AST DEFEASANCE RATE MARKET UPDATE

Wednesday, August 23, 2023

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for August 23, 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, swaptions or other derivative hedging products. Please feel free to reach out to us anytime!

RATE MARKET UPDATE:

- **Rates open lower as traders reprice FOMC expectations**
- **Market looking ahead to Chairman Powell's speech on Friday morning**
- **U.S. housing data weaker on higher rates and low inventory**

U.S. Treasury and SOFR swap rates opened lower this morning as traders weighed weaker than expected U.S. housing data and looked ahead to Chairman Powell's keynote speech on Friday morning. At the moment, SOFR swap rates are 9-12 basis points lower than yesterday's close *(See Chart 3)*.

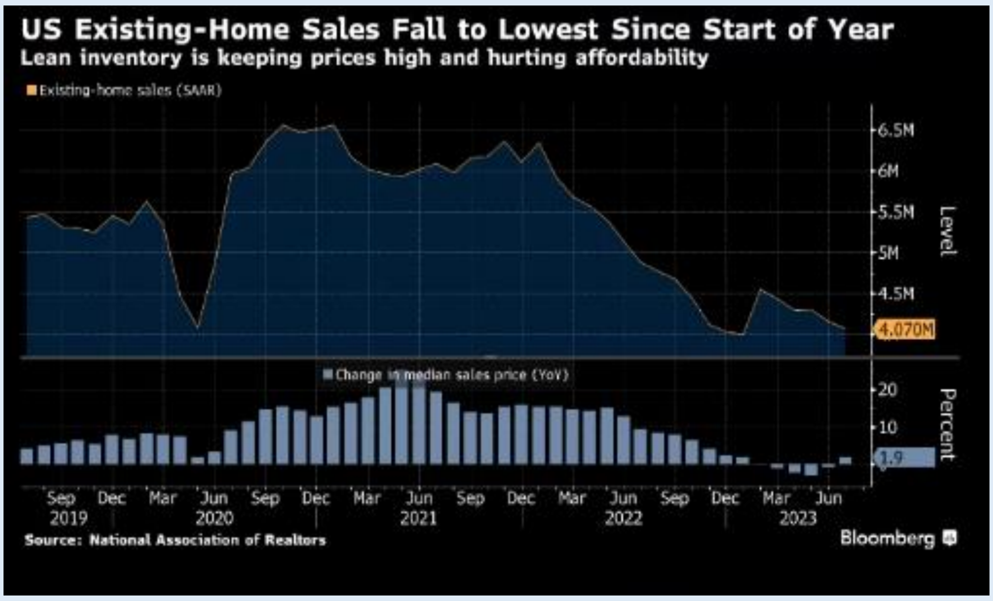
Weaker U.S. housing data *(See Charts 1 & 2)*, cooler employment data and concerns about a global economic slow-down have prompted traders to rethink the probability of additional FOMC rate hikes this year. Rates have slowly drifted higher since the July FOMC meeting as the market still anticipated one or possibly two more 25 bp rate hikes – today's rate move has basically priced-*out* the possibility of a rate hike in September. Given recent economic data and the disinflation trend we have witnessed recently, a FOMC pause is now a distinct possibility.

The "Jackson Hole" Fed-sponsored economic symposium is scheduled for 8/24-8/26. This is a globally watched event and many prominent global business figures, economists and central bankers will be in attendance. Chairman Powell will give the keynote address on Friday morning at 10 AM eastern. While the annual Jackson Hole gathering is always a "big event", the symposium has added significance this year given the uncertainty that still surrounds the forward path for monetary policy. A resilient U.S. economy has prompted market participants to position for the Fed to keep borrowing costs elevated. We have seen a slow but steady increase in rates since the July Fed meeting and the swap curve has flattened somewhat, indicating the market is gaining confidence the Fed will be able to engineer lower inflation without causing a severe economic downturn. However, as we have seen today, the market is still data sensitive and is once again toning down expectations for another rate hike this year.

The market will be looking once again to The Chairman for clarification on forward monetary policy, particularly on how long the Fed plans to hold rates at current levels or slightly higher. This is a key crossroads for the Fed – they have worked hard to gain the credibility they now enjoy – Powell must be careful not to sound *too* dovish and risk losing market confidence, but he must also not appear *too* hawkish given inflation is clearly in decline. The other significant risk for the Fed to consider is that the market "gets ahead" of the Fed and we see term rates move lower *prior* to any actual rate cuts. A premature market-driven "easing" could re-stimulate the economy and rekindle inflation – the *last* thing the Fed wants.

CHART 1: U.S. Existing-Home Sales Slide Lower

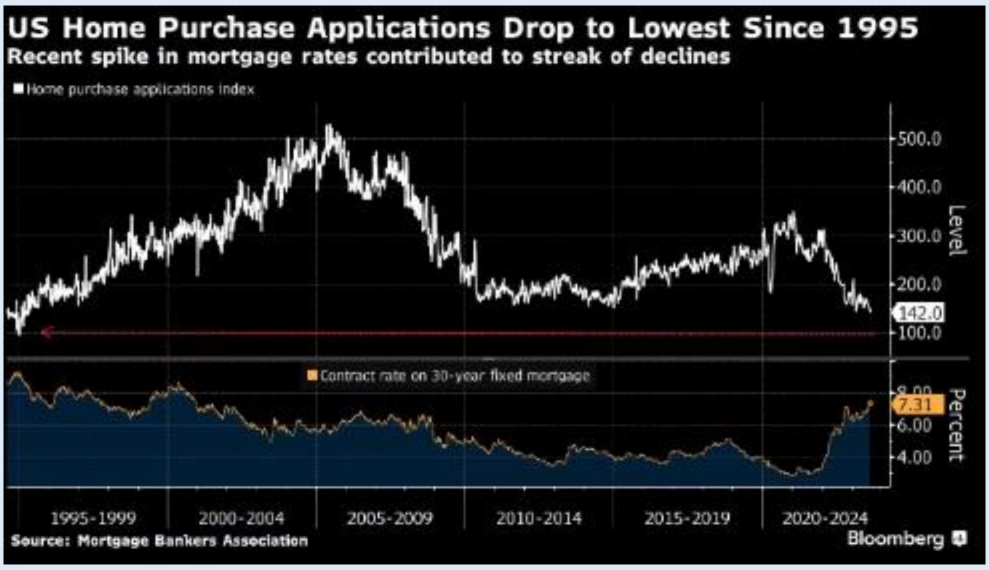
Existing Home Sales in July fell to the lowest level since the start of 2023, due mainly to low inventory and higher borrowing costs. The FOMC's tight monetary policy has led to a more than doubling of mortgage rates over the past two years. Higher mortgage rates have discouraged homeowners from listing their properties and have kept existing inventory asking prices elevated. Given 30-year fixed mortgage rates have recently topped 7.00%, demand will likely continue to struggle. The combination of extremely low inventory and dramatically higher rates will continue to drag on the housing market for the foreseeable future. Please see the below Bloomberg graph for details.



Source: Bloomberg, LLP

<u>CHART 2:</u> Home Purchase Applications Continue to Dwindle

Mortgage applications for home purchases fell last week to the lowest level in almost 30 years, indicating U.S. residential real estate is reeling from the recent spike in borrowing costs. The index of home-purchase applications fell 5% to 142, the lowest level since 1995. The 30-year fixed mortgage rate increased ~15 basis points to ~7.31% last week, the highest level since 2000. Higher rates are clearly discouraging U.S. residential buyers and leading to the significant decline in new home purchase applications. Please see the below Bloomberg chart for graphical detail on the data.



Source: Bloomberg, LLP

<u>CHART 3:</u> 2Y, 3Y & 5Y SOFR Swap Rates – Prior 30 Days

You can see from the below Bloomberg graph that rates *had* steadily drifted higher since the July FOMC meeting. This week, weaker than expected economic data has prompted traders to rethink forward FOMC policy. As mentioned, today's swap rate move indicates the market firmly expects a pause from the Fed in September – and possibly a move to a neutral policy, which would signal end of any further rate hikes. We will see what Mr. Powell has to say about all this on Friday morning, and the Fed will see additional data ahead of the September 20th FOMC meeting. *Stay tuned!*

Source: Bloomberg, LLP

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

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Rate Cap Advisers 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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