Retail Sales Rebound, Strengthening the Case for a Fed Rate Hike

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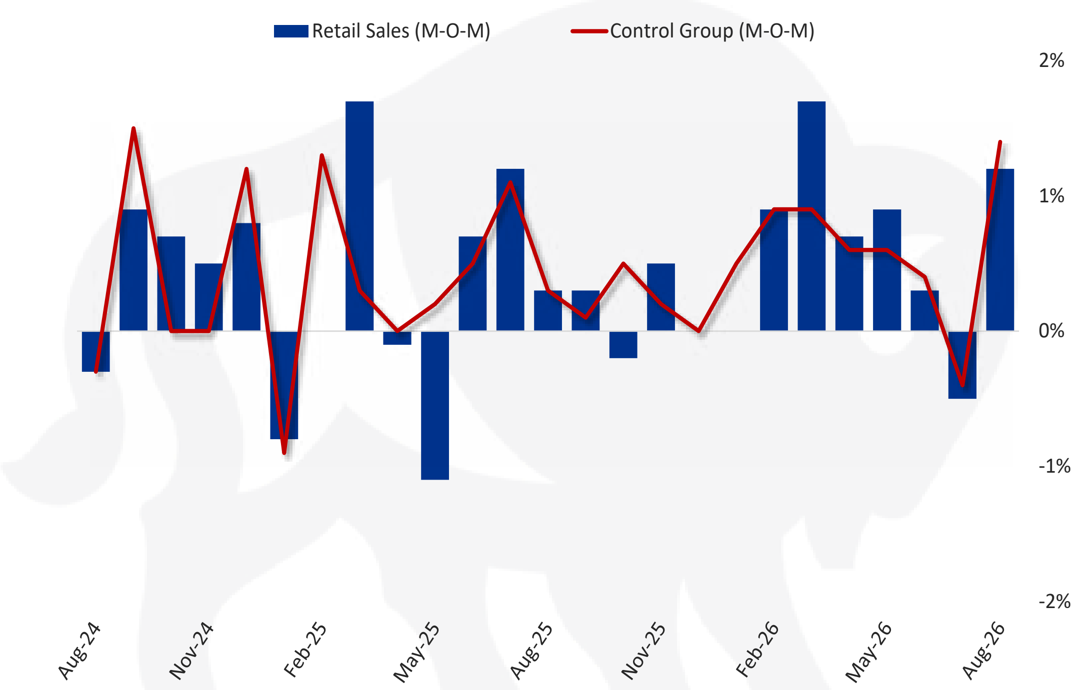
U.S. retail sales rebounded sharply in August as American consumers prepared for the new school year and generally continued to defy less optimistic forecasts with surprisingly resilient spending. Today's strong economic data should further validate what is expected to be the first interest rate increase by the Fed in two years.

Headline sales jumped +1.2% last month, well above the +0.8% median forecast. At the same time, disappointing July sales were revised slightly upward from -0.6% to -0.5%. Gas station sales rose +3.1%, adding 0.25 percent to the headline. Back-to-school purchases were evident in several categories, most notably sales of clothing and general merchandise, both logging +0.7% gains. With much of that school shopping occurring online, internet sales bounced from a -1.7% decline in July to a gain of +2.6% in August, contributing almost half a point to the overall increase.

One of the bigger surprises in the report was how broad spending was last month as 12 of 13 categories rose. Particular strength was apparent in sales of motor vehicle and parts dealers, which gained +0.6%, as well as a +1.2% increase in restaurant sales, the only service sector contributor. "Control group sales," which exclude gasoline, autos, food services and building materials, rose +1.4% following a -0.4% drop in July. This sub-category is especially important as control group sales feed directly into the GDP calculation.

Retail Sales (Month-over-Month Percent Change)



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Source: US Census Bureau

The retail sales report measures mostly goods and is not adjusted for inflation but is otherwise a reliable measure of consumer spending. Since the personal consumption component of GDP contributes roughly 70% of U.S. economic growth, today's release implies that the economy is on more solid footing than previously thought. Strong control group sales in August suggest Q3 GDP, already tracking well above +4.0%, per the Atlanta Fed's GDPNow measure, could be even higher.

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From the Fed's perspective, not only is inflation getting warmer, but economic growth has improved. Although it's far from clear that a 25 basis point increase would have much, if any effect on price pressures, Fed officials have little choice but to begin tapping the brakes. The futures market is currently indicating a 94% probability that Fed officials will announce a quarter point hike in the overnight target this afternoon.

Market Indications as of 9:51 A.M. Central Time

DOW	Down -77 to 52,016 (HIGH: 54,349)
NASDAQ	Up 168 to 26,149 (HIGH: 27,094)
S&P 500	Up 17 to 7,602 (HIGH: 7,799)
1-Yr T-bill	current yield 4.33%; opening yield 4.35%
2-Yr T-note	current yield 4.62%; opening yield 4.65%
3-Yr T-note	current yield 4.71%; opening yield 4.75%
5-Yr T-note	current yield 4.78%; opening yield 4.82%
10-Yr T-note	current yield 4.96%; opening yield 4.99%
30-Yr T-bond	current yield 5.34%; opening yield 5.36%