

Peripheral Europe Update

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- **Italy: 1.6% public deficit more difficult to reach amid rising pressures from 5 star**
- **ECB: toward an extension of the forward guidance beyond the first rate hike**

Main market events

Peripheral spreads hardly moved this week, the only exception being Italian bonds which continued to tighten further, despite ongoing headlines regarding the 2019 deficit involving a relaxing fiscal stance. The complacency of market vis-à-vis Italy may appear surprising but the mood was rather on a risk-on mode over the past days. Italian bonds have returned -2.9% year-to-date, Spanish bonds 1.7%, Portuguese bonds 1.6% and Irish bonds 0.0%.

ECB

This week, the ECB has communicated its intention to extend the forward guidance beyond the first rate hike. Two speeches from Executive Board Members, Coeure and Praet, were devoted to the rising importance of this monetary policy tool to guide market expectations on the pace of rate hikes. The form of this forward guidance is not clear yet, although Coeure rejected the idea of a precise numerical guidance such as the Fed dots. They need to proceed with caution given the fragility of future inflation path toward their 2% target.

Italy

Disagreements among Italian officials regarding the 2019 fiscal deficit have continued to trigger headlines this week. Surprisingly the market did not react to the proposal by Di Maio on Wednesday to target a deficit of 2.5% of GDP. Meanwhile, the 1.5 %-1.6% objective defended by the Minister of Finance Tria – which would be acceptable for the European Commission – may prove more difficult to reach. A Lega key official, Giorgetti in charge of negotiating the budget has been reported to aim a higher deficit. It could indeed reach 1.7-1.8% and even possibly above 2% but such levels would require “serious and credible proposals, not measures of demagogic type”. Any level between 1.7% and 2% would involve a deviation from a neutral fiscal stance, but of contained magnitude. It is likely that tensions will continue to escalate between 5 Star and the other members of the government, as Di Maio requests EUR 25bn(1.5% of GDP) to finance his basic income electoral promise(EUR 10bn), the flat tax (EUR 7bn) and the pension reform (EUR 8bn).

Robeco Euro Government Bonds

We maintained our exposure in Spain versus France this week. In Italy we entered a 6-10 slope steeper, as the belly of the Italian curve is flat and we expect it to normalize after the publication of the 2019 budget on September 27th. The 6-year yield may rally more than the 10-year if the deficit is lower than 2%, while the downside risk of this position appeared contained. 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 37% invested in peripheral bonds, less than the index level as expressed in market value. Year-to-date the fund's absolute return is -0.47%*.

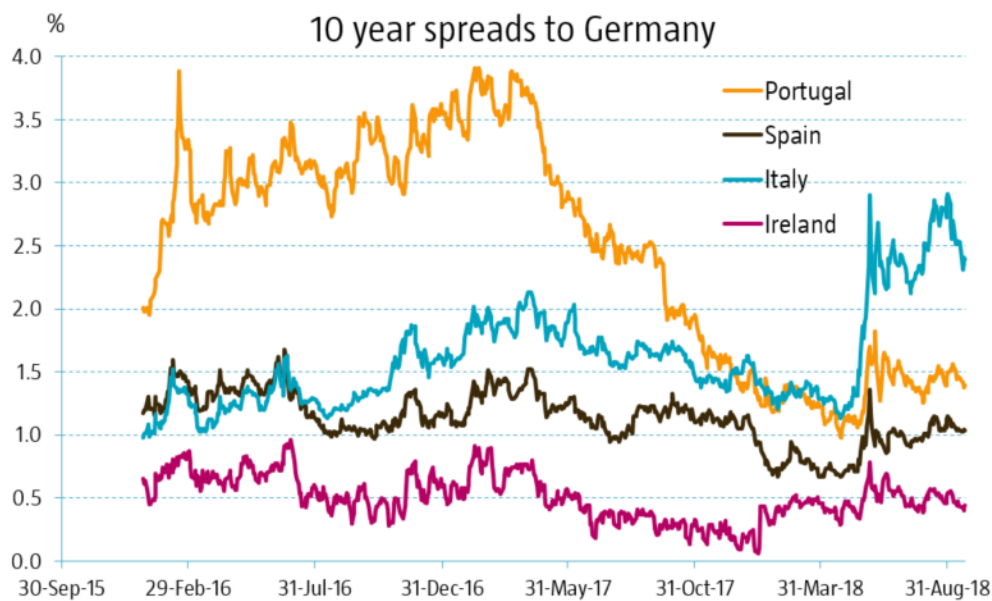
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 20 September, 2018. The value of your investments may fluctuate. Past results are no guarantee of future performance.

Current 10-yr spreads versus Germany

Maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.58	0.05									
2	-0.53	0.17	1.34	0.32	-0.02	0.09	0.09	1.93	0.10	0.05	0.46
3	-0.42	0.22	1.64	0.42	-0.01	0.09	0.09		-0.03	0.02	0.46
4	-0.26	0.23	1.88	0.43	-0.01	0.09	0.04		0.15	0.10	0.66
5	-0.10	0.25	1.99	0.61	0.01	0.18	0.10	3.18	0.10	0.13	0.82
6	-0.01	0.21	2.31	0.78	0.08	0.19	0.17		0.26	0.10	0.91
7	0.11	0.25	2.34	0.91	0.10	0.25	0.23		0.35	0.20	1.25
8	0.24	0.27	2.25	0.97	0.10	0.28	0.10			0.18	1.32
9	0.36	0.25	2.32	1.02	0.12	0.32	0.23				1.35
10	0.48	0.32	2.39	1.03	0.11	0.33	0.20	3.59	0.49	0.23	1.40
15	0.75	0.45	2.30	1.24		0.45	0.35	3.98	0.70	0.29	1.67
20	0.91	0.40	2.41			0.56	0.26	4.19			1.76
30	1.14	0.55	2.36	1.49	-0.01	0.60	0.34			0.16	1.81

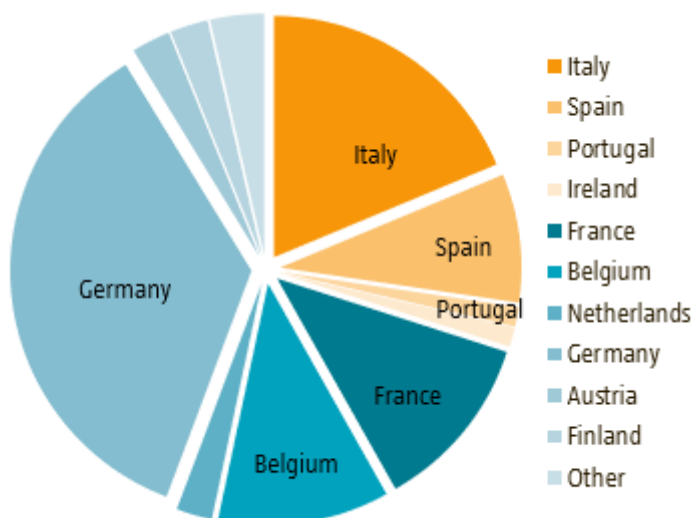
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (20 September, 2018)



Source: Robeco

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