

Peripheral Europe Update

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- **Persisting tensions within the Italian coalition**
- **Spain: Likely defeat today of the fiscal plan in parliament**

Main market events

Over the past week, peripheral bond spreads have tightened somewhat except in Italy. While the ECB Governing Council and President Draghi did not deliver any meaningful new information on Thursday, the populist rhetoric of Deputy PM Salviani for a higher deficit and his attacks against Finance Minister Tria further damaged foreign investors' confidence in BTPs. Italian bonds have returned -3.0% year-to-date, Spanish bonds 2.8%, Portuguese bonds 2.5% and Irish bonds 0.6%.

Spain

Late today parliament may vote down the government spending plan, which aims at strengthening the social cohesion and reducing inequality. The expected deficits for 2019 Budget would then reach 2.7% of GDP, 0.5 percentage points higher than the deficit this year. But the proposal to increase by 4.4% spending to boost welfare is likely to suffer a setback. This highlights the fragility of the new PM Pedro Sanchez, who has to govern with only 84 seats of its own in the 350 member chamber. In the event of possible repeated defeats in parliament, the authority of the administration could be eroded, increasing thereby the likelihood of fresh elections before their scheduled date in 2020. In the short term, if the spending proposal were to be refused, this would prevent regions from accessing further funding from the government.

Italy

When speaking about the EU fiscal constraints, Salviani stressed that "If we have to go above those limits for the good of the Italians, that won't be a problem for us". He also added that his main priority was to cut taxes, which "will be included in the next budget". Contrasting with this populist rhetoric, Finance Minister Tria has tried to reassure markets that the EU deficit rules will be respected. His conservative posture is key, considering that the sell-off of BTPs in May was triggered by foreign bond investors dumping record volumes of Italian bonds. The amount sold was indeed higher than during any months of the Euro Area crisis. Given the uncertainty surrounding the future stance of fiscal policy in Italy, the current 100bp premium is likely to persist at least up to September 27, when the first draft of the 2019 Budget will be presented. Otherwise, further details about the ECB initiative to tackle non-performing loans in the Eurozone banking system have been released this week. Overall, it is a rather light proposal to reduce banking risk in the Eurozone, before addressing the risk sharing topic. As banks will have seven years to take measures to reduce risks in their balance sheet, it is not too worrisome for Italy.

Robeco Euro Government Bonds

The positioning of the fund in periphery markets has remained broadly unchanged in the past weeks. Overall, our risk position in peripheral bonds is slightly higher than that of the index, mainly located in Spain and Ireland. We remain cautious towards Italy as markets are vulnerable to headline-risk. Currently the fund is 35% invested in peripheral bonds, less than the index level as expressed in market value. Year-to-date the fund's absolute return is 0.25%*.

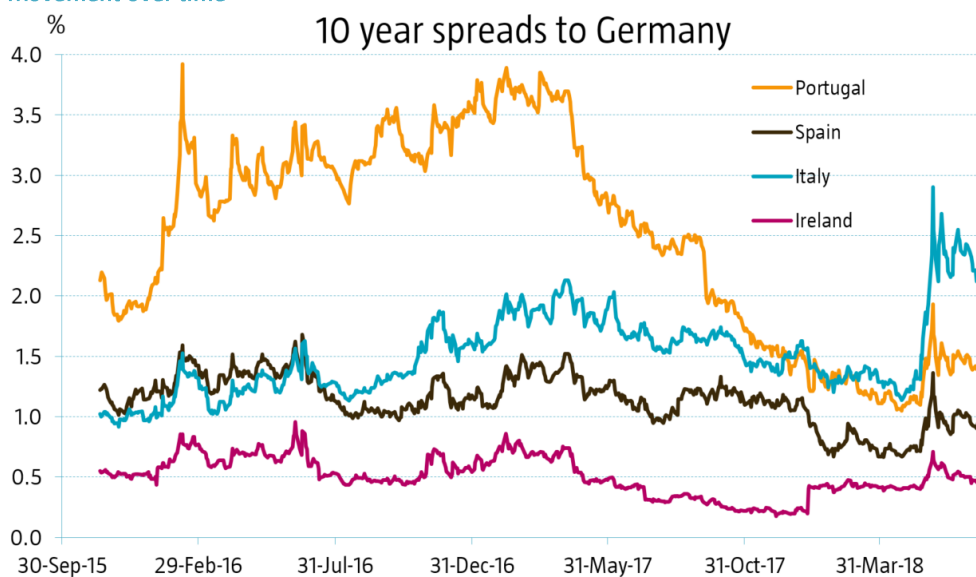
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 26 July, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.66	0.12									
2	-0.60	0.18	1.31	0.26	-0.02	0.09	0.13	2.00	0.13	0.02	0.40
3	-0.47	0.21	1.57	0.31	-0.02	0.00	0.09		0.02	-0.04	0.34
4	-0.33	0.22	1.80	0.34	0.00	-0.05	0.06		0.15	-0.10	0.52
5	-0.16	0.23	1.94	0.49	-0.01	0.16	0.09	3.04	0.09	-0.06	0.65
6	-0.08	0.20	2.16	0.69	0.07	0.17	0.17		0.24	0.04	0.76
7	0.04	0.23	2.25	0.82	0.10	0.22	0.23		0.33	-0.01	1.14
8	0.17	0.26	2.24	0.89	0.10	0.25	0.09			0.08	1.23
9	0.29	0.23	2.32	0.94	0.12	0.29	0.22			0.05	1.26
10	0.41	0.29	2.28	0.95	0.10	0.30	0.19	3.41	0.46	0.10	1.30
15	0.69	0.41	2.36	1.17		0.47	0.32	3.74	0.65	0.12	1.55
20	0.84	0.37	2.47			0.54	0.23	3.88			1.62
30	1.07	0.51	2.41	1.42	-0.02	0.56	0.32			0.14	1.69

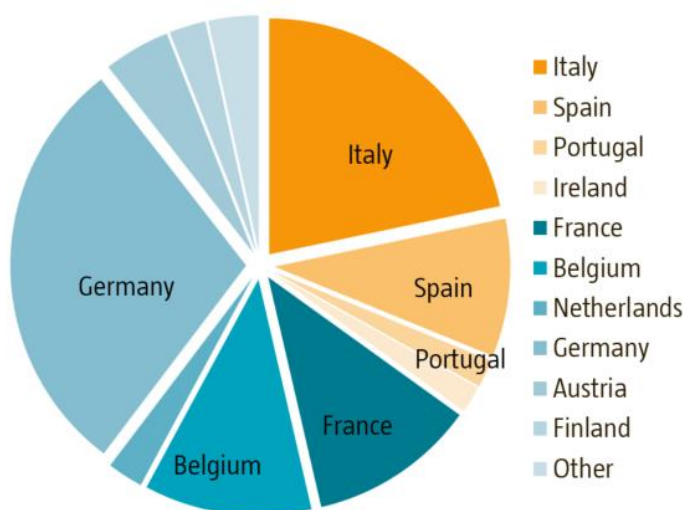
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (26 July, 2018)



Source: Robeco

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