

Flash Update: US Rate Markets - Friday 5/31/2024

- April PCE prints as expected across the board, signaling inflation has stabilized
- Personal Income figures came in as expected, but Personal Spending unexpectedly cools-off
- Market reaction was lower rates; Rates are down ~3-6 bps across the swap curve
- Forward pricing barely adjusts; Market comfortable with current forward pricing
- Current forward pricing implies ~40 bps of interest rate cuts this year, or just under two 25 bp rate cuts
- The data this morning provides the Fed some breathing room to cut rates later this year
- Market will now look ahead to the June 12th FOMC meeting and the release of the new "dot-plot"
- Next week's data will also be a primary focus for the market; Employment Report released 6/7

April PCE data printed "as expected" across the board, and Consumer Spending unexpectedly softened. SOFR swap rates and bond yields drifted lower in response, as stable inflation and a cooldown in spending reinforced bets policymakers will have room to cut rates this year. Core PCE, which strips out the volatile food and energy components, increased 0.2% from the prior month. From a year ago, the measure rose 2.8%. Inflation-adjusted consumer spending unexpectedly fell 0.1% from the prior month. A disappointing Chicago PMI print also contributed to lower rates this morning.

Rates had a somewhat muted response to the data – the market's reaction felt more like a sigh of relief! Worries that another uptick in inflation would wipe out any chance for a rate cut this year have permeated the market in recent weeks. Hawkish Fed-speak that touched on rate *hikes* in recent weeks did not help market sentiment. Today's PCE and Personal Spending data went a long way towards calming those fears, and validating current forward pricing calling for one (and possibly two) interest rate cuts this year. Current forward pricing implies ~40 bps of rate cuts this year. That tells me the market is confident that the Fed will cut rates by 25 bps once this year, but there is the chance the Fed will be able to cut rates twice later this year.

The June 12th FOMC meeting now has even more significance for the market. Traders will hear from Chairman Powell and we will see the new consensus "dot-plot". Prior to today's data release, there was growing speculation that the new "dot-plot" will only show one potential rate cut this year. Market pricing currently reflects 1.5 rate cuts this year – if the "dot-plot" shows two possible rate cuts this year, rates are likely to move lower. Should the new "dot-plot" show only one, or worse, no potential rate cuts this year, rates will move higher as the forward curve reprices.

CHART 1: US RATES SNAPSHOT: 10:30 AM Eastern

UST YIELDS		SWAP SPREADS		SOFR SWAP RATES	
2Y	4.881 -0.043	-9.5400	-0.0715	4.7871	-0.0459
3Y	4.686 -0.055	-15.9700	-0.2600	4.5279	-0.0548
4Y	4.579 -0.060	-23.0625	-0.2375	4.3675	-0.0585
5Y	4.509 -0.058	-24.0625	-0.0575	4.2690	-0.0595
7Y	4.501 -0.057	-33.0225	-0.1595	4.1732	-0.0588
10Y	4.491 -0.056	-36.7500		4.1234	-0.0566
20Y	4.709 -0.051	-63.2150	-0.0275	4.0780	-0.0520
30Y	4.632 -0.048	-74.7518	-0.1268	3.8845	-0.0495

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



Note: First column is the current market level, second column is the change on the day; 'Red' = Lower; 'Green' = Higher; 'White' denotes active trading

CHART 2A & 2B: PCE Recap - PCE Prints As Expected, But Spending Unexpectedly Cools

April PCE printed as expected, calming market fears that inflation would continue to tick higher. Today's data showed (hopefully!) that inflation has stabilized, after several successive months of missing expectations to the upside. Progress on inflation was interrupted in the first quarter of 2024, so traders are encouraged that inflation will resume a downward trend. That is certainly a big assumption, which partially explains the muted reaction to the data this morning, Yes, traders were relieved, but there is still lingering suspicion that inflation will plateau here and progress will stall. Although Fed officials have clearly leaned hawkish recently, they have not been crystal clear on what they will do should inflation stick at these levels.

The tremendous progress on inflation the Fed has orchestrated, while preserving and even growing the economy, cannot be understated. That leads me to believe that the Fed may not hold to the 2.00% target, particularly if growth and the jobs market continue to weaken. They may reach a conclusion that inflation "close to" or "moving towards" 2.00% is acceptable, and that may be good enough to prompt them to cut rates. That makes next week's Employment Report even more critical than usual.

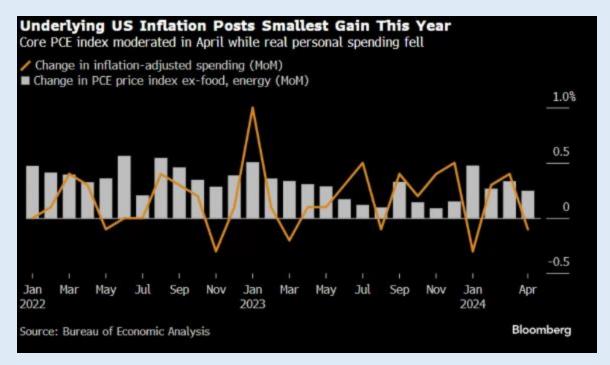
Chart 2A: PCE RECAP

Metric	Actual	Estimate	
PCE price index (MoM)	+0.3%	+0.3%	
Core PCE price index (MoM)	+0.2%	+0.2%	
PCE price index (YoY)	+2.7%	+2.7%	
Core PCE price index (YoY)	+2.8%	+2.8%	
Real consumer spending (MoM)	-0.1%	+0.1%	

Source: Bloomberg, LLP | PCE RECAP TABLE

Chart 2A: HISTORICAL PCE





Source: Bloomberg, LLP | HISTORICAL PCE SINCE JANUARY 2022

CHART 3: SOFR Swap Rates Drop As Inflation Stabilizes And Spending Cools-Off

SOFR swap rates dropped slightly this morning after data showed a stabilization in inflation and weaker-than-expected consumer spending. Swap rates immediately moved lower after the number printed, but then quickly leveled off. The reaction to today's data felt like relief. Traders were growing increasingly worried that inflation was trending the "wrong-way". Today's PCE data assuaged those fears, at least for the time being. The softer consumer spending was an added bonus. The encouraging PCE data and softer consumer spending bolstered hopes that the Fed will have some breathing room to cut rates later this year.

The scale of the below graph is somewhat deceiving – 2Y SOFR swap rates are only down ~4-5 bps from last night's close – not a dramatic move by any means, but certainly directionally significant. The market clearly wants to believe that the Fed will be prompted to cut rates this year. The drop in rates yesterday and today tells me that traders are prepared to adjust rates down quickly to accommodate Fed interest rate cuts. The big question now is what will the Fed have to say about this at the June 12th meeting? And almost as important, what will the new consensus "dot-plot" show?

Next week is another important week for data and Fed officials will enter the pre-meeting "quiet period", so we won't really hear from Fed officials until after the meeting. We will see a wide range of economic and inflation data: ISM Manufacturing Prices Paid on 6/3, Factory Orders and Durable Goods on 6/4, ISM Services Prices Paid on 6/5 and the main event for the week, the Employment Report on 6/7. We also see a host of secondary numbers as well. More to come on that next week.

Chart 3: SOFR SWAP MARKET REACTION TO THIS MORNING'S PCE DATA





Source: Bloomberg, LLP | 2Y SOFR SWAP RESPONSE TO PCE

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