MORTGAGE RATE WATCH
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Mortgage Rates Recover Slightly, But Thursday Could Bring Much Bigger Movement

Mortgage rates are based primarily on the prices and yields of bonds. Bonds take cues from several places, but always from inflation and the economy--at least to some extent. As such, economic reports (including those focused on inflation) can have an immediate impact on bonds and immediate implications for rates at the moment they're released.

The single most important economic report (as far as rates are concerned) will be released Thursday morning at 8:30am Eastern time. The Consumer Price Index (CPI) is the first, broad-based look at inflation in the US on any given month. It's a report that has consistently had a bigger influence on rates than any other scheduled monthly data for roughly a year now.

Economists submit forecasts to data aggregators like Reuters and Bloomberg. The median forecast becomes the market's consensus and traders move bonds into position for those numbers, generally speaking.

In other words, it won't be a surprise to the market if annual inflation comes in lower tomorrow. The headline level (which includes all prices measured) is seen dropping from 7.1% to 6.5% annually. To reiterate, if 6.5% turns out to be the result, there's no real implication for rates.

If, on the other hand, inflation were to fall to 6.3% or lower, rates would likely fall sharply. If we see 6.7% or higher, expect a big rate spike.

There are other inflation numbers in the report and, in fact, the market is more likely to focus on the monthly "core" CPI number which factors out more volatile food and energy prices. Other traders will look deeper still and subtract the "shelter" component (which measures the cost of housing) as it can be a big stick in the mud that obscures the underlying trends in prices.

The bottom line is that if traders see that inflation is falling faster than expected, it could be very good for rates. Vice versa if prices unexpectedly jump.

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