SMBC SMBC Group

US Rates Strategy Weekly

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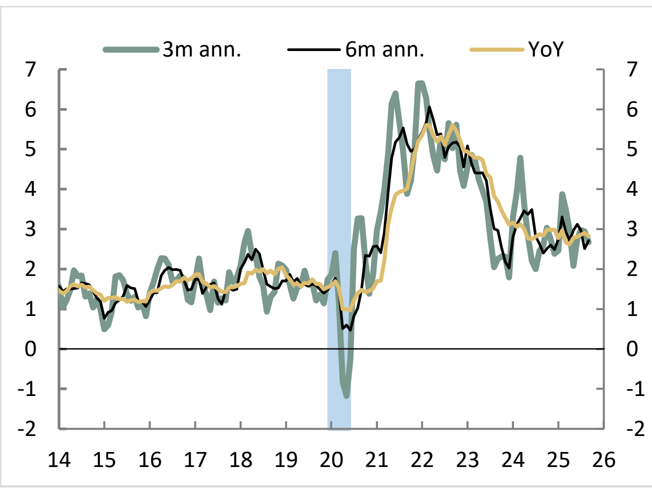
Week ahead

- **PCE and Core PCE Deflator (Nov., Thursday):** We expect relatively modest gains in the PCE and core PCE deflators of 0.2% M/M and 0.15% M/M. November saw headline and core CPI return at contained readings of 0.2% and 0.13% respectively. Additionally, the PPI healthcare subcomponent, which is a direct input into the PCE deflator, increased by just 0.13% in November. This is particularly important considering the near 20% weight that healthcare carries in the PCE deflator.
- **Personal Income and Spending (Nov., Thursday)**: We are forecasting a 0.4% increase in income due to a 0.04% increase in November nonfarm payrolls, a 0.24% MoM increase in average hourly earnings and a slight uptick in hours worked. We forecast a below consensus 0.4% increase in personal spending. The personal savings rate has declined to just 4.0%, which is the lowest reading since 2022 and Q3 2008 prior. Despite this, we remain optimistic on consumer spending in 2026 even if consumers are exhibiting signs of strain (Figure 2) with consumer credit delinquencies rising, and indicators of consumer sentiment remaining weak.

- **Fedspeak**: 2026 brings a slate of new voters from the regional Fed banks (Cleveland, Philadelphia, Dallas and Minneapolis versus Boston, Chicago, St Louis and Kansas City). The Federal Reserve communications blackout period begins on January 17.

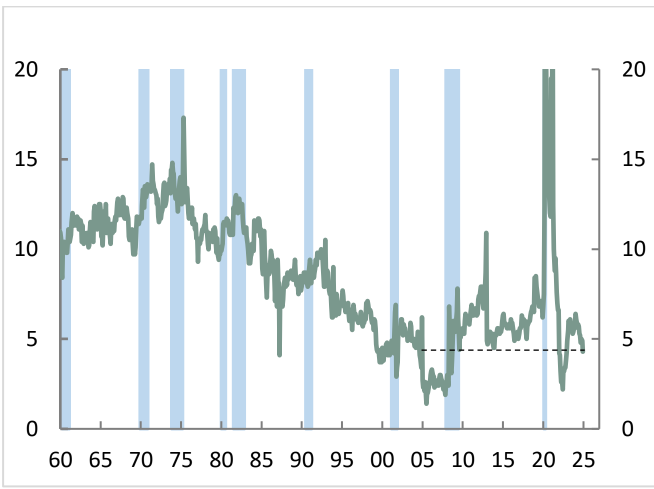
- **UST Auctions**: The Treasury will sell $13bn 20-Year (reopening) on Wednesday and $21bn 10-Year TIPS on Thursday. The Fed will conduct bill RMPs on Tuesday and Thursday.

Figure 1: Core PCE Inflation (%)



Source: BEA, Haver, SMBC Nikko

Figure 2: Personal Saving Rate (% of DPI)



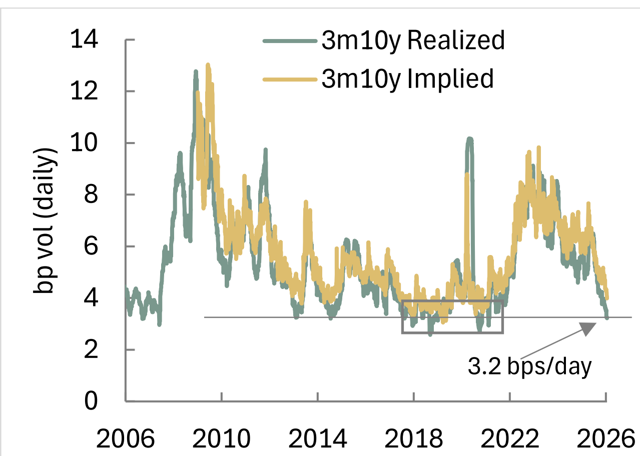
Source: BEA, Haver, SMBC Nikko

Buy Gamma on Dips

Implied vol is at multi-year lows, driven by tight ranges and subdued realized volatility (Figure 3). This is a result of a Fed in no hurry to cut and a market caught between opposing forces — robust GDP and sticky inflation on one side and softening job creation and weak tariff-sensitive goods prices on the other. Fading this move lower has been painful. It is likely that gamma drifts lower in the near term as the Fed signals it can afford to wait for more data at the next FOMC meeting. **However, the risk-reward favors using dips over the next month to build gamma longs**.

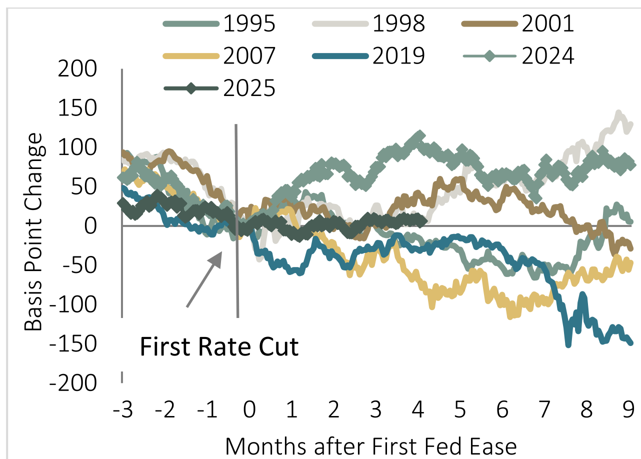
1) **Valuations are appealing** with realized vol only lower in the 2017-2021 period – and even then, volatility periodically picked up. The current regime is very different from both 2017-2019 and the 2020-2021, given uncertainty and fiscal concerns.
2) Fed easing cycles also support the case for long gamma. Historically, ranges have shown a tendency to break within six months after the first cut (Figure 4). In the current cycle, the disconnect between strong growth and weak labor market is unlikely to persist and a resolution should lift volatility.
3) We **favor the 1y10y**, which offers a slower decay profile.

Figure 3: Realized/Implied Vol at Multiyear Lows



Source: Bloomberg, ICAP, SMBC Nikko

Figure 4: 10y yields into First Cut and Thereafter



Source: Bloomberg, SMBC Nikko

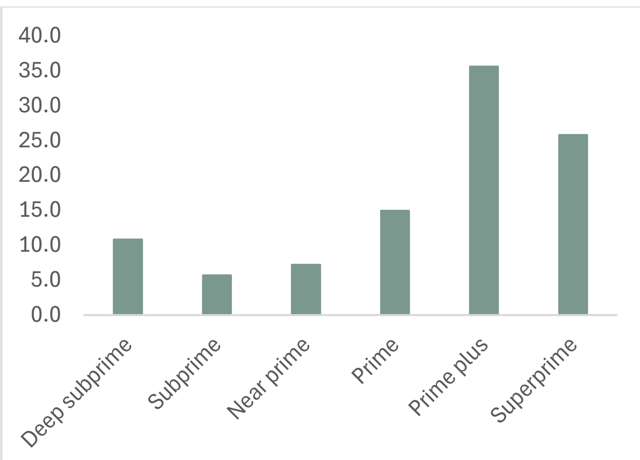
Capping Credit Card Costs

Late last week, the President proposed implementing a temporary cap of 10% on credit card interest rates. No details have been released yet so there is some uncertainty about how such a limit might be structured. Legally, the President cannot enforce a 10% cap as he does not have the authority to set credit card rates. Rather, these are governed by the Truth in Lending Act (TILA) and enforced by the Consumer Financial Protection Bureau (CFPB). **Congress can authorize changes to TILA governing fees and interest rates**. Interestingly, there is already legislation pending in both Houses to cap credit card interest rates at 10% (S.381/HR 1944). The legislation was proposed in February 2025 and has Democratic and Republican sponsors. **But it has not moved forward**. Unlike the President's statement, the legislated cap would not be temporary, and it would include credit card fees in the 10% limit. Violations would be subject to Section 130a of TILA which could subject the issuer to statutory damage and class action status.

Banks are opposed to the cap – even a temporary one. They note it would reduce credit availability – particularly at the lower end of the income distribution – and push borrowers into less regulated markets (Figure 5).[1] According to Calem and Kim, roughly 22% of families in the Fed's 2019 Survey of Consumer Finances (SCF) "rarely" pay off their balances at the end of the cycle. Since families typically have more than one credit card**, the percentage of *accounts* with revolving balances is higher – 50% in 2024 and up from 45% in 2021**.[2] Among accounts with revolving balances 15% only paid the minimum monthly payment. The minimum monthly payer share is its highest since 2015.

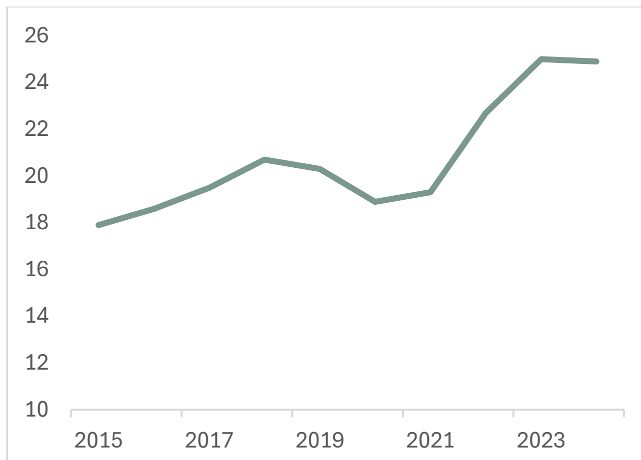
The 10% cap in S.381/HR 1944) applied to the annual percentage rate (APR). **The average APR on general purpose credit cards has risen with the increase in the prime rate in 2022-23 and has since held around 25%** (Figure 6).[3] APRs, however, do not reflect short-term promotional rates and as a result effective interest rates on credit cards are somewhat lower. In 2024, the average annual effective interest rate on revolving balances was 20% although this varies by borrower type. The effective interest rate for subprime borrowers is around 25% but lower than 22% for prime or better borrowers.

Figure 5: Borrower distribution (%)



Source: CPFB, SMBC Nikko

Figure 6: Credit card APR (%)



Source: CPFB, SMBC Nikko

Temporary promotional rates on credit cards are common. As of December 2024, more than half (52.8%) of balances on general purpose credit cards were in some introductory promotional period.[4] **Nearly all of the promotions offered in 2023-24 had 0% introductory APRs with periods ranging from 6 to 21m.** About 1/3 of yearly purchases in 2024 (or $900bn) are made on credit cards with promotional interest rates (Figure 7). The promotional share has been declining since 2015. Interestingly according to the CPFB, more than 80% of cardholders do not cancel their promotional cards when the period ends. And about half (52%) continue making purchases on these cards even after the promotion period has expired. While promotions lower effective credit card rates, they are typically offered only to prime or better credit borrowers.

[1] See "The Potential Adverse Consequences of a Credit Card Interest Rate Cap", P. Calem and A. Kim, Bank Policy Institute, May 19, 2025.

[2] See "The Consumer Credit Card Market: Report to Congress", Consumer Financial Protection Bureau, December 2025

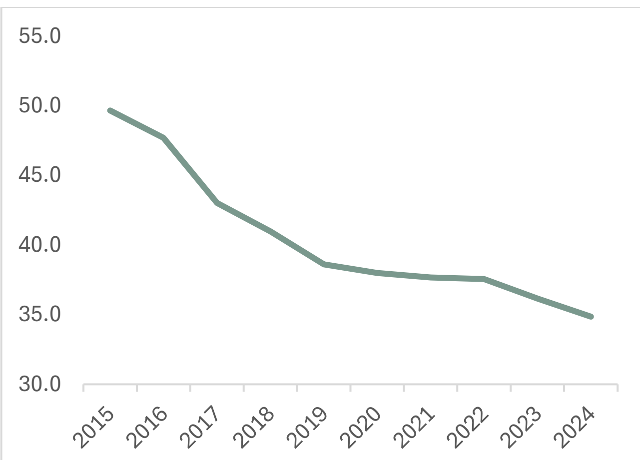
[3] The prime rate increased by over 500bp between March 2022 and September 2023.

[4] CFPB, December 2025

Total credit card interest costs in 2024 were $160bn up from $105bn in 2022. Most of the increase reflected rising APRs with the Fed's rate tightening. Households paid an additional $30bn or so in fees. It is difficult to determine how much a temporary cap would lower these costs and what effect it might have on spending. Most credit card holders are either prime or better borrowers and their APRs (along with their effective interest costs) are lower even though their balances are significantly larger than the rest of the credit universe. Based on SCF data Calem and Kim estimate that perhaps as many as **14m below-prime borrowers would lose access to credit** if a 10% cap were put in place. But these borrowers typically have lower balances and spend less annually (Figure 8).

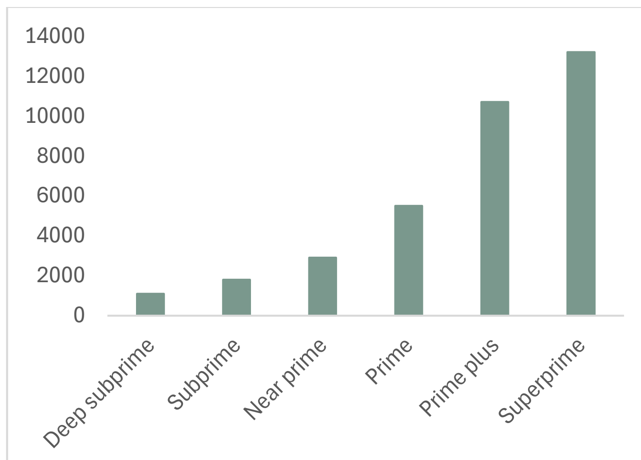
Separately, it is unclear how banks (and households) might respond to a *temporary* cap on credit card APRs. Banks may tighten access to credit – either by reducing credit limits, raising minimum payment requirements or eliminating rewards. Alternatively, they may make fewer adjustments as the cap will be quickly lifted and industry competition is stiff that they might be reluctant to lose market share. Likewise, the subprime households most affected by any tightening in credit standards might either use their interest savings to increase their non-credit card expenditures or, since the interest relief is temporary, they may move to improve their credit by paying down balances.

Figure 7: Promotional spending (% balances)



Source: CPFB, SMBC Nikko

Figure 8: Annual purchases by borrower type ($)



Note: Purchases are measured by account. Source: CPFB, SMBC Nikko

Weekly economic indicator calendar

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Jan 22	Q3 GDP (3rd est.) (8:30 AM)	4.3%	4.3%	4.3%	4.1% - +4.3%	Final estimate for Q3
Jan 22	Q3 PCE (3rd est.) (8:30 AM)	3.5%	3.5%	3.5%	-	Final estimate for Q3
Jan 22	Q3 GDP Deflator (3rd est.) (8:30 AM)	3.8%	3.8%	3.8%	-	Final estimate for Q3
Jan 22	Q3 Core PCE Deflator (3rd est.) (8:30 AM)	2.9%	2.9%	2.9%	-	Final estimate for Q3
Jan 22	Nov. Personal Income (8:30 AM)	0.4%	0.4%	0.4%	0.3% - +0.4%	Payrolls up 0.04% MoM, avg hourly earnings up 0.24% MoM, hours ticked up in November.
Jan 22	Nov. Personal Spending (8:30 AM)	0.4%	0.5%	0.3%	0.3% - +0.5%	November retail sales increased by 0.6% MoM.
Jan 22	Nov. PCE Deflator (8:30 AM)	0.20%	0.3%	0.3%	0.2% - +0.3%	CPI increased 0.2% MoM, core CPI increased by 0.13% MoM.
Jan 22	Nov. Core PCE deflator (8:30 AM)	0.15%	0.2%	0.2%	0.1% - +0.2%	PPI healthcare -- a direct input into PCE and Core PCE deflators -- increased by just 0.13% MoM.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Quarterly GDP and Rates Forecasts

	2025		2026			
(%)	Q3 Act	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP QoQar	4.3	1.2	2.4	1.5	2.5	2.4
Real GDP YoY	2.3	2.2	3.0	2.4	1.9	2.2
Core PCE YoY	2.9	2.5	2.3	2.1	2.0	2.1
Unemployment	4.3	4.7	5.1	4.8	4.5	4.5
Fed Funds Rate Upper Bound	4.25	3.75	3.25	3.25	3.25	3.25
2 Year	3.61	3.47	3.25	3.25	3.25	3.25
5 Year	3.74	3.73	3.50	3.50	3.50	3.50
10 Year	4.15	4.17	4.00	4.25	4.25	4.25
30 Year	4.73	4.84	4.75	4.75	4.80	4.85

Source: SMBC Nikko

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