

Peripheral Europe Update

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- **Tensions between Italian coalition parties ahead of the 2019 Budget**
- **Greece already derailing?**

Main market events

Italian bond have continued to rally sharply this week, while other peripheral spreads have tightened modestly. Italian bonds have returned -3.4% year-to-date, Spanish bonds 2.0%, Portuguese bonds 1.7% and Irish bonds 0.4%.

ECB

On Thursday, the ECB press conference that followed the Governing Council meeting was slightly hawkish relative to market expectations. Draghi appeared quite confident about both the strength of the Eurozone economy and the core inflation path, thanks to the recent vivid and broad-based recovery of real wages. Meanwhile the message sent by Mario Draghi this week to the Italian government was pretty clear: the ECB is expecting that the 2019 budget will comply with the EU rules, after the "damage" done on interest rates by certain "words".

Italy

Negotiation about the 2019 Budget led to some tensions between the two coalition parties over the past days. As Italy has now turned to a more prudent and realistic fiscal strategy, the funding available to meet electoral promises appears quite limited. Strains may escalate somewhat as 5 star is losing momentum in polls and may intensify the pressure to get the EUR 10bn to fund its basic income. Meanwhile Lega would prefer a reduction in the minimum retirement age to 62 years in the Budget law (currently 67 from 2019 onwards) rather than the tax rate cut. It would represent 0.3% of GDP if this measure were to be included in the budget next year. If implemented, the probability of rating agencies downgrading Italy would then increase. Against the uncertain political background, economic activity sharply declined in July with industrial production falling by 1.8% MoM (against -0.3% expected).

Greece

This week the head of the European Stability Mechanism (ESM) Klaus Regling threatened Greece to stop debt relief measures if Prime Minister Tsipras were to implement broad tax cuts, raise the minimum wage and postpone the pension cuts. These promises clearly circumvent the agreed fiscal plan with the IMF and the European Commission which targets a primary surplus of 3.5% of GDP.

Robeco Euro Government Bonds

We increased our exposure to long-term Spanish bonds against France this week amid receding tensions surrounding the Italian 2019 Budget. 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 35% invested in peripheral bonds, less than the index level as expressed in market value. Year-to-date the fund's absolute return is -0.37%*.

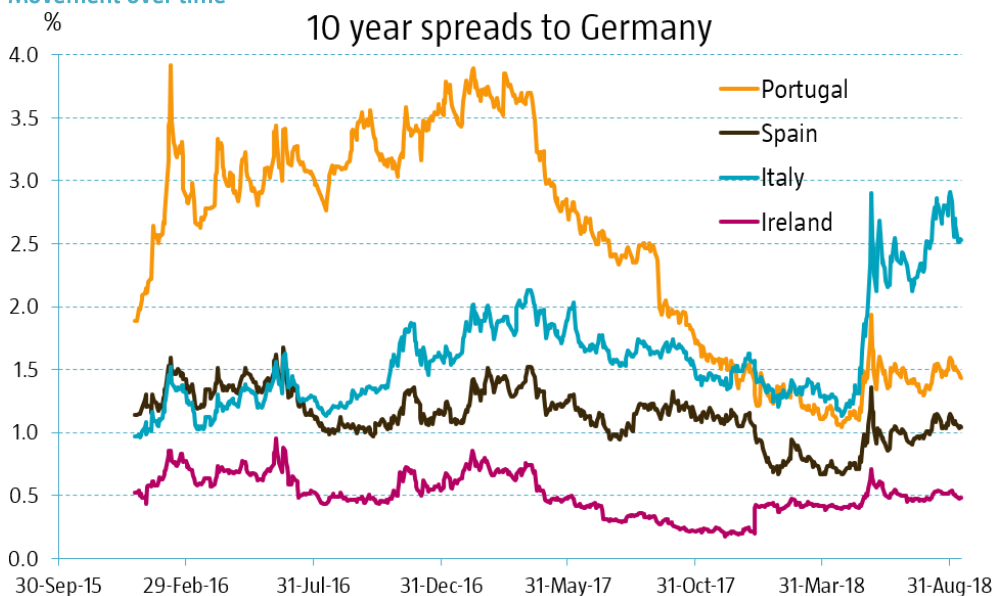
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 13 September, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.59	0.04									
2	-0.54	0.17	1.40	0.31	-0.01	0.10	0.09	1.95	0.10	0.06	0.42
3	-0.44	0.21	1.72	0.41	-0.01	0.10	0.09		-0.01	0.03	0.42
4	-0.30	0.22	1.99	0.44	-0.01	0.09	0.05		0.15	0.10	0.64
5	-0.14	0.25	2.12	0.62	0.00	0.19	0.12	3.29	0.11	0.13	0.82
6	-0.05	0.21	2.45	0.78	0.07	0.20	0.17		0.27	0.11	0.91
7	0.06	0.25	2.49	0.91	0.10	0.27	0.22		0.35	0.21	1.28
8	0.20	0.27	2.39	0.98	0.09	0.29	0.10			0.18	1.36
9	0.32	0.25	2.46	1.03	0.11	0.32	0.21				1.38
10	0.44	0.31	2.53	1.04	0.10	0.33	0.19	3.65	0.48	0.22	1.43
15	0.71	0.45	2.43	1.27		0.45	0.34	4.02	0.70	0.29	1.71
20	0.87	0.40	2.53			0.57	0.25	4.22			1.79
30	1.11	0.55	2.46	1.51	-0.01	0.61	0.33			0.16	1.84

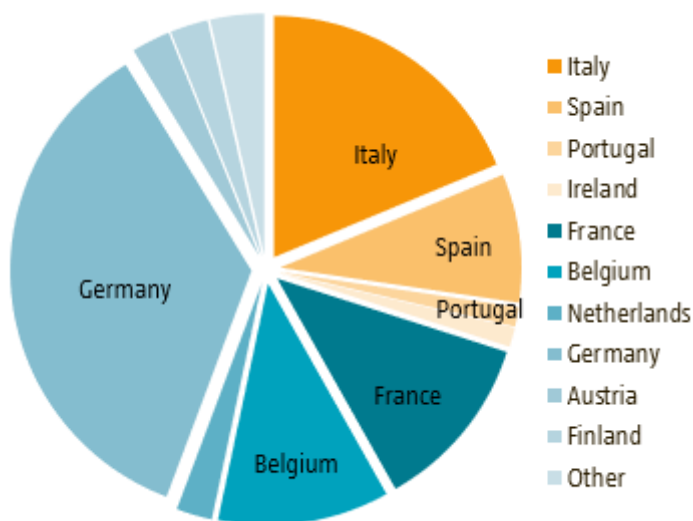
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (13 September, 2018)



Source: Robeco

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