

Month-End Index-Linked Index Projections

Germany, France and UK inflation indices to extend

- **EMU ILSI:** The EMU ILSI is projected to extend by a modest 0.03 at the end of this month. At a country level, France and Germany are projected to extend, whereas Italy should contract. On the curve, the changes suggest support for 10yr France, and flattening pressure on 5s10s German real yield curve.
- **World ILSI:** We expect the IL gilt index to extend at the end of September. The TIPS index should contract slightly due to duration take up by the Fed in *Operation Twist*. The changes should put steepening pressure on TIPS 10s30s.

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End-Sep Inflation Linked Index Projection

The EMU ILSI index is expected to extend by a small 0.03 at the end of September. Within the World ISLI, the IL gilt index is expected to extend, whereas the TIPS index should contract slightly due to duration take up by the Fed in *Operation Twist*. The changes are expected to put steepening pressure on TIPS 10s30s.

September compositional change in the World ILSI index

EMU Supply from Germany, France and Italy
IL Gilt Mar34 issued
TIPS Sep22 reopened

Within EMU-11 this month¹, there was supply from all three linker issuers: Italy (€0.8bn across BTPei Sep16 and Sep19), France (€1.78bn across OATei 22, OATei 27, OATi 29 and OATei32) and Germany (€1bn of Bundeis 0.1% Apr23). The UK DMO issued £1.35bn of IL Gilt Mar34². The only TIPS issuance was a 10-year reopening (0.125% Sep22) for \$13bn. No bond will drop out of the index.

Projected end-September change in the EMU ILSI index

Average extension in EMU ILSI

We expect the duration of the EMU ILSI to extend by a modest 0.03 at the end of September (Figure 1).

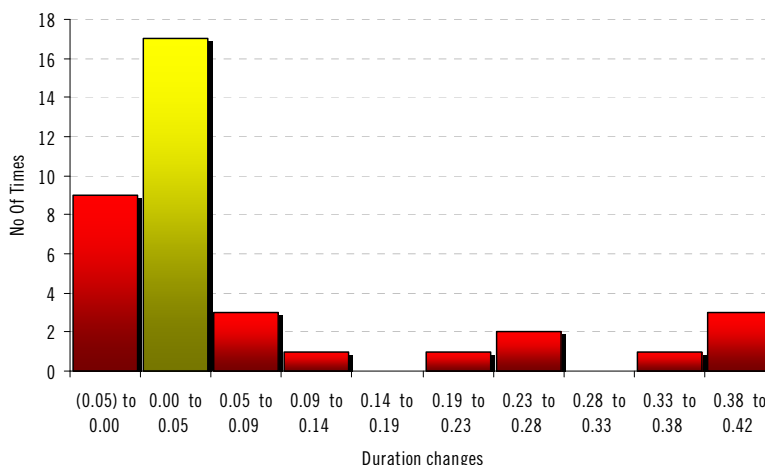
Figure 1. EMU ILSI: Projected End-September Change due to compositional change

EMU ILSI Duration			Largest absolute Duration changes over last year		
End Aug	End Sep(e)	Duration Change(e)	-ve	+ve	Average Absolute Change
8.10	8.13	0.03	-0.05	0.41	0.11

Source: Citi Research

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

Figure 2. Average duration change in context of 3-year distribution



Source: Citi Research

¹ 28 August to 24 September 2012.

² Today's IL Gilt 2052 syndication will not impact the index this month since it comes after the fixing period. It would have caused a further extension of approximately 0.22 years.

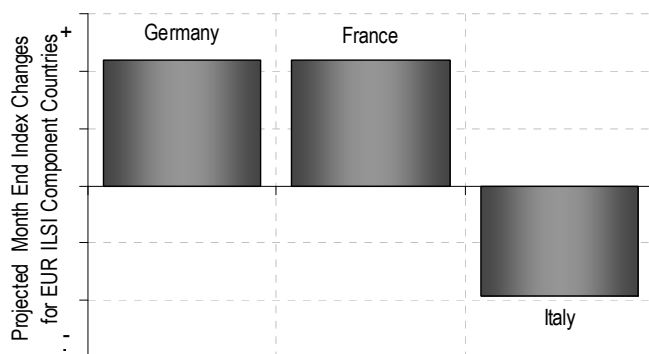
Country breakdown of end-September EMU ILSI projection

Index changes supportive for German and French linkers at the margin

On an unweighted basis, Germany is projected to extend the most within EMU, and should get support from domestic portfolio holders (Figure 5). However, on an EMU-weighted basis, we expect both France and Germany to extend equally (Figure 3). Italian index should contract both in weight and duration.

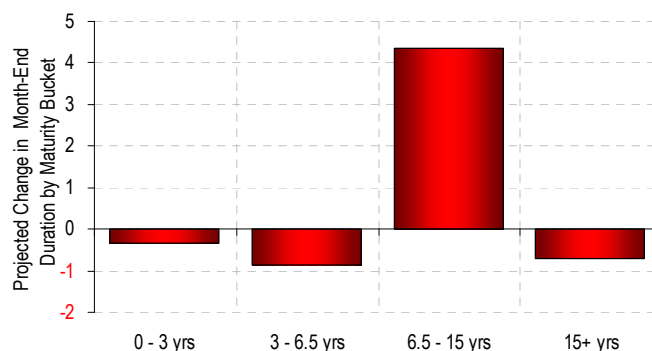
In terms of the maturity split, the index changes should be supportive for the 10yr sector, at the expense of other sectors on the curve (Figure 4).

Figure 3. Projected Weighted Duration Change suggest support for Germany and France at the margin



Source: Citi Research

Figure 4. Changes supportive for 10yr real yields on the curve



Source: Citi Research

Figure 5 shows the detailed breakdown of the projected end-September duration and index weight changes by country.

Figure 5. End-September EMU ILSI Projections

24-Sep-12	End of Aug - Actual		End of Sep - 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
Germany	15.0	5.78	15.1	5.88	2.19	0.09	0.10	(0.01)	1.06	0.14
Italy	32.3	7.59	32.1	7.57	(1.92)	(0.14)	(0.02)	(0.13)	0.81	0.11
France	52.7	9.07	52.8	9.11	2.19	0.07	0.04	(0.08)	0.81	0.11

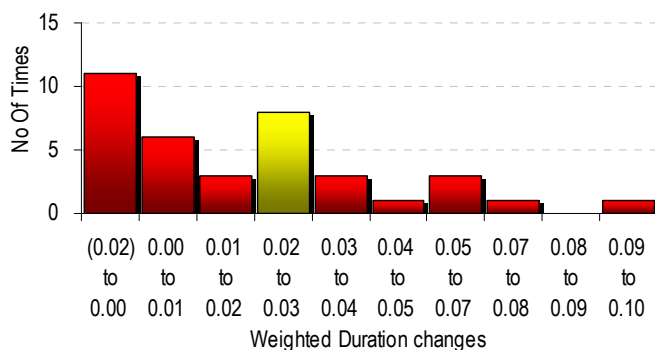
Source: Citi Research

Historical distribution and changes on the curve

Support for 10yr France
flattening pressure on 5s10s Germany

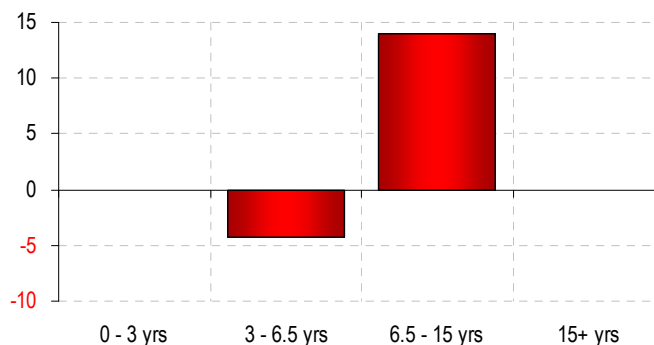
Figure 6 to Figure 11 show the distributions of weighted duration changes and the curve splits of the projected changes. The changes in all the three country indices are average by historical comparison. On the curve, the changes suggest support for 10yr France, and flattening pressure on 5s10s German real yield curve.

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



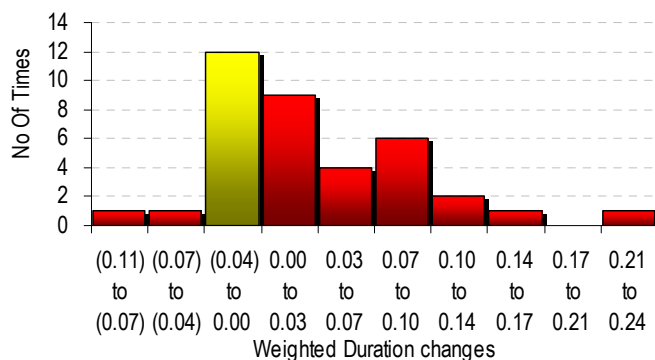
Source: Citi Research

Figure 7. Germany: End-September Projected Changes suggest 5s10s flattening pressure



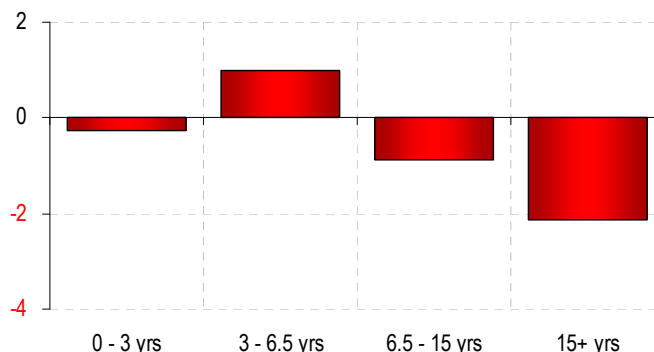
Source: Citi Research

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



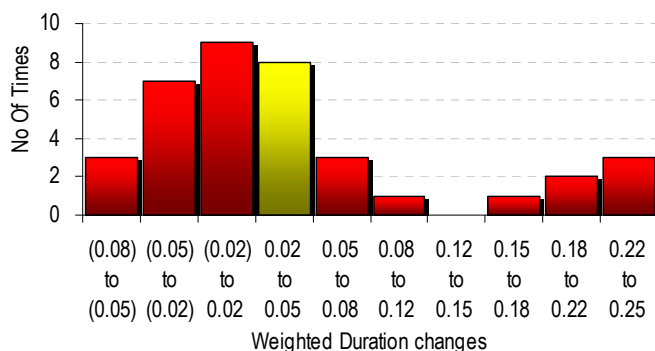
Source: Citi Research

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



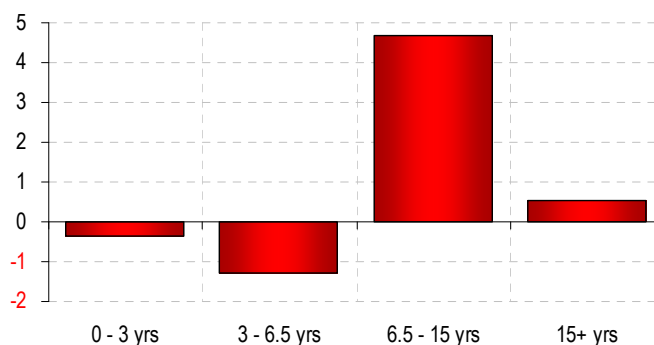
Source: Citi Research

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



Source: Citi Research

Figure 11. France: Support for 10yr

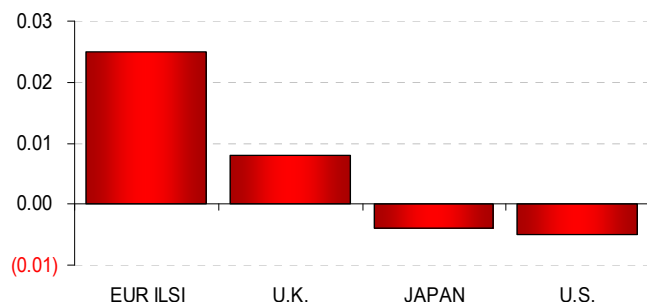


Source: Citi Research

End-September World ILSI projection

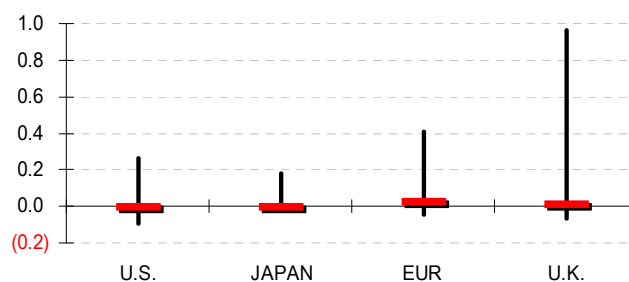
Within the World ILSI, the IL gilt index is projected to extend slightly at month-end, but the TIPS index should contract due to duration take up by the Fed in *Operation Twist* (Figure 12 and Figure 13).

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



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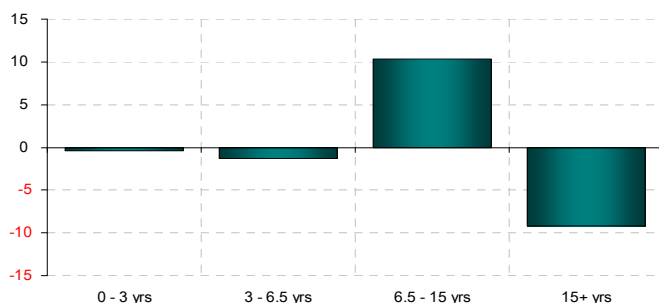
Figure 13. Projected Duration Changes vs 12-Month Range



Source: Citi Research

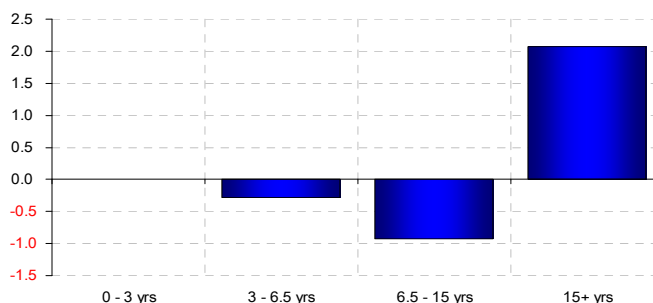
Looking at the curve breakdown of individual countries, the changes should be supportive for 30yr index-linked gilts, while putting steepening pressure on TIPS 10s30s (Figure 14 and Figure 15).

Figure 14. US: End-September Projected Index Change by Maturity (Weighted Duration) – steepening pressure on 10s30s



Source: Citi Research

Figure 15. UK: End-September Projected Index Change by Maturity (Weighted Duration) – support for long end



Source: Citi Research

Figure 16 shows the projected index changes for Europe, Japan³, US and UK components of the World ILSI.

Figure 16. End-September World ILSI Projections

24-Sep-12	End of Aug - Actual		End of Sep - 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	22.2	8.100	22.3	8.125	0.07	0.03	0.03	0.03	0.04	0.00	0.11	(0.05)	0.41
JAPAN	0.9	4.881	0.9	4.877	(0.04)	(0.00)	(0.01)	0.00	(0.03)	(0.00)	0.02	(0.02)	0.18
U.S.	47.5	8.661	47.6	8.656	0.12	(0.00)	0.18	0.01	(0.06)	(0.02)	0.11	(0.09)	0.27
U.K.	27.4	17.888	27.3	17.896	(0.13)	0.01	(0.18)	0.01	0.05	0.00	0.25	(0.07)	0.97

Source: Citi Research

³ 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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