AST DEFEASANCE RATE MARKET UPDATE

Friday, July 28th 2023

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for July 28, 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! *-RCA | AST Interest Rate Hedging Desk*

RATE MARKET UPDATE:

- **FOMC raises benchmark rate 25 bps to 5.25%**
- **Fed moves to a "data dependent" mode**
- **Powell confirms no rate cuts this year**
- **Rate market reaction to the announcement was muted**
- **PCE and Employment Cost Data this morning was better than excepted causing rates to drop ~5-6 bps**
- **GDP prints better than forecast at +2.40% (+1.80% expected)**

Economic Data Released this Morning:

The inflation and employment cost data released this morning printed better than expected. As a result, rates have dropped ~5-6 bps, basically erasing most of the slow drift higher we saw yesterday for swap rates since FOMC. We don't foresee that these numbers fundamentally change anything for the Fed outlook – even though the inflation data was slightly better than forecasted, we still have a 4 handle on YoY PCE. The market and the FOMC would love to see a 3 handle on that number. Personal income dropped slightly more than expected and personal spending actually increased, which can happen in a declining inflation environment. That said, the numbers this morning were encouraging.

Economic Data

	Date Time	A	M	R	Event	Period	Surv(M)	Actual	Prior	Revised
21)	07/28 08:30				Employment Cost Index	2Q	1.1%	1.0%	1.2%	--
22)	07/28 08:30				Personal Income	Jun	0.5%	0.3%	0.4%	0.5%
23)	07/28 08:30				Personal Spending	Jun	0.4%	0.5%	0.1%	0.2%
24)	07/28 08:30				Real Personal Spending	Jun	0.3%	0.4%	0.0%	0.1%
25)	07/28 08:30				PCE Deflator MoM	Jun	0.2%	0.2%	0.1%	--
26)	07/28 08:30				PCE Deflator YoY	Jun	3.0%	3.0%	3.8%	--
27)	07/28 08:30				PCE Core Deflator MoM	Jun	0.2%	0.2%	0.3%	--
28)	07/28 08:30				PCE Core Deflator YoY	Jun	4.2%	4.1%	4.6%	--

Source: Bloomberg, LLP

Treasury Rates / SOFR Swap Spreads / SOFR Swap Rates

GV Ask/Chg			SOFR/GV		SOFR OIS	
2Y	4.879	-0.049	-7.1300	-0.4300	4.8083	-0.0562
3Y	4.525	-0.057	-12.6500	-0.3900	4.3979	-0.0626
4Y	4.336	-0.057	-21.6300	-0.3800	4.1402	-0.0593
5Y	4.188	-0.050	-20.7200	-0.2200	3.9819	-0.0541
7Y	4.085	-0.051	-27.5400	+0.5400	3.8125	-0.0466
10Y	3.965	-0.033	-26.2500	-0.2700	3.7035	-0.0387
20Y	4.227	-0.020	-63.1800	-0.3000	3.5968	-0.0225
30Y	4.025	-0.014	-65.6300	-0.1300	3.3702	-0.0148

Source: Bloomberg, LLP

RECAP of Wednesday's FOMC Meeting:

The FOMC, as expected, raised the overnight rate 25 basis points at Wednesday's meeting and Chair Jerome Powell left open the possibility of further hikes, which he firmly emphasized will depend on incoming economic data that has recently signaled a resilient US economy. After pausing rate hikes at the June meeting, the Fed lifted borrowing costs again at their policy meeting on Wednesday for the 11th time since March 2022. The 25 bp hike, a unanimous decision, boosted the target range for the Fed's benchmark federal funds rate to 5.25% to 5.5%, the highest level in 22 years. While Chair Powell pointed to encouraging signs that rate hikes are working to curb price pressures, he reiterated that policymakers have a long way to go to return inflation to their 2% goal.

Powell refused to be pinned down on when they may hike again, citing a multitude of economic data due prior to the next meeting in September. Upcoming data includes two employment reports, two CPI reports and data on housing, personal consumption, retail sales and employment costs. As mentioned, Powell did not provide anything definitive regarding the September meeting. He said, "all of that information is going to inform our decision as we go into that meeting." He added: "It is certainly possible that we would raise again at the September meeting, if the data warranted. And I would also say it's possible that we would choose to hold steady at that meeting." The

FOMC *did* make one thing clear: they are still in a fight to contain and lower inflation to the target level and will do what is necessary to achieve that goal. The market would *like* to believe this is the last rate hike in the cycle (see Chart 2) and is hoping the economic data released over the next six weeks backs up that view.

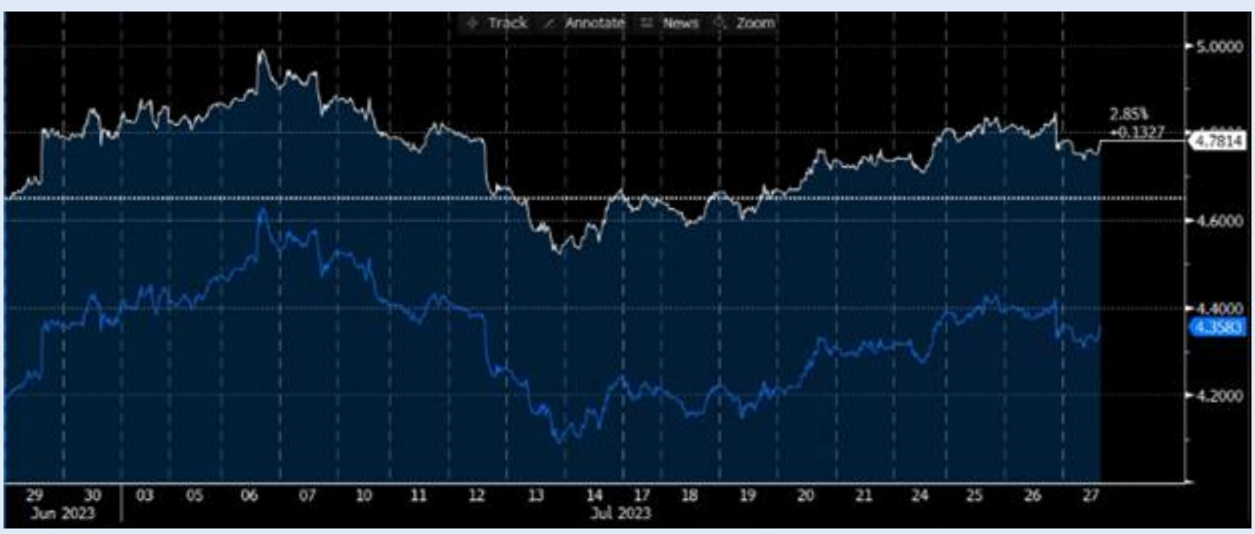
Here are some other highlights from the FOMC meeting Wednesday and the meeting statement:

- The decision to hike 25 bps was unanimous.
- Statement signaled further increases ahead are possible
- Fed now in "data dependent" monetary policy mode
- FOMC is taking into account the "cumulative and lagged" effects from prior hikes
- Economic growth outlook upgraded from "modest" to "moderate"
- Fed sees job gains robust, low unemployment and elevated inflation
- Fed says effects of tighter credit "uncertain"
- Powell again rules out rate cuts this year
- **Next FOMC rate announcement September 20, 2023**

CHART 1: 2Y, 3Y SOFR SWAP RATES – PRIOR 30 DAYS: Swap Rates Remain Range Bound

The Bloomberg chart below shows the movement in 2Y and 3Y SOFR swap rates over the prior 30 days (Key: 2Y white, 3Y blue). As mentioned, the rate market had a muted reaction to Wednesday's rate decision - the 25 bp hike was already priced into the swap curve and the Fed did not exactly provide a clear path forward. As a result, rates held steady during and after the FOMC rate announcement and during Powell's presser.

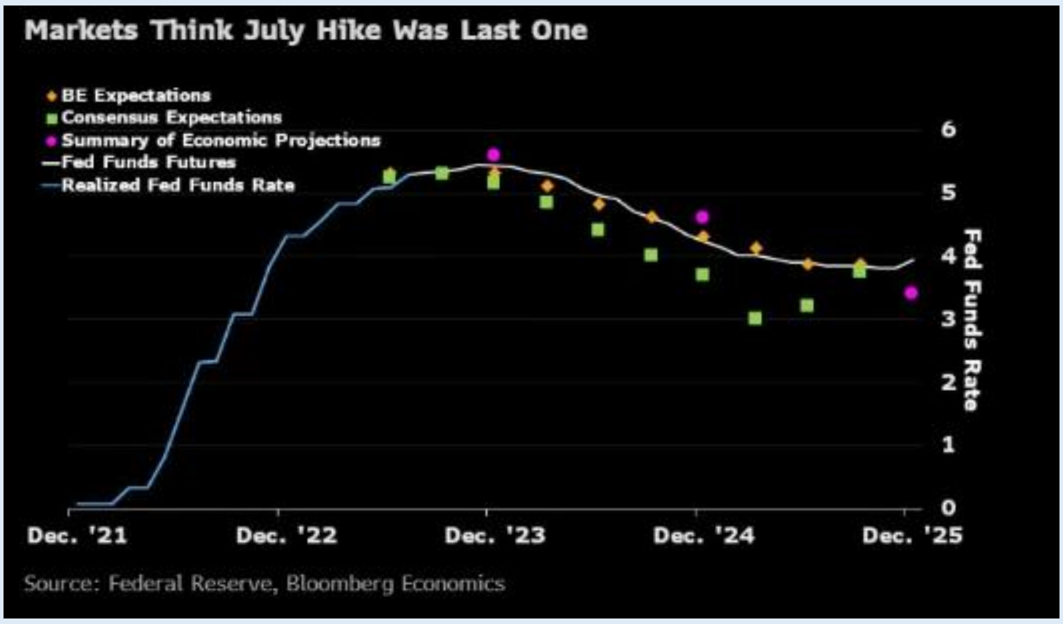
We did not get a ton of new info – they are prepared to raise rates further to battle inflation if the data warrants it and they are aware of (and considering) the cumulative effect of prior rate hikes. The market has bounced around in a range for a few weeks as traders tried to pinpoint the odds of a September rate hike. Going forward, the market is likely to focus on economic data – it is clear the Fed is nearing the end of this rate cycle – what is unclear is precisely how close to the end we are. Many market prognosticators now feel a Fed "pause" is likely back on the table for the September meeting (and maybe beyond) should inflation continue to decrease rapidly, and economic data continue to portend a soft landing (or even better, no recession).



Source: Bloomberg, LLP

CHART 2: FOMC Path Forward

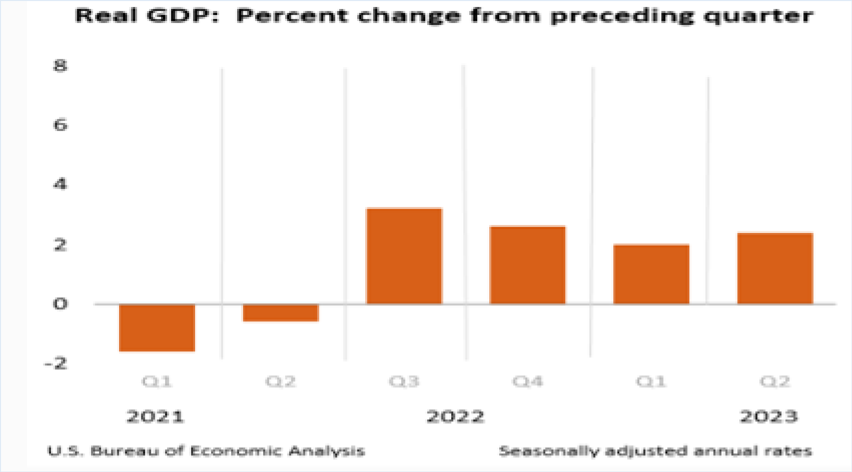
The Bloomberg graph below details a variety of forward FOMC expectations. As we discussed you can see that "the market" (green boxes) thinks that this hike was the last. Fed funds futures (white line) are still flirting with one more 25 bp hike and economists (gold diamond) think rate hikes are done. All the forecasts shown diverge on the timing and pace of the perceived rate cuts that are eventually coming – all predict rate cuts in the first half of next year. The Fed and Chair Powell signaled they are in a "data dependent" mode with respect to the need for future rate hikes. The FOMC is fearful that stopping too soon could rekindle inflation and force them to resume an even more restrictive monetary policy. That is the primary reason they will likely hold rates at these levels *at least* through the end of the year and be prepared to raise 25 bps this year if necessary. Thus far, the US economy has remained *extremely* resilient, and inflation is rapidly moving in the right direction - that supports a Fed pause at the next meeting.



Source: Bloomberg, LLP

CHART 3: U.S. 2Q 2023 GDP – Better Than Forecast

The FOMC saw some important economic data yesterday with the release of 2Q GDP. You can see from the US Bureau of Economic Analysis chart below that 2Q GDP printed at +2.40%, better than expectations, which had called for +1.80%. This continues a trend of better than forecast GDP and underscores the resilience of the US economy in the face of unprecedented rate hikes. The price component of the GDP data also showed price pressures continue to ease. The encouraging GDP data lends further credence to the Fed's view that the economy can *and will* suitably withstand the aggressive rate hikes undertaken by the FOMC to date.



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