<u>Flash Update:</u> US Rate Markets – Tuesday 7/16/2024

- **June Retail Sales data prints better-than-expected; Rises by the most in three months**
- **Data signals US consumer remains resilient**
- **Rates barely react to Retail Sales numbers, as traders assess the prospects for rate cuts this year**
- **SOFR swap rates have traded in a tight range this week**
- **Short-end SOFR swap rates ticked higher this morning on the positive Retail Sales news**

June retail sales rose by the most in three months, suggesting resilient consumer spending at the end of the second quarter. Retail purchases excluding motor vehicles rose 0.4% last month, following an upwardly-revised 0.1% advance in May. Total retail sales were unchanged, restrained by a drop in receipts at auto dealers. The data reversed a trend in recent months showing a gradual slowdown in consumption growth as consumers feel the pinch of high interest rates and a cooling labor market, suggesting the economy's main driver is still holding up as inflation recedes and the Federal Reserve nears a start to rate cuts. SOFR swap rates largely shrugged-off the data this morning, as traders pause to assess the latest economic data series results. Optimism for a potential third rate cut this year gained momentum after last week's CPI data showed a decrease in retail inflation. However, a disappointing PPI print and a resilient consumer have tempered that view and caused market participants to back-off the prospect of a third rate cut this year.

Chairman Powell spoke yesterday at the Economic Club of Washington DC. The Fed chief said second quarter economic data has provided policymakers greater confidence that inflation is heading down to the central bank's 2% target, but made it crystal clear that he did not intend to send any specific message about the timing of rate reductions. Powell's remarks helped to pause rates and dampen any growing enthusiasm for a third rate cut. SOFR swap rates are likely to trade in a tight range until the market sees additional economic data.

There are several Fed officials on the tape this week, but the market is gearing up for the "quiet period" that begins on 7/22. Fed officials will be blacked out until after the FOMC meeting concludes on 7/31 at 2:00 PM. Traders will be listening to Fed-speak this week for any clues on the timing and magnitude of rates cuts. That said, traders will be eagerly anticipating Powell's comments on 7/31. Market participants are hoping to get an accurate reading from Powell on the potential for a September rate cut.

<u>CHART 1:</u> *US RATES SNAPSHOT: 10:30 AM Eastern*

	UST YIELDS		SWAP SPREADS		SOFR SWAP RATES	
2Y	4.459	+0.002	-18.0860	+0.0866	4.2790	+0.0028
3Y	4.235	+0.000	-20.7390	+0.2252	4.0282	+0.0017
4Y	4.153	-0.013	-28.1860	+0.1910	3.8955	-0.0057
5Y	4.118	-0.013	-29.3851	+0.2665	3.8257	-0.0113
7Y	4.140	-0.024	-37.1570	+0.6070	3.7705	-0.0178
10Y	4.200	-0.028	-43.7300	+0.5156	3.7642	-0.0238
20Y	4.512	-0.043	-72.4987	+1.0946	3.7881	-0.0323
30Y	4.413	-0.044	-78.6192	+0.9148	3.6279	-0.0357

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*

<u>CHART 2 & 2A:</u> June Retail Sales Recap: Largest Increase In Prior 3-Months; Market Shrugs-Off The Data

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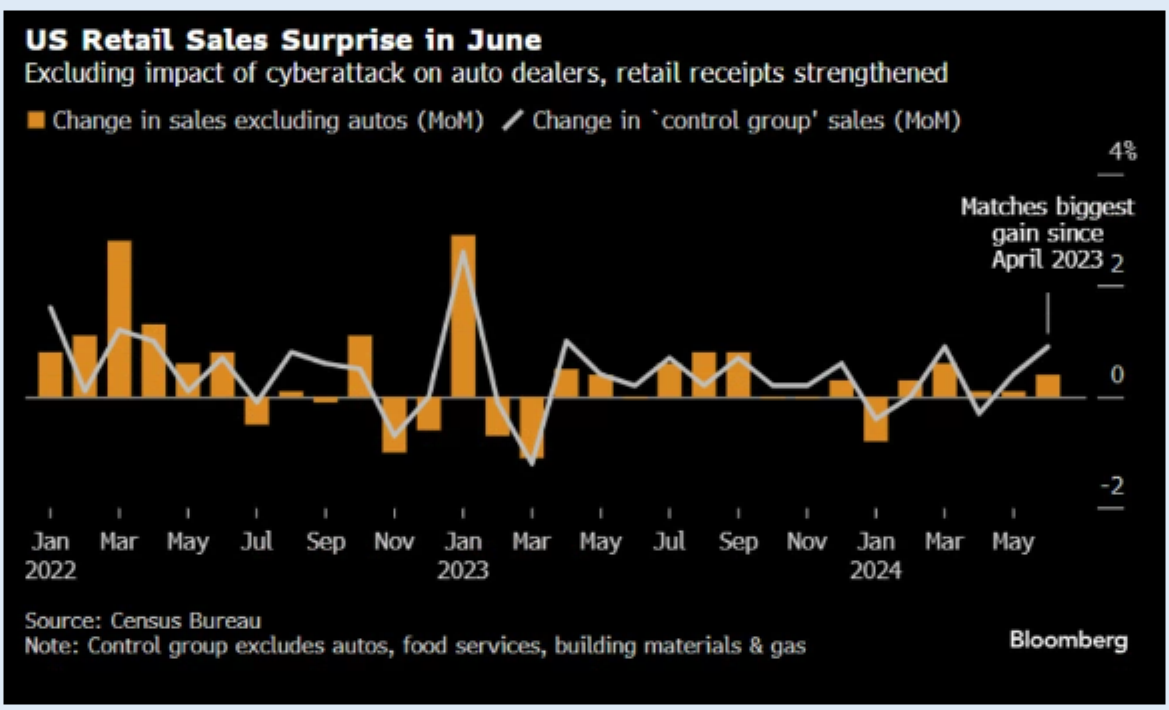
June US Retail Sales, excluding the impact of a cyberattack on auto dealerships, rose in June by the most in three months, a sign consumers regained their footing at the end of the second quarter. Retail purchases less motor vehicles rose 0.4% last month after an upwardly-revised 0.1% advance in May. Total retail sales were unchanged. The better-than-expected consumer data surprised market participants expecting a decline in MoM retail sales. Rates barely moved after the data release, as market participants paused to assess the big picture for US economic data.

<u>CHART 2:</u> JUNE RETAIL SALES RECAP

	Actual	Median	Survey Range	Prior
Overall	0.0%	-0.3%	-0.6% to 0.3%	0.3%
Ex auto	0.4%	0.1%	-0.3% to 0.4%	0.1%
Ex auto/gas	0.8%	0.2%	-0.1% to 0.5%	0.3%
Control group	0.9%	0.2%	-0.3% to 0.5%	0.4%

Source: Bloomberg, LLP | RETAIL SALES Recap

<u>CHART 2:</u> RETAIL SALES HISTORICAL DATA



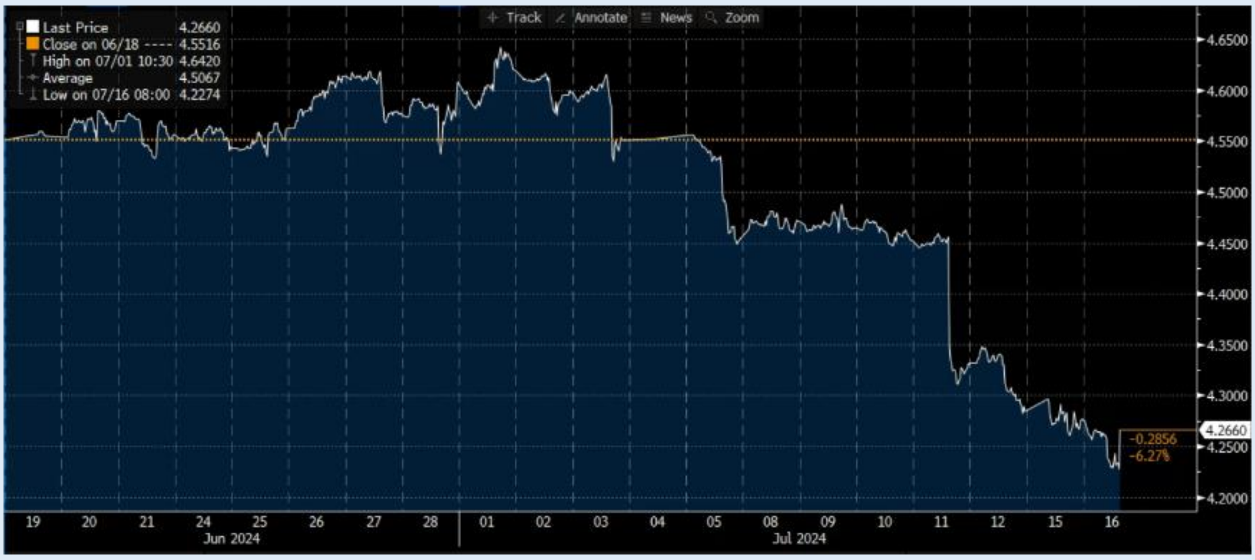
Source: Bloomberg, LLP | RETAIL SALES Historical Data Since January 2022

<u>CHART 3:</u> Retail Sales Data Barely Moves Swap Rates

SOFR swap rates had a muted reaction to this morning's Retail Sales data release. Short-end SOFR swap rates were mostly unchanged from last night's closing levels. Longer term swap rates ticked a bp or two higher on the positive economic news. Over the prior 30 days the market has moved lower on optimism that the FOMC will cut rates 25 basis points twice this year.

RateCap Advisors

2Y SOFR SWAP – PRIOR 30 DAYS



Source: Bloomberg, LLP | 2Y SOFR SWAP – PRIOR 30 DAYS

<u>RCA Product Update:</u>

<u>Week of 7/15/2024</u> - *What We Are Seeing In The Rates & Derivatives Markets*

Markets are extremely volatile and there could be even more volatility on the horizon. Borrowers should be as nimble as possible in this market environment. Cap purchasers should onboard as quickly as possible – there is no cost to onboard. It is important to be in a position where you can take advantage of market opportunities quickly and efficiently. We have all seen how fleeting these opportunities can be, so it is important to be ready to execute.

New cap volume continues to increase slightly, as does existing cap extension volume. Despite a shift in market pricing regarding Fed rate cuts, the forward curve is *still* pricing in ~2 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 rates are going down next year.

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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.

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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