

Dovish feathers

- Fed: not so hawkish Warsh
- ECB: room to cut, if needed
- PBoC: everything but
- BoJ: caught between a weak yen and bond-market volatility

We believe that the portrayal of Kevin Warsh, the likely new Fed Chair, as a hawk is overstated and expect that he will support a further reduction in policy rates by June. Regarding his view that the Fed's balance sheet may be excessively large, we believe it will be difficult in practice to shrink it meaningfully without regulatory adjustments to the ample-reserves regime in the banking system.

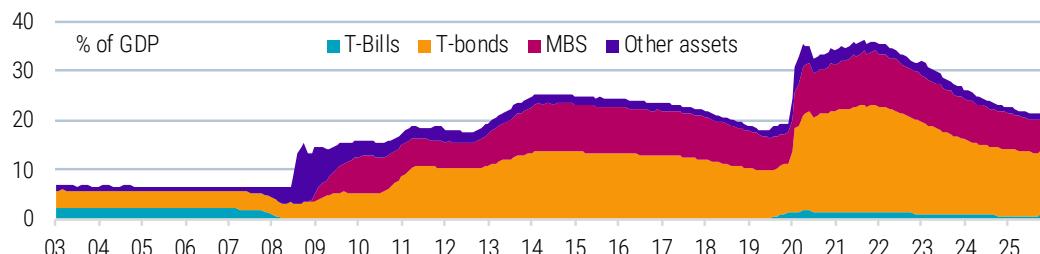
A plausible outcome is that the balance sheet – around 20% of GDP (see chart below) – expands more slowly than the US economy in the coming years, and/or that Warsh advocates for a faster shortening of the average maturity of the Fed's bond portfolio. Regardless of Warsh's perceived preferences on balance-sheet policy, we continue to see more value in the 2- to 5-year segments of the Treasury curve relative to 10-year maturities.

The ECB is in a "good place", but a significantly stronger euro could pressure the bank to soften its hawkish tone, giving the doves an opportunity to assert themselves. We maintain a downward bias for short-term euro rates.

The PBoC is doing everything it can to avoid cutting the key policy rate, aiming to protect banks' net interest margins. However, the recent reduction in rates on structural lending tools and the continued yield-curve management through bond purchases indicate that the central bank's stance remains decidedly dovish. We continue to expect at least one more policy-rate reduction, with late Q1 or early Q2 providing a logical window.

The BoJ, by contrast, will need to shed its dovish feathers if it intends to curb volatility in the yen and long-term yields. Our base case assumes a minimum of two 25 bps rate hikes this year.

Figure 1 – Federal Reserve assets, as % of GDP



Source: Bloomberg, Robeco, 6 February 2025

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The Federal Reserve: Not so hawkish Warsh

- Easing cycle unlikely over despite pause
- Chair pick Warsh less hawkish than feared
- We keep a steepening bias despite altered levels

Easing cycle is likely not over despite current pause

The situation feels somewhat like *déjà vu*. As in 2024, the Fed lowered short-term rates between September and December 2025, only to pause again in January.

Last month's press conference suggested that an extended pause in the near term is quite possible. Chair Powell adopted a more upbeat tone on the economy and labor-market conditions, while maintaining neutral forward-looking guidance.

Nevertheless, we continue to expect at least two additional 25 bps cuts this year. This outlook is premised on renewed signs of labor-market cooling and a more dovish FOMC composition. In particular, starting in May – likely the first meeting chaired by Kevin Warsh – we expect the Fed's easing bias to become more pronounced.

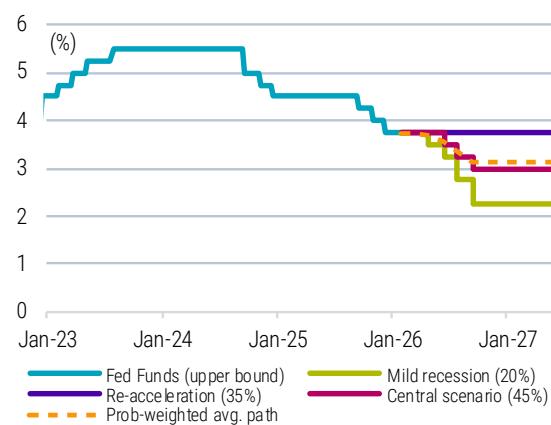
Figure 2 presents our current base case of three cuts later this year, alongside alternative scenarios and related probabilities. Combining these outcomes, our probability-weighted forecast for the Fed funds rate remains slightly below market pricing (Table 1).

Regarding Warsh's view that the Fed's balance sheet may be too large, we believe it will be challenging in practice to shrink it meaningfully without regulatory adjustments that reduce the level of excess bank reserves needed to keep money markets functioning smoothly. A plausible outcome is that the balance sheet – currently around 20% of GDP – grows more slowly than the economy in the coming years, and/or that Warsh advocates for a faster shortening of the WAM of the SOMA portfolio. In any case, he

will be careful not to signal that the Fed intends to fully withdraw from the Treasury market.

Whether Powell steps down (or remains as governor until 2028) will determine whether Governor Miran – who sees room for much more rate cuts – can stay on. We expect Powell to provide clarity once the DOJ probe is resolved, which also appears necessary for Senate approval of Warsh's appointment.

Figure 2 – Three scenarios for the Fed through Jun-27



Source: Bloomberg, Robeco, 6 February 2025

Keeping a steepening bias

Markets currently price around 45 bps of easing in the effective Fed Funds rate, bringing it to roughly 3.2%, close to the midpoint of the FOMC's long-run 'neutral' rate range. Against this backdrop – and considering that the economy retains decent forward momentum – we maintain a near-neutral stance on duration. From a curve perspective, we continue to see more value in the 2-year and 5-year sectors compared to 10-year maturities, given the still-insufficient nominal and real term premia on longer tenors. Indeed, 10-year breakeven inflation at 2.30-2.35% still appears too low to us. With further regulatory easing for banks expected soon, we remain constructive on long positions in 3-5-year Treasuries versus SOFR swaps.

Table 1 - What is priced in for the Fed versus our expectations

Fed funds rate (% upper bound)	3.75	Mar-26	Jun-26	Sep-26	Dec-26
Change implied by FF Futures (bps)		-5	-23	-44	-56
Our probability-weighted expectation (bps)		-5	-24	-64	-64
Our central scenario (bps)		0	-25	-75	-75
Fed funds rate central scenario (% upper bound)	3.75	3.50	3.00	3.00	

Source: Bloomberg, Robeco 6 February 2026

European Central Bank: Room to cut, if needed

- Cuts are not discussed, but there is room to move if needed
- Back up in yields creates opportunities
- Long-end steepening expected to continue

A balanced outlook by the ECB

From the ECB's February meeting we can conclude that the central bank is not rushing to change rates. The statement expressed confidence in the resilience of the economy, which was notable, especially in the current uncertain international environment. What was not mentioned was also important: There was no reference to the strength of the euro, while recent commentary from ECB officials suggested this was becoming a more prominent topic. The euro strength was also downplayed by ECB President Christine Lagarde, by stating that the appreciation was already fully embedded in the December staff forecasts. In answer to other questions Lagarde also took a more hawkish standpoint. The recent decline in headline inflation (now 1.7%) to below target levels, for instance, was seen as not changing the medium-term baseline forecasts "at all." This left an impression that the ECB that has a high hurdle to cut rates. Still, the barrier for hiking rates seems at least equally large. There were also no hints of any discussion in that direction from the February meeting.

The stronger euro matters

For us, the continued decline in inflation and the strength of the euro remain relevant. Not because this will quickly lead to any rate cuts, for that to happen, much larger moves would still be needed. What the inflation and euro moves have done, though, is create room for a rate cut if one were needed should an external shock occur.

We expect core inflation (now 2.2%) and wage growth to calm further in the coming quarters.

Table 2 - What is priced in for the ECB versus our expectations

ECB deposit rate (%)	2.0	Mar-26	Jun-26	Sep-26	Dec-26
Change implied by market pricing (bps)		-1	-4	-7	-7
Our probably-weighted expectation (bps)		-5	-8	-10	-10
Our central scenario (bps)		0	0	0	0
Depo rate central scenario (%)		2.00	2.00	2.00	2.00

Source: Bloomberg, Robeco; 6 February 2026

Growth will benefit from increased fiscal spending, but probably remain close 1.5%. In our opinion this creates two scenarios for the coming quarters: either the ECB keeps rates unchanged (baseline), or they will be cut in response to an external event.

The stable to lower view on official rates should bring some support for front end yields in the Eurozone, notwithstanding some day-to-day volatility. At current yield levels (German 5-year at 2.4%) we see value in long positions in especially 5-7-year Euro Government Bonds. The German yield curve has steepened further in the past months. We see remaining steepening potential in 10-year plus maturities, as an increasing supply meets a falling (pension fund) demand for long-end euro duration.

Figure 3 – German 2-year yield and ECB depo rate (%)



Past performance is no guarantee of future results. For illustrative purposes only. Source: Bloomberg, Robeco, 6 February 2026

The ECB's bond holdings have been shrinking at a stable pace. The new ECB's preferred policy on the balance sheet is as follows: If liquidity in euros becomes scarce, the ECB would not immediately stop reducing its bond holdings. Rather, it would opt to first increase standard refinancing operations, followed by structural and possibly long-term refinancing operations (LTRO). Building a new structural securities portfolio, with short-term bonds, would only come after that.

People's Bank of China: Everything but

- PBoC is pulling multiple levers...
- ...yet continues to resist a further OMO/RRR cut
- CGB purchases still cap long-end yield upside

PBoC continues to resist a cut in the key policy rate

In mid-January, the PBoC decided to reduce rates on various structural liquidity-injection facilities – such as the Pledged Supplementary Lending (PSL) facility – by 25 bps. Lending quotas were also increased.

However, no reduction was made to the key policy rate, the 7-day reverse repo rate. The likely reason is that the PBoC took banks' net interest margins into account: lower borrowing costs from the central bank are giving banks some relief.

At the subsequent press conference, the PBoC nevertheless signalled that it sees room for further monetary easing. This supports our view that cuts in both the reverse repo rate and the RRR are still likely. Domestic demand and inflation pressures remain weak, and a turnaround in the housing market has yet to materialize.

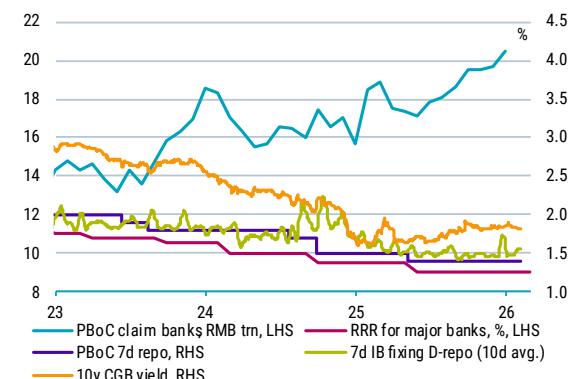
Still, we have not abandoned hopes that the modest improvement in M2 growth and the credit impulse will help domestic cyclical momentum strengthen this year. If this proves correct, the need for additional rate cuts would diminish.

For now, however, we continue to expect at least one more policy rate reduction in our base case. A logical first window would be late Q1 or early Q2. Our outlook for policy rates remains slightly more dovish than current market pricing (see Table 3).

Finally, the central bank's recent commentary on its resumed CGB purchases – less aggressive than in late 2024, as we anticipated – suggests that it

remains ready to counter any sharp rise in government bond yields.

Figure 4 – PBoC claims on banks continue to rise



Source: Bloomberg, Robeco, 6 February 2026

Upside yield control

The 10-year CGB yield, currently around 1.80%, reached 1.90% in January following a strong start for the Chinese equity market. We view 1.90% as a level at which it becomes attractive to take a more constructive stance on longer-term CGBs. This view partly reflects the structural outlook for China's economy, but also the PBoC's de facto yield-curve control mentioned earlier. For now, we prefer to maintain an underweight position.

The 2s10s CGB curve has steepened since November – when we recommended a steepening bias – to around 45 bps. With the 2-year yield slightly below 1.40%, close to the current PBoC 7-day reverse repo rate, we expect curve dynamics to be driven primarily by the 10-year tenor.

Table 3 - What is priced in for the PBoC versus our expectations

PBoC 7-day reverse repo (%)	1.40	Mar-26	Jun-26	Sep-26	Dec-26
Change implied by forwards (bps)		-1	-9	-9	-7
Our probability-weighted expectation (bps)		-2	-8	-11	-13
Our central scenario (bps)		0	-10	-10	-10
PBoC 7-day reverse repo in central scenario (%)	1.40	1.30	1.30	1.30	1.30

Source: Bloomberg, Robeco; 6 February 2026

Bank of Japan: Caught between a weak yen and bond-market volatility

- Sweeping victory for PM Takaichi
- BoJ to gradually normalize rates
- Weak yen remains the strongest inflation driver

A lone decanter

Following December's hike to the highest rate in decades, the January MPM delivered an 8–1 vote to keep policy rates unchanged. From the Summary of Opinions, it's evident that the BoJ is preparing to declare victory on the 2% price target, outlining the specific conditions, and stating they are likely to be met in the spring. This comes despite inflation dipping into Q1 as last year's surge in rice prices drops out and temporary government subsidies for electricity and gas kick in.

LDP secures landslide victory

The LDP victory simplifies legislation, securing 316 out of the 465 seats. The party thereby reaches a two thirds majority on its own, allowing them to overrule upper house vetoes. One of the campaign pledges was to eliminate the 8% VAT rate for food, a measure costing around 0.8% of GDP annually. The announcement of the plan sent jitters through global bond markets. Japan is running a modest primary deficit of around -0.9% and high nominal growth has helped to bring down the very high government debt-to-GDP ratio. The coalition parties are walking a tightrope as the rise in interest rates will steeply increase the debt servicing costs going forward. Historically, the LDP has favored greater fiscal discipline relative to many opposition parties, though Takaichi's actual policies are yet to be tested.

Sticking with June for the next hike

Headline CPI will decline during Q1. A June hike allows policymakers to incorporate the April CPI report (released in May). This will be an especially important inflation print as many Japanese firms implement price changes at the start of a new fiscal

year. At the June meeting the BoJ will also update its tapering schedule of JGB purchases and we expect they will maintain a gradual quarterly reduction. After June, we pencil in a continued semi-annual hiking path but acknowledge that hikes can be brought forward if inflationary pressures broaden out. The terminal rate is priced in the middle of BoJ's neutral range at 1.75%. We believe the market is right not to price into restrictive territory given that inflation is predominantly driven by goods and a weak currency.

Figure 5 – 10 & 30 year JGB yields



Past performance is no guarantee of future results. The value of your investments may fluctuate. Source: Bloomberg, Robeco, 6 February 2026

Taking both political risk and BoJ expectations together, we remain cautious on JGB duration and are positioned for a flatter curve. We avoid the long end, as volatility is high in this unbalanced part of the JGB market. The BoJ holds over half of the JGB market, but its holdings are concentrated around the 10-year maturity (around 70% of issued bonds). In contrast, they hold only a quarter of 30-year bonds. This leaves a high free-float in the long-end and does not match domestic demand, causing foreign investors (who are typically sensitive to short-term market moves) to take-up the excess supply.

Table 4 - What is priced in for the BoJ versus our expectations

Policy balance rate (%)	0.75	Mar-26	Jun-26	Sep-26	Dec-26
Change implied by OIS (bps)		7	26	42	56
Our probability-weighted expectation (bps)		8	24	42	60
Our central scenario (bps)		0	25	25	50
Policy balance rate in central scenario (%)	0.75	1.00	1.00	1.00	1.25

Source: Bloomberg, Robeco, 6 February 2026

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