Hi «Name»,

Please see our week in review from yesterday along with a quick update about this morning's CPI release immediately below.

This rate market move is not unexpected – inflationary pressures linger, so the market move today just further shifts the market back in line with what the Fed has communicated. Given the movement today, we project further hikes of +25 bps in March and May (which are in the midst of being priced into the market). The possibility of a June hike is likely unless today's number was an anomaly and inflation suddenly plunges over the next 3 or 4 months. Short end swap rates up 8-10 bps post number. Medium to long end swap rates up 3-7 bps. The market was already starting to come around to the Fed's view – today's CPI merely reinforced that commitment. Had the market not already reacted (higher rates), we would have seen a dramatic increase in rates today. The market has been positioning for this in many ways since last week, hence the somewhat muted reaction to CPI this morning. Finally, the 0.5% increase in MoM CPI was the most in the past three months. Annual and Core CPI also came in higher than expected.

U.S. RATE MARKET UPDATE | (as of February 13, 2023):

- **Treasury and Swap yields continue to drift higher on strong economic data**
- **Rates continue to "catch-up" to the Fed and perceived future rate hikes**
- **Recent comments by Fed officials portray a (still) hawkish and determined FOMC**
- **Market awaits key CPI inflation data, released Tuesday 2/14 at 8:30 AM.**
- **Expectations hint CPI data may be hotter than forecast**

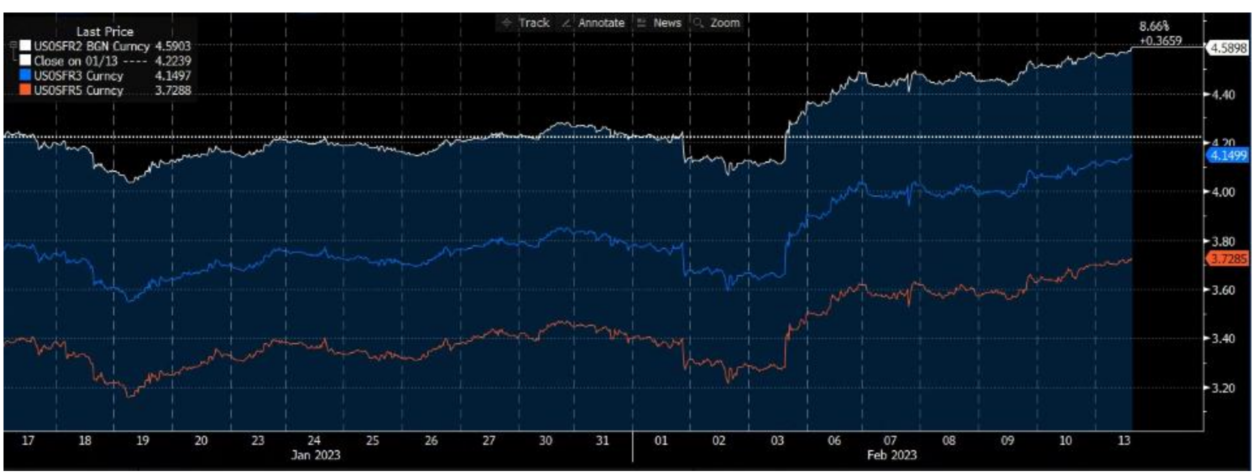
Treasury and SOFR swap rates opened the trading week slightly higher and continued to drift upward as the market recalibrates FOMC expectations. Forward rate expectations continue to shift as market participants see evidence the Fed will stay the course and raise rates until inflation is contained. Recent economic data has been positive and Fed officials are once again pounding a hawkish drum-beat in their comments and speeches. There are also increasing hints that the much anticipated CPI data tomorrow may print hotter than expected. If CPI is higher than anticipated, 2Y & 3Y treasury and swap rates will likely increase in the short term, as those tenors are most vulnerable to FOMC rate decisions. As we have been discussing, the market appears to finally "hear" the Fed's message. That said, make no mistake, the market is *reluctantly* capitulating to the Fed and as we know, *market perception can change quickly*. At the moment the market is acknowledging the Fed may have to continue to raise rates and shift the target terminal rate higher. However, there is still a tremendous amount of uncertainty present in the market, so we expect rate volatility to continue for the near term as the market tries to sort out rate expectations for the first half of the year.

Currently, market pricing is calling for a 25 basis point hike at each of the next two FOMC meetings (March 22nd, May 14th) and there is growing speculation a 25 bp hike may be needed at the June 14th meeting. Right now a nervous market is asymmetrically biased toward higher rates – a hawkish Fed has been keeping the pressure on and the U.S. economy, by most measurements, remains healthy. Monetary policy *appears* to be working, which will continue to embolden the Fed to stay on the current path until they are satisfied inflation is firmly under control. Market hopes for an imminent dovish Fed pivot appear to get dimmer each day. A stronger than expected CPI print would only fuel expectations that the Fed will remain committed to the current monetary policy and continue to hike rates. The rate market's immediate reaction could be to push rates higher. If tomorrow's CPI shows *lower* inflation, the market is likely to pause and wait for the rest of the week's economic data and Fed-speak before reacting.

As mentioned, the market is waiting for headline CPI data, released tomorrow morning at 8:30 am. CPI kicks off a busy week for economic data *and* for our friends at the Fed. In addition to CPI, we will see Retails Sales and NY State Manufacturing data on 2/15, PPI, Housing Starts and weekly employment numbers on 2/16 and Import/Export information on 2/17. In addition to the full plate of economic data released this week, we have a host of Fed officials on the tape as well: Bullard, Barkin, Mester, Logan, Bowman, Williams and more! There is *always* the possibility that their comments could rile the rate market. Finally, keep an eye on the geopolitical landscape – we still have the looming U.S. debt ceiling issue, global political tensions remain high and the growing "spy-balloon" situation may further escalate global tensions, particularly between the U.S. and China.

CHART-OF-THE-DAY: 2Y, 3Y & 5Y SOFR SWAP RATES – *PRIOR 30 DAYS*

The following Bloomberg graph depicts SOFR swap rates for the past 30 days (white = 2Y, blue = 3Y, orange = 5Y). The white dotted line represents the 2Y swap rate 1-month ago. As we discussed in the last update, rates were largely range bound until we approached the February FOMC Meeting. The market had positioned for lower rates, but a reassessment of Powell's comments and strong economic data forced the market to rethink FOMC expectations and adjust rates higher. Over the past ten days rates have broken out of the range and moved higher on expectations the Fed will raise rates more than the market had initially projected for the first half of this year.



Best Regards,

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