

Peripheral Europe Update

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- **Italian GDP growth reach a standstill**
- **Spanish Citizens party breaks ranks with Partido Popular on budget reform**

Main market events

Peripheral spreads tightened last week, although on limited news. As widely expected, S&P did not downgrade Italy's credit rating last Friday, and only lowered the outlook to 'negative'. As credit rating actions are now out of the way markets felt slightly relieved. Italian bonds have returned -5.71% year-to-date, Spanish bonds 1.44%, Portuguese bonds 1.79% and Irish bonds 0.06%.

Italy

Italian GDP growth reached a standstill. Quarter on quarter GDP growth over the 3rd quarter came out at 0%, even below consensus of 0.2%. Weak exports and export-driven manufacturing was the main cause for the disappointing number. The figure increases the fiscal risks for 2019 as the government's growth assumptions behind the 2019 budget become even more unattainable.

The Italian government will argue that the 'true' budget deficit target for next year will be 2% of GDP instead of 2.4%, when it replies to the EU Commission's objections. The 2.4% deficit target is reportedly not taking into account the positive feed-back effect of the fiscal stimulus on tax revenues, while government expenditures may be lower than originally planned because of delayed implementation of some of the measures

Spain

The centrist party Citizens unexpectedly decided to stop blocking the reform of the budget approval process. The reform is vital for the Socialist government in order to approve its 2019 budget plans, which lifts the 2019 deficit from 1.3% of GDP to 1.8%. Currently the conservative Partido Popular can veto the plans due to its absolute majority in the Senate.

Real GDP growth in Spain remains strong at 2.5% year on year, showing Spanish economic resilience to the weaker growth numbers observed in the rest of the Eurozone.

Robeco Euro Government Bonds

During the week we added to 5-yr Spanish government bonds, while also reducing the underweight in French government bonds. Spreads have widened in October and are now at levels 'new bad news' is needed to widen further. As we do not see an easy solution yet on the stalemate between the Italian government and the European Commission, we prefer not to increase our BTPS exposure as long as there is no more clarity on the topic. We run overweight positions in Spain and Ireland, versus underweight positions in Portugal and France. Currently the fund is 38% invested in peripheral bonds, slightly below the index level as expressed in market value. Year-to-date the fund's absolute return is -0.98%*.

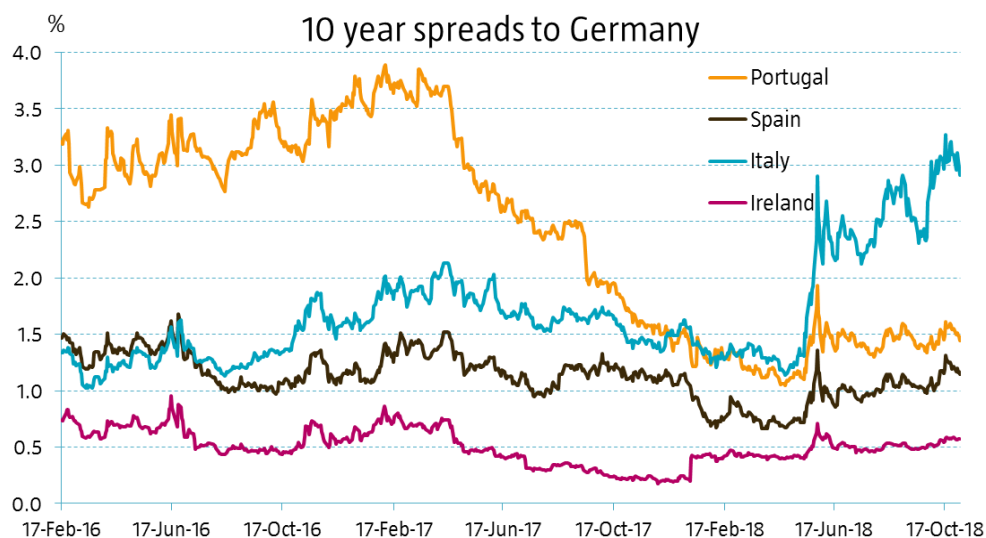
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 31 October, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads										
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal	
1	-0.65	0.04										
2	-0.61	0.19	1.54	0.48	-0.05	0.09	0.05	2.02	0.16	0.10	0.47	
3	-0.50	0.26	1.99	0.46	-0.01	0.12	0.07		0.06	0.05	0.48	
4	-0.34	0.26	2.38	0.64	0.02	0.14	0.13		0.23	0.14	0.69	
5	-0.17	0.28	2.52	0.72	0.02	0.21	0.11	3.55	0.17	0.14	0.85	
6	-0.06	0.24	2.86	0.89	0.08	0.22	0.18		0.33	0.11	0.91	
7	0.05	0.30	2.96	1.02	0.12	0.29	0.23		0.43	0.23	1.28	
8	0.18	0.32	2.74	1.08	0.11	0.34	0.26			0.20	1.35	
9	0.30	0.29	2.84	1.14	0.13	0.38	0.23				1.40	
10	0.42	0.36	2.91	1.14	0.12	0.39	0.20	3.88	0.57	0.25	1.45	
15	0.69	0.49	2.83	1.37		0.52	0.39	4.15	0.78	0.31	1.73	
20	0.85	0.43	2.89			0.63	0.30	4.31			1.81	
30	1.05	0.59	2.84	1.63	0.03	0.68	0.37			0.21	1.91	

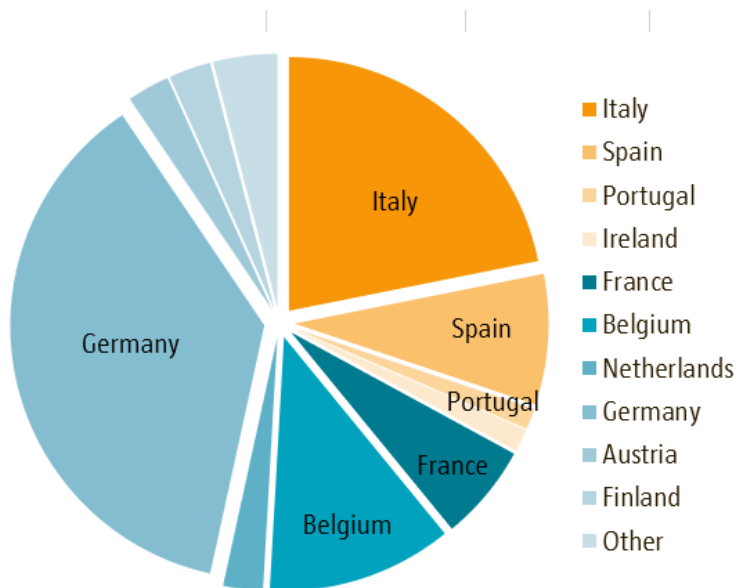
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (1 November, 2018)



Source: Robeco

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