

# Peripheral Europe Update

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- **The European Commission bluntly rejected Italy's draft budget plan**
- **Moody's downgraded Italy to Baa3 but with a stable outlook**

## Main market events

Last Friday Moody's published its rating decision on Italy and their downgrade to Baa3 was widely expected. However the rating agency took away some uncertainty as the downgrade was accompanied with a stable outlook. This eased market fears towards Italy falling to sub-investment grade. Therefore on Monday Italian bonds rallied hard, however the relief proved to be short lived as the European Commission in an unprecedented move rejected the Italian draft budget plan and requested Rome to re-submit a revised compliant budget within three weeks. So the ball is back in the Italian camp. For now it seems that the Italian government does not want to budge. However economy minister Tria mentioned in his answer to the EC that the government would take action if the debt-to-GDP and deficit-to-GDP ratio did not evolve in line and also stressed a commitment to a constructive dialogue with the EC.

## ECB/EC

At Thursdays governing council meeting the ECB left its forward guidance unchanged (rates unchanged through at least the summer of next year). It also expects net QE purchase to end in December, but has not officially announced the end yet. On QE re-investments and on the recalculation of the capital key for next year the ECB did not announce any details, clearly the governing council would like to keep its options open. Although the ECB acknowledged somewhat weaker momentum in the eurozone economy they did not see this as a downturn and therefore not sufficient to change the outlook. On Italy Draghi mentioned that it's not a central banker's job to play a mediator role. Personally he was confident that an agreement could be found. On an eventual back stop for Italy, Draghi mentioned OMT but such support would come only with strict conditionality.

## Italy

The Italy- Germany spread consolidated this week at around 300 basis points. The market seemed to have found some comfort that risks of a downgrade to sub-investment grade for now have subsided. Also positioning seems to be much cleaner with investors reportedly being more neutral. Tonight (Friday 26<sup>th</sup>) its S&P's turn to publish its rating update. Currently S&P rates Italy BBB with a stable outlook. As S&P actually upgraded Italy's rating from BBB- to BBB last year it's envisioned that only a change to the outlook from stable to negative will be announced.

## Robeco Euro Government Bonds

Periphery positions are unchanged with small longs in Italy and Spain and an underweight in Portugal. In semi-core we still have a large underweight in France. We slightly added to this underweight versus Ireland. Ireland is supported by a significant index extension this month whilst in France October coupon and redemption flows, which had underpinned the spread, are now behind us. 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 -1.25%\*.

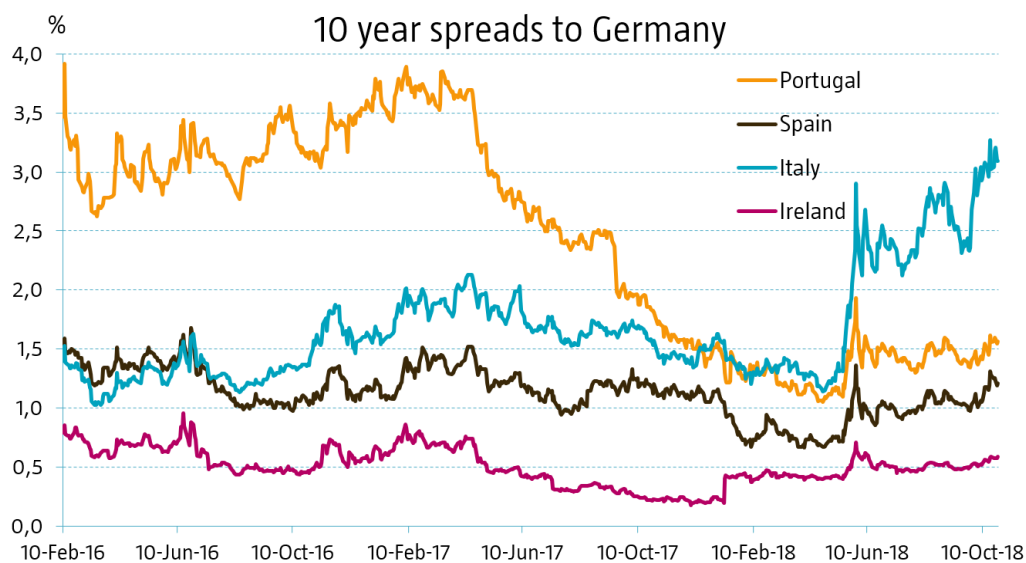
\* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 25 October, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0,69	0,07									
2	-0,63	0,20	1,76	0,45	-0,04	0,09	0,06	2,03	0,17	0,08	0,50
3	-0,53	0,27	2,26	0,53	0,00	0,13	0,08		0,08	0,05	0,56
4	-0,37	0,28	2,66	0,57	0,02	0,16	0,15		0,24	0,14	0,76
5	-0,21	0,31	2,79	0,76	0,04	0,25	0,13	3,58	0,19	0,14	0,93
6	-0,11	0,28	3,09	0,94	0,10	0,25	0,20		0,34	0,13	1,00
7	0,00	0,33	3,18	1,07	0,13	0,32	0,24		0,46	0,25	1,37
8	0,13	0,35	2,94	1,14	0,13	0,37	0,28			0,22	1,45
9	0,24	0,32	3,03	1,20	0,16	0,41	0,26				1,51
10	0,36	0,38	3,08	1,20	0,14	0,42	0,25	3,94	0,59	0,28	1,56
15	0,64	0,51	3,00	1,42		0,55	0,40	4,19	0,79	0,33	1,84
20	0,79	0,46	3,07			0,67	0,31	4,35			1,92
30	1,00	0,63	3,01	1,69	0,04	0,73	0,40			0,22	2,02

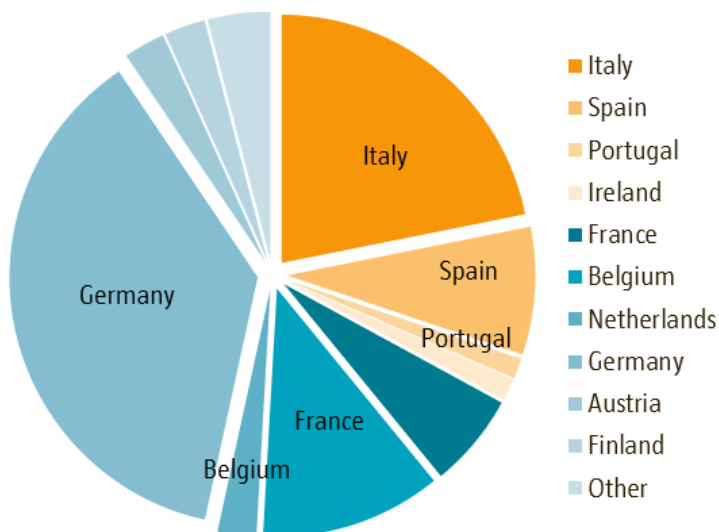
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (18 October, 2018)



Source: Robeco

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