

Peripheral Europe Update

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- **Political uncertainty likely to last in Italy**
- **ECB on a cautious QE exit path**

Main market events

Peripheral spreads have tightened this week, even in Italy, despite initial spread widening after last Sunday's elections. The periphery benefited from the German SPD vote in favor of a Grand Coalition as well as the rather dovish tone of the press conference following the ECB meeting. Draghi downplayed the removal of the easing bias of QE – the possible increase in purchases if needed –, qualifying it as a “backward looking” change. Italian bonds have returned 1.29% year-to-date, Spanish bonds 1.85%, Portuguese bonds 1.34% and Irish bonds -0.25%.

Italy

The two main winners of the Sunday elections were the anti-establishment parties, Five Star (32%) and Northern League (17.6%). Together these parties gained around 50% of the seats, much more than predicted by the polls. That said, it is unlikely that they form a government together. The President of the Republic has still to assign the mandate to form a government to the Prime Minister which is most likely to obtain an absolute majority both in the Lower House and in the Senate. This may not be an easy task as no absolute majority emerged from the three main blocs.

Furthermore, recognizing the defeat of the centre-left, Renzi will resign as PD party leader on 23 March, after the election of the house speaker. Negotiation may last for a protracted period as no party has a real interest to form a coalition with Five Star and at the current juncture we may not exclude repeat elections. Against this background, the European Commission this week requested Italy to implement an additional 0.3pp adjustment to its fiscal stance for 2018 in order to comply with the EU fiscal rules, given the elevated level of its government debt.

Spain

Today the Ministry of Finance and the main unions of civil servants reached an agreement for a rise in payrolls of more than 8% until 2020. Two key conditions will prevail though, which relate to the economy maintaining its pace of growth and the administration continuing their effort in terms of deficit and debt reduction.

Robeco Euro Government Bonds

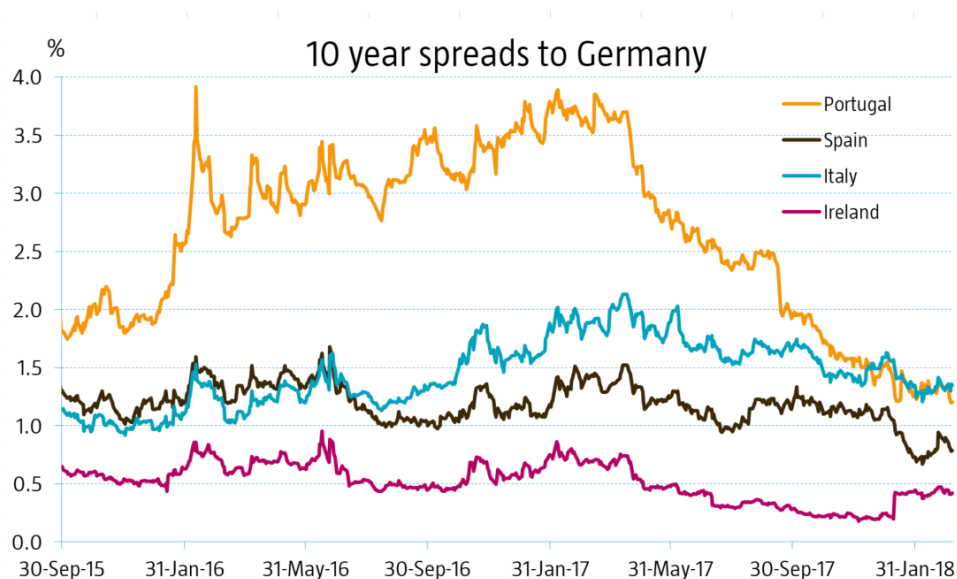
We increased our exposure to Italian government bonds as spreads widened on the outcome of the elections. Italian bond spreads are clearly higher than Spanish spreads, compensating for the weaker fundamentals and the political risks. With strong economic growth, supportive monetary policy and Macron and the new German government pushing for further EMU integration, all spread markets will be supported. We also significantly reduced our underweight position in French government bonds against Bunds. The fund is now overweight Italian 5- and 10-year bonds and 10-year and longer-dated Spanish bonds. The fund still holds no Irish bonds as their spreads over France do not compensate for the potential risks stemming from Brexit and the volatility inherent to Ireland's size. Currently the fund is 47% invested in peripheral bonds, well above index level. Year-to-date the fund's absolute return is 0.43%*.

* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 8 March, 2018.
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Current spreads and the movement over time

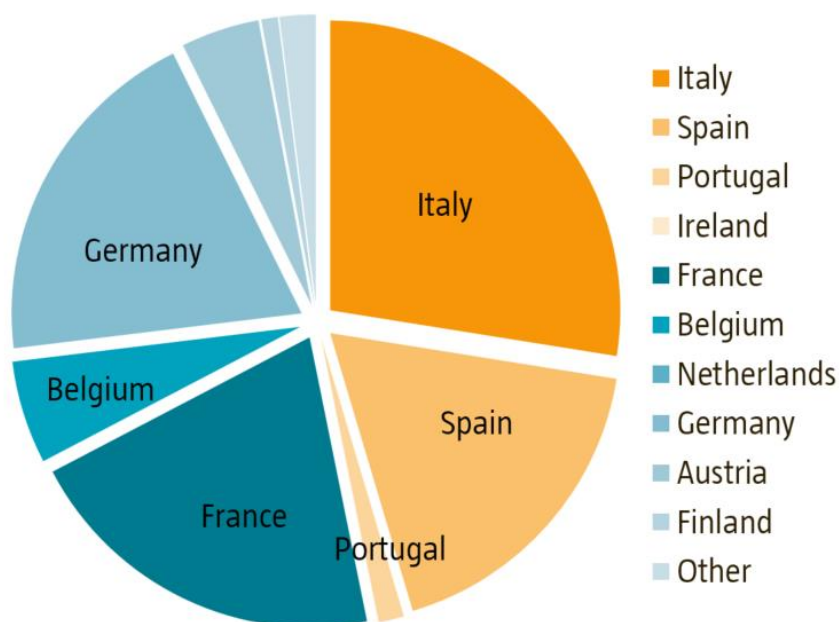
maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.66	0.09									
2	-0.56	0.10	0.33	0.30	-0.07	0.05	0.18	1.96	0.13	-0.02	0.45
3	-0.37	0.17	0.44	0.34	-0.11	0.00	0.20		-0.07	0.02	0.48
4	-0.17	0.16	0.52	0.19	-0.12	-0.03	0.12		0.14	-0.07	0.27
5	0.03	0.12	0.63	0.30	-0.19	0.19	0.17	3.44	0.10	-0.03	0.50
6	0.15	0.15	0.86	0.54	-0.04	0.19	0.22		0.23	0.06	0.82
7	0.29	0.18	1.06	0.60	-0.01	0.23	0.22		0.28	0.02	1.11
8	0.41	0.21	1.19	0.70	0.03	0.25	0.08			0.09	1.13
9	0.53	0.22	1.23	0.75	0.02	0.26	0.22			-0.20	1.15
10	0.65	0.24	1.35	0.78	0.04	0.28	0.20	3.53	0.42	0.10	1.20
15	0.80	0.49	1.70	1.14		0.49	0.39	3.91	0.39	0.20	1.46
20	1.05	0.34	1.72			0.42	0.18	3.85			1.51
30	1.29	0.43	1.74	1.19	-0.02	0.40	0.22			0.09	1.59

Source: Bloomberg



Source: Bloomberg. Note: the recent jump in Irish yields is due to the issuance of a new 10-year bond.

Country allocation Robeco Euro Government Bonds (8 March, 2018)



Source: Robeco

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