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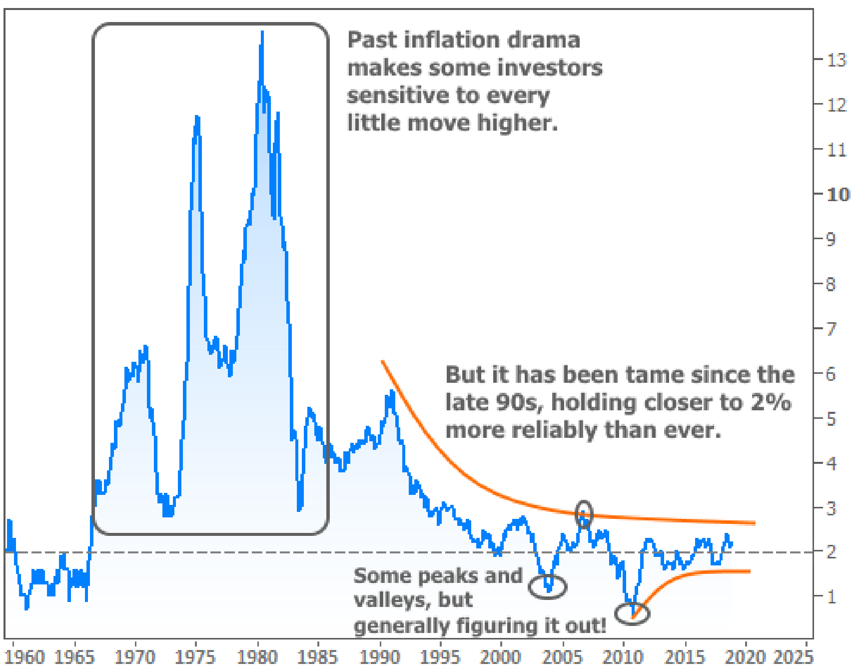
The Day Ahead: Does Inflation Still Matter?

Today's Consumer Price Index was one of the week's only "**important**" pieces of economic data. Or perhaps we should say it was one of the week's only 'big-ticket' reports in the sense that it has been one of the bigger market movers among most of its peers in the long run.

Does it still deserve its **big-ticket status?**

It **depends** whom you ask, and perhaps WHEN you ask. The farther back into the past one goes, the more interesting inflation becomes. But since the late 90's, the economy and the Fed's monetary policy framework increasingly seem to be honing in on the 2% goal fairly reliably.

Core Inflation



Does it matter that inflation is running above 2%? If 2% is the target and we're at 2.2% currently, isn't that bad for bonds?

No and no. The Fed has talked repeatedly about a "symmetric inflation target." This simply means that they'll try to get inflation to stay a bit above 2% for a while if it had just been a bit below 2% for a while. In visual terms, this results in the blue line (in the chart above) "orbiting" around the dotted

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.0	99.37	+0.02
MBS GNMA 5.0	99.93	+0.02
10 YR Treasury	3.9068	+0.0029
30 YR Treasury	4.1960	+0.0028

Pricing as of: 9/1 7:34PM EST

Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85

line.

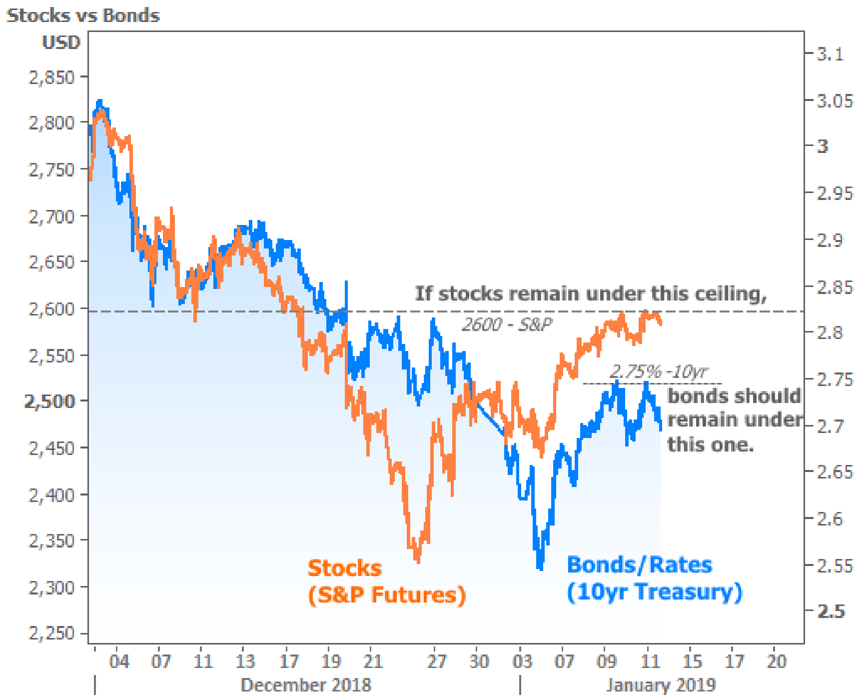
	Rate	Change	Points
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

And if we needed proof that being over 2% doesn't matter, we need look no further than the 5+bp rally in 10yr yields this morning. In fact, the rally could lead to a separate question: is the absence of higher inflation helping the bond market?

That's a bit more **complicated**. In a general sense, yes, but it depends on the definition of "helping." I think it's more accurate to say it's not hurting the bond market. Tame inflation provides a neutral environment in which other market movers can have their say.

At present, it still seems that **stocks are having the biggest say**. The magnitude of the correlation between stocks and bonds has varied, but in general, when stocks hold or bounce under a technical ceiling, bonds have tended to mimic the move. The current trading levels suggest the two sides of the market line up around 2600 in the S&P and 2.75% in 10yr Treasury yields.



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