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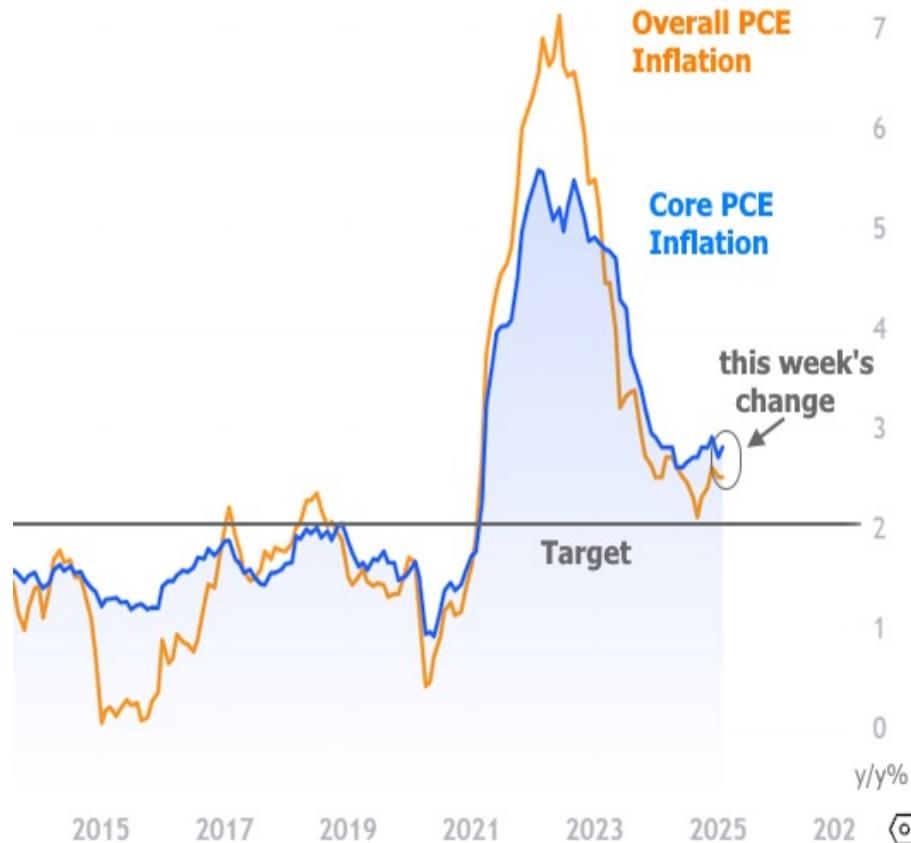
Inflation Told Rates to Rise. Rates Didn't Listen

Heading into the week, market watchers knew (or thought they knew) that Friday's PCE inflation data had a chance to help or hurt interest rates more than any other economic report. When PCE came out higher than expected on Friday morning, market watchers knew (or thought they knew) what would happen next. But instead, the opposite happened.

Events like this send pundits, journalists, and all other manner of rate watcher scurrying for explanations. Some are fairly logical, such as the fact that the unrounded PCE numbers were much closer to what the market was expecting. Specifically:

- Official monthly core inflation:
 - 0.4 versus a 0.3 forecast
- Unrounded version of the same numbers:
 - 0.362 versus a 0.300

In other words, inflation looked like it rose more than it actually did due to the custom of rounding the numbers to the nearest tenth of a percent. In addition, the 0.400 forecast is also rounded. It could be that forecasters were already expecting a higher unrounded number like 0.340. It could also be that the 2.5% annual rate of headline inflation simply isn't that threatening.



On a less speculative note, we can be sure that rates have been more than willing to move a bit lower on days where the stock market is tanking. Friday was definitely one of those.



David Luxton

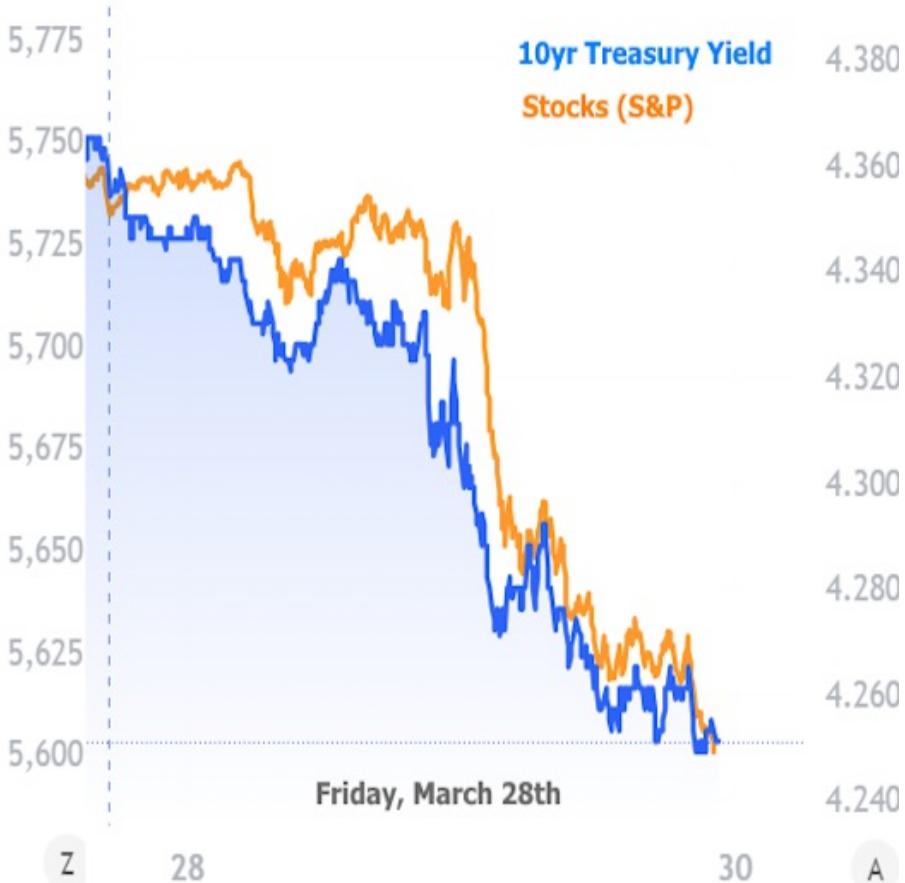
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It would be nice if all this meant that rates were invincible and could endure an onslaught of unfriendly economic data, but a bit of caution is in order. First off, it's highly likely that there are distortions in the bond market due to the unique trading that takes place at the end of any given month/quarter (March is both). This is a time where traders may be buying or selling large amounts of bonds (thus putting downward or upward pressure on rates, respectively) for reasons that have nothing to do with the latest economic data.

The implication is that we could be seeing some artificial support at the end of the present week from the combination of stock market weakness and month/quarter end distortions. At least one of those things will no longer be in play for most of next week.

What we do know is that the first week of any given month always plays host to an active and important slate of economic data. Among those reports, next Friday's jobs report is always one of, if not the biggest potential flashpoint for rate volatility in terms of scheduled data.