Consumer Spending Rises Along with Inflation

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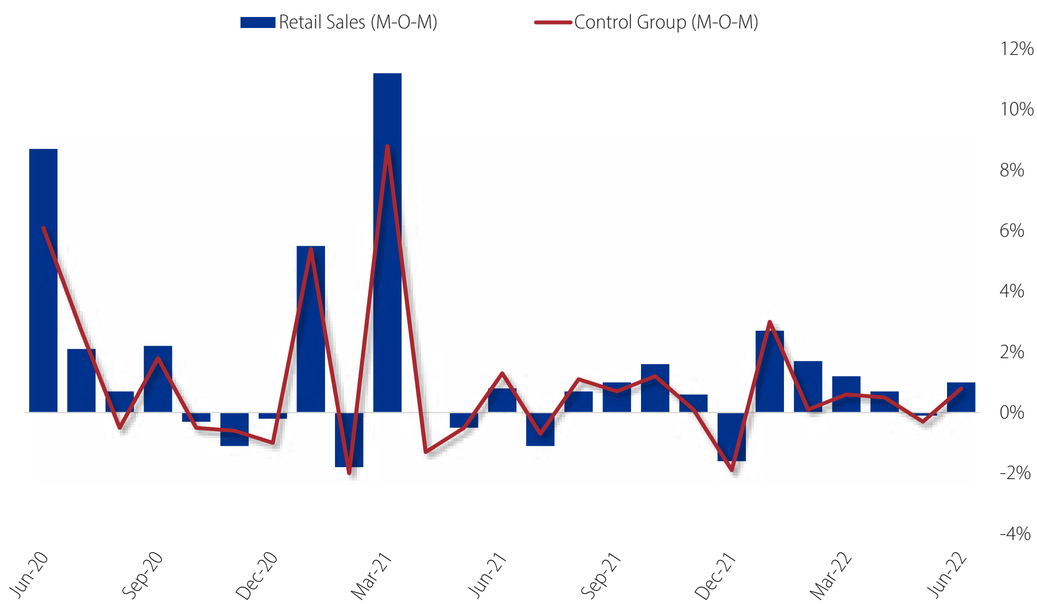
Retail sales rose +1.0% in June, bettering the +0.7% median forecast, as spending on gasoline, autos, restaurants and e-commerce all increased.

Gas station sales were the biggest contributor to the overall number, up +3.6% following a +5.6% rise in May. This category accounted for 0.4 of the +1.0% gain in June. Since sales are not adjusted for inflation, the jump in gasoline sales is a direct reflection of soaring pump prices experienced last month. Since gas prices have dropped throughout July, the next report is expected to be softer.

Non-store (online) sales rose +2.2% during the month, contributing one-third of the headline advance. This may reflect scorching May temperatures throughout the U.S. and a preference to shop online where it's cooler.

Retail Sales (Month-over-Month Percent Change)



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Source: US Census Bureau

Vehicles and vehicle parts increased by +0.8% in June, adding 0.15 to the headline. Sales at eating and drinking establishments (the only service category included in the report) climbed +1.0%, and have now risen in each of the last five months. This category added 0.1 to the overall number.

On a year-over-year basis, retail sales are +8.4% higher, but on a three-month annualized basis, sales are up +9.5%. This is a big number, but the majority of the increase can be attributed to the highest inflation rate in decades. *In real terms, retail sales declined for the second consecutive month, falling -0.3%.*

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The retail sales "control group," which excludes gasoline, autos, building materials and food service rose +0.8%, well above the unchanged forecast. The control group number feeds into GDP.

The markets have generally interpreted the data as favorable with stocks up in early trading and bonds mostly flat. Yesterday, Fed Governor Chris Waller said if consumer spending doesn't cool off, he'd lean toward a larger hike at the July FOMC meeting. This report doesn't indicate cooling per se, but the recent retreat in gas prices bodes well for next time.

The better-than-expected spending increase in June along with a slight upward revision to May will boost second quarter GDP …maybe not into positive territory, but close. As long as the U.S. economy continues to grow, Fed officials will have complete latitude to slow it down with aggressive rate hikes. However, monetary policy will be enacted on a meeting-by-meeting basis and signs of weakness are already present in the economy. For now, it's full speed ahead for the Fed, but the outlook is evolving.

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The FOMC meets next on July 26-27. Although a 100 bp rate hike hasn't been ruled out, 75 bp is the best bet. After that, there are eight long weeks before the September meeting. Between now and then, there will be two more CPI reports and two more retail sales reports to chew on. At this point, we expect both prices and consumption to gradually fall as monetary policy takes effect.

Market Indications as of 8:57 A.M. Central Time

DOW	Up 321 to 30,951 (HIGH: 36,800)
NASDAQ	Up 68 to 11,319 (HIGH: 16,057)
S&P 500	Up 39 to 3,829 (HIGH: 4,797)
1-Yr T-bill	current yield 3.14%; opening yield 3.10%
2-Yr T-note	current yield 3.16%; opening yield 3.13%
3-Yr T-note	current yield 3.18%; opening yield 3.15%
5-Yr T-note	current yield 3.07%; opening yield 3.06%
10-Yr T-note	current yield 2.95%; opening yield 2.95%
30-Yr T-bond	current yield 3.11%; opening yield 3.10%