

US Rates Strategy Weekly

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- The labor market is balanced at full employment with the jobless rate hovering around 4.2% since last year. Yet wage measures are decelerating.
- **The cause may be psychological; in a low-hire environment, workers may be more reluctant to leave their jobs as they fear not finding an adequate replacement.** This could be exacerbated by AI fears.
- **Some estimates suggest that job insecurity reduced wage growth by 0.3-0.7%/year in the mid-1990s because of fear about globalization and downsizing.** However, the effects are difficult to disentangle from other labor market changes.
- **Evidence of AI-related firing is weak. Instead, it seems to be suppressing the hiring of junior and less experienced workers.**
- Thus, while we think AI-fears *may* be suppressing wage growth, it is possible the softening simply reflects low demand in a low hiring environment.
- **Since the war began at the end of February, rates have shown a consistent directional relationship with crude; when oil prices rise, yields, across the curve increase.**
- Ten-year Treasury yields are now roughly one standard deviation cheap relative to our fair value model.
- **We are forecasting 0.45% m/m for headline CPI and 0.23% m/m for core CPI.** Retail sales are likely to soften following robust gains in August. We look for headline and ex auto sales to increase 0.2% and 0.4%, respectively.

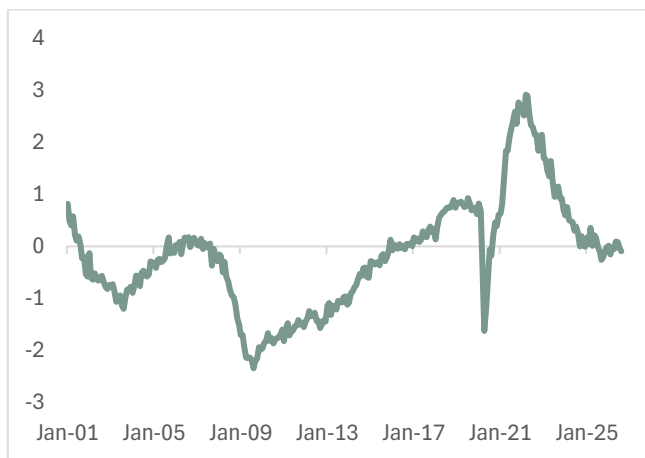
Worker insecurity?

The labor market is balanced at full employment with the jobless rate hovering around 4.2% since last year. The New York Fed's HPW index measures relative labor market tightness using data on quits and

vacancies. Like the jobless rate, it, too, has been flat near zero since last year and suggests the labor market is evenly balanced (Figure 1).¹

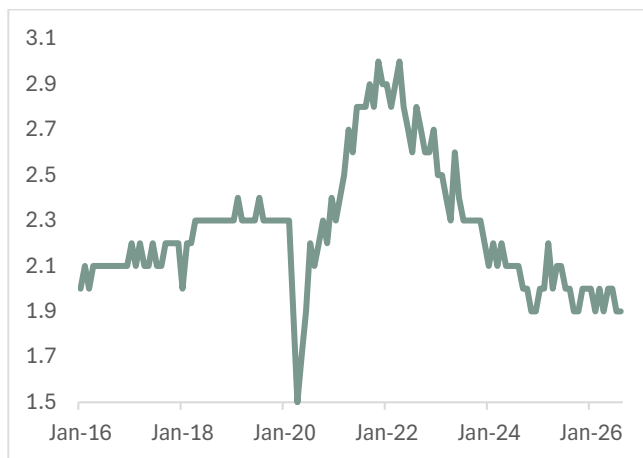
In theory, the low unemployment rate should be associated with increased worker bargaining power and higher wages. Workers with jobs might be more willing to leave their jobs for greener pastures elsewhere. Similarly, the duration of unemployment spells should decline as a steady pace of job openings absorbs the newly unemployed. But while the voluntary quit rate has hovered around 2% for more than a year, wages are trending lower (Figure 2). Average hourly earnings have cooled to 3.4% y/y (Figure 3). This does not appear to be a compositional issue related to the averaging of low and high-wage workers. Indeed, the wage component of the ECI has slipped to 3.2% y/y in June. Moreover, the HPW, which is correlated with the ECI by construction, also points to subdued wage inflation. **So, why is worker pay barely keeping pace with overall inflation?**

Figure 1: HPW labor tightness (%)



Source: Federal Reserve Bank of New York, SMBC Nikko

Figure 2: Quit rate (%)



Source: BLS, SMBC Nikko

One reason for this apparent softness in workers' bargaining power might be psychological. In a low hire environment like today, workers may be more reluctant to leave their jobs as they fear not finding an adequate replacement. This could be exacerbated by AI fears. And while anxiety over p(doom) is a relatively new phenomenon, workers have been worrying about technological job loss for some time.

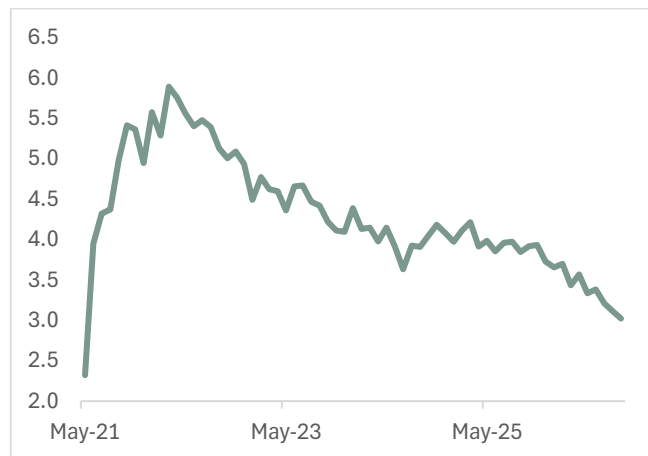
However, the connection between worry and reality is tenuous. Most [studies show evidence of hiring](#) but not firing effects. These effects appear to be concentrated among more junior and less experienced workers. Brynjolfsson et al. use ADP employment data to compare trends in employment by age before and after the introduction of ChatGPT.² Employment among "early career" workers (aged 22-25) has fallen since 2022 while employment in older age cohorts has increased. Through July 2025, employment among workers 35-49 increased 8% while it fell 6% for those 22-25. Prior to the introduction of ChatGPT employment across both cohorts moved in tandem. Likewise, Simon notes that a 10-percentage point

¹ See, "Wage Growth and Labor Market Tightness", S. Heise, J. Pearce, and J. Weber, Federal Reserve Bank of New York, March 2025

² See, "Canaries in the Coal Mine? Six Facts about the Recent Employment Effects of Artificial Intelligence", E. Brynjolfsson, B. Chandar, and R. Chen, Stanford University, November 13, 2025.

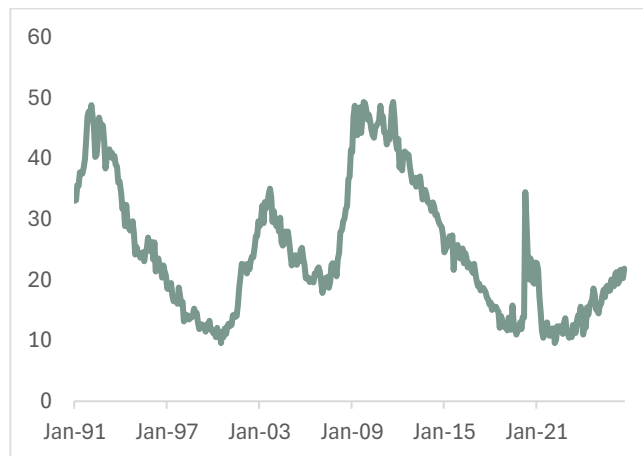
increase in AI exposure is associated with a 7% *increase* in the demand for non-entry level jobs but an 11% *decline* in entry level roles.³

Figure 3: Hourly earnings (%y/y)



Source: BLS, SMBC Nikko;

Figure 4: Jobs hard to get (%)



Source: University of Michigan, Consumer Sentiment, SMBC Nikko

But a recent regional survey from the Federal Reserve Bank of New York found that while some firms were scaling back hiring due to AI, others had increased their hiring.⁴ And Anthropic notes that while “job starts” for workers aged 22-25 – where a worker reports a job she did not have 12m earlier – have fallen 14% since November 2022, the effect is barely statistically significant.⁵

That said, there was a strand of academic thought in the 1990s and 2000s that argued **heighted job insecurity had contributed to a weakening in labor’s bargaining power**.⁶ As noted by Fed Chair Greenspan, “atypical restraint on compensation increases has been evident for a few years now and appears to be mainly the consequence of greater worker insecurity”.⁷ Worried workers were reluctant to ask for more pay fearful that they could be added to the wave of downsizings and globalization. Aaronson and Sullivan observed that worker displacements and job insecurity reduced wage growth by 0.3-0.7%/y in the mid-1990s. More recent work is more guarded in part because it is difficult to separate the wage effects of actual job losses from the fears of job loss. And while job insecurity made good headlines, most of the data was anecdotal. Indeed, the percentage of workers reporting that jobs were hard to get fell steadily through the 1990s (Figure 4).

As a result, while we think AI-fears *may* be suppressing wage growth, it is possible the softening simply reflects low demand in a low hiring environment.

³ See, “Is AI Responsible for the Rise in Entry-Level Unemployment?”, L. Simon, Revelio Labs, August 4, 2025

⁴ See, “Businesses are Using AI to Transform Work, Not Cut Jobs”, J. Abel, R. Deitz, N. Emanuel, N. Montalbano, Liberty Street Economics, Federal Reserve Bank of New York, September 1, 2026.

⁵ See “Labor Market Impacts of AI: A New Measure and Early Evidence”, M. Massenkoff and P. McCrory, Anthropic, March 5, 2026.

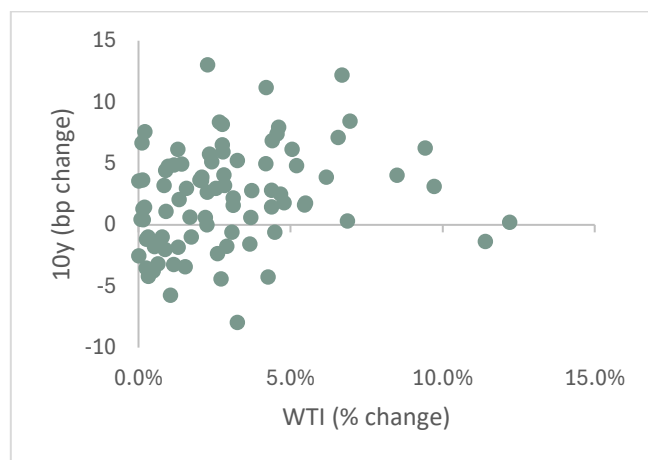
⁶ See, for example, “The Decline of Job Security in the 1990s: Displacement, Anxiety, and their Effect on Wage Growth”, D. Aaronson, and D. Sullivan, Federal Reserve Bank of Chicago, Economic Perspectives, 1997

⁷ See, Humphrey Hawkins testimony, February 1997.

Will the oil-rates link weaken?

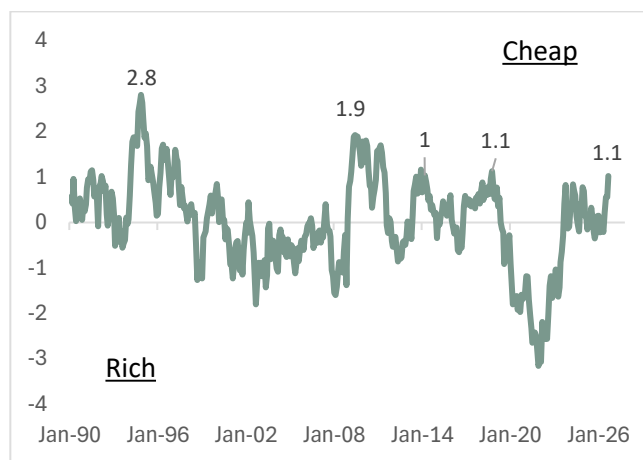
Yesterday was one of the roughly 30% of sessions since the war began in which 10y Treasuries rallied despite a jump in the front-month WTI contract. We think this is noteworthy given how sensitive Treasuries have been to oil prices and Iran-related headlines. Since the war began at the end of February, rates have exhibited a consistent directional relationship with crude. On days in which oil prices increased, yields across the curve increased. In Figure 5, we plot the correlation in 10y yields.

Figure 5: 10y UST Daily Change when WTI rises



Source: Bloomberg, SMBC Nikko;

Figure 6: 10y rich/cheap vs. fair value model (z score)



Source: Bloomberg, SMBC Nikko

This correlation does not imply that crude has been the sole driver of rates. Indeed, economic data, the Fed's reaction function, global yields, Treasury supply, and broader risk sentiment have also pushed yields higher. Yet the high hit ratio underscores crude's consistent directional influence on Treasuries, even as the magnitude of individual moves is shaped by other factors. Following record investor demand at this week's 10y auction, we think it is worth watching whether this relationship continues to hold.

Valuations matter

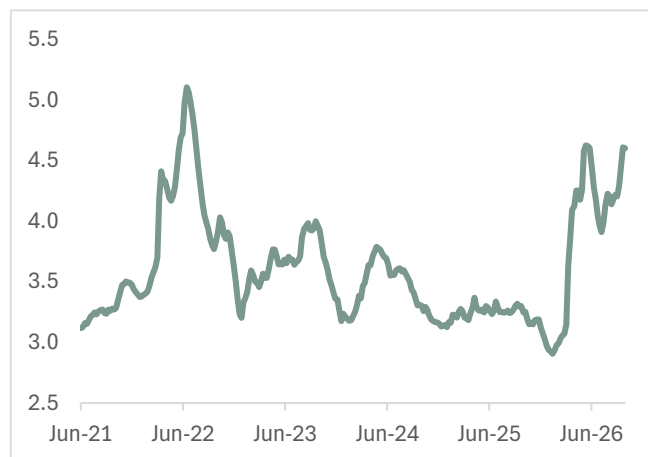
Ten-year Treasury yields are now roughly one standard deviation cheap relative to our fair value model. Using the HLW estimate of 1.0% for r^* and long-term inflation expectations, the model implies a fair value of 4.3%, leaving yields nearly 100bp cheap to fair value. Even if we assume a higher 1.5% r^* , consistent with the upper end of current estimates, fair value rises only to 4.8%, leaving a residual of roughly 45bp. We forecast the 10y will end the year at 4.75%.

While a catalyst for a sustained rally has remained elusive, valuations are becoming increasingly difficult to ignore. Across a [range of plausible \$r^*\$](#) assumptions, fair value remains well below current yields, suggesting an asymmetric risk-reward profile. In our view, the upside in yields may be limited to another 15-25bp, while the potential for a sharp short-covering rally remains elevated should a credible catalyst emerge.

Week ahead

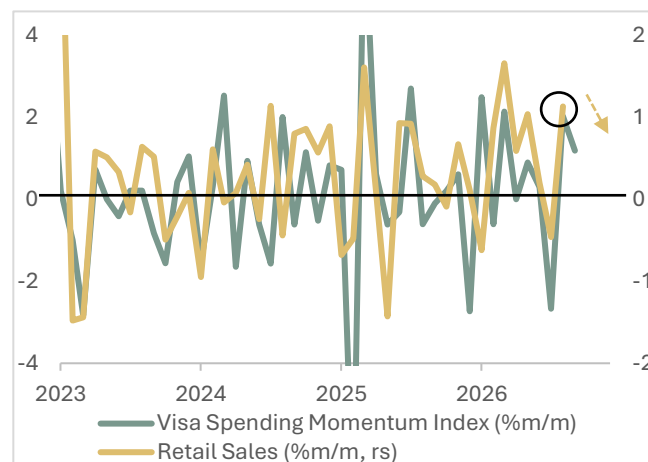
- Consumer Prices Report (Sep, Wed):** We are forecasting 0.45% m/m for headline CPI and 0.23% m/m for core CPI. We look for CPI energy prices to rise 3.3% led by a 7.1% increase in gasoline prices and a 13.9% jump in diesel prices (Figure 7). We expect core CPI to slow to 2.3% y/y this year and 2.1% in 2027. That said, PCE is running 3.5% this year and 2.0% next year.
- Retail Sales Report (Sep, Thurs):** Retail sales are likely to soften following robust gains of 1.2% and 1.4% in August for headline and ex autos retail sales. We are forecasting gains of 0.2% and 0.4% for headline and ex autos retail sales. Total vehicle sales (units) fell 3.5% m/m decline in September, while the Visa spending momentum index decelerated – from 2%m/m in August to 1.2% in September (Figure 8).

Figure 7: Gasoline prices (\$/g)



Source: Bloomberg, SMBC Nikko

Figure 8: Visa Spending Momentum Index vs. Retail Sales (%)



Source: Visa, Census, Haver, SMBC Nikko

Table 3: Economic indicator forecasts

Date	Indicator	SMBC US Forecasts				Notes:
		SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	
Oct 13	Existing Home Sales (10 AM)	-0.5%	-0.1%	-2.0%	-1.5% - +0.5%	Existing home sales remain depressed at 3980k, and trending sideways since 2023.
Oct 14	CPI MoM (8:30 AM)	0.5%	0.6%	0.4%	0.5% - +0.6%	(unrounded: 0.45%) Gasoline prices increased 7.1% in Sep. Forecasting: CPI energy +3.3%, CPI food at 0.24%.
Oct 14	CPI YoY (8:30 AM)	3.5%	3.6%	3.4%	3.5% - +3.7%	Agricultural commodities increased 1.9%, while used car prices fell -1.1%.
Oct 14	Core CPI MoM (8:30 AM)	0.2%	0.2%	0.3%	0.2% - +0.3%	(unrounded: 0.23%) Forecasting: shelter & core ex shelter at 0.23%.
Oct 14	Core CPI YoY (8:30 AM)	2.4%	2.5%	2.4%	2.4% - +2.6%	Core CPI follows real personal incomes with a 12m lag. Indicates core CPI falling to 2.3% YE-26 and 2.1% YE-27.
Oct 15	Retail Sales (8:30 AM)	0.2%	0.3%	1.2%	0.0% - +0.4%	Gasoline prices up 7.1% m/m. Visa spending momentum index decelerated to a 1.2% m/m gain.
Oct 15	Retail Sales ex autos (8:30 AM)	0.4%	0.4%	1.4%	0.3% - +0.9%	Total vehicle sales fell -3.5%.
Oct 15	PPI MoM (8:30 AM)	0.5%	0.5%	0.4%	0.4% - +0.7%	Crude oil increased by 16.1% in the month.
Oct 15	Core PPI MoM (8:30 AM)	0.3%	0.3%	0.2%	0.2% - +0.3%	PPI trade services--margins received by wholesalers and retailers--has increased by a 4.5% y/y which is elevated.
Oct 16	Industrial Production MoM (9:15 AM)	0.2%	0.4%	0.0%	0.2% - +0.6%	Likely soft as steel production fell -3.2% in the month and ISM manufacturing production fell -1.6 points.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Table 4: Federal Reserve communication

Federal Reserve Communication		
Oct 12	12:10 PM	Clev Fed's Hammack (hawk) speaks on outlook + monetary policy with text and Q&A. 2028 voter.
Oct 13	3:45 PM	Fed Governor Waller (neutral) speaks on economic policy in the age of AI. Voter.
Oct 13	4:00 PM	Boston Fed's Collins (neutral) speaks at Community Bankers Conference w/ text and Q&A. 2028 voter.
Oct 14	5:40 AM	Fed Governor Bowman (neutral) participates in moderated IMF conversation. Voter.
Oct 14	2:00 PM	Fed Beige Book.
Oct 15	4:30 PM	Clev Fed's Hammack (hawk) participates in discussion on leadership/career with Q&A. 2028 voter.
Oct 15	11:30 PM	Fed Chair Warsh (hawk) participates in fireside chat with IMF's Georgieva w/ Q&A. Voter.

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