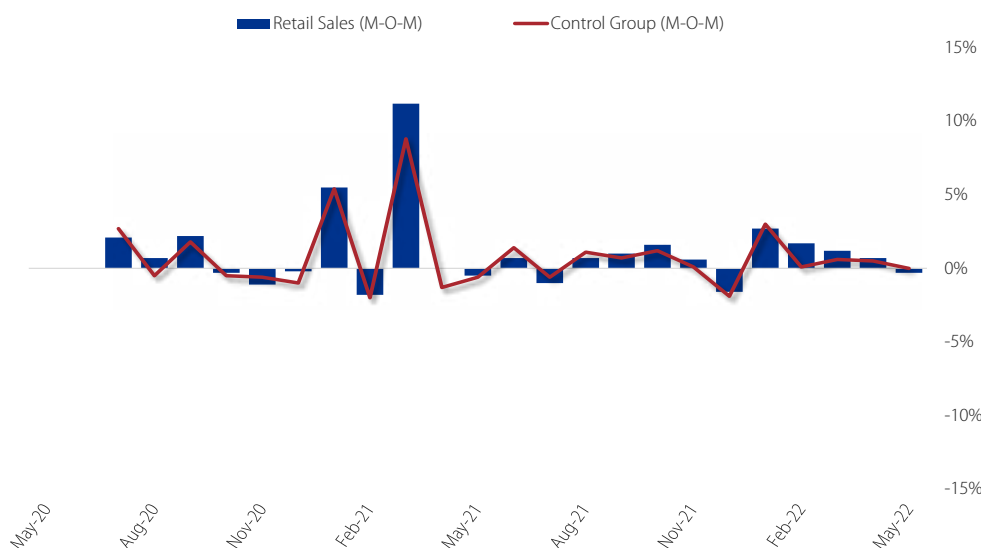


Consumer Spending Shows Signs of Weakening

Retail sales fell last month for the first time this year, signaling that inflation and restrictive Fed policy may be starting to weigh on the consumer. It's rare that the financial markets are able to appreciate a -0.3% decline in spending, but in this case the apparent weakness suggests Fed policy may not be as far behind as investors had come to believe.

The majority of the weakening last month can be pinned on a -3.5% drop in auto sales, although 6 of 13 categories logged declines. Sales at furniture and electronics stores fell significantly in May, perhaps related to supply.

Retail Sales (Month-over-Month Percent Change)



Source: US Census Bureau

One category that didn't fall was gas station sales, which increased by +4.0%. Much of this can be attributed to higher pump prices rather than increased demand as receipts aren't adjusted for inflation. It was the same story with grocery store sales, which rose another +1.2% in May.

The retail sales report primarily reflects spending on goods. The only pure service category is sales at eating and drinking establishments, which were up +0.7% in May after averaging +3.8% gains over the previous three months. Despite the signs of moderation at restaurants and bars last month, analysts expect the overall service sector to make a significant contribution to the U.S. economy this summer, which could help balance out the decline in sales of goods.

The retail sales "control group," which excludes auto dealers, gas station sales, building materials and food services (and is used in the GDP calculation) was *unchanged* in May, while the previously reported April control group gain was chopped from

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+1.0% to +0.5%. The Atlanta Fed's GDPNow model was showing +0.9% Q2 growth with data collected through last Wednesday. This morning's report suggests an even slower pace.

The consumer is getting battered on several fronts: higher lending rates, rising gas and grocery prices, and deteriorating stock market values. The savings rate has declined and borrowings have increased to fill the gap. There are clear signs that demand is already stressed, but the Fed's sights are set squarely on combating inflation. Scattered focus would further compromise strained credibility.

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The FOMC will announce its latest policy decision this afternoon. Whether the committee tightens the overnight target rate by 50 or 75 basis points has been a hotly debated topic over the past several days. Fed officials had long insisted it would be 50, but the markets have concluded a bigger move is now necessary. The bond market rally this morning indicates investors are a little less certain the Fed will need to be as aggressive *going forward*, but a 75 bp hike is still completely baked-in for today. All ears will be on Powell this afternoon, who once again is facing the most important Fed meeting in years.

Market Indications as of 9:05 A.M. Central Time

DOW	Up 369 to 30,734 (HIGH: 36,800)
NASDAQ	Up 195 to 11,024 (HIGH: 16,057)
S&P 500	Up 52 to 3,787 (HIGH: 4,797)
1-Yr T-bill	current yield 3.03%; opening yield 3.08%
2-Yr T-note	current yield 3.31%; opening yield 3.40%
3-Yr T-note	current yield 3.45%; opening yield 3.56%
5-Yr T-note	current yield 3.46%; opening yield 3.56%
10-Yr T-note	current yield 3.37%; opening yield 3.44%
30-Yr T-bond	current yield 3.38%; opening yield 3.40%

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