

# Peripheral Europe Update

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- **Italy: on its way to fiscal realism**
- **Spanish fiscal slippage: a non-event**

## Main market events

While most peripheral spreads hardly moved this week, Italian bonds rallied. The spread versus German Bunds tightened 17bps, as the Italian government appears to have revised its fiscal strategy. Recent government comments suggest a move towards a more prudent and realistic stance, more in line with European rules, albeit not yet fully compliant. Recent economic news in the Eurozone has been rather disappointing, pointing towards a slowdown. Italian bonds have returned -4.2% year-to-date, Spanish bonds 2.1%, Portuguese bonds 1.6% and Irish bonds 0.6%.

## Italy

As expected, Fitch downgraded Italy's rating outlook last Friday, pointing out the risk of fiscal loosening that would make the high level of debt more vulnerable to potential shocks. Both Fitch and Moody's now have a negative outlook. The risk of a downgrade is probably highest for the Moody's rating. Fitch already rated Italy 4 notches below the rating implied by their model, which makes an outright downgrade less likely. Against this background, Finance Minister Tria seeks a deficit at about 1.2% of GDP for the 2019 budget amid the ongoing economic slowdown, while Lega leader Salviani aims for a 2% deficit according to Italian media. It is worth noting that the previous government committed to a 0.8% fiscal deficit for 2019. Discussions will continue over the coming weeks, with Tria attending the informal Ecofin meeting on Friday and Saturday. It is possible that the Italian government will have to agree on a modest deficit in negotiations with the European Commission. To remain within the EU fiscal rule, the 2019 deficit should not be higher than 1.6-1.7%. If agreed at this level, BTPs may rally further, as the government would have demonstrated good will in dealing with EU rules.

## Spain

The fiscal slippage of about 0.5% of GDP for both the 2018 and 2019 budgets was agreed with the European Commission. This may therefore not appear as a surprise with a negative impact on Spanish spreads. While the initiative of the PSOE government to change the budget law is not a positive, it may not jeopardize the trajectory of the public debt in the short-term. Meanwhile the Regional Catalan government announced this week that it intends to push forward for splitting from Spain.

## Robeco Euro Government Bonds

We have continued to build a more defensive portfolio this week. We reduced our exposure to long Italian bonds after the significant rally since Monday to have a modest underweight in BTPs. The fund is slightly overweight long dated peripheral bonds, while it does not hold any Irish, Portuguese or Spanish bonds with up to 7-year maturities. Currently the fund is 30% 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%\*.

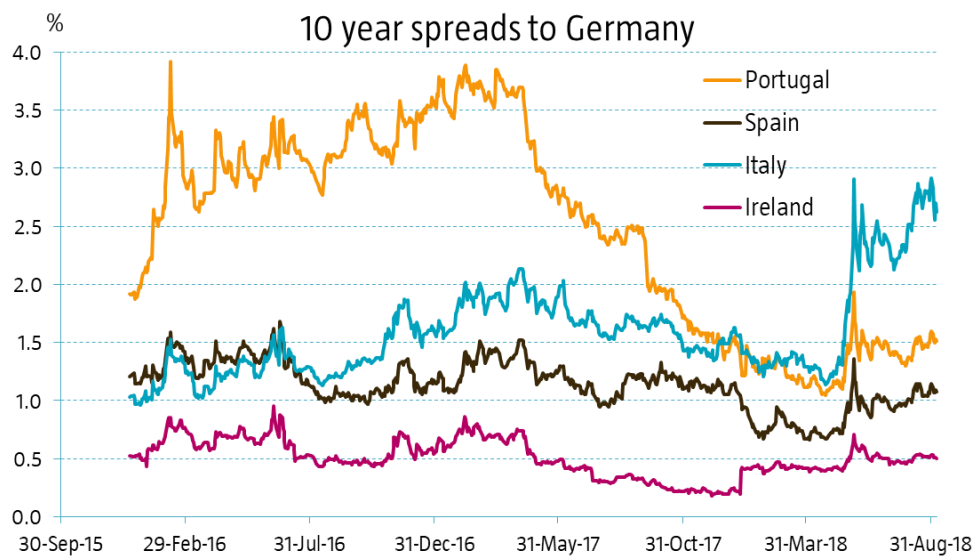
\* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 06 September, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.60	0.06									
2	-0.57	0.16	1.43	0.30	-0.01	0.09	0.10	1.97	0.11	0.06	0.44
3	-0.47	0.21	1.74	0.40	-0.01	0.10	0.10		0.03	0.03	0.43
4	-0.34	0.22	2.07	0.43	0.00	0.10	0.07		0.18	0.09	0.67
5	-0.19	0.25	2.18	0.62	0.01	0.19	0.12	3.54	0.13	0.13	0.86
6	-0.11	0.22	2.51	0.79	0.08	0.21	0.18		0.29	0.11	0.97
7	0.01	0.26	2.54	0.92	0.11	0.28	0.24		0.36	0.21	1.34
8	0.14	0.29	2.45	1.00	0.10	0.30	0.10			0.18	1.43
9	0.25	0.27	2.55	1.05	0.12	0.34	0.23				1.46
10	0.37	0.34	2.62	1.07	0.11	0.35	0.20	3.89	0.50	0.11	1.51
15	0.65	0.46	2.52	1.30		0.47	0.35	4.30	0.72	0.27	1.78
20	0.81	0.41	2.59			0.59	0.26	4.47			1.87
30	1.04	0.57	2.52	1.53	-0.01	0.63	0.33			0.15	1.92

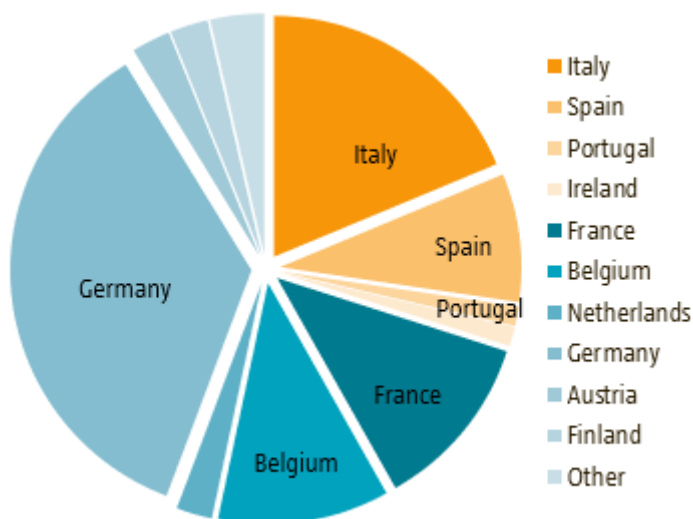
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (06 September, 2018)



Source: Robeco

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