Flash Update: US Rate Markets – Wednesday 1/15/2025

- **SOFR swap rates and US Treasury yields drop on softer-than-expected CPI inflation data**
- **Core CPI eased for the first time in six months; The softer CPI data calms growing inflation fears…for now**
- **Next Up for data: December Retail Sales & Weekly Jobless Claims are due tomorrow at 8:30 AM**
- **The next FOMC rate decision is due on January 29th at 2:00 PM**
- **The Fed is expected to hold rates steady at the January meeting**
- **With today's rate move, current market pricing now implies a 25 bp rate cut in July**
- **Short-end SOFR swap rates are trading ~10-12 bps lower than last night's closing levels**
- **Long-end swap rates are down ~10-14 basis points this morning**

Good Morning – US Treasury yields and SOFR swaps rates gapped lower this morning (See Chart 1) after a softer-than-expected December CPI report (See Chart 2) calmed market fears that core inflation was poised to move higher. Core CPI declined for the first time in six months and average hourly earnings also declined, a positive sign for wage inflation. This morning's inflation report also had implications for market rate cut expectations – traders once again fully priced in a 25 bp rate reduction as soon as July (See Chart 2A). SOFR swap rates are down ~10-14 basis points this morning, providing some relief on cap premiums.

Next up for data is tomorrow's release of the December Retail Sales report at 8:30 AM, which will provide a glimpse into consumer spending during the December holiday season. Expectations for Headline Retail Sales are calling for 0.6% MoM (vs. 0.7% prior) and Retail Sales ex-autos of 0.5% (vs. 0.2% prior). The December Retail Sales report is anticipated to show that the US consumer remained resilient to close-out 2024.

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

SOFR Swap Rates & Change-On-Day (In Bps) Two Far Right Columns

UST YIELDS			SWAP SPREADS		SOFR SWAP RATES	
2Y	4.268	-0.099	-13.7720	-0.0639	4.1313	-0.1002
3Y	4.345	-0.123	-21.8995	+0.0555	4.1270	-0.1254
4Y	4.424	-0.143	-26.3750	-0.0305	4.1346	-0.1364
5Y	4.449	-0.147	-30.7500	+0.3636	4.1434	-0.1422
7Y	4.553	-0.153	-39.0500	+1.1159	4.1624	-0.1406
10Y	4.653	-0.140	-46.6000	+0.5250	4.1890	-0.1325
20Y	4.945	-0.114	-72.0870	+0.7848	4.2234	-0.1086
30Y	4.875	-0.099	-82.3700	+0.2323	4.0529	-0.0968

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

CHART 2 & 2A: DECEMBER CPI BEATS EXPECTATIONS; RATES DROP IN RESPONSE

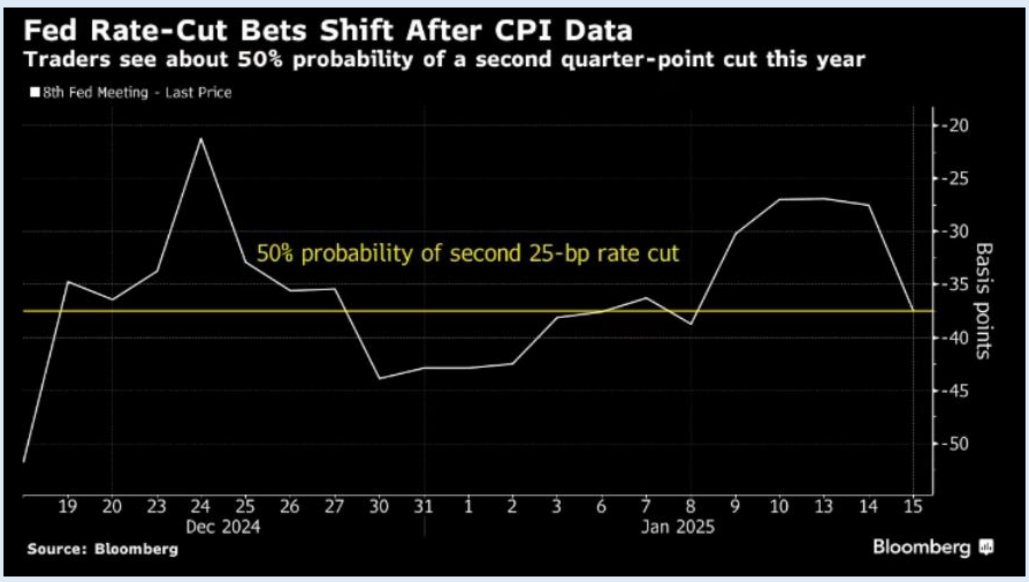
US consumer prices rose in December by less than forecast after months of faster underlying inflation – December Core CPI increased 0.2% after four straight months of 0.3% growth. YoY core CPI also posted lower-than-expected at 3.2%, vs. 3.3% forecasted. Market participants welcomed the news, but Fed officials will likely need to see a series of subdued readings to reassure them that inflation progress has resumed. The FOMC is expected to leave interest rates unchanged at their meeting later this month, and traders do not see another cut until later this year. Core CPI — which excludes food and energy costs — increased 0.2% after rising 0.3% four straight months. The data revealed that cheaper hotel stays, a smaller advance in medical care services and *relatively* tame rent increases helped restrain the December figure. From my perspective, the story today is that core inflaton is *not* accelerating. At least for now…

CHART 2: ***December CPI Prints Lower-Than-Expected, Calming Inflation Fears…For Now***

Metric	Actual	Estimate
CPI MoM	+0.4%	+0.4%
Core CPI MoM	+0.2%	+0.3%
CPI YoY	+2.9%	+2.9%
Core CPI YoY	+3.2%	+3.3%

Source: Bloomberg, LLP | December CPI Recap

CHART 2A: ***Fed Rate Cut Expectations Shift Again – Rate Cut Now Anticipated In July; Odds For A Second 25 BP Rate Cut Increase***



Source: Bloomberg, LLP | Market Fed Rate Cut Expectations For 2025 (As of 1/15/2025)

CHART 3 & 3A: CPI RECAP – SOFT DECEMBER CPI PRINT SENDS RATES MATERIALLY LOWER

SOFR swap rates and US Treasury yields plunged this morning after the favorable CPI data. The forward curve also repriced Fed rate cut expectations – traders now see the next rate cut in July. As of Tuesday morning, traders did not expect another rate cut until *September*! Today's rate move clearly illustrates that the market was *very* apprehensive about the path forward for inflation – and by extension, for rate cuts. Today's soft CPI print definitely takes some of the pressure off of rates and has rekindled hopes for two 25 bp rate cuts this year (See Chart 3A). Note, the Fed's "dot-plot" shows two rate cuts penciled in for this year, so market and Fed expectations are pretty closely aligned at the moment.

A strong Retail Sales report tomorrow could rain on the post-CPI parade. As we know, the US consumer has been one of the driving forces behind an incredibly resilient US economy. A strong number tomorrow could see rates reverse and tick higher. That said, the labor market and inflation are the two dominant themes for the FOMC, so the market could shake-off an "as expected" Retail Sales print and focus on the positive inflation data. In that case we might see rates drift slightly lower. That said, proceed with caution – we still have yet to see the December PCE data (the Fed's preferred inflation gauge), which prints later this month.

CHART 3: ***SOFR Swap Rates Gap Lower After Softer-Than-Forecasted Core CPI Print***

Source: Bloomberg, LLP | 1Y (WHITE), 2Y (GOLD) & 3Y (ORANGE) SOFR SWAP RATES, PRIOR (3) TRADING SESSIONS

<u>**CHART 3A:**</u> ***10Y Treasury Yields Drop After CPI Prints***

Source: Bloomberg, LLP | 10Y UST NOTE YIELD REACTION TO DECEMBER CPI REPORT

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