

Peripheral Europe Update

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- ECB: Draghi extends forward guidance and signals readiness to ease
- Italy likely faces a debt-based excessive deficit procedure

Main market events

Risk sentiment improved considerably during the week, primarily in anticipation of a very dovish ECB meeting. Although the imminent market reaction was slightly underwhelming, the market rally resumed on Friday, with especially Italy performing well. The 10-year Bund yield reached a new all-time low at -0.26%, but also the yield on 10y Portugal declined to 0.60%, a fresh record low. Italian bonds have returned 2.7% year-to-date, Spanish bonds 6.7%, Portuguese bonds 7.1% and Irish bonds 5.1%.

Italy

The EU Commission has recommended to open a debt-based EDP procedure against Italy. The formal decision has to be formally approved by the Eurogroup, possibly at the 9 July meeting. The initial reaction from the Italian government has been constructive as PM Conte and FinMin Tria replied that the 2019 budget deficit will be lower than currently estimated (2.1% vs. 2.5% of GDP projected by the EU) thanks to better-than expected tax revenues year-to-date and lower spending for the two flagship measures, citizenship income and early retirements.

Spain

The EU Commission recommended abrogating the Excessive Deficit Procedure for Spain. The EC noted Spain has corrected its excessive deficit and brought it below 3.0% of GDP in 2018, hence it will now be subject to the preventive arm rather than the corrective arm of the Stability Pact.

ECB

ECB President Draghi delivered a dovish message on Thursday. He stated that the risks to the Eurozone economic outlook “remain tilted to the downside”. The ECB now expects to keep policy rates “at their present levels” at least through the first half of 2020 – a six-month extension from the previous guidance. He also stressed the Governing Council “is determined to act in case of adverse contingencies and stands ready to adjust all of its instruments...”, which indicates both restarting of QE or further rate cuts. The terms of the newly announced TLTRO’s were slightly less generous than the previous series.

Robeco Euro Government Bonds

At the start of the week we closed the Italian 10-30 flattener position and moved to a slight overweight position in Italy, as we anticipated the upcoming EDP was more or less priced in, while we expected a dovish message from the ECB. Directly after the ECB meeting we switched all of our remaining Portugal bonds into Italian bonds. Investments in peripheral bonds increased slightly to 33%, which is 7% below the level of the index. This is mainly because of expensive valuations in very short dated peripheral bonds. Year to date the absolute return of the fund is 4.38%*.

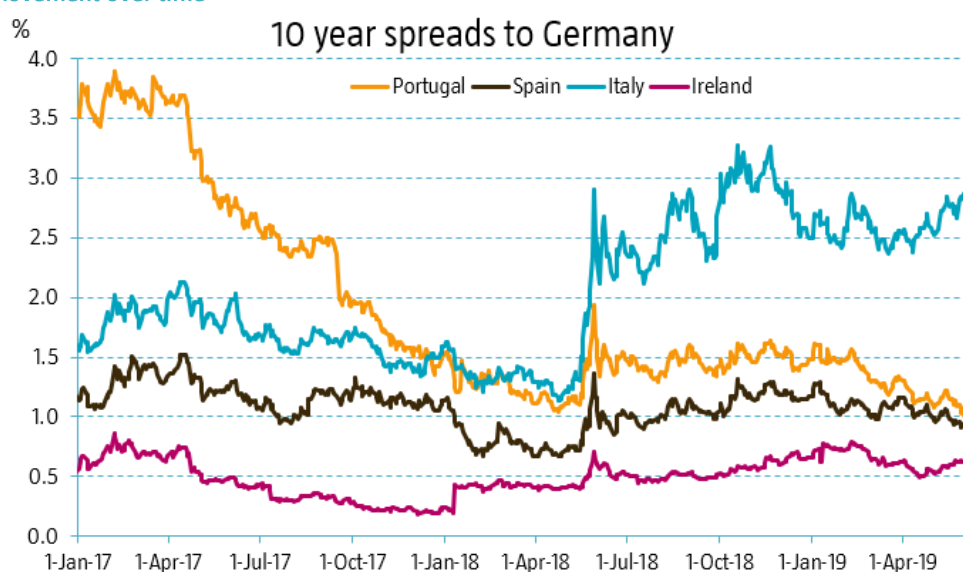
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 6 June, 2019. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads	France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.59	0.05										
2	-0.66	0.07	1.13	0.28	0.07	0.08	0.08			0.22	0.11	0.28
3	-0.66	0.09	1.78	0.33	0.02	0.11	0.14			0.26	0.14	0.42
4	-0.65	0.13	1.96	0.49	0.03	0.21	0.18			0.26	0.20	0.48
5	-0.58	0.16	2.29	0.52	0.04	0.27	0.22		2.29	0.27	0.16	0.49
6	-0.55	0.24	2.28	0.58	0.15	0.29	0.27			0.39	0.26	0.64
7	-0.49	0.28	2.43	0.67	0.17	0.33	0.32			0.43	0.26	0.68
8	-0.41	0.30	2.52	0.74	0.19	0.37	0.29				0.32	0.76
9	-0.33	0.33	2.48	0.77	0.18	0.41	0.29					0.88
10	-0.23	0.35	2.69	0.83	0.18	0.42	0.30		3.15	0.54	0.32	0.90
15	-0.02	0.52	2.91	1.19		0.58	0.44		3.30	0.70	0.38	1.14
20	0.16	0.47	2.88			0.67	0.34		3.39			1.21
30	0.36	0.75	3.05	1.33	0.04	0.83	0.43				0.28	1.35

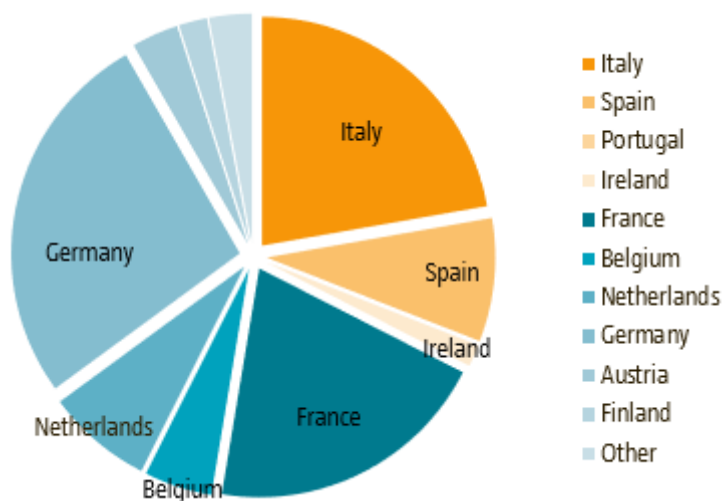
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (7 June, 2019)



Source: Robeco

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