MBS & TREASURY MARKETS
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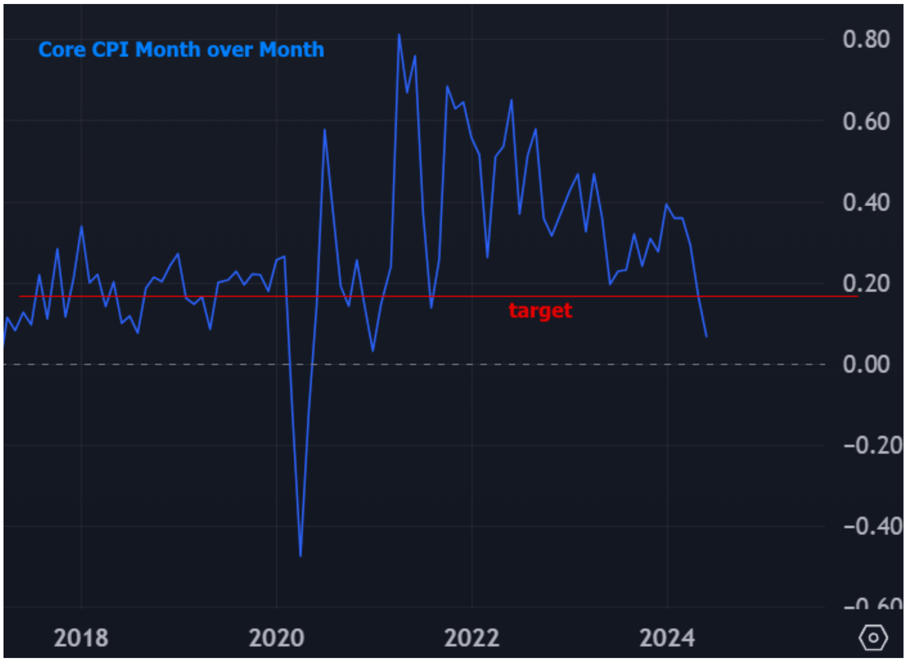
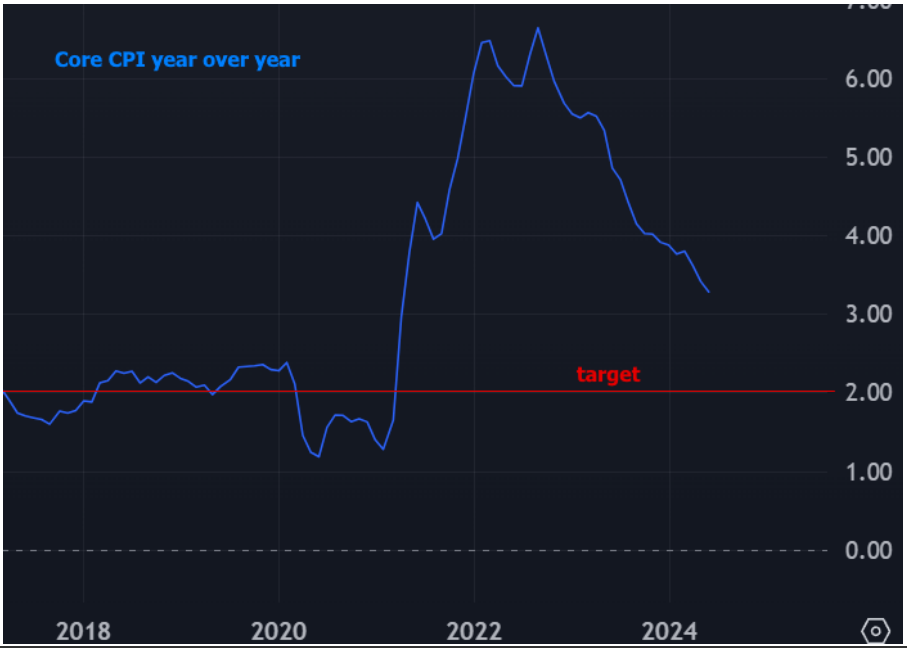
The Day Ahead: This is The Inflation Data You Were Hoping For

The Consumer Price Index (CPI) is the most important economic report for the bond market these days. The most important line item in that report is month over month core CPI, which excludes food and energy. That number was forecast to hit 0.2% but instead came in at 0.1, rounded up from 0.065.



That means if this report were repeated for 12 months, core inflation would be under 0.8% for the year. Considering the Fed's inflation target it 2%, it's no surprise that bonds are rallying in response, even though official year over year core inflation is still over 3%.



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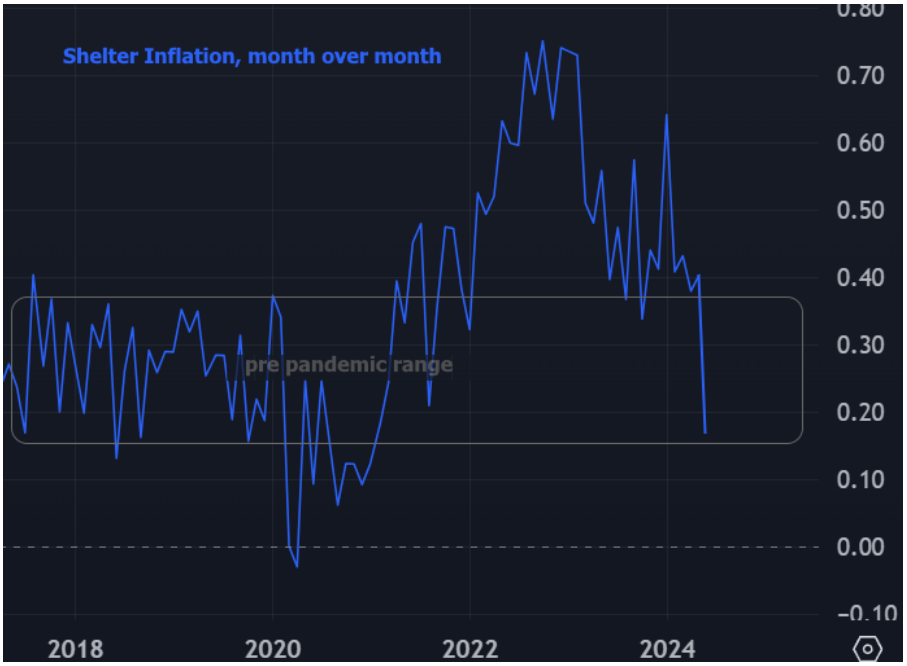
To make matters better, the most problematic component of the core CPI numbers--the one that tracks housing expenses--finally made the big downward shift that analysts have been waiting for. "Shelter" dropped to an unrounded 0.17% from 0.4% last month. That's actually lower than most of the PRE-Pandemic trend.



The bond market response was logical and immediate with 10yr yields down about 10bps at 4.18+. MBS are up more than a quarter point. Fed rate cut expectations also ramped up significantly, roughly matching the drop seen after the last CPI report.