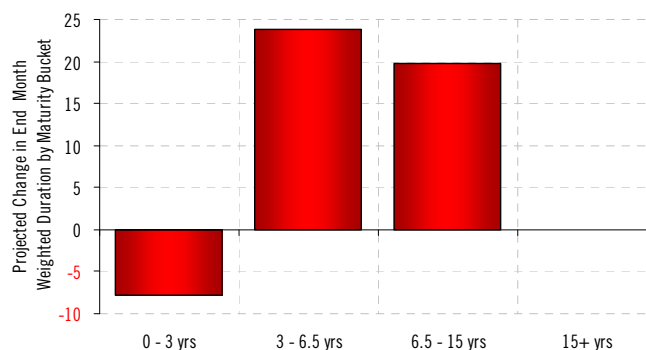
Source: Citi Research

Figure 13. Ireland: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



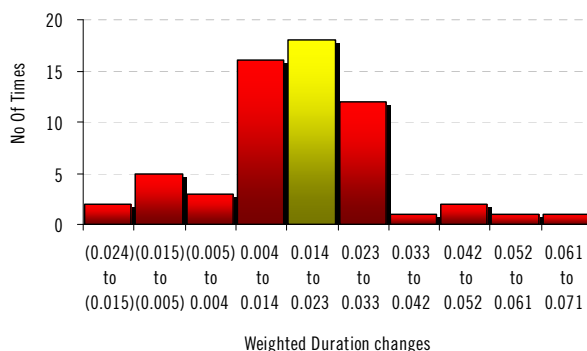
Source: Citi Research

Figure 14. Ireland: Support for the belly of the curve



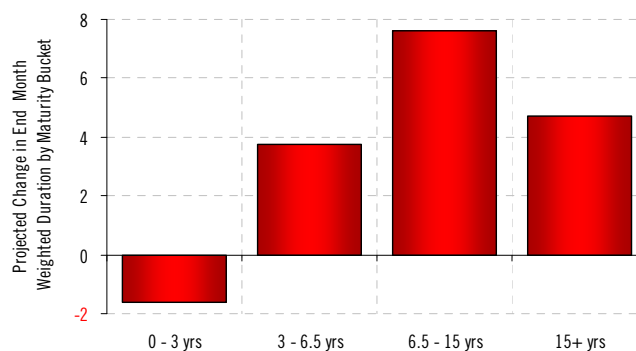
Source: Citi Research

Figure 15. France: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



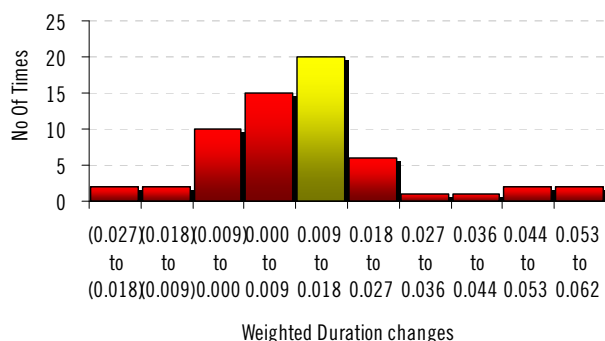
Source: Citi Research

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



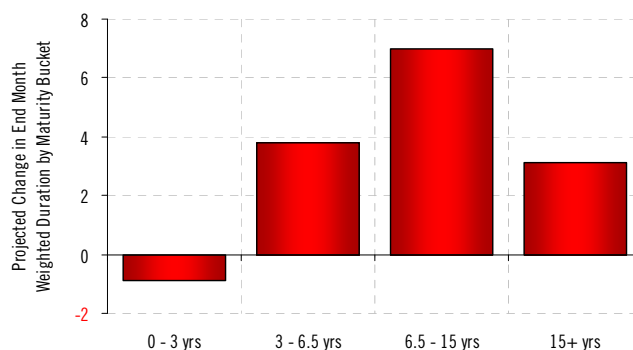
Source: Citi Research

Figure 17. Germany: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



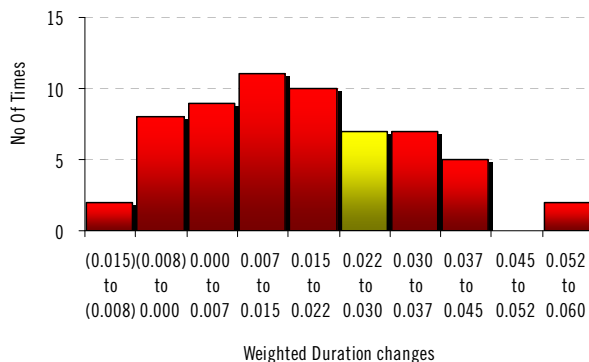
Source: Citi Research

Figure 18. Germany: Maturity split of projected index changes (weighted duration)



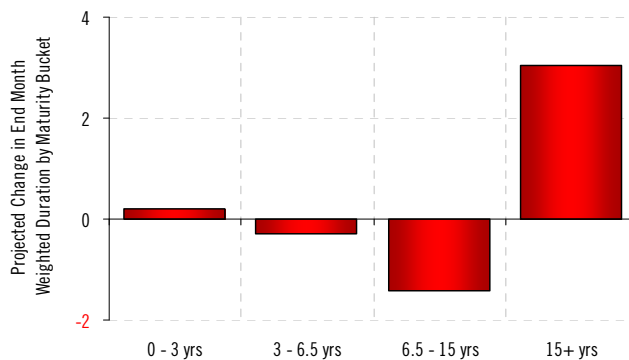
Source: Citi Research

Figure 19. Italy: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



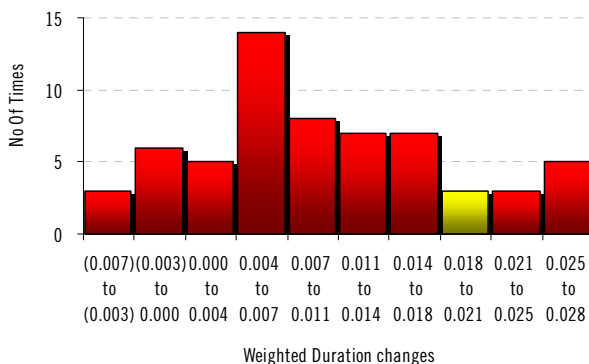
Source: Citi Research

Figure 20. Italy: Maturity split of projected index changes (weighted duration)



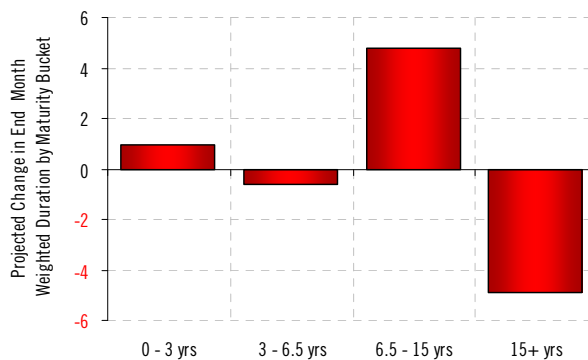
Source: Citi Research

Figure 21. Spain: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



Source: Citi Research

Figure 22. Spain: End-January Projected Index Change by Maturity (Weighted Duration)



Source: Citi Research

Trades supported by month-end changes

1. Spain: Long 10yr or vs 2s

We still see 2s10s flatteners as the most positively convex way to position in the current environment (Figure 23).

- a. Index changes point to support for the 10yr sector in Spain (Figure 22).
- b. Healthy demand for the 10yr syndication this week indicates investors confidently moving out along the curve in search of yield. As we highlighted in our latest publication ([European Rates Weekly - Spain – what happens next?](#)), the short-term balance of risks points towards a continuation of the risk-on rally, with yield-hungry investors chasing the market and helping the rally feed on itself. While good news should see 10yr led flattening, bad news should see front-end led flattening (which is likely to be amplified by positioning).
- c. The supply schedule also points towards flattening pressure at the margin with 2-5yr issuance expected on 7 February, but no 10yr issuance until 21 February.

2. The Netherlands: 10s30s flattener

The projected index changes should be supportive of the long-end of the DSL curve (Figure 10). The historical steepness of 10s30s offers investors (with a bearish view) an attractive opportunity to initiate flatteners (Figure 24).

With the 30yr DSL supply out of the way this should be supportive of flattening pressure on DSL 10s30s. The 30yr Bund auction on 30 January should also help the Dutch curve flatten relative to Germany.

Figure 23. Spain 2s10s (%)



Source: Citi Research

Figure 24. Netherlands 10s30s (bps) is historically steep



Source: Citi Research

Appendix A-1

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