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US Rates Strategy Weekly

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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

- **CPI (Dec., Tuesday):** We expect headline and core CPI to increase 0.2% m/m (2.6%) and 0.3% m/m (2.6%) (Figure 1). ISM services data show prices falling to the lowest since March 2025. CPI energy is likely to be soft on the back of a -4.9% decline in gasoline prices. Used car prices increased by 0.3%. Weak national home prices are expected to weigh on CPI shelter through 2026. For PPI, we expect 0.2% m/m readings for both the total and core. Agriculture and livestock prices increased by +0.6%. The PPI healthcare component is a direct input in the PCE/Core PCE deflator.

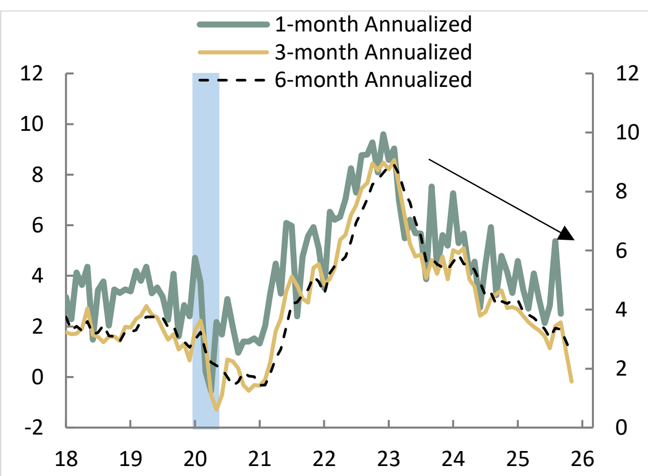
- **Retail sales (Nov., Wednesday)**: We are forecasting a 0.5% increase in headline and ex autos retail sales. Total vehicle sales rose 1.9% m/m in November, partially offset by a 0.3% m/m decline in November gasoline prices. We remain optimistic on consumer spending in 2026 even if retail spending is struggling to overcome the rate of inflation (Figure 2), consumer credit delinquencies are rising, and indicators of consumer sentiment remain 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). Investors will likely focus on Williams (Mon. and Wed.), Paulson and Kashkari (Wed.), and Jefferson (Fri.).

- **UST Auctions**: The Treasury will sell $59 Bn 3-Year and $39 Bn 10-Year (reopening) on Monday and $22 Bn 30-Year (reopening) on Tuesday.

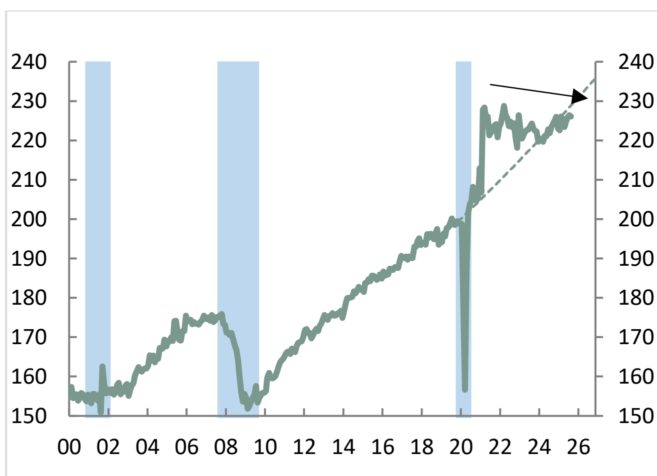
- **Reserve management purchases**: The Fed will announce the January schedule and amount possibly on Wednesday with the first purchases (1-4m bills) on Friday.

Figure 1: CPI Shelter (%)



Source: BLS, Haver, SMBC Nikko

Figure 2: Real Retail Sales vs. 2010-19 ($bn)



Source: Census, BLS, Haver, SMBC Nikko

The Case for 4% 10y Yields

Following the employment report, we now expect two Fed cuts this year - April and June - as the Fed can afford to wait for additional data. In our base case, we expect the 10y Treasury to end Q1 near 4%, supported by a cooling labor market and ongoing disinflation, even as overall growth remains resilient. With the Fed poised to take policy rates 50 bps lower by end of 2026, the front end should anchor long-end yields.

- Regime Mapping Signals the 10y Near 4%: Figure 3 shows two recent regimes linking the 10-year yield to the cycle's terminal rate. Under the post-Liberation Day regime, a **3% terminal rate implies a 4% 10y; the prior regime points closer to 3.75%**. Our Q1 target remains 4%, with scope for temporary moves to 3.75–4.00% if rising unemployment sparks recession concerns.

- Favor Steepeners: Steepeners stalled at resistance and may consolidate, but weakening labor data and rising fiscal risks (including IEEPA-related uncertainty) keep us biased toward steepeners. **Re-enter near support**: 2s10s for investors who expect earlier-cuts and 5s30s for those expecting a slower-cut path where the negative carry is less onerous.

- **More Room for the Belly to Cheapen**: The 5y has cheapened versus the 2y and 10y since early September, and our analysis suggests there is more room. Given the sharp move in the 2y5y10y fly, investors can use any richening to add to cheapening exposure.

- **Wider Swap Spreads**: The key near-term drivers remain corporate issuance, potential MBS purchases by Fannie/Freddie, and the outcome of the IEEPA ruling. Spreads have only tightened modestly despite heavy issuance. Based on analyst estimates of roughly 25 bps of tightening in MBS spreads, we see the upper-bound impact of GSE MBS purchases at about 2–3 bps in 10-year spreads. An adverse IEEPA ruling on tariffs would likely trigger a knee-jerk tightening in long-end spreads. However, once investors judge that January corporate supply is fully priced in—which we expect by next week—they are likely to enter into wideners.

Impact of IEEPA Reversal on 10-Year Yields

The US Custom's Bureau collected $215bn in tariffs in FY 25. However, not all these revenues came from the IEEPA and reciprocal tariffs. We annualized Custom Bureau data to account for the various implementation dates by country and **estimate IEEPA annual revenues of $170bn**. Revenues directly attributable to reciprocal tariffs are $110bn of that amount. Assuming no changes to the rates or behavioral shifts in import demand, the **reversal of IEEPA tariffs might reduce Treasury revenues by between $1.1 and $1.7trn over the next decade**. But this likely overstates the revenue loss as the Treasury might be able to replace, perhaps 25-50% of the amount (see below). **As a result, we estimate an IEEPA reversal could push 10y yields up potentially 30bp**.[1] However, some of this may have already been incorporated into yields as market expectations around the fate of IEEPA began to shift after oral arguments at the Supreme Court on November 5.

The Administration has alternatives to IEEPA that are less likely to face legal challenge. But they are not large revenue generators and may take some time to implement. Under Section 232 rules, the President can impose tariffs on imported products that are deemed a threat to national security by the Commerce Department. There are no limits on the rate applied or the duration of these levies. Section 232 tariffs on

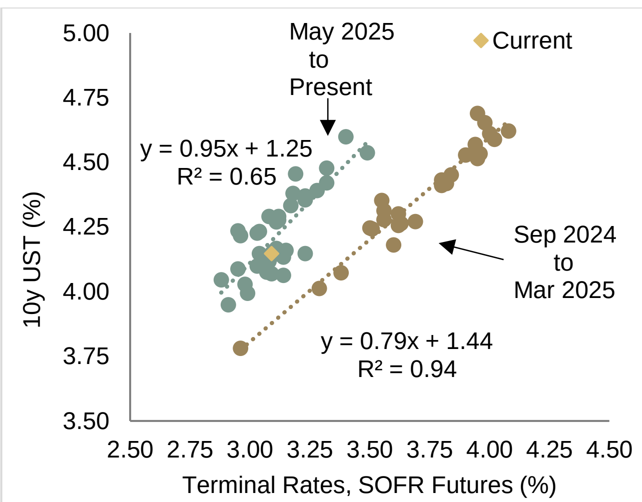
[1] There is a broader question – are these tariffs meant to collect revenue or change behavior?

steel, aluminum and autos have been in place since 2018 so extending coverage to other products seems to have more legal support than some of the other tariff alternatives. The Commerce Department is currently reviewing 12 other products for national security-based tariffs. But Section 232 tariffs raised just $35bn in FY 25.

The other major source of tariff revenue is Section 301. Section 301 is applied against countries deemed to be discriminating against US businesses. Like 232 there is no limit on the rate, but Section 301 tariffs have a 4y limit after which they must be renewed. Currently, Section 301 applies only to Chinese goods. It raised about $36bn in FY 25.

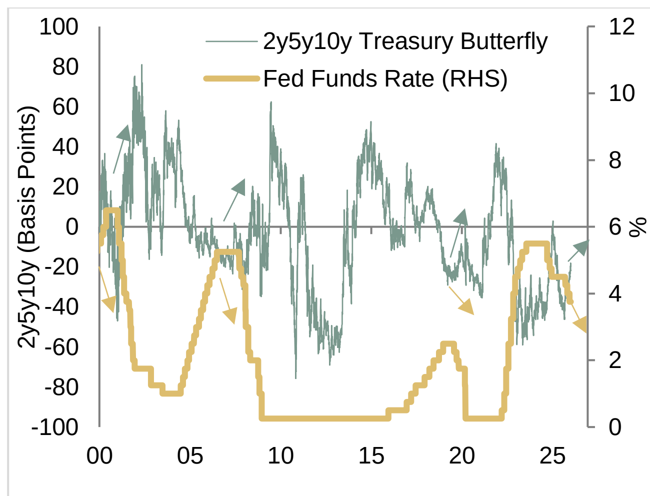
There are two additional sections (122 and 338) that might be applied more broadly although we suspect each would face some legal challenge. Section 122 allows the Administration to impose 15% tariffs for up to 150d. While it can be extended, the extension requires Congressional approval. Section 338 was created in 1930 and allows for unilateral tariffs of 100% or even import bans.

Figure 3: 10y vs. cycle's terminal rate (%)



Source: Bloomberg, SMBC Nikko

Figure 4: 2y5y10 TSY butterfly and FF (bp, %)



Source: Bloomberg, SMBC Nikko

Weekly economic indicator calendar

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Jan 13	CPI MoM (8:30 AM)	0.2%	0.3%	-	0.0% - +0.4%	Forecasting: CPI energy at -1.5% MoM; food at 0.5%, shelter at 0.22% MoM.
Jan 13	CPI YoY (8:30 AM)	2.6%	2.7%	2.7%	2.5% - +2.9%	Gasoline prices -4.9% MoM, WTI -2.7%, nat gas +11.6%, ag & livestock prices +0.6%, used vehicle prices +0.1%.
Jan 13	Core CPI MoM (8:30 AM)	0.3%	0.3%	-	0.1% - +0.4%	Weak national home prices, will weigh on shelter and overal CPI in 2026.
Jan 13	Core CPI YoY (8:30 AM)	2.7%	2.7%	2.6%	2.7% - +2.9%	Core inflation lags incomes by 12 months and suggests continued disinflationary progress.
Jan 13	New Home Sales (10 AM)	-13.3%	-12.5%	-	-16.9% - -3.4%	At 4.8M, total home sales sit at lowest levels since 2011.
Jan 14	PPI MoM (8:30 AM)	0.2%	0.2%	-	0.1% - +0.3%	PPI is sensitive to *Crude* oil which declined -2.7% MoM.
Jan 14	Core PPI MoM (8:30 AM)	0.2%	0.2%	-	0.1% - +0.3%	PPI healthcare--a direct input into the Fed preferred PCE and core PCE Deflators--is slowing. At just 1.7% 6m ann.
Jan 14	Retail Sales (8:30 AM)	0.5%	0.4%	0.0%	0.2% - +0.8%	Total vehicle sales up 1.9% MoM in November, which will be partially offset by weaker gasoline prices.
Jan 14	Retail Sales ex Autos (8:30 AM)	0.5%	0.4%	0.4%	-0.1% - +0.7%	Chicago Fed CARTS tracker up 0.25% MoM in November.
Jan 14	Existing Home Sales (10 AM)	2.2%	2.4%	0.5%	-0.2% - +4.1%	Mortgage applications declined -1.6% MoM in December.
Jan 16	Industrial Production (9:15 AM)	0.1%	0.2%	0.2%	0.1% - +0.2%	Steel production declined -18.75% 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	3.75	3.25	3.25	3.25
2 Year	3.61	3.35	3.25	3.00	3.00	3.00
5 Year	3.74	3.50	3.50	3.35	3.35	3.35
10 Year	4.15	4.00	4.00	4.25	4.25	4.25
30 Year	4.73	4.65	4.75	4.75	4.80	4.85

Source: SMBC Nikko Securities, Bloomberg

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