

FIXED INCOME

US: Pendulum swings back to inflation

- Markets were buffeted by stagflation currents as oil prices surged above USD100/bbl and Feb NFP fell 92k, complicating the Fed’s policy path.
- Headline inflation is set to re-accelerate while core pressures remain persistent, increasing stagflation risks. Elevated core inflation lowers the real policy rate and reduces the Fed’s room to ease.
- The uncertain geopolitical outcome in Iran/Hormuz Strait, and the broad range of inflation outcomes delay the Fed’s first cut to 4Q26.

Headline impulse, persistent core pass-through

The escalation in US-Iran tensions has lifted crude prices sharply, reintroducing upside risks to inflation just as disinflation was beginning to stabilise. Our model suggests that if Brent prices remain sustained at USD100/bbl, 2026 headline inflation could rise by 0.7%pts to 3.1%, from 2.4%, while core CPI is projected to increase by around 0.3%pts annually. Conflitti & Luciani (2017) find that oil pass-through into core inflation occurs primarily through broader macro channels – transport costs, production inputs and pricing behaviour – and tends to be sticky. Their estimates suggest a 10% oil shock lifts core PCE by around 0.09%pts, with effects that decay gradually but remain positive for an extended period. With core PCE already set to exceed 3% yoy in Jan, sustained energy strength risks raising the inflation floor and delaying a return to target. The result is a more pronounced stagflation tilt, complicating the balance between growth support and inflation control.

Fed policy outlook: Easing pushed to 4Q26

Despite the recent NFP report showing a sharp payroll decline – larger than the market-moving Aug 2025 print – we assess the balance of risks as tilting back toward inflation. The 92k drop included over 40k losses tied to the Kaiser Permanente strike and the federal government shutdown, suggesting the underlying deterioration may be less severe than the headline implies. At the same time, the projected rebound in both core CPI and core PCE materially raises the hurdle for easing. We therefore revise our base case to just one cut in 2026, now in 4Q26, as we expect the temporary oil-driven inflation spike to ease by then, assuming de-escalation brings Brent down toward USD85/bbl in 2Q26. Inflationary pressures are likely to outweigh labour market concerns, consistent with prior Fed behaviour of requiring clearer and sustained evidence of disinflation before cutting. Our Taylor Rule model (Figure 6) shows that room to ease narrows significantly as oil prices rise. While the real policy rate remains above its long-run average, persistent core inflation would slow the normalisation of real rates and reinforce the Fed’s reluctance to ease prematurely. Should Brent move toward USD120/bbl, with headline CPI potentially peaking near 4.8%, the risk would shift toward renewed tightening rather than easing if the conflict proves prolonged.

Near-term bear-flattening bias takes over

The conflict has reinforced a bear-flattening bias, reflected in the 2s10s spread compressing from 73bps in Feb to around 52bps currently. Markets have sharply repriced easing expectations, with only 18bps of cuts currently priced for 2026. While our base case still sees one cut in 4Q26, we expect yields to continue reflecting inflation risks in the near term, with 2s10s likely testing 40bps as cuts are priced out further. A stagflation-leaning environment typically favours flatter curves, as front-end yields reprice higher on delayed easing while long-end yields remain capped by growth concerns. We view the 3.80% level in the 2Y as increasingly attractive for positioning ahead of a potential 4Q26 easing cycle. The 10Y, meanwhile, should remain relatively anchored by weaker growth expectations stemming from the conflict.

Spillover impact on regional curves

The regional impact should reinforce our flattening narrative. The magnitude of the flattening move could be larger than previously expected as rising inflation pressures increase the risk of policy staying tighter for longer. With regional front-end yields highly correlated with USTs (Figure 9), short-end regional rates should move higher in tandem with USTs as oil-driven inflation risks rise and Fed cuts are priced out.

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Figure 1: CIMB forecast

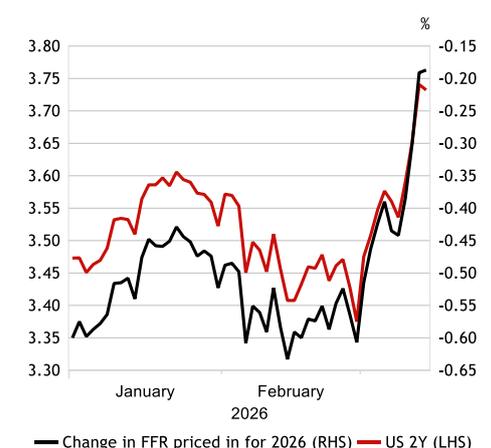
Policy Rate	Current	1Q26	2Q26	3Q26	4Q26
US (upper bound)	3.75	3.75	3.75	3.75	3.50
Rates	Current	1Q26	2Q26	3Q26	4Q26
UST 2Y	3.74	3.80	3.70	3.65	3.55
UST 10Y	4.27	4.20	4.25	4.20	4.10

Figure 2: The impact of higher oil prices and its translation to our Fed outlook

Average Brent price (USD/bbl)	Impact on annual CPI	2026 CPI	Policy rate expectations
80	0.20	2.60	1 cut
100	0.72	3.12	No changes
120	1.41	3.81	1 hike

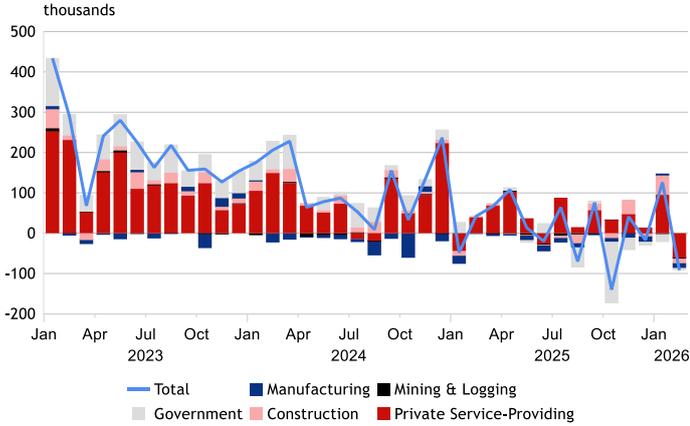
Quoted in percentage points

Figure 3: 2Y vs cut pricing in 2026



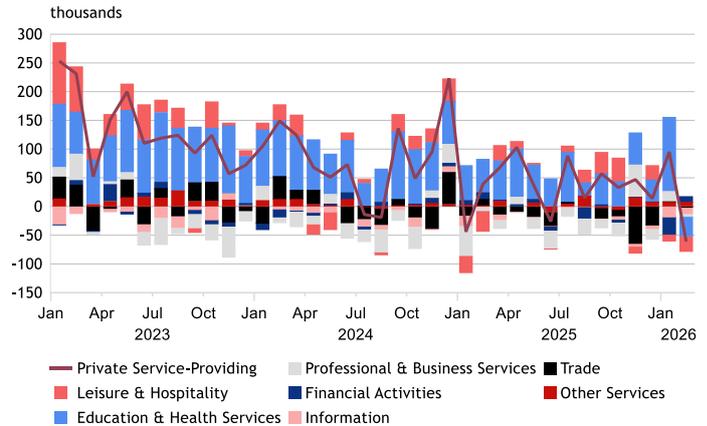
SOURCE: MACROBOND, CIMB TREASURY AND MARKETS RESEARCH

Figure 4: Nonfarm payrolls contract sharply with a weaker print even compared to Aug 2025



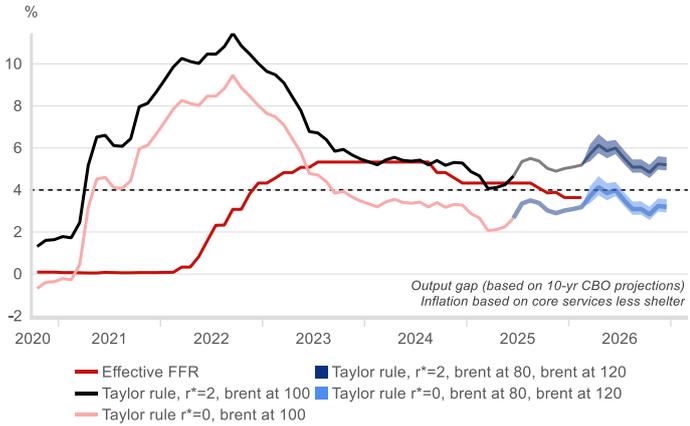
SOURCE: MACROBOND, CIMB TREASURY AND MARKETS RESEARCH

Figure 5: The Kaiser Permanente strike exacerbated the decline in payrolls however the number is still weak excluding healthcare



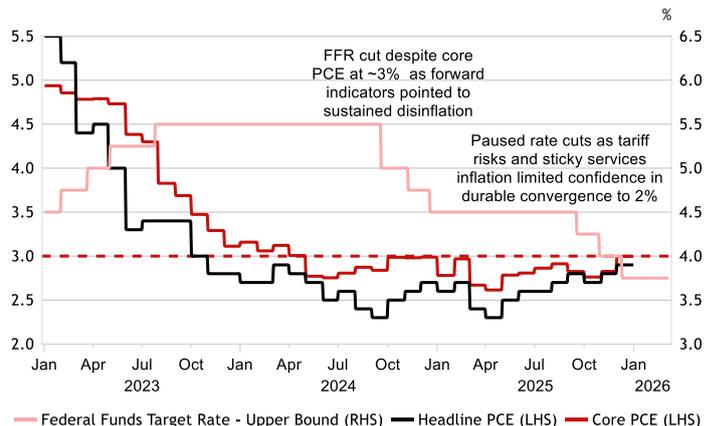
SOURCE: MACROBOND, CIMB TREASURY AND MARKETS RESEARCH

Figure 6: Room for policy easing narrows amid higher inflation, with sustained oil prices at USD120/bbl expected to lead to hikes



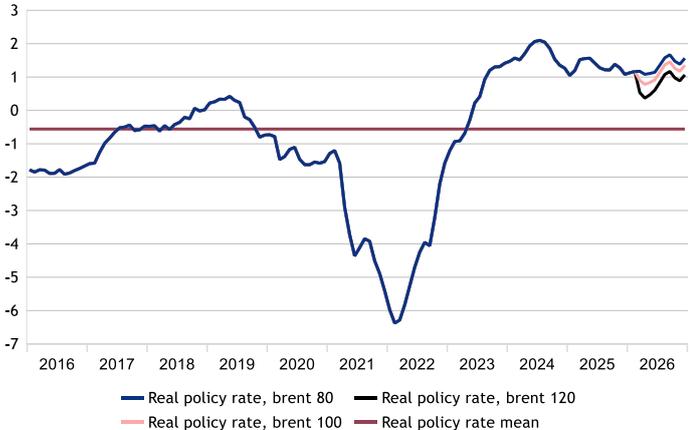
SOURCE: CONFLITTI & LUCIANI (2017), CIMB TREASURY AND MARKETS RESEARCH

Figure 7: PCE levels near 3% without a clear disinflation narrative historically made the Fed reluctant to cut



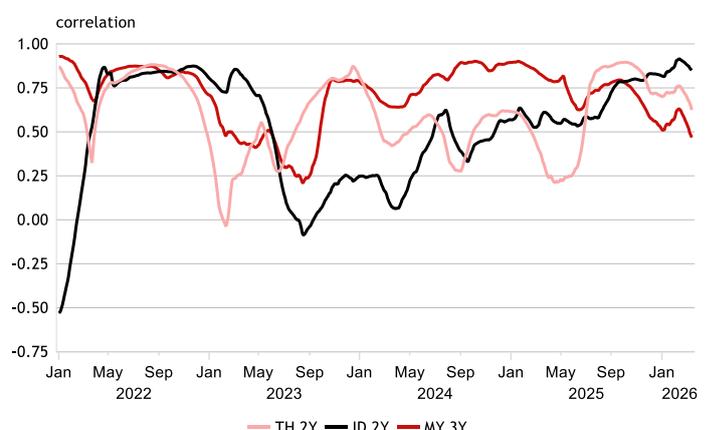
SOURCE: MACROBOND, CIMB TREASURY AND MARKETS RESEARCH

Figure 8: Real policy rate remains above long-run average, but higher oil compresses the buffer



SOURCE: MACROBOND, CIMB TREASURY AND MARKETS RESEARCH

Figure 9: MIT front-end yields remain correlated with UST 2Y, though below Russia-Ukraine shock levels



SOURCE: MACROBOND, CIMB TREASURY AND MARKETS RESEARCH

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