Consumer Spending Slows as Fed Meeting Approaches

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Retail sales unexpectedly increased by +0.3% in August, above the median forecast for an *unchanged* reading. Although this follows a revised -0.4% decline in the previous month, the August gain doesn't necessarily signal a resilient consumer. Strong auto sales (reflecting pent-up demand) were the primary driver, climbing +2.8% last month after a -2.0% drop in July. When autos are excluded, retail sales actually fell -0.3%, worse than the expected *unchanged* reading.

Weighing on the downside last month were gasoline station sales, which dropped -4.2%. Because the data is not inflation-adjusted, significant changes in prices paid exaggerate sales receipts. Also on the weak side were furniture sales, falling -1.3% as home sales fade.

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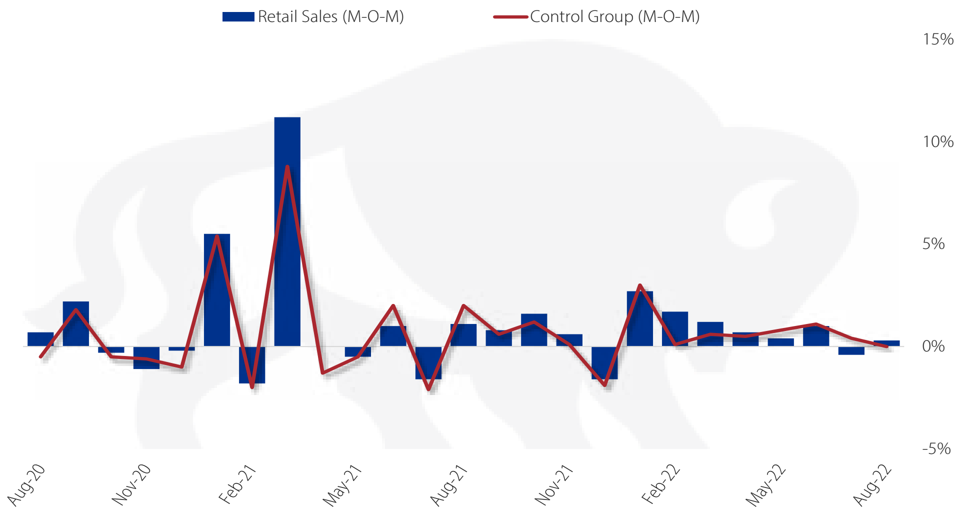
Retail Sales (Month-over-Month Percent Change)



Source: US Census Bureau

Sales at eating and drinking establishments (the only service category included in the Commerce Department data) climbed +1.1% in August, while sales at building materials stores also rose +1.1%. Also notable was a +0.4% rise in clothing sales and a +0.9% increase in department store sales, likely reflecting seasonal back-to-school shopping.

Whereas softening sales would normally be viewed as a negative, in this case it suggests Fed tightening is gradually having the desired effect.

The retail sales "control group," which excludes sales at auto dealers, gas stations, food service establishments and building materials stores, was *unchanged* last month, well below the +0.5% Bloomberg median forecast. In addition, the July control group gain was revised lower from +0.8% to +0.4%. Since this is the number used to calculate GDP, third quarter growth now appears to be a bit weaker. Whereas softening sales would normally be viewed as a negative, in this case it suggests Fed tightening is gradually having the desired effect.

On a year-over-year basis, headline retail sales are up +10.4%, but much of this can simply be attributed to inflation. When looking at sales on a 3-month annualized basis, the increase was just +3.7% in August and significantly negative when adjusted for inflation.

Bonds are once again selling-off in early trading despite the underlying weakness in the retail sales report. The best explanation is the tone of the market has become decidedly negative. Bond investors who have been severely punished this week, are exercising caution with the September FOMC meeting now just days away.

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On a positive note (*which isn't necessarily all that positive when the Fed's objective is to pump the economic brakes*), a potentially crippling rail strike was averted early this morning after a marathon 20-hour negotiation period. Although the agreement between rail worker unions and management has not been ratified, the cooling-off period was extended for several weeks, during which time workers have agreed not to strike.

Market Indications as of 9:09 A.M. Central Time

DOW	Up 86 to 31,221 (HIGH: 36,800)
NASDAQ	Up 12 to 11,732 (HIGH: 16,057)
S&P 500	Up 5 to 3,951 (HIGH: 4,797)
1-Yr T-bill	current yield 3.98%; opening yield 3.91%
2-Yr T-note	current yield 3.84%; opening yield 3.79%
3-Yr T-note	current yield 3.84%; opening yield 3.80%
5-Yr T-note	current yield 3.65%; opening yield 3.60%
10-Yr T-note	current yield 3.44%; opening yield 3.40%
30-Yr T-bond	current yield 3.48%; opening yield 3.45%