

Mild PPI Report Rekindles Bond Rally

The monthly measure of wholesale prices in the U.S. was unexpectedly negative in May, reversing an increase the previous month and adding a dose of fuel to yesterday's bond rally. The headline producer prices index (PPI) fell -0.2% last month, the biggest drop since last October. The May reading was below the +0.1% median forecast and much cooler than the +0.5% advance in April. When food, energy and trade are excluded, producer prices were *unchanged* last month, the mildest measure in 12 months.

According to the Bureau of Labor Statistics (BLS), final demand *goods* fell -0.8% in May, while final demand *services* were unchanged. Nearly 60% of the decline in goods costs was attributed to lower gasoline prices. So far in June, pump prices are down another -4.5%, suggesting the next PPI report will also be on the cooler side.

On a year-over-year basis, final demand PPI is rising at a +2.2% pace, slightly below the median +2.5% forecast. Final demand PPI, ex food, energy and trade, were up an annual +3.2% for the second straight month.

The bond market is rallying in early trading but producer prices (which don't include shelter costs) aren't all that significant in terms of relevant inflation measures. Consumer prices are the Fed's main focus, and May CPI was released yesterday. Still, parts of the monthly PPI feed into the Fed's preferred inflation measure – personal consumption expenditures (PCE) - and most of those feeds were softer.

In other news this morning, initial jobless claims (first-time filings for unemployment benefits) climbed to 242k, the highest weekly total since last August. Ongoing benefit claims rose to 1.82 million, the highest in 14 weeks. The weekly increase in unemployed workers, along with the fact that these unemployed workers are receiving benefits longer suggests a softer jobs market. This should ease wage pressure, along with overall inflation, and probably contributed to the morning rally.

The futures market has now priced-in two quarter point rate cuts for later this year. The chances the first reduction is announced at the September meeting has risen to around 70%.

Market Indications as of 9:01 A.M. Central Time

DOW	Down -228 to 38,454 (HIGH: 40,004)
NASDAQ	Up 117 to 17,725 (NEW HIGH)
S&P 500	Up 10 to 5,431 (NEW HIGH)
1-Yr T-bill	current yield 5.09%; opening yield 5.10%
2-Yr T-note	current yield 4.71%; opening yield 4.74%
3-Yr T-note	current yield 4.46%; opening yield 4.48%
5-Yr T-note	current yield 4.27%; opening yield 4.30%
10-Yr T-note	current yield 4.28%; opening yield 4.30%
30-Yr T-bond	current yield 4.45%; opening yield 4.47%

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