

Developed Market Rates

19 October 2011 | 11 pages

Global Month-End Index Projections

End-Oct 2011 EGBI and WGBI Projections

- **EGBI:** We project a slightly above average extension in the effective duration of the EGBI at the end of October. The projected index changes should be supportive for the 10-year sector. On a country level, Germany should receive the most support from weighted duration increase, followed distantly by Italy, France, Spain and the Netherlands.
- **EMU AAAs:** Significant support for Germany; support for belly of the French curve. The changes also suggest bear-steepening pressure on the long end of the Netherlands.
- **EMU Non-AAAs:** Support for Italy and Spain; support for the 10yr sector in Spain; steepening pressure on the Italian curve.
- **WGBI:** The US component of the index should extend by only 0.01, while the UK should extend for the sixth consecutive month. The UK and US index changes will be largely driven by the central bank operations.

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	EGBI Effective Duration			Largest Duration changes over last year		
	End Sep	End Oct(e)	Duration Change(e)	-ve	+ve	Average Absolute Change
EGBI excl. Portugal and Ireland	6.31	6.37	0.063	0.00	0.16	0.06
	6.35	6.42	0.065			

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

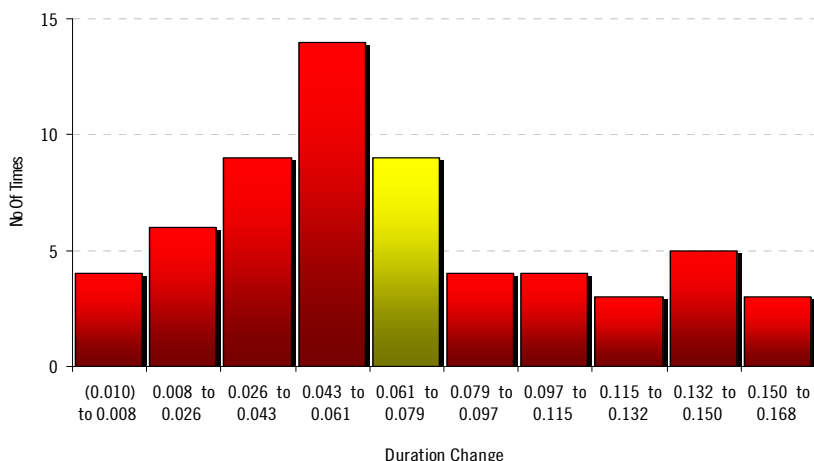
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End-October EGBI Projection

Average EGBI extension projected at the end of October

The effective duration of the EGBI should increase by 0.063 at the end of Oct¹. The change is slightly above the 1-year median (58th percentile), and close to its 5-year mean of 0.068. Figure 1 shows the five year frequency distribution of month-end changes.

Figure 1. Five Year Distribution of Month-End EGBI Duration Changes (Projected October Change Highlighted)



Source: Citi Investment Research and Analysis

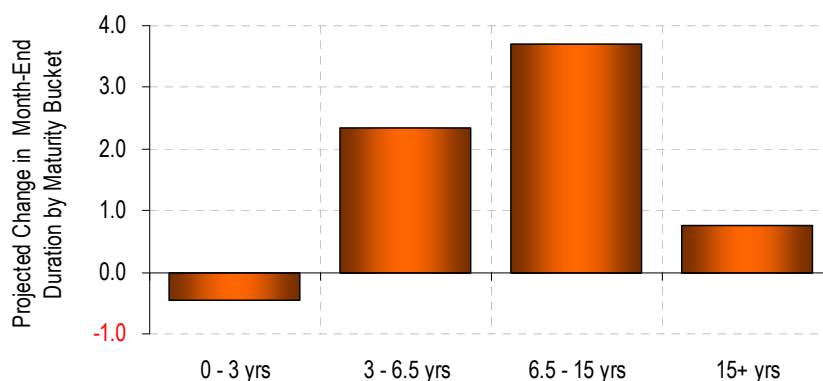
Bonds dropping out of the EGBI at the end of October

Three bonds drop out of the EGBI in the end-of-month fixing²: Bund 4.25% Oct12 (€16bn), BTP 4.25% Oct12 (€18bn) and OAT 4.75% Oct12 (€20bn).

Curve breakdown of end-Oct EGBI projection

Looking at the curve break down of the weighted duration changes, the 10-year sector stand to benefit the most from the month-end adjustments. The changes also point to a flattening pressure on the curve (Figure 2).

Figure 2. End-Oct Projected Index Changes by Curve Sector (Weighted Duration)



Source: Citi Investment Research and Analysis

¹ Please see the supply section of our weekly *International Interest Rate Strategist* for details of the estimated issuance on which this and related projections are based. Supply is the main driver of projections but other factors, e.g., yield level and curve shape, also affect the calculations and are subject to change.

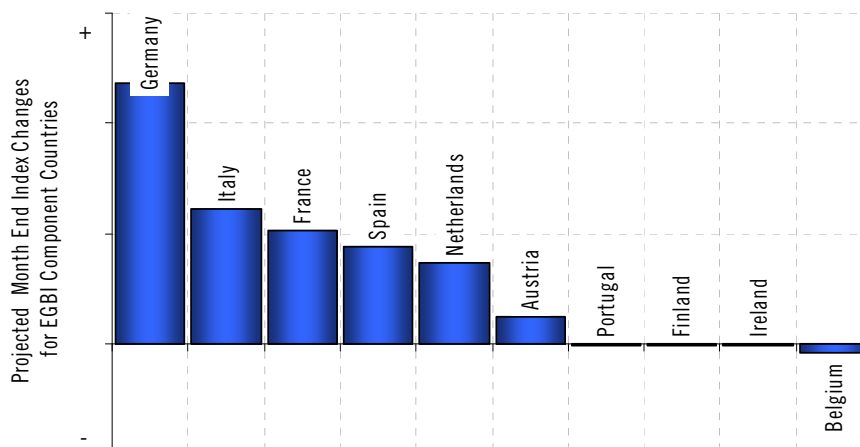
² 27 September 2011 to 25 October 2011.

Support for Germany and France but investors may allow the index changes to take them short Italy and Spain

Country breakdown of end-Oct EGBI projection

Looking at a country level, the largest duration extension is in Germany, followed by Italy, France, Spain and the Netherlands. The projected index changes should reinforce bid for Germany and be supportive for our long Bobl recommendation (please see [Euro Rates Strategy](#) for details). It should also be supportive of France, Italy and Spain.

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



Source: Citi Investment Research and Analysis

Detailed breakdown of end-Oct EGBI projections

Figure 4 shows the detailed breakdown of projected end-Oct duration and index weight changes by country.

Germany, Italy and France should have the largest duration extensions in the EGBI, but the extent should be muted by a fall in index weights of the latter two.

Figure 4. End-Oct EGBI Projections

18-Oct-11	End of Sep - Actual		End of Oct - Projected		Projected Change			Duration change range over last year (unweighted)			
	% weight in EGBI	Duration	% weight in Index	Duration	Weighted Dur Change	Weight Change	Duration Change	-ve	+ve	Average Absolute	1yr Percentile
Germany	23.0	6.540	22.9	6.649	2.36	(0.02)	0.11	(0.08)	0.20	0.08	66
Italy	21.8	5.996	21.7	6.094	1.23	(0.15)	0.10	(0.02)	0.20	0.06	75
France	23.6	6.728	23.4	6.830	1.03	(0.20)	0.10	(0.03)	0.17	0.06	66
Spain	10.3	5.782	10.5	5.757	0.87	0.20	(0.03)	(0.04)	0.28	0.07	16
Portugal	1.5	4.776	1.5	4.776	(0.02)	(0.00)	0.00	(0.08)	0.50	0.07	58
Belgium	6.1	6.016	6.1	6.016	(0.09)	(0.01)	0.00	(0.01)	0.33	0.07	16
Netherlands	6.2	6.723	6.4	6.642	0.73	0.19	(0.08)	(0.08)	0.40	0.09	0
Ireland	1.7	5.177	1.7	5.177	(0.02)	(0.00)	0.00	(0.03)	0.37	0.07	41
Austria	4.2	6.658	4.2	6.690	0.25	0.02	0.03	(0.03)	0.34	0.06	50
Finland	1.5	5.661	1.5	5.661	(0.02)	(0.00)	0.00	(0.02)	0.44	0.08	25

Source: Citi Investment Research and Analysis

Summary of expected impact on domestic curves

Pressures on individual country curves

Figure 5 summarises the pressures on individual country curves from the projected index changes. Green arrows indicate support for prices and red arrows indicate downward pressure on prices, relative to the domestic curve. Double arrows indicate strong pressure on that part of the domestic curve relative to other maturities. The underlying detail is shown in Figure 6 to Figure 17.

Projected index changes indicate support for 10-year Italy (Figure 9) and the belly of the French curve (Figure 11). The changes also suggest bear-steepening pressure on long-end Netherlands (Figure 15), and bull-flattening of 2s10s in Italy³.

Figure 5. Summary of Pressure on Prices of Individual Country Curve Sectors

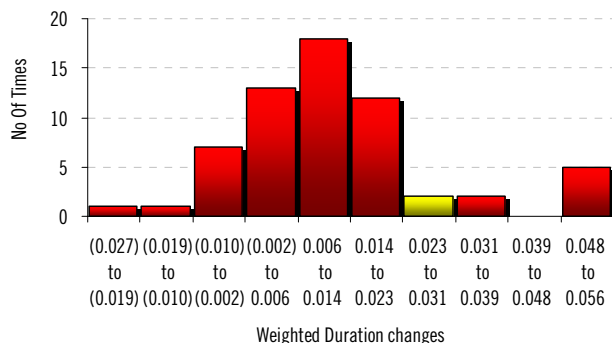
	2yr	5yr	10yr	30yr	
Germany		↑	↑	↑	Germany
France		↑	↑		France
Netherlands				↓ ↓	Netherlands
Austria				↑ ↓	Austria
Spain				↓	Spain
Italy			↑		Italy
	2yr	5yr	10yr	30yr	

Source: Citi Investment Research and Analysis

Putting projected country changes in perspective

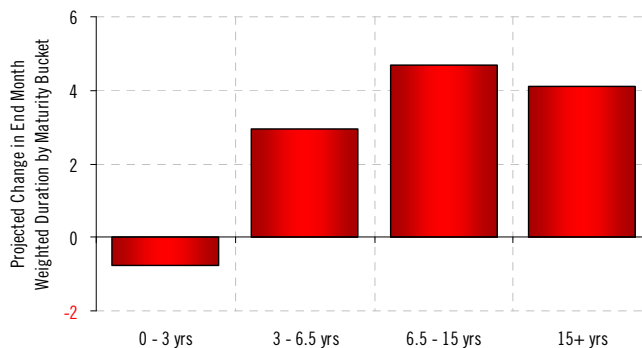
Below we show the distributions of weighted duration changes and the curve splits of the projected end-Oct changes. The most significant change from the historical perspective is evident in Germany (Figure 6) and the Netherlands (Figure 14).

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



Source: Citi Investment Research and Analysis

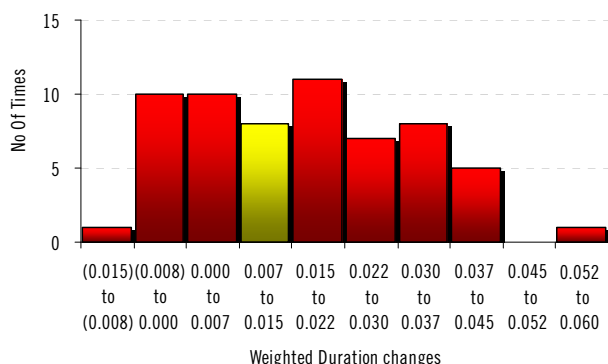
Figure 7. Germany: End-Oct Projected Index Change by Maturity (Weighted Duration)



Source: Citi Investment Research and Analysis

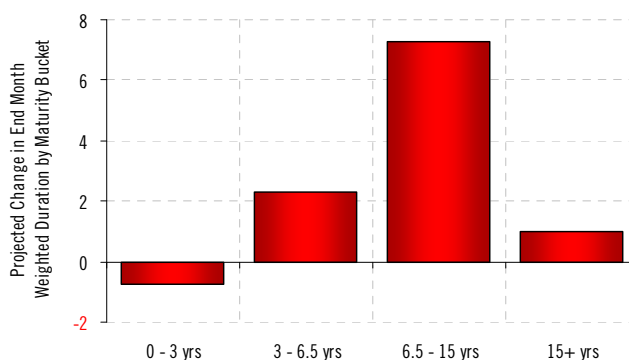
³ Note that all these changes are on the domestic curve only and should not be viewed as necessarily indicating cross-market opportunities.

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



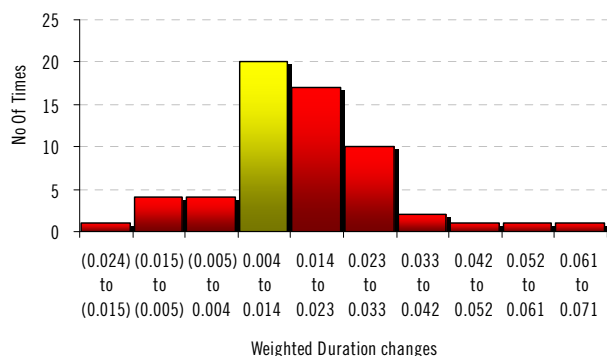
Source: Citi Investment Research and Analysis

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



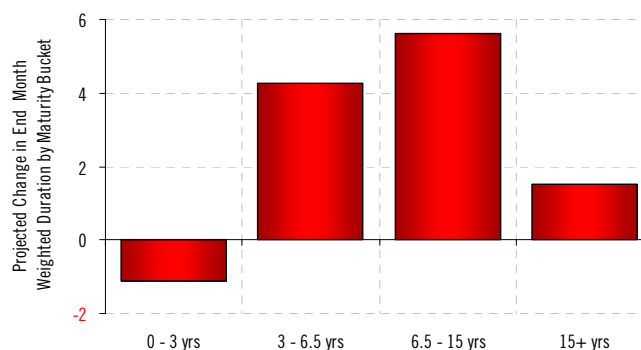
Source: Citi Investment Research and Analysis

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



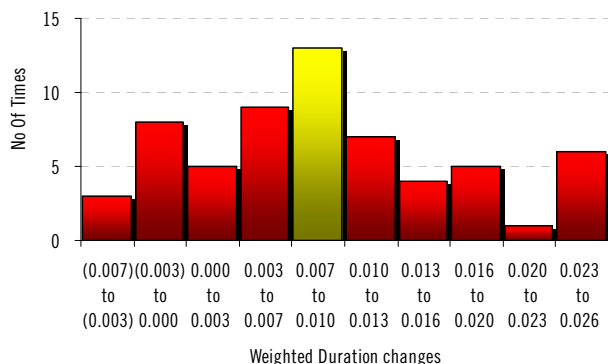
Source: Citi Investment Research and Analysis

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



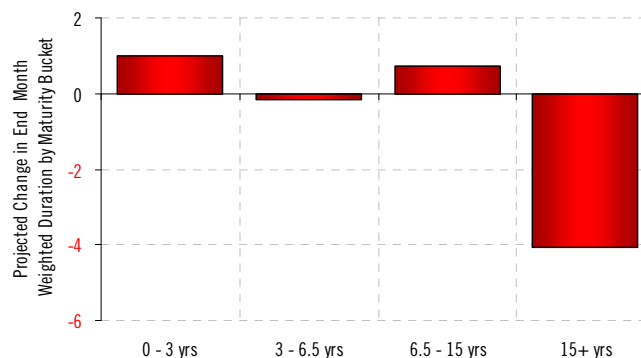
Source: Citi Investment Research and Analysis

Figure 12. Spain: Distribution of Month-End Duration Changes Over The Last Five Years



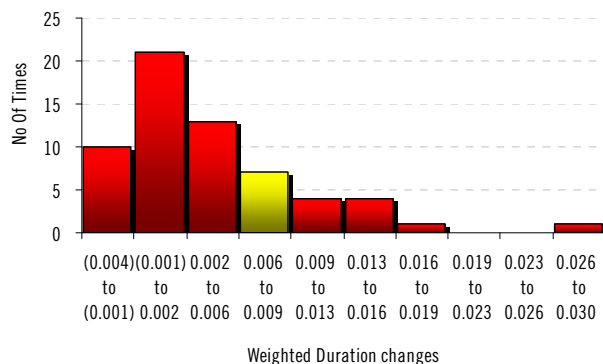
Source: Citi Investment Research and Analysis

Figure 13. Spain: End-Oct Projected Index Change by Maturity (Weighted Duration)



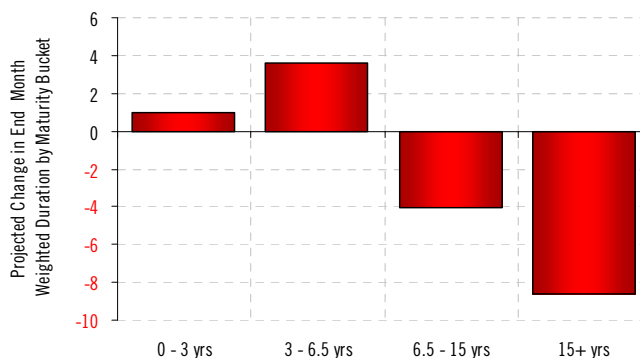
Source: Citi Investment Research and Analysis

Figure 14. Netherlands: Distribution of Month-End Duration Changes Over The Last Five Years (Weighted Duration)



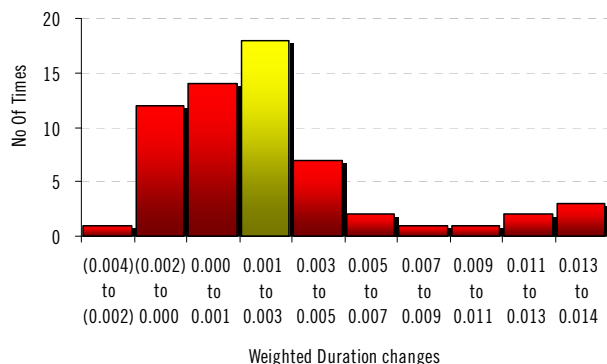
Source: Citi Investment Research and Analysis

Figure 15. Netherlands: End-Oct Projected Index Change by Maturity (Weighted Duration)



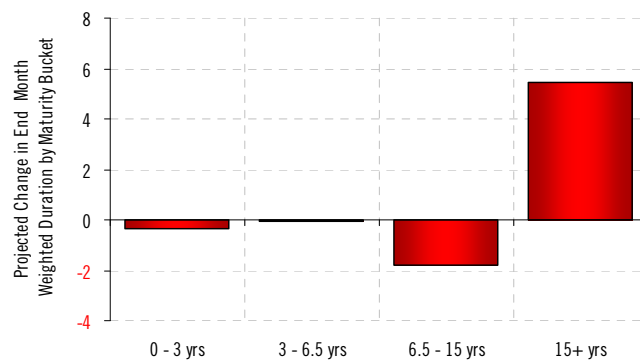
Source: Citi Investment Research and Analysis

Figure 16. Austria: Distribution of Month-End Duration Changes Over The Last Five Years



Source: Citi Investment Research and Analysis

Figure 17. Austria: End-Oct Projected Index Change by Maturity (Weighted Duration)

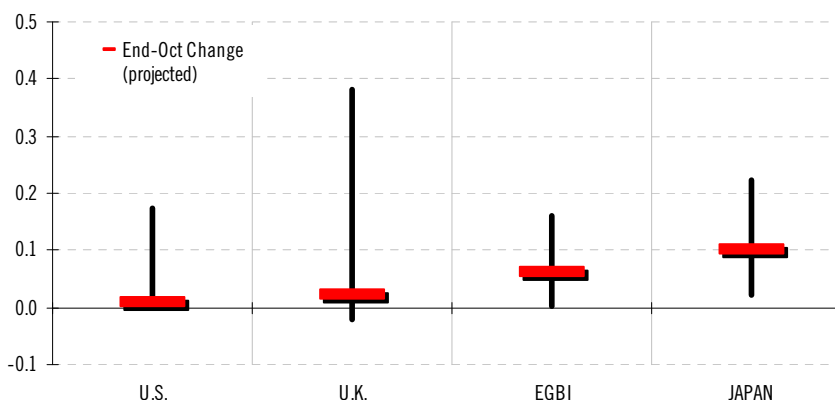


Source: Citi Investment Research and Analysis

End-October WGBI Projection

Figure 18 shows the projected end-October index changes for the EGBI, Japan, UK and US components of the WGBI, and places them in the context of their respective 12-month ranges.

Figure 18. Projected Duration Changes for WGBI Components and 12-Month Range



Source: Citi Investment Research and Analysis

Central Bank operations moderate the extensions in the US and UK indices

Figure 19 shows the details of these changes. We expect the US extension to be the smallest for the year, when taking into account the duration uptake by the Fed in Operation Twist. Without that, the extension would have been 0.06. This change is at a 5-year z-score of -0.98. Similarly, the UK component of the WGBI should extend by a meager 0.02 in contrast to 0.07 without the APF program⁴. Still, this would be the sixth consecutive extension of the UK index, and we would expect it to be negative next month because of fuller impact of the APF in the next fixing month.

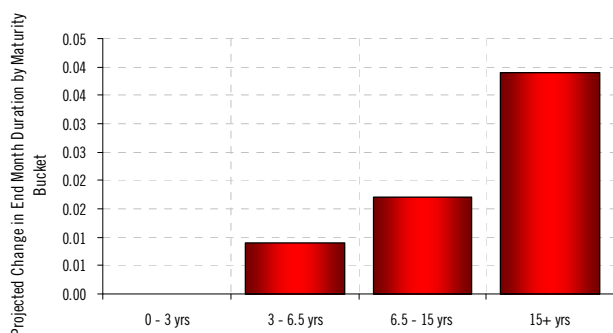
Figure 19. End-Oct Projected Duration Changes for the Main Components of the WGBI

18-Oct-11	End of Sep - Actual		End of Oct - Projected		Projected Change		Duration change range over last year (unweighted)		
	% weight in WGBI	Duration	% weight in Index	Duration	Weight Change	Duration Change	-ve	+ve	Average Absolute Change
EGBI	28.6	6.308	28.4	6.371	(0.16)	0.06	0.00	0.16	0.06
JAPAN	32.6	7.741	32.7	7.797	0.15	0.06	0.02	0.22	0.10
U.S.	26.9	5.849	27.1	5.858	0.20	0.01	0.01	0.18	0.09
U.K.	5.7	10.028	5.6	10.051	(0.03)	0.02	(0.02)	0.38	0.10

Source: Citi Investment Research and Analysis

Inferring from the curve breakdown of projected changes, the US Treasury curve should face flattening pressure led by the long end (Figure 20). On the other hand, the changes should be very supportive for the 5- and 30-yr sectors of the UK yield curve (Figure 21).

Figure 20. US: End-Oct Projected Index Change by Maturity (Un-weighted duration)



Source: Citi Investment Research and Analysis

Figure 21. UK: End-Oct Projected Index Change by Maturity (Un-weighted duration)



Source: Citi Investment Research and Analysis

Conclusion

The changes in EMU are supportive for subsets of both Tier 1 and Tier 2 countries. With a headline driven market fluctuating between risk-on and risk-off sentiments and portfolio rebalancing typically done around month-end, the actual impact of duration change will depend of what transpires at the 23 October EU summit and how that changes the risk sentiments and expectations of the market. This should result in support for either German yields, or French, Spanish and Italian ones, coming from investors without a hard mandate of matching the index.

The UK and US index changes will be largely driven by Central Bank operations. The profile of both the operations would tend to reduce the duration of the index. This month's change in the US index is the smallest since August 09, and the UK extension is only a fifth of the average absolute change for the last year.

⁴ We have assumed that the impact of operations yet to take place will be roughly in line with that of similar operations in the past. Actual index duration changes will be dependant on specific bonds bought and sold by the central banks.

Appendix A-1

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