US Rates Strategy Weekly

February 13, 2026

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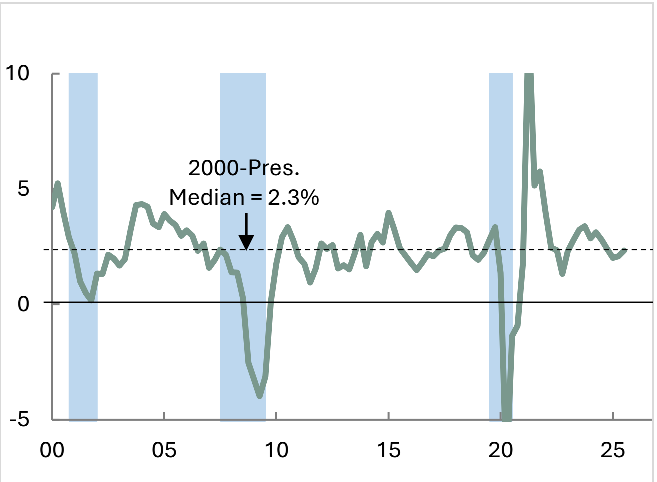
Week ahead

- **FOMC Meeting Minutes (Jan., Wed.)**: The FOMC minutes are likely to be neutral to slightly hawkish as the Fed seeks to pause their interest rate adjustments, until inflation moves back to 2%. Following the stronger than expected January employment report, we now see the Fed cutting rates just once this year in July.

- **GDP Report (Q4, Fri.)**: We are forecasting a 2.9% q/q, ar increase in Q4 GDP. The main drivers of this report are personal consumption, private inventories, intellectual property products (IP), and capital expenditures, for which we are forecasting gains of 2.7%, +$19B, 5.0%, and 2.4%, respectively. Census data show that manufacturers' inventories increased 2.3% at an annualized rate in October and November, while industrial production — an indirect inventories signal — increased 2% annualized in Q4. The 2.9% Q4 GDP reading would bring 2025 growth to 2.6% y/y which is mildly above the longer run average (Figure 1). Additionally, we will receive monthly national accounts data including the monthly PCE and Core PCE Deflators, for which we are expecting 0.3% m/m increases, and income data. The Fed's preferred inflation indicator, the core PCE deflator, remains above the Fed's 2% target at 2.8% y/y (Figure 2). Persistent above target inflation has weakened US consumer health, lowering the personal savings rate, and increasing delinquencies in elevated delinquencies in student loans, auto loans, credit cards.

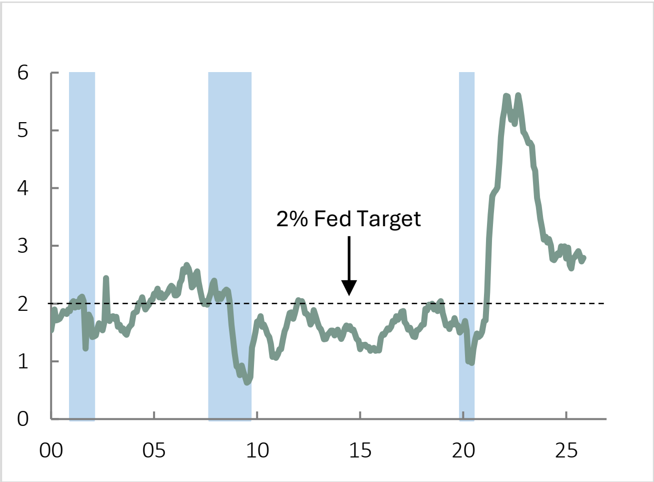
- **UST Auctions**: The Treasury will sell $16bn 20-Year on Wednesday and $9bn 30-Year TIPS on Thursday. The Fed will conduct bill RMPs on Tuesday and Thursday.

Figure 1: Real GDP (%y/y)



Source: BEA, SMBC Nikko

Figure 2: Core PCE Deflator (%y/y)



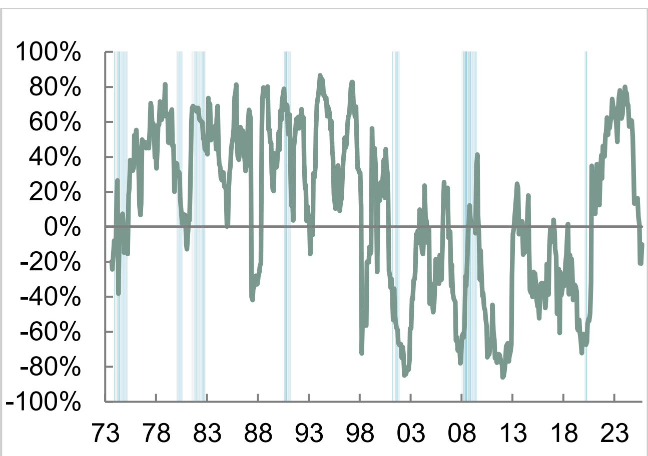
Source: BEA, SMBC Nikko

Will Treasuries Reassert Their Role as a Portfolio Hedge?

We expect the 10y to remain range bound (3.90-4.30%), with the lower end of the range likely to be tested if risk assets experience a correction. While the labor market has shown signs of stabilization, some concerns linger following the weak real retail sales. However, we expect the 10y to end the quarter at 4.15% as the market begins to price in stronger consumer spending driven by bigger tax refunds.

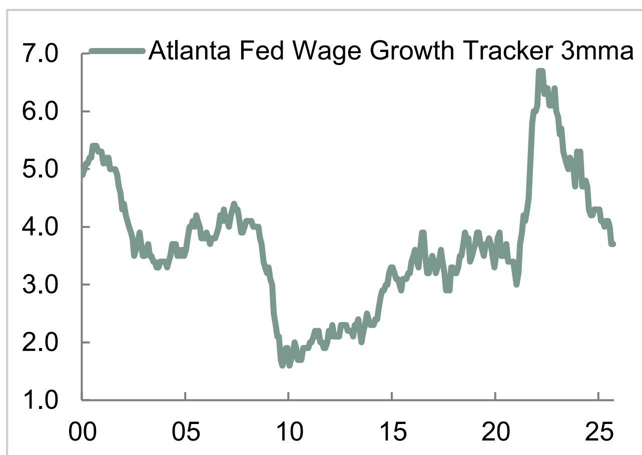
The flight to quality bid in Treasuries has revived the question of whether they can once again serve as an effective hedge to risk assets over the longer run. Figure 3 shows that the stock-bond correlation—was negative for most of the period since the early 2000s—turned positive after COVID. That correlation began to retreat in late 2024 and has now slipped slightly negative.
Figure 4 indicates that wages have returned to pre-COVID levels, suggesting reduced concerns about wage-led inflation pressures. Markets may still need another 3–6 months to fully discount tariff-related inflation risks, and the Fed is likely on a similar timeline.
Finally, fiscal concerns appear to have peaked in the first half of 2025. Budget forecasts since then have improved by roughly 0.5% for 2026. While the direction is encouraging, deficits are still projected at around 6–6.25% of GDP—meaning the fiscal backdrop is better but far from benign. Conditions are moving in the right direction for Treasuries to regain their hedge characteristics, but more meaningful fiscal improvement is likely needed for that restoration to be sustained for the longer run.

Figure 3: Stocks Bonds Correlation (%)



Note: Rolling 12m monthly percentage change in S&P500 and the Treasury index. Source: Bloomberg, SMBC Nikko

Figure 4: Wages (%y/y)



Source: FRB Atlanta, Bloomberg, SMBC Nikko

Cyber-risk and repo

Recently, the Office of Financial Research published a piece examining cyber security risk in the tri-party repo market.[1] The paper is less focused on the points of weakness or how technology might fail. Instead, it seeks to quantify the implications to the market of a cash lender's temporary absence.

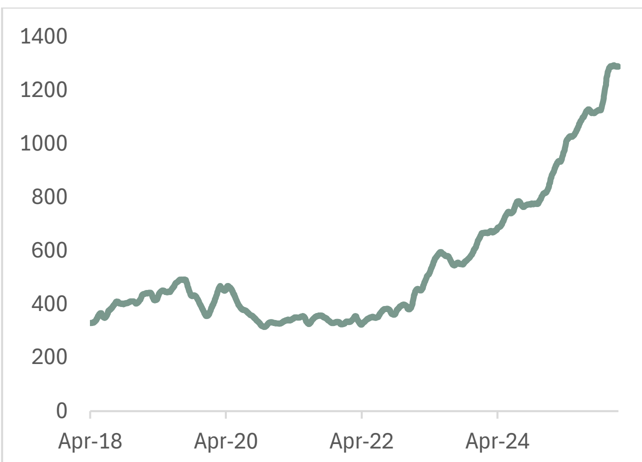
The tri-party repo market, unlike the bilateral market, is a financing market where borrowers pledge Treasury collateral in return for (generally) overnight cash. Overnight tri-party volumes are over $1trn/day (Figure 5). Cash lenders are typically money funds while borrowers are primary dealers. **But, while the**

[1] See, "Short-Circuiting Short-term Funding", R. Jay Kahn, N. Karunamuni, and M. Paddrik, Office of Financial Research, US Treasury, February 10, 2026.

market is no more vulnerable to cyber risk than others, its unique features may amplify cyber shocks.

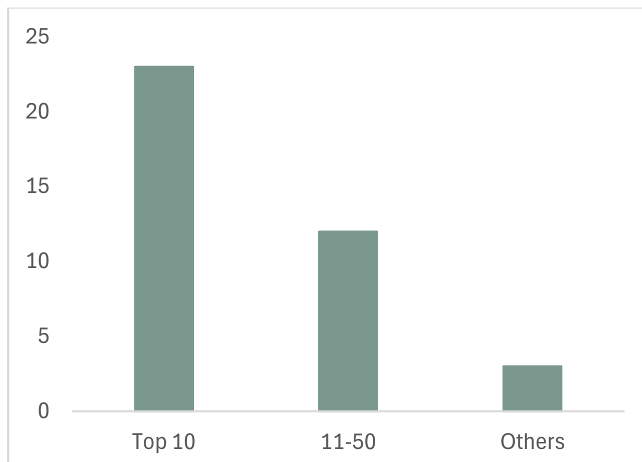
Participants trade with a narrow group of counterparties. Activity between cash providers and borrowers is relationship-driven and counterparties rarely change. Both sides of the transaction prioritize stability – that is, rolling the same amount from day-to-day – over "counterparty shopping". The median number of money fund repo counterparties is 7, although some funds may face as many as 15 or more borrowers.[2] **This makes it harder for a borrower to find a replacement cash provider**, **if, say, its primary lender is temporarily unavailable**. Over the 2016-24 period, Kahn et al, identify 139 distinct tri-party lenders and 73 borrowers. So, the number of potential lender/borrower combinations is 10,147. But on the typical day, they note only 680 unique lender/borrower pairs. And 97.5% of these unique pairs are the *same* the following day.

Figure 5: Overnight tri-party ($bn)



Source: Federal Reserve, SMBC Nikko

Figure 6: Hedge fund lenders



Note: By the size of the fund. As of Q3 2025. Source: SEC, SMBC Nikko

Strains from replacing a temporarily unavailable provider are amplified because of the size variation among cash providers. For example, the largest money fund, with $455bn in assets, lends $90bn against Treasury repo. Of this, $30bn is lent outside the FICC's centrally cleared platform – to 17 different primary dealer and bank borrowers. **Although hedge funds do not face money funds directly, they too, have a similarly concentrated set of lenders**. The ten largest have about 23 counterparties, while smaller funds typically only have 3 (Figure 6).

Finally, trading in the repo market is concentrated at certain times of the day. This means the volume and rate effect from a disruption depends on when it occurs and how quickly activity is restored. The longer the lender is off-line, the larger the volume effect and the greater the pressure on funding rates. We suspect that this influences decisions to use the SRP – borrowers with access to the program may be less willing to wait out the funding gap.

[2] Excluding the FICC.

Kahn et al, run a series of simulated shocks in which cash providers are temporarily shut out of the market. They note that the *median* effect on borrowing volumes and rates is small. **But, the distribution of outcomes is highly skewed. At the 90th percentile, the technology disruption is large enough to strain $100bn or more in funding and push repo rates 50bp higher**. Borrowers have enough replacement providers to absorb an average cyber shock, but larger disruptions, or ones where the outage lasts longer will likely require tapping the SRP.

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Weekly economic indicator calendar

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Feb 18	Housing Starts MoM (8:30 AM)	-0.5%	5.1%	-4.6%	2.3% - +10.0%	Home building continues to slow. Homes under construction -10% YoY.
Feb 18	Industrial Production (9:15 AM)	0.5%	0.4%	0.4%	-0.1% - +0.5%	ISM manufacturing jumped 4.7 points--second largest jump since 2000. Steel production up 34% MoM.
Feb 18	FOMC Minutes (2 PM)	-	-	-	-	Likely to be neutral to slightly hawkish as Fed seeks a near term pause.
Feb 20	Personal Income (8:30 AM) (Dec.)	0.4%	0.4%	0.3%	0.3% - +0.6%	Jobs up 0.1% MoM, hours up, wages up 0.4% MoM.
Feb 20	Personal Spending (8:30 AM) (Dec.)	0.3%	0.4%	0.5%	0.4% - +0.5%	Downside risk. CPI 0.3%, retail sales 0.0% MoM.
Feb 20	PCE Deflator (8:30 AM) (Dec.)	0.3%	0.3%	0.2%	0.2% - +0.4%	CPI +0.3% MoM.
Feb 20	Core PCE Deflator (8:30 AM) (Dec.)	0.3%	0.4%	0.2%	0.2% - +0.4%	Core CPI +0.24% MoM.
Feb 20	Q4 GDP (8:30 AM)	2.9%	2.8%	4.4%	2.5% - +3.8%	Drivers: consumption (2.7%), inventories (+$19B), IP (5.0%) and Equipment investment (2.4%).
Feb 20	Q4 PCE (8:30 AM)	2.7%	-	3.5%	-	Q4 Retail Sales slowed to 1.7% QoQar.
Feb 20	Q4 GDP Deflator (8:30 AM)	3.5%	3.7%	3.8%	-	Q4 CPI decelerated notably to 2.3% QoQar.
Feb 20	Q4 Core PCE Deflator (8:30 AM)	2.6%	2.6%	2.9%	-	Q4 Core CPI decelerated to1.9% QoQar.
Feb 20	New Home Sales (10 AM) (Dec.)	-0.4%	0.4%	3.8%	-1.6% - +2.4%	Mortgage applications for home purchase declined -1.6% MoM in December.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Quarterly GDP and Rates Forecasts

	2025		2026			
(%)	Q3 Act	Q4 Act	Q1F	Q2F	Q3F	Q4F
Real GDP QoQar	4.3	2.9 (f)	2.4	1.5	2.6	2.4
Real GDP YoY	2.3	2.6 (f)	3.2	2.6	2.2	2.2
Core PCE YoY	2.9	2.7 (f)	2.4	2.4	2.2	2.3
Unemployment	4.3	4.4	4.3	4.4	4.4	4.5
Fed Funds Rate Upper Bound	4.25	3.75	3.75	3.75	3.50	3.50
2 Year	3.61	3.47	3.50	3.40	3.40	3.40
5 Year	3.74	3.73	3.60	3.50	3.50	3.50
10 Year	4.15	4.17	4.15	4.30	4.30	4.30
30 Year	4.73	4.84	4.75	4.75	4.80	4.85

Source: SMBC Nikko

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