RateCap Advisors

## <u>Flash Update:</u> US Rate Markets – Wednesday 2/28/2024

- **Market shakes-off revised GDP; All eyes on tomorrow's critical PCE inflation data**
- **Inflation is back in focus; the most recent CPI, PPI and GDP reports all showed higher than expected inflation**
- **Chairman Powell's two-day Congressional testimony and Q&A is next week (3/6, 3/7 @10:00 AM)**
- **There are a host of Fed-officials scheduled to speak this week and next week**
- **There is the potential for elevated rate volatility this week and next week**

Good Morning –

US Treasury and SOFR swap rates traded a few bps lower overnight ahead of the GDP release this morning. Market participants largely ignored the GDP data released this morning at 8:30 AM. Post-GDP release, swap rates are down a couple of basis points (See Chart 1).

The second revision to Q4 2023 GDP printed basically as expected (See Chart 2). SOFR swap rates barely moved after the release. Keep in mind that today's GDP data is a second revision to backward looking information. The market did not really expect GDP to provide any new information. Market participants are clearly looking ahead to tomorrow's critical PCE inflation data. Amazingly, fears of a recession have been replaced recently with renewed concerns about inflation. We know that PCE, particularly Core PCE, is the Fed's favored inflation gauge. Recent inflation data has evidenced an unwanted uptick in inflation. The Fed is watching the inflation situation closely. From my perspective, we are not at a point yet where the Fed may actually consider another rate hike to stifle inflation. However, as we have seen the past two weeks, the market has dramatically repriced Fed rate cut expectations. The forward curve is now in line with the Fed "dot-plot" – both are calling for three 25 basis point rate cuts in 2024. The timing of the first rate cut is still up for debate, but the market has reluctantly accepted that the Fed is in no hurry to cut rates.

Tomorrow's PCE data is the highlight of the week. If PCE shows "hotter-than-expected" inflation, the horizon for the first rate cut will get longer. Yes, we are only in February and it is a long year, but as we have discussed, the Fed is not going to cut rates without a compelling reason. The Fed is in data driven mode, so it is unlikely they will put too much emphasis on any given number. They are more concerned with the "big picture" the data is painting. Right now, given the recent uptick in inflation and relatively strong economy, the Fed will be in no hurry to cut rates.

<u>Chart 1:</u> ***US RATES SNAPSHOT: 10:00 AM Eastern***

**UST YIELDS | SOFR SWAP SPREADS | SOFR SWAP RATES**

| GV Ask/Chg | | | SOFR/GV | | SOFR OIS | |
|---|---|---|---|---|---|---|
| 2Y | 4.675 | -0.019 | -10.8600 | -0.7600 | 4.5674 | -0.0264 |
| 3Y | 4.469 | -0.018 | -18.3400 | -0.3400 | 4.2856 | -0.0200 |
| 4Y | 4.383 | -0.016 | -25.5000 | -0.1700 | 4.1302 | -0.0159 |
| 5Y | 4.299 | -0.011 | -26.1300 | | 4.0390 | -0.0125 |
| 7Y | 4.323 | -0.005 | -36.7700 | +0.1700 | 3.9565 | -0.0056 |
| 10Y | 4.301 | -0.001 | -38.1400 | +0.2400 | 3.9207 | +0.0019 |
| 20Y | 4.571 | +0.012 | -67.7300 | -0.4800 | 3.8951 | +0.0072 |
| 30Y | 4.439 | +0.011 | -73.1500 | -0.2700 | 3.7081 | +0.0097 |

**Source: Bloomberg, LLP | 10:00 AM NY Rates Snapshot**

<u>Chart 2:</u> ***GDP Recap***

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The table below provided a recap of this morning's GDP release. Gross domestic product rose at a revised 3.2% annualized pace in the fourth quarter, compared with a prior estimate of 3.3%. Consumer spending advanced at a 3% rate, faster than initially estimated. The GDP inflation component was revised higher. Last year the economy expanded 2.5%, marking an acceleration from 2022 and far outperforming most forecasts. The economy last year ended up surprising many economists who expected the US would slip into a recession after aggressive Federal Reserve interest-rate hikes. Instead, a robust labor market supported consumer spending and kept the economy moving forward. While economists largely expect growth to cool somewhat this year as high borrowing costs restrain household demand and business investment, they still anticipate the US can avoid a downturn.

Market focus has definitely shifted from concern about an economic downturn to concern about a renewed and sustained uptick in inflation. If PCE prints higher than expected, that would mean the last CPI, PPI, GDP Price Component and PCE all evidenced higher than expected inflation. It is only one series of data and it is early in the year – right now it is just a lingering market concern. Stay tuned!

**GDP RECAP**

| Metric | Revision | Initial Estimate |
|---|---|---|
| GDP | +3.2% | +3.3% |
| Consumer spending | +3.0% | +2.8% |
| Nonresidential investment | +2.4% | +1.9% |
| Residential investment | +2.9% | +1.1% |
| Government spending | +4.2% | +3.3% |

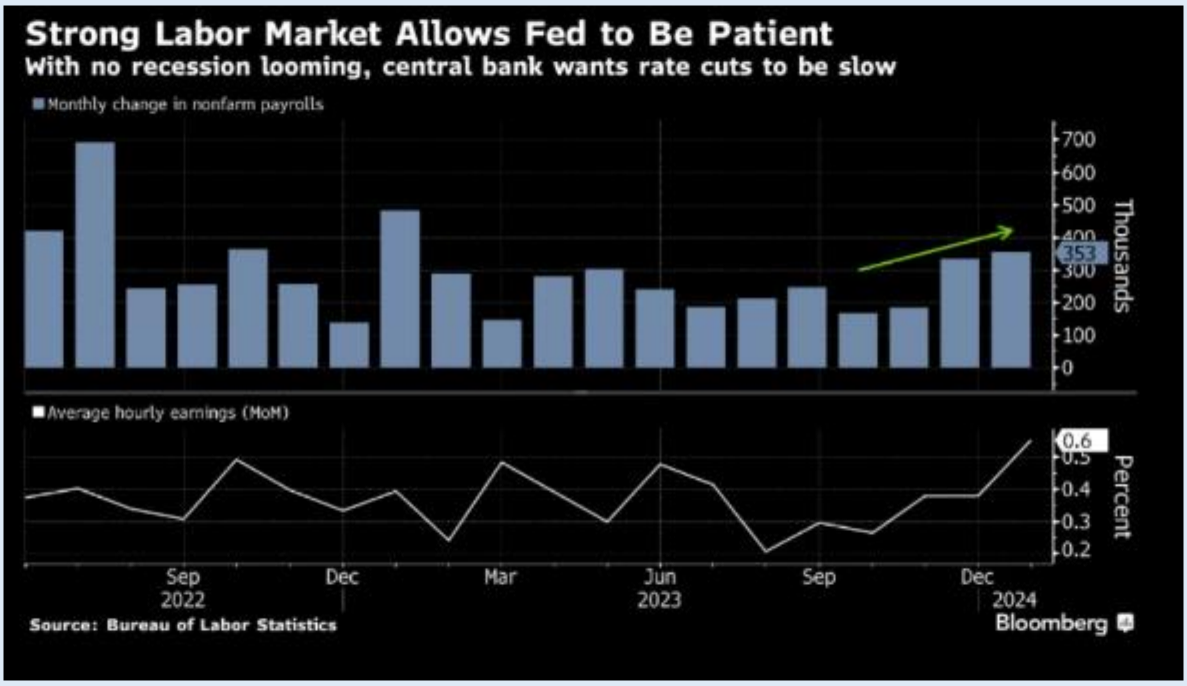
**Source: Bloomberg, LLP | GDP Recap**

Chart 3: ***Labor Market Remains Resilient***

The next employment report is due next week on 3/8. As we know, a strong and resilient jobs market has helped prop up the economy since the Fed started raising rates. Recent figures show that resilience continues. In addition, Average Hourly Earnings (read: wage inflation) has been ticking higher since September 2023. I included this chart for two reasons. The first reason is to underscore the strength of the US labor market. It simply keeps rolling along! The second reason is that a strong labor market, resilient economy and inflation that is drifting higher supports the Fed's current "wait-and-see" monetary policy approach. By most measurements, there is no compelling reason for the Fed to begin cutting rates anytime soon.

The vast majority of market participants now predict the Fed will cut rates three times this year, 25 bps each time. Currently, the market is aligned with the Fed dot-plot. The rate cuts are expected to begin in June, followed by rate cuts in September and December. We will see if tomorrow's PCE data changes that perception.

*Next week is a big week for the rate markets.* Chairman Powell gives his semi-annual testimony to Congress (followed by an extensive Q&A) on 3/6 and 3/7 at 10:00 AM and we see the aforementioned jobs report released next Friday, 3/8 at 8:30 AM. There are also a host of Fed officials on the tape this week and next. Between the data releases, Chairman Powell's testimony and the full plate of Fed-speak, there will be plenty for the market to digest.




Source: Bloomberg, LLP | Labor Market Remains Resilient

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**Rate Cap Advisors** was established in 2015 that focus on providing commercial real estate interest rate cap solutions. Our innovation and desire to explore new possibilities that benefit our clients have allowed us to save our clients millions of dollars. No matter the service or product, we take great pride in our pursuit of perfection with a unparalleled closing track record.

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