

US Rates Strategy Weekly

October 2, 2026

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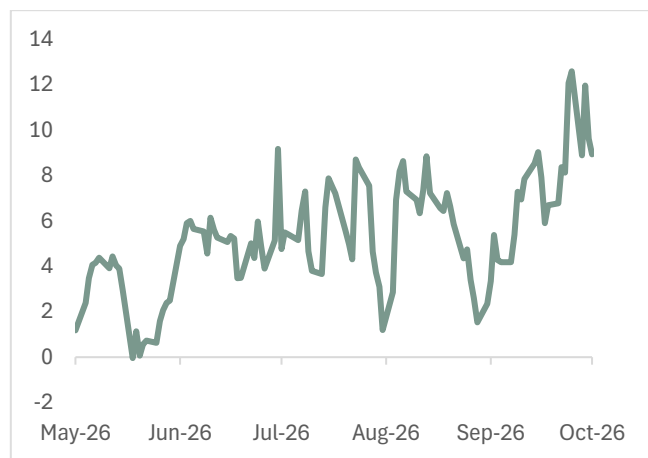
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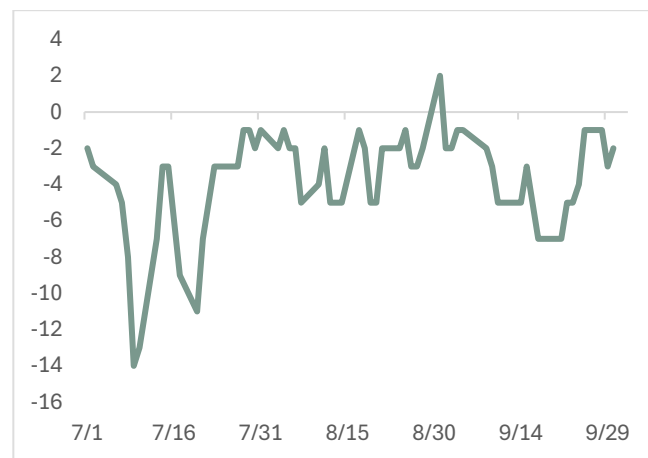
- **Three-month bills have cheapened from around 6bp above OIS this summer to 10-12bp currently.** This is a bit surprising as issuance *fell* \$160bn in September. By contrast, supply increased \$500bn (8%) in July and August, with no change in front-end yields.
- **We see few signs of weakening bill demand.** Money fund balances have increased since the mid-September tax date. As interest rates rise we expect money fund balances to increase given low bank deposit rate betas.
- We look for the Fed to restart its RMPs in December. **The Fed's secondary market bill purchases may total \$70bn through year-end.** Stablecoins, however, are unlikely to be a sizable source of new bill demand.
- **Treasuries finally found support following a flight-to-quality bid out of Europe, where a country-specific issue in France appeared to spread into broader widening of European sovereign spreads.** This episode suggests that investors may have underestimated the amount of tightening already delivered through financial conditions. **This favors buying front-end on dips.**
- **We are forecasting a modest month-over-month drop in the University of Michigan consumer sentiment index to 47.0.** This is close to the lowest reading in the history of the series (1952). **We look for small monthly decline in the September ISM services report to 54.9** led by declines in the business activity and new orders indexes

The other end of the curve

The Treasury and markets have been focused on the long-end of the curve where 10y yields have risen nearly 60bp since the beginning of August. But yields have also increased at the short-end of the curve. Three-month bills have cheapened from around 6bp above OIS this summer to 10-12bp currently (Figure 1). Overnight repo rates have traded somewhat closer to IORB in recent days although this likely reflects quarter-end balance sheet positioning than any longer-run reduction in the availability of funding (Figure 2). The increase in bill yields is a bit surprising as issuance *fell* \$160bn in September. By contrast, supply increased \$500bn (8%) in July and August, with no change in front-end yields. As issuance has resumed climbing (and is expected to increase \$250bn this quarter) are yields poised to increase more?

Figure 1: 3m bill less OIS (bp)


Note: 20d average. Source: Bloomberg, SMBC Nikko

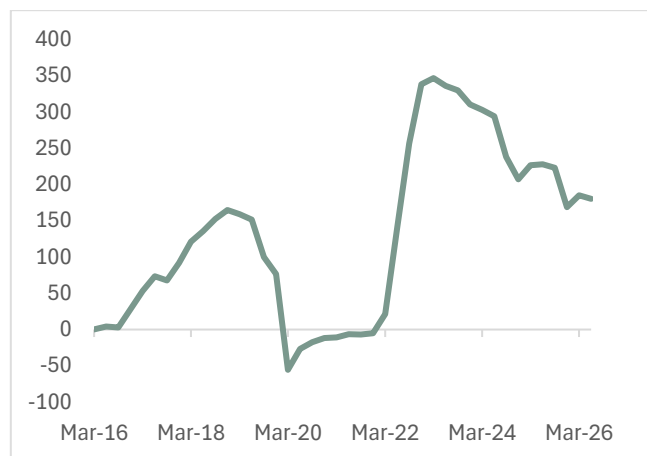
Figure 2: Tri-party less IORB (bp)


Source: Federal Reserve, SMBC Nikko

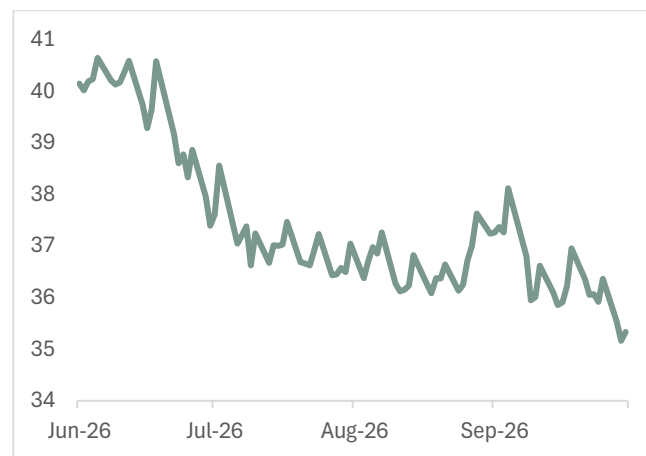
We see few signs of weakening bill demand. Deputy Treasury Secretary Brooke recently highlighted three types of buyers with strong appetites: money market funds, the Federal Reserve, and stablecoin issuers.¹ Money funds are the most important as they collectively hold nearly \$3.3trn worth of bills (or about half of the outstanding stock). As issuance increased this summer, money funds absorbed 72% (\$360bn) of Treasury's new supply. Money funds are also large buyers of the 2y FRN. Their holdings increased by \$50bn this summer. Our sense is that floaters compete more with repo allocations than bills because of their yield pick-up and overnight WAM. **The Treasury is considering issuing a short-maturity SOFR-based floater.** We think such an [issue](#) would cannibalize the demand for the Treasury's existing bill floater. That said, the Treasury may raise the issue at next month's quarterly refunding.

This summer balances in institutional gov-only money funds held steady around \$2.8trn but fell ahead of the mid-September tax date. However, we don't think this accounts for the increase in bill yields. Balances fell \$90bn (or 3%) and have begun recovering. **Moreover, as interest rates rise, we expect more money to flow in from bank deposits.** Deposit rate betas – or the sensitivity of deposit rates to changes in the fed fund rate – were less than 50% in the last tightening cycle. That is, banks passed along less than half of the increase in the fed funds rate to their depositors over the two-year tightening cycle that ended in 2024. As of June, there was still a 180bp spread between the average money fund return (proxied using the fed funds rate) and deposit rates (Figure 3). Our sense is that yield pick-up in money funds has increased since last month as deposit betas typically start low at the beginning of tightening cycle and gradually increase as the cycle lengthens. Institutional fund WAMs have trended lower this summer. We think this may continue as fund managers may wait until the uncertainty around the outcome of the October FOMC meeting clears up (Figure 4).

¹ See, "Deputy Treasury Secretary F. Brooke, Treasury Conference, Federal Reserve Bank of New York, September 22, 2026.

Figure 3: FF less deposit rate (bp)


Source: FDIC, Federal Reserve, SMBC Nikko

Figure 4: Institutional gov-only WAMs (d)


Source: Crane's Data, SMBC Nikko

The Fed suspended its reserve management (RMPs) bill purchases this summer as bank reserves were comfortably ample and repo rates traded below IORB. We expect these purchases to restart in December as the Fed gears up for the late-April peak in the Treasury's cash balance. Our expectation is that the Fed will start with \$25bn/mo in secondary market bill purchases and then ramp them up to \$45bn/mo in January-March. MBS roll-offs will continue to be reinvested in bills. **As a result, the Fed's net bill purchases might be as much as \$70bn through year-end.**

Stablecoins may not absorb as much bill demand as predicted last year. Some estimates had stablecoins increasing 10-fold by 2028 with their bill demand growing to \$1.2trn or more.² Instead balances have held steady at \$265bn this year. We are skeptical that demand will increase significantly in coming years as banks and money funds have begun tokenizing their balances. And as a medium of exchange, stablecoins transactions are quite small – “retail sized” transactions totaled \$8bn over the last 30d. Larger-sized transactions boost volumes to \$320bn. But our sense is that stablecoins are still largely a crypto asset. Activity appears correlated with [DeFi activity](#) where the stablecoins are used as a stable numéraire to move in and out of contracts.

Buy front end on dips, as something broke...

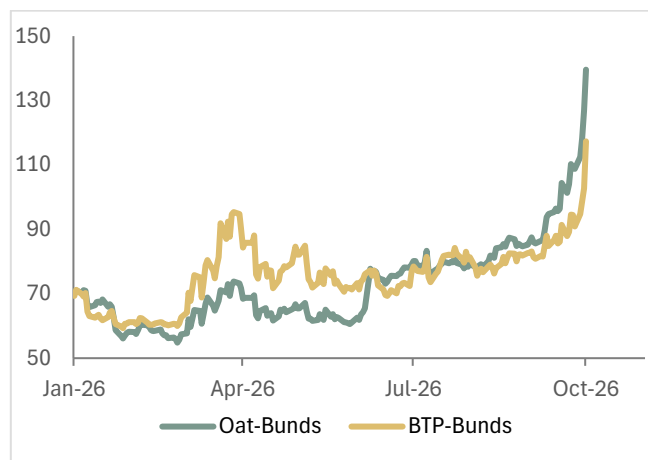
Treasuries finally found support following a flight-to-quality bid out of Europe, where a country-specific issue in France appeared to spread into broader widening of European sovereign spreads versus Bunds (Figure 5). Price action in several popular carry trades (Figure 6) points to some deleveraging, which helped drive the bull steepening in Treasuries.

We continue to believe the US front end should find greater support in this environment. This episode suggests that investors may have underestimated the amount of tightening already delivered through financial conditions. Our sense is that too many rate hikes may have been priced into this cycle. In any case, Williams, Kashkari and Jefferson sounded more dovish this week although Logan appears

² See, Treasury Borrowing Advisory Committee Presentation, Treasury Quarterly Refunding (April 2025).

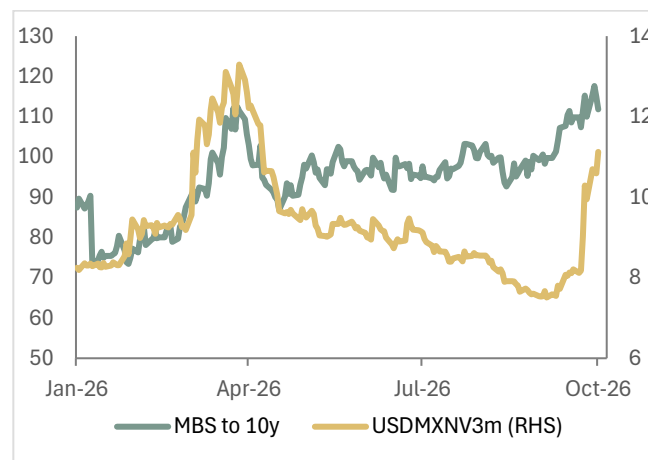
ready to move more. The curve still prices roughly three additional hikes this cycle. This morning's payroll report also favors a dovish Fed, with a labor market that is stable around 50k (3mma) and average hourly earnings continuing to fall. With investors still running sizable short Treasury positions, the risk of a sharp short-covering rally remains elevated.

Figure 5: 10y Oat/Bunds and BTP/Bunds (bp)



Source: Bloomberg, SMBC Nikko;

Figure 6: MBS-10y spread and USDMXN3m vol (bp and %)

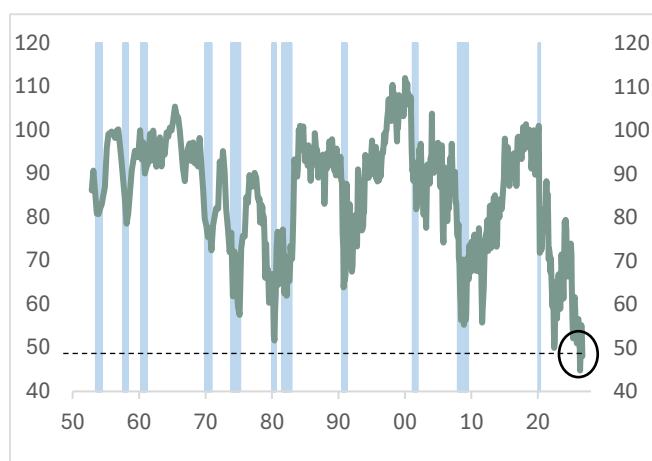


Source: Bloomberg, SMBC Nikko

Week ahead

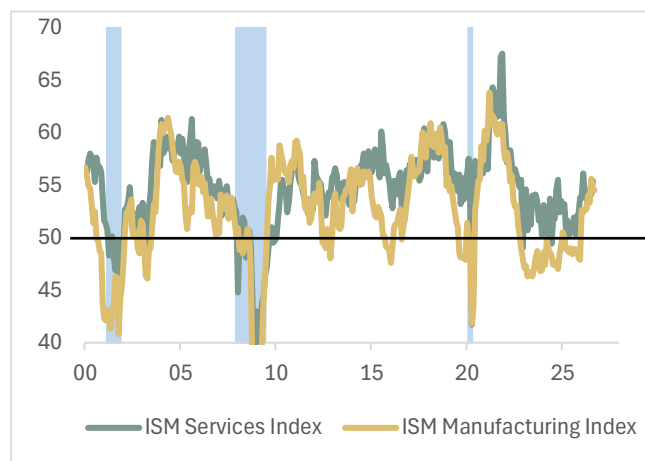
- University of Michigan Consumer Sentiment:** We are forecasting a modest month over month drop in consumer sentiment to a reading of 47.0. September's preliminary value of 48.1 was the lowest since May 2026, but both levels are near their historical lows (Figure 7). Consumer sentiment is particularly sensitive to gasoline prices and news sentiment as measured by the San Francisco Federal Reserve Bank. Gasoline prices have risen while the news sentiment measures has drifted sideways since late July.
- ISM Services (Sep, Fri):** We are forecasting a small monthly decline in the September ISM services report to 54.9 led by declines in the business activity and new orders indexes. We look for increases in the employment and delivery time indexes to offset some of this softness (Figure 8). Employment in the ISM manufacturing index increased to 52.7 in September. As hiring broadens out we expect both the manufacturing and service sector employment components of the indexes to increase.

Figure 7: University of Michigan Consumer Sentiment Index



Source: University of Michigan, Haver, SMBC Nikko

Figure 8: ISM Services vs. ISM Manufacturing Index



Source: ISM, Haver, SMBC Nikko

Table 3: Economic indicator forecasts

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Oct 5	ISM Services (10 AM)	54.9	55.0	55.4	54.5 - 56.3	Expecting modest MoM decline due to a cooling in bus. activity & new orders. Uptick in emp. and delivery times.
Oct 7	FOMC Meeting Minutes (2:00 PM)	-	-	-	-	We expect a mildly hawkish minutes.
Oct 9	U Mich Consumer Sentiment (10 AM)	47.0	48.0	48.1	47.0 - 49.0	September's 48.1 print is the second lowest on record after May's 44.8 reading. Continues to trend lower.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

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