RateCap Advisors

Flash Update: US Rate Markets – Friday 4/5/2024

- **March Employment Report beats expectations; Unemployment Rate 3.8%**
- **Rates move higher in response to the strong jobs number**
- **Odds for a June rate cut hovering at 50/50**
- **Focus shifts to inflation data coming next week; CPI released on 4/10; PPI on 4/11**

Good Morning!

US Treasury yields and SOFR swap rates moved higher on better-than-expected employment data. The strong jobs report makes it more likely that the Fed will hold off on a June rate cut and keep rates higher for longer than market participants anticipated. Rates moved higher, but traders held off on the temptation to overreact to the data. Market participants know that next week's inflation data may be even more important for monetary policy than today's jobs report. A combination of continued strong economic data and an uptick in inflation would make it highly unlikely the FOMC would be prompted to cut rates anytime soon. Speculation is growing that the FOMC will only cut rates twice this year. Next week's inflation data is *critical*. Should we see another uptick in inflation, you may actually begin to hear whispers of a potential FOMC rate *hike*!

Overall, today's Employment Report underscores the strength of the job market within the broader context of a US economy that has continued to be largely resistant to the effects of higher rates. Market participants and investors are also being reminded that the FOMC *does not alter monetary policy on a whim, or on some set schedule*. The Fed has been using the "higher-for-longer" terminology for *months* – probably even longer than that. It should no longer surprise the market that the Fed is prepared to hold rates at these levels for as long as necessary to stifle inflation.

Expect rates to be biased higher for the near term. SOFR swap rates will likely stay near the top of the recent range or drift higher as we await next week's inflation data.

TABLE 1: *FED SPEECH CALENDAR FOR FRIDAY 4/5*

Date Time	A	M	R	Event
04/05 08:30				Fed's Collins Gives Opening Remarks
04/05 09:15				Fed's Barkin Speaks on Economic Outlook
04/05 11:00				Fed's Logan Speaks at Duke University
04/05 12:30				Fed's Bowman Speaks on Risks in Monetary Policy

Source: Bloomberg, LLP | Fed Speech Calendar For April 5, 2024

Chart 1: *US RATES SNAPSHOT: 10:30 AM Eastern*

UST YIELDS | SOFR SWAP SPREADS | SOFR SWAP RATES

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GV Ask/Chg			SOFR/GV		SOFR OIS	
2Y	4.711	+0.064	-9.0100	+0.0500	4.6222	+0.0643
3Y	4.519	+0.058	-15.7300	+0.5800	4.3635	+0.0652
4Y	4.427	+0.058	-22.7800	+0.2200	4.2114	+0.0624
5Y	4.357	+0.061	-23.7400	+0.0100	4.1209	+0.0602
7Y	4.371	+0.061	-33.2300	-0.1000	4.0388	+0.0593
10Y	4.371	+0.063	-37.3800	-0.2500	3.9989	+0.0590
20Y	4.633	+0.057	-66.6000	-0.2500	3.9673	+0.0513
30Y	4.529	+0.052	-74.7300	-0.5500	3.7820	+0.0470

Source: Bloomberg, LLP | 10:30 AM NY Rates Snapshot

Chart 2A & 2B: ***March Employment Report Recap***

Chart 2A and 2B recap today's Employment Report. US payrolls rose in March by the most in nearly a year and the unemployment rate dropped, pointing to a strong labor market that continues to power the economy.
Payrolls advanced 303,000 last month - the rise exceeded expectations. The unemployment rate fell to 3.8% and average hourly earnings increased 0.3% for the month, in line with economist's expectations. Job growth in March was led by faster hiring in health care, leisure and hospitality, and construction.

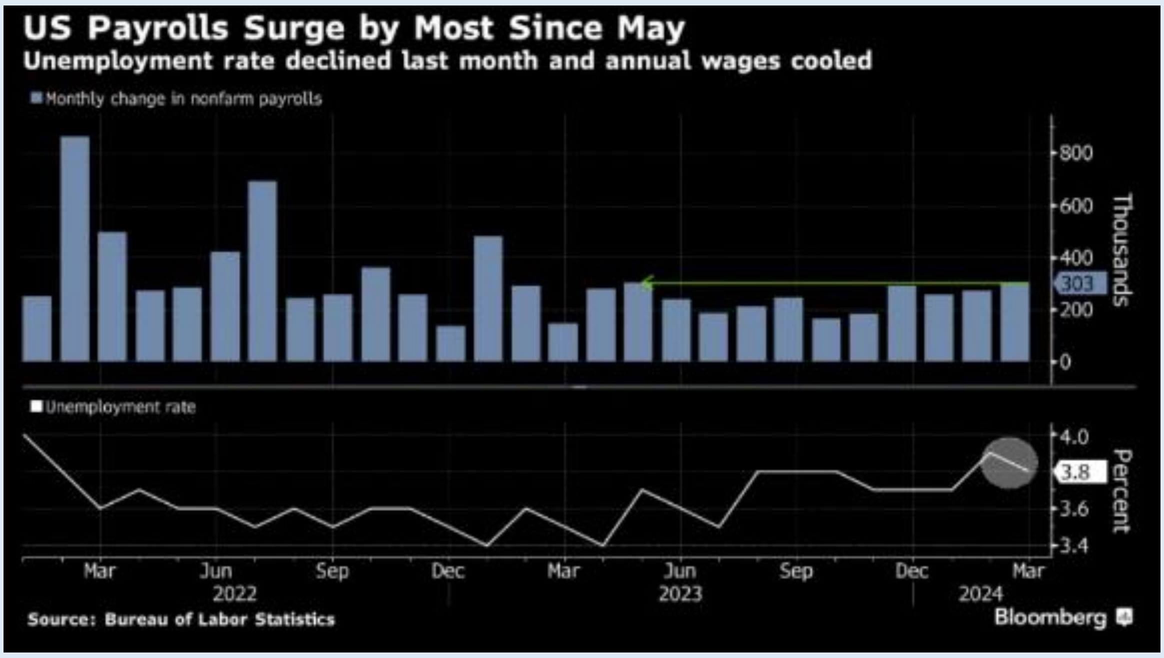
Today's employment data underscores the strength of the US labor market. We continue to see new job creation and labor participation also beat estimates. The strong employment report was largely anticipated by the market, but the increase in payrolls caught the market by surprise. The market reaction was higher rates. Today's jobs data makes it more likely the Fed will remain in a "wait-and-see-mode" for longer than anticipated by the market. It was not necessarily groundbreaking news - odds for a June rate cut are still hovering at 50/50. However, it did push swap rates toward the top of the recent range and will keep rates biased higher, especially with next week's inflation data looming.

Chart 2A – March Employment Report Summary

Metric	Actual	Estimate
Change in payrolls (MoM)	+303,000	+214,000
Unemployment rate	3.8%	3.8%
Average hourly earnings (MoM)	+0.3%	+0.3%

Source: Bloomberg, LLP | March Jobs Report

Chart 2B – Employment Report Historical Detail – Payroll Growth Surges



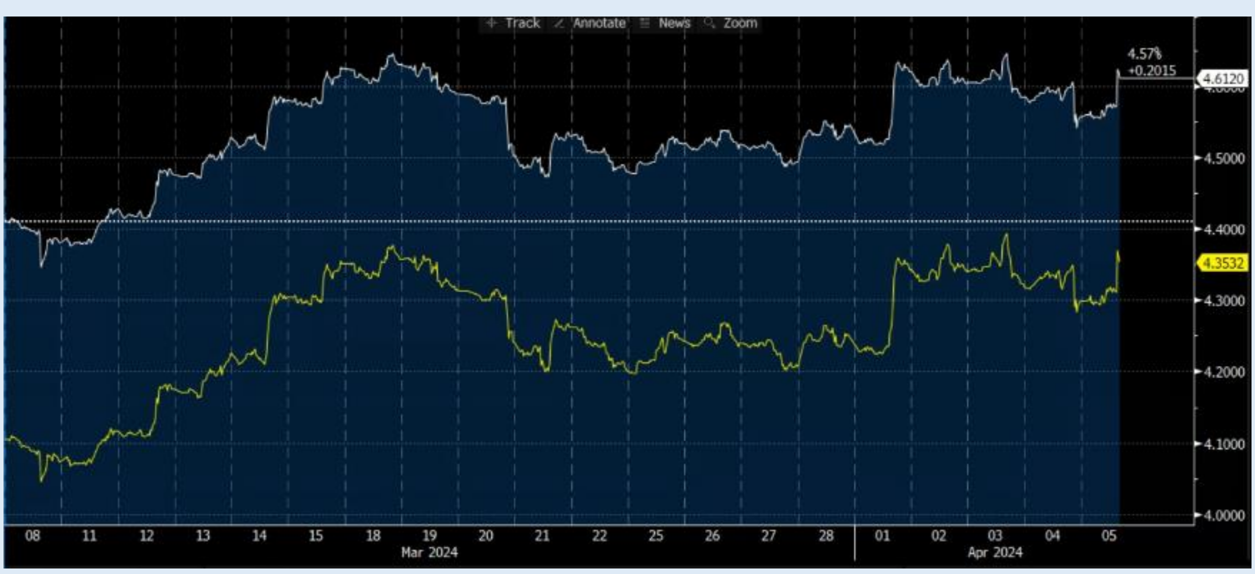
Source: Bloomberg, LLP | Employment Report Historical Detail

[Chart 3:]{.underline} ***Swap Rates Move Higher on Strong Jobs Data***

SOFR swap rates immediately jumped higher after the employment data was released. The market expected a strong number, but as mentioned, the payrolls component (+303k) dramatically exceeded expectations. That caught the market's full attention. A payrolls number above 200k is considered strong – above 300k is robust. Although wages stabilized, a positive sign the Fed wants to see, wages grew in March at a solid 0.3%.

I also wanted to point out that there are many factors that impact rates – not just the FOMC. Yes, an active FOMC can and will have a dramatic impact on the market. However, keep an eye on geopolitical developments and remember we are heading into US election season. The energy markets have been volatile recently as well. There are many factors that can impact rates for the remainder of 2024. The lead factor will be the FOMC, but there are a number of wildcards to monitor as well. For example, from my perspective that is the primary reason equity markets are rallying today. Despite the delayed rate cuts implied by today's data, the strong economic data cannot be ignored by equity traders.

2Y & 3Y SOFR SWAP RATES – PRIOR 30 DAYS



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Source: Bloomberg, LLP | 2Y & 3Y SOFR SWAP RATES PRIOR 30 DAYS

Product Update:

Week of 4/1/24 - *What We Are Seeing In The Rates Market*

New cap volume continues to increase as do borrowers seeking to extend existing caps. 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. We are also seeing increased demand for interest rate floor indications – to offset high loan floors or simply to benefit from declining variable rates.

Given the uncertainty that still 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 recently 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 rate 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 payout 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.

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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.

Disclaimer: *The information provided in this communication is intended for discussion purposes only. Nothing presented in this communication should be taken as a recommendation or forecast. All market data shown is indicative only and subject to change depending on current market conditions.*

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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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