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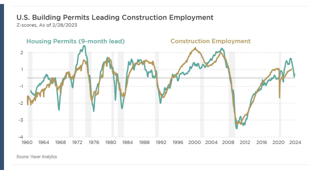


Chart of the Moment: Cracks May Be Building in Construction

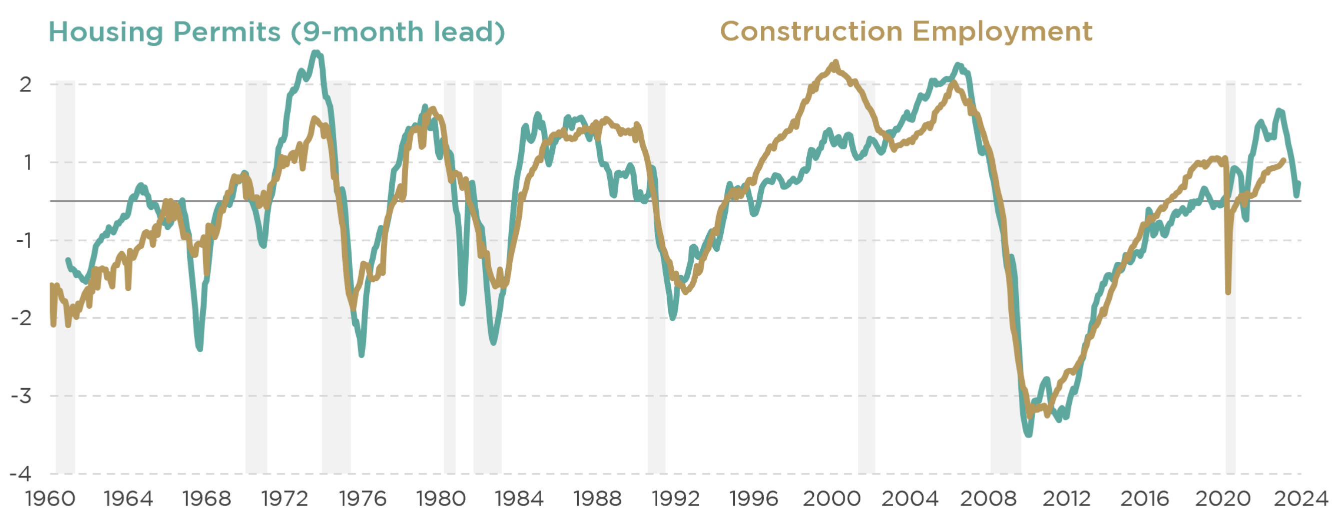
Paul Mielczarski |

We have written extensively about the lag effects of monetary tightening, which are typically long and variable. Given the atypical nature of this economic cycle, we expect the eventual constraints on employment from tighter financial conditions to be even further delayed. The uncertain timing around the impact on employment has been compounded by an extremely tight labor market, as robust job openings contend with a shortage of workers. However, The Federal Reserve (Fed) remains unduly focused on certain components of core CPI and labor market conditions during this tightening cycle. To date, the decreases in inflation have had little to do with Fed tightening. Meanwhile, we have yet to see any meaningful weakness in the labor market, a necessary prerequisite for a pause or pivot in Fed policy.

One area that might hint at coming signs of weakness is construction. Construction employment, fueled by post-pandemic normalization and fiscal largesse, still remains at cyclical highs. According to U.S. employment data, both residential and non-residential construction employment show no signs of slowing yet. However, job openings in the construction sector are starting to peak and roll over. As this chart shows, there is typically a nine-month lag between building permits and construction employment. Therefore, we should start to see outright declines in construction employment over the next 6-12 months. Admittedly, in 2021-2022 construction employment did not increase as much as permits would have suggested, so there likely will be an element of labor hoarding. But this indicator could be one of the first signs of coming labor market weakness.

U.S. Building Permits Leading Construction Employment

Z-scores, As of 2/28/2023



Source: Haver Analytics

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