

Peripheral Europe Update

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- **Italy: sell off loses steam and spread stalls albeit at very elevated levels**
- **ECB: minutes confirm confidence on growth, less so on core inflation**

Main market events

Whilst volatility remained significant, the selloff in Italy did lose some steam over the past week. The Italy-Bund spread stabilized at just over 300 basis points. So far the main political actors in the government have not in any way backtracked on the 2.4% fiscal deficit target for 2019. Negotiations with the European commission are underway and before the end of October we expect rating verdicts from both Moody's and S&P. Contagion to other markets has remained subdued. There was some spread widening in France and Spain later in the week, but this may also have been the result of sliding equity markets and deteriorating risk sentiment in general.

ECB

The minutes of the September ECB meeting signal that the governing council is relatively confident that eurozone growth will remain robust, although there was a bit more debate than Draghi indicated at the press conference. On the inflation front the council expressed confidence on wage growth picking up, but there was much less conviction on higher wages leading to a pick-up in core inflation. This is an interesting divergence from the tone that was expressed by Draghi in September, when he mentioned "relatively vigorous" underlying inflation. Yields rose substantially after these initial comments, but hardly corrected after the release of the minutes.

Italy

The European commission has already communicated that Italy's fiscal plans involve a significant deviation from the EU fiscal rules. As it remains very doubtful (unless forced by market developments) that the Italian government backtracks, it seems that the commission has no choice other than to implement an excessive deficit procedure later in the quarter. What is worrying the most is not necessarily the level of the planned deficit, but the fact that it involved reversing structural reforms that were aimed to put debt on a sustainable path in the medium term. This will leave Italy very vulnerable to any slowdown in growth or tightening of financial conditions.

Robeco Euro Government Bonds

Over the week we kept exposures towards the periphery unchanged. We remain a touch overweight Italian BTPs (5y maturity). In Spain we reduced the overweight slightly, but remain relatively constructive. We believe the growth and fiscal outlook still support tighter spreads. We do have a considerable underweight in France. The outlook for French OATs has not improved much. Spreads are still priced at the average of the past years, while contagion risks from political tensions between the EC and Italy have grown. We think these risks are underpriced. Currently the fund is 34% invested in peripheral bonds, less than the index level as expressed in market value. Year-to-date the fund's absolute return is -1.00%*.

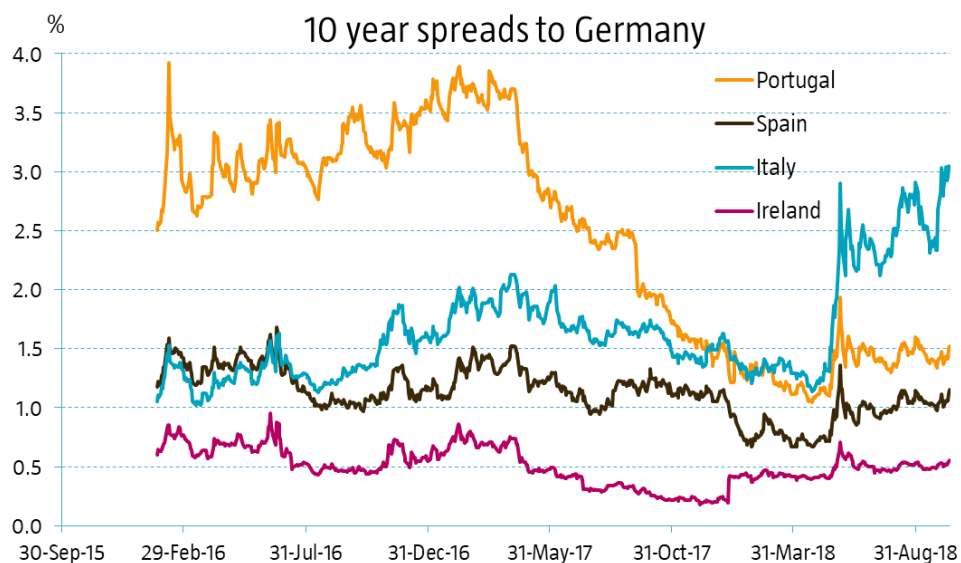
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 11 October, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads										
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal	
1	-0.61	0.01										
2	-0.54	0.17	2.02	0.41	-0.03	0.06	0.08		1.95	0.13	0.05	0.44
3	-0.42	0.27	2.52	0.52	0.00	0.09	0.09			-0.03	0.02	0.51
4	-0.24	0.28	2.83	0.56	0.01	0.13	0.03			0.22	0.13	0.77
5	-0.07	0.30	2.88	0.75	0.03	0.24	0.11		3.49	0.16	0.14	0.94
6	0.04	0.25	3.09	0.92	0.08	0.23	0.17			0.32	0.11	1.00
7	0.16	0.30	3.07	1.03	0.10	0.29	0.21			0.42	0.22	1.36
8	0.29	0.32	2.88	1.09	0.10	0.34	0.10				0.18	1.44
9	0.41	0.30	2.97	1.15	0.13	0.37	0.23					1.48
10	0.52	0.36	3.02	1.15	0.12	0.39	0.21		3.90	0.55	0.26	1.52
15	0.79	0.48	2.85	1.38		0.50	0.35		4.09	0.76	0.30	1.79
20	0.94	0.44	2.92			0.60	0.26		4.32			1.89
30	1.15	0.59	2.82	1.64	0.02	0.65	0.34				0.19	1.97

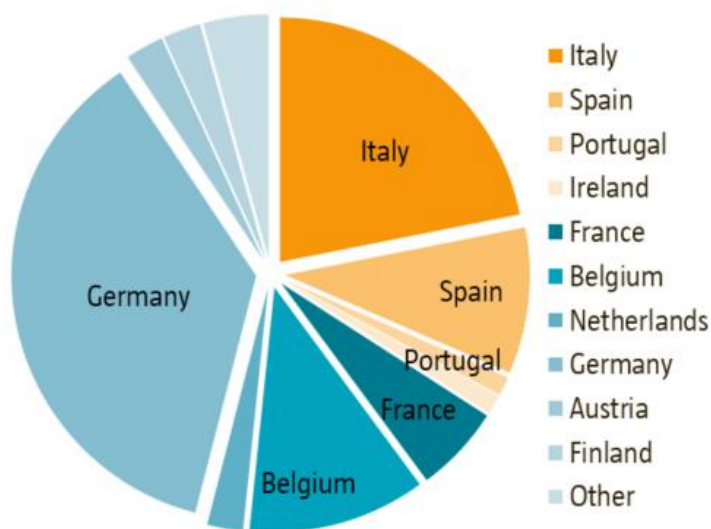
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (12 October, 2018)



Source: Robeco

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