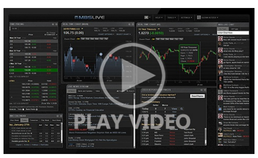
Straightforward Gains After Important Inflation Data

Market Summary: Saturday, July 27, 2024 - 8:29AM

While today's monthly core PCE headline may have technically been higher than the median forecast, a vast majority of forecasters abstained from submitting updated guesses to data aggregators after yesterday's quarterly PCE data. Had they been compelled to do so, the forecast would almost certainly have risen to 0.2 from 0.1 and today's unrounded number of 0.182 would be the logical beat that the market traded... logically. In fact, one might call the 2 day action "boring" considering this morning's quick PCE-driven rally almost perfectly offset yesterday's PCE-driven sell-off and neither was very big in the bigger picture.

Latest Video Analysis



Straightforward Gains After Important Inflation Data

Philip Bennett
President, Bennett Capital Partners
bcpmortgage.com
P: (800) 457-9057
M: (305) 407-0747
1101 Brickell Ave, Suite 800
Miami FL 33131
Pers# 1098318
Corp# 2046862

BENNETT CAPITAL PARTNERS

MBS & Treasury Markets

UMBS 5.5 99.63 +0.22 | 10YR 4.193% -0.050% 7/26/2024 5:00PM EST

Bonds Rallying Despite Higher Core PCE

After yesterday's quarter over quarter core PCE price index came in 0.2% higher than expected, we knew today's monthly PCE data would have to include higher numbers divided across the months of April, May, and June in some unknown proportion. If April and May were not revised, it suggested an unrounded monthly core PCE of 0.37 today, which would have rounded to a 0.4% headline versus the 0.1% forecast. But that would be very uncommon, so markets split the difference and figured the extra inflation would be spread more evenly across the quarter. Forecasters who updated their predictions changed to 0.2% for the m/m core number, and that's exactly what we got.

The more we drill down, the better the news gets. After all, 0.2 is a rounded number. The unrounded version was 0.182... even better! Perhaps just as important was the fact that the housing component of the PCE data fell to its lowest level since it was first on the way up in 2021.

The following heat map shows another way to visualize the progress:

The main takeaway is really the same in that it shows significant cooling in what has been the most problematic sector. It also serves to remind us that there are months like January that will continue to distort 6 month and 1 year metrics.

Bottom line to all this: the market knew the previous 0.1% forecast for today's core PCE was a long shot after yesterday. That's why we sold off yesterday instead of today. Now that today's PCE came out with what was probably the softest possible realization of yesterday's warning, bonds are breathing a small sigh of relief, moving to the stronger end of this week's range.

UPDATE: PCE Slightly Higher, But Bonds Are OK With It

MBS MORNING: Strong Start Despite Data Driven Volatility

Today's Mortgage Rates

30YR Fixed 6.86% -0.05% | 15YR Fixed 6.31% -0.02% 7/26/2024

Inflation Data Continues Paving The Way For (Eventual) Rate Cuts

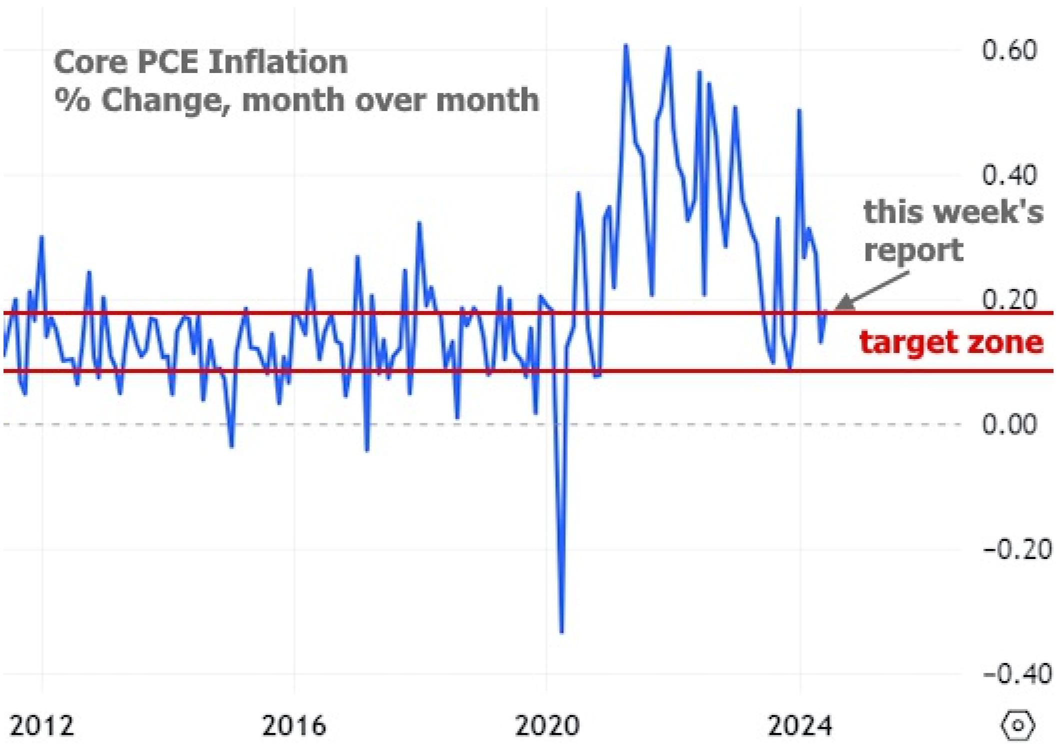
This week's most important economic data was the PCE price index which is the gold standard of big picture inflation measurement. For those hoping to see rates drop, it was important for PCE to confirm the progress seen in the CPI data (the other major inflation index that came out 2 weeks ago).

Spoiler alert: PCE confirmed the progress, but there are a few nuances.

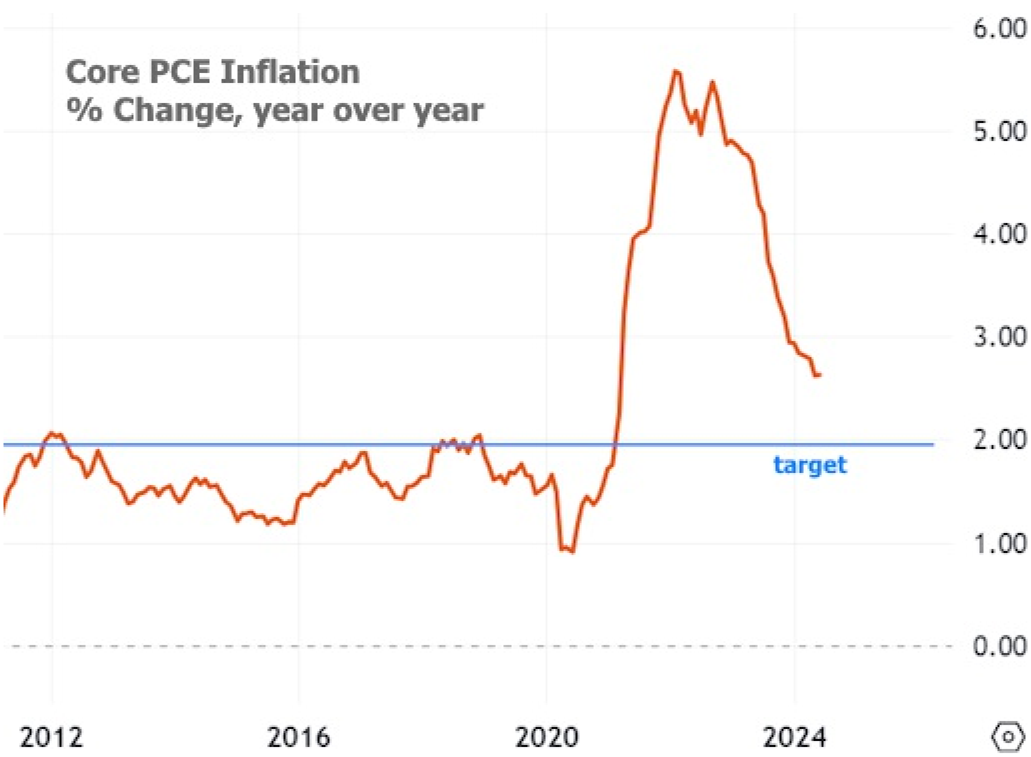
Perhaps most importantly, this week's PCE data covers the same time frame as the CPI data two weeks ago. In other words, it's not quite as awesome as 2 consecutive months of "mission accomplished" levels of inflation (which has now arguably been cemented for June), but it's nonetheless an important milestone in the path toward rate cuts.

What exactly does "mission accomplished" mean? This simply refers to Fed's 2% annual inflation target, typically tracked via Core

PCE which excludes more volatile food and energy prices. In order to hit 2%, monthly inflation readings need to average roughly .17%. This time around, it was .182%--definitely in the historical range of on-target inflation from before the pandemic.



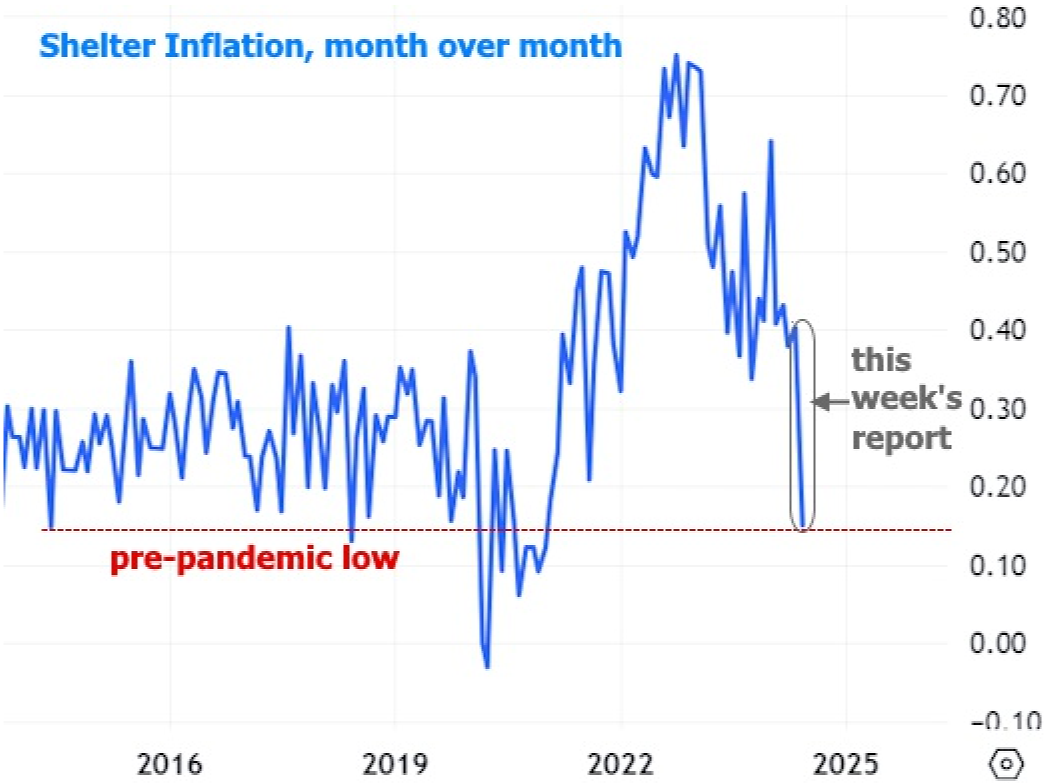
While the chart above makes it look like victory has been achieved, the inflation target is technically an annual thing, so we need to see more months in the target zone before the year over year number falls into line.



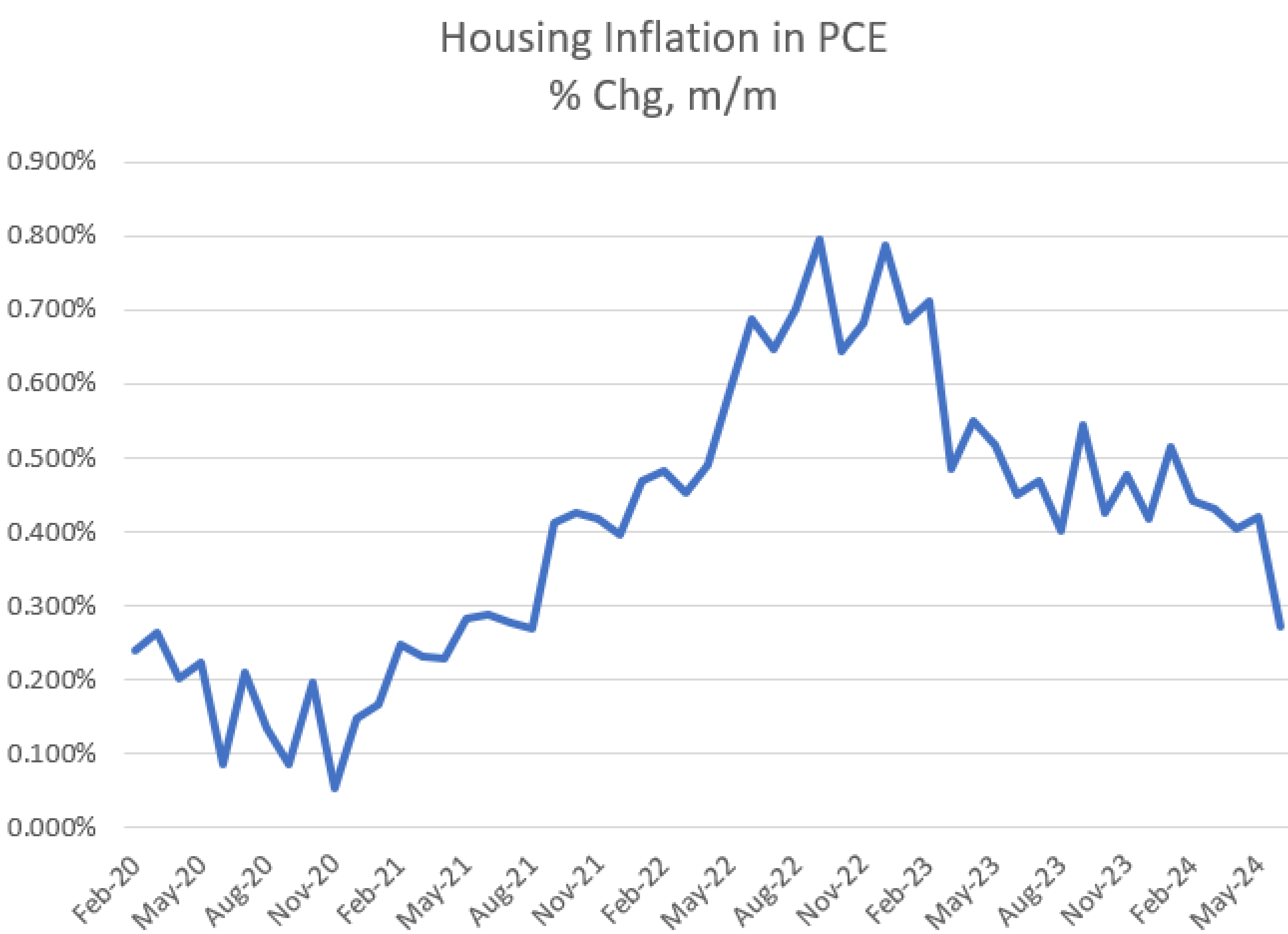
Even then, the Fed has clearly stated that the annual change doesn't need to hit 2% as long as they're confident that it will. Prior to this week's data, the average Fed member has expressed an increasing amount of said confidence. It's not thought to be enough for a rate cut at next week's Fed meeting, but it's widely believed to result in a September rate cut, as long as the data doesn't do anything crazy between now and then.

The Fed can also consider other aspects of the inflation data--especially in categories that have been stubbornly high while also accounting for a large proportion of the total. Housing is the by far and away the best example of this, accounting for about a quarter of all inflation in this week's data, and more than a third in the CPI data.

Here's how CPI's shelter component looked for June when we covered it 2 weeks ago:

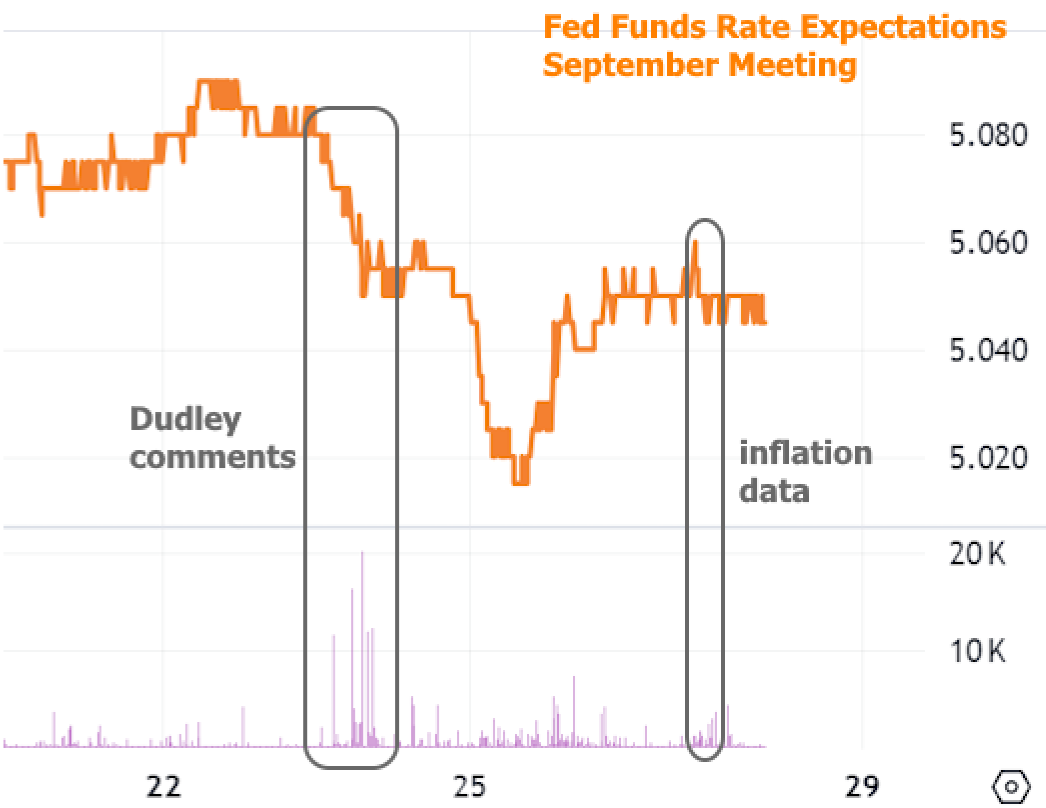


And here's how this week's PCE data confirmed the big drop in housing inflation:

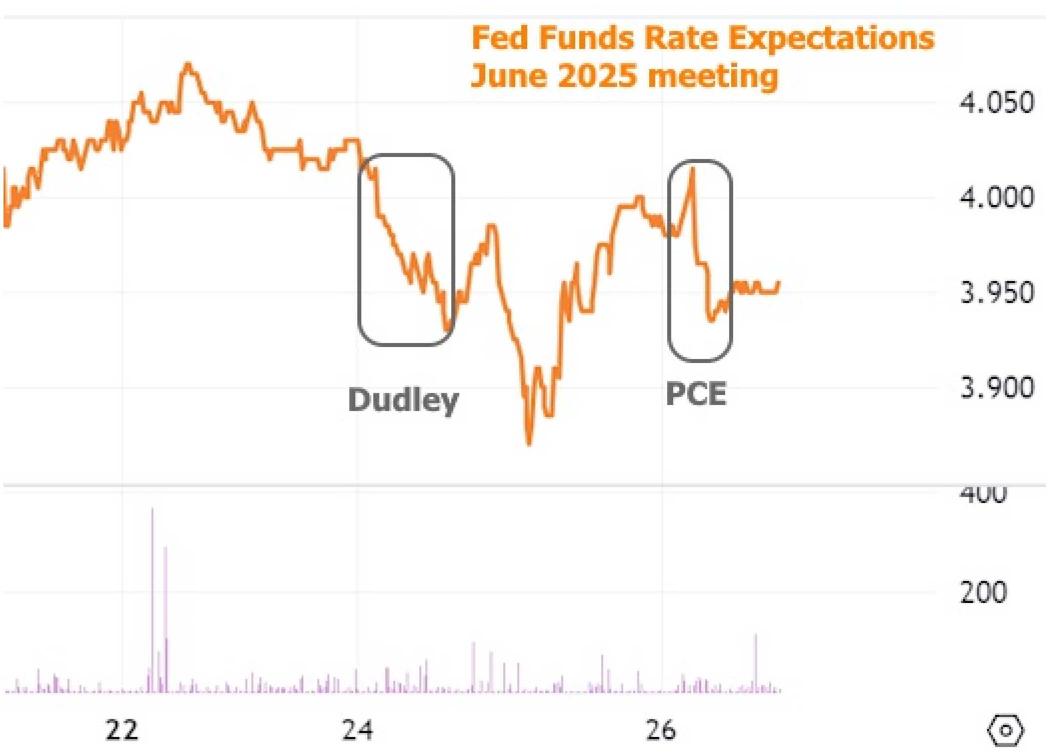


The scales of the two charts are different, but the message is the same: housing inflation dropped sharply to the slowest pace since it was still on the way up in 2021. If this stubborn ingredient is finally softening, it's hard to imagine the Fed being anything other than perfectly confident that it's time to start cutting rates. They wouldn't need to see any improvement in housing inflation from here. It would merely need to remain near these levels.

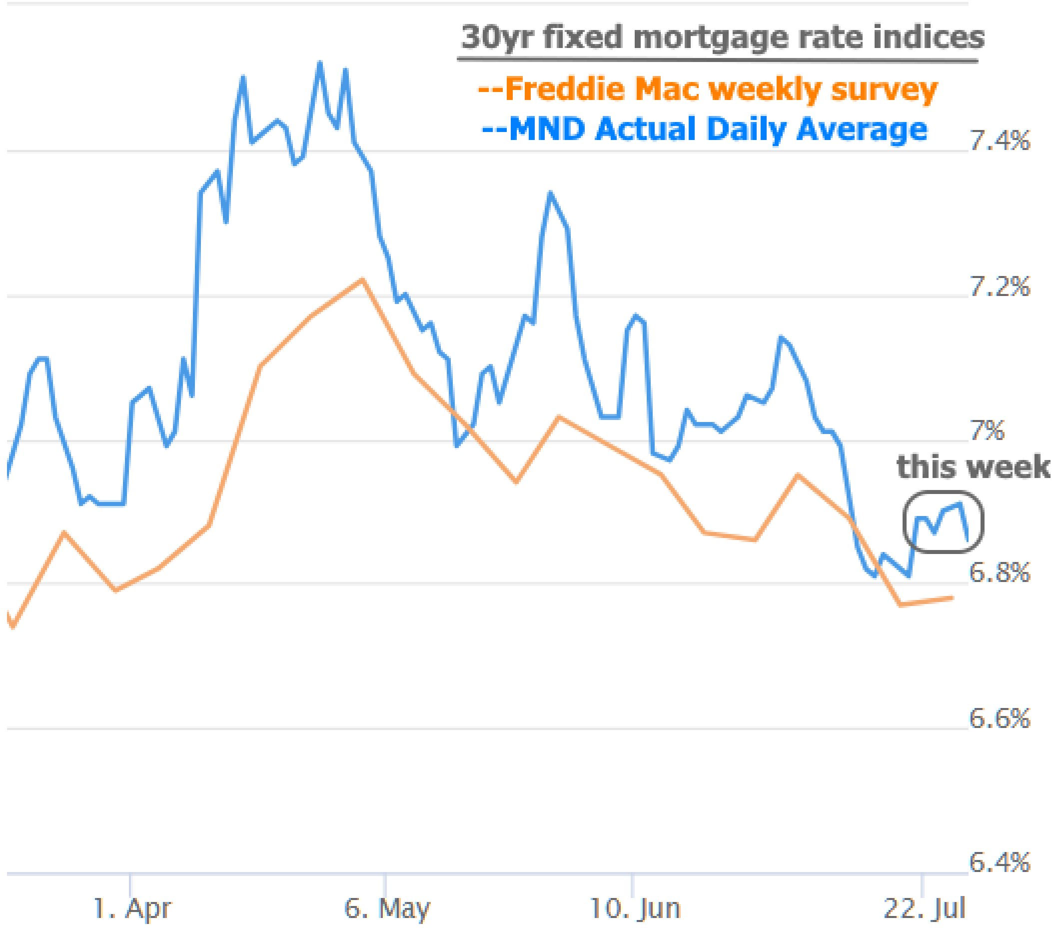
If all of the above sounds fairly compelling, there's a major curve ball to be aware of. While it's all true and while the conclusions are very much in line with the market consensus, it didn't have any impact on the odds for a rate cut in September. The only thing that made a dent in those odds this week was an op-ed from former NY Fed Pres William Dudley who said the Fed should cut even sooner.



The best way to take a swing at that curve ball would be to point out that the PCE data still mattered, but its effects on the rate cut outlook don't show up in near term Fed meeting months. If we change the chart above from September to next June, things make more sense.



Despite the important big picture milestone, movement in the bond/rate market was subdued yet again this week.



Volatility risks increase in the coming week with the arrival of more timely big ticket economic data. Friday's jobs report is always the headliner on the first week of a new month, but this time around, we'll also get a chance to hear from the Fed on Wednesday.

To reiterate, it's highly unlikely that the Fed opts to shock the market with a surprise rate cut, but precedent suggests that they'll do something to tee up a September cut if they're as convinced as the market is. This could either occur in the text of the policy announcement or in the press conference with Fed Chair Powell that follows 30 minutes later.

Economic Calendar

Last Week | This Week | Next Week

Time	Event	Actual	Forecast	Prior
Friday, Jul 26				
8:30AM	Jun Core PCE (m/m) (%)	0.2%	0.1%	0.1%
8:30AM	Jun PCE (y/y) (%)	2.5%	2.5%	2.6%
8:30AM	Jun Core PCE Inflation (y/y) (%)	2.6%	2.5%	2.6%
8:30AM	Jun Personal Income (%)	0.2%	0.4%	0.5%
8:30AM	Jun PCE price index mm (%)	0.1%	0.1%	0%
8:30AM	Jun Inflation-Adjusted Spending (Consumption) (%)	0.3%	0.3%	0.2%
10:00AM	Jul Sentiment: 5y Inflation (%)	3%	2.9%	3%
10:00AM	Jul Michigan Consumer Expectations Final	68.8	67.2	69.6
10:00AM	Jul Consumer Sentiment (ip)	66.4	66	68.2
10:00AM	Jul U Mich conditions	62.7	64.1	65.9
10:00AM	Jul Sentiment: 1y Inflation (%)	2.9%	2.9%	3%
1:00PM	Jul/26 Baker Hughes Oil Rig Count	482		477
1:00PM	Jul/26 Baker Hughes Total Rig Count	589		586
Monday, Jul 29				
10:30AM	Jul Dallas Fed Manufacturing Index			-15.1
11:30AM	52-Week Bill Auction (bl)	76		
11:30AM	6-Month Bill Auction			4.990%
11:30AM	3-Month Bill Auction			5.190%
11:30AM	26-Week Bill Auction (bl)		70	
3:00PM	Treasury Refunding Financing Estimates (%)			

Recent Housing News

- New Home Sales Post Small Decline
- Mortgage App Volume in a Wait and See Mood?
- Existing Home Sales: Is the Market Shifting Toward Buyers?

Read My Latest Newsletter

Inflation Data Continues Paving The Way For (Eventual) Rate Cuts

This week's most important economic data was the PCE price index which is the gold standard of big picture inflation measurement. For those hoping to see rates drop, it was important for PCE to confirm the progress seen in the CPI data (the other major inflation index that came out 2 weeks ago). Spoiler alert: PCE confirmed the progress, but there are a few nuances. Perhaps most ...

Mortgage Calculators

- Mortgage Payment w Amortization
- Loan Comparison
- Advanced Loan Comparison
- Early Payoff
- Should I Refinance?
- Rent vs. Buy
- Blended Rate