US Macroeconomics

February 1, 2023

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Where are the First Labor Market Cracks Likely to Appear?

Monetary policymakers will continue to strike a hawkish hue due to low unemployment. Thus, until the unemployment rate rises meaningfully from its current 3.5% rate, **the Fed will reinforce the "higher for longer" mantra with respect to the level of interest rates**. However, the labor market may be closer to an inflection point than many investors think.

According to consensus estimates, nonfarm payrolls rose 190k last month, continuing a trend of moderating employment. This estimate is potentially too high. One area of potential weakness is construction, where job gains have been robust. As we can see from the left-hand side chart below, **the level of construction employment is at an all-time high**. However, this does not jibe with the level of construction activity shown by the accompanying right-hand figure.

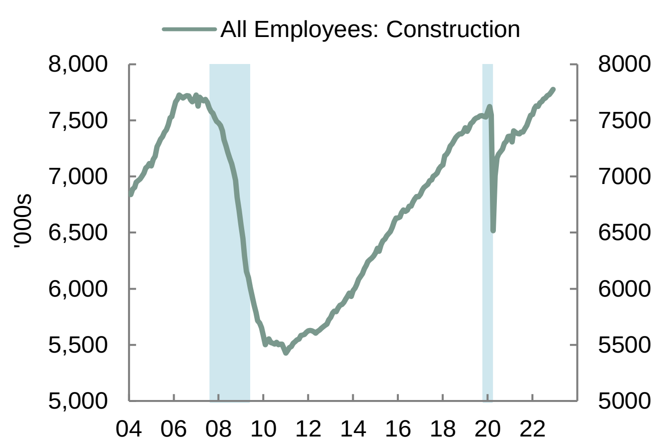
Over the past four quarters, **inflation-adjusted construction spending both commercial and residential is down a whopping 13.7%**. This is the largest decline since the deep housing-induced 2008-2009 downturn and the third largest cyclical drop on record. Yet, construction payrolls have been immune. Why?

One, lingering supply-chain issues may be hampering the completion of various projects. If so, employees will remain on the payroll even though the backlog of projects has meaningfully fallen. In other words, there will be a delay before construction firings begin.

Two, builders may be hesitant to shed labor because of pandemic-related difficulty in finding workers. If so, employees will remain on the payroll if firms absorb weaker demand in their margins. What scenario do we envision going forward?

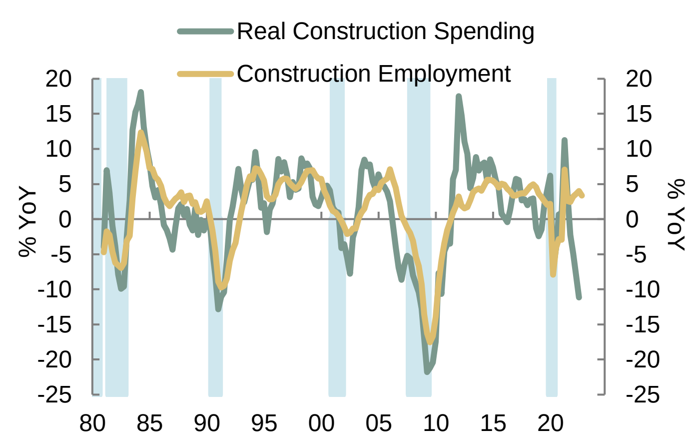
The significant decline in construction spending combined with little evidence we are at a bottom means that construction layoffs may have been delayed but are still coming. A similar situation arose in 2006-07 before the sharp downturn that began in 2008. Based on the current level of activity, the level of construction employment should be over 700k lower. This alone would push the unemployment rate up nearly half of a percentage point. We will see if this Friday's employment report marks the beginning of this inflexion. Stay tuned.

All Employees: Construction



Sources: Haver, BEA, BLS, SMBC Nikko

Construction Spending and Employment



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