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US Rates Strategy Weekly August 28, 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 • We expect to have more to write about after the Chair’s Jackson Hole speech. In the meantime, we take a closer look at the latest round of tariffs. • Since March 1, the Treasury has collected about $150bn in tariffs but paid out $120bn in IEEPA refunds. • On July 24, it expanded Section 301 duties to include 10 or 12.5% tariffs on 60 countries in violation of forced labor rules. These new duties are expected to fully replace the roughly $20bn/month that Section 122 was collecting. • As of August 19, a new 50% duty will apply to Canadian alcohol, dairy, wood, and consumer products. • Most businesses (roughly 75%) pass along some or all of their higher tariff costs to their customers . But, even for businesses that fully pass along their higher import costs, the effect may not be immediate because of existing contracts or a wish to avoid customer price shock. • As of June, about half of firms had yet to fully phase in their tariff pass-throughs. A plurality expected this to occur within the next 6m . We look for tariff inflation effects to ebb this fall. • Bearish September seasonals could pressure Treasuries, though policy support may provide opportunities to buy 10s on dips especially if there is relief on global risk factors . • We are forecasting gains of 57,000 and 68,000 for headline and private NFP respectively . We look for the unemployment rate to hold steady at 4.1%. Nonfarm payrolls have grown an average of 20,000/m over the last three months Replacement tariffs We expect to have more to write about after the Chair’s Jackson Hole speech. In the meantime, we take a closer look at the latest round of tariffs. Section 232 1 and 301 tariffs remain in place following the expiration of the IEEPA reciprocal and Section 122 duties, at the end of February and July, respectively. Section 122 tariffs were temporary duties of 10% lasting 150d. Since March 1, the Treasury has collected about $150bn in tariffs but paid out $120bn in IEEPA refunds (Figure 1). The administration is seeking to replace the lost revenue from the expiration of Section 1 Section 232 applies national security tariffs against steel, aluminum, autos, and semiconductors. These tariffs vary between 10-50% depending on the product and the country of origin.

SMBC US Rates Strategy Weekly 2 122. On July 24, it expanded Section 301 duties to include 10 or 12.5% tariffs on 60 countries in violation of forced labor rules. These new duties are expected to fully replace the roughly $25bn/month that Section 122 was collecting between March and July. This month, the administration added a new set of duties on Canada under Section 338. As of August 19, a new 50% duty will apply to Canadian alcohol, dairy, wood, and consumer products. Following the expiration of IEEPA, the average effective tariff, or the ratio of duties to import value, fell to 7% from a peak of over 11% last fall (Figure 2). 2 The effective rate is adjusted for economic effects to account for changes in behavior as importers shift to domestically produced substitutes or increase their inventories. Without replacement tariffs, the CBO revised its 10y budget deficit projection $2trn higher. 3 The primary deficit was expected to increase $1.6trn from the lost revenue, and because the Treasury needs to finance an extra $1.6trn its interest costs increase by $400bn. As the expansion in Section 301 has roughly the same coverage as the Section 122 duties, we expect the average effective tariff rate to hold near 7% next year. Likewise, the Treasury should be able to recover the $1.6trn of revenue. We do not expect the 301 expansion to increase inflation although there may still be some lingering pass-through effects in coming months from earlier tariffs. Most businesses (roughly 75%) pass along some or all of their higher tariff costs to their customers. Abel et al (2025) estimate that about 1/3 of manufacturers and 45% of service providers fully pass along tariffs. 4 Roughly similar percentages of manufacturers and servicers (that is, between 20-25%) absorb their higher import costs. The balance pass along some of the tariff cost. Significantly, even for businesses that fully pass along their higher import costs, the effect may not be immediate . First, many of the goods or services are governed by contracts that were signed before Liberation Day. As a result, new customer prices can only take effect when the existing agreement expires. 2 See “Effective Tariff Rates and Revenues”, Penn Wharton Budget Model, August 10, 2026 3 See “An Update about CBOs Projections of the Budgetary Effects of Tariffs”, P. Swagel, Congressional Budget Office, March 5, 2026 4 See, “Are Businesses Absorbing the Tariffs or Passing Them On to Their Customers?”, J. Abel, R. Deitz, S. Heise, B. Hyman, and N. Montalbano, Federal Reserve Bank of New York, Liberty Street Economics, June 4, 2025 Figure 1: Net tariff revenues ($bn) Figure 2 : Effective tariff rate (%) Note: Tariffs less IEEPA refunds. Source: US Treasury, SMBC Nikko Source: Penn Wharton Budget Model, SMBC Nikko -30 -20 -10 0 10 20 30 40 Nov-25 Jan-26 Mar-26 May-26 Jul-26 0 2 4 6 8 10 12 Jan-25 Apr-25 Jul-25 Oct-25 Jan-26 Apr-26

SMBC US Rates Strategy Weekly 3 Second, we suspect businesses are reluctant to impose an immediate increase in prices for fear of losing business. Instead, to the degree that they have some contract flexibility, they may increase prices gradually over a year or so to recapture their import costs. As of June, Abel et al (2026) found that about half of service sector and goods companies had already either fully passed along tariffs or absorbed them. The remainder have yet to complete their phase in although a plurality expected this to happen within the next 6m . We expect tariff effects on inflation to slowly ebb by year-end. September seasonals vs. Treasury put The curve twist flattened since the buyback announcement. Going into September, the bond market faces four forces: macro, geopolitics/ oil, Warsh’s reaction function and a Bessent put . In addition, market seasonals are bearish. September is seasonally a heavy corporate issuance month and so far this year, the maturity mix has been concentrated toward the long-end because of heavy AI-related borrowing. The offsets . Even if the Bessent is unlikely to change the long-run dynamics, it can still squeeze yields lower for a short time particularly if it coincides with relief on oil prices and on G10 long end yields. There is a supporting signal in the options market. The 3m 25delta put vs. call skew on 30y futures has receded off the highs (Figure 3), while yields have lagged. Historically the drop in the risk reversal has coincided with lower yields. The second offset comes from equities which are only a few percent off their highs and susceptible to a risk-off move heading into the mid-term elections. How to play it. Buy the 10y on dips in early September, or as and when the ACM term premium is above 80bp. It has been in the 50-90bp range since April 2025 (Figure 4). The same corporate supply argues for tighter swap spreads in the first week to week and a half of September. There is scope for more tightening if equities show any weakness into the mid-terms. Spreads are near local wides after the increase in buybacks - good levels to lighten up longs and re-enter once the September supply has cleared. Figure 3: 30y futures 3m 25delta puts vs. calls Figure 4 : 10y term premium Source: Bloomberg, SMBC Nikko; Source: Fed, SMBC Nikko -3.0 -2.0 -1.0 0.0 1.0 2.0 3.0 4.0 4 4 5 5 6 Jan-23 Jan-24 Jan-25 Jan-26 30y (LHS) 25d puts v calls on Long bond futures 0.00 0.25 0.50 0.75 1.00 Jan-25 May-25 Sep-25 Jan-26 May-26

SMBC US Rates Strategy Weekly 4 Week ahead • ISM Manufacturing (Aug, Tue) and ISM Services (Aug, Thur) : We look for ISM manufacturing index to increase in August, rising to 56.1 from 55.6 in July. This would follow strong regional indexes like the Empire State and Philadelphia Fed surveys which rose to their highest levels since 2021 in August. The ISM index has risen 7.7pts since year-end (Figure 5). This year’s increase has been driven by broad-based recoveries in all the sub-components, but particularly in employment. By contrast, the ISM services index has moved sideways this year. We look for the index to post a modest increase to 54.7 in August with rebounds in employment and supplier deliveries. New orders and business activity may soften. • Employment Report (Aug, Friday) : We are forecasting gains of 57,000 and 68,000 for headline and private NFP respectively. We look for the unemployment rate to hold steady at 4.1%. Nonfarm payrolls have grown an average of 20,000/m over the last three months. Part of this weakness is tied to the government sector. The lapsing of a pandemic stimulus bill in March (ESSER) has resulted in a cumulative decline of 98,000 in local education payrolls (Figure 6). We estimate this subcomponent of local government could decline by another 87,000 workers (by year-end). A second pandemic stimulus bill (SLFRF) expires on December 31, 2026, which might subtract 127,000 jobs from state and local government payrolls excluding education (over 2027). By contrast, private sector employment has been stronger, rising an average of 40,000/m over the past 3m. Anemic job growth – in both the private and public sectors – has not pushed the unemployment rate higher as labor supply has been weak. Figure 5: ISM Manufacturing (7m Change) Figure 6 : Payrolls of Local Government Education Services (Thous.) Source: ISM, Haver, SMBC Nikko Source: BLS, Haver, SMBC Nikko -15 -10 -5 0 5 10 15 20 25 -15 -10 -5 0 5 10 15 20 25 2000 2005 2010 2015 2020 2025 7200 7400 7600 7800 8000 8200 8400 7200 7400 7600 7800 8000 8200 8400 2000 2005 2010 2015 2020 2025

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