US Rates Strategy Weekly

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- **Global supply chain pressures were building before the Iran conflict.** Purchasing managers have reported slower delivery times and larger backlogs since last fall.

- **We think the increase in the GSCPI has been driven by two factors: higher transportation costs caused by the Iran conflict and strong demand for technology inputs**. Memory chip prices have increased six-fold since last spring.

- Transportation costs should eventually simmer down once the Straits of Hormuz re-open. **However, it is not clear when supply chain pressure driven by heavy AI investment will abate**.

- Household year-ahead inflation expectations have increased since the start of the Iran Conflict. But wage growth has continued to decelerate.

- The US economy remains broadly resilient and supply side price pressures are still working through the inflation data. **As a result, we think it will be difficult for a sustained rally in yields without either a concrete geopolitical resolution or signs of labor market deterioration.**

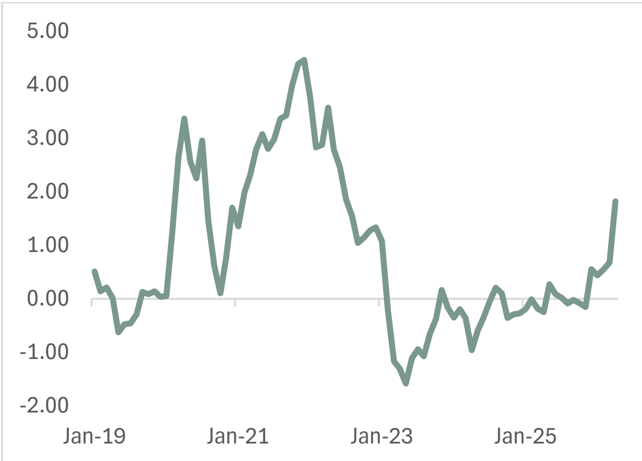
- We think the seasonals in June are yield-supportive (lower) for both nominals and TIPS inflation breakevens.

- We look for ISM manufacturing to increase modestly to 53.2. ISM services are expected to increase reflecting a rebound in new orders. **We expect nonfarm payrolls to increase 93,000 in May accompanied by a flat unemployment rate (4.3%).**

Supply-side price pressures

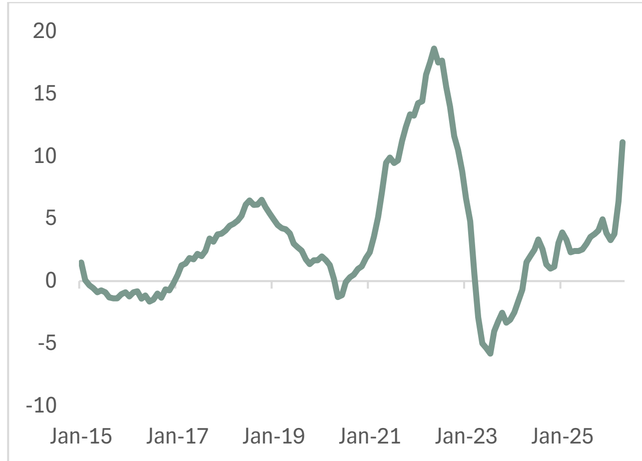
Analysts have been counting oil barrels and the number of ships transiting the Strait of Hormuz since February. **But broader metrics suggest that supply-side price pressure was building *before* the start of the Iran conflict**. Indeed, while the New York Fed's global supply chain pressure index (GSCPI) has more than tripled since the start of the Iran conflict, it had begun increasing last Fall (Figure 1). The index responds to changes in transportation costs and other supply disruptions that cause product delivery times to lengthen and order backlogs to grow. The percentage of purchasing managers reporting slower delivery times jumped to 22.6% in April from an average of 12% in 2025. That said, managers were already reporting longer delivery times last September.

Figure 1: Global supply chain pressure (index)



Source: Federal Reserve Bank of New York, SMBC Nikko

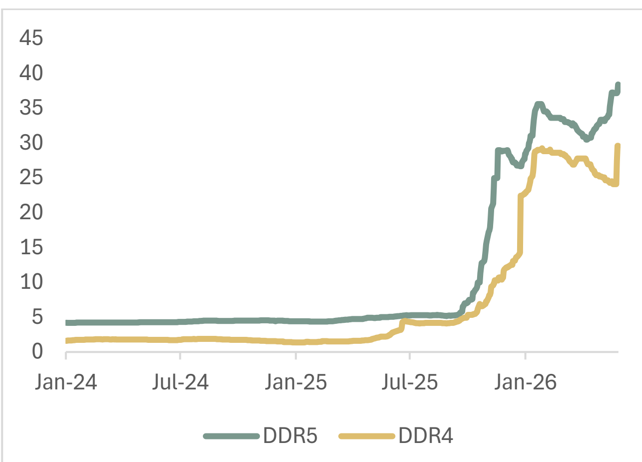
Figure 2: PPI transportation services (%y/y)



Source: BLS, SMBC Nikko

Our sense is that the increase in the GSCPI reflects two phenomena. First, the closure of the Straits of Hormuz has disrupted the supply of oil and distillates while increasing cargo insurance rates. The most direct effect of this has been the roughly 50% increase in gasoline and diesel prices since late February. As a result, transportation costs have increased to over 11% y/y.

Figure 3: Chip prices ($)



Source: Federal Reserve Bank of New York, SMBC Nikko

Figure 4: HH inflation expectations and AHE (%)

Note: Median 1y ahead expectation. Source: New York Fed, SMBC Nikko

But the earlier increase in the GSCPI is potentially worrying as it may point to some economic overheating that may not abate with the re-opening of the Straits of Hormuz. Input prices for various products used in the production of in-demand technology have accelerated and we suspect that this is causing backlogs to increase alongside a slowing in delivery times that are unrelated to shipping costs. For example, the price of memory chips used in consumer electronics such as laptops and tablets as well as in cloud computing and AI has jumped since last spring. **Indeed, prices for both the DDR5 and DDR4 chips have increased nearly six-fold since last spring** (Figure 3). Until recently, DDR4 prices were slowing as the older technology was replaced with faster, more energy efficient DDR5 chips. Recently, prices of these chips have re-accelerated as it has become harder to find DDR5 chips. Production has not kept up with demand and chipmakers have focused more of their output toward AI applications and away from lower value uses in laptops and tablets.

We continue to look for signs that supply chain pressure is feeding into general prices through household expectations. Year-ahead inflation expectations have risen 0.5% to 3.6% in April. However, worker pay continues to decelerate suggesting workers may not have the bargaining leverage they did in 2021-22 to push their pay higher (Figure 4).

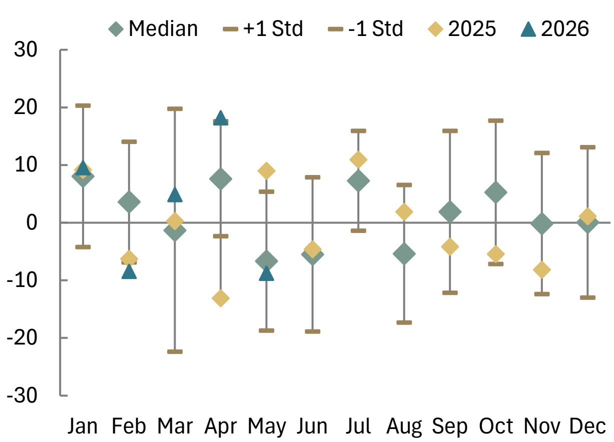
Summer seasonals

Treasury yields have retraced from the recent highs, with the 10s back to around 4.44% after reaching 4.68% on May 19. Optimism around a potential Iran deal and some stabilization in long-end G10 bond markets has improved sentiment.

The US economy remains broadly resilient and supply side price pressures are still working through the inflation data. As a result, we think it will be difficult for a sustained rally in yields without either a concrete geopolitical resolution or signs of labor market deterioration. We look for payrolls to increase 93,000 in May and the unemployment rate holding steady at 4.3%. That said, we think the seasonals in June are yield-supportive (lower) for both nominals and breakevens. Figure 5 shows over the last ten years, the median June change in 10y BE's was -5bps, with a move lower 70% of the time. Similarly, 10y nominal yields moved lower 60% of the time.

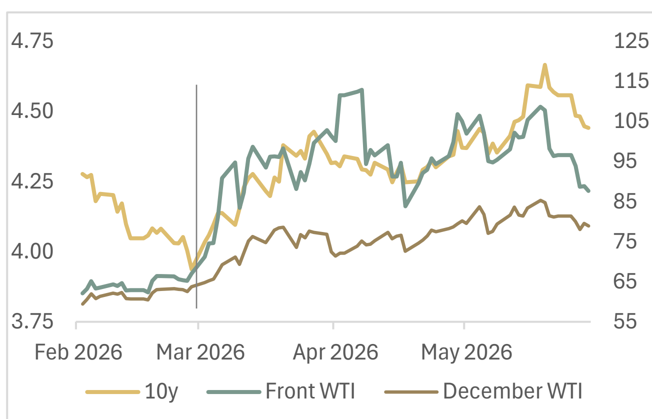
We think both tails of the geopolitical distribution – an escalation or an agreement – are yield friendly for the belly of the curve. Escalation that drives oil sharply higher would likely trigger demand destruction and weigh on growth, while de-escalation removes the inflation risk premium directly. Our sense is that the problematic scenario for yields is one in which oil prices hold around $100bbl (Figure 6). Prices would not be high enough to sharply reduce employment and consumption but might still be high enough to keep inflation around 3%. This scenario might also keep the Fed biased toward tightening.

Figure 5: Monthly seasonals in 10y BE (bp)



Source: SMBC Nikko, Bloomberg;

Figure 6: 10y vs WTI (%, LHS and $/bbl, RHS)



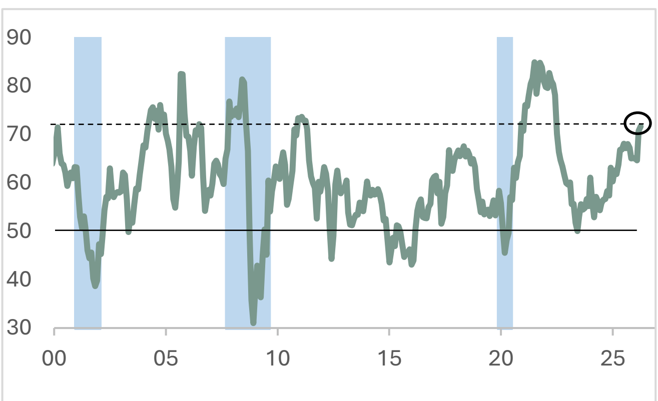
Source: SMBC Nikko, Bloomberg;

Week ahead

- **ISM Manufacturing (May, Mon) and Services (May, Wed)**: The ISM manufacturing index has rebounded this year to historically average readings (2000 to present) following four years of weakness (2022-2025). We look for this to continue in May led by the employment and production subcomponents. The index is projected to increase to 53.2. The prices paid subcomponent the manufacturing and services PMIs have each risen to their highest levels since 2022. The weighted average of the two suggests CPI may accelerate in coming months (Figure 7). ISM services are expected to increase reflecting a rebound in new orders.

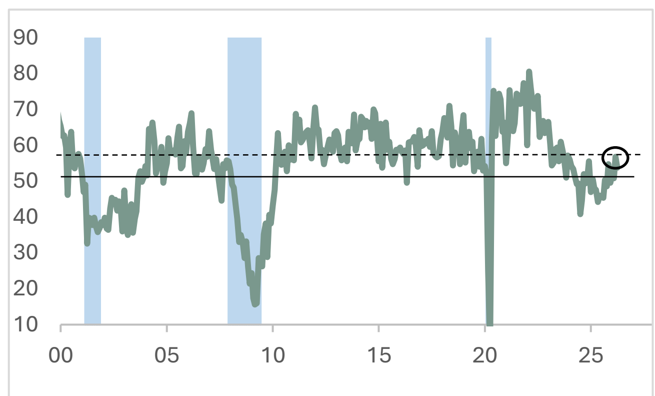
- **Employment Report (May, Friday)**: **We project a solid increase in nonfarm payrolls of 93,000 in May**. Private sector employment gains are expected to be 101,000. We look for large gains in the private education and health services sector (up 70,000), and leisure and hospitality sector (up 25,000). The private payroll diffusion index is near 60% (Figure 8). This index measures the percentage of industries reporting expanding job growth less half those reporting no change. Labor demand and supply have both fallen since 2022 and the recent pace of hiring has meant the unemployment rate has held mostly steady since last fall. The labor force participation rate has fallen to 61.8% - its lowest since 1977. We are forecasting a flat unemployment rate of 4.3% in May.

Figure 7: Composite ISM Prices (Index)



Source: ISM, BEA, Haver, SMBC Nikko

Figure 8: Private NFP Diffusion Index (% Balance)



Source: BLS, Haver, SMBC Nikko

Table 3: Economic indicator forecasts

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Jun 1	ISM Manufacturing (10 AM)	53.2	53.2	52.7	52.5 - 53.5	Employment and production expected to strengthen.
Jun 3	ADP Employment (8:15 AM)	75k	110k	109k	65k - +125k	ADP employment averaging +47k monthly gains over the last 12 months.
Jun 3	ISM Services (10 AM)	53.5	53.7	53.6	52.5 - 54.5	Look for a mechanical rebound in new orders (forward looking measure of demand)
Jun 5	NFP (8:30 AM)	93k	90k	115k	60k - +120k	12m avg job growth = +22k. Forecasting gov't at -8k.
Jun 5	Private NFP (8:30 AM)	101k	90k	123k	75k - +120k	Forecasting Private education and health services at +70k. --> private NFP excl P.E. & H.S. at +31k.
Jun 5	Avg. Hourly Earnings (8:30 AM)	0.3%	0.3%	0.2%	0.2% - +0.3%	Wage gains back at pre-Covid levels of approximately 3.6% YoY.
Jun 5	Unemployment Rate (8:30 AM)	4.3%	4.3%	4.3%	4.2% - 4.5%	Expecting household survey to show a +226k increase in employment & +92k increase in labor force.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Disclaimers