Monthly Interest Rates Chartbook
September 2025

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Economic Summary

US Forecasts

We expect near-term growth softening with rebound in H2 26.

	2025			2026			
(%)	Q2 Act	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP QoQar *	3.0	2.6	1.2	1.0	2.1	3.1	2.7
Real GDP YoY	2.0	1.9	1.6	2.0	1.7	1.9	2.2
Core PCE YoY *	2.7	2.8	3.0	2.8	2.9	2.7	2.2
Unemployment *	4.2	4.6	4.7	4.7	4.5	4.3	4.2
FDTR Lower Bound	4.25	4.00	3.50	3.00	3.00	3.00	3.00
FDTR Upper Bound	4.50	4.25	3.75	3.25	3.25	3.25	3.25
FDTR Midpoint	4.38	4.13	3.63	3.13	3.13	3.13	3.13
2 Year	3.72	3.60	3.25	3.25	3.25	3.25	3.25
10 Year	4.23	4.00	4.00	4.25	4.25	4.25	4.25

Summary of views

- We expect the Fed to cut rates in response to the slowing labor market
  - We look for the Fed to cut the fed funds rate by 75 bps by year-end
    - And to move quickly next year to bring the policy rate back to neutral (est. 3%)

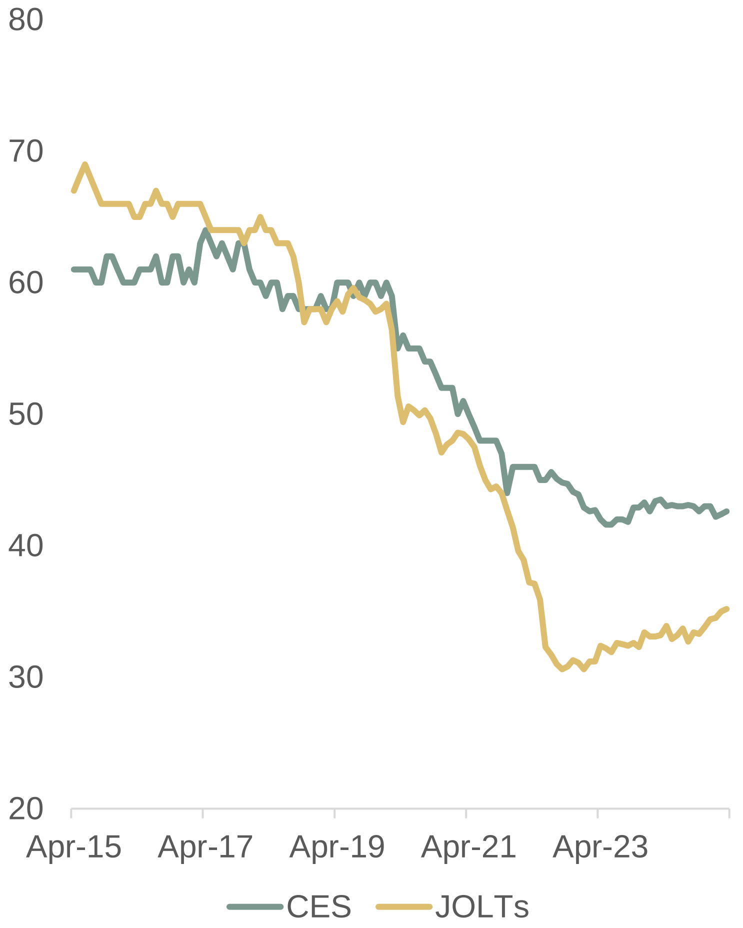
- The slowdown in hiring has accelerated since April
  - But the BLS' preliminary benchmark revision (of -911,000, or -0.6%) suggests that hiring was *already* cooling in 2024 and early 2025
    - This is in addition to labor supply slowing, driven by changes in immigration flows

- Tariffs and policy uncertainty have added to the downward pressure on growth

- We look for inflation to trend lower as weakness in the housing market pulls shelter costs lower
  - We expect lower services inflation will overcome the effect of tariffs on goods prices
    - So far, the effect on goods prices has been small and disparate

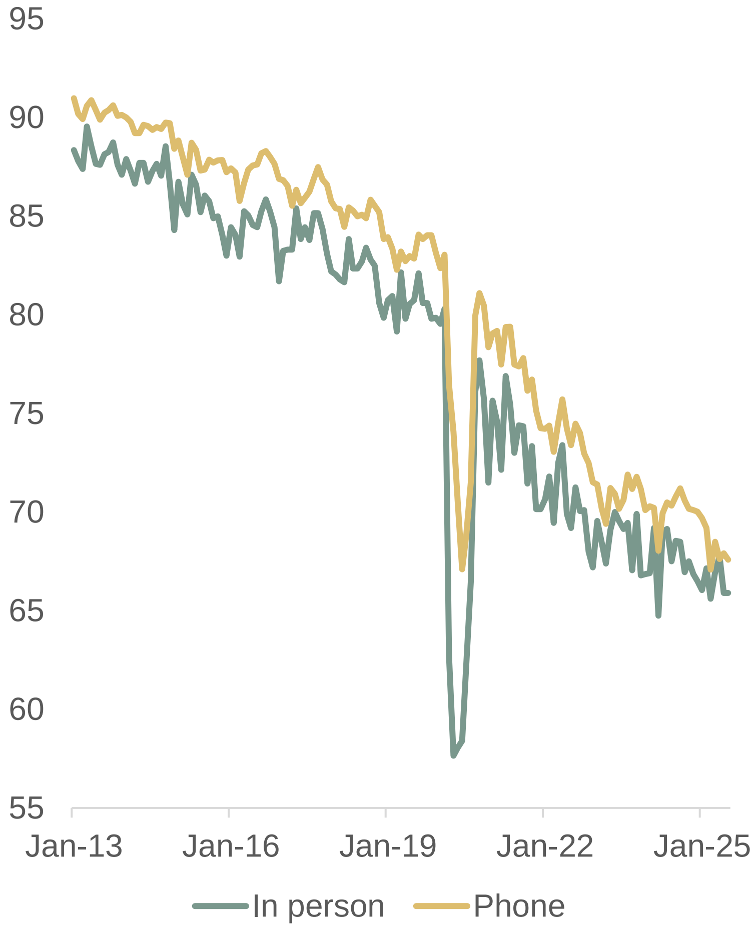
Labor statistics response rates are falling

Employer surveys (% response)



Note: Non-farm payroll data are collected from the CES.
Sources: BLS, SMBC Nikko

Household survey (% response)



Note: Households are sampled for 8 non-consecutive months of which two are in-person interviews with BLS agents. The figures are averages.
Sources: BLS, SMBC Nikko

Do non-responses bias the unemployment rate?

- In theory, the decline in the response rate should not bias the unemployment rate *if* non-respondents and respondents are similar. But, in practice the two groups may be different.
- Assessing the scale of any bias is difficult because, unlike the payrolls data, there is no easily available benchmark data set.
- A comprehensive mapping of income and administrative data between survey respondents and non-respondents suggests the latter are more likely to be unemployed and have lower incomes.
- However, these differences are small and within the monthly measurement error in the jobless rate.

Paying survey for responses

- Past data collections suggest that paying respondents can increase response rates.

  - Our sense is that this might speed up responses and reduce the need for follow-up interviews for “harder-to-reach” respondents in the household survey.
    - But it might not overcome non-response resistance in the household survey.

- We expect non-responses will continue to grow
  - The BLS may need to do more work linking the household survey to administrative data from other sources. This may become easier through AI.

Interest Rates Strategy

Interest rates summary

- The funding outlook through year-end will depend on two key influences:
    - Liquidity – or the ampleness of reserves relative to bank demand
    - Dealer balance sheet capacity

- Both seem relatively benign although there may be intermittent pressure on settlement and reporting dates. This may trigger some SRF borrowing

- Tariff effects on inflation are expected to be temporary – 10y inflation breakevens are only slightly higher this year.
    - That said, they are about 40bp higher than our model estimate which may also reflect concerns about Fed independence

- Investors expect the Fed will pull the fed funds rate below 3% by 2027. The FOMC consensus, however, expects the rate to remain above that level through 2028
    - We think the Fed's projected easing path and (global) fiscal worries argues for curve steepening

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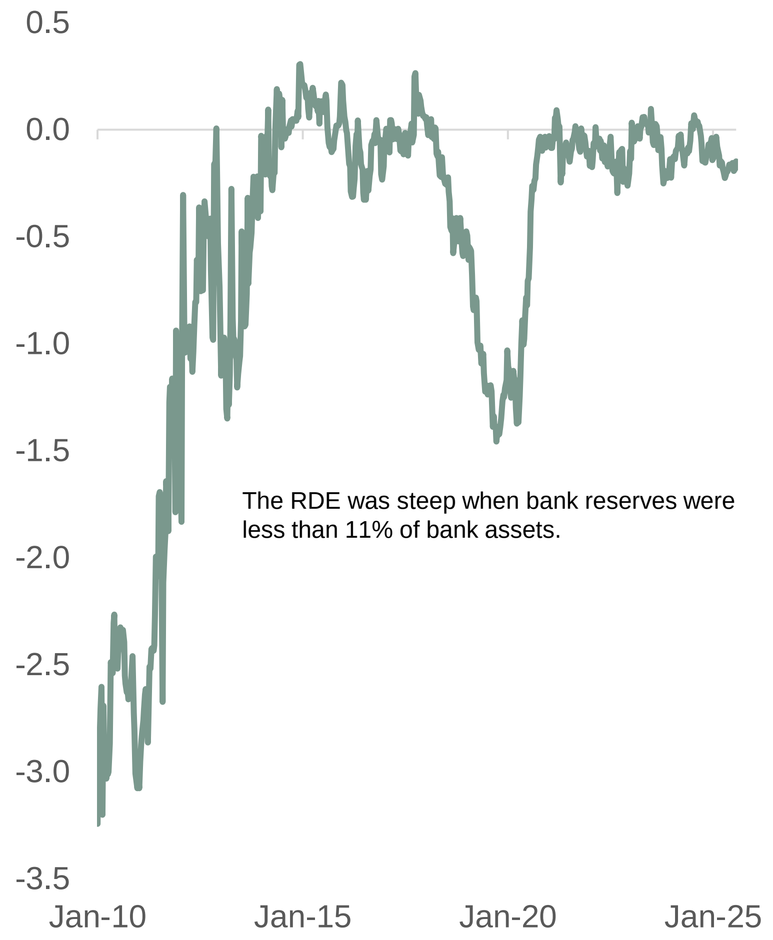
Bank reserves remain ample for now…

- Reserve demand elasticity (RDE) measures the slope of banks' demand curve for reserves
  - When the slope is close to zero, a 1% decline in the ratio of bank reserves to total bank assets has no effect on the FF-IORB spread

- Past periods when the RDE was steep have been associated with bank reserves at 11% or less

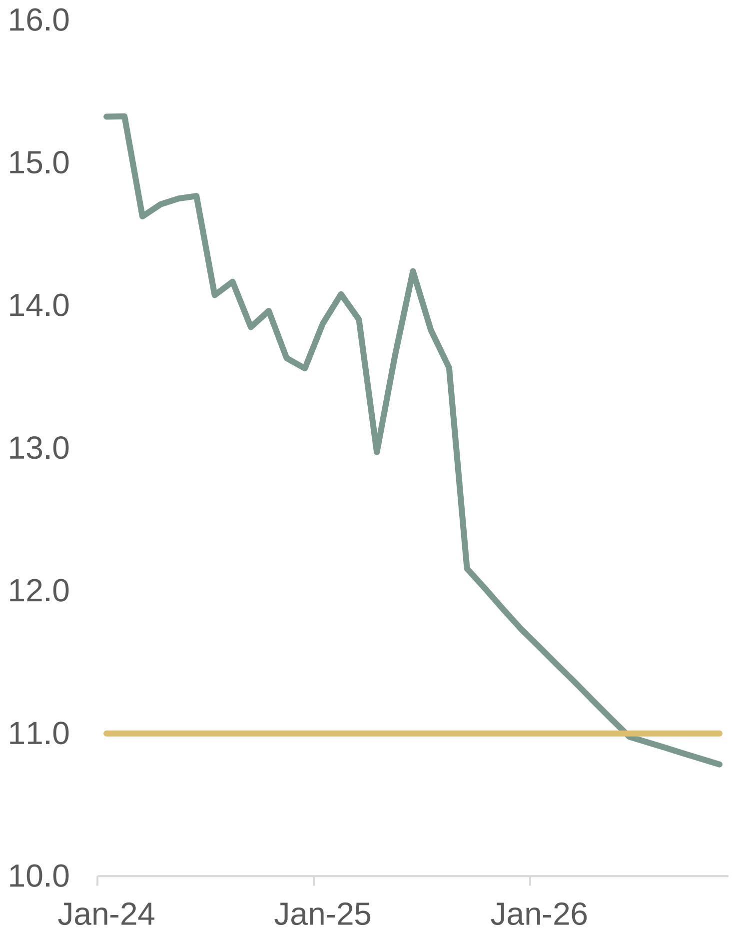
Median RDE (bp)



Source: Federal Reserve Bank of New York, SMBC Nikko

…but balances are expected to fall sharply this fall

Bank reserves (% bank assets)

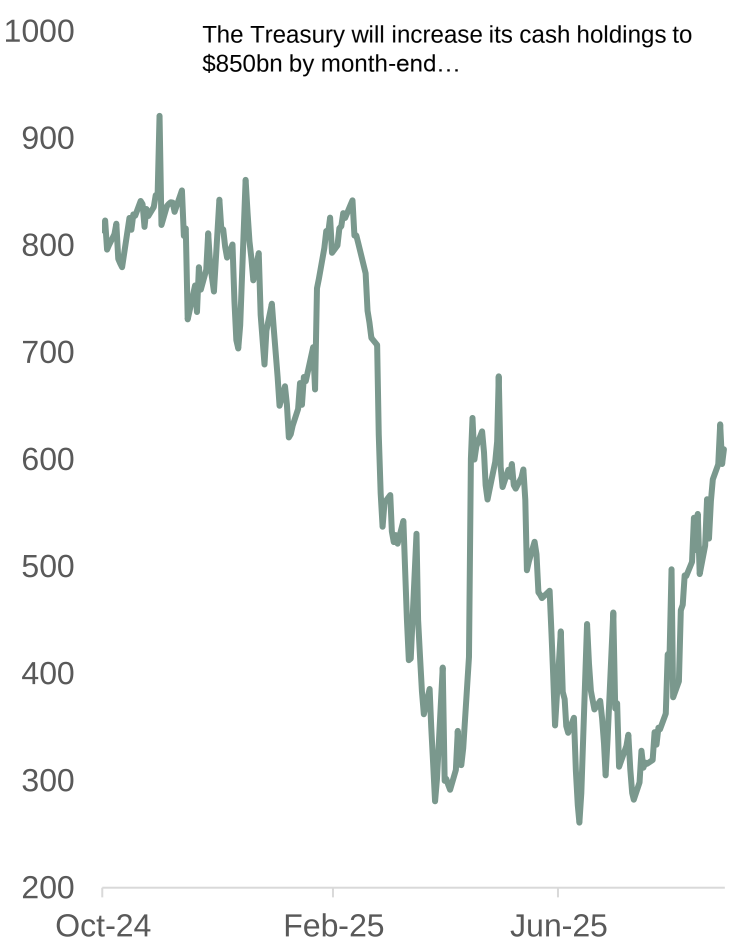


Sources: Federal Reserve, SMBC Nikko

- The Treasury's cash restocking (to $850bn) is likely to pull the bank reserve ratio from 13.6% in August to 12.2% in September
  - Thereafter we expect balances to drift below 12% by year-end

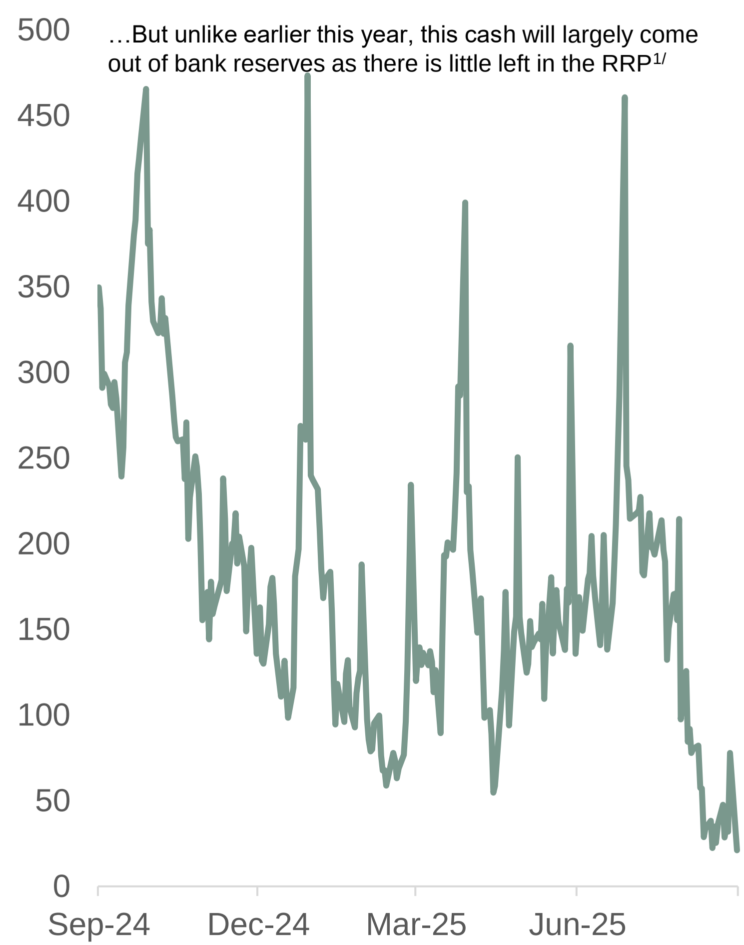
…as the Treasury restocks its cash balance

Treasury cash balance ($bn)



Sources: US Treasury, SMBC Nikko

RRP balances ($bn)

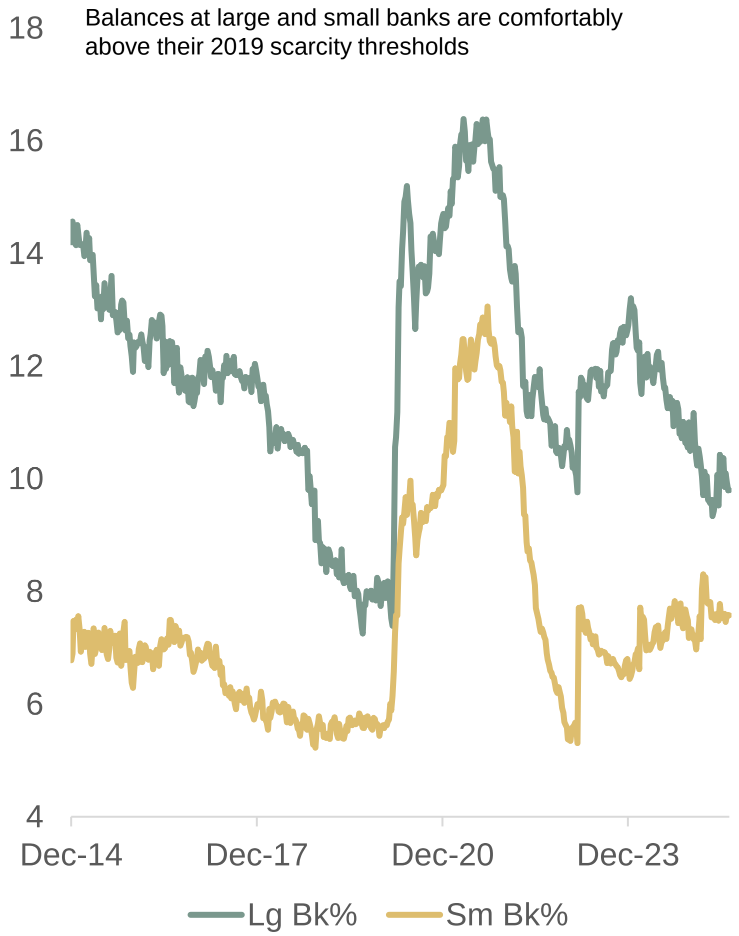


Sources: Federal Reserve, SMBC Nikko

1/ Mechanically, this will occur as money fund investors buy bills and repo

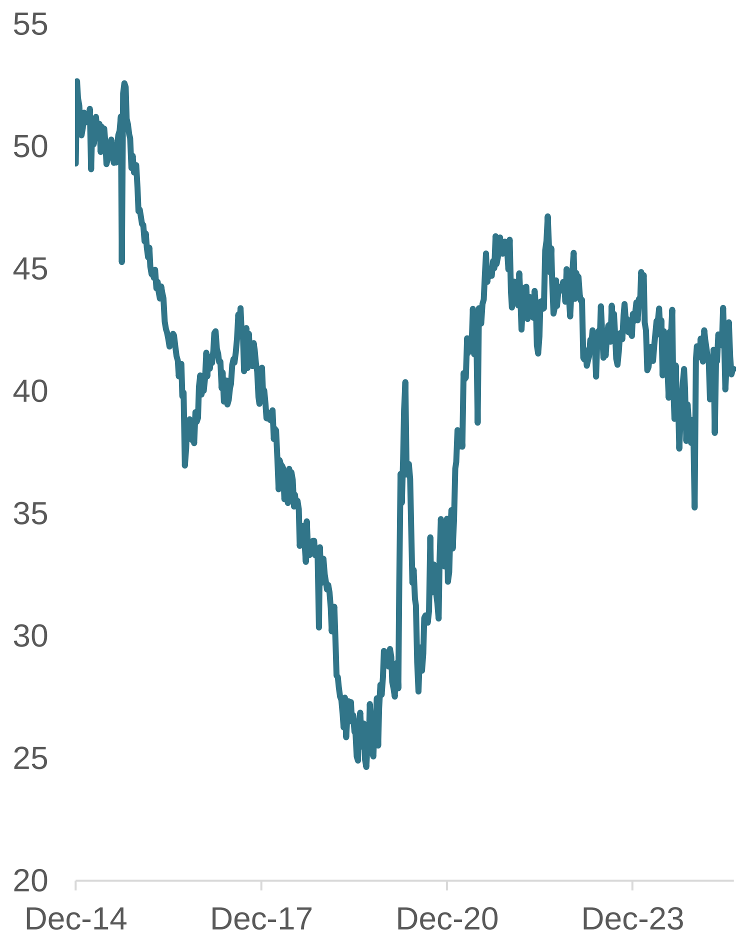
Bank reserves

US banks (% assets)



Sources: Federal Reserve, SMBC Nikko

Non-US banks (% assets)

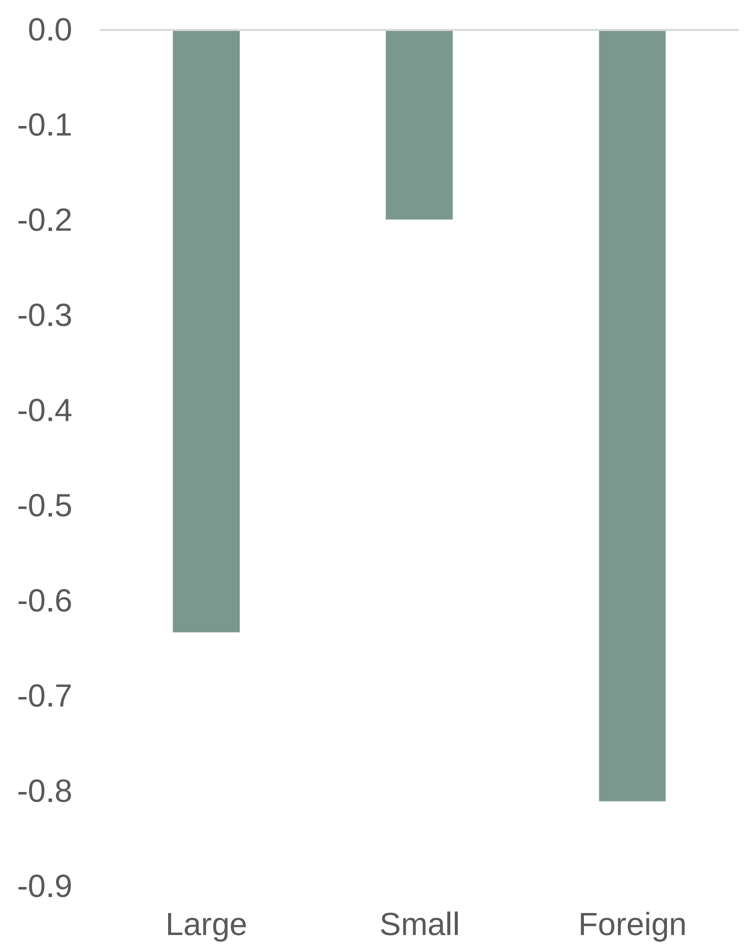


Sources: Federal Reserve, SMBC Nikko

Reserve loss

- On the Fed's balance sheet, the increase in the Treasury's cash account since the end of June has been "financed" by cash leaving the RRP
    - *But as this shifts to reserves, which banks will lose more reserves?*

Change in balances (% change)



Note: Change since the end of June. Sources: Federal Reserve, SMBC Nikko

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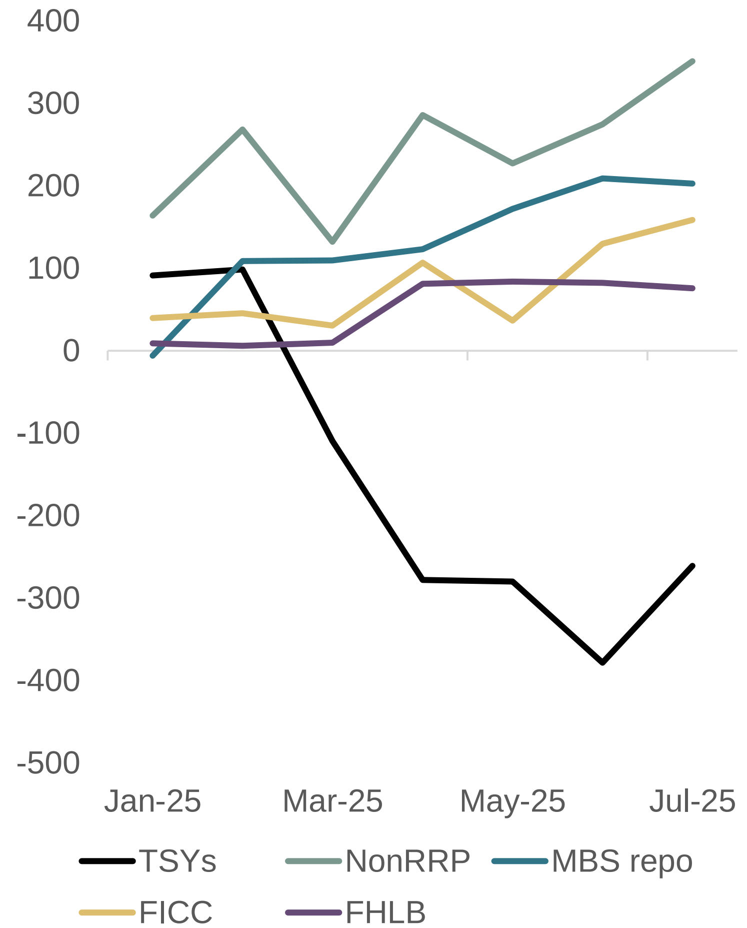
Leaving the RRP

- Money fund cash leaving from the RRP has shifted largely into TSY repo[1/]
    - But it has also moved into MBS repo and FHLB discount notes

Money fund holdings ($bn)



Note: Cumulative change since January 2025. Source: Crane's Data, SMBC Nikko

1/ Nearly half of this has been intermediated through sponsored repo

Balance sheet or spread target?

- The Fed is looking to target an "efficiently-sized" balance sheet
  - One that is no bigger than necessary to support policy implementation
    - While maintaining a limited presence in markets

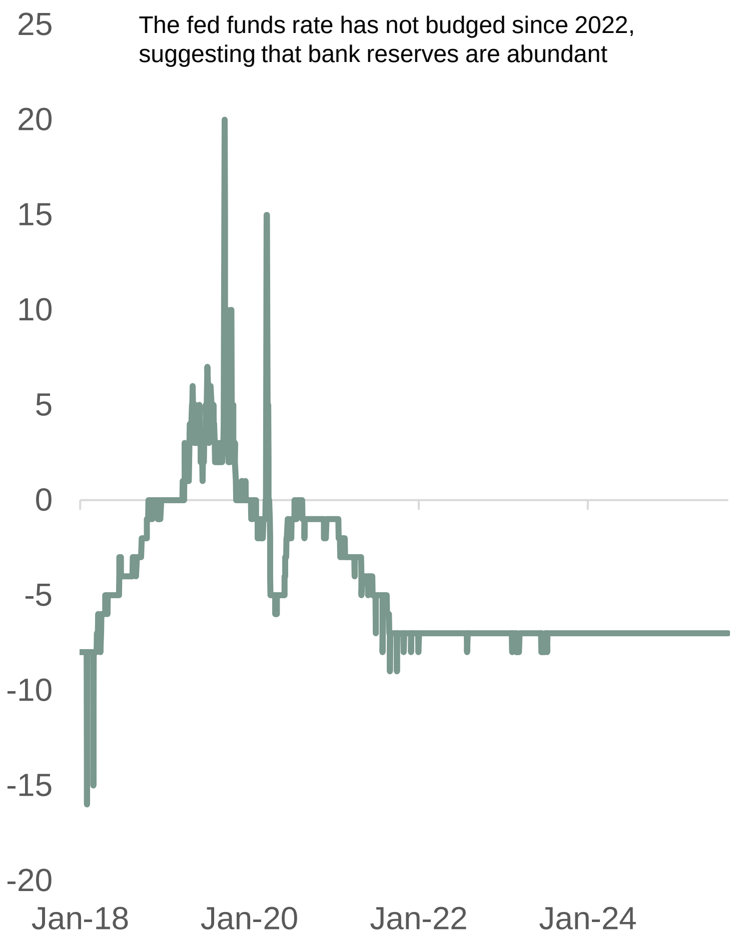
- But the optimal size is unknown
  - And shrinking the balance sheet until it reaches a specific target level – of, say, $6.5trn – risks repeating the spike in financing rates that occurred in September 2019

- Some Fed officials argue that balance sheet normalization should continue until the spread between overnight rates and IORB is minimized[1/]
  - This would imply that the cost of overnight liquidity and its return was roughly equal
    - With the spread between FF and IORB around -2bp and tri-party repo trading at a similar level

1/ See "Efficient and effective central bank balance sheets", L. Logan, Dallas Federal Reserve Bank, February 25, 2025.

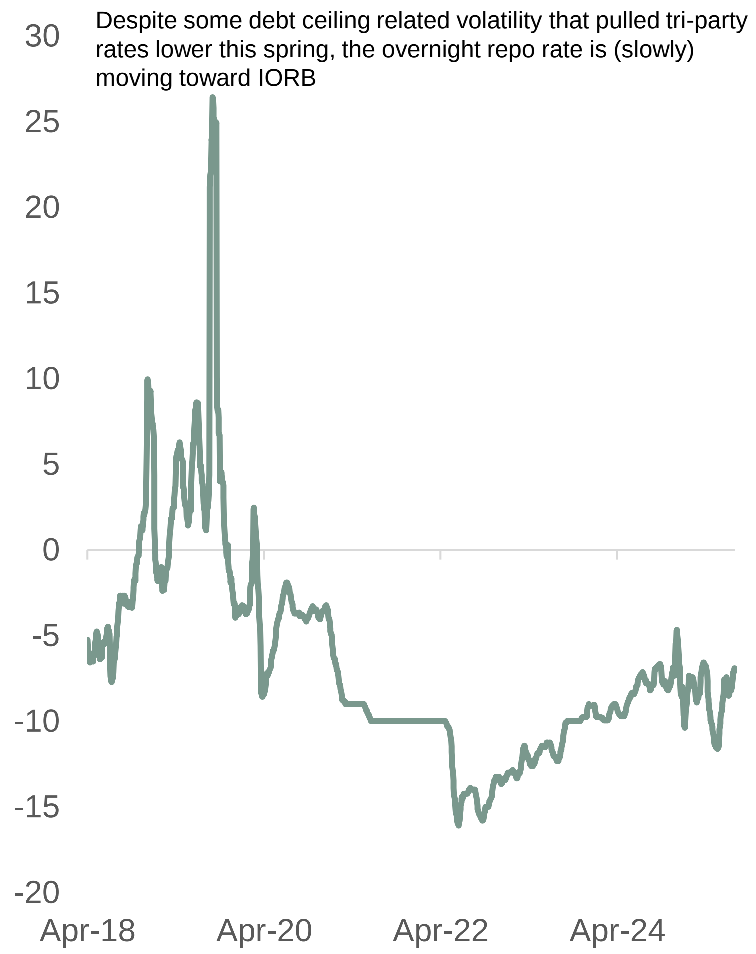
More room for QT?

FF-IORB (bp)



Source: Federal Reserve, SMBC Nikko

Tri-party repo –IORB (bp)



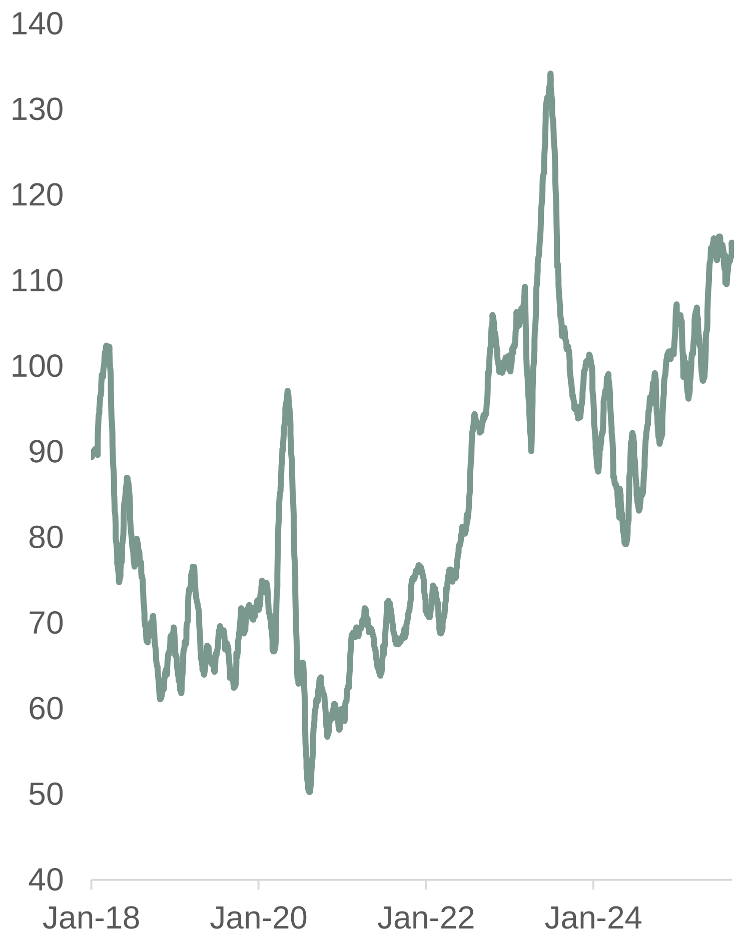
Note: 20d average. Source: Federal Reserve, SMBC Nikko

Liquidity risk

- The RDE assumes that the slope is relatively smooth
  - That the fed funds rate doesn't jump abruptly from IORB-7bp to IORB-2bp as the level of bank reserves nears 11%
- But the fed funds rate is more of a *negotiated* than traded rate
  - Ample reserves mean that banks only borrow in the fed funds market to arb IORB
    - And their ability to negotiate depends on their other costs such as deposit insurance premia
      - Which limits borrowing to non-US banks
- And while the RDE is estimated over a long period, the fed funds rate has not moved since 2022
  - And this could reduce some of the measure's sensitivity

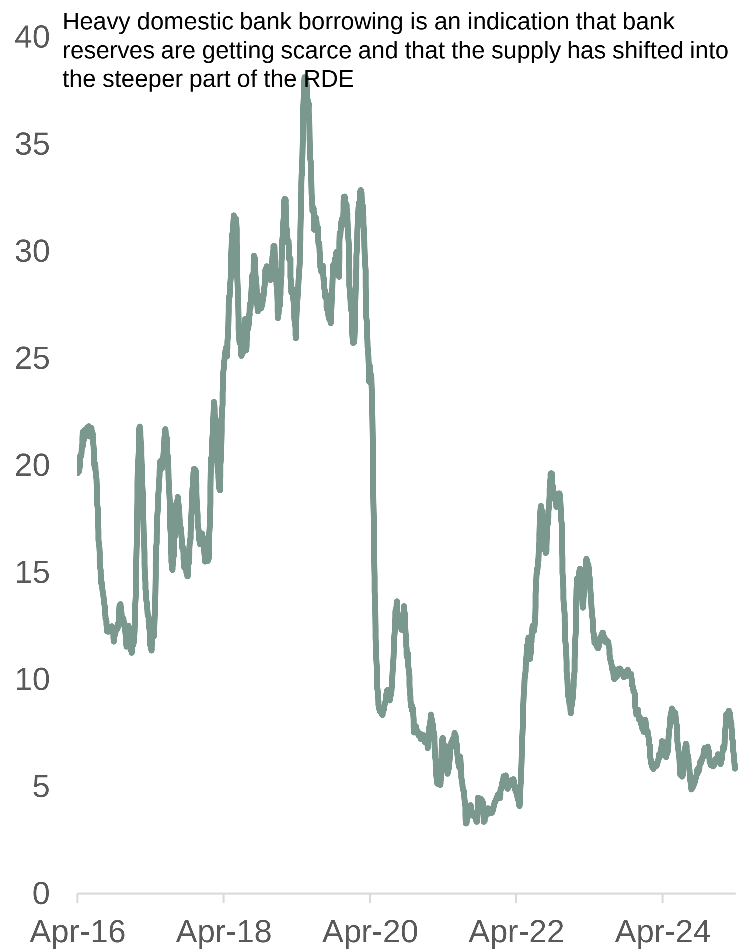
Fed funds market

Fed funds volumes ($bn)



Note: 20d average. Sources: Federal Reserve Bank of New York, SMBC Nikko

Domestic bank borrowing (% ff vol.)



Sources: Federal Reserve Bank of New York, SMBC Nikko

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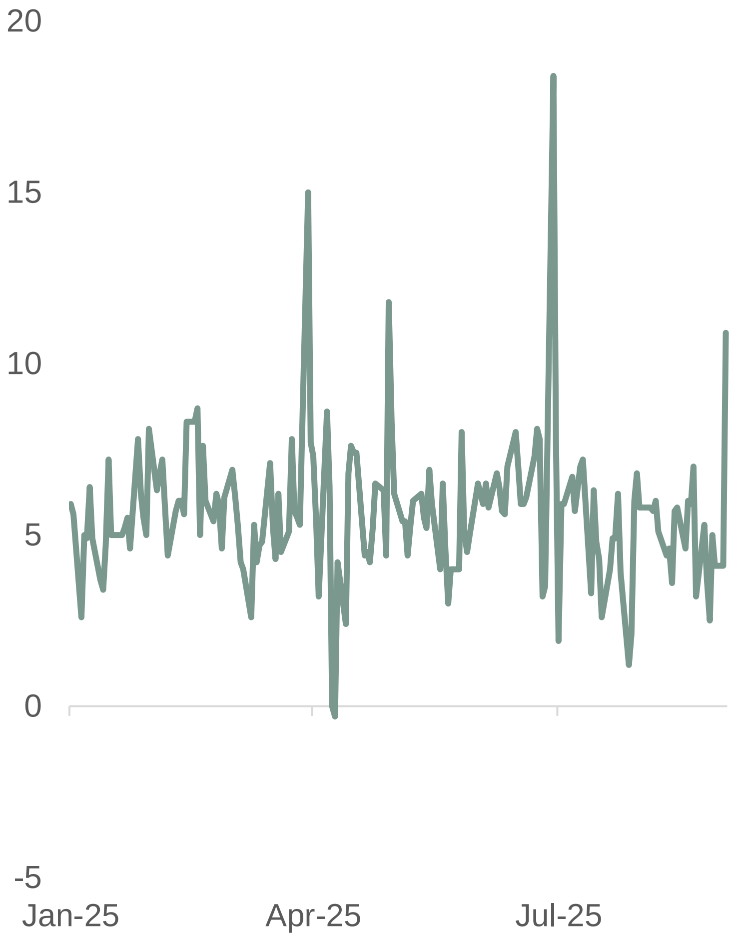
Dealer balance sheet capacity is ample for now

GCF less tri-party repo (bp)

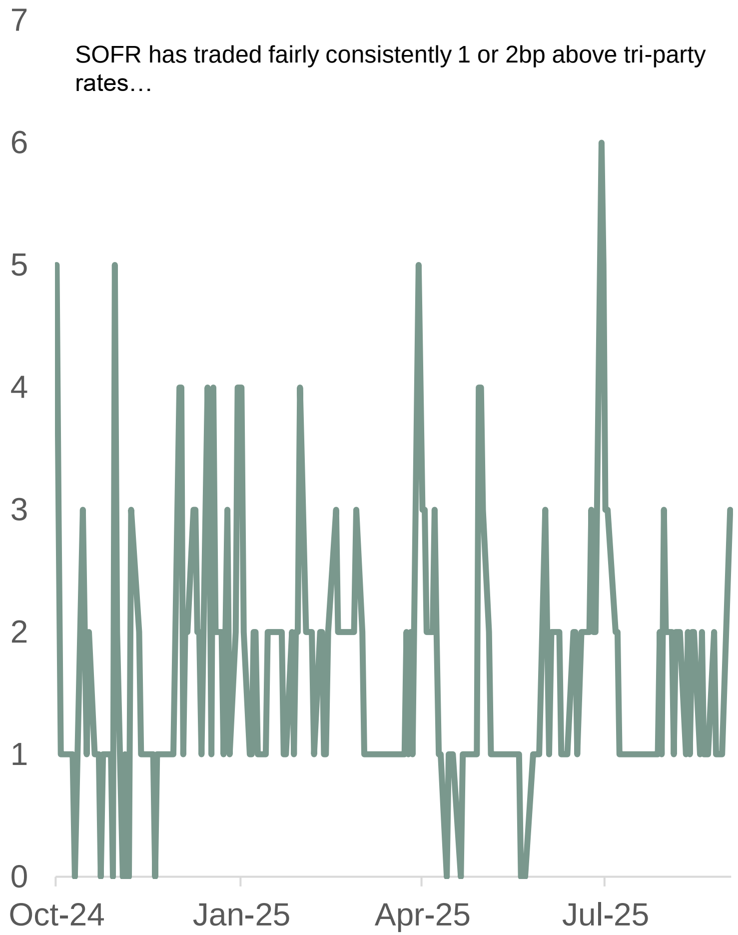


- The GCF-tri-party repo spread has held around 6bp all year
  - Despite month-end pressure
- This spread is correlated with dealer intermediation capacity
  - As it reflects rate differences facing different participants in the repo market
- *As reserves thin out, tighter dealer balance sheet capacity may increase the frequency of GCF spikes on reporting and settlement dates*
  - *Accompanied by SRF use*

Sources: Federal Reserve Bank of New York, SMBC Nikko

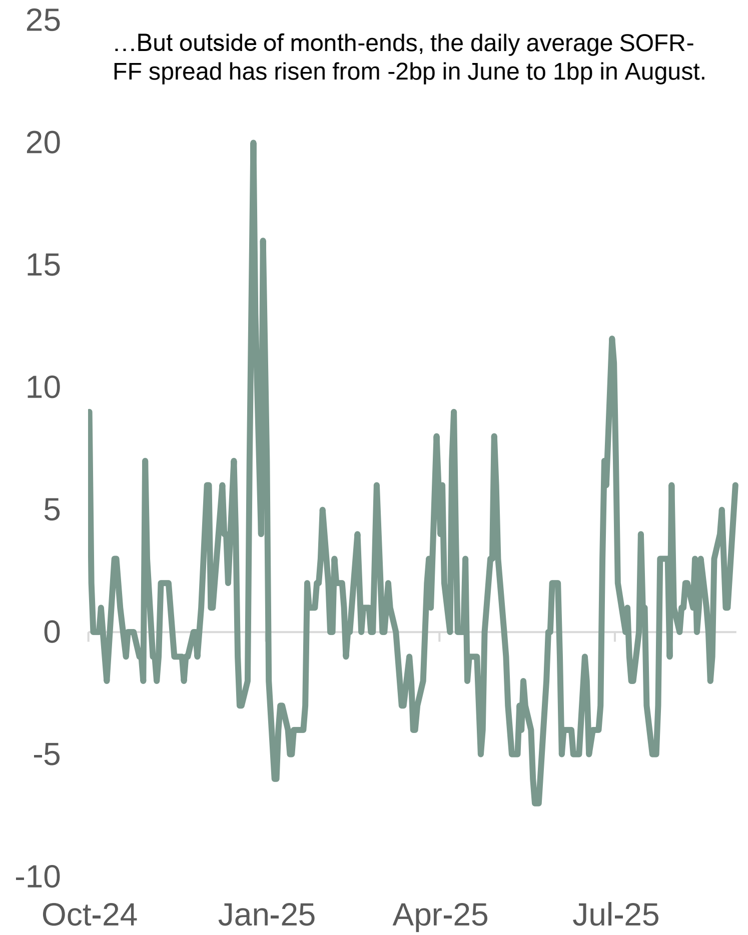
Other repo spreads

SOFR less tri-party (bp)



Sources: Federal Reserve Bank of New York, SMBC Nikko

SOFR less fed funds (bp)

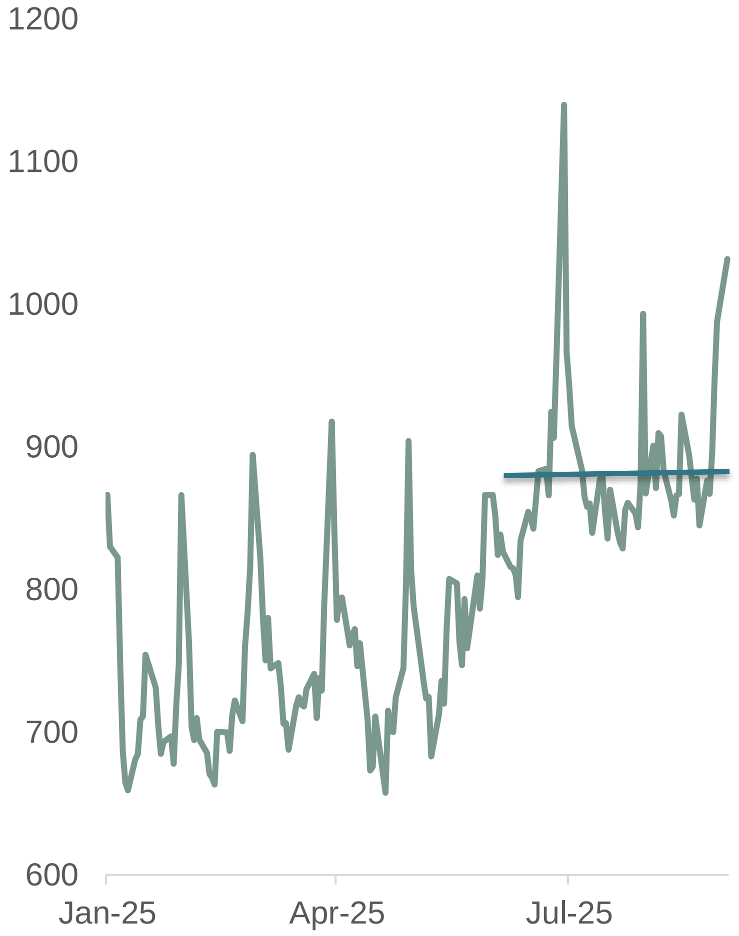


Sources: Federal Reserve Bank of New York, SMBC Nikko

Demand for funding

- Sponsored repo volumes have been somewhat steady this summer[1/]
  - Suggesting that the demand for funding is not increasing
    - Or overwhelming dealer's intermediation capacity

Sponsored repo volume ($bn)

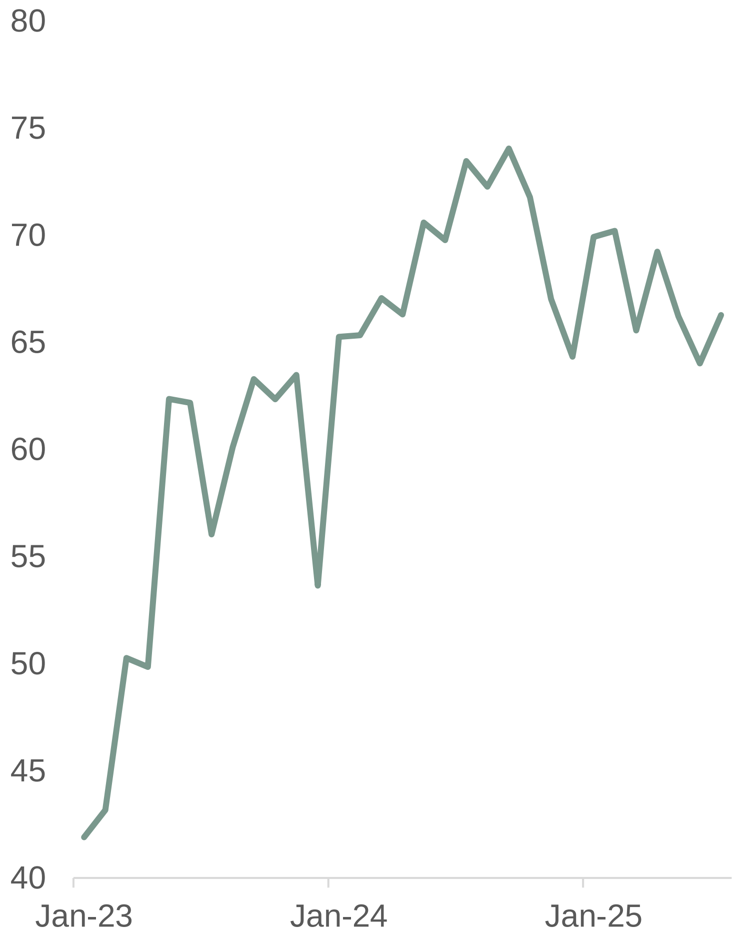


1/ That is, outside the normal month-end volume spikes tied to balance sheet scarcity on reporting dates

Source: DTCC, SMBC Nikko

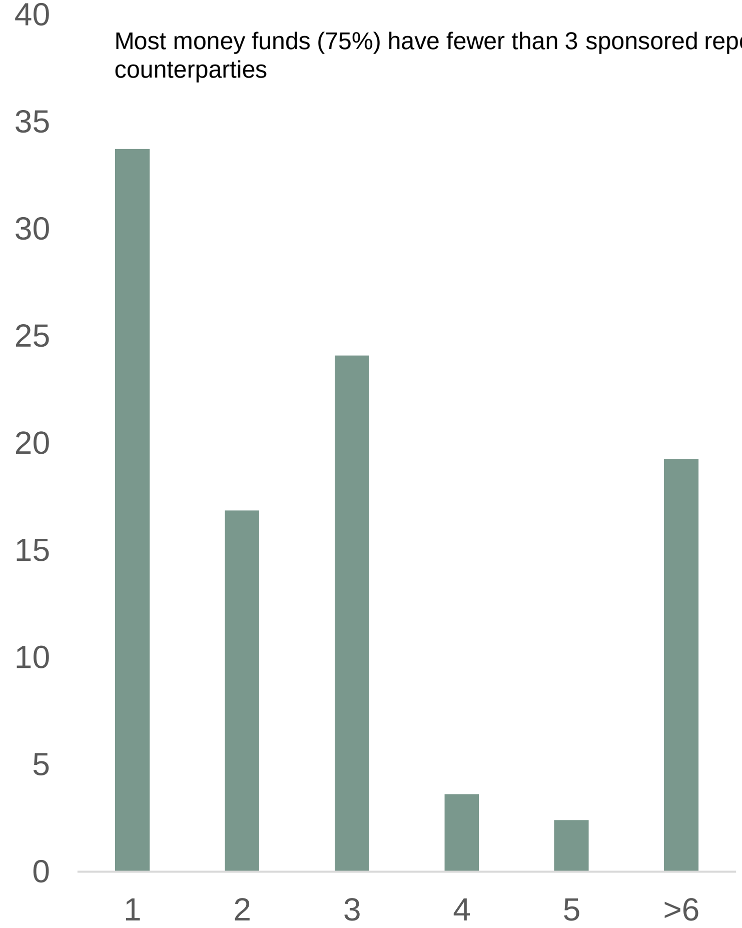
Most sponsored repo cash comes from money funds

Money fund FICC repo (% sponsored)



Sources: Crane's Data, DTCC, SMBC Nikko

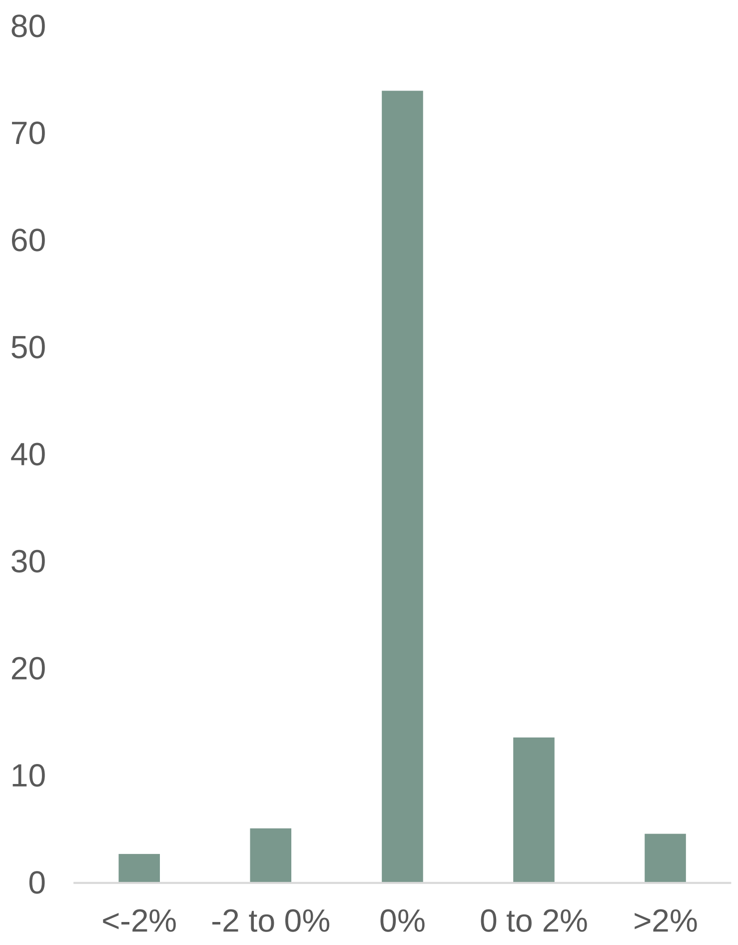
Sponsored counterparties distribution (% funds)



Note: Across the 83 funds reporting sponsored repo activity at the end of May.
Sources: Crane's Data, DTCC, SMBC Nikko

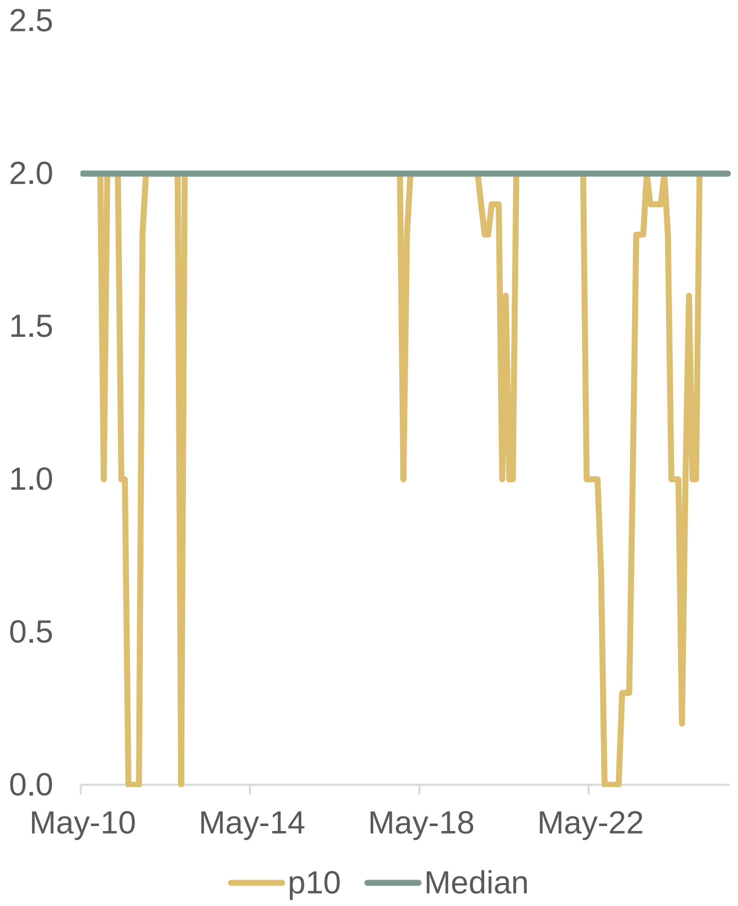
Repo haircuts

Haircut distribution (% NCCBR)



Note: NCCBR is non-centrally cleared bilateral repo against Treasuries. Sources: Hempel et al., SMBC Nikko

Tri-party haircuts (%)



Note: p10 are the haircuts applied to the lowest 10% of the haircut distribution. Sources: Federal Reserve, SMBC Nikko

See, “Why is so much repo not centrally cleared?”, S. Hempel, R. Jay Kahn, R. Mann, and M. Paddrik, Office of Financial Research, US Treasury, May 2023

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Not as common

- Un-haircutted repo transactions may reflect other factors unrelated to leverage
  - Hempel et al. found that some 60% of the zero haircut Treasury repo trades were part of packages with naturally offsetting exposures[1/]
  - And some of this activity in internal – that is, between affiliates of the same institution[2/]
    - In late 2024, interaffiliate repo was around $300bn/day
      - Interaffiliate transactions are excluded from the calculation of the Fed's benchmark repo rates
- The SEC requires the FICC to collect margin on cleared transactions
  - But significantly, it does not specify who ultimately pays the margin – the direct or indirect, sponsored, client
    - In practice the direct member frequently fully funds the clients' direct margin
  - And while the Treasury Markets Practices Group is not recommending changes to the practice or considering minimum haircut requirements, it is asking dealers to take a closer look at their risk management in both cleared and uncleared markets

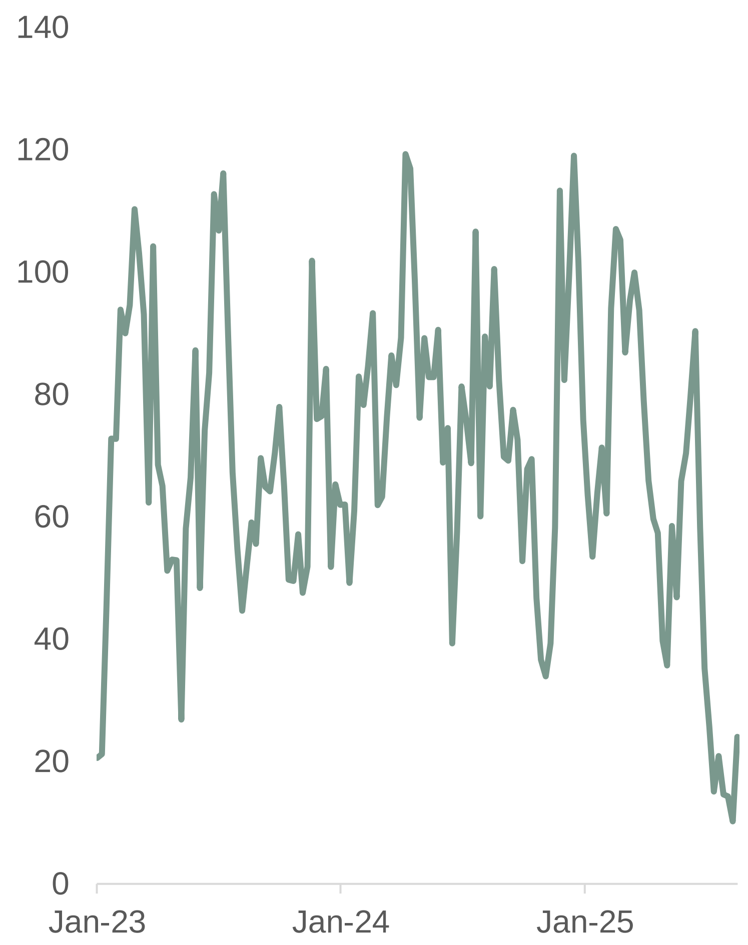
1/ See, "Why is so much repo not centrally cleared?", S. Hempel, R. Jay Kahn, R. Mann, and M. Paddrik, Office of Financial Research, US Treasury, May 2023
2/ See, "Affiliate Repo and the 2024 Short-term Funding Monitor Update", M. Friedrichs, R. Mann, L. Olson, and K. Potapov, US Treasury Office of Financial Research, August 2025

Heavy bill issuance is not creating balance sheet pressure…

- Bill issuance has increased $650bn (10%) since July
    - We expect an additional $400bn in Q4

- But despite this increase, bills have not piled up on dealer balance sheets
    - Or created funding congestion

Dealer bill inventories ($bn)



Source: Federal Reserve, SMBC Nikko

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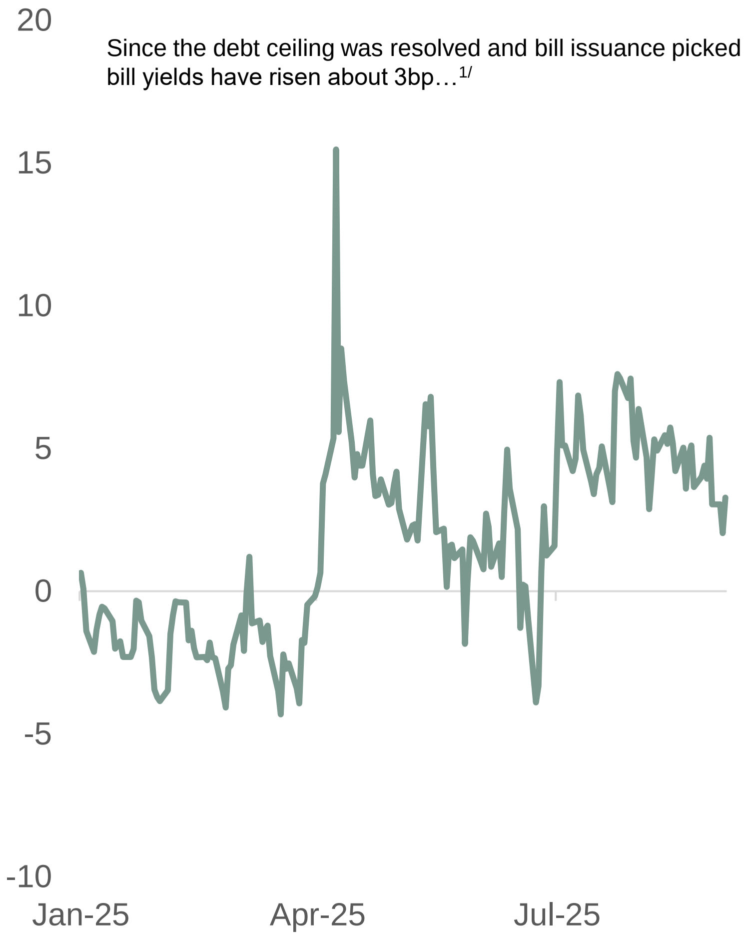
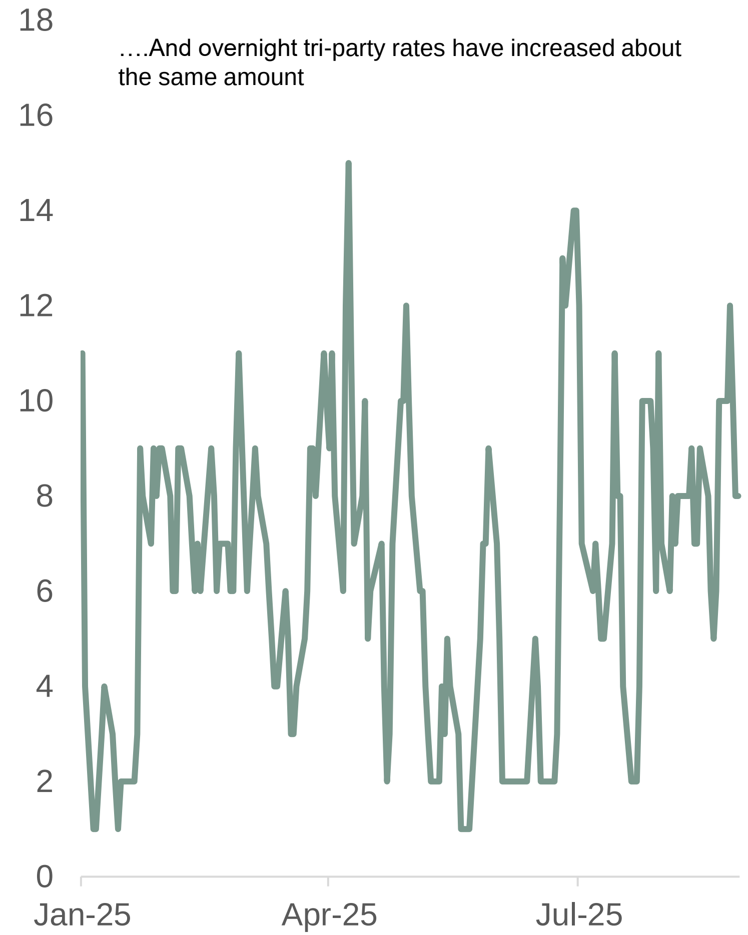
…Although yields have risen slightly this summer

3m bill less OIS (bp)



Sources: Bloomberg, SMBC Nikko

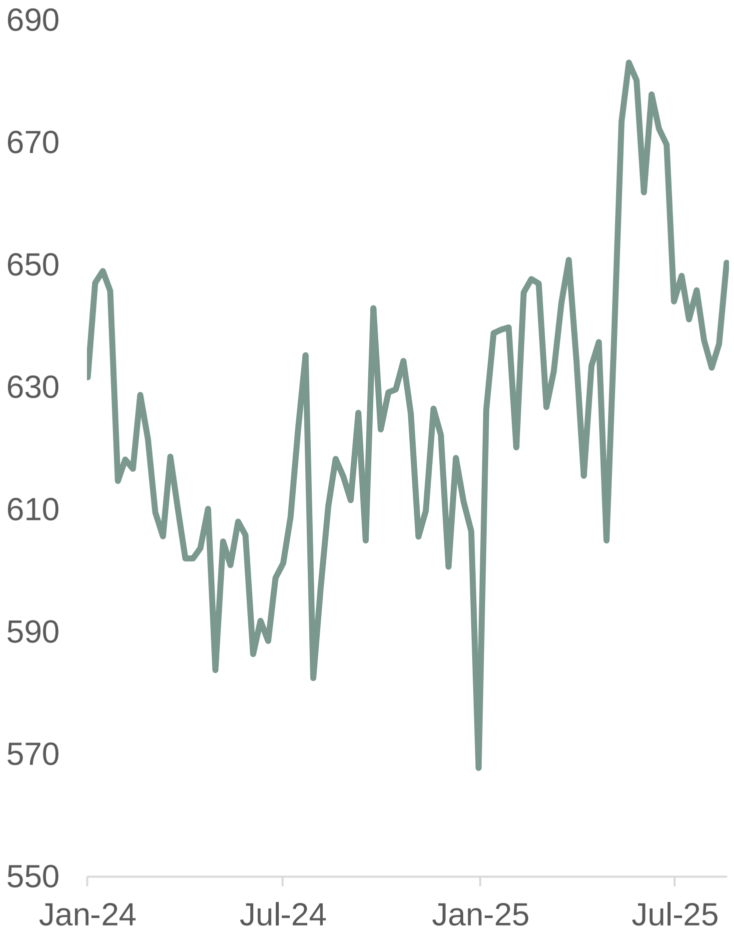
Tri-party less RRP (bp)



Sources: Federal Reserve, SMBC Nikko

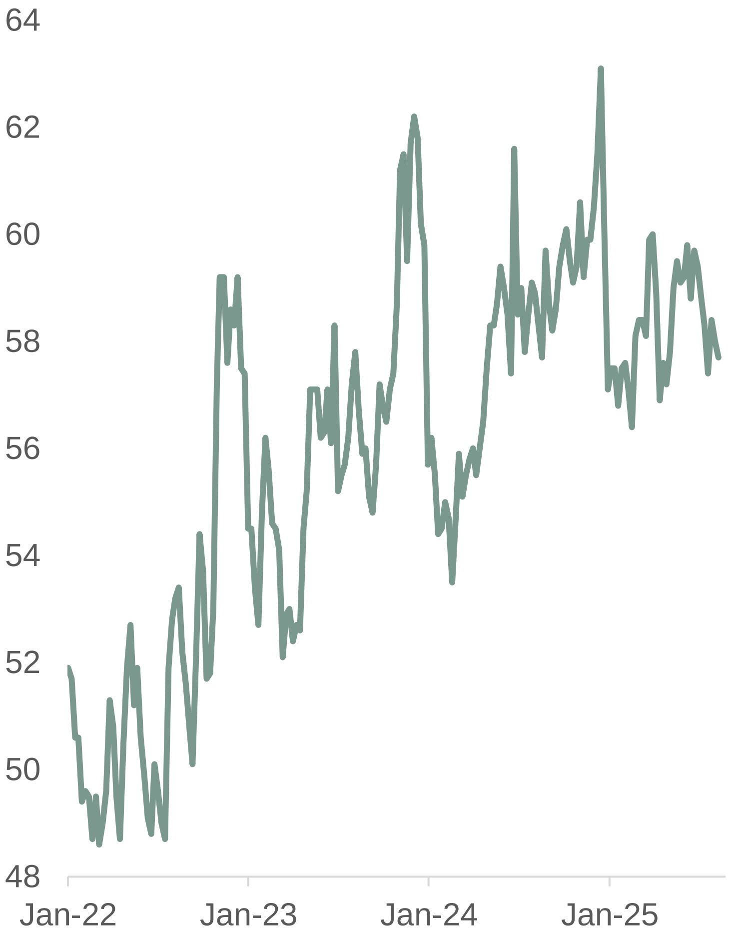
CP outstanding

Financial CP outstanding ($bn)



Sources: Federal Reserve, SMBC Nikko

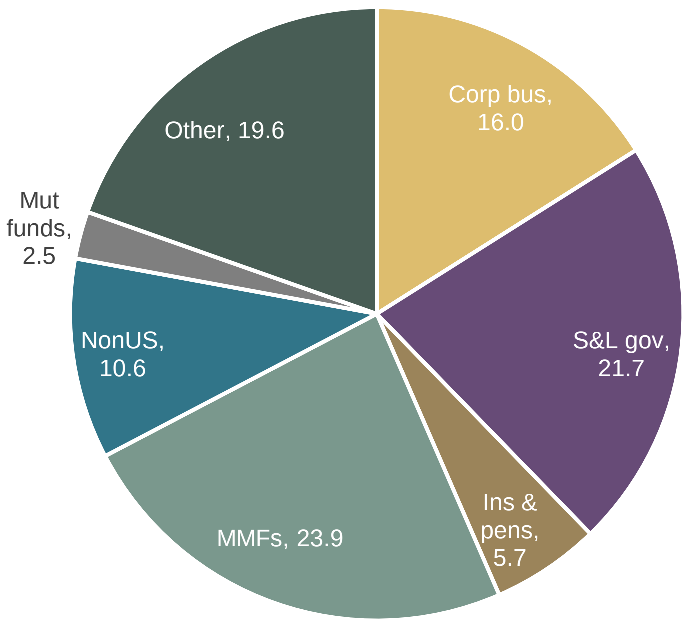
CP WAMs (d)



Sources: Federal Reserve, SMBC Nikko

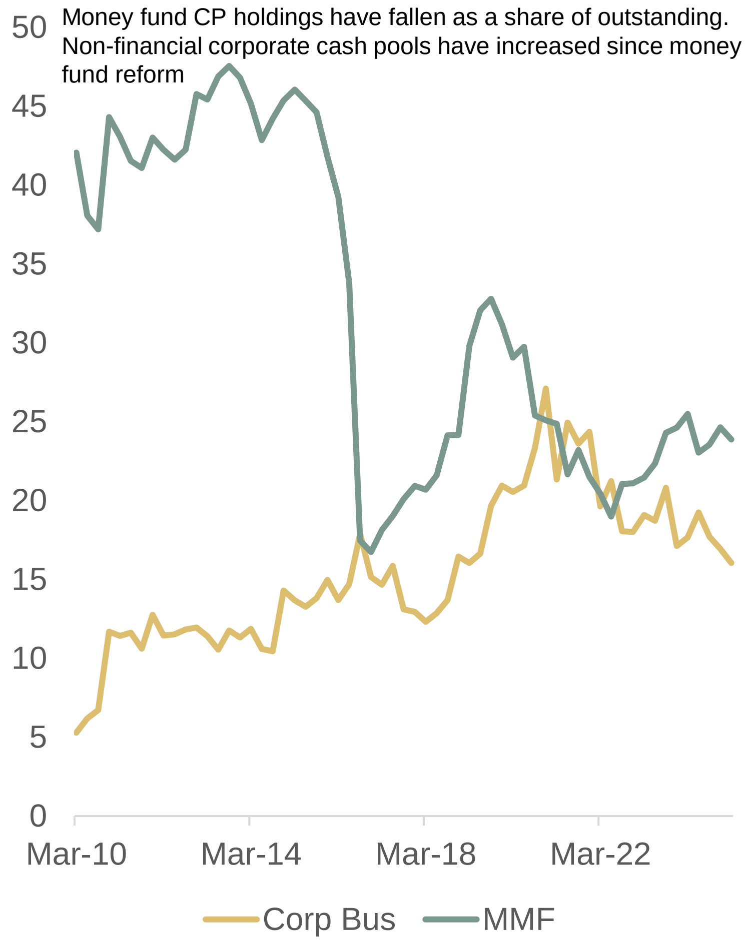
CP owners

CP owners (% total outstanding)



Note: As of March 2025. Other includes funding corporations, banks and property and casualty insurance companies. Sources: Federal Reserve, SMBC Nikko

Money fund holdings (%)



Sources: Federal Reserve, SMBC Nikko

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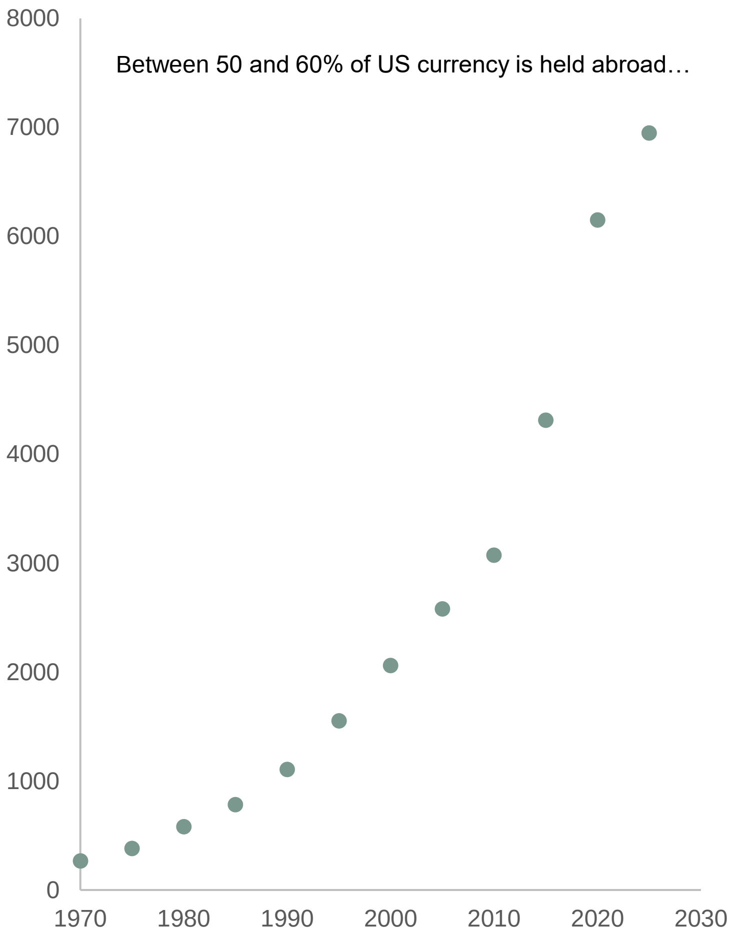
Digital dollarization

- Dollarized stablecoins are likely to be especially attractive in areas with significant unbanked populations, or regions with unstable domestic units and high remittance fees.
- This also helps explain the significant offshore demand for physical US currency – particularly, the $100 bill. Between 50 and 60% of the $2.2trn in outstanding paper dollars is held offshore.
- Potential demand for dollar stablecoins as substitutes for large denominations and as lower-cost remittance vehicles could exceed $1trn over the next decade. This might translate into $600-700bn in incremental demand for bills over the period.
- However, substituting U.S. currency with stablecoins would mean replacing a non-interest-bearing liability with an interest-bearing one, even if the stablecoin holder does not receive interest directly.

Source: US Treasury, SMBC Nikko

Currency

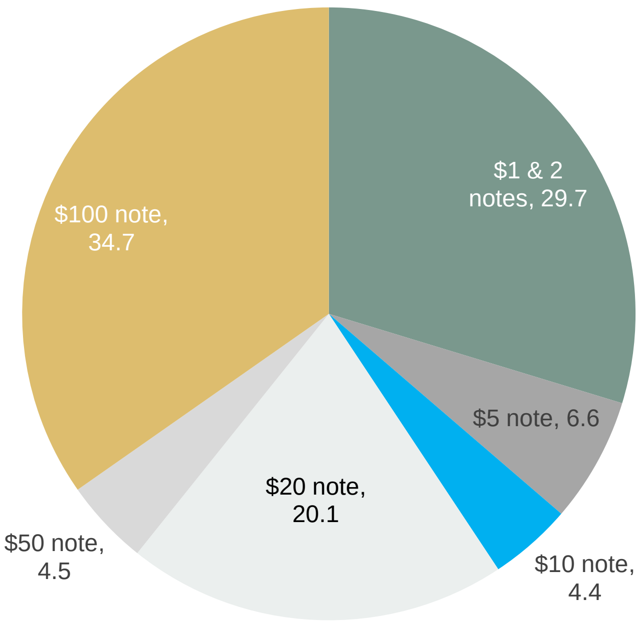
Per capita US currency ($)



Sources: US Treasury, SMBC Nikko

Currency by denomination (% total)

We think a significant portion of the future offshore demand for $100 bills might be replaced by stablecoins

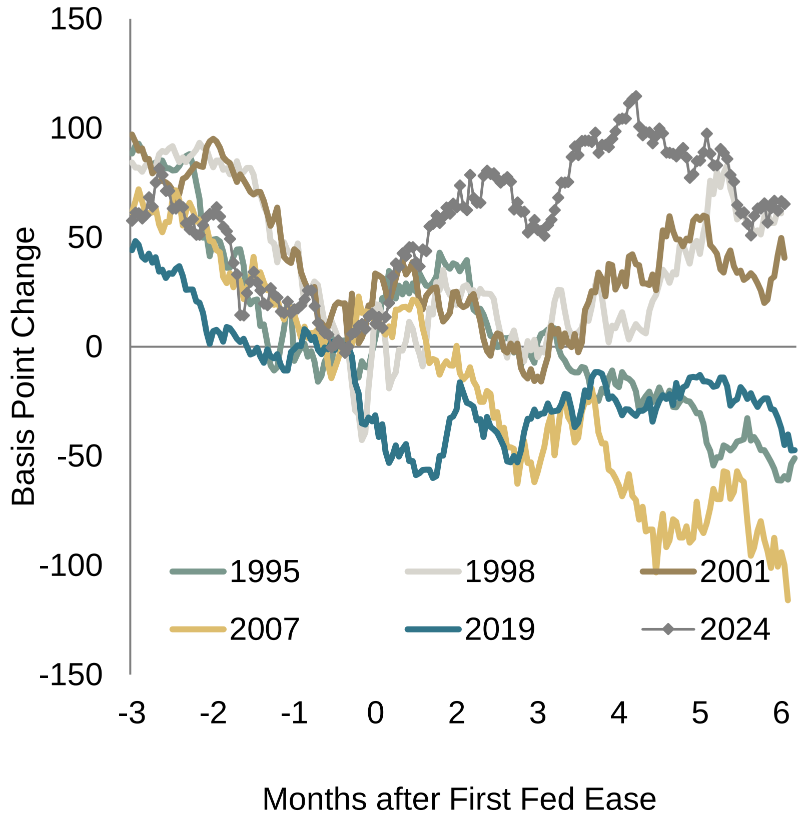


Sources: US Treasury, SMBC Nikko

Will the 10-Year repeat its pattern of rallying into the first cut?

- This template seems set to repeat even though the easing cycle began last year
  - We expect the 10y yield to fall to 4% ahead of the September ease
    - Thereafter the 10y should range trade in the weeks ahead.
    - Any large directional moves higher or lower in the months ahead are likely to be dictated by the growth outlook

10y Treasury yields (bp)

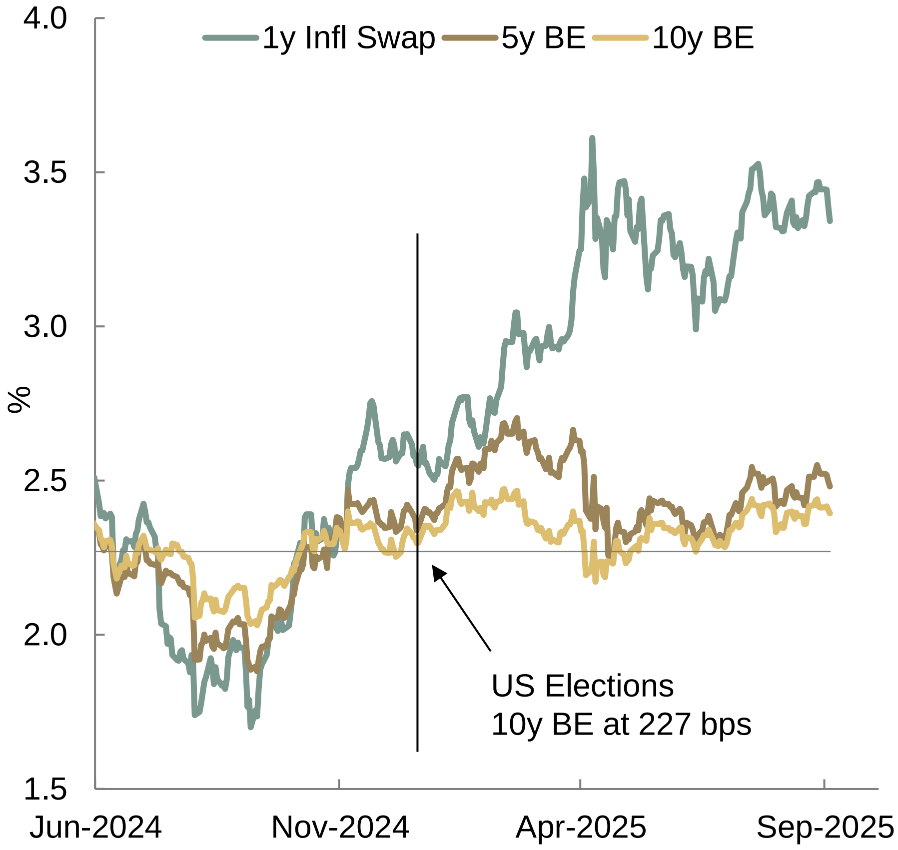


Sources: SMBC

Tariff inflation: Muted impact further out the inflation BE curve

- 1y Inflation Swaps are 130bp higher since the end of September and 100bp since the election
  - But, 10y TIPS breakevens are only slightly higher than their election day levels

Inflation breakevens (%)

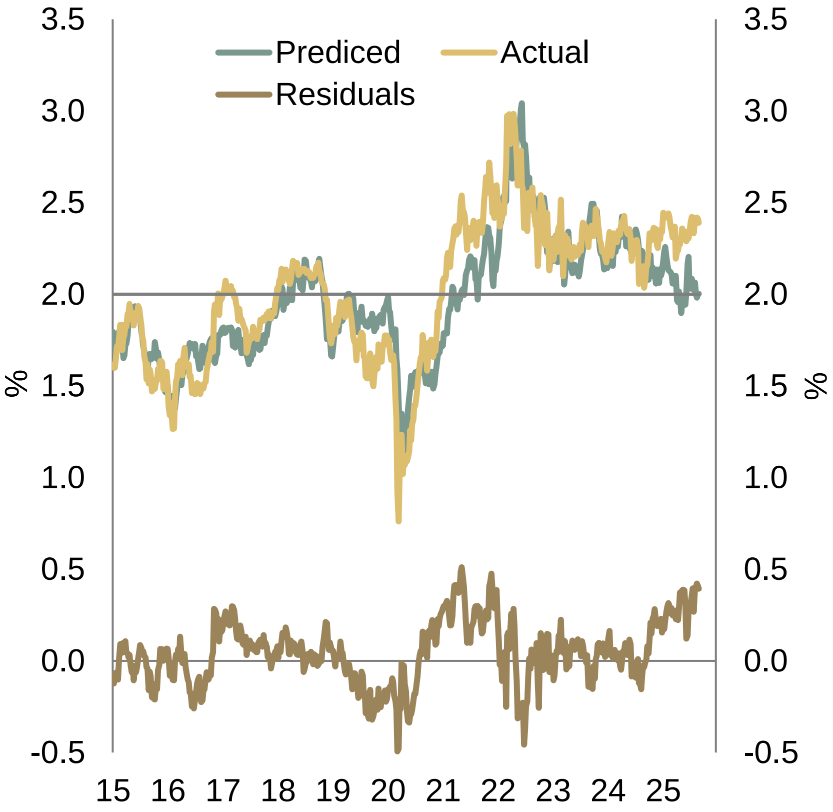


Sources: US Treasury, Bloomberg, SMBC

Breakeven premium is near 2021 level

- 10y Inflation breakevens are 40 bps cheaper than our model
  - Likely reflecting some concerns about central bank independence

10y inflation breakevens (%)

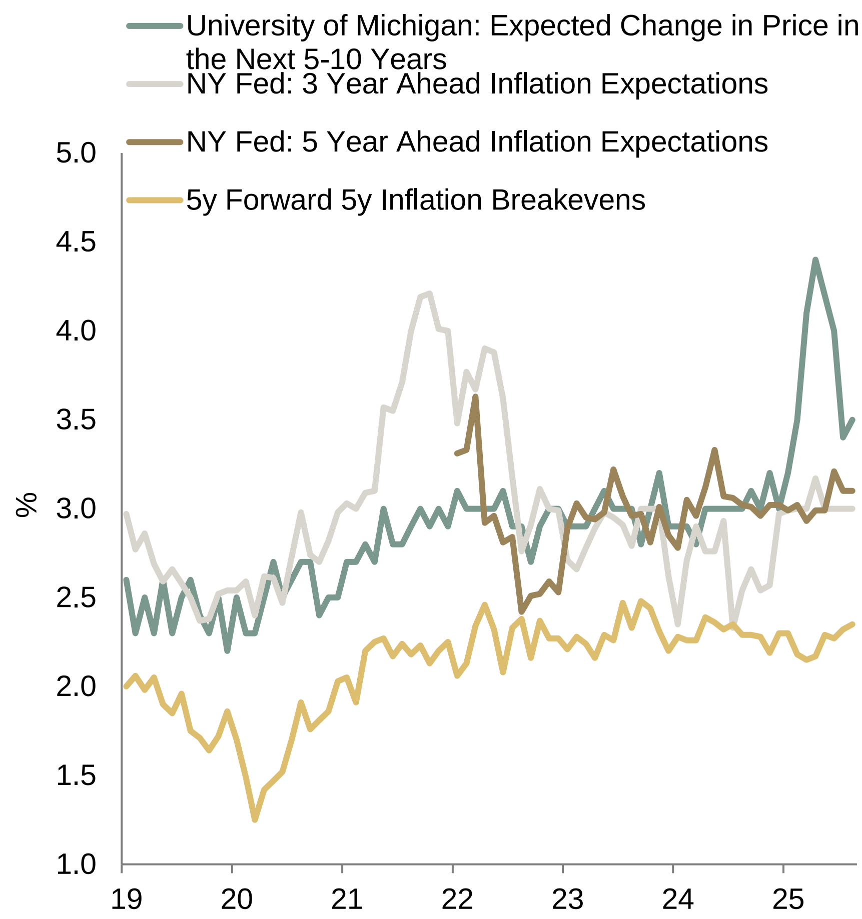


Sources: US Treasury, Bloomberg, SMBC

Long-term inflation expectations: Mixed signals

- Uncertainty about the persistence of inflation pressures remains.
- The jump in University of Michigan long-term inflation expectations has not been reflected in other surveys
  - Which appear to be holding steady

Long-term inflation expectations (%)

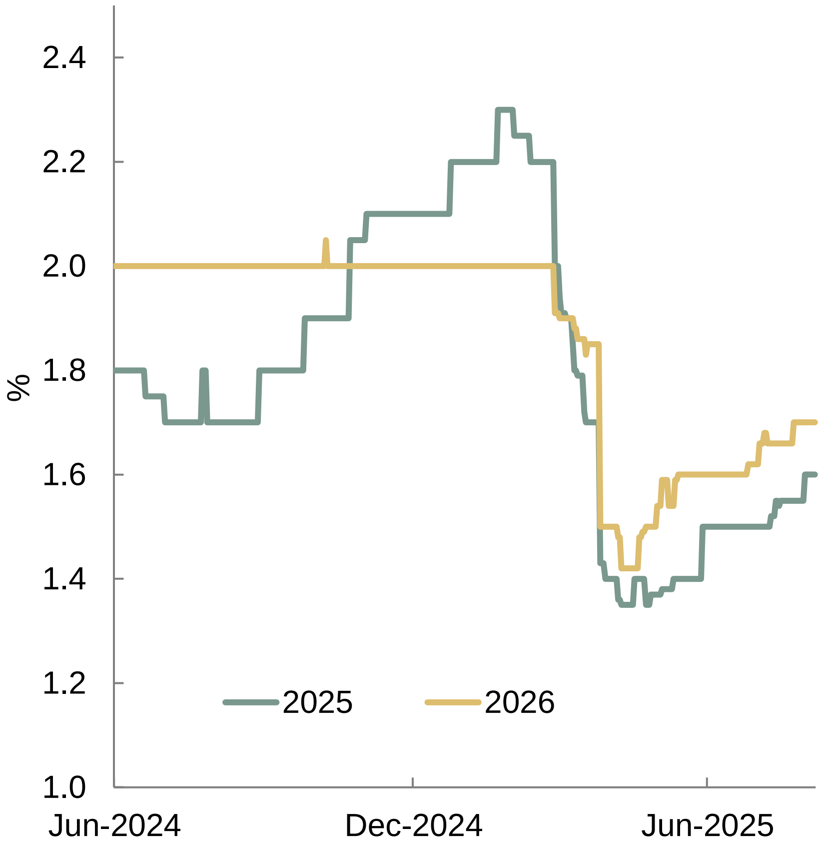


Sources: Federal Reserve, NY Fed, University of Michigan, Bloomberg, SMBC

Policy uncertainty is reflected in the growth outlook

- Growth expectations were revised down after Liberation Day and since then have inched higher.

Consensus GDP estimates (%)

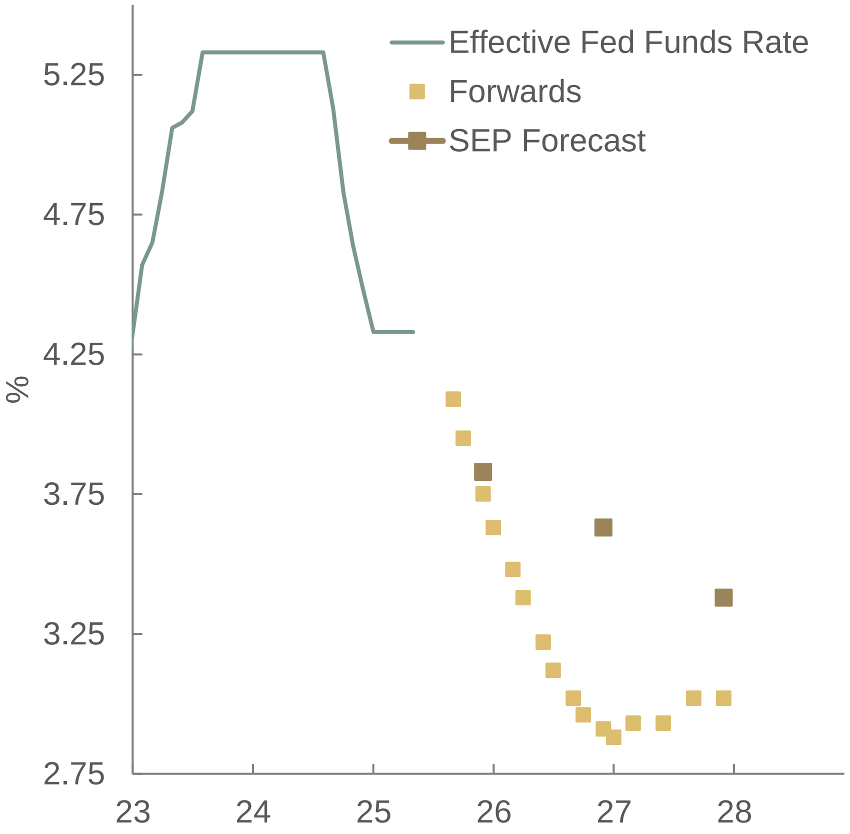


Sources: Bloomberg, SMBC

Fed funds path

Projected fed funds path (%)

- Investors expect policy rates to be taken slightly below neutral (est. 3%) following the recent deterioration in the employment situation

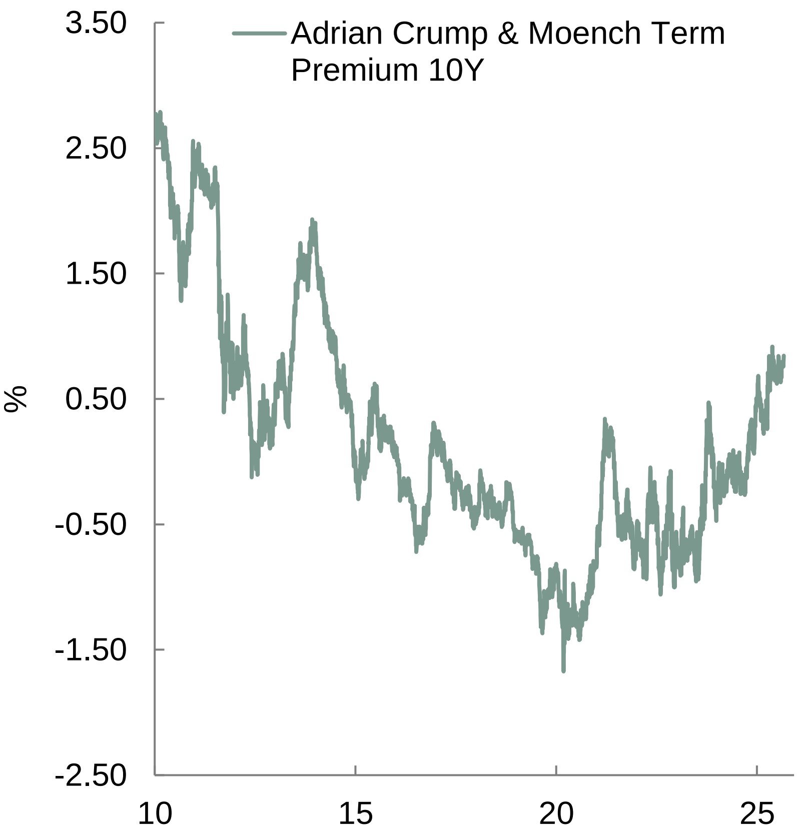


Sources: Federal Reserve, Bloomberg, SMBC

Term Premium Rise Reflects Fiscal Risks ?

- Approximate 160 bp rise in term premium since the start of the 2022 hiking cycle.
- Currently term premium at 64 bps vs. 10y average at -37 bps.

Estimated term-premium (%)

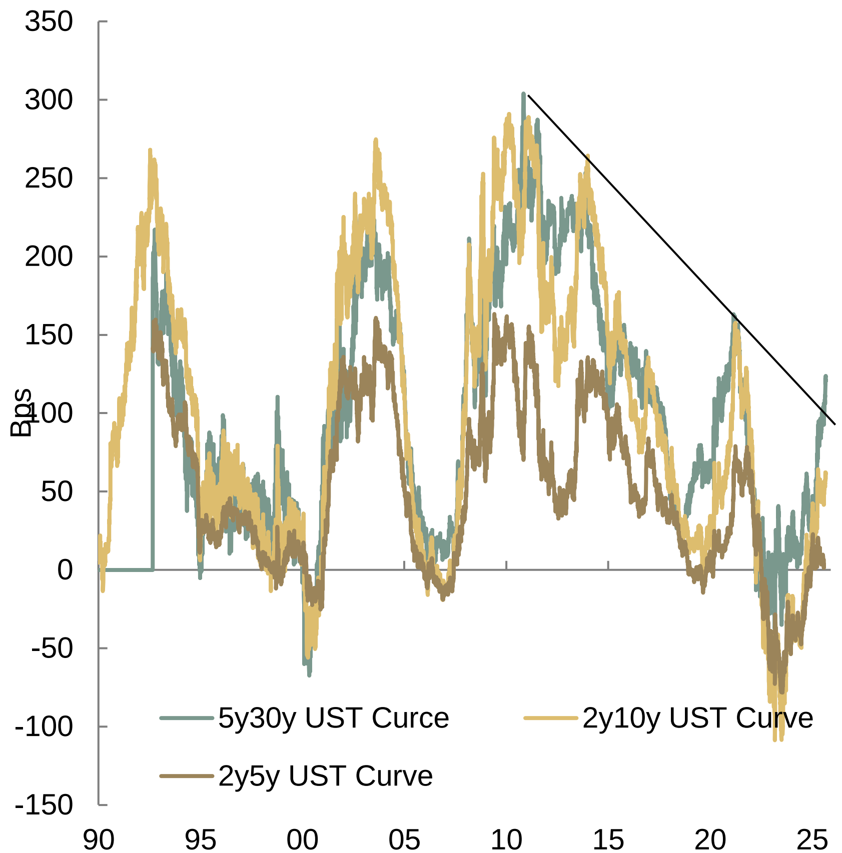


Sources: Federal Reserve, Bloomberg, SMBC

The case for a steeper curve

- Fed in easing mode and fiscal worries globally supports a steeper curve
- Favor 5s30s curve with significantly uncertainty and negative carry in the 2s10s curve

Curve spreads (bp)



Sources: US Treasury, Bloomberg, SMBC

Will the 5y Cheapen with the Fed Easing vs. the 2y and 10y

				Level of 2y5y10y (Basis Points)					Change in 2y5y10y (Basis Points)			
				Months Before Ease	Months After First Ease				Months After Ease vs. 1m Before Ease			
Start of Easing	End of Easing	First Ease in bps	Total Cuts	-1	+ 1	+ 2	+ 3	+ 6	+ 1	+ 2	+ 3	+ 6
7/6/1995	1/31/1996	-25	-75	10.8	-1.8	3.1	-2.9	-5.6	-13	-8	-14	-23
9/29/1998	11/17/1998	-25	-75	-2.7	-7.9	-32.4	-15.1	6.5	-5	-30	-12	-3
1/3/2001	12/11/2001	-50	-475	-17.4	-4.6	-4.9	4.6	40.3	13	13	22	30
11/6/2002	11/6/2002	-50	-50	-8.5	22.6	19.0	27.0	-2.4	31	27	35	40
6/25/2003	6/25/2003	-25	-25	-5.2	28.6	53.7	36.4	35.1	34	59	42	39
9/18/2007	12/16/2008	-50	-513	-12.5	-11.5	-14.7	-28.6	50.2	1	-2	-16	13
9/18/2019	12/11/2019	-25	-75	-20.1	-20.3	-14.0	-8.5	-27.2	0	6	12	20
3/3/2020	3/15/2020	-50	-150	-19.0	-8.1	-9.5	-21.7	-28.4	11	9	-3	30
9/18/2024	12/18/2024	-50	-75	-42.9	-27.9	-15.8	-7.1	-36.2	15	27	36	58
								Median	5.9	7.8	4.4	24.9

- Our analysis shows that there is moderate cheapening within 3-months after ease and more thereafter

- The 1995-96, 1998 and 2007-08 cycles saw little to no cheapening during the first three months. In the prior two cases, the cheapening occurred after the end of the 75 bps cycles.

Sources: US Treasury, Bloomberg, SMBC

Disclaimers