

Consumer Spending Slows but Inflation is Still the Market Driver

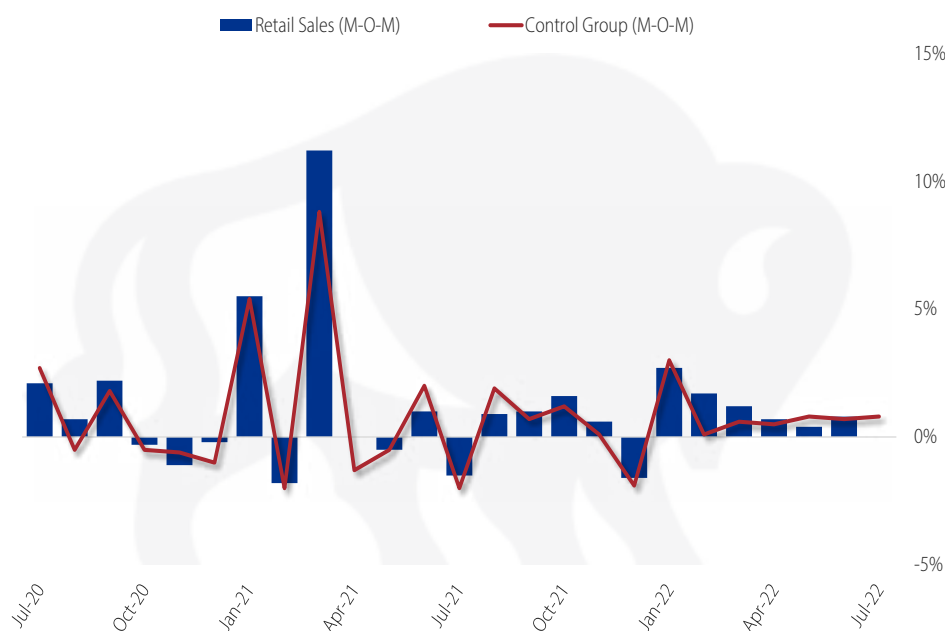
Retail sales were *unchanged* in July, while the June increase was revised downward from +1.0% to +0.8%. Last month's weaker-than-expected sales were primarily due to drops in autos and auto parts (-1.6%) and gasoline (-1.8%). When these two volatile components are excluded, sales were up +0.7%, well above the +0.4% ex auto and gas forecast.

Moderation in sales last month were also found in clothing (-0.6%) and general merchandise stores (-0.7%). This probably reflects discounted prices on excess inventory. Sales at eating and drinking establishments were up just +0.1% in July after averaging +2.6% over the previous five months. Categories showing large increases included building materials (+1.5%) and online sales (+2.7%). The big increase in July e-commerce was fueled in large part by "Amazon Prime Day(s)."

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Retail Sales (Month-over-Month Percent Change)



Source: US Census Bureau

The retail sales "control group," which excludes gasoline, autos, building materials and food service topped the +0.6% median forecast with a solid +0.8% gain. The control group number is used in the GDP calculation, and suggests that economic growth could pick up after two negative quarters.

This morning's release is open for interpretation. Headline sales missed the mark and the previous headline was revised lower, suggesting that consumer spending capacity is stretched. On the other hand, control group sales have been solid, and that's what counts. ... And the elephant on the sales floor is inflation. Retail sales aren't inflation-adjusted, so the +8.6% annual increase would all but disappear when prices are considered.

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Bond prices are significantly lower in early trading (pushing yields higher), but all of the damage was done before the report was released. The reason for the market selloff has to do with a continued increase in the rate of inflation throughout Europe. Early this morning, the U.K. reported an unsettling +10.1% year-over-year rise in July prices, while eurozone prices are up an annualized +8.9%. Food and energy prices are to blame, and unfortunately *the worst may be ahead*. According to the Bank of England, U.K. consumer inflation is expected to top +13% by October as natural gas prices soar. This is expected to push the U.K. into a recession that much of Europe will be hard-pressed to dodge.

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Market Indications as of 9:08 A.M. Central Time

DOW	Down -157 to 33,995 (HIGH: 36,800)
NASDAQ	Down -118 to 12,984 (HIGH: 16,057)
S&P 500	Down -34 to 4,271 (HIGH: 4,797)
1-Yr T-bill	current yield 3.31%; opening yield 3.23%
2-Yr T-note	current yield 3.34%; opening yield 3.27%
3-Yr T-note	current yield 3.29%; opening yield 3.21%
5-Yr T-note	current yield 3.04%; opening yield 2.97%
10-Yr T-note	current yield 2.89%; opening yield 2.82%
30-Yr T-bond	current yield 3.15%; opening yield 3.10%

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