CP-Eye Popping

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An eye-popping headline for June's consumer price index, which nearly doubled forecasts with a +0.9% print that was the largest increase since June 2008. Over the last 12 months, the all items CPI is up +5.4%. The core rate, excluding food and energy, matched the headline's monthly +0.9% increase while the year-over-year core was up a slightly more restrained +4.5%. Still, that was the largest 12-month change in the core rate since 1991. Base effects do account for some of the year-over-year change, but the monthly gains continue to be driven by transportation, supply bottlenecks, and other reopening related factors.

The most obvious of these is automobiles. New car prices surged 2% in June alone as the chip shortage has depleted inventories and given dealers pricing power. That, in turn, has impacted used car and truck prices which have logged three straight months of massive gains, +10%, +7.3%, and +10.5% for April, May and June, respectively. June's increase in used car prices was the largest ever reported, going back to 1953, and accounted for more than one-third of the headline CPI increase. Over the last 12 months, used car prices have shot up +45.2%. Car rental prices have exhibited a similar pattern and are up +87.7% over the last year. While somewhat shocking to see, these gains are clearly related to base effects and supply chain issues. They are very likely transitory factors that should fade in the months ahead, but the longer they persist the more concerning they become.

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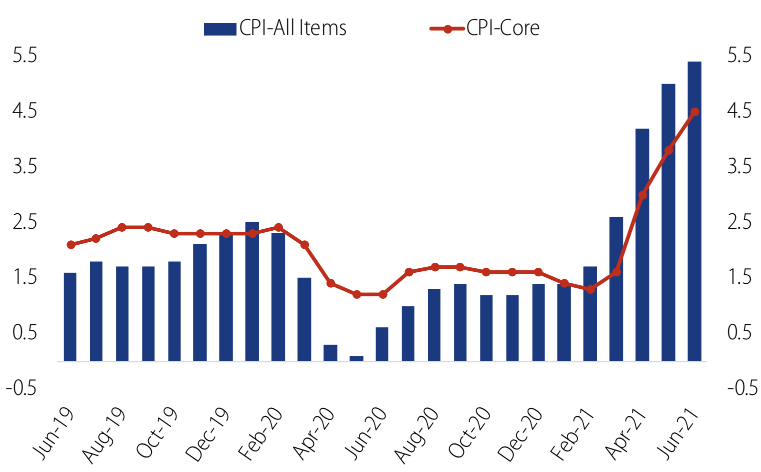
Base effects and reopening trends are all over this month's report. Gasoline has risen +45.1% in the past year and was the main driver behind a +24.5% gain in the energy index. The travel industry is straining with the surge in demand and prices reflect it with airfares rising +2.7% in June; car rental prices up +5.2%; and lodging away from home +7%. Food away from home rose +0.7% last month and is up +4.2% over the last year, the largest yearly gain since 2009 as restaurants are no doubt raising prices in an attempt to offset higher labor costs.

Inflation Indicators (Year-Over-Year Percent Change)



Source: Bureau of Labor Statistics

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While it's tempting to say all this is transitory and won't last, there are signs of inflation broadening out as nearly every major category except medical care increased last month. Momentum is building as well. Over the last six months headline CPI is up at an annualized +7.3% pace and over the last three months it's up 8.4% annualized. And yet, there is enough noise and enough readily explainable one-off items that it's still difficult to tell for sure where inflation will head in the long run. That has muted the bond market's reaction. Yields at the short end of the curve are slightly higher, presumably on the assumption that hotter inflation will garner a quicker reaction from the Fed. At the long end of the curve, however, yields have fallen, presumably on the assumption that recent inflation gains will prove transitory and that a quicker reaction from the Fed will ensure that's the case.

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Market Indications as of 10:31 A.M. Central Time

DOW	Down 44 to 34,952 (HIGH: 34,996)
NASDAQ	Up 67 to 14,800 (NEW HIGH)
S&P 500	Up 2 to 4,387 (NEW HIGH)
1-Yr T-bill	current yield 0.07%; opening yield 0.06%
2-Yr T-note	current yield 0.25%; opening yield 0.23%
3-Yr T-note	current yield 0.46%; opening yield 0.42%
5-Yr T-note	current yield 0.82%; opening yield 0.79%
10-Yr T-note	current yield 1.36%; opening yield 1.36%
30-Yr T-bond	current yield 1.97%; opening yield 1.99%