The Day Ahead: Early Gains Speak to Underlying Inflation Anxiety

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Bonds managed a moderate rally in response to this morning's inflation data. While it has since been mostly erased, it was as strong of a showing as we could have possibly hoped for at the time, and one that speaks to the recent increase in underlying inflation anxiety.

The anxiety stemmed from the past 2 CPIs popping back near 0.3% (core, M/M) after averaging 0.13% in the 3 months before that. Looked at another way, Core CPI increased every month starting in July, and that trend was finally defeated today.

Without the shelter component, inflation is at or below the Fed's 2% target (2.1% core and 1.3% overall). In early trading bonds moved back in line with yesterday morning's levels--not a huge victory in the bigger picture, but a strong showing given the asymmetric risks.

The CPI reaction nearly garnered the same volume as the jobs report over the first 30 minutes of the reaction.

For those interested in more nuance, here are several charts from the CPI data. The first shows how goods and energy prices are contributing to deflation while housing and services continue accounting for almost all of the inflationary pressure.

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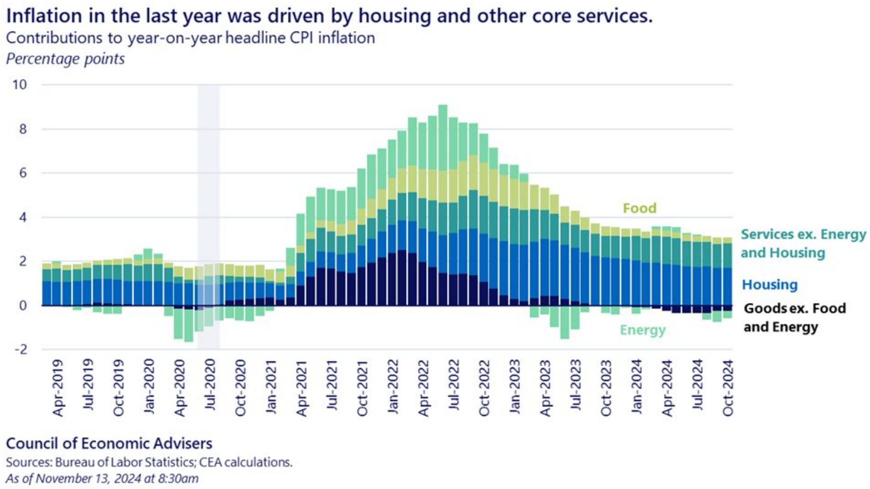
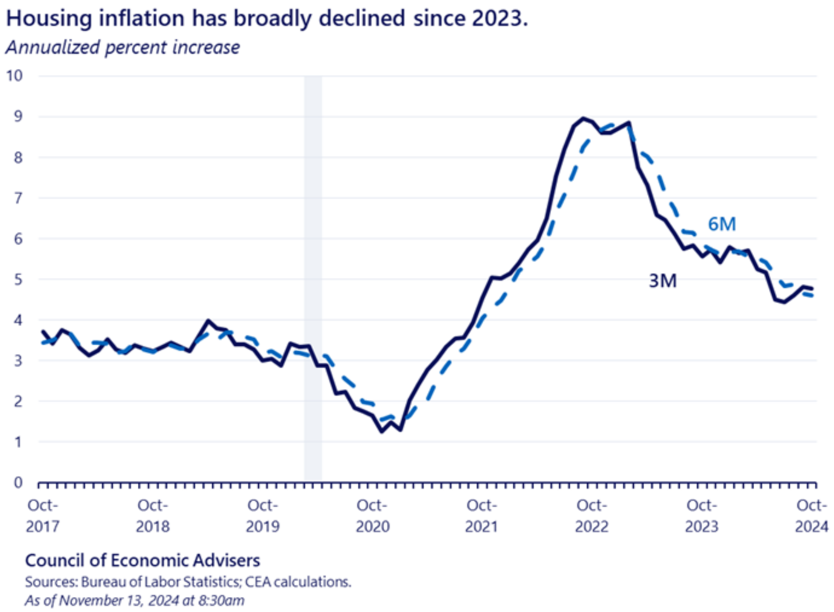


The following chart focuses on housing inflation specifically. It's still elevated, and month-to-month readings can be volatile, but the broad, slow decline is the key reason that the Fed is confident in the eventual return to 2% (because, again, without housing, we're already there).



The next chart shows actual rental rates mostly back to pre-pandemic levels and in a flatter trend compared to OER, which remains elevated. That said, OER is also broadly trending lower.

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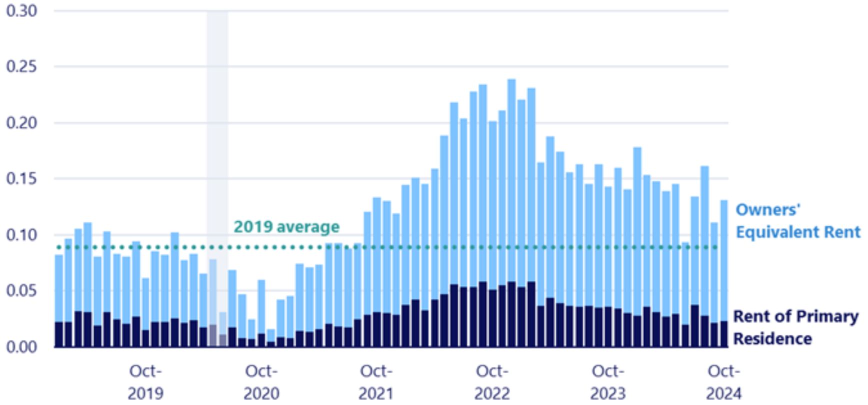
Housing added 13 bps to monthly headline inflation.

Contribution of housing to monthly headline CPI inflation

Percentage points, monthly rate



Council of Economic Advisers

Sources: Bureau of Labor Statistics; CEA calculations.

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