US Macroeconomics

September 25, 2023

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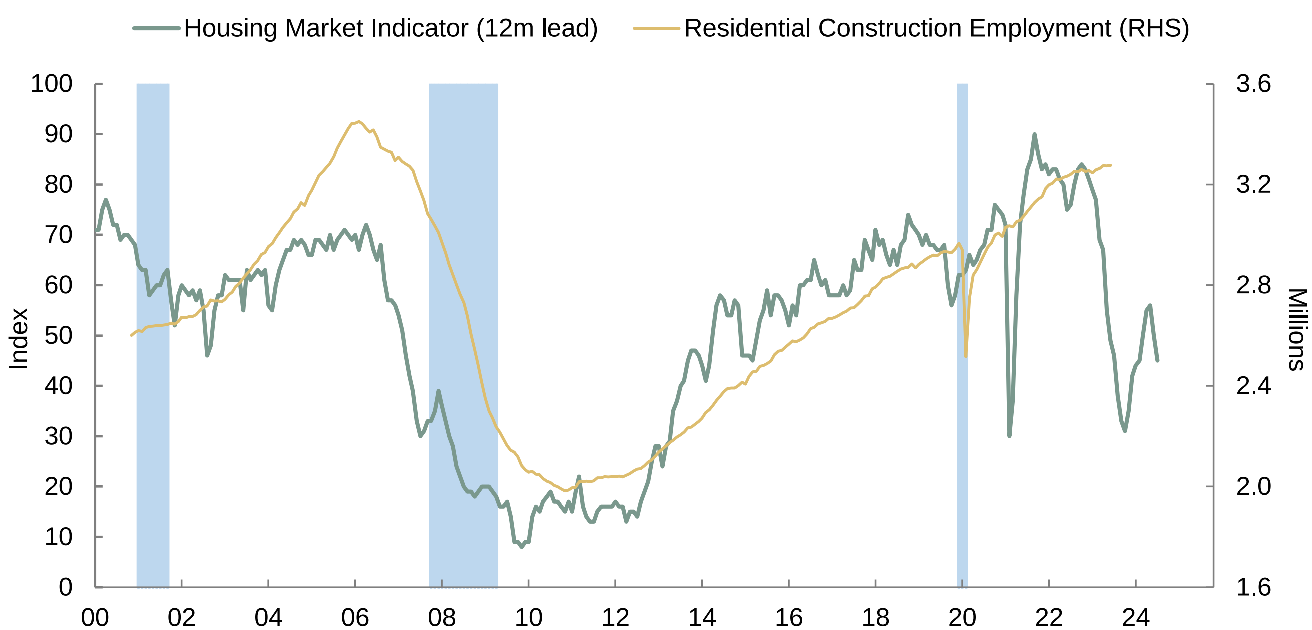
Weak Sentiment Should Lead to Weak Hiring

The National Association of Homebuilders' housing market sentiment index is comprised of three subcomponents: present single-family home sales, expected single-family home sales over the next six months, and traffic of prospective buyers. Sentiment is a leading indicator of the housing market, which itself is a leading indicator of the broader economy. When sentiment is high and rising, residential construction spending and hiring are growing. **Renewed weakness in sentiment poses downside risk for residential construction jobs in the months ahead**.

Homebuilders' sentiment fell five points to 45 this month, its lowest level since April as all three series declined by a similar amount. With interest rates approximately 100 basis points higher than where they were in the spring, sentiment is likely to remain depressed. If so, the current level of employment appears too high. In the chart below, we show the level of sentiment (and a 12-month lead) versus the level of residential construction employment. If sentiment remains in the mid-40s, builder pessimism may lead to significant construction layoffs.

The gap in the chart is worth about 750k construction jobs if the latter follows the level of sentiment lower. Incidentally, this is consistent with another estimate we made based on the growth rate in real residential investment spending. The sharp drop in construction outlays is also consistent with much lower housing-related employment. One of the reasons it has not happened yet could be due to labor hoarding. For example, many industries, not just the real estate sector, had difficulty finding and attracting labor after the reopening of the economy during the pandemic. But that may no longer be the case because job openings have begun to decline while the unemployment rate has started to increase. Put another way, the labor market (i.e., the Beveridge Curve) is normalizing.

Consequently, today's multi-decade high in mortgage rates, which is dampening homebuilder optimism, could eventually lead to sizeable real estate-related job losses. Consequently, this is where investors should focus their attention next week, when the September employment report is released on October 6th even though job gains are likely to increase by only 130k in our view. Stay tuned.



Sources: NAHB, BLS, Haver, SMBC Nikko

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