AST DEFEASANCE RATE MARKET UPDATE

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for July 5, 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:

- **U.S Employment Report Due Friday at 8:30 AM Eastern**
- **FOMC will be monitoring the employment data closely**
- **FOMC releases June meeting minutes today at 2:00 PM Eastern**
- **Market is looking for further clarity on the "hawkish pause"**
- **Market trading still calls for a 25 bp rate hike at the July 26 FOMC meeting**

Rates remain range bound as the market awaits the release of the FOMC meeting minutes this afternoon at 2:00 PM and the US Employment Report on Friday morning at 8:30 AM. The Federal Reserve will shed some light today on the discussions at their June meeting that left rate market participants somewhat perplexed. At the June meeting the FOMC paused rate increases after 10 consecutive hikes spanning 15 months, even with inflation cooling more slowly than projected. At the same time, monetary policymakers forecast two additional 25 bp *increases* this year (more than the market expected), a confusing result that left traders and investors seeking answers. Fed Chairman Jerome Powell has said central bank officials wanted more time to assess economic data in light of aggressive prior increases as well as tightening credit following the bank failures in March. The market fears that the minutes may sound more hawkish than the Fed communicated in post-meeting comments. While the minutes may shed some additional light on the Fed's thinking at the time, Friday's June employment number is a key indicator for the Fed and next week we get CPI on July 12. We could definitely see rate volatility escalate beginning with this afternoon's FOMC minutes right through next week's CPI data. Friday's employment report is not anticipated to provide any major surprises – the data is expected to show a robust, but moderately cooling US labor market. The Fed wants full employment, but not at a cost of higher inflation. They pay close attention to wage inflation which tends to become more entrenched and hence more difficult to curtail.

CHART 1: 2Y, 3Y, 5Y & 10Y SOFR SWAP RATES – PRIOR 30 DAYS

The Bloomberg chart below shows 2y (white), 3y (orange), 5y (purple) and 10y (blue) SOFR Interest Rate Swap rates (a key driver for cap premiums) for the prior 30 days. You can see term SOFR rates have stabilized the past week or so as the market awaits further clarity on forward monetary policy. SOFR swap rates may break out of the range as we see the Fed minutes and Employment report details. Next week is also heavy on economic data, the highlights being Retail Sales on 7/11, CPI inflation Data on 7/12 and PPI on 7/13. Rate volatility has stabilized recently, but is poised to increase in the coming weeks given the large plate of economic data that will be feeding the market.

Source: Bloomberg, LLP

CHART 2: Inflation Still Too Hot for FOMC?

The below Bloomberg chart details current headline and core PCE, one of the Fed's favored inflation gauges. The below chart shows that even though inflation is cooling, it remains above the Fed's targeted 2.00% level. Despite the disinflationary trend witnessed recently, inflation likely remains "too hot" for the Fed, making it more likely they will raise rates 25 bps at the July meeting and indicate they may need one more rate hike this year. We will see if the FOMC minutes released later today provide any insight into the Fed's view on inflation and we will get critical CPI data on July 12TH. **The next FOMC rate decision is announced on July 26th.**

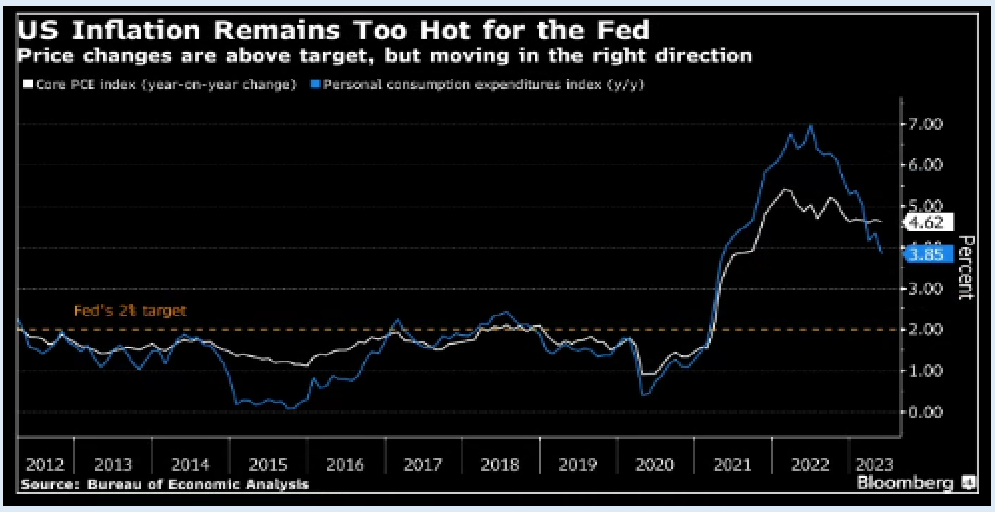
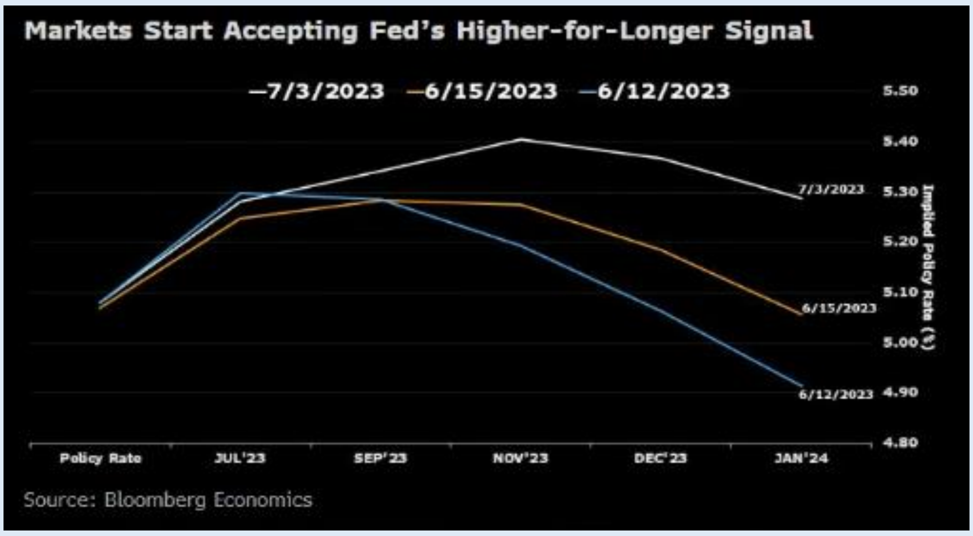


CHART 3: The Market Has Capitulated to FOMC's "Higher for Longer" Message

We have shown the below Bloomberg chart in our updates at various intervals since May. Heading into the May meeting the market had resisted the notion of more rate hikes or a "higher for longer" rate policy and had even priced in multiple rate *cuts* for the back-end of this year. There was a *wide* gap between the Fed's anticipated path forward and the market's preferred path for rates. You can see that since May, the market has significantly revised the outlook for forward rates. It is clear from the latest market pricing that the market now anticipates at least one more 25 bp rate hike and then a sustained period of time at or around that level (~5.25% lower bound / 5.50% upper bound). The market has once again learned you cannot "fight the Fed" indefinitely.



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