

Subject: AST | RCA RATE MARKET UPDATE 3/13/2024: A Tense Market Waits for FOMC Guidance

Flash Update: US Rate Markets – Wednesday 3/13/2024

- Market quiet as traders await data, FOMC guidance
- No data released today
- PPI and Retail Sales data released tomorrow at 8:30 AM
- Next FOMC meeting March 20, 2024

Good Morning -

US Treasury and SOFR swap rates opened slightly higher this morning, as a tense market waits for the release of key economic data and next week's FOMC meeting (See Chart 1). PPI and Retail Sales are released at 8:30 AM tomorrow. Tomorrow's PPI data will be the last inflation data that the FOMC sees prior to next week's meeting. Yesterday, swap rates drifted ~5 bps higher in reaction to higher-than-anticipated CPI inflation data. The uptick in inflation recently is a concern for the market and justifies, at least for the time being, the FOMC's "wait-and-see" approach to monetary policy. The market has grudgingly capitulated to the Fed and forward pricing now reflects ~3 rate cuts this year. Here are the current odds for rate cuts at the next three meetings, per the forward curve and SOFR futures pricing: **March** – 0%, **May** – 11% chance for a 25 bp rate cut, **June** – 58% chance for a 25 bp rate cut, 7% chance of a 50 bp rate cut, and a 35% chance they hold rates steady. The "split" June odds tells me the market is willing to push out the timing of the first rate cut, but still believes there is a chance the FOMC will need to cut rates more than 3 times this year. There is still a feeling in the market that the next few data series will show a slowing economy and softening labor market. There is also a belief that, despite the recent uptick, inflation will quickly resume its overall downward trend. We will see what tomorrow's data, and next week's important Fed meeting have to say about that!

Tomorrow's economic data will provide a glimpse of US consumer strength and producer-level inflation. US consumers have been exceedingly resilient through the Fed's tightening cycle, despite continued price pressure. Producer prices have been dropping in recent months – the market would love to see that trend continue tomorrow, which would partially offset the higher-then-expected CPI data. Lower PPI can foreshadow lower CPI, as price relief takes time to flow to the consumer level.

Expectations are calling for Advanced Retail Sales to increase **0.8%**. That would be a large increase over last month's -0.8% drop in Retail Sales, Headline PPI is estimated to print at **1.2%** and Core PPI at **1.9%**. Should PPI print "as expected" tomorrow, fears of potential "runaway" inflation would likely abate. Make no mistake though, all eyes are on the FOMC meeting next week. We will see a new Fed "dot-plot" and revised economic projections – both are key factors in determining the potential path forward for rates. Stay tuned!

Chart 1: US RATES SNAPSHOT: 11:00 AM Eastern

GV Ask/Chg			SOFR/GV		SOFR OIS	
			-10.7600	+0.2200	4.4930	+0.0160
3Y	4.348	+0.016	-15.7300	+0.2000	4.1910	+0.0158
4Y	4.261	+0.019	-23.5000	-0.1200	4.0233	+0.0163
5Y	4.167	+0.019	-24.2500	-0.2500	3.9258	+0.0163
7Y	4.177	+0.018	-34.2400	-0.2200	3.8371	+0.0174
10Y	4.174	+0.024	-37.7500	-0.2500	3.7974	+0.0185
20Y	4.436	+0.025	-66.4500	-0.3900	3.7730	+0.0210
30Y	4.341	+0.028	-74.8800	-0.6300	3.5926	+0.0226

UST YIELDS | SOFR SWAP SPREADS | SOFR SWAP RATES

Source: Bloomberg, LLP | 11:00 AM NY Rates Snapshot

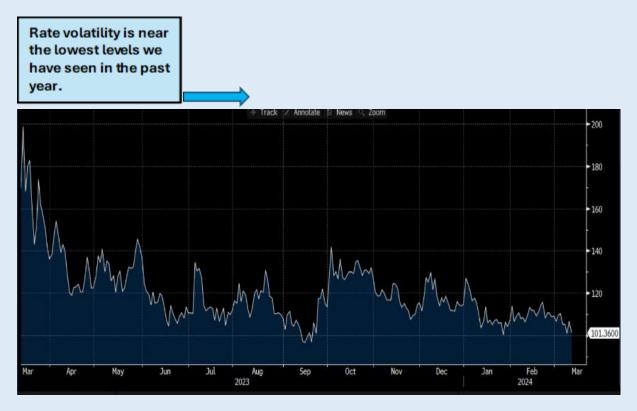


Chart 2 & 2A:

Chart 2: Rate Volatility Subdued Ahead of FOMC Meeting

The Bloomberg graph below details the MOVE volatility index for the prior 12 months. The MOVE index is a composite volatility index that includes US Treasuries and swaps. You can see at the far left of the graph that volatility was at *extremely* elevated levels one year ago during the Silicon Valley Bank debacle, but gradually dropped since then. Currently, rate volatility is very close to the lowest levels we have seen over the prior 12-months. Low volatility environments can be an ideal opportunity to purchase a rate cap.

BLOOMBERG "MOVE" COMPOSITE VOLATILITY INDEX



Source: Bloomberg, LLP | MOVE Volatility Index

Chart 2A: Swap Rates Still Well Below 2023 Highs

Despite the recent uptick in rates as traders repriced forward rate cut expectations, SOFR swap rates remain well below the 2023 highs. The main risk next week is that the Fed's revised "dot-plot" *may* show *fewer* than 3 rate cuts. Currently, the market does not expect the FOMC to revise the "dot-plot" to include more than 3 rate cuts. Consensus is that they hold the "dot-plot" unhanged at 3 potential rate cuts this year, but given the recent inflation uptick and solid economic data, there is certainly the possibility that the Fed could revise the "dot-plot" to reflect fewer than 3 rate cuts this year. Should that happen next week, rates will likely move higher as the market adjusts forward pricing to reflect fewer rate cuts.

2Y (WHITE), 3Y (BLUE), 5Y (ORANGE) & 10Y (PURPLE) SOFR SWAP RATES: PRIOR 6-MONTHS



Despite the recent increase, swap rates remain well below the highs for 2023.



Source: Bloomberg, LLP | SOFR Swap Curve – Prior 6-Months

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