

# Peripheral Europe Update

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- **Fitch downgrades Italy**
- **Relief rally after French first round election**

## Main market events

As a result of the market friendly first round election outcome in France, the week started with a relieve rally. French bond yields decreased sharply this week and peripheral bonds followed suit although to a lesser extent. The sharpest moves came from Ireland and Portugal while Italian spreads lagged. The lagging performance of Italy can most likely be explained by last week's downgrade from Fitch. The second and final round of the French presidential election is scheduled for May 7<sup>th</sup>. Italian bonds have returned -1.40% this year, Spanish bonds -0.47%, Portuguese bonds 3.47% and Irish bonds -0.75%.

## Italy

Fitch surprised the market last Friday by downgrading Italy to BBB from BBB+ and switched the outlook from negative to stable. Fitch underscored the low economic growth, the still increasing debt to GDP ratio which stands at 133%, fiscal slippage and political instability as the main reasons for the downgrade. In addition, Fitch added that the weak banking sector is a drag for the economy. According to Fitch political risks have increased as support for the centrist parties have decreased and therefore risks for a weak and unstable government have increased.

## ECB

As expected at last Thursday's ECB meeting, no monetary policy changes were announced. Draghi sounded rather upbeat with regards to the economic development in the euro area, while at the same time saying that inflation and underlying inflation are still too low. In addition, the ECB expects that the current higher inflation is only temporary and therefore the current monetary stance is warranted, and is not expected to change any time soon.

## Spain

The first estimate of Spanish economic growth for the first quarter came out stronger than expected at 0.8 vs 0.7% quarter on quarter and is also stronger compared to the third and fourth quarter of 2016. Although the data on the components of the GDP number are not yet available, it's likely that private consumption was stronger than expected, as confidence and employment numbers have recently improved.

## Robeco Euro Government Bonds

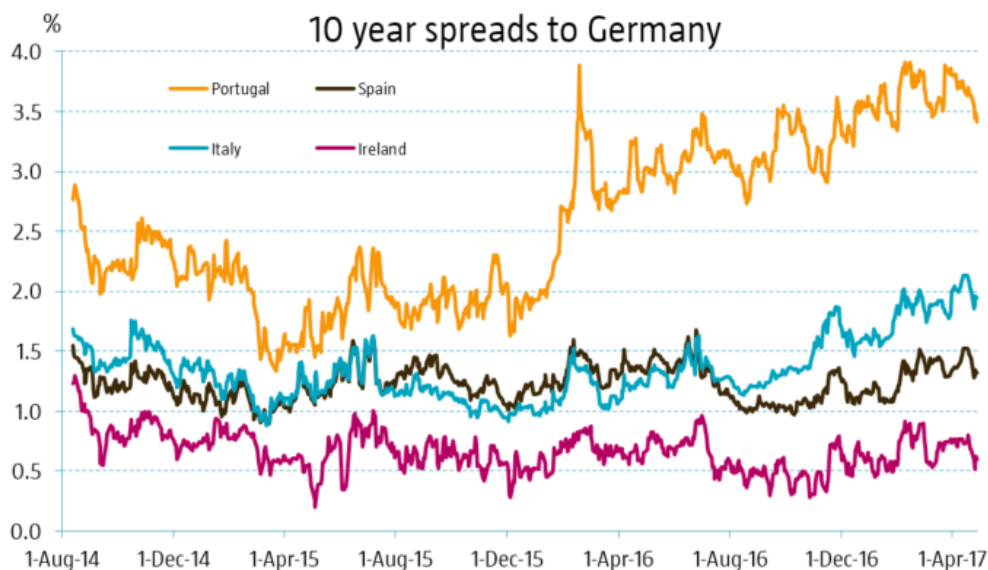
The current positioning in Italy and Spain is neutral. Country spreads have widened this year and are now a better reflection of the current political risks. Spreads can recover if the uncertainty around the French elections abates. On a longer horizon, the withdrawal of the ECB's extraordinary stimulus looms and our fundamental view especially on Italy remains bearish. We maintain our overweight position in Ireland. Irish bond spreads are attractive given the improved Irish fundamentals and its strong ESG scores. Currently the fund is 39% invested in peripheral bonds, in line with the index. Year-to-date the fund's absolute return is -0.86%\*.

\* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, April 27, 2017.  
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Current spreads and the movement over time

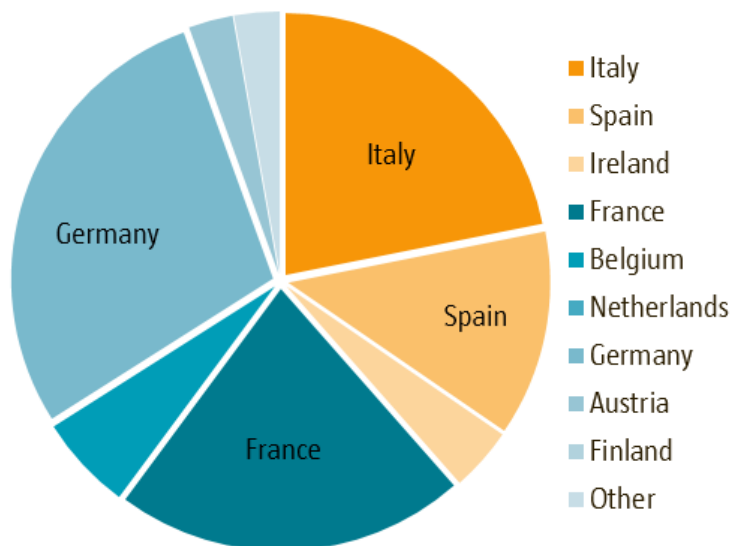
maturity	German yields	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.74	0.19									
2	-0.72	0.28	0.64	0.48	0.07	0.17	0.16		0.31	0.10	1.14
3	-0.66	0.22	0.93	0.59	0.10	0.19	0.21	7.7	0.31	0.09	1.37
4	-0.52	0.25	0.95	0.61	0.08	0.20	0.22		0.27	0.10	1.73
5	-0.36	0.30	1.42	0.80	0.07	0.22	0.16		0.37	0.18	2.34
6	-0.24	0.35	1.53	0.87	0.15	0.24	0.12		0.44	0.12	2.79
7	-0.12	0.41	1.83	1.14	0.20	0.38	0.14		0.56	0.19	2.89
8	0.03	0.50	1.88	1.26	0.24	0.45	0.19			0.10	3.00
9	0.17	0.53	1.93	1.33	0.24	0.45	0.17		0.50	0.18	3.06
10	0.35	0.52	1.95	1.32	0.23	0.46	0.29	6.01	0.53	0.09	3.18
15	0.56	0.67	2.23	1.52		0.60	0.47	6.28	0.78	0.32	3.34
20	0.84	0.69	2.06			0.39	0.31	5.99			3.20
30	1.13	0.70	2.25	1.85	0.07	0.67	0.37			0.19	3.16

Source: Bloomberg



Source: Bloomberg

Country allocation Robeco Euro Government Bonds (April 27, 2017)



Source: Robeco

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