

Dutta's Monetary Thoughts

Don't sleep on housing

Neil Dutta

Review: Soft September

Last week, while retail sales surprised to the upside, measures surveying consumers and homebuilders remained sluggish, deteriorating somewhat from the previous month. Manufacturing surveys were mixed. Our nearby figure summarizes the hard-data released for August, beginning with unit vehicle sales, and survey measures for the latest month of September. As the table illustrates, it is mostly red, with a little bit of green.

Event	Period	Survey	Actual	Prior
Wards Total Vehicle Sales	Aug	16.10m	16.07m	16.41m
ADP Employment Change	Aug	68k	54k	106k
Change in Nonfarm Payrolls	Aug	75k	22k	79k
Change in Private Payrolls	Aug	75k	38k	77k
Unemployment Rate	Aug	4.3%	4.3%	4.2%
U. of Mich. Sentiment	Sep P	58.0	55.4	58.2
U. of Mich. Current Conditions	Sep P	62.0	61.2	61.7
U. of Mich. Expectations	Sep P	56.2	51.8	55.9
Empire Manufacturing	Sep	5.0	-8.7	11.9
Retail Sales Advance MoM	Aug	0.2%	0.6%	0.6%
Retail Sales Ex Auto MoM	Aug	0.4%	0.7%	0.4%
New York Fed Services	Sep	-5.8	-19.4	-11.7
Industrial Production MoM	Aug	-0.1%	0.1%	-0.4%
Manufacturing (SIC) Production	Aug	-0.2%	0.2%	-0.1%
NAHB Housing Market Index	Sep	33	32	32
Housing Starts	Aug	1365	1307	1429
Building Permits	Aug	1370	1312	1362
Philadelphia Fed	Sep	1.7	23.2	-0.3

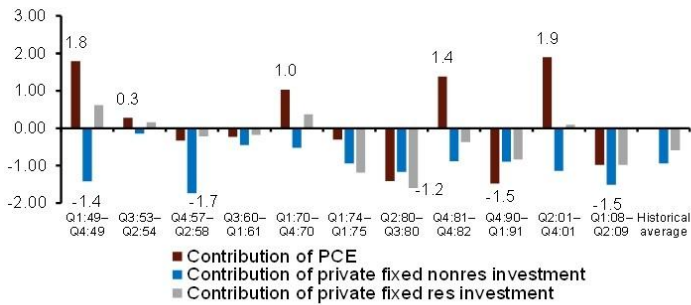
Within the hard-data itself, I tend to put the most weight on employment since it is the most stable measure of economic activity and has the largest sample-size of any of the high-frequency economic data released to the public. Moreover, I'd put more emphasis on timelier September data.

In short, hard data for August have been mixed at best, with weak employment being partially offset by stronger retail sales. Meanwhile, survey data for September has been soft, on net. The evidence that conditions are sustainably turning a corner remains thin.

Hot topic: Banking on the consumer?

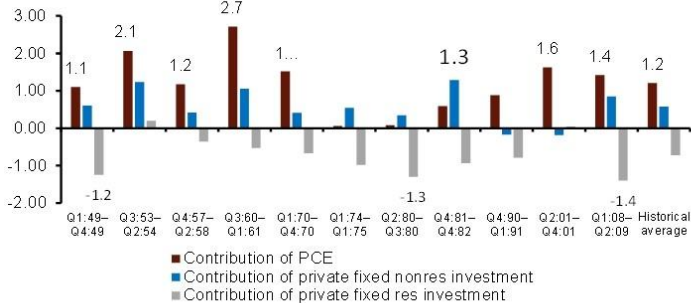
The recent strength of retail sales reinforces an important thesis among growth optimists. Consumers' spending represents a large share of the economy. If it is not slowing, the economy and labor market will be fine, or so the thinking goes. I think the causality here is backward. A consumer slowdown is never the precipitating cause of an economic slump.

Consumer spending has cushioned several economic blows
(Percent change annualized, quarterly average, ppt)



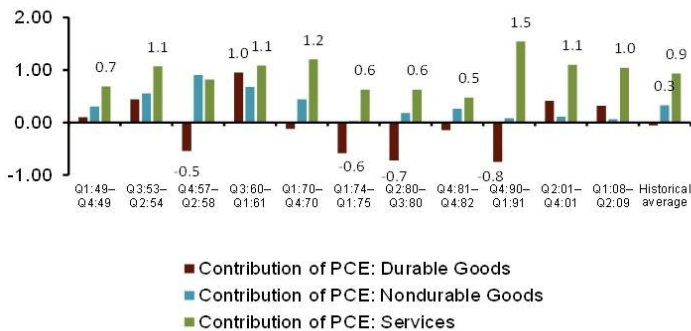
Source: Renaissance Macro Research, Haver Analytics

Consumer spending shows no slump before recession
(Percent change annualized, quarterly average, 2-qtrs before recession, ppt)



Source: Renaissance Macro Research, Haver Analytics

Durable goods spending typically declines during pre-recession
(Percent change annualized, quarterly average, 2-qtrs before recession, ppt)



Source: Renaissance Macro Research, Haver Analytics

Consumption is not where the signal is

For starters, consumption has managed to grow modestly in several previous economic slumps, contributing to GDP. That is, in a few downturns, consumption helps economic conditions from getting worse, cushioning the blow. Specifically, in 1948, 1970, 1982, and 2001, real consumption expanded *during* the recession. On average, the contribution of consumption to GDP during recessions is close to zero.

Next, consumption has never declined in front of an economic slump. Importantly, the growth in recent quarters does not look especially unusual. Assuming current-quarter tracking estimates are in the ballpark, average annualized growth in real consumers' spending will run about 2.2% SAAR in the two quarters ending in Q3. This is slightly slower than consumption growth in the two-quarter period preceding each of the last three recessions but hardly anything out of the ordinary.

Finally, we can expand this analysis to the different parts of consumption: durable goods, nondurable goods, and services. Perhaps consumers cut back on big ticket durables before cutting consumption in service industries. Indeed, in the two-quarters before recession, consumers tend cut back on durables, on average. As our figure shows, this happens just over half the time going back 11 cycles. So far this year, the contribution of durables has been about flat. Meanwhile, during the recession durable goods spending tends to fall while spending on services holds up.

For a similar discussion, see the [link](#).

Of course, one issue today is that tariff-announcements are toying with the data creating a push and pull in consumer behavior with respect to durables. The threat

of tariffs might pull forward activity while the hope for a removal of tariffs might cause consumers to wait it out. Moreover, the big story in the first half of this year has been the slowing in services – spending that’s likely less sensitive to tariff news.

I think what this analysis shows is that if you are waiting on the consumer to make a call about a turn in the business cycle, you are likely waiting too long. Consumption contracts after the slump starts and sometimes it does not fall at all.

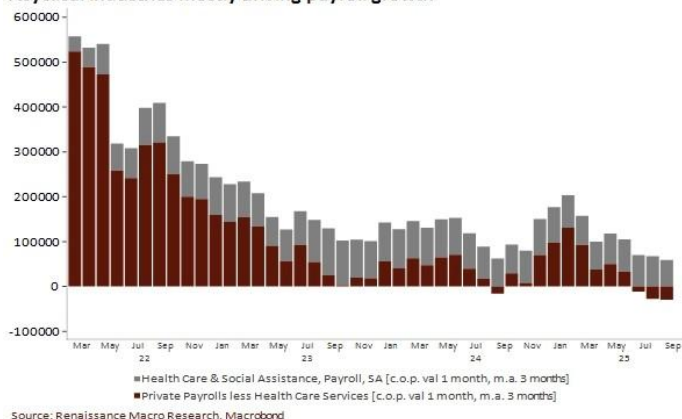
Labor markets cool despite solid spending

The **broader problem here is that real consumers’ spending has been doing quite well in recent years and nevertheless, labor market conditions have been cooling**. In 2023 and 2024, real PCE expanded 3.0% and 3.1%, respectively. The unemployment rate rose 0.3ppt in each of those two years. So far this year, the unemployment rate is on track to finish up another 0.3ppt.

Importantly, key areas of the jobs market appear to be slowing. First, the bulk of recent jobs growth has been in acyclical industries such as healthcare. Growth here has been slowing lately; if that continues, it is hard to see what picks up the slack right away. Second, cyclical areas of the jobs market – goods-producing jobs – have been contracting already. Third, despite “loose” financial conditions, labor markets have now reached a point where the level of unemployment exceeds job vacancies.

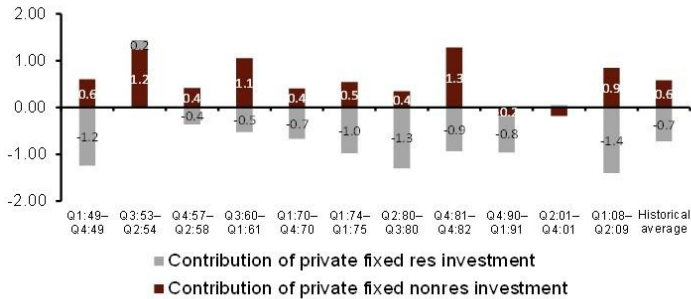
If consumption is the end all and be all of employment (“sell more stuff, hire more people”) why has the labor market slowed to begin with?

Acyclical industries mostly driving payroll growth



Investment signals provide more reliable recession warning

(Percent change annualized, quarterly average, 2-qtrs before recession, ppt)



Source: Renaissance Macro Research, Haver Analytics

notable that residential investment has been contracting for five of the last six quarters with more slowing likely in train.

A better signal in residential investment

By contrast, investment tends to send a more reliable signal in front of and during a recession. During a recession nonresidential business investment always contracts while residential investment almost always declines (2001 was the lone exception). Moreover, in the two quarters before a recession, the contribution of residential investment to GDP growth is negative (again, with 2001 being an exception) while the contribution of nonresidential business investment tends to be positive.

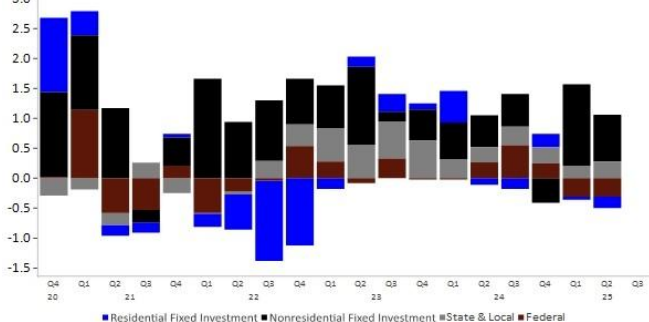
Thus, to the extent any one sector provides a tell, it is

This of course is not the first time residential investment has declined in the post-COVID era. In 2022, there was a notable drop in residential investment as the Fed embarked on its rate tightening campaign; however, there are some important distinctions between now and then.

- Government spending and investment was a meaningful tailwind to GDP growth. By Q4 2022, government spending and investment was adding about as much to GDP as residential investment was taking away. Today, by contrast, government spending and investment has been slowing, cutting GDP modestly.

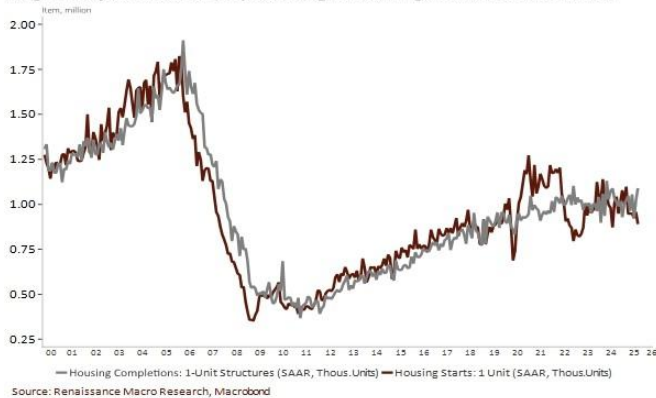
Government and investment shifted from GDP tailwind to modest drag

(Contribution to Real GDP %Chg(SAAR,ppt))



Source: Renaissance Macro Research, Macrobond

Single family starts below completions signal declining units under construction

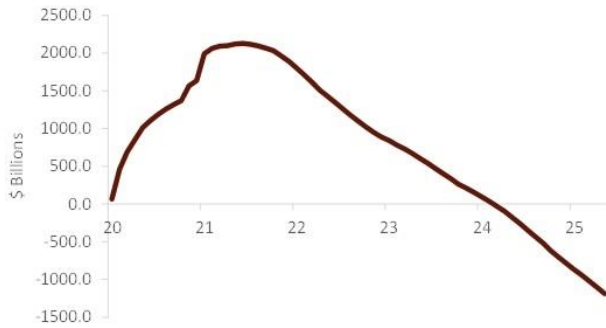


Source: Renaissance Macro Research, Macrobond

- Through most of 2023, units under construction were elevated. Builders had a meaningful backlog of homes to work through and kept adding construction workers to their ranks. Today, by contrast, no such backlog exists. With housing starts running below completions, units under construction have more room to decline.

Pandemic-era excess savings completely depleted

(Cumulative excess savings since Mar-20 wrt Pre-pandemic trend)



Source: Renaissance Macro Research, Haver Analytics

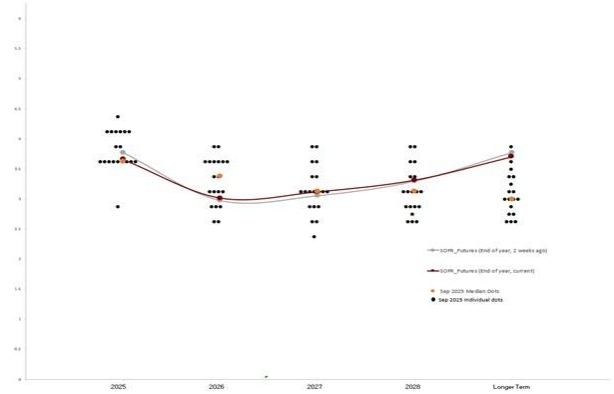
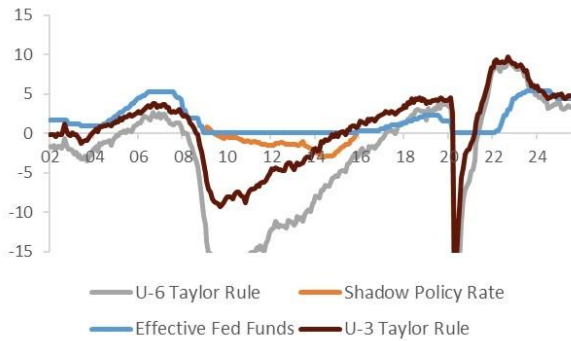
- Finally, households were still drawing down pandemic era excess saving, supporting consumption at a time housing was slowing. Pandemic era excess saving was drawn down completely sometime in 2024. That puts the onus on labor incomes as the primary driver of consumption now.

In short, there are reasons to assume the slowdown in residential might matter a little bit more for the broader outlook than was the case before.

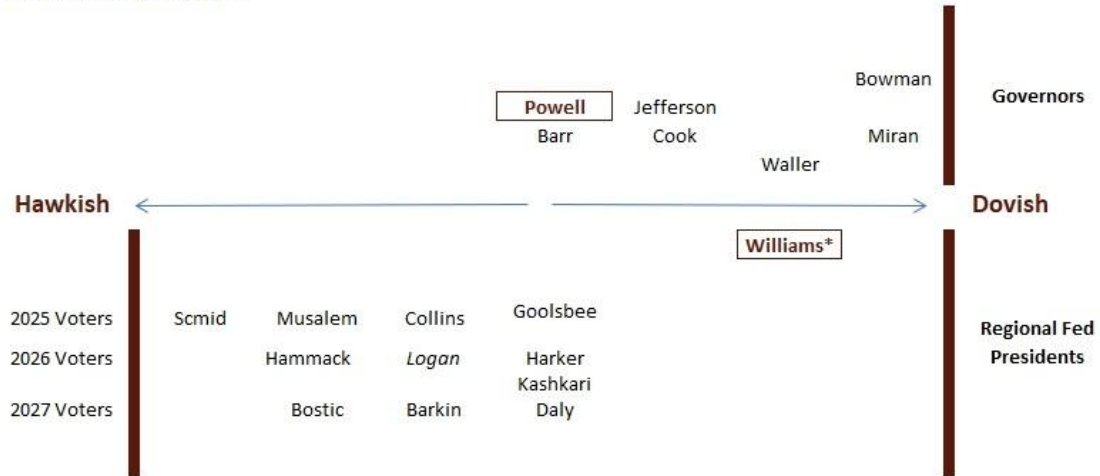
Preview: Powell speaks on the outlook

Chair Powell delivers a speech on the economic outlook this week, and I'm curious to hear his evolving views on the risks in the labor market. On the economic data calendar, flash PMIs will be released for September, and we'll be paying particularly close attention to new home sales. If new homes are not being sold, the pipeline of future construction will continue to dry up.

Monetary metrics



Hawks and Doves



*Federal Reserve Bank of NY President always votes
Boxed individuals represent FOMC core

FOMC Forecasts	Median					Central Tendency				
	2025	2026	2027	2028	Longer run	2025	2026	2027	2028	Longer run
Change in real GDP	1.6	1.8	1.9	1.8	1.8	1.4–1.7	1.7–2.1	1.8–2.0	1.7–2.0	1.7–2.0
June projection	1.4	1.6	1.8		1.8	1.2–1.5	1.5–1.8	1.7–2.0		1.7–2.0
Unemployment rate	4.5	4.4	4.3	4.2	4.2	4.4–4.5	4.4–4.5	4.2–4.4	4.0–4.3	4.0–4.3
June projection	4.5	4.5	4.4		4.2	4.4–4.5	4.3–4.6	4.2–4.6		4.0–4.3
PCE inflation	3.0	2.6	2.1	2.0	2.0	2.9–3.0	2.4–2.7	2.0–2.2	2.0	2.0
June projection	3.0	2.4	2.1		2.0	2.8–3.2	2.3–2.6	2.0–2.2		2.0
Core PCE inflation	3.1	2.6	2.1	2.0		3.0–3.2	2.5–2.7	2.0–2.2	2.0	
June projection	3.1	2.4	2.1			2.9–3.4	2.3–2.7	2.0–2.2		
Projected policy path										
Fed funds rate	3.6	3.4	3.1	3.1	3.0	3.6–4.1	2.9–3.6	2.9–3.6	2.8–3.6	2.8–3.5
June projection	3.9	3.6	3.4		3.0	3.9–4.4	3.1–3.9	2.9–3.6		2.6–3.6

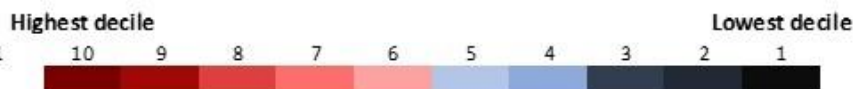
High frequency data heat-map



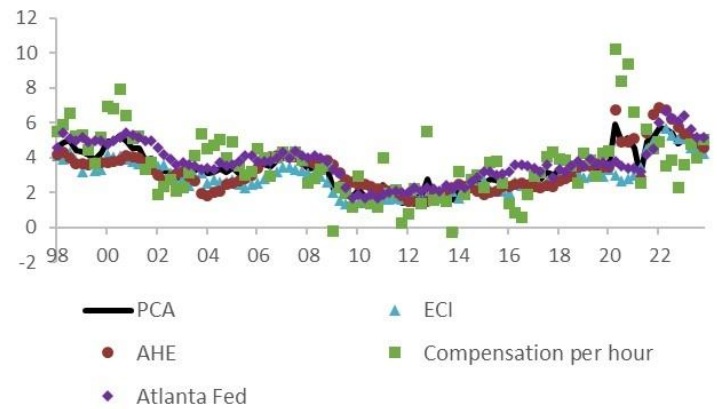
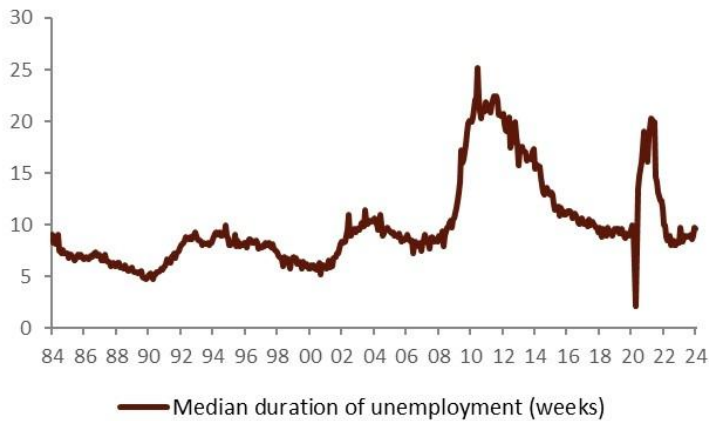
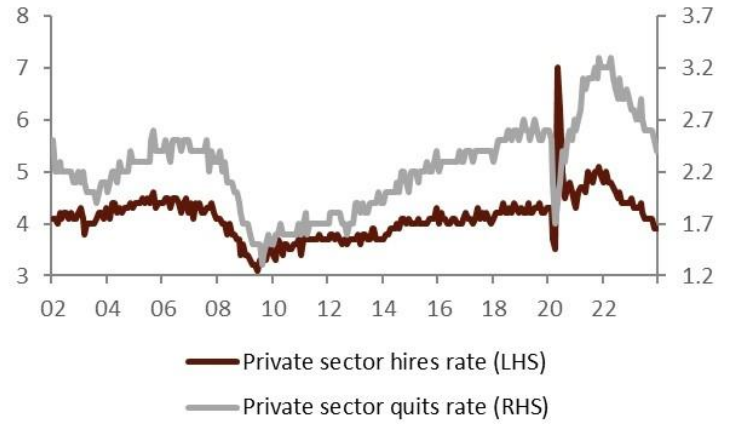
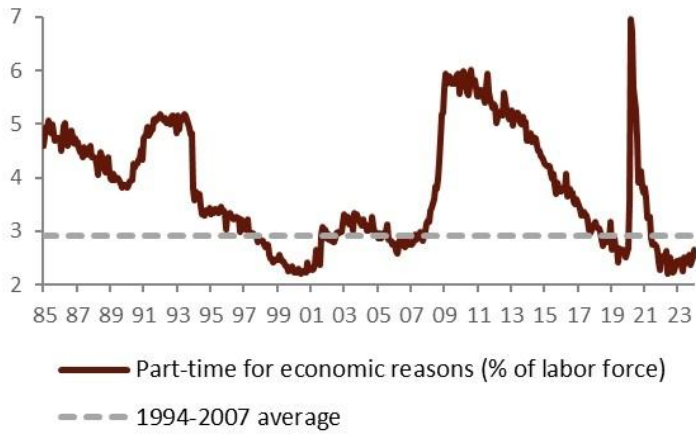
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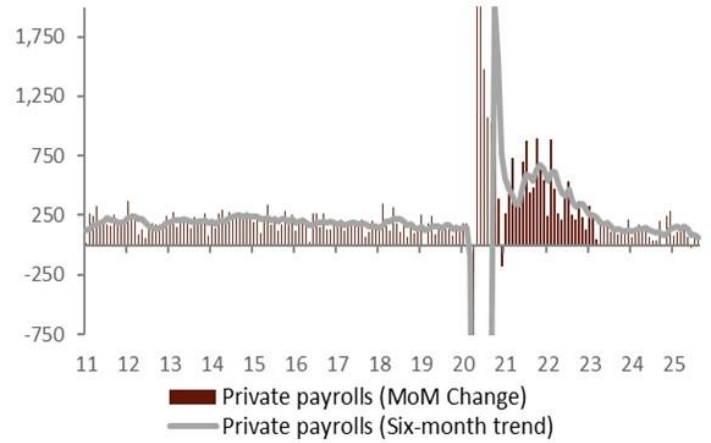
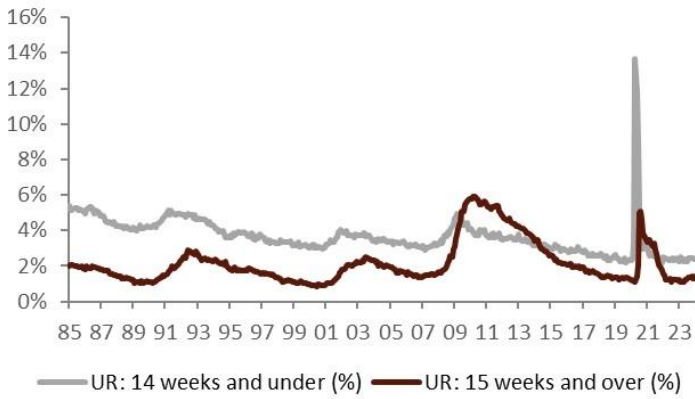
R - Reverse Formatting

Deciles are based on expanding window since 2001

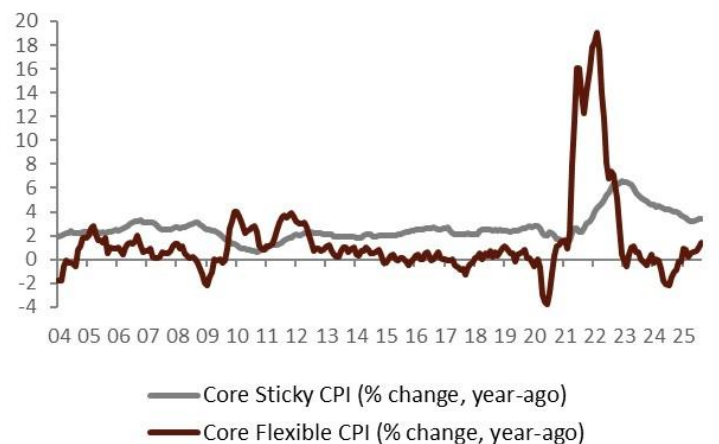
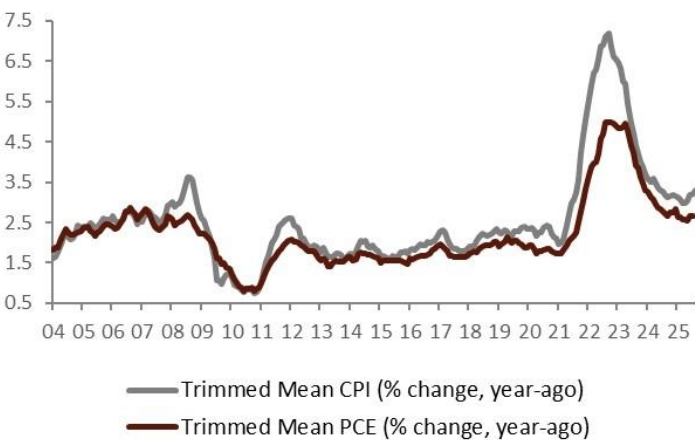
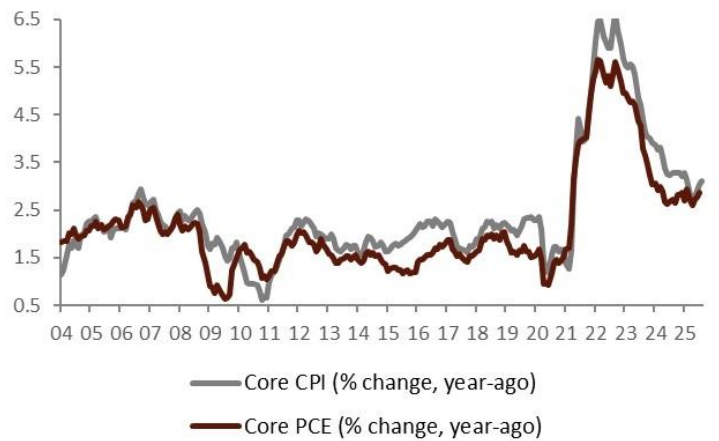
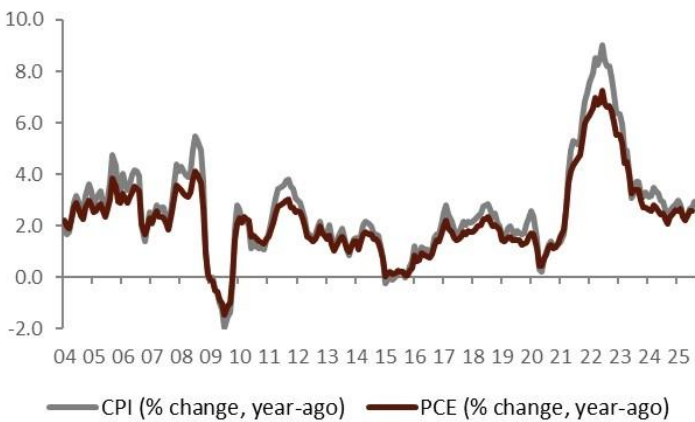


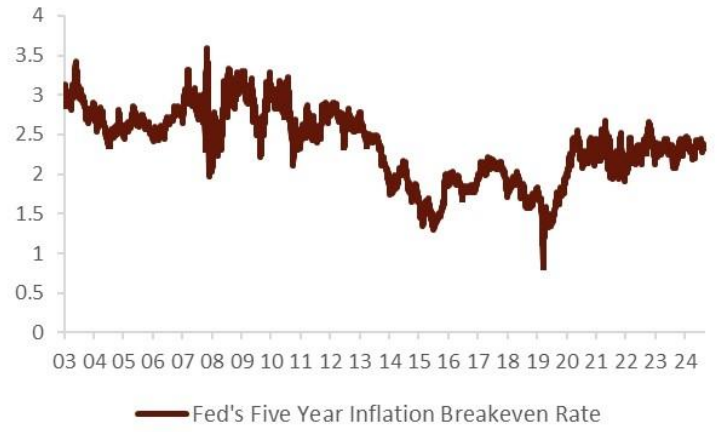
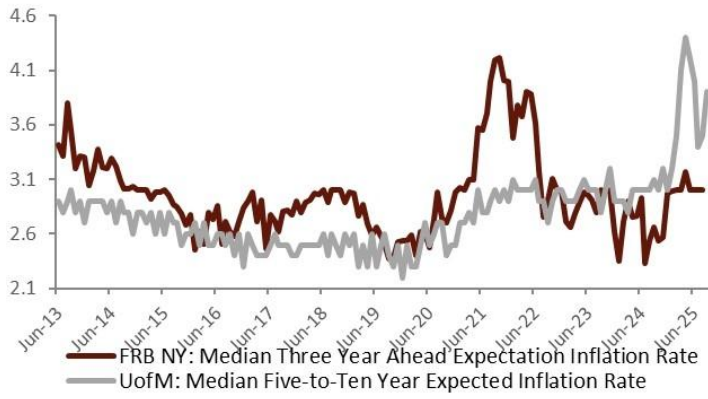
Labor market indicators





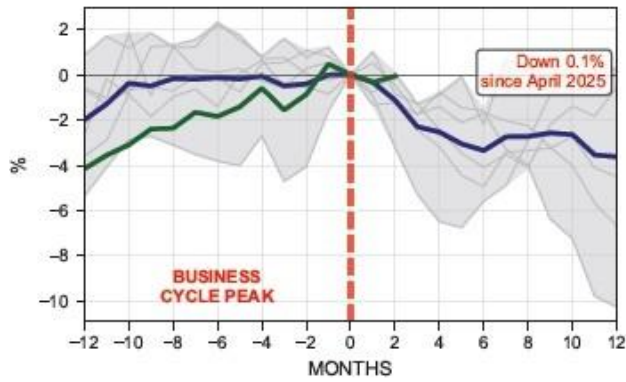
Inflation indicators



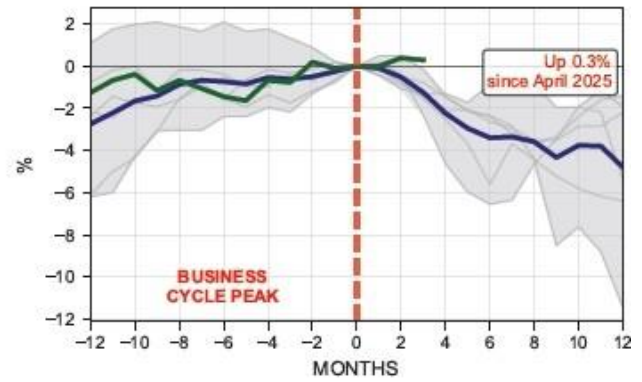


NBER RECESSION INDICATORS DASHBOARD

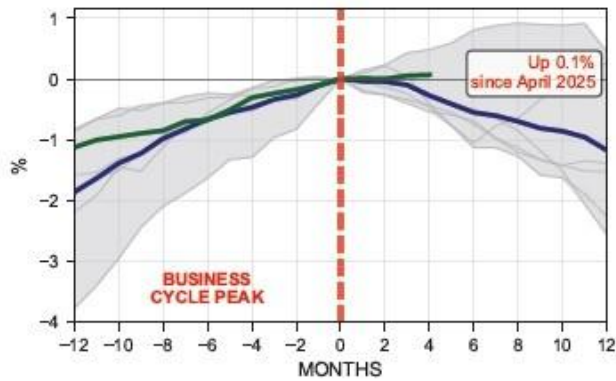
REAL SALES: MANUFACTURING AND TRADE INDUSTRIES



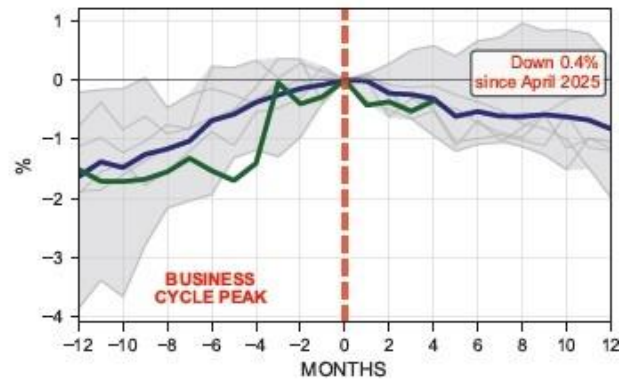
INDUSTRIAL PRODUCTION



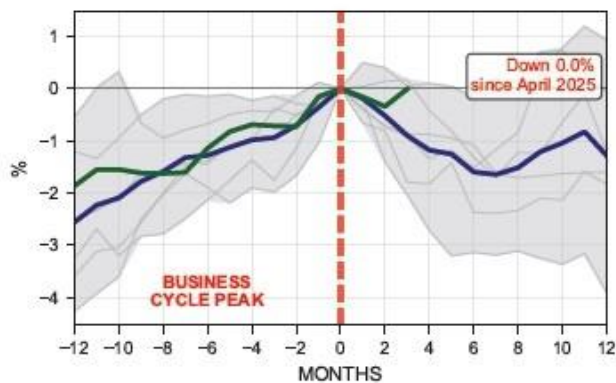
US NONFARM PAYROLLS



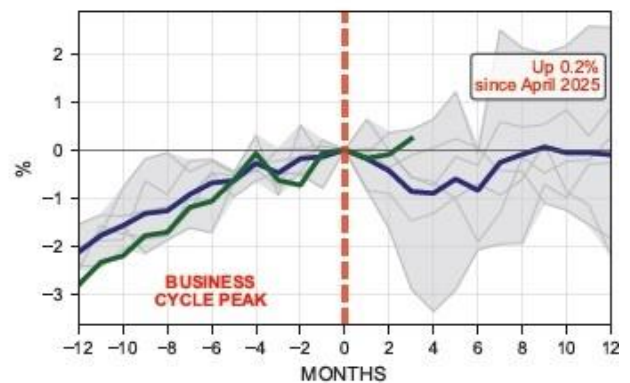
CIVILIAN EMPLOYMENT



REAL PERSONAL INCOME MINUS CURRENT TRANSFER RECEIPTS



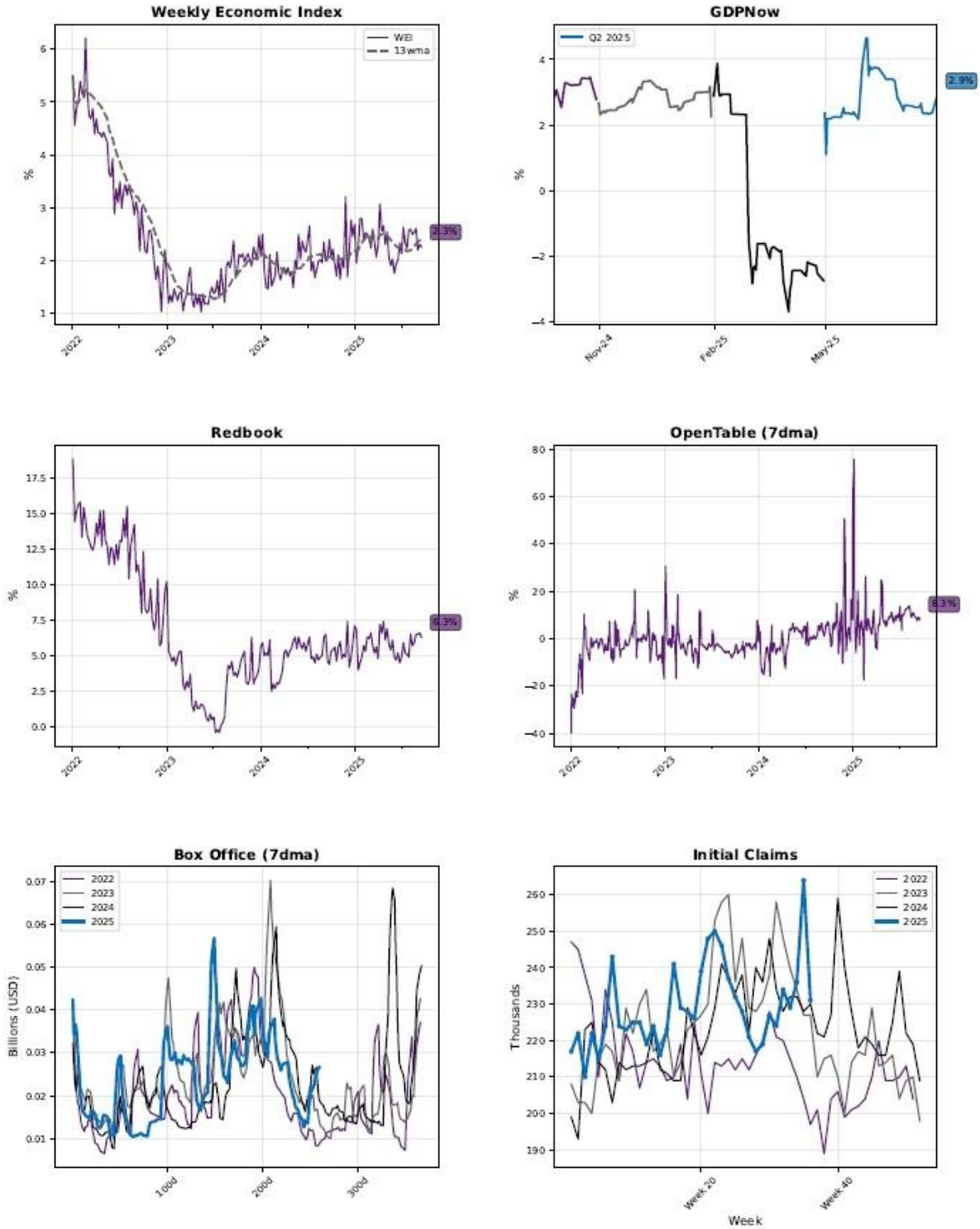
REAL PCE



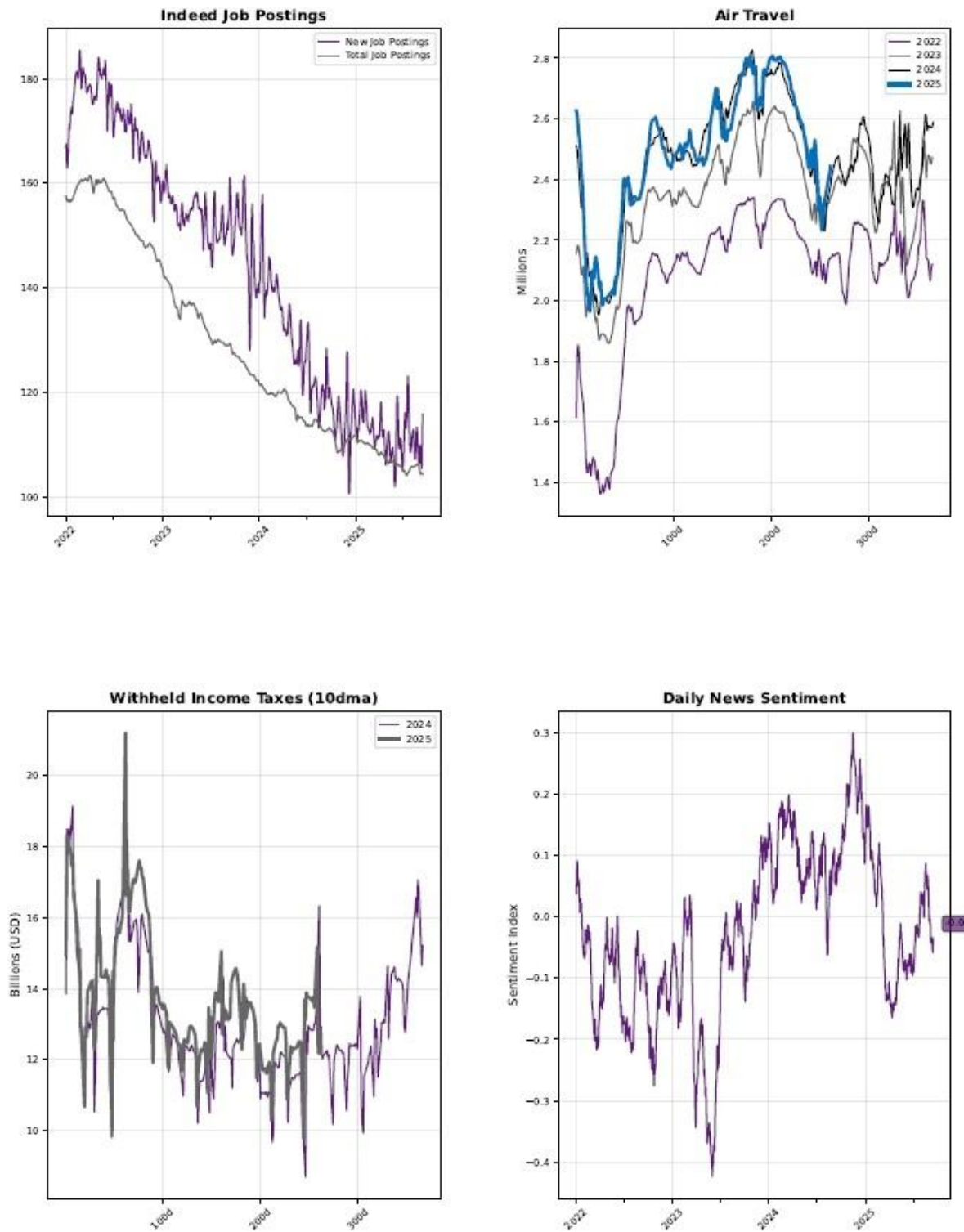
PAST CYCLES (RANGE) — PAST CYCLES — PAST CYCLES (MEAN) — CURRENT CYCLE

Past 7 cycles excluding Covid-19 period

High Frequency Economic Dashboard



High Frequency Economic Dashboard



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