[Flash Update:] **US Rate Markets – Tuesday 3/12/2024**

- **CPI prints slightly higher than forecast (See Charts 2 & 2A)**
- **CPI data showed inflation remains "sticky"**
- **This morning's data signals it will be challenging for the FOMC to hit 2.00% target inflation**
- **Traders shook off the CPI data – rates barely moved after CPI was released (See Chart 1)**
- **Next FOMC meeting March 20, 2024**

Good Morning –

US Treasury and SOFR swap rates opened a few basis points higher this morning in reaction to the slightly worse-than-expected CPI print (See Chart 2). Headline CPI printed as expected, but Core CPI topped estimates for the second straight month. Stubborn inflation will make the Fed's job more difficult, as they attempt to find the "sweet spot" for starting rate cuts. This morning's CPI underscores the challenging task ahead for the FOMC. Today's inflation data shows we are still far from the Fed's stated 2.00% target. That said, the Fed has been dropping hints recently that they would be comfortable cutting rates with inflation *above* the 2.00% target level. However, inflation above 3.00% is still likely too high for the Fed to consider cutting rates anytime soon. From my perspective, the FOMC will want to see inflation sustainably below 3.00% before they consider a rate cut.

We see a wide range of economic data the remainder of the week, highlighted by PPI and Retail Sales on 3/14. The Fed will be watching this data closely, as will market participants. Given the reaction to today's data, it feels like the market will sit back and absorb the data this week. Unless the data wildly diverges from expectations, it is clear the market is focusing on next week's Fed meeting. The muted market reaction to CPI this morning was more of a sigh of relief (See Chart 1). Traders were fearful CPI would surge – the market was encouraged to see CPI print near expectations. The number this morning definitely has the market concerned, so from our perspective the bias is toward rates creeping slightly higher ahead of the FOMC or at least until we see the next "big" numbers on Thursday. It would not be a surprise if rates remained stuck in a range (or drifted higher) until the FOMC meeting next week. Today's data reinforces that the Fed is in no hurry to cut rates. Stay tuned!

Chart 1: *US RATES SNAPSHOT: 10:00 AM Eastern*

UST YIELDS | SOFR SWAP SPREADS | SOFR SWAP RATES

GV Ask/Chg			SOFR/GV		SOFR OIS	
2Y	4.578	+0.043	-11.5100	-0.3500	4.4642	+0.0382
3Y	4.320	+0.045	-16.1200	+2.3300	4.1605	+0.0440
4Y	4.227	+0.045	-23.3800	+1.3700	3.9945	+0.0456
5Y	4.135	+0.048	-23.6300		3.8998	+0.0472
7Y	4.148	+0.052	-33.6200	-0.2500	3.8140	+0.0488
10Y	4.147	+0.049	-37.0300	+0.1000	3.7773	+0.0497
20Y	4.407	+0.048	-65.3000	+0.3300	3.7558	+0.0520
30Y	4.310	+0.048	-73.5000	+0.3800	3.5760	+0.0530

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

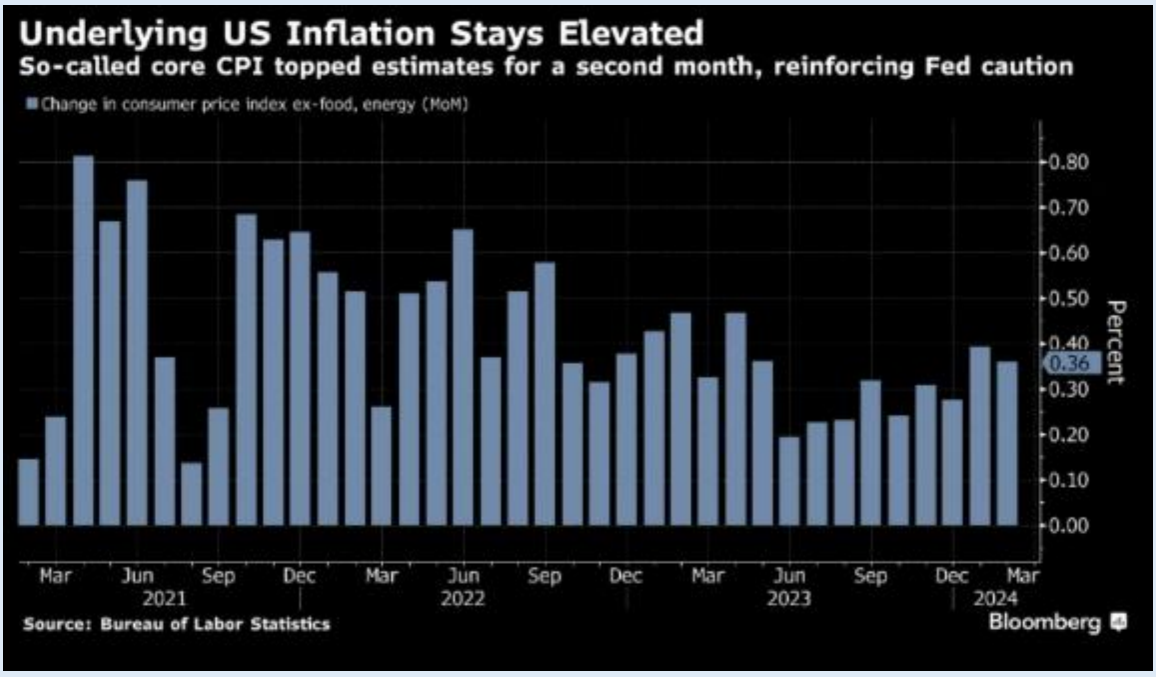
Chart 2 & 2A: *CPI Recap*

Chart 2: ***CPI Recap***

Metric	Actual	Estimate
CPI MoM	+0.4%	+0.4%
Core CPI MoM	+0.4%	+0.3%
CPI YoY	+3.2%	+3.1%
Core CPI YoY	+3.8%	+3.7%

Source: Bloomberg, LLP | CPI Recap

Chart 2A: ***Stubborn "Core" Inflation is a Worry For the Fed***



Source: Bloomberg, LLP | Core CPI Historical

Underlying US consumer inflation topped forecasts for a second straight month in February, reinforcing the FOMC's "wait-and-see" approach to cutting interest rates. Core CPI, which excludes food and energy costs, increased 0.4% from January and from a year ago, it advanced 3.8%. Economists generally see the core gauge as a better indicator of underlying inflation than headline CPI. Headline CPI climbed 0.4% from January and 3.2% from a year ago, boosted by higher gasoline prices. After a "higher-than-expected" January reading, today's CPI data adds to evidence that inflation is proving stubborn, which is keeping central bankers wary of easing policy too soon. Other than the upcoming release of the producer price index (PPI), this is the last major inflation report the Fed will see before its meeting next week. With policymakers expected to hold interest rates steady for a fifth straight meeting, economists and market participants will be looking for clues as to when the FOMC will start lowering borrowing costs.

Chart 3: ***SOFR Swap Rates Move Slightly Higher After CPI Print – Rates Still Stuck in a Range***

SOFR swap rates largely shook off the number. Traders probably believe they have adjusted forward pricing enough for the time being. Market participants have already adjusted for fewer rates cuts in 2024, beginning later in the year than originally anticipated. The stubborn inflation data gives the market more confidence that the adjustment to the forward curve (read: higher rates recently) is warranted. As mentioned above, the market is likely to sit back, digest the remaining data this week, and wait for the FOMC. Keep in mind we also see a new Fed

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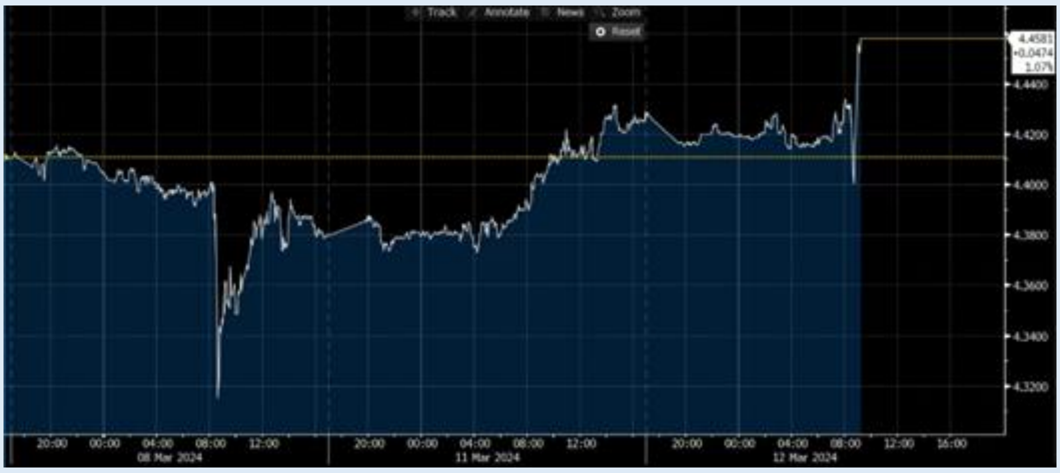
“dot-plot” and revised economic projections next week – and of course we hear from Mr. Powell again at his press conference. We will see if the Fed’s interpretation of the inflation data matches the market’s view. Reminder: The next FOMC meeting is Wednesday, 3/20. Rate decision at 2:00 PM, followed immediately by Chairman Powell’s press conference and Q&A.

2Y SOFR SWAP RATES, PRIOR 3 TRADING SESSIONS



Source: Bloomberg, LLP | US 2Y SOFR SWAP / Prior 3 Trading Sessions

<u>Product Update:</u>

Week of 3/11/24 - *What We Are Seeing In The Rates Market*

New cap volume continues to increase as do borrowers seeking to extend existing caps. The massive bond rally that ended 2023 is still *somewhat* intact. In addition, despite a shift in market pricing regarding Fed rate cuts, the forward curve is *still* pricing in ~3 rate cuts for 2024 – just starting a bit later in the year. Should inflation continue to trend higher, rate cut expectations may be reduced further.

Given the uncertainty that remains about forward rates, many clients are grappling with when or if to extend. This is a difficult question – our advice has been to monitor the market closely and be on-boarded and ready to trade, should the market move in your favor. We also advise borrowers to check the market pricing for extensions, similar to how you purchased the original cap. Market pricing discovery is a key component to any cap transaction – new caps, extensions or terminations.

We also encourage our clients to speak to their lenders. In some cases, we have seen lenders approve shorter term extensions (i.e. 3 months) – some borrowers may need to extend, but not for the *full* year. Other borrowers are simply looking to dynamically manage hedging rate risk by entering shorter term caps and hoping cap premium costs will drop ahead of the next cap purchase. This is not without risk but could be a viable strategy if you believe rates are going down next year.

There is an increasing interest in exploring interest rate swaps as a possible hedge alternative. IR Swaps lock in a synthetic fixed rate and do not require an upfront premium. Unlike an interest rate cap, swaps are secured derivatives, so the counterparty selection process is more challenging with a swap. There are also additional variables that factor into the decision to pursue an interest rate swap, or to unwind an existing swap. *Please let us know if you would like to learn more about interest rate swaps.*

On another front, borrowers who have "floors" embedded in their loan have been considering purchasing a separate, stand-alone interest rate floor to *offset* the loan floor. Borrowers with a loan floor will *not* be able to benefit from floating rates that drop below the loan floor rate. They will miss out on the benefit of lower floating rates, which depending on the rate environment can be significant. To offset the loan floor, borrowers can purchase an interest rate floor which will pay out should floating rates drop below the floor's strike rate. Details vary depending on the individual situation – some borrowers prefer to choose a strike on the floor that matches the floor rate on the loan, whereas others look to use a strike rate below the loan floor. (For example: Your loan floor is 3.50% - the floor you purchase can be priced at the loan floor of 3.50%, or you could look at a strike of 3.00%). The lower the floor strike, the cheaper the premium cost of the floor. Pricing ultimately depends on the individual situation and objective.

We also continue to see clients grappling with ways to manage burdensome replacement cap escrow costs. In certain cases, there *may* be a way to restructure the existing cap to extract value which can offset escrow created cash-flow pressure. Short of biting the bullet and purchasing the replacement cap and ceasing escrow deposits, restructuring the cap can add risk. Many of the solutions are designed to alleviate short term cash flow pressure but as mentioned, often create additional rate risk.

Please contact us if you would like to discuss an upcoming rate cap extension, explore ways to reduce or eliminate escrow deposits for replacement caps or learn more about interest rate Swaps or Floors.

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AST Defeasance Consultants, one of the nation's leading commercial real estate consulting firms, was founded in 2007. We have extensive experience in commercial real estate defeasance, hedging, derivatives, and financial instruments. More than $50 billion worth of transactions have been executed by the AST team. Only AST can combine innovation, expertise, and exceptional customer service.

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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