Navigating Economic Crossroads

The intricate relationship between job growth, interest rates, housing and labor markets

By **Don Neff**

Job growth leads to household formation, which has historically been a direct 1:1 relationship. Having a job means independence to find your own home. However, high-interest rates reduce affordability and directly affect housing demand. Interest rates and housing demand are always an inverse relationship.

Over the past year, the Fed has been reluctant to cut interest rates due to continuing strong employment growth as we recover from the Covid-19 job losses. These are now mostly replaced, but with different types and locations. In the future, growing inventories and faltering job growth will lead to slowing business activity and a recession for other industries. Housing is already in recession given the Fed's aggressive interest rate increases beginning in 2022. And the current inverted yield curve is positive proof of a coming national recession. Several important questions to consider will be: when will it happen? How long and how severe? Will it be limited to only the United States or specific regions of the U.S. or manifest in other countries?

Higher interest rates = lower housing demand: This explains the current malaise in many real estate markets around the country and has led to creative homebuilders' interest rate "buy down programs." These are important tools designed to encourage home-buying activity. Veterans in our industry remember the double-digit interest rates up to 18-20% over 40 years ago in 1980-1982 when these programs first emerged to deal with generational high rates. Today the rates are dramatically lower by comparison, yet the mechanics of buy-down programs are still the same and equally effective, particularly for those young buyers on the fence of making the "go-no-go" decision to buy their first home.

High inflation = lower disposable income: In the Fed's continuing battle against inflation with a target of 2%, more economic pain is likely. Sadly, the exuberant combination of federal capital spending and their energy policies over the past three years, including the drive toward greening the U.S. economy away from traditional carbon-based energy has only fueled the inflationary flames for consumers, specifically for basic human needs—housing, food and energy. So, we have major Federal policies in direct conflict with each other.

"After the rest of the U.S. economy finally slips into a cyclical decline, the homebuilding industry will lead the economy back to health again beginning with entry-level priced housing"

Food costs have risen everywhere, and this is from energy inputs for production, processing, distribution and marketing. As people are spending more to meet these basic needs, housing upgrades become discretionary and are deferred into the future. Getting onto the homeownership equity ladder is being postponed for many until the next recession brings down interest rates to a more "affordable" level. For prospective homebuyers, be mindful that, "patience is a virtue."

Interstate migration = challenged labor markets: Government policies to manage the COVID-19 pandemic have also contributed to new migration patterns over the past three years. People have chosen lifestyles for their families as their new priority over job locations and moved from high-tax to low-tax states. Technology advances have allowed more flexibility for remote workers in knowledge-based industries, but not so much for line workers anchored to manufacturing operations. Moreover, massive numbers of workers have left the job market.

Replacing skilled craft workers in the construction field has become a universal challenge for builders and developers nationwide. This includes the myriad of specialty trades for all construction projects. Fortunately, new AI-related software tools have emerged in the recent past and will continue to evolve, helping alleviate the deficit of skilled construction workers. Software for handling routine processes from the back office to field monitoring of projects including Pro-core, Plan-grid and CaptureQA® are all examples.

A significant contributing solution to the challenged construction labor markets has also been the adoption of high school construction training, internships, mentorships and on-the-job training programs in robust growth markets. These provide a pragmatic alternative to the expensive college degree route for young job seekers and provide easily employable skill sets in high demand with good wages throughout the workplace. "A savvy rabbit has many burrows," and skill sets.

Concluding thoughts: After the rest of the U.S. economy finally slips into a cyclical decline, the homebuilding industry will lead the economy back to health again beginning with entry-level priced housing. Soon enough it will be time again to secure those choice parcels of land which will serve this future need. As a famous saying goes, "The early bird gets the worm.". B&D

Don Neff *is president of LJP Construction Services.*