

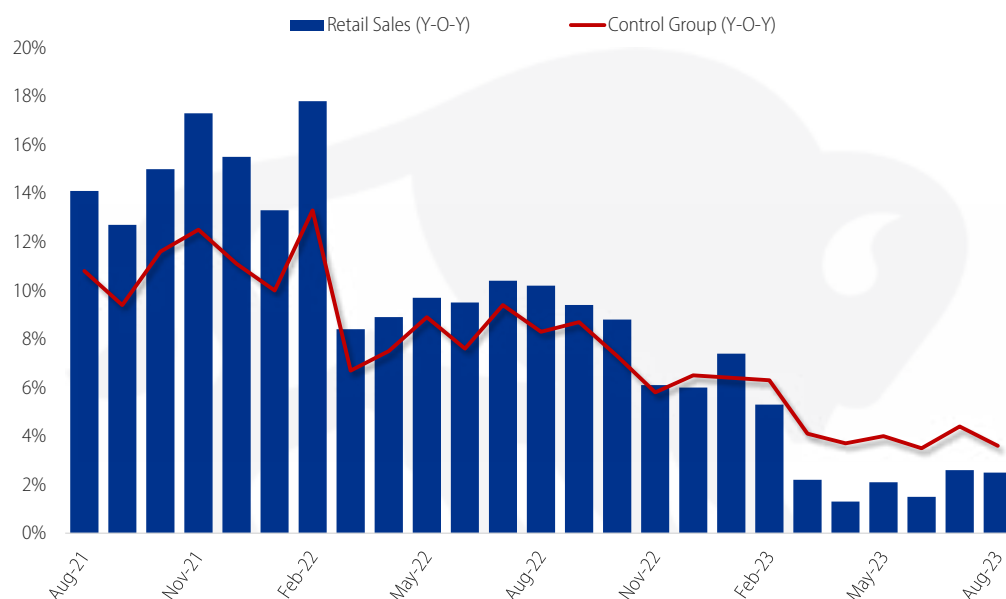
Yields Edge Higher as Consumer Spending and Producer Prices Top Forecasts

The total value of retail sales in the U.S. surprised to the upside once again as August sales climbed +0.6%, well above the +0.1% median forecast. Of the 18 spending categories, only nine increased last month, but gas station sales surged +5.2%, strong enough to drive the headline higher. Sales at gas stations are not adjusted for inflation, so the jump in receipts primarily reflects soaring pump prices during the month. When gas station receipts are excluded, sales are up a more contained +0.2%.

The three-month annualized sales pace has risen from +0.4% in June, to +3.8% in July, to +5.2% in August. With good news being bad news, this resilient consumer spending will keep the door open for additional Fed rate hikes in the event that inflation doesn't retreat as expected in the coming months. That being said, the futures market is signaling just a 2% probability of a quarter point hike at next week's FOMC meeting and slightly below a 50% probability of a quarter point increase before year end.

"Control group" sales, which exclude sales at gas stations, auto dealerships, food service establishments and building materials stores, rose +0.1%, not especially strong, but above the -0.1% median forecast. It's the more contained control group numbers that are used in the GDP calculation. Before today's release, the Atlanta's Fed's GDPNow measure was tracking third quarter growth at +5.6%.

Retail Sales (Year-over-Year Percent Change)



Source: US Census Bureau

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In other news this morning, the August Producer Price Index (PPI) followed a similar narrative as final demand PPI increased by +0.7%, bettering the +0.4% forecast. The primary driver, according to the BLS, was a 20% rise in the cost of gasoline. Core PPI, which excludes food and energy, was up +0.2%, matching expectations. On a year-over-year basis, overall PPI was up +1.6% and core PPI +2.2%. Similar to CPI, annual PPI has been trending higher over the past two months.

The European Central Bank (ECB), in a bit of surprise, raised its key deposit rate a quarter point this morning to 4%. Whereas the Fed is tasked with balancing its dual mandate of full employment and maintaining a stable and moderate rate of inflation, the ECB has only the inflation mandate. Although the eurozone is currently in recession, inflation remains too high, thus another hike was necessary to weaken demand further.

The bond market initially rallied, but has subsequently sold off as investors digest the unexpected show of consumer strength, rising producer prices and the ECB rate hike.

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Market Indications as of 9:11 A.M. Central Time

DOW	Up 140 to 34,715 (HIGH: 36,800)
NASDAQ	Up 13 to 13,826 (HIGH: 16,057)
S&P 500	Up 15 to 4,483 (HIGH: 4,797)
1-Yr T-bill	current yield 5.42%; opening yield 5.38%
2-Yr T-note	current yield 5.01%; opening yield 4.96%
3-Yr T-note	current yield 4.68%; opening yield 4.63%
5-Yr T-note	current yield 4.41%; opening yield 4.37%
10-Yr T-note	current yield 4.28%; opening yield 4.24%
30-Yr T-bond	current yield 4.38%; opening yield 4.34%

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