

Peripheral Europe Update

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- **A populist government in Italy**
- **Rajoy defeated in a no-confidence vote today**

Main market events

The sell-off in Italian bonds has accelerated quite substantially early this week, with larger daily spreads widening than those observed during the peak of the Euro area crisis. The political turnarounds in Italy coupled with the no-confidence vote in Spain triggered some contagion effects to all peripheral bond markets. That said, the financial stress was not significant enough for the ECB to intervene and dampen tensions. But it is very likely that the latest developments in Italy will be discussed in the next Governing Council in two weeks, leading the ECB to postpone the announcement of a QE taper to July. Italian bonds have returned -4.24% year-to-date, Spanish bonds 1.02%, Portuguese bonds 0.82% and Irish bonds 0.09%.

Italy

This week has been full of unpredictable about-turns on the Italian political scene, big enough for short-dated BTPs to price in a significant denomination risk, in other words a non-negligible risk of Italy leaving the euro. The market capitulated early this week after President Mattarella vetoed the controversial anti-EU institutions Savona as finance minister and nominated Cottarelli as interim Prime Minister to form a caretaker government. The market fear was that this decision could have been perceived as denying the democratic vote, thereby further fueling populist sentiment in the run up to the next elections. Such elections would have likely be seen as a referendum on the euro. But quite unexpectedly, 5S and Lega came back to the Italian President with a new list of ministers, which was accepted today. Italy has finally a new government.

Spain

Premier Mariano Rajoy was defeated today after the opposition parties pledged their support to Socialist Pedro Sanchez. It is the first time since Spain returned to democracy in 1978 that a prime minister has been ousted by a no-confidence vote. Against a backdrop of corruption scandals that hit Rajoy's government over the past seven years, Sanchez received the backing of the anti-establishment group Podemos and some Catalan separatists, the so-called "Frankenstein coalition" according to Rajoy. The first message of the Sanchez's economic advisor was to re-affirm the pro-European commitment of Spain: 'We will always fulfill our duties vis-à-vis the European Commission. Strengthening the euro system is important for us, as is some fiscal harmonization.' The message clearly aimed at differentiating the new Spanish government from its Italian populist peer. In particular, it was stated that the new Socialist government will not amend the Budget voted last week, which target a 2.2% fiscal deficit.

Robeco Euro Government Bonds

This week the overweight position in Spanish bonds has been further reduced, while our overweight position in Italy has been closed. We therefore remain slightly overweight risk in the periphery. Currently the fund is 35.4% invested in peripheral bonds, less than the index level. Year-to-date the fund's absolute return is -0.33%*.

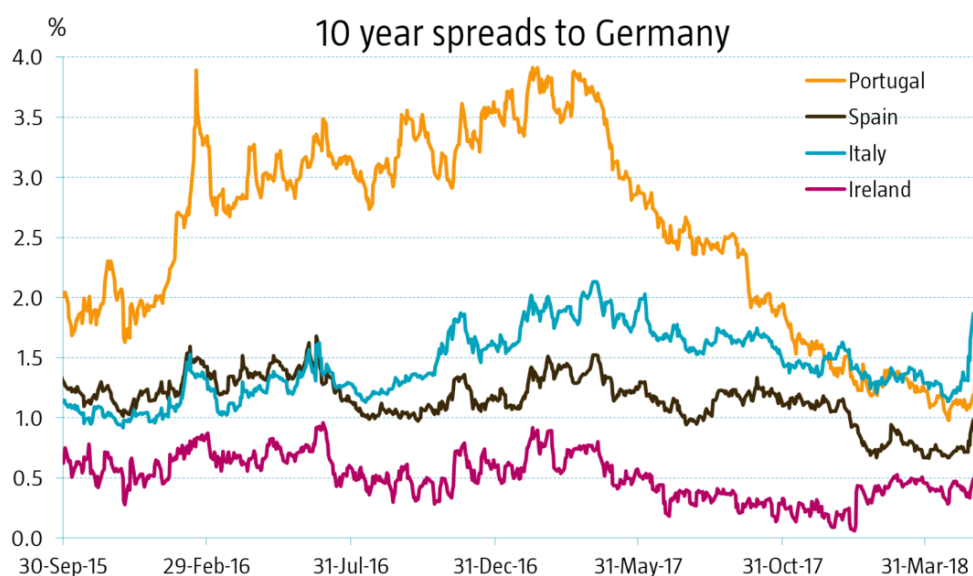
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 31 May, 2018.
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Current 10-yr spreads versus Germany

Maturity	German yields	Spreads	France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.64	0.08										
2	-0.63	0.13	1.46	0.47	0.03	0.13	0.17	2.03	0.17	0.06	0.61	
3	-0.55	0.17	1.61	0.54	0.08	0.05	0.18		0.11	0.09	0.66	
4	-0.40	0.19	1.76	0.44	0.11	0.03	0.17		0.29	0.02	0.86	
5	-0.22	0.16	1.77	0.49	0.10	0.26	0.19	4.02	0.23	0.06	0.92	
6	-0.10	0.21	2.06	0.79	0.17	0.26	0.27		0.36	0.13	0.96	
7	0.03	0.25	2.13	0.81	0.18	0.33	0.33		0.46	0.09	1.27	
8	0.15	0.27	2.19	0.94	0.18	0.36	0.17			0.18	1.36	
9	0.27	0.31	2.20	0.95	0.19	0.38	0.31			0.07	1.40	
10	0.39	0.31	2.16	0.97	0.17	0.39	0.30	4.08	0.58	0.19	1.45	
15	0.54	0.61	2.38	1.34		0.67	0.53	4.26	0.92	0.32	1.83	
20	0.80	0.45	2.31			0.61	0.32	4.22			1.78	
30	1.09	0.53	2.21	1.43	-0.02	0.56	0.36			0.17	1.75	

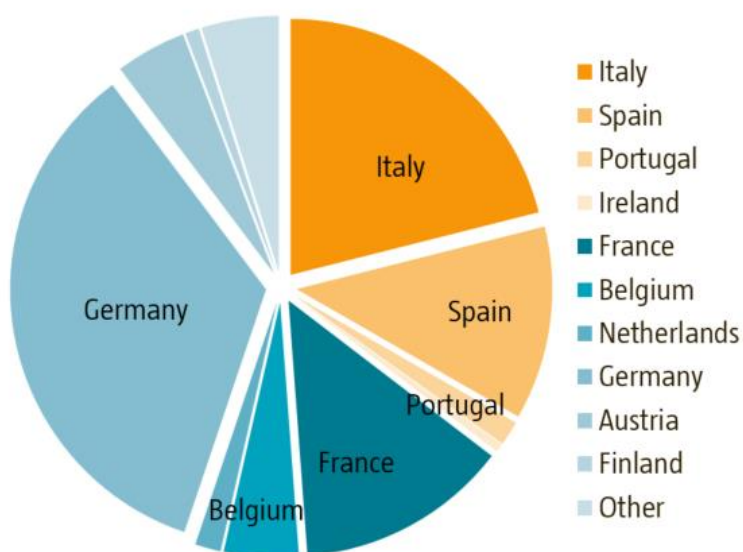
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (31 May, 2018)



Source: Robeco

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