SMBC Group

US Rates Strategy Weekly

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Week ahead

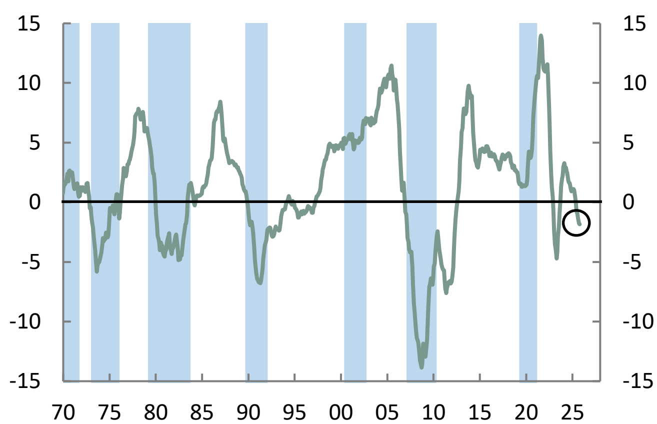
- **Case-Shiller Home Prices (Nov., Tuesday):** We expect home prices to continue to slow (real and nominal) on the back of the lowest first-time home buyer affordability since Q2 1985 (Figure 1).

- **Conference Board Consumer Confidence (Jan., Tuesday)**: Consumers' vacation plans have been robust (Figure 2), while the differential series is indicating rising unemployment.

- **Federal Reserve decision (Jan., Wednesday)**: We look for no change to the fed funds rate or the monthly RMPs. The statement will likely highlight above-target inflation along with the recent decline in the unemployment rate. It is still unclear which way the growth and inflation will break. Data clarity is further muddled by lingering aftereffects of the government shutdown and policy uncertainty around expected tariffs, MBS purchases, and credit card caps. We think these will sideline the Fed until after March although there may be a dissent for a rate cut at this meeting. Markets are focused on Chair Powell's replacement. An announcement might occur next week.

- **Producer Prices Report (Dec., Friday)**: We are forecasting 0.3% MoM for headline and core PPI. Earlier in the month, headline and core CPI returned at 0.3% and 0.24% MoM respectively.
- **UST Auctions**: The Treasury will sell $69B 2-Year on Monday, $70B 5-Year on Tuesday and $44B 7-Year on Thursday. The Fed will conduct bill RMPs on Monday and Thursday.

Figure 1: Real Case-Shiller home prices (%y/y)



Source: S&P, SMBC Nikko

Figure 2: Vacation plans abroad (% respondents)

Note: Percent with plans to visit a foreign country in the next 6 months. Source: Conference Board, SMBC Nikko

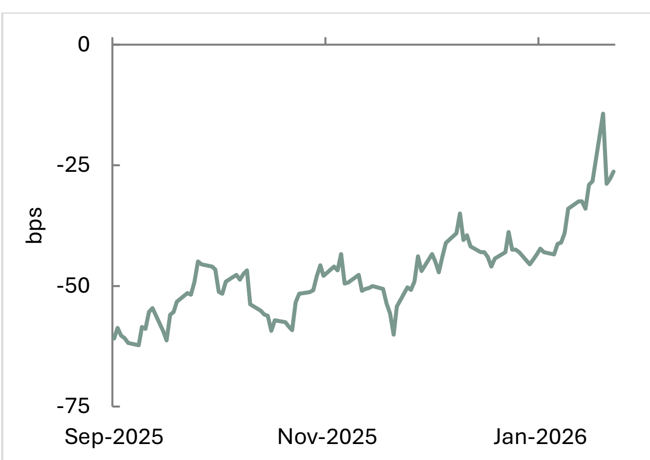
Cuts Underpriced as Fed Signals Patience

The Fed appears comfortable signaling patience. Combined with firm incoming data, this has positioned the market for no cuts until July. Futures now price only a ~75% probability of a 25 bp cut by the June meeting, with the first cut not fully priced in until July (Figure 3). Heading into next week's FOMC meeting, it is possible that more cuts can be priced out. However, with a new Fed Chair expected to take over by the June meeting, we believe that investors should use any opportunity to position for additional easing by the **June/July FOMC meetings**. In a scenario where the economic data remains substantively similar, the markets are likely to expect at least one or two cuts from the incoming Chair. If our view of two Fed cuts in Q2 is correct, the position should outperform.

Downtrend from Early 2025 Still Intact for 10y Yields: The 10y has broken above the 3.90–4.20% range that has held since September. However, the broader downtrend channel from January 2025 remains unbroken: a sustained weekly close above ~4.25% is needed to confirm a true upside breakout (Figure 4). While the FOMC poses near-term risk, much of the selloff in Q4 and early January was driven by higher JGB and Bund yields. With those markets showing early signs of stabilization, domestic inflation surprising on the soft side, and labor-market concerns persisting, we continue to favor lower 10y yields — toward ~4%.

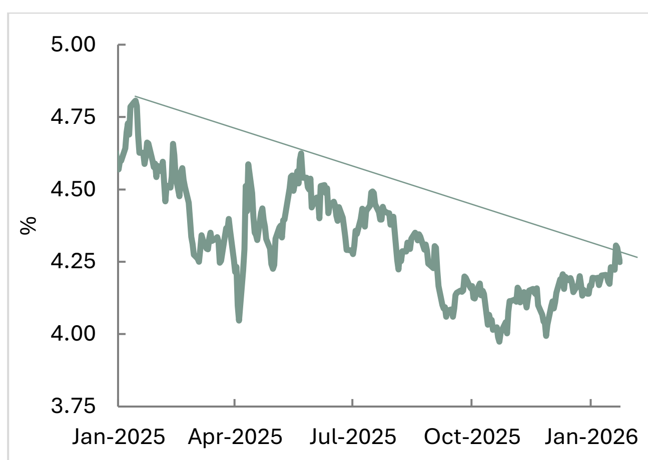
Favor Steepeners Medium Term: Two weeks ago, we favored adding steepeners near key support levels following signs of consolidation. Positioning is only likely to build after the FOMC, and subsequent press conference are fully digested. But the medium-term case remains intact. With rising fiscal risks and lingering labor market concerns, we continue to favor curve-steepening structures.

Figure 3: Cumulative Cuts – Jan to Jul 2026



Source: Bloomberg, SMBC Nikko

Figure 4: 10y Yields – Downtrend Channel



Source: Bloomberg, SMBC Nikko

Tax refund season

Next Monday, the 2025 tax filing season starts. The President has observed that he expects this will be "the largest tax refund season ever". **Hyperbole aside, we expect the OBBB will sharply boost 2026 refunds compared to recent years**.

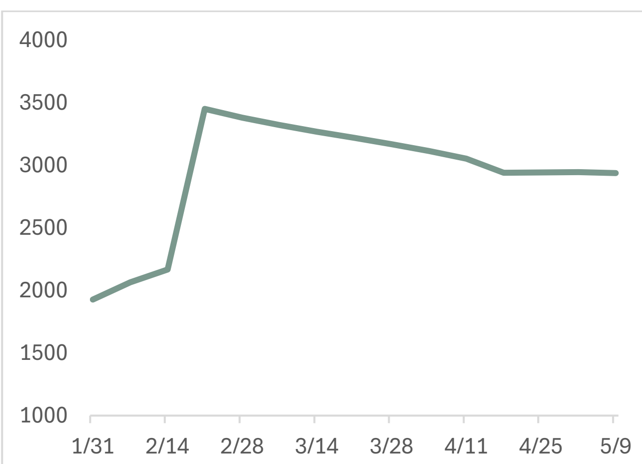
OBBB is expected to reduce 2025 personal taxes by $130bn.[1] Just over half the savings comes from three provisions in the legislation. The standard deduction was increased by $750 for single filers (and $1500 for joint filers). OBBB adds a special $6000 deduction for seniors, that directly lowers adjusted gross income. This deduction applies even if the taxpayer does not itemize. However, the largest savings come from the increase in the SALT cap – from $10,000 to $40,000. The SALT deduction allows filers to deduct taxes paid at the state and local level from their federal obligations. Although the $40,000 cap phases out at higher income, the Tax Foundation estimates that it might lower personal taxes this year by about $32bn.

Because the IRS did not adjust withholding tables last year to reflect the OBBB changes, most households will receive their tax cuts as higher refunds when they file their taxes this year. **In rough terms, tax refunds this season are expected to increase by $100bn – up 36% from last year's approximately $275bn**.[2] Last year, the average tax refund was about $3000, so a 36% gain might mean an additional $1000 per recipient.

The effects on consumer spending and financing markets will depend on the timing of when the Treasury sends out the refunds. This is the first year in which the Treasury will not mail paper checks, so in theory, households may get their refunds sooner after filing. Typically, households expecting a refund file earlier than those who owe money to the US Treasury. And those who are expecting bigger refunds file earlier. As a result, average refunds tend to be larger at the start of the tax season (Figure 5).

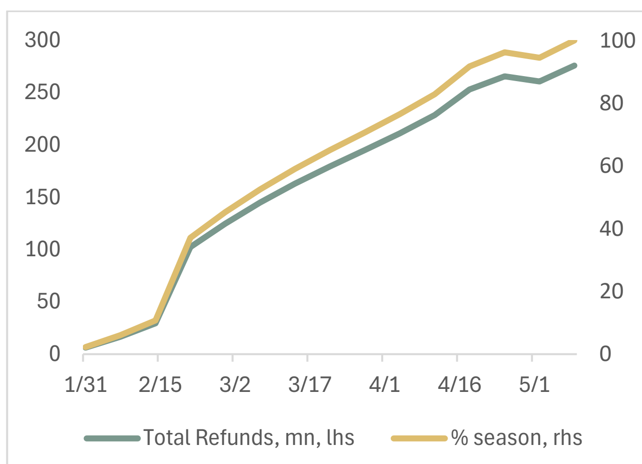
Roughly 94m tax refunds were issued between the start of the filing season and mid-May last year. Approximately 1/3 were issued by the third week of February and more than half were sent out before mid-March (Figure 6). As a result, effects on spending should build next month.

Figure 5: Average 2025 refund size ($)



Source: US Treasury, SMBC Nikko

Figure 6: Refunds processed (%)



Note: Cumulative change since March 2022. Source: OFR, SMBC Nikko

[1] See, "Tax Refunds and the One Big Beautiful Bill Act", E. York, and G. Watson, Tax Foundation, January 15, 2026.

[2] Tax Foundation estimate

Balancing act

The Treasury has already begun ramping up bill issuance in anticipation of tax refund payments. Like last fall, the increased supply has been concentrated in shorter maturities – 4w and 8w bills. This week it increased the 4w and 8w bill auctions by $15bn on top of a $25bn increase last week. If the Treasury's refund forecasts are correct, its planned increase in bill supply will match both the timing and size of the refund outflows from its deposit at the Fed. As a result, bank reserves will hold steady along with overnight funding rates. **However, we think there is some chance that refunds are stronger than expected this year and as a result, the outflows from the Treasury account may be faster than the ability of bill issuance to restock it**. The resulting increase in bank reserves could temporarily *depress* overnight rates.

Interestingly, the exact opposite effect may occur after April 15. We expect last year's market rally to generate significant non-withheld tax obligations. As money flows out of bank deposits to the Treasury's coffers, bank reserves will decline. The Fed's RMPs are scaled to anticipate and offset this effect on reserves.

Weekly economic indicator calendar

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Jan 26	Durable Goods (8:30 AM)	5.8%	3.0%	-2.2%	-1.4% - +15.0%	Unfilled durable goods orders sit at record highs of $1.49T!
Jan 26	Durable Goods ex trans. (8:30 AM)	0.2%	0.2%	0.1%	0.0% - +0.3%	Unfilled orders of Nondefense aircraft and parts sit at cyclical high of $660B.
Jan 27	Case Shiller Home Prices (9:00 AM)	0.3%	0.2%	0.3%	-0.2% - +0.2%	Case Shiller home prices up just 1.4% YoY and points to further disinflationary progress for CPI shelter in 2026.
Jan 27	Conf. Board Consumer Confidence (10 AM)	88.4	90.1	89.1	88.0 - 92.0	Watch for Conference Board's labor market differential series which implies a 5%+ unemployment rate.
Jan 28	Fed Funds Rate (upper bound) (2 PM)	3.75%	3.75%	3.75%	3.5% - +4.0%	FOMC wants to pause until inflation slows more meaningfully back to 2%.
Jan 30	PPI (8:30 AM)	0.3%	0.2%	0.2%	0.2% - +0.3%	Dec. CPI increased by 0.31% MoM.
Jan 30	Core PPI (8:30 AM)	0.3%	0.2%	0.0%	0.2% - +0.4%	Dec. Core CPI increased by 0.24% 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	3.47	3.25	3.25	3.25	3.25
5 Year	3.74	3.73	3.50	3.50	3.50	3.50
10 Year	4.15	4.17	4.00	4.25	4.25	4.25
30 Year	4.73	4.84	4.75	4.75	4.80	4.85

Source: SMBC Nikko

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