dynamics, as investors and dealers reduce risk. More crucially it is likely to be related to the increased supply of duration from peripheral issuers. We had highlighted over the last few weeks that peripheral countries were likely to increase the duration of their new issuance to raise the average maturity of their outstanding debt back to pre-crisis levels. We expected the increase in duration to be a headwind to the spread tightening trend, but not to lead to a spread widening. On closer inspection, the duration supply could actually be quite meaningful. Indeed, Spain and Italy have increased the maturity of their issuance in 2015 by 2.5-3.0 years relative to 2014. If this increase in maturity is maintained for the duration of the QE programme, Spain and Italy would be issuing significant additional duration to the market relative to last year (see the table below and Euroland Strategy for more details). In fact, for Italy, the duration supply could be comparable to the duration taken out by the ECB. Of course, some maturity extension was likely to have been expected and already priced in by the market. Also, the maturity increase from Italy and Spain may be particularly high at the moment and may decelerate. Nonetheless, this simple calculation suggests that the magnitude of the duration supply could be material.

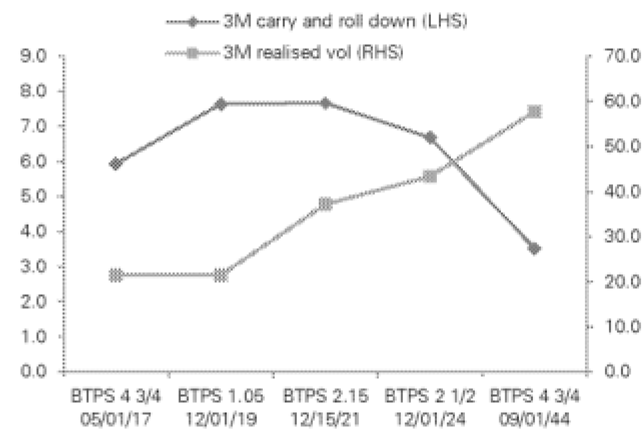
Duration supply in the periphery could be material

	[1] Estimated Gross Supply Mar-15 Sep-16	[2] Maturity Increase 2015 YTD vs. 2014 (in years)	[3] = [1] * [2] / 10 Approximate Duration Supply in 10Y	Approximate ECB QE in 10Y
Italy	427.5	3.0	135.5	124.1
Spain	142.0	2.4	34.1	86.7
France	345.2	-0.7	-21.1	130.1
Germany	254.9	-0.2	-6.6	146.2

Source: Deutsche Bank, ECB, Ministry of Finances, Bloomberg Finance LP

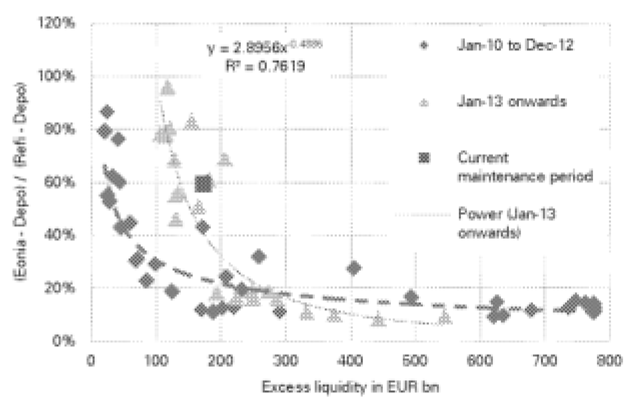
For core countries, there has been no supply response so far. Germany is unlikely to adapt its issuance to market conditions. However, France could prove to be more opportunistic. Net selling could come from non-domestic investors as these are the ones who have increased their ownership of core rates during the crisis. As we discussed last week, there are fewer incentives for Japanese investors to hold EGBs at these relative yield levels. For instance, the France-Japan 10Y spread has tightened from over 200bp in 2011 to less than 15bp today. Japanese investors may thus reduce their current holdings (which consists mostly of France) once the new fiscal year starts next week.

Vol adjusted carry is more attractive in the belly of the Italian curve



Source: Deutsche Bank, Bloomberg Finance LP

Eonia is proving to be relatively sticky given the increase liquidity



Source: Deutsche Bank, ECB, Bloomberg Finance LP