US Rates Strategy Weekly

March 27, 2026

Joseph Abate, US Rates Strategy
joseph.abate@smbcnikko-si.com
1 212 893-1592

Monty Gandhi, US Rates Strategy
mgandhi@smbc-cm.com
1 212 224-5114

Troy Ludtka, US Economist
troy.ludtka@smbcnikko-si.com
1 212-224-5483

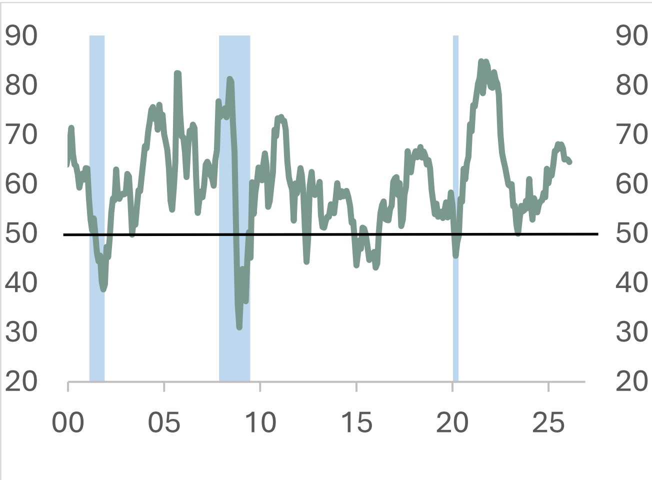
Week ahead

- **Retail Sales (Feb., Wed)**: Retail sales have struggled to beat the broader rate of consumer price inflation, which we expect will continue in the short run. Nominally, however, retail spending was likely quite strong in February as gasoline prices and vehicle sales jumped by 3.5% and 5.9%.

- **ISM Manufacturing (Mar., Wed) and ISM Services reports (Mar., Fri)**: We are forecasting a below-consensus reading of 51.7, due to declines in new orders, production and employment. Prices here have steadily risen, signaling an acceleration in goods inflation more broadly. We are forecasting a slowdown in the March services index to 54.6 from 56.1 as business activity and new orders retreat. While services prices have been *declining* over the past year, the current energy shock is likely to boost sector inflation.

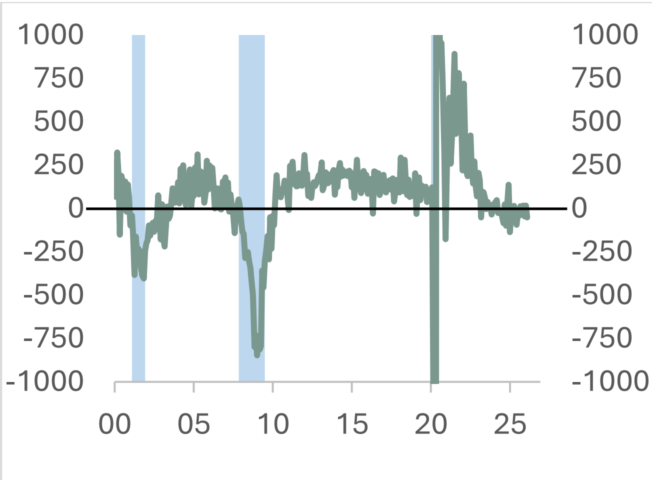
- **Employment Report (Mar., Fri)**: The labor market is exhibiting a low-hiring and low-firing dynamic. The former is a leading indicator, as firms slow hiring before cutting jobs. Increased uncertainty and energy prices will likely chill labor demand further. Excluding the education and health services sector, which added 658k jobs in the past year, private payrolls have declined by -266k over the period. We are forecasting +38k and +40k for headline and private payrolls, and a 4.5% unemployment rate.

Figure 1: Composite ISM Prices (Index)



Source: ISM, BEA, Haver, SMBC Nikko

Figure 2: Growth in Private NFP excl. Private Education and Health Services (Thous. 3m ma)



Source: BLS, Haver, SMBC Nikko

Revising the forecast

President Wilson had 14 Points and President Trump's 15 seem no closer to ending the conflict than the earlier effort.[1] As the prospect of a longer war increases we are revising our inflation forecasts higher and simultaneously lowering growth estimates (see table). **While we think an easing is more likely than a rate hike, the Fed may not see enough of a cooling in inflation to be able to deliver one until next spring** (April 2027). Instead, we look for policy to be sidelined all year.

The Iran conflict is forcing interest rate strategists to become military and geopolitical strategists. We are out of our depth; we do not know how long the conflict will last or when the Straits of Hormuz may re-open. In the forecast table, **we attempt to map out the growth and inflation path assuming the conflict continues at its present intensity for another two months**. Over the period, oil prices hold at \$100/bbl and afterward decline toward \$80/bbl by the year-end.[2] The resulting price shock will push PCE and core PCE inflation to 3.7%, and 3.2%, respectively in Q2. Higher energy prices will divert household consumption from discretionary spending and increase input costs for corporates. We expect both effects to reduce Q2 GDP by 0.5pp to 1.1% q/q. Assuming prices follow the forwards path, we expect GDP to recover in Q3 (to 2.1% q/q) and PCE deflator to slow from 5.6% to 2.3% q/q.

The job market was already on a "slow hiring-low firing" path since early last year. In February, non-farm payrolls shrank 92,000 while the three-month average slowed to just 3,000. Monthly average job gains in the last year have averaged just 16,000/mo – their slowest pace outside of a recession since 2011. Meanwhile the unemployment rate has bounced around 4.4% since last May. Average hourly earnings growth has cooled to 3.8% from 4.2% a year ago. As result, the tax imposed by higher energy prices on household budgets may be felt more acutely.

Indeed, the temporary boost from larger tax refunds this year that we were expecting has been disappointing. Through March 13, refunds have totaled \$182bn – up 12% from last year. But this is considerably lighter than the \$220bn we were looking for at this point in the issuance cycle. And unless refund issuance picks up in the next month, the average check this year is likely to be \$3,600 or about \$400 less than expected. As we wrote last week, any federal gasoline tax holiday (of 18.4c/gallon) will be too small to fully offset the nearly \$1/gallon jump in pump prices since the end of February.

Our baseline assumes that the oil shock quickly dissipates once the conflict ends. This requires no lasting damage to consumer confidence or financial markets. We look for the economy to rebound in Q3 while avoiding a recession in Q2.

Monetary policy uncertainty

We think that as long as inflation expectations remain anchored, the Fed will be able to look through the energy price shock without raising interest rates. Our sense is that a longer conflict with persistently higher energy prices would damage confidence and households and businesses would retrench their spending. In turn, we think this would offset the inflationary impulse from higher energy prices. But this assumes that inflation expectations remain anchored. In February, the New York Fed's household survey's median 1y, 3y, and 5y, inflation expectations were 3% (Figure 3). And last month, measures of expected inflation uncertainty were falling. We will pay careful attention to the next report (April 7) which will reflect the effects of the war.

[1] Wilson's 14 Point speech was made in January 1918; the armistice wasn't signed until November.
[2] We are using the Brent forward contract pricing from June through December 2026.

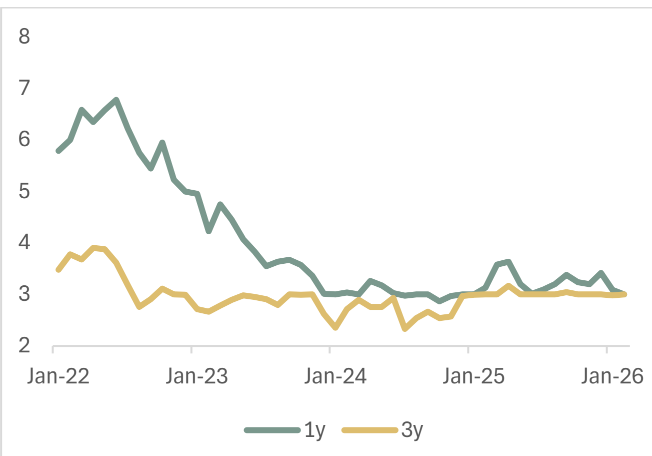
Even without the "fog of war" there was some uncertainty about the timing of the Fed's next move. There is resistance on the Senate Banking Committee to advance Warsh's nomination until the pending Department of Justice investigation is resolved. Chair Powell has also indicated that he plans to remain at the Fed while the investigation is ongoing. As a result, we don't really know when the new Chairman will be seated.

Treasury forecast

We have also updated our Treasury yield forecasts (Table 3) consistent with the shift in the macro forecasts. In the near term, forecasts are marked to market. Beyond this, the path becomes macro driven. As softer growth materializes in Q2, we look for front-end yields to move lower, before stabilizing with the anticipated economic rebound in H2.

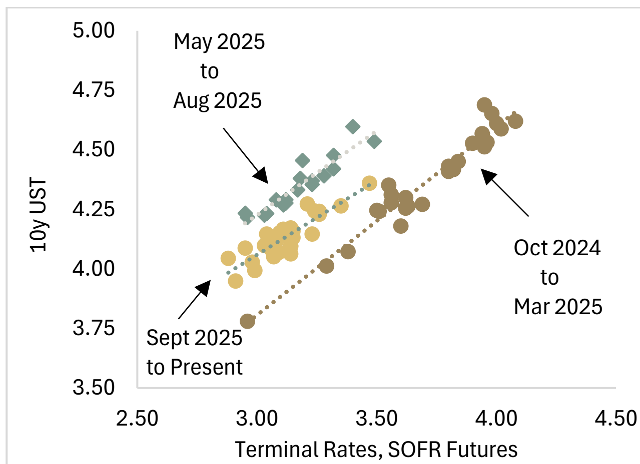
By year-end, the 2y yield should settle around 3.60%. Using the September 2025 regime model and our expected terminal rate expectation, we expect the 10y yields to end the year at 4.30%. Our forecast assumes a modest steepening into Q4, driven by a combination of lower front-end rates and a rebound in growth.

Figure 3: Median inflation expectations (%)



Source: FRBNY, SMBC Nikko

Figure 4: 10y UST vs. Terminal Rate (%)



Source: US Treasury, SMBC Nikko

Table 2: Economic indicator forecasts

SMBC US Forecasts							
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Mar 31	Case Shiller Home Prices (9 AM)	0.4%	-	0.5%	-	We expect home prices will slow to 0% YoY due to a dearth of demand. Affordability is near record lows.
Mar 31	Conf. Board Consumer Confidence (10 AM)	89.0	88.8	91.2	88.0 - 91.0	Consumer confidence likely to weaken as S&P -5.6% MTD, and gasoline prices up 33.6%.
Apr 1	ADP Employment (8:15 AM)	20k	40k	63k	37k - +96k	Weakest 12-month average job growth (+26.5k) in ADP since June 2021.
Apr 1	Retail Sales (Feb) (8:30 AM)	0.6%	0.4%	-0.2%	-	Total vehicle sales increased +5.9% MoM in February. Ninth largest monthly increase dating back to 2020.
Apr 1	Retail Sales ex autos (Feb) (8:30 AM)	0.5%	0.3%	0.0%	-	Gasoline prices increased 3.5% MoM in the month.
Apr 1	ISM Manufacturing (10 AM)	51.7	52.2	52.4	51.2 - 52.5	Expecting slower delivery times due to war, higher prices, lower new orders from Feb. level.
Apr 3	NFP (8:30 AM)	38k	51k	-92k	14k - +95k	Forecasting -2k decline for gov't jobs. Last 12m: priv. ed & health +658k jobs vs. -502k for all other sectors.
Apr 3	Private NFP (8:30 AM)	40k	49k	-86k	20k - +110k	Forecasting +70k for priv. education and health services. This remains the dominant source of US job growth.
Apr 3	Unemployment Rate (8:30 AM)	4.5%	4.4%	4.4%	4.3% - +4.5%	Over next few months, upside risk for unemployment. We expect a -187k decline in Mar. household employment.
Apr 3	Avg. Hourly Earnings (8:30 AM)	0.4%	0.4%	0.4%	0.3% - +0.4%	Wage growth trending sideways at 3.8% YoY.
Apr 3	ISM Services (10 AM)	54.6	55.0	56.1	53.0 - 56.0	New orders, business activity, and employment to downshift in the month. Higher supplier delivery times.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Table 3: GDP and interest rate projections (%)

(%)	2025		2026			
	Q3 Act	Q4 Act	Q1F	Q2F	Q3F	Q4F
Real GDP QoQar	4.3	1.4	1.6	1.1	2.1	2.2
Real GDP YoY	2.3	2.2	2.8	2.1	1.6	1.8
Core PCE YoY	2.9	2.9	2.7	3.2	2.8	2.4
Unemployment	4.3	4.4	4.5	4.8	4.7	4.6
Fed Funds Rate Upper Bound	4.25	3.75	3.75	3.75	3.75	3.75
2 Year	3.61	3.47	3.90	3.65	3.60	3.60
5 Year	3.74	3.73	4.00	3.80	3.75	3.75
10 Year	4.15	4.17	4.40	4.20	4.25	4.30
30 Year	4.73	4.84	4.85	4.70	4.80	4.85

Source: SMBC Nikko

Disclaimers

This document has been prepared by SMBC Group (including, collectively or individually, Sumitomo Mitsui Banking Corporation (“SMBC”), SMBC Nikko Securities America, Inc., SMBC Nikko Securities Canada, Ltd., SMBC Capital Markets, Inc., SMBC Leasing and Finance, Inc., and JRI America, Inc.) and is being furnished by SMBC Group solely for use by the client(s) or potential client(s) to whom such materials are directly addressed and delivered. SMBC Nikko Securities America, Inc. (“SMBC Nikko America”) is a U.S.-registered broker-dealer. SMBC Nikko Securities Canada, Ltd. (“SMBC Nikko Canada”) is a U.S. and Canadian registered broker-dealer. SMBC Capital Markets, Inc. (“SMBC Capital Markets”) is a U.S. swap dealer registered with the Commodity Futures Trading Commission (“CFTC”). SMBC Group deal team members may be employees of any of the foregoing entities. In the U.S., capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko America, SMBC Nikko Canada, and SMBC Capital Markets. Derivative activities may be performed by SMBC Capital Markets or SMBC. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. SMBC operates in the U.S. through state-licensed branches, and representative offices, and does not accept deposits from the general public. SMBC is not a member of the Federal Deposit Insurance Corporation (“FDIC”) and is not an FDIC-insured institution. Deposits placed with SMBC are not insured by the FDIC. FDIC deposit insurance coverage only protects against the failure of an FDIC-insured depository institution. Non-deposit products are not insured by the FDIC; are not deposits; and may lose value, subject to certain limited exceptions.

This document is for informational purposes only and is not intended to be advice, a recommendation, an offer to sell or the solicitation of an offer to buy any securities, enter into any transaction or adopt any hedging, trading or investment strategy, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax, accounting, or legal advice. Any transactions or strategies discussed herein do not take into account the particular investment objectives, financial situations, or needs of any client, and may not be suitable for all parties. This document is not a research report, and neither this document nor its author(s) is subject to SMBC Group policies and procedures that apply to the globally branded research reports and research analysts of SMBC Group and its affiliates or to legal requirements designed to promote the independence of investment research. This document has been prepared for and is directed exclusively at Qualified Institutional Buyers, sophisticated institutional investors, and other market professionals. It is not intended for distribution to or use by retail customers.

SMBC Group makes no representations to, and does not warrant, this document’s accuracy or completeness. In preparing this document, SMBC Group has relied on information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Any specific prices, indices or measures, including ranges, listed in this document were determined at or around the time the document was prepared and are subject to change without notice. SMBC Group expressly disclaims any liability for any results in connection with use of the information set forth herein, including, without limitation, any use of the information in the preparation of financial statements or accounting material. SMBC Group does not provide tax, accounting, or legal advice. Accordingly, any discussion of tax matters contained herein (including any attachments) is not intended or written to be used in connection with the promotion, marketing or recommendation by anyone for the purpose of avoiding any tax-related penalties. Prior to participating in any transaction or strategy, you should consult your own independent legal, tax, accounting and other professional advisors.

This document may contain forward-looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets, or similar analysis. Any such forward-looking statements, prices, indices, or measures are based upon certain assumptions. All forward-looking statements are based on the information available at the time the document was prepared and SMBC Group is not obligated to provide an update. Any opinions, projections, price/yield information or estimates are subject to change without notice. Actual events may differ from those assumptions or available information. There can be no assurance that any estimated returns or projections will be realized, that forward-looking statements will materialize, or that actual results will not be materially different from those presented herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The value, price, or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices or rates mentioned in this document, at any time.

This document is confidential and is the property of SMBC Group, subject to copyright. Any reproduction of this document, in whole or in part, is prohibited, and you may not release this document to any person, except to your advisors and other professionals to assist you in evaluating the document, provided that they are obligated, by law or agreement, to keep the document confidential.