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## Cooler Inflation Prompts Big Shift in Rate Outlook

The Consumer Price Index (CPI) is one of two big, monthly economic reports that have the strongest track records of causing volatility for rates. This makes sense considering inflation is the primary reason rates are as high as they are.

Other economic data matters too. The other big report is the Employment Situation, typically referred to as "the jobs report." It was responsible for continuing what had already been a big drop in rates 2 weeks ago. But after that, there wasn't anything major on the calendar until this week's CPI. As such, that left a lot of room for anticipation.

Many times, that sort of anticipation proves overdone and reality ends up being less volatile, but this was not one of those times. The following chart shows the interest rate reaction in terms of 10yr Treasury yields, which tend to move much like mortgage rates over time. Treasuries give us a timely way to observe intraday momentum in the bond market.

## National Average Mortgage Rates



	Rate	Change	Points
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### Mortgage News Daily

30 Yr. Fixed	7.13%	-0.01	0.00
15 Yr. Fixed	6.47%	-0.02	0.00
30 Yr. FHA	6.60%	-0.02	0.00
30 Yr. Jumbo	7.29%	-0.01	0.00
5/1 ARM	7.10%	0.00	0.00

### Freddie Mac

30 Yr. Fixed	6.86%	-0.01	0.00
15 Yr. Fixed	6.16%	+0.03	0.00

Rates as of: 7/2

## Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.31	+0.10
MBS GNMA 6.0	100.52	+0.13
10 YR Treasury	4.3980	-0.0346
30 YR Treasury	4.5616	-0.0442

Pricing as of: 7/3 9:51AM EST

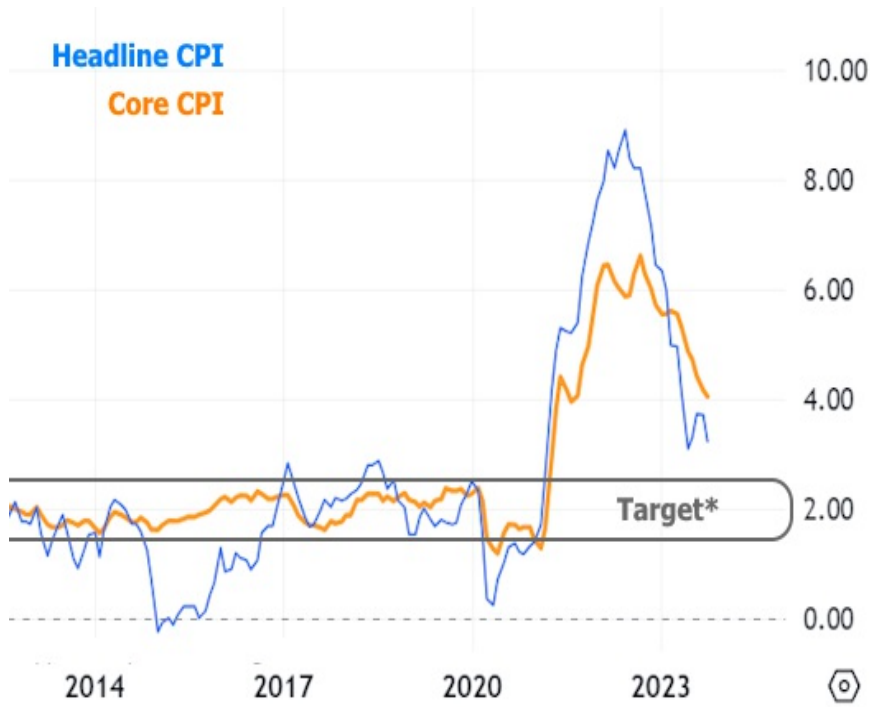
## Recent Housing Data

		Value	Change
Mortgage Apps	Jun 12	208.5	+15.58%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%



In other words, CPI accounted for even more movement in yields (another word for "rates") as well as the trading volume of the underlying bonds. This reaction is made all the more stunning by the fact that CPI was nowhere near as surprising as the jobs report in terms of reality versus forecasts.

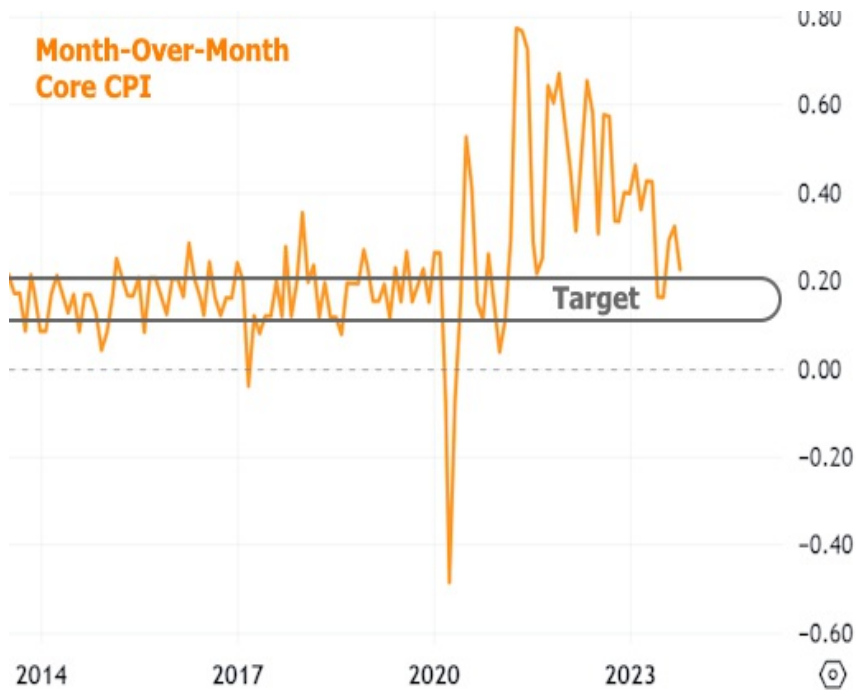
The Fed wants to see core inflation (a more stable metric that excludes food and energy) at 2% year-over-year. We're currently still over 4%, but heading in the right direction.



*\*applies only to the orange line*

The investors driving these sorts of big reactions in the bond market are instead looking at month-over-month numbers to better gauge the progress. After all, if we have several months of 0.17% core inflation, that would ultimately add up to 2.0% annually.

There's no question that progress is more apparent in the monthly numbers, but target levels were only achieved briefly a few months ago and this week's result was actually a bit higher than target.



So what's up with the big reaction in the bond market? It's all about expectations versus reality. If traders are pretty sure that economic data will come in at a certain level, they'd be foolish to wait for the report to come out. The median forecast among hundreds of economists serves as a consensus for traders until the actual numbers come out. If reality is better or worse than the consensus, the market reacts accordingly.

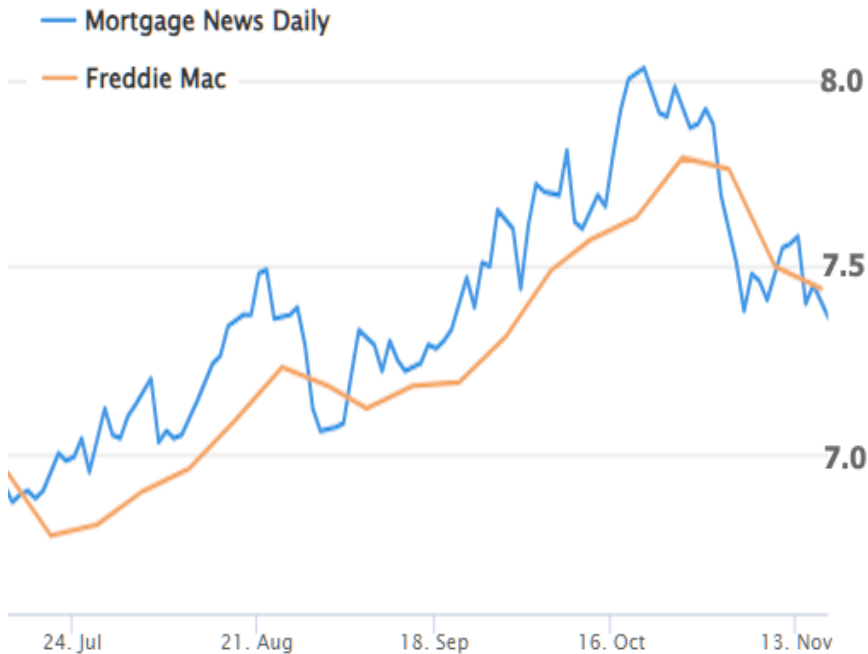
Because the consensus is already factored into bond market trading levels, we often see big ticket economic data come in very close to forecasts without any major market reaction. Arguably, this week's CPI fit the bill with the core month-over-month reading at 0.2% versus a consensus of 0.3%. So why the big reaction?

On one hand, we can consider that traders were simply planning on moving in one direction or the other given that this CPI was in a position to cast an important vote on the recent shift in the bond market.

Those who want to dig deeper for cause and effect might consider that some key internal components of the report spoke to progress in areas where progress has been slow to materialize. Specifically, the housing component fell from a 0.6% pace last month to a 0.3% pace in the current report. It remains one of the key factors keeping inflation above target, so the progress is good news for rates.

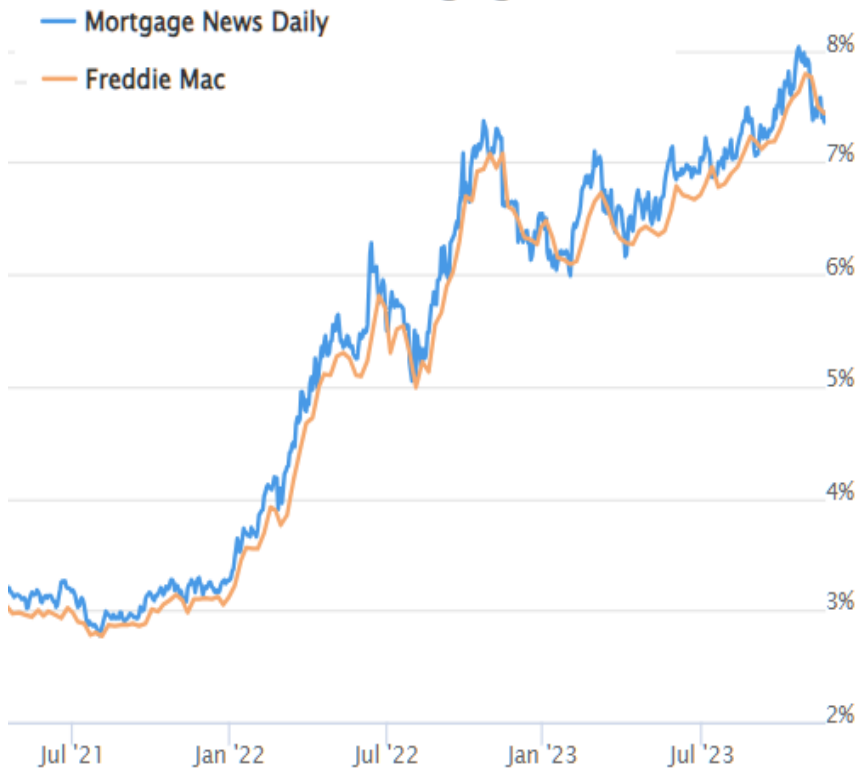
Mortgage rates, specifically, are in line with their lowest levels since mid-September

## 30 Year Fixed Mortgage Rates



But these are merely the first steps of a longer journey. The chart below provides good reminders that rates have appeared to have turned a corner in the big picture several times only to resume an upward march.

## 30 Year Fixed Mortgage Rates



In the cases of the previous false starts, it was a rebound in inflation and economic growth that caused the rate reversal. Bottom line: we'll need to continue seeing data like this week's CPI in order for things to be different this time. On that note, the next round of important data won't arrive until the first full week of December. That means rates may be less interested in big moves higher or lower between now and then.

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With 27+ years of expertise in mortgage banking you can be confident in my knowledge and abilities to deliver a seamless loan transaction while providing personalized service.

**Rich E. Blanchard**

