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The Day Ahead: Bonds Navigate Dual Landmines in CPI and Fed Dots

Today brings **2 key developments** in the form of the 8:30am CPI data and the afternoon's Fed announcement. CPI--the Consumer Price Index--was one of the top inflation metrics in terms of market movement. Like other inflation metrics, it faded into obscurity for post of the decade following the financial crisis. Markets simply didn't care about inflation data because the general notion of inflation was so far off the radar.

The Nov 2016 presidential election seemed to mark a sharp turning point for inflation hawks. With Trump seen as highly likely to increase deficit spending and perhaps even aggregate demand (via promises of stimulus and tax cuts), there was a legitimate reason to fear an uptick in inflation. But even before that, the Fed had begun to warn that inflation was inexplicably low and set to rise at any moment. The manifestation of that narrative is the marked rise in CPI heading into early 2016. The bond market impacts were **muted for 2 reasons**. First, traders would believe in the inflation bogeyman when it actually stuck around for a bit. Second, the Summer of 2016 was dominated by the Brexit trade and a snowball buying in bond markets around the world.

Rates had slowly begun to creep up heading into the Fall. Trump won the election. Rates spiked on inflation expectations (and spending fears, which implied more bond market supply). Then early 2017 saw a rapid decline in core annual inflation. Before revisions, Core y/y CPI was hanging out at **1.6% for several months**. Subsequent revisions brought the number to **1.7% for 5 straight months**--still frustratingly low given that the Fed is targeting 2.0% (or slightly higher), and that other economic metrics suggest 2.0% should be a done deal based on a conventional understanding of monetary policy and economics.

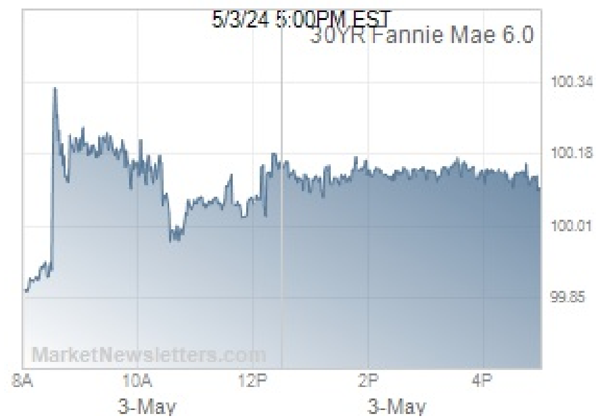
The last CPI report marked the first lift-off from the 5 months spent at 1.7%. **Today now runs the risk** of Continuing that trend.

The **afternoon brings its own landmines** in the form of the Fed's rate hike outlook (via the economic projections, or "dots," due to their dot plot format) only 4 times a year. At some point, the median Fed member will forecast a plateau in rates (for now, that member has seen higher rates at each of the past 3 sets of forecasts). Whenever that happens, it will likely be a big deal for bonds--at least in the short term.

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.09	+0.31
MBS GNMA 6.0	101.03	+0.29
10 YR Treasury	4.5138	-0.0657
30 YR Treasury	4.6711	-0.0579

Pricing as of: 5/3 5:04PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.28%	-0.09	0.00
15 Yr. Fixed	6.75%	-0.07	0.00
30 Yr. FHA	6.70%	-0.12	0.00
30 Yr. Jumbo	7.48%	-0.07	0.00
5/1 ARM	7.35%	-0.07	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.24%	+0.11	0.66
15 Yr. Fixed	6.75%	+0.11	0.64
30 Yr. FHA	7.01%	+0.11	0.94
30 Yr. Jumbo	7.45%	+0.05	0.56
5/1 ARM	6.64%	+0.12	0.87

Rates as of: 5/3

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Conversely, the **risk can't be ruled out** that the Fed continues to see hikes happening a bit faster or ending at slightly higher levels compared to their September outlook. If that happens, it would likely put pressure on rates to challenge the upper boundaries of the recent range, even before finding out the fate of the tax bill. The dots are released at 2pm along with the announcement itself. The Fed's rate hike is fully priced into bonds. Any 2pm volatility will be due to the dots (rate hike forecasts) or some implication in the announcement's verbiage.

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