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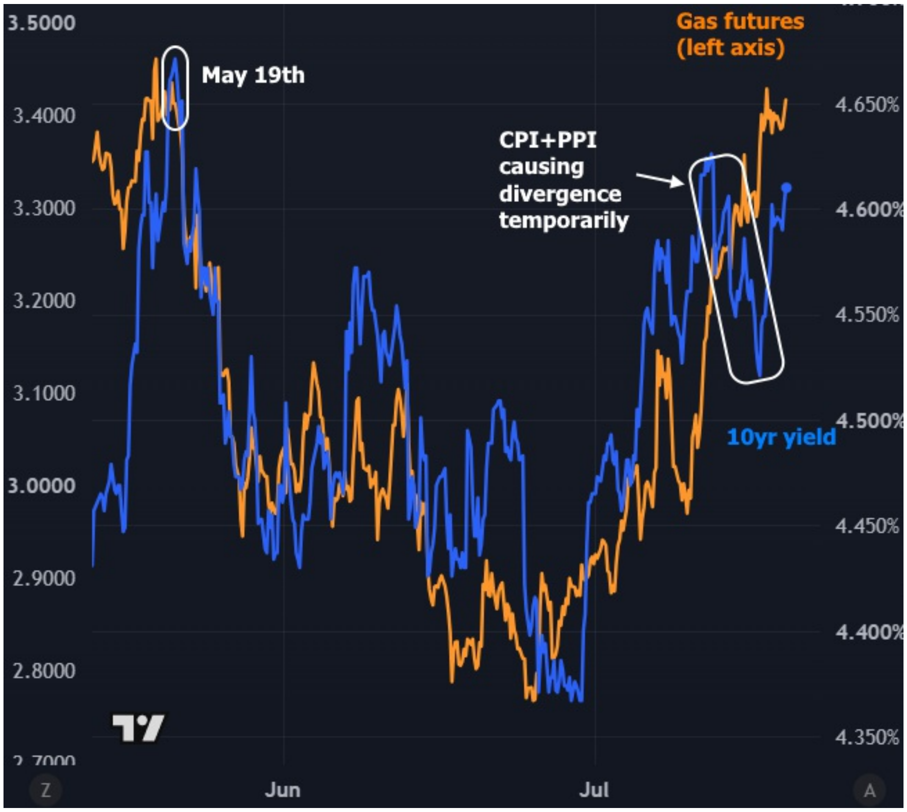
The Day Ahead: Bonds Grudgingly Giving Back Last Week's Inflation Rally

While last week's CPI and PPI reports were unabashedly great news, the bond market spent Friday and yesterday gradually unwinding most of the resulting gains. The least complicated way to approach this phenomenon would be to observe that fuel prices spent the same 2 days breaking to the highest levels since May 19th and they continue to hold near those highs today. Even without that fuel price rally, we were already skeptical that June inflation data was a durable justification for lower yields in light of the resurgence of the Iran war in July and the associated resurgence of inflation risks. As we discussed last week in the "crack spread" article, the x factor here is the fact that consumer fuel prices are doing much worse than oil prices suggest. A chart of 10yr yields vs gasoline futures makes this clear. In this context, bonds are actually a bit stronger than the May 19th correlation suggested.


104.00
100.00
96.00
92.00
88.00
84.00
80.00
76.00
72.00
68.00
10yr yield
4.650%
4.600%
4.550%
4.500%
4.450%
4.400%
4.350%
Oil Prices
(left axis)
Jun
Jul


3.5000
3.4000
3.3000
3.2000
3.1000
3.0000
2.9000
2.8000
Gas futures
(left axis)
May 19th
CPI+PPI
causing
divergence
temporarily
10yr yield
4.650%
4.600%
4.550%
4.500%
4.450%
4.400%
4.350%
Jun
Jul