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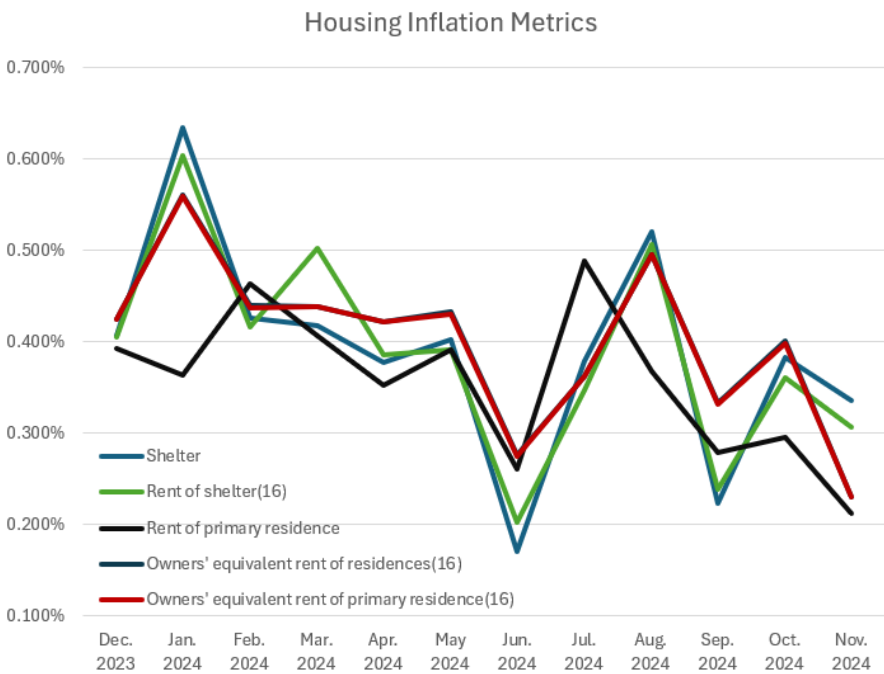
The Day Ahead: Why Bonds Rallied After CPI (And Why They Reversed Course an Hour Later)

Today's headline and core CPI readings were both perfectly in line with forecasts. After the data came out, bonds rallied and Fed Funds Futures moved to price in a near certainty of a Fed rate cut next week. To make matters more confusing, monthly core CPI was 0.31% before being rounded to 0.3%, so it's not as if a low unrounded number explains the rally. Instead, we have to turn toward housing inflation--the biggest problem child for this data series--and consider the substantial progress in this report and in general.



Owners' Equivalent Rent (OER) is especially notable when we consider the broader context (along with the fact that it's the single largest individual component of CPI). If there is no other reason for this morning's paradoxical move, it is the implication of the following chart.

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Despite the initial gains, bonds have turned around and moved back in line with pre-data levels. Blame Canada? The Bank of Canada (BOC) released its latest policy statement this morning and despite a 50bp rate cut, the rest of the announcement was interpreted as hawkish by bond traders. The spike in CA yields corresponds with the reversal in US rates, at the very least, but US traders may also be interested in preparing for this afternoon's 10yr Treasury auction.