Markets Tumble as Fed's Preferred Inflation Number Heats Up

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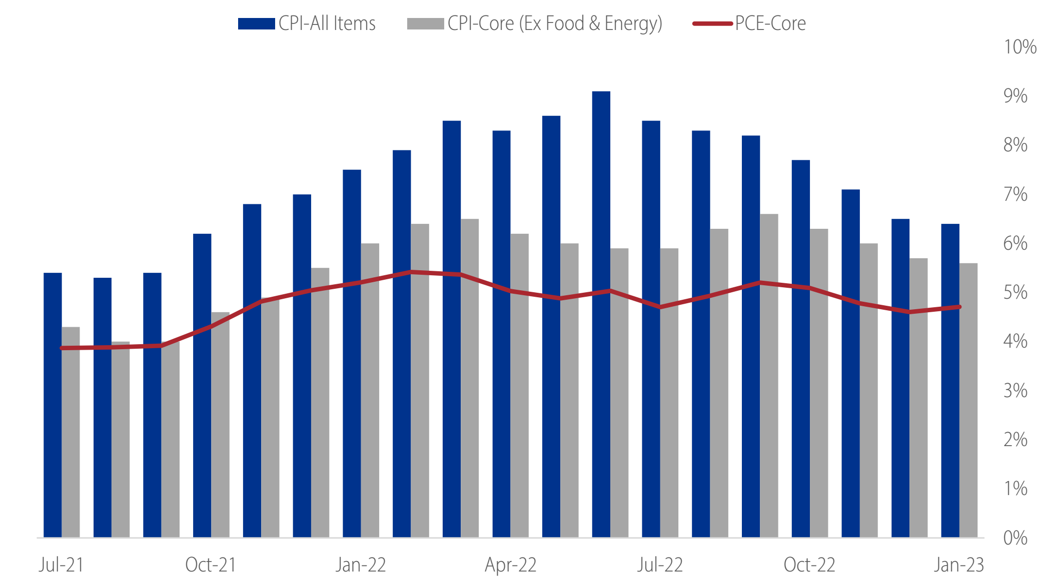
The latest batch of January inflation data wasn't expected to be a market-mover, despite PCE being the Fed's preferred measure. As it turned out, not only did PCE follow last week's hotter-than-expected CPI script, but it amplified it, abruptly halting the year-over-year downward inflation trend.

Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

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The headline Personal Consumption Expenditures (PCE) deflator climbed +0.6% in January, topping the +0.4% median forecast, while the December gain was revised upward from +0.1% to +0.2%. On an annual basis, PCE actually *increased* to +5.4%, reversing a seven-month decline.

The core PCE deflator (ex food and energy) rose +0.6% In January, following a revised +0.4% December increase. On a year-over-year basis, core PCE climbed from a revised +4.6% to +4.7%. *The optics aren't pretty.* Momentum has disappeared.

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Several other economic releases this morning were also a bit too warm. Personal spending rose +1.8% in January, after declines of -0.1% and -0.2% in the previous two months, while new home sales rose +7.2% in January to a +670k unit annual pace, *the highest since last August.* Unseasonably warm weather played a role in the winter spending boom, but signs of increased consumer activity suggest a more resilient economy which, in turn, implies additional Fed tightening.

Bond yields are higher across the curve in early trading as investors digest the latest round of unwelcome economic news and anticipate the Fed's reaction. The U.S. economy will eventually weaken, easing price pressure, but the failure of analysts and Fed officials to predict the broad January surge has resulted in a loss of faith.

The two-year Treasury note yield has risen an astonishing 75 basis points in the three-week period following the Fed's announcement of a quarter point hike on February 2nd. The 10-year note yield is roughly 60 bps higher.

Yesterday, in the first of two GDP revisions, fourth quarter growth was trimmed from +2.9% to +2.7%. Despite the relatively minor headline revision, there was significant movement within categories. In particular, personal consumption was whittled down from +2.1% to +1.4%, *the weakest consumer spending since the Q2 2020 pandemic crash*, while gross fixed investment (business spending) was revised sharply upward from +1.4% to +3.7%. On a year-over-year basis, GDP rose by just +0.9%, *also the weakest since the 2020 economic shutdown*.

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In terms of contributions to the overall GDP headline, inventories (+1.5) and net exports (+0.5) still combined to make up over 70% of real growth during the quarter. Both of these can be wildly volatile. Core GDP, which excludes inventories and trade as well as government spending, was revised downward from +0.2% to just +0.1%. This is an extremely weak growth number, but it's also grown stale. *January data has clearly heated up.*

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Earlier this week, existing home sales fell by -0.7% in January to an seasonally-adjusted annual rate of 4.0 million. The sales pace has fallen for 12 consecutive months on a seasonally-adjusted basis and is now -37% lower year-over-year. Although data from the National Association of Realtors showed average time on the market had risen from 19 days a year ago to 33 days in January, 54% of those homes still sold within a month, indicating a tight market. Supply has improved, but remains a problem. Listings increased for the first time since July, but available supply (at the current sales pace) was just 2.9 months in January, roughly half of "normal."

Market Indications as of 10:29 A.M. Central Time

DOW	Down -351 to 32,803 (HIGH: 36,800)
NASDAQ	Down -204 to 11,387 (HIGH: 16,057)
S&P 500	Down -60 to 3,953 (HIGH: 4,797)
1-Yr T-bill	current yield 5.05%; opening yield 4.99%
2-Yr T-note	current yield 4.82%; opening yield 4.70%
3-Yr T-note	current yield 4.54%; opening yield 4.41%
5-Yr T-note	current yield 4.22%; opening yield 4.11%
10-Yr T-note	current yield 3.95%; opening yield 3.88%
30-Yr T-bond	current yield 3.92%; opening yield 3.88%