

## Month-End Index-Linked Index Projections

### EMU, US And UK Inflation Indices All Extend At Month-End

- **EMU ILSI** – The EMU ILSI is projected to extend by its largest in three years at the end of this month. The most significant extension is in France.
- **World ILSI** – Both the US and UK indices are expected to extend at month-end. The changes should be supportive for 10yr TIPS and 30yr IL gilts.

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## End-July Inflation Linked Index Projection

The EMU ILSI index is expected to extend by the largest amount in three years at the end of this month. The most significant extension is in France. Within the World ISLI, both the TIPS and IL Gilt indices are expected to extend, with little impact due to Operation Twist. The changes are expected to be supportive for 10yr TIPS and 30yr IL gilts.

### July Compositional Change in the World ILSI Index

Within EMU-11 this month,<sup>1</sup> there was supply from Italy (€0.63bn of BTPei 2.1% Sep16), France (€1.25bn across OATi19, OATei22, OATei40) and Germany (€1bn of Bundeis 0.1% Apr23). Also, the Italian Tesoro bought back 4 index-linked bonds in exchange for BTP May17. The UK DMO issued three IL gilts this month: £1.37bn of IL gilt 0.125% 2029, £0.93bn of IL gilt 0.5% 2050 and £4bn of a new 0.125% 2044 (via syndication). The only TIPS issuance was a new 10-year bond (0.125% Jul22) for \$15bn. Bonds dropping out of the index are TIPS 1.875% Jul13 (\$20bn) and OATi 2.5% Jul13 (€15.7bn).

### Projected end-July change in the EMU ILSI Index

We expect the duration of the EMU ILSI to extend by its largest in three years at the end of July (Figure 1).

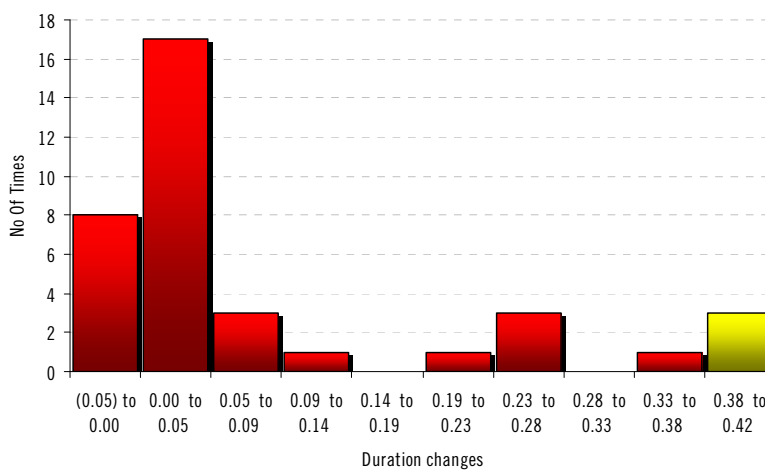
Figure 1. EMU ILSI: Projected End-July Change due to compositional change

EMU ILSI Duration			Largest absolute Duration changes over last year		
End Jun	End Jul(e)	Duration Change(e)	-ve	+ve	Average Absolute Change
7.65	8.07	0.42	-0.05	0.42	0.10

Source: Citi Research

Figure 2 shows the historical distribution of month-end changes.

Figure 2. EMU ILSI: 3-year Distribution of Month-End Duration Changes (July Change Highlighted)



Source: Citi Research

<sup>1</sup> 26 June 2012 to 25 July 2012.

EMU ILSI  
Supply from Germany, France and Italy  
Exchange Auction by Italy Tesoro  
OATi13 dropping out of the index

Largest extension in the last 3 years

## Country breakdown of end-July EMU ILSI projection

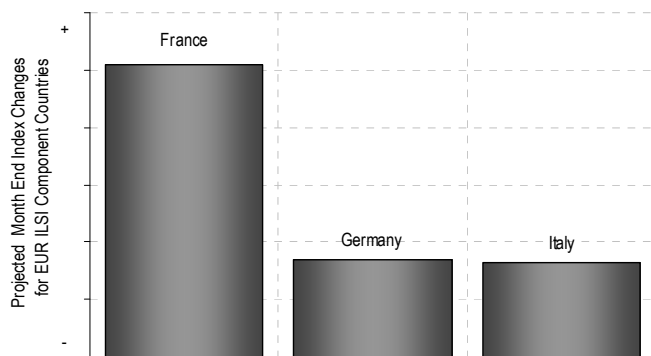
### Index changes supportive for French linkers at the margin

Despite a fall in its country weight, France is projected to extend the most amongst EMU countries, largely due to OATi13 dropping out of the index (Figure 3).

The exchange auction conducted by Italian Tesoro on 25 July is expected to result in a duration reduction of 0.04years for the BTPEi index.

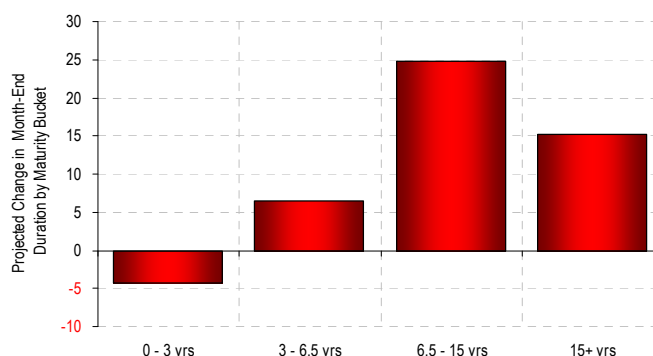
In terms of the maturity split, the weighted duration changes are greatest in the 10yr sector of the curve (Figure 4).

Figure 3. End-July Projected Index Changes by Country (Weighted Duration)



Source: Citi Research

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



Source: Citi Research

Figure 5 shows the detailed breakdown of the projected end-July duration and index weight changes by country. Looking at unweighted changes (for domestic portfolio holders), France is projected to extend the most in three years.

Figure 5. End-July EMU ILSI Projections

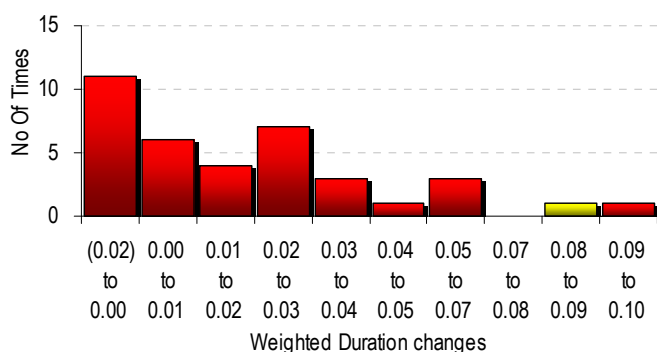
25-Jul-12	End of Jun - Actual		End of Jul - Projected		Projected Change			Largest absolute duration changes over last year (unweighted)			
	% weight in Index	Duration	% weight in Index	Duration	Weighted Dur Change X 100	Weight Change	Duration Change	-ve	+ve	Average Absolute Change	Percentile
Germany	14.7	5.87	15.9	5.97	8.40	1.18	0.10	(0.01)	1.06	0.13	83
Italy	28.1	7.15	29.5	7.10	8.23	1.41	(0.06)	(0.13)	0.81	0.11	8
France	57.1	8.35	54.6	9.20	25.52	(2.53)	0.86	(0.08)	0.86	0.10	100

Source: Citi Research

## Historical distribution and changes on the curve

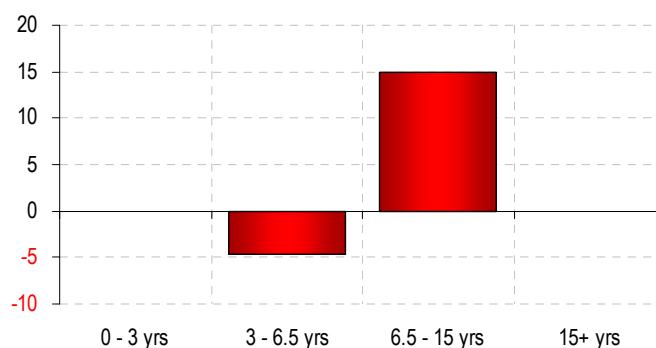
Figure 6 to Figure 11 show the distributions of weighted duration changes and the curve splits of the projected changes. The changes in all the three country indices are large by historical comparison.

**Figure 6. Germany: Distribution of Month-End Duration Changes Over The Last Three Years (Weighted Duration)**



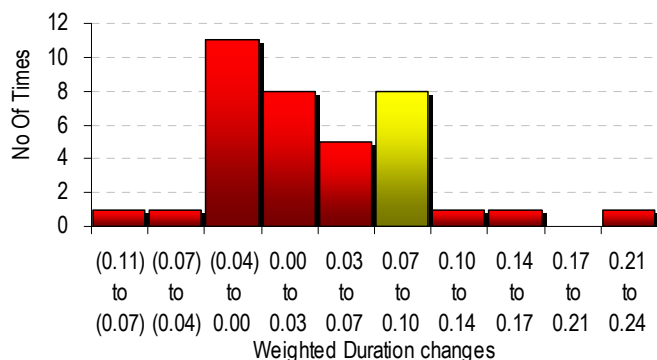
Source: Citi Research

**Figure 7. Germany: End-July Projected Index Change by Maturity (Weighted Duration)**



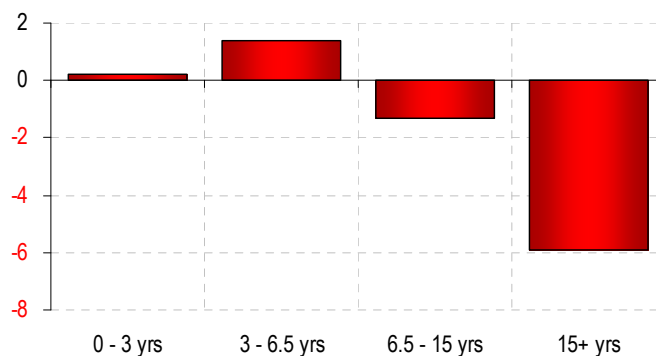
Source: Citi Research

**Figure 8. Italy: Distribution of Month-End Duration Changes Over The Last Three Years (Weighted Duration)**



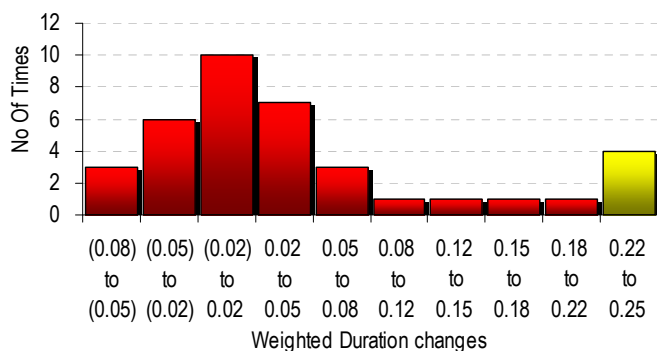
Source: Citi Research

**Figure 9. Italy: End-July Projected Index Change by Maturity (Weighted Duration)**



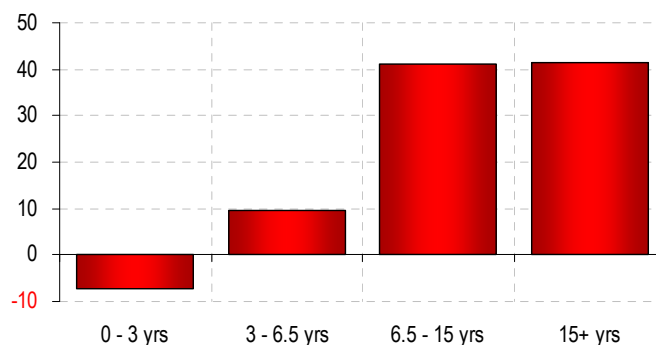
Source: Citi Research

**Figure 10. France: Distribution of Month-End Duration Changes Over The Last Three Years (Weighted Duration)**



Source: Citi Research

**Figure 11. France: End-July Projected Index Change by Maturity (Weighted Duration)**

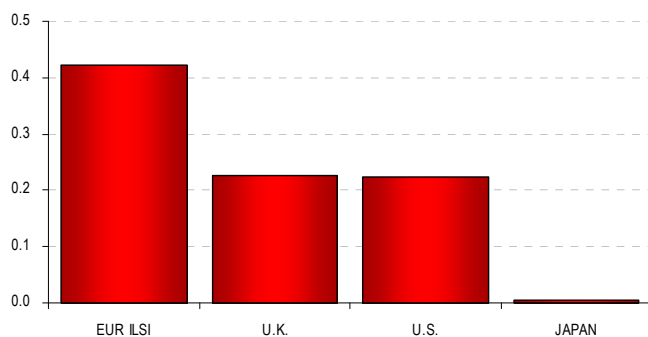


Source: Citi Research

## End-July World ILSI projection

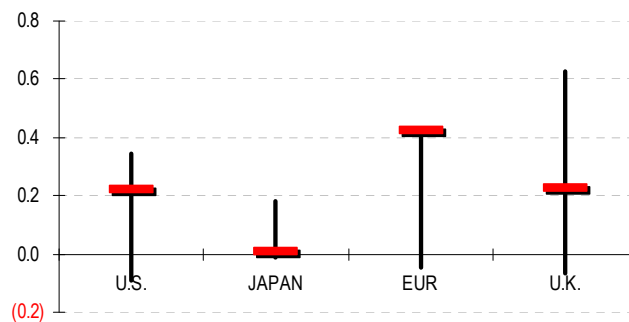
Within the World ILSI, both TIPS and IL gilt indices are projected to extend at month-end, though the extension is smaller than the EMU counterpart (Figure 12 and Figure 13).

Figure 12. Projected End-July Duration Changes for World ILSI Components



Source: Citi Research

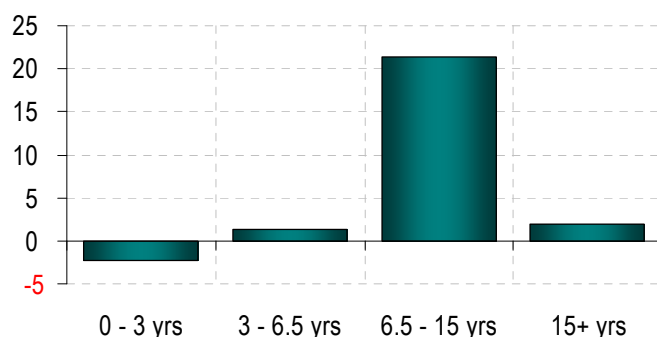
Figure 13. Projected Duration Changes vs 12-Month Range



Source: Citi Research

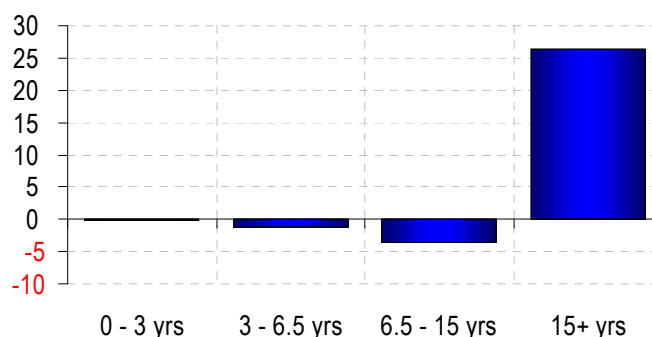
Looking at the curve breakdown of individual countries, the changes should be supportive for 10yr TIPS and 30yr index-linked gilts (Figure 14 and Figure 15).

Figure 14. US: End-July Projected Index Change by Maturity (Weighted Duration)



Source: Citi Research

Figure 15. UK: End-July Projected Index Change by Maturity (Weighted Duration)



Source: Citi Research

Figure 16 shows the projected index changes for Europe, Japan<sup>2</sup>, US and UK components of the World ILSI.

Figure 16. End-July World ILSI Projections

25-Jul-12	End of Jun - Actual		End of Jul - Projected		Projected Change						Largest absolute duration changes over last year (unweighted)		
					Overall		due to compositional change		due to Central Bank Operations				
	% weight in Index	Duration	% weight in Index	Duration	Weight Change	Duration Change	Weight Change	Duration Change	Weight Change	Duration Change	Average Absolute Change	-ve	+ve
EUR ILSI	20.9	7.645	20.1	8.067	(0.86)	0.42	(0.88)	0.42	0.02	0.00	0.10	(0.05)	0.42
JAPAN	1.0	5.051	1.0	5.057	(0.02)	0.01	0.01	0.00	(0.03)	0.01	0.02	(0.01)	0.18
U.S.	47.8	8.756	47.8	8.979	(0.06)	0.22	(0.01)	0.24	(0.05)	(0.02)	0.11	(0.09)	0.35
U.K.	28.4	17.145	29.3	17.371	0.92	0.23	0.86	0.23	0.05	0.00	0.16	(0.07)	0.63

Source: Citi Research

<sup>2</sup> We have estimated BoJ buybacks by taking an average of the last three month purchases. The actual index change will depend on the issues purchased.

## Appendix A-1

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