EW | ECONOCAST™ WEEKLY

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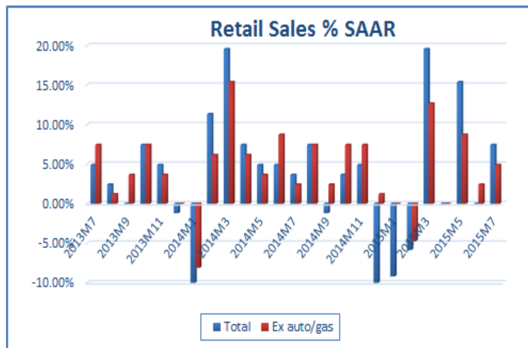
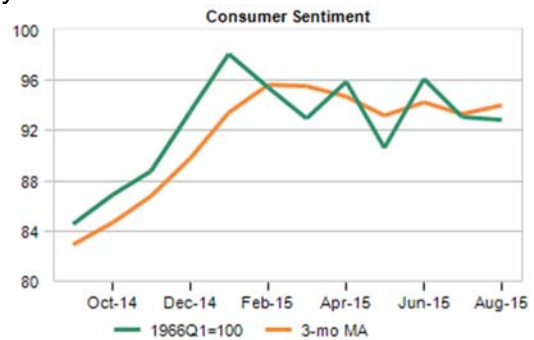
U.S. Economy – Retail Sales Rebound

Stronger gains in retail sales over the last few months confirm accelerating growth in real GDP. Retail sales rebounded in July rising at a 7.4% annual pace, and core sales (sales less autos and gasoline) were up at a near 5% pace. The initial reports of weak sales in May and June were revised up by significant amounts.

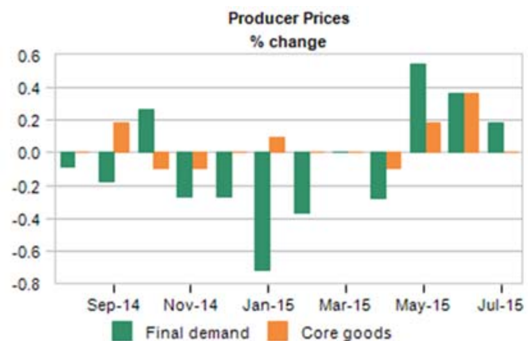


Retail sales have been surprisingly volatile this year, but on average sales are up at a 4% pace this year compared to the 6% annual rate in 2014. This year's volatile and smaller gains in sales are surprising given that the fundamentals are stronger this year. Job growth is higher, wagers are up, the prices for stocks and for homes are higher, and gas prices are down. By all accounts sales should be rising faster not slower this year. This suggests that there is substantial pent up demand available for the 2nd half of 2015.

Consumer confidence remained strong in August, supporting the conclusion that retail sales will accelerate over the balance of this year.



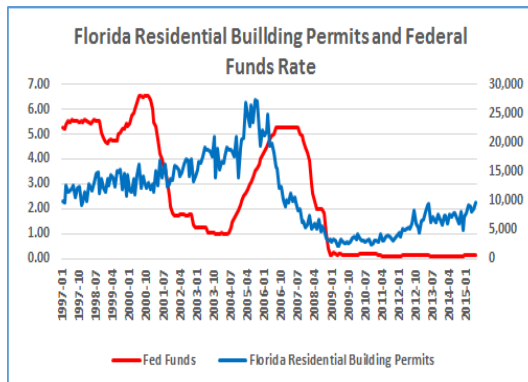
Producer prices slowed in July, because of sliding energy and commodity prices. West Texas crude dropped 20% in July after holding steady in May and June. Core prices did not increase.



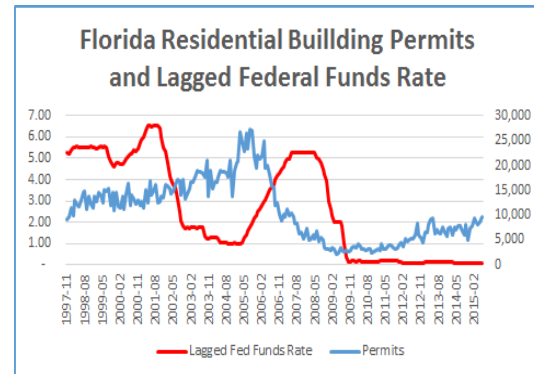
Florida Economy: What Will Higher Interest Rates Do to Florida's Housing Market?

The Federal Reserve has promised to raise the federal funds rate as early as next month. The Fed's timing is tied to the performance of the U.S. economy. It looks increasingly likely that the first rate hike will occur in after the Fed's mid-September meeting. While the pace of future rate increases and the ultimate magnitude of the increases are unknown, there will undoubtedly be impacts on Florida's housing markets.

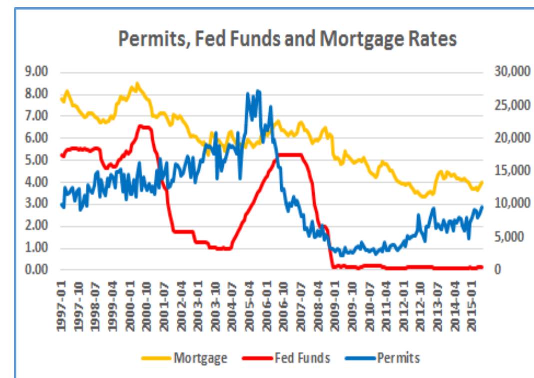
All other things being equal, building permits and interest rates should be inversely correlated. Higher rates should be consistent with lower permit volumes and vice versa. However, while there clearly should be an inverse relationship between the federal funds rate and the volume of residential building permits issued in Florida, the trajectories are confusing exhibiting a positive correlation coefficient of 0.44 since 1997. This does not make much sense,



Part of the answer is that permits do not respond to rates in real time. Instead, permits respond to changes in rates with a lag. The lowest level of the funds rate in the prior business cycle was 1.03% reached in May 2004. Building permit volume peaked 17- months later in August 2005. As the graph below shows, lagging the values for the funds rate produces a chart showing a clearer inverse relationship between the funds rate and permit volume. But, the relationship is not very tight.



The federal funds rate is the only interest rate that the Fed directly controls. However, homebuyers and homebuilders cannot borrow money at the fund rate. Homebuyers are directly affected by mortgage rates. The Fed can only indirectly impact mortgage rates. As the chart below shows, the funds rate has been much more volatile than have mortgage rates over the last 30 years.



All of this suggests that there will be very little negative fallout from the long expected increases in the funds rate for at least six months to a year later following the inevitable increases in the funds rate.

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