Mortgage Broker's Best
Financing Your Future!

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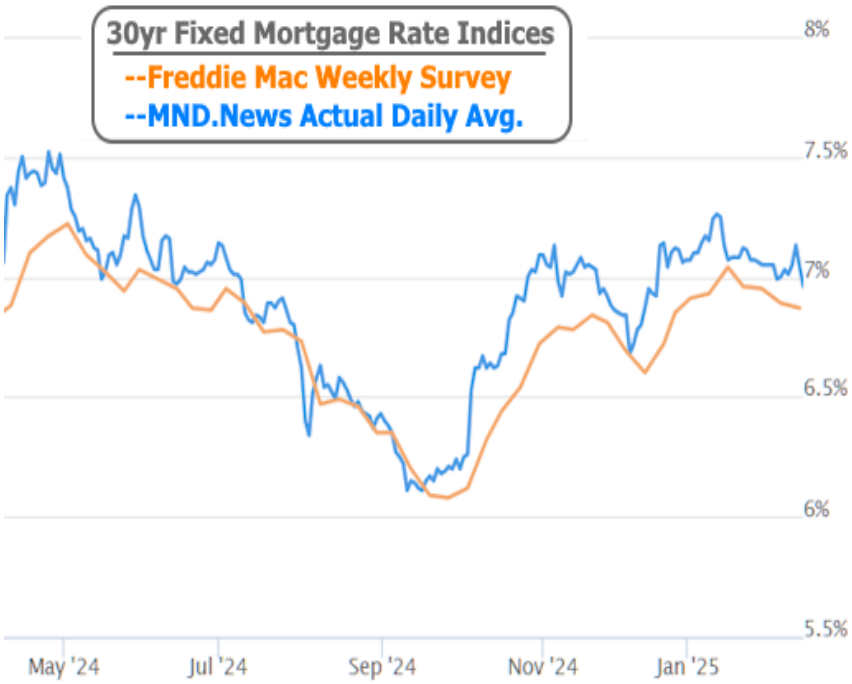
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The Unlikely Story of Mortgage Rates Falling to 2 Month Lows Despite Higher Inflation

The final two days of the present week weren't on many bingo cards as of Wednesday afternoon. At the time, rates were jumping higher in response to inflation data. That same morning, the Consumer Price Index (CPI) showed consumer inflation accelerating much faster than expected last month.

CPI is one of the most important economic reports as far as interest rates are concerned. This is especially true these days as annual inflation has stalled just over 3% on its way back down to the 2% target. In not so many words, rates are higher than they otherwise would be due to that stall.

To get a sense of what rates might be doing without the stall, we need only look back to September. At that time, trends in the data suggested lower inflation as well as some concern about higher unemployment--both of which are good for rates. A few short weeks later, the data began telling a more upbeat story for the economy. The impact on interest rates was obvious with the 30yr fixed rate index rising roughly 1% in short order.



MBS and Treasury

	Price / Yield	Change
MBS UMBS 6.0	100.21	+0.46
10 YR Treasury	4.8931	-0.0772
30 YR Treasury	5.2847	-0.0471

Pricing as of: 11/4 12:40PM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Oct 21	195	+3.39%
Building Permits	Sep	1.4M	+0.43%
Housing Starts	Sep	1.22M	-4.24%
New Home Sales	Sep	676K	-1.17%
Pending Home Sales	Aug	71.2	0%
Existing Home Sales	Oct	3.99M	+0.25%
Builder Confidence	Oct	29	-9.38%

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As keen eyes may note in the chart above, daily rates ended the week at 2 month lows. How can that be considering the unfriendly inflation data and the bounce to 1 month highs on Wednesday? It all had to do with the next 2 days of data.

Thursday morning brough the Producer Price Index (PPI), which is similar to CPI, but for the wholesale/producer level (whereas CPI focuses on how costs are passed through to consumers). It is extremely rare to see PPI cause anywhere close to the amount of rate movement as CPI. It only happens when the underlying data has obvious implications for consumer inflation.

Here's where things get a little bit tricky. Even though we tend to focus on CPI as the biggest volatility risk among the big inflation reports, there's actually another report that's arguably more important: The Personal Consumption Expenditures (PCE) Price Index.

PCE is the Fed's preferred way to track progress toward the 2% inflation goal. It's much broader, and it adapts to changing buying habits faster. CPI only gets more attention because it comes out **substantially** earlier in any given month and tends to do a pretty good job of foreshadowing movement in PCE.



Looked at another way, we could say it is in fact PCE that is the biggest deal for rates, but that CPI does a good enough job foreshadowing PCE inflation that rates simply move on CPI week instead of waiting. The only catch is that PPI also has several components that feed into the PCE calculation.

It's here we find the x factor on Thursday morning. All but one of those PCE-related components in the PPI data suggested LOWER inflation. In fact, many economists immediately revised their forecasts for PCE (2 weeks from now) to lower levels after PPI came out this week.

Confused yet? Here's a recap:

- 3 inflation reports: CPI, PPI, PCE
- CPI and PPI have components that directly influence PCE
- This week's PPI components said PCE would move lower, even though CPI did not
- Lower-than-expected inflation = lower rates

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Friday morning added momentum to the rate-friendly move in a more straightforward way. The Retail Sales report came in much lower than expected with broad-based declines led by online spending (seasonally adjusted, so it's not a holiday issue).

Weaker economic data = lower rates, all other things being equal. Using 10yr Treasury yields as a benchmark, we can see the impact of each of the week's key data points, ultimately resulting in a come-from-behind victory for rates.



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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Monday, Feb 10				
11:00AM	Jan Consumer Inflation Expectations	3%		3%
Wednesday, Feb 12				
7:00AM	Feb/07 MBA Refi Index	640.6		584.3
7:00AM	Feb/07 MBA Purchase Index	153.1		156.7
8:30AM	Jan y/y CORE CPI (%)	3.3%	3.1%	3.2%
8:30AM	Jan m/m CORE CPI (%)	0.4%	0.3%	0.2%
Thursday, Feb 13				
8:30AM	Feb/08 Jobless Claims (k)	213K	215K	219K
8:30AM	Jan Core Producer Prices MM (%)	0.3%	0.3%	0%
8:30AM	Jan Core Producer Prices YY (%)	3.6%	3.3%	3.5%

Event Importance:

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

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Date	Event	Actual	Forecast	Prior
Friday, Feb 14				
8:30AM	Jan Retail Sales (%)	-0.9%	-0.1%	0.4%
8:30AM	Jan Retail Sales (ex-autos) (%)	-0.4%	0.3%	0.4%

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Work with a mortgage lending expert to secure the most favorable terms and a stress free financing experience.

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