

Balance sheet blues

- Fed: rushing to stop QT
- ECB: maintains its worn, but worthy, catch phrase
- PBoC: if it looks like QE...
- BoJ: waiting for wages

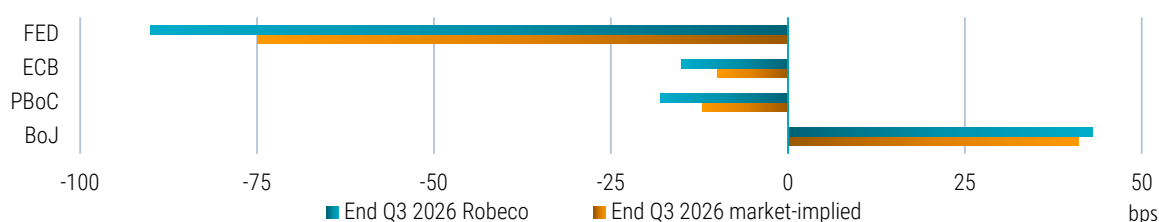
The Fed's balance sheet rundown has been creating some blues in the US. Money market conditions have been tightening, resulting in the Fed's decision to end its quantitative tightening (QT) program as per 1 December. From early 2026, we expect the Fed to start reserve management purchases (RMP) as well as grow its balance sheet again in line with nominal GDP. This should alleviate some pressure on front-end rates, which we expect to fall further in the coming months and quarters, even in the event of a December rate pause.

Meanwhile, the ECB's balance sheet reduction has been running smoothly. In a recent speech, Governing Council member Isabel Schnabel laid out her plans for future balance sheet adjustments. She sees the reduction of bond holdings as a process of Quantitative Normalization (so QN, not QT). Schnabel has no intention of stopping the process, and her view most likely reflects those of a broader coalition of Council members.

In contrast, the People's Bank of China prefers to give its balance sheet a boost. In October, the PBoC announced the resumption of Chinese government bond (CGB) purchases to cap bond yields and stimulate the economy.

Perhaps the purest balance sheet blues is being felt in Japan. The balance sheet of the BoJ has been declining for over a year and is scheduled to do so at an ever-faster rate over the next two years. The combination of rate hikes and a smaller BoJ influence on Japanese government bonds (JGBs) has pushed rates higher. We will monitor this closely as the new Takaichi government has expressed a preference for looser monetary and fiscal policies.

Figure 1 – Outlook for central banks' policy rates



Source: Bloomberg, Robeco, based on money market futures and forwards, 14 November 2025

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The Federal Reserve: rushing to stop QT

- Easing cycle not done even with near-term pause
- Fed to soon expand its balance sheet again
- Keeping a steepening bias; eyeing 5y on ASW

Caution creeps in, but easing path remains open

Since May, we have anticipated that a softening labor market would prompt the Fed to resume its easing cycle, ultimately returning policy to a neutral stance despite ongoing inflation risks. Thus far, this scenario is unfolding as expected.

Admittedly, Chair Powell emphasized in late October that a further rate cut at the December meeting is 'far from a foregone conclusion', while highlighting that inflation risks remain tilted to the upside. Nonetheless, Powell also noted that monetary policy is still considered 'modestly restrictive', which in our view keeps the door open for further easing.

So even if the Fed opts to pause in December, the easing cycle is unlikely to be done. Our base case continues to expect a terminal policy rate of 2.75 – 3.00%. This could be reached in 1H 2026 if labor market conditions fail to improve, or later – after a new Fed Chair assumes office in May 2026. We view Mr. Hassett and Mr. Rieder as the key candidates.

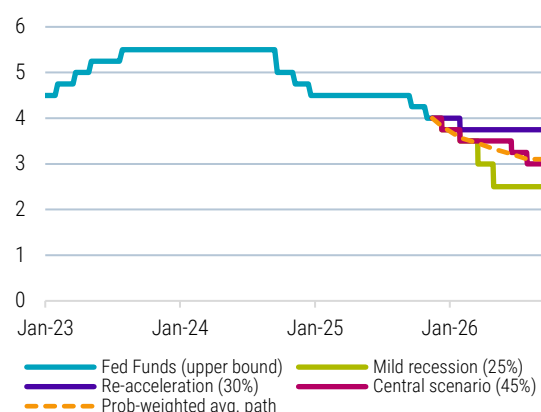
We assign a 25% probability to a recessionary scenario, which would warrant deeper rate cuts. Conversely, we also assign a 30% chance to a scenario in which only limited further easing occurs – should inflation prove more persistent, and the economy re-accelerate. Considering these scenarios, our probability-weighted forecast for the Fed funds rate is slightly below market pricing (Table 1).

Due to tightening money market conditions, the Fed has also decided to end the reduction of its aggregate securities holdings (i.e., Quantitative Tightening, QT) on December 1. This is earlier than most had expected and sooner than implied by the forward guidance Powell gave earlier in October.

From December all principal payments from Treasury holdings will be reinvested across the curve, while all mortgage-backed securities (MBS) redemptions will be reinvested in Treasury bills.

From early 2026, we expect the Fed to start reserve management purchases (RMP) and grow its balance sheet again, in line with nominal GDP, as presaged in the NY Fed's [2024 Annual Report on Market Operations](#). Some will call it quantitative easing (QE), we will simply say that now around 20% of GDP in US government debt will have been permanently monetized by the Fed.

Figure 2 – Three scenarios for the Fed through Sep-2026 (%)



Source: Bloomberg, Robeco, 14 November 2025

Keeping a steepening bias

The market is pricing in a Fed funds' trough of 3%, which sits within the Fed's long-term neutral range. This means weak labor market data are required to push short-end rates a lot lower. Curve wise, we still see more value in owning 2-year and 5-year bonds than 7-year or 10-year, given the still-too-small nominal and real-term premium observed in the latter. Indeed, 10-year break-even inflation at 2.30%, seems too low. Regulatory easing for dealers could result in further outperformance, especially of 3–5-year cash bonds versus swaps. We are eyeing sub-32 bps as a level to suggest long positions in 5-year US bonds.

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

Fed funds rate (% upper bound)	4.50	Dec-25	Mar-26	Jun-26	Sep-26
Change implied by FF Futures (bps)		-13	-34	-57	-75
Our probability-weighted expectation (bps)		-18	-55	-79	-90
Our central scenario (bps)		-25	-50	-75	-100
Fed funds rate central scenario (% upper bound)		3.75	3.50	3.25	3.00

Source: Bloomberg, Robeco, 14 November 2025

European Central Bank: a worn but worthy catch phrase

- ECB sees little reason to change policy
- Searching for entry levels to increase duration
- Back-end steepening expected to continue

Gradually cooling inflation

The ECB Governing Council is quite happy with the current level of official rates. That's the unmistakable impression of the last Governing Council meeting, as well as from remarks over the past few weeks. In fact, ECB officials will have to start looking for a new catch phrase, as 'in a good place' is starting to feel stale. Despite the 'tired' text, we have to agree with the ECB's message.

Given current economic conditions, there's not much reason for immediate action. The same can be said for inflation, which looks set to decline slightly but remain close to the 2% target. The stabilization of the euro, following a period of rapid appreciation, also supports a calmer growth and inflation outlook. The market agrees and is pricing in a stable trajectory for official rates. Over a six-month period, pricing indicates a slight tilt towards cuts rather than hikes. We agree with this view. Our base case is for the ECB to keep rates unchanged in the coming quarters, however with a probability-weighted outlook that skews downward.

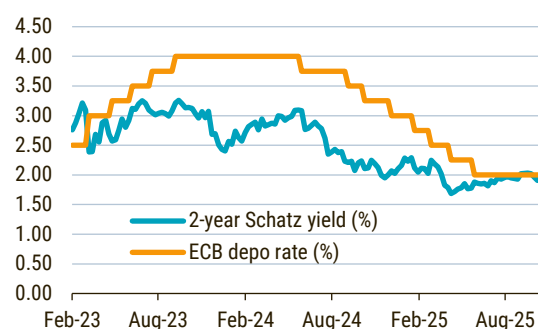
Risks remain skewed towards lower rates

While international trade risks have reduced, there's still a lingering chance of a negative shock from trade tensions. Risks to inflation seem quite balanced; if anything, the upside risks seem to be getting smaller. The continued moderation of wage growth adds to this trend, suggesting that, for now, the hurdle to hike is probably still larger than the hurdle to cut rates.

The ECB's rate pause means there is some room for more volatility at the front end. Still, given economic conditions, we don't expect a major shift in front-end

rates. Bunds have been cheapening recently, and we see value in long positions from a level of circa 2.75% in the 10-year Bund, or 2.35% in the 5-year Bobl. For the curve, we expect continued steepening potential in 10-year plus maturities, as an increasing supply meets 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. The value of your investments may fluctuate. Source: Bloomberg, Robeco, 17 November 2025.

After a long period of silence, ECB balance-sheet policy also received some attention. In a recent speech, ECB executive committee member, Isabel Schabel, ([Towards a new Eurosystem Balance Sheet](#)) explained the preferred policy in case of liquidity scarcity. Liquidity in euros is not scarce at the moment, but in the event of a decline, 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). Sometime after the launch of LTROs, it could build a new structural securities portfolio. This portfolio would primarily invest in short-term securities. This is clearly a different route than the Fed (see previous section).

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

ECB deposit rate (%)	2.0	Dec-25	Mar-26	Jun-26	Sep-26
Change implied by market pricing (bps)		0	-5	-10	-10
Our probability-weighted expectation (bps)		0	-10	-10	-15
Our central scenario (bps)		0	0	0	0
Depo rate central scenario (%)		2.00	2.00	2.00	2.00

Source: Bloomberg, Robeco, 17 November 2025

People's Bank of China: if it looks like QE...

- PBoC has resumed CGB purchases
- Makes rate- and RRR cut less likely near term
- And caps upside potential in long-end yields

If it looks like QE...

Since the People's Bank of China (PBoC) introduced a broad stimulus package in May – including a 10 bps rate cut – it has kept its key policy rate, the 7-day reverse repo rate, unchanged at 1.40%.

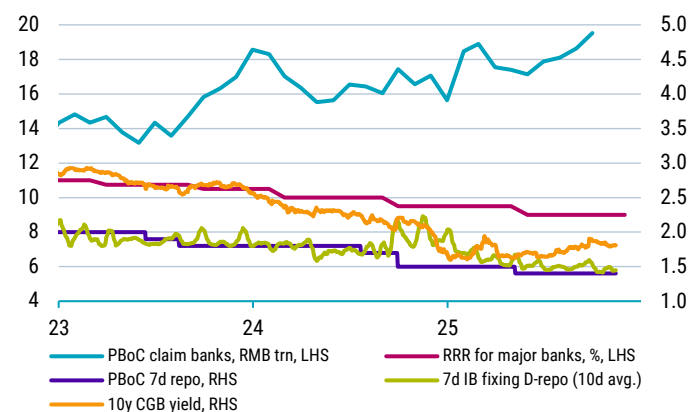
Since then, however, the PBoC has continued to expand its balance sheet to support the economy and financial markets. Last month, it also announced the resumption of Chinese government bond (CGB) purchases starting in late October. This move was likely aimed at capping the rise in bond yields that accompanied the rally in equity prices.

The rationale appears twofold: first, despite the trade truce with the U.S., the Chinese economy remains vulnerable, relying heavily on exports, with few signs of a meaningful recovery in the housing market. Second, inflation remains subdued. Headline inflation may rise slightly in the coming months – helped by base effects in food and energy – after returning to positive territory in October. However, core inflation (currently 1.20% YoY) could ease again, as part of last month's increase was driven by higher gold prices.

In the second half of 2024 – when long-term sovereign bond yields fell sharply (see Figure 4) – the PBoC purchased more than 2.5% of outstanding CGBs, based on our calculations. Although we do not expect purchases of the same magnitude as in Q4 2024, the implication is that the reserve requirement ratio (RRR) cut and the additional 10 bps policy rate reduction we had anticipated by year-end are now likely to be pushed into 2026.

Looking further ahead, our outlook for policy rates remains slightly more dovish than current market expectations (see Table 3).

Figure 4 – PBoC is pulling several levers (%)



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Yield control¹

Although the yield on 10-year CGBs (currently around 1.80%) is higher than at the start of the year (1.60%), when the PBoC had just halted its bond purchases, the net increase has been fairly limited. In September, it briefly appeared that the 2% level was within reach, partly due to tax changes on coupon interest. However, the announcement of the second round of central bank bond purchases effectively capped the 10-year yield around 1.80%. The 2s10s CGB curve is also trading in a narrow range near 35 bps.

While a renewed rise in the 10-year yield to 2% or above seems less likely in the near term – given the PBoC's de facto yield curve control – we still lean toward maintaining a slight underweight in long-dated CGBs. We also retain a steepening bias on the 2s10s curve. That said, we are lowering the threshold for further reducing the underweight position.

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

PBoC 7-day reverse repo (%)	1.40	Dec-25	Mar-26	Jun-26	Sep-26
Change implied by forwards (bps)		-3	-6	-12	-12
Our probability-weighted expectation (bps)		-2	-8	-17	-18
Our central scenario (bps)		0	-10	-20	-20
PBoC 7-day reverse repo in central scenario (%)		1.40	1.30	1.20	1.20

Source: Bloomberg, Robeco, 14 November 2025

¹ Past performance is no guarantee of future results. The value of your investments may fluctuate.

Bank of Japan: waiting for wages

- BoJ pause drags on
- A hike in January very likely
- Fiscal risks nearing, as Takaichi assumes power

Split votes between BoJ members

At its October meeting, the Bank of Japan (BoJ) maintained its policy stance, with members voting 7-2 in favor of keeping rates unchanged. The meeting minutes show policymakers opted to wait and assess the momentum ahead of next year's spring wage negotiations. This momentum should become clear before the December or January meeting, in the form of individual trade union announcements as well as from the regional branch report due in January. Early signs of progress on wages came from UA Zensen, Japan's largest industrial trade union, which in late October demanded a 6% wage increase for 2026.

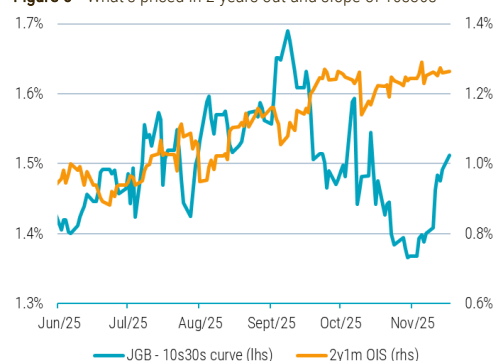
Easy as 1-2-3

In the meantime, Japan's economy is still on course to meet BoJ conditions, namely: 1% real economic growth, 2% inflation, and 3% realized wage growth. While realized wage growth on some measures has come in below 3%, the central bank stated this could be due to sampling biases. Inflation remains above target, driven mostly by energy and food costs with the weak JPY causing this to continue. Headline GDP growth is volatile due to US tariffs affecting the trade components, a deeper look reveals domestic consumption remains solid.

In our base case, we continue to expect a semi-annual hiking pace which should plateau around 1.5 - 1.75% in 2 years' time. Our probability weighted path aligns closely with market pricing, as a tail risk remains that the BoJ at some point will be forced to halt its normalization process, driven by a US slow-down or a deviation from the domestic economy's '1-2-3' growth path.

Looking ahead, we think a December hike is unlikely without additional BoJ guidance. In addition, liquidity decreases in the second half of December make a move in January more likely. In the meantime, Japanese government bond (JGB) yields up to the 10-year are in a holding pattern, driven by stable BoJ expectations. However, as there is some uncertainty over Takaichi fiscal policies, we skew somewhat underweight JGBs.

Figure 5 –What's priced in 2 years out and slope of 10s30s



Source: Bloomberg, Robeco 17 November 2025

Waiting to pounce on long-end flatteners

Following the formation of a new LDP-Ishin coalition, Sanae Takaichi has been confirmed as Japan's next Prime Minister. Takaichi is widely regarded as a proponent of loose monetary and fiscal policy. The first key test for markets will be the supplementary budget expected later this month. Takaichi has stated she will increase spending 'without hesitation' and will allow for a more flexible spending budget, in effect, watering down previous governments' commitments to fiscal consolidation.

This could unsettle long-end JGB yields. Given our base case for gradual hikes and a very steep JGB curve, this creates opportunities to enter flatteners – trades that benefit from reducing spreads between long and short-term rates. In most other rates markets, the 10s30s curve tends to flatten as the policy rate is increased. However, this behavior has yet to materialize in Japan.

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

Policy balance rate (%)	0.50	Dec-25	Mar-26	Jun-26	Sep-26
Change implied by OIS (bps)		8	22	32	41
Our probability-weighted expectation (bps)		9	23	33	43
Our central scenario (bps)		0	25	25	50
Policy balance rate in central scenario (%)		0.50	0.75	0.75	1.00

Source: Bloomberg, Robeco; 17 November 2025

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