AST DEFEASANCE RATE MARKET UPDATE

RATE MARKET UPDATE: May 31, 2023 | Debt-Ceiling Vote; FOMC Rate Hike?; Employment Report

- **Debt-limit deal faces final test in Congress; vote expected tonight**
- **Lawmakers on both sides of the aisle are optimistic it will pass**
- **Hawkish Fed-speak fuels speculation FOMC will raise rates 25 bps at the June meeting**
- **Key US Employment Report released Friday 6/2 at 8:30 am**
- **Next FOMC meeting June 14th, 2023**

Rate market participants remain primarily focused on the debt-limit deal forged by President Joe Biden and House Speaker Kevin McCarthy. The bill is heading for a House vote Wednesday night. Congress is racing to pass the measure before June 5, the date when Treasury Secretary Janet Yellen has warned the US risks default. Concerns are also growing about global economic growth – weaker than expected data from China, Europe and to some extent, the US, have augmented fears of a global recession. As a result, SOFR swap rates are down this morning ~5-8 basis points across the curve.

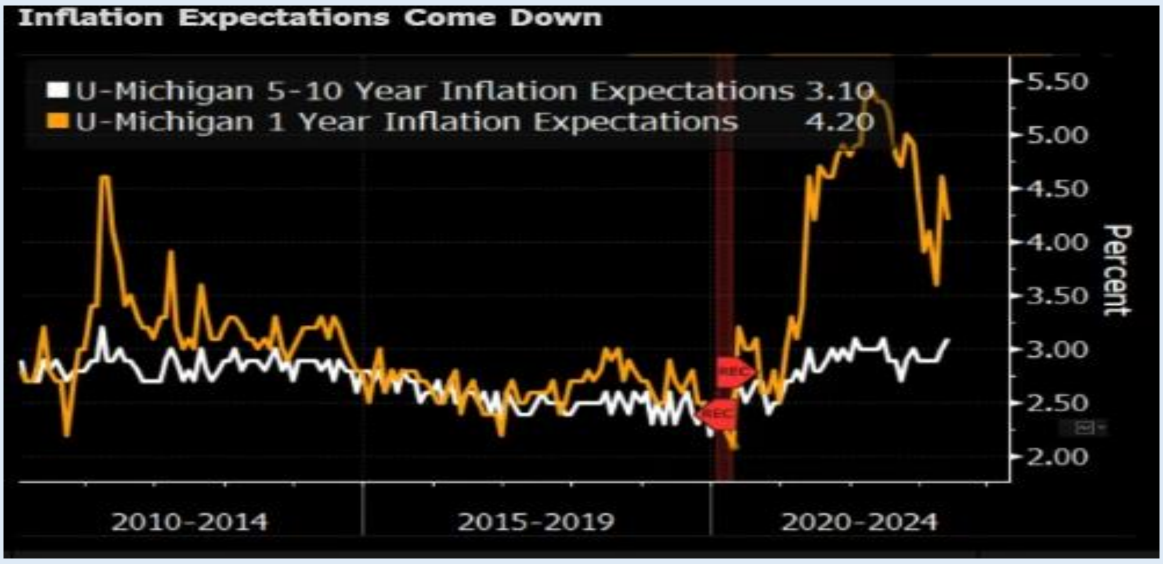
Given the many crosswinds the market faces at the moment, rate volatility remains elevated. However, recent Hawkish Fed-speak is likely to prevent any significant drop in term rates. Federal Reserve Bank of Richmond President Thomas Barkin said he is looking for signs that demand is cooling in order to be convinced that US inflation will ease. Cleveland Fed President Loretta Mester dialed the hawkish Fed-speak up a notch, saying she sees no “compelling reason” to pause interest-rate increases, particularly in the wake of the anticipated debt-limit deal. This has increased speculation the Fed will raise rates another 25 basis points at the June 14th meeting. The FOMC will see US Employment Data Friday morning and will see CPI inflation data on June 13th, the day before the meeting. Fed officials have recently emphasized that monetary policy decisions will be largely “data dependent”, so they will be paying close attention to the data ahead of the meeting. Overall, stronger-than-expected economic data since the last meeting, sticky inflation and optimism on the debt-ceiling deal have built market expectations for another rate hike in June. Expected elevated rate volatility as the market moves on from the debt-ceiling drama and back to focusing on the economy and FOMC expectations. Once again the market faces uncertainty – is a recession on the horizon or not? Will the FOMC continue to raise rates or pause?

We will see the JOLTS jobs data at 10:00 am this morning. As a precursor to Friday’s employment data, we could see some market movement after the JOLTS data prints. A stronger than expected number could cause rates to drift higher.

CHART 1: 1Y, 2Y, 3Y & 5Y SOFR SWAP RATES – PRIOR 30 DAYS

The Bloomberg chart below details 1y (green), 2y (white) and 3y (orange) and 5y (purple) SOFR swap rates for the past 30 days. You can see from the graph below that rates have steadily moved up over the past 30 days. The debt-ceiling drama and global economic concerns curtailed the move higher, but the rate move this week (rates lower) has a temporary feel to it. Odds for a 25 bp FOMC rate hike in June continue to increase, so we may see rates start to creep higher once the debt-ceiling deal is done and dusted (hopefully tonight!). Unless the employment data throws us a curve ball on Friday, speculation will continue to increase for a 25 bp rate hike at the next Fed meeting. 2Y SOFR swap rates are approximately 10% (or 37 bps) higher than they were 30 days ago.

CHART 2: Inflation Still Far from FOMC Target



Source: Bloomberg; Univ. of Michigan

The Bloomberg chart above shows the University of Michigan 1Y and 5-10Y US inflation forecasts . You can see from the chart that, although expectations have dropped, short term and longer term inflation forecasts have recently ticked higher and the overall inflation predictions (3.10%, 4.20%) are still far from the Fed's stated 2.00% objective. As mentioned, recent inflation data and hawkish Fed-speak are fueling renewed speculation that the FOMC may not be done raising rates. *Stay tuned!*