AST DEFEASANCE RATE MARKET UPDATE

Thursday, March 23, 2023

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for April 18, 2023. Please let us know if you would like additional market color or have any questions. We are also always happy to provide indications for your defeasance needs, or for interest rate caps, swaps or other derivative hedging products. Please feel free to reach out anytime! *-RCA | AST Interest Rate Hedging Desk*

RATE MARKET UPDATE: April 18, 2023 | Housing Data Mixed, All Eyes on FOMC

- **Housing Starts Data released this morning was mixed but overall softer than forecast**
- **Market reaction to data was relatively muted**
- **SOFR swap rates across the curve are down ~5 bps**
- **Bank earnings season continues; So far, so good!**
- **Market gearing up for May 2 FOMC meeting**

US Treasury and SOFR swap rates opened lower this morning as Housing Starts data posted weaker than forecast. Upon closer inspection however, traders viewed the housing data as mixed and the overall market reaction to the data was muted. SOFR swap rates across the curve are down approximately 5 basis points this morning. Bank earnings season continues, so the market will be monitoring the banking sector closely. So far, there have not been any major bank earnings surprises, but as we have discussed the banking crisis is likely to have a lagging effect on bank earnings and a long tail. Bank earnings and loan portfolio performance will remain front and center for the foreseeable future. Also of note, there are 5 Fed officials scheduled to give public speeches on Thursday. Fed-speak recently, although softening somewhat, has remained hawkish. Fed officials are approaching the pre-meeting blackout period, so these speeches will be some of the last comments we get from Fed officials prior to the May 2 meeting. The market will be paying attention. We expect to see periods of elevated volatility but rates are likely to remain in a range ahead of the FOMC. That said, the rates market is definitely susceptible to headline risk and has been prone to overreact recently to Fed-speak and data.

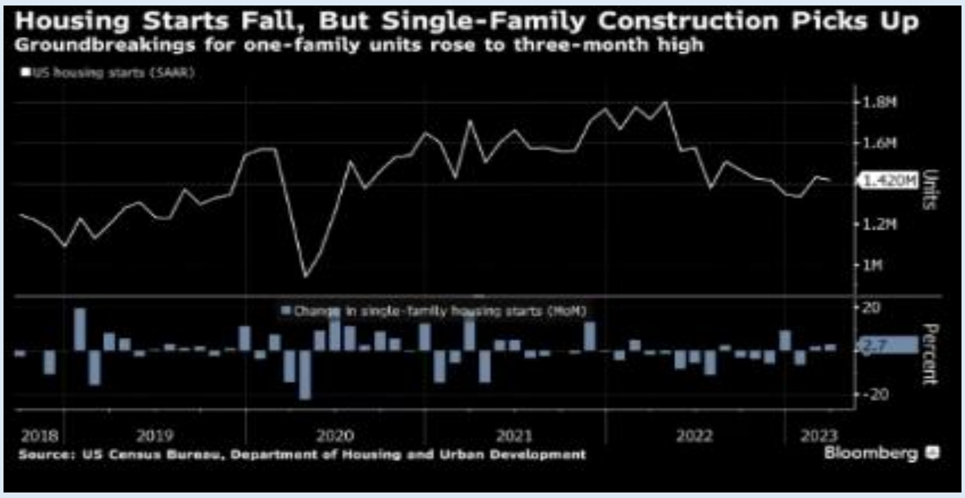
CHART 1: 1Y, 2Y & 3Y SOFR Swap Rates – Prior 30 Days

The Bloomberg chart below details 1Y (green line), 2Y (white line) and 3Y (blue line) SOFR swap rates for the past 30 days. The major takeaway from this chart is that swap rates, despite periods of tremendous volatility over the prior 30 days, have increased back to the levels they were one month ago.

1Y, 2Y & 3Y SOFR SWAP RATES: PRIOR 30 DAYS

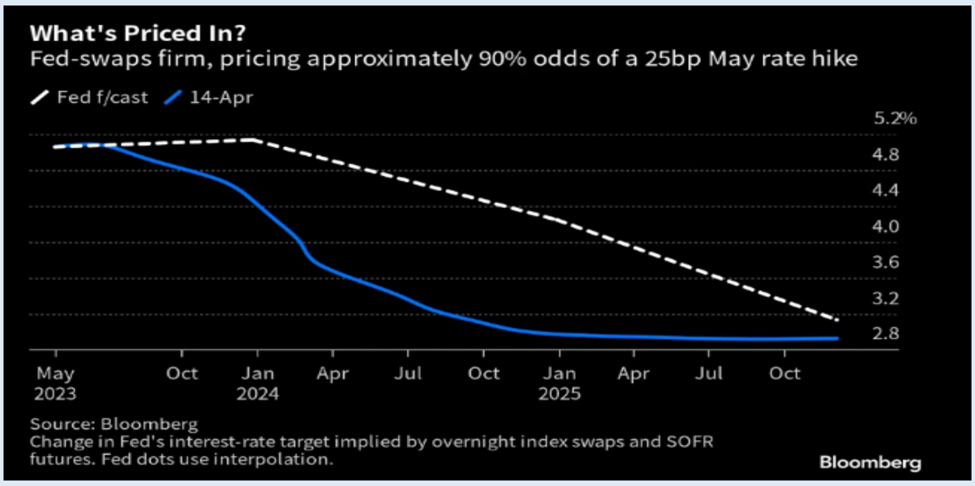
CHART 2: Housing Starts Data Mixed; Overall, Housing Data Weaker Than Forecast

The Bloomberg chart below shows historical US Housing Starts data for the past 5 years. US housing starts fell in March as a pullback in multifamily projects offset an increase in construction of single-family homes. New home construction fell 0.8% to a 1.42 million annualized rate. Multifamily starts dropped 5.9%, while single-family homebuilding increased 2.7% to a three-month high. The rise in single-family home construction may reflect builders' efforts to create demand after a surge in borrowing costs last year sidelined many prospective buyers. With home inventories constrained in the resale market, homebuilders may have an opportunity to fill the void with new construction. However, the industry will no doubt face headwinds that include tighter loan and credit standards for borrowers and mortgage rates that are twice as high as they were at the end of 2021. The housing market will likely stay in focus as the year progresses, particularly if the FOMC does in fact hold rates higher for longer.



<u>CHART 3:</u> FOMC Expectations vs. Fed "Dot Plot"

The Bloomberg chart below shows the market expectations (blue line) for forward rates vs. the Fed's dot plot forecast (white dashes). You can see that the FOMC and the market arrive at the same destination but via very different routes. The market is expecting rate cuts beginning in the second half of 2023 – the FOMC dot plot shows at least one more rate hike and them a sustained period at the terminal rate. The FOMC dot plot does not currently contemplate a rate cut until ~June 2024. The current dichotomy between the FOMC and the market portends more volatility on the horizon. There are numerous factors impacting rates at the moment and there is still a large amount of uncertainty in the market. Traders have grudgingly accepted there will be a 25 bp hike at the May meeting and are currently pricing in a 90% chance that happens. Beyond that, the chart below evidences the gulf between the market and the FOMC with respect to forward rates. Fed-speak has remained hawkish – the Fed has been adamant that they will continue to raise rates to battle inflation if necessary. As mentioned there are a number of Fed officials speaking this week – we will see if their comments provide any further clarity. Stay tuned!



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