AST DEFEASANCE RATE MARKET UPDATE

RATE MARKET UPDATE: June 9, 2023 | Market Awaits CPI Data, FOMC Rate Decision

- **Market awaits CPI data (6/13) and the FOMC rate decision (6/14)**
- **Market pricing currently signals pause in June, 25 bp hike in July**
- **Rates drift higher this morning as market looks ahead to CPI data, FOMC**

Treasury and SOFR swap rates ticked higher on Friday morning as the market prepares for the FOMC meeting on June 14. Currently, swaps traders have priced in roughly a one-third chance of a FOMC rate hike next week, and almost 90% odds of one in July. However, sentiment is building that the Fed may be ready to pause and may even be done raising rates. There is growing sentiment that the US economy will remain healthy but continue to slow and that inflation will continue to drop. The question then becomes how long the Fed will hold rates at these levels. Recent Fed-speak, current inflation levels and forward market pricing now suggest that the FOMC has no plans to cut rates this year. As we know, the market has often overreacted to economic data and has at times missed the mark on monetary policy – I would caution against drawing any firm conclusions on the FOMC prematurely. Make no mistake, there is still tremendous uncertainty permeating the market – traders and market participants will be looking to the Fed for guidance. This is the first FOMC meeting in some time where the rate decision and Powell's comments will be equally compelling.

CHART 1: CPI Preview

The Bloomberg chart below details US CPI. The CPI report due Monday is anticipated to show consumer inflation cooled in May, driven primarily by a decline in gasoline prices. Expectations call for MoM headline inflation to decelerate to 0.2% (vs. 0.4% in April). Core CPI is expected to remain static at 0.4% (vs. 0.4% in April). Headline CPI is forecast at 4.1% and core CPI at 5.2%. If this trend continues, by the July FOMC meeting Fed officials *could* have a CPI report in hand that shows 3% year-over-year growth. That is another compelling reason the FOMC may embark on an extended rates pause, rather than the "skip" they will likely signal at the June 14 meeting. You can see from the chart below that inflation is forecast to continue to cool this year and into 2024 – that is the primary reason the Fed is likely to hold rates higher for longer and move to a neutral monetary policy. The Fed will not want to derail the disinflation momentum created by monetary policy to date by cutting rates too soon.

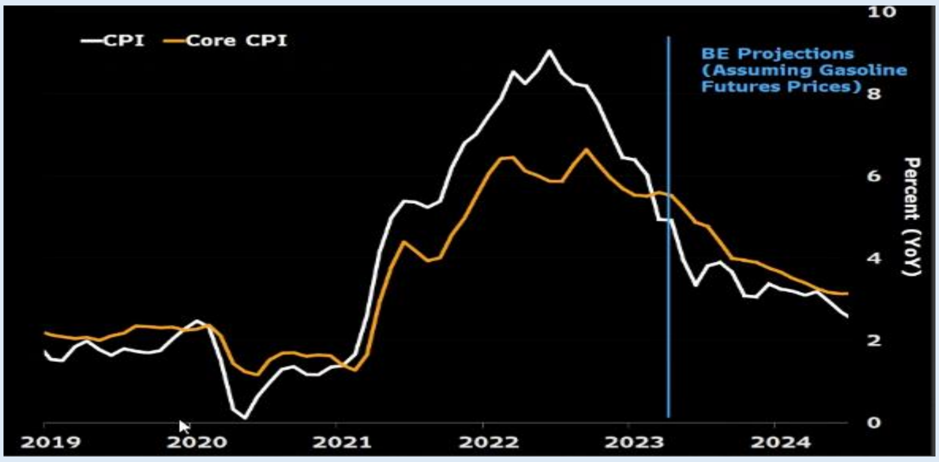
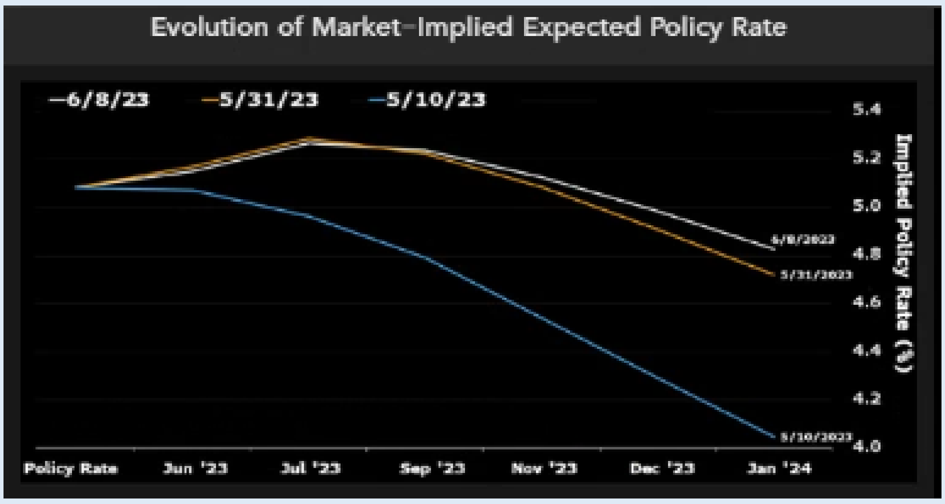


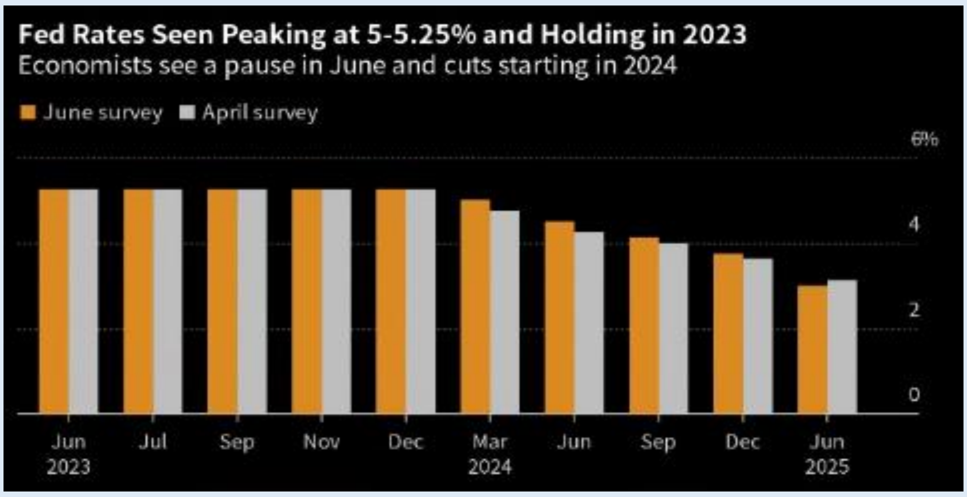
CHART 2: FOMC Preview: Market Forward FOMC Expectations Shift

The below Bloomberg chart shows the degree to which the market's (traders) forward rate expectations have *dramatically* shifted over the prior 30 days. You can clearly see that forward market pricing has all but abandoned the idea of a rate *cut* this year. The latest market pricing is holding on to 1 more potential rate hike, then a prolonged period of neutral rates. Market pricing still shows the possibility of one rate cut in the 4th quarter, but that is a far cry from one month ago when the market had priced in almost 3 rate cuts this year, starting as early as this summer! Market pricing has now shifted to be more in line with the rates "higher for longer" mantra the Fed has been signaling in recent months. We have been pointing out the dichotomy between the market's expectations and the Fed's "message" – it is clear *the market* has capitulated for the time being.



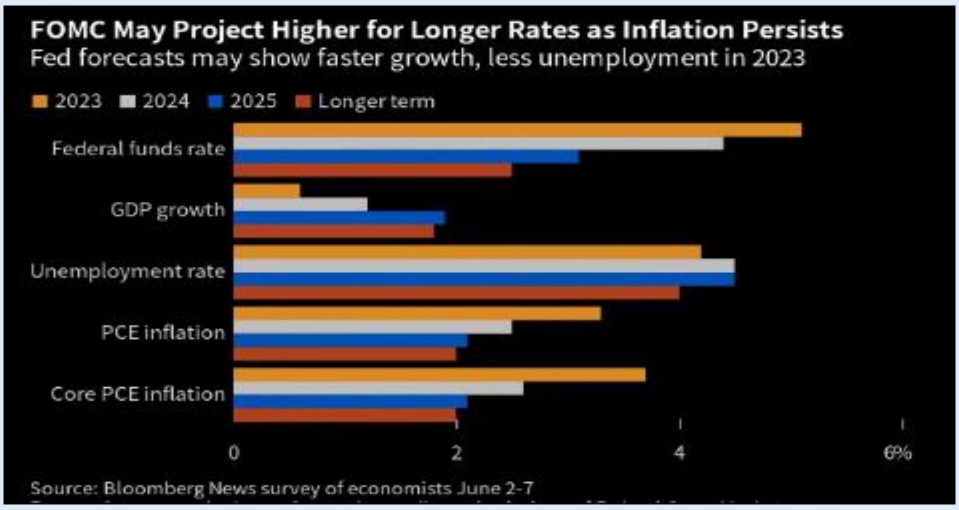
[CHART 3:](#) FOMC Preview: Economists View

The below Bloomberg chart shows *economists'* forecasts for the FOMC through June 2025. The chart contrasts their forecast in April against the most recent survey yesterday. Economists forecast higher for longer rates in April and that continues to be the case today. As you can see from the chart, economists expect the Fed Funds rate to hold where it is now for the remainder of the year. Many economists feel economic data and the pace of disinflation do not warrant additional rate hikes, but they support a "higher for longer" monetary policy to continue the trend. Economists are also now inching toward calling for rate cuts to begin modestly (-25 bps) beginning in the first half of 2024.



[CHART 4:](#) FOMC Preview: Fed Forecasts

The Bloomberg chart below details the most recent Bloomberg News economists' survey for Fed economic forecasts. We can see in the chart below (and in the headline) that the FOMC is likely to continue to signal they will need to keep rates higher for longer. Economists anticipate the FOMC to back that up on Tuesday. Faster growth and tight labor markets for 2023 would likely keep overnight rates at current levels (or slightly higher if economic data merits another increase) for the remainder of the year. *You can also see that the Fed is not yet contemplating significant rates cuts in 2024.* The market will be paying close attention to the FOMC's forecasts as they will likely provide clues and insight into forward monetary policy thinking. *Stay tuned!*



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