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US Rates Strategy Weekly August 21, 2026 Joseph Abate, US Rates Strategy Monty Gandhi, US Rates Strategy Troy Ludtka, US Economics joseph.abate@smbcnikko-si.com mgandhi@smbc-cm.com troy.ludtka@smbcnikko-si.com 1 212 893-1592 1 212 224-5114 1 212-224-5483 • The highest bond yields in 30y have unnerved the Treasury and at the same time increased its willingness to take “activist” measures to bring yields lower. While we do not expect it to cut term issuance, this week’s announcement suggests the bar is now lower. • Assuming the Treasury’s buyback operations are only doubled, the outstanding supply of off-the-run paper in these maturities will decline an additional $12bn. 1 Because these issues are trading below par, the increase in bill supply will be smaller and not big enough to cheapen front-end rates. • Provided the demand for bills remains strong (and growing) the Treasury can successfully shift its issuance to flatten the yield curve. We think the Treasury might be able to increase the bill/debt ratio to 25% without much widening in bill/OIS spreads. • But replacing term debt with bills will increase the sensitivity of the Treasury’s debt service costs to changes in monetary policy. • Buybacks may help reduce term yields by absorbing dealer inventory and new issuance . But with no purchases scheduled until September 10, yields remain exposed to supply and broader G10 pressures. Market attention will be on the Treasury Secretary’s new deficit reduction initiative. • Investors will need more than buybacks to bring down term rates . While influences, like G10 long-end rates or an easing of corporate supply may help, deficit reduction is a necessary requirement for lower term rates. • We expect a benign PCE report and weaker payroll revisions next week , while investors will watch Jackson Hole for clues on the near-term Fed outlook . Buyback doubling In a surprise announcement, the Treasury this week increased the size of its longer-maturity buybacks. It plans to at least “double” the size of its buybacks in the 10-30y sectors over the remaining 6 buyback operations this quarter. Assuming these operations are doubled, the outstanding supply of off-the- run paper in these maturities will decline by an additional $12bn . Unlike the Fed’s QE operations, the Treasury’s secondary market purchases are financed by issuing replacement debt (rather than the creation of bank reserves). We expect the Treasury to increase bill supply to fund the buybacks. But as the securities it is buying back are trading below par, the dollar increase in bill supply will be less than 1 Treasury Secretary Bessent suggested they might be larger.

SMBC US Rates Strategy Weekly 2 $12bn (around $10bn) . All things equal, the extra $10bn in bill supply this quarter will hardly change bill yields - even with the Fed’s temporary RMP pause. Bill supply is expected to increase $350bn this quarter and another $250bn in Q4. Last summer, the Treasury also increased the size of its buybacks in the long-end; doubling the frequency of the operations from 2 to 4 per quarter but keeping the dollar amount at $2bn/operation. But, unlike last year’s change, this announcement occurred after the Treasury’s quarterly refunding. This changes their context. Rather than an effort to improve the secondary market liquidity of off-the-run issues, the change looks more like an attempt to bring term rates lower. Indeed, this was how markets interpreted this week’s announcement. Long-bonds rallied 7bp after the announcement but by Thursday morning, yields had reversed nearly all their previous move. The Treasury’s buyback announcement raises two issues. First, it suggests that the highest bond yields in 30y have unnerved the Treasury and at the same time increased its willingness to take “activist” measures to bring yields lower. While we still think more aggressive responses to higher yields are unlikely, we are much less confident. The decision to spontaneously increase buybacks suggests the Treasury is more comfortable with experimenting with "activist" issuance . This coupled with the fact that yields briefly rallied and then reversed might suggest the Treasury needs to be more aggressive. While we think this lowers the bar for the reducing term supply – either by reducing the frequency of auctions or their sizes – eliminating a sector (like the 20y) is probably less likely. The Treasury would need to balance its goal of regular and predictable auctions against its desire to manhandle term rates lower. The second issue is more theoretical. Can the Treasury successfully "starve" the long -end investors of term supply and force them into MBS and corporate bonds? And will this bring down term rates economy-wide? Indeed, this was the Fed's hope when it launched its first round of QE in 2008. But the Treasury market is several times larger than it was back then and term auction sizes are considerably bigger. That said, term premia rose sharply during the financial crisis – reaching 3.3% and remaining above 2% for several years (Figure 1). The Fed discovered that keeping term rates lower at the zero lower bound required strong forward guidance . Rather than committing to fixed-amount QE purchases over a set period as it did during its first rounds of purchases, it moved to open-ended operations tied to the state of the economy. The size of these purchases became reinforcement tools that visibly established its commitment to keep term rates low for long . Unlike the Fed which can finance QE indefinitely through the creation of reserves, the Treasury needs to pay for any reduction in term supply with additional issuance of bills. Overall Treasury supply is unchanged; term debt is replaced with bills. Provided the demand for bills remains strong (and growing) the Treasury can successfully shift its issuance maturities to flatten the yield curve . Fed rate increases, RRP shrinkage, and growth in money fund balances allowed the Treasury to ramp up bill issuance to 22% of Treasury debt without a significant cheapening. Bill/OIS spreads have been steady since 2023 despite the increase in issuance from 15% of debt (Figure 2).

SMBC US Rates Strategy Weekly 3 And while money fund balances continue to increase, we expect the pace will be slower than it was during the last tightening cycle when QE left banks oversupplied with non-interest bearing (and largely uninsured) deposits (Figure 3). Moreover, despite heightened expectations, stablecoins have not become a new source of growing bill demand (Figure 4). Our sense is that the Treasury might be able to increase bill issuance further – perhaps to 25% of debt outstanding without causing a significant widening in bill/OIS spreads. In choosing what maturities, the Treasury trades off its debt service costs with their volatility. Term debt is more expensive but because it rolls over less frequently, it is less sensitive to changes in monetary policy. The Treasury's current maturity mix is close to the efficient frontier balancing these tradeoffs. As a result, we think aggressively shifting term issuance into bills risks not only increasing bill yields but also increasing the volatility of the Treasury's debt service costs . Figure 1: 10y term premia (%) Figure 2 : 3m bill less OIS (bp) Source: Federal Reserve, SMBC Nikko Note: 20d average. Source: Bloomberg, SMBC Nikko -2 -1 0 1 2 3 4 Jan-06 Jan-10 Jan-14 Jan-18 Jan-22 Jan-26 -25 -20 -15 -10 -5 0 5 10 15 20 Apr-23 Apr-24 Apr-25 Apr-26

SMBC US Rates Strategy Weekly 4 Buybacks and the long end From a stock perspective, the table below shows that buybacks are trivial relative to the outstanding stock of Treasuries with maturity greater than 10 years, which totaled $5.5trn at the end of July. Ultimately, only deficit reduction and easing inflation concerns are likely to have a durable impact on long-end yields. The flow argument is more supportive , with the increase in buybacks potentially absorbing 16-24% of the new supply or 20-30% of the dealer inventories. The challenge is timing. The next long-end buyback operation is not scheduled to occur until September 10 (10-20y sector), leaving the market without a supporting flow mechanism for the next three weeks. That creates an opportunity for investors to test Secretary Bessent's resolve, particularly if higher oil prices coincide with continued pressure across G10 long-end rates with AI led supply in the background. Figure 3: Non-interest deposits (% deposits) Figure 4 : Stablecoins ($bn) Source: FDIC, SMBC Nikko Source: Visaonchainanalytics, SMBC Nikko Figure 5:

10-20y and 20-30y buyback size Figure 6 : 10y UST vs. oil Source: US Treasury, SMBC Nikko; Note: 6 operations left in the August refunding period. Source: Fed, SMBC Nikko 15 17 19 21 23 25 27 29 31 33 Mar-10 Mar-13 Mar-16 Mar-19 Mar-22 Mar-25 125 145 165 185 205 225 245 265 285 Jan-24 Jul-24 Jan-25 Jul-25 Jan-26 Jul-26 Buybacks Prior to change New floor If they push Per operation $2bn Max $4bn $6bn Per refunding (8 ops) $16bn Max $32bn $48bn % of 10/20/30 supply ($231bn) 6.9% 13.9% 20.8% % of >10y outstanding (5.5Tr) 0.3% 0.6% 0.9% % of >10y dealer investory ($117bn) 13.7% 27.4% 41.0% Remaining refunding ops (6) $12bn $24bn $36bn % of 10/20/30 supply ($148bn) 8.1% 16.2% 24.3% % of >10y outstanding (5.5Tr) 0.2% 0.4% 0.9% % of >10y dealer investory ($117bn) 10.3% 20.5% 30.8% 4.4 4.5 4.6 4.7 4.8 60 65 70 75 80 85 90 95 100 Jul 26 Aug 26 Oil (WTI) 10y UST (RHS)

SMBC US Rates Strategy Weekly 5 A close above 5.25% today would suggest that such a test is becoming increasingly likely. Complicating the outlook, Secretary Bessent indicated that the administration could announce a new deficit reduction initiative as early as Monday. We remain skeptical that bond markets will view such an announcement as sufficiently credible. Instead, relief from current pressure points, corporate supply, oil and G10 long-end yields, combined with a hawkish Fed and buybacks would likely do more to stabilize the long-end. What brings the buyers back? Credible deficit announcement. As we discussed above, the administration is expected to announce a new deficit reduction initiative. If deemed credible, it could lead to a sizable decline in yields. Slowing growth or lower inflation. Consensus forecasts still point to relatively resilient growth of 2.2% in 2026 and 2.1% in 2027, supported by strong private investment, while core PCE is expected to fall to 3.2% by the end of 2026 and 2.4% by the end of 2027. A faster disinflation process, a sharper slowdown in growth, or a significant drawdown in risk assets that revives recession concerns would likely force investors to cover shorts and add duration. For now, investors are not pricing in a meaningful deterioration in growth, and while recent inflation prints have been benign, hawkish Fed rhetoric has kept some investors cautious. Easing corporate supply. The wave of issuance from hyperscalers, driven by expanding capex plans, has weighed on Treasuries. Even Secretary Bessent noted that, if he were the CFO of one of these companies, he would consider issuing more in the belly of the curve rather than the long end in anticipation of disinflation. For now, yield levels themselves are unlikely to constrain borrowing given the scale of the AI buildout. As a result, meaningful alleviation of supply pressure is more likely to come from a moderation in investment plans than from higher rates alone. Removal of oil tail risk . A credible de-escalation with Iran would help. The current “ no war, no peace ” backdrop has left commercial shipping operating at a fraction of the pre-war levels while attacks on cargo vessels and tankers continue to highlight the fragility of the situation. Figure 6 shows that yields remain highly correlated with oil prices, even as Fed uncertainty has added another layer of risk. The rise in long- end yields does not appear to be driven by inflation expectations, with breakevens remaining relatively contained. Instead, oil-related geopolitical uncertainty is likely contributing to a higher term premium and elevated real yields. A reduction in that tail risk could compress the risk premium embedded in long-end rates and help draw underweight investors back into duration. Relief in the G10 long end . This has never been solely a US story. 10y JGB yields approached 3%, their highest level in three decades, while 30y Bund yields reached their highest level since 2011, 30y OATs their highest levels since 2008 and 30y Gilts their highest levels since 1998. Similarly, the long-bond reached 5.33%, its highest level since 2007. Long-ends are trading as a bloc because the drivers are common – fiscal deficits, reduced central bank buying and the retreat of some structural buyers such as Japanese and Taiwanese lifers. Against this backdrop, a Nikkei report that the MOF and FSA are studying tax incentives for retail JGB investors is potentially significant. JGBs have been a key driver of the global repricing in duration, and any renewed domestic bid should help relieve pressure across the broader G10 long-end.

SMBC US Rates Strategy Weekly 6 Week ahead • PCE and Core PCE Deflators (Jul, Wed) . We are forecasting relatively contained prints of 0.15% m/m and 0.22% m/m for the headline and core PCE deflators. This follows similar readings 0.1% and 0.2% from the July headline and core CPI reports. While the core PCE deflator is elevated at 3.3% y/y, we are expecting core inflation to slow due to a disinflating US housing market, slowing wage growth — which now sits at just 3.2% y/y — tariff costs now having passed through into prices, and favorable base effects next year. Also, the BEA will be revising its pricing methodology for portfolio management services, legal services and software next month, which is likely to result in core PCE being revised downward by between 10 and 20 basis points. We are also paying special attention to the July personal savings rate, which fell to an ultra low 2.7% in June. Households have drawn down their savings to maintain their consumption in the face of higher post war prices. • Preliminary Benchmark Revisions (March 2026, Friday) : On Friday, the BLS will provide a preliminary estimate for its annual efforts to re-benchmark the level of nonfarm payrolls to sample data from the more comprehensive Quarterly Census of Employment and Wages (QCEW). Preliminary revisions have been notable recently, with the level of payrolls being revised down by an average of -259k over the last five years (-911k in 2025, -818k in 2024, - 306k in 2023, +462k in 2022, and -374k in 2021). Another downward revision to the level of payrolls is likely to further reduce rate hiking pressure on the Fed. • The Fed's Annual Jackson Hole Symposium (Friday) : Fed Chair Warsh is expected to deliver a speech at 10 AM on Friday. Little is known about the speech at the time of writing. While Warsh is unlikely to offer near term guidance in this address, he did express at the recent July Fed meeting that he would be checking in with the five task forces beforehand. Depending on the results, this could provide clues about the FOMC possible reaction function. Figure 5: Personal Savings Rate (%, Disposable Personal Income) Figure 6 : Past Benchmark Revisions to the Level of Nonfarm Payrolls Source: BEA, Haver, SMBC Nikko Source: BLS, Haver, SMBC Nikko 0 5 10 15 20 0 5 10 15 20 90 95 00 05 10 15 20 25

SMBC US Rates Strategy Weekly 7 Table 3: Economic indicator forecasts

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