March 10, 2025

The State of the Labor Market: Fears of Emerging Weakness, *Again*

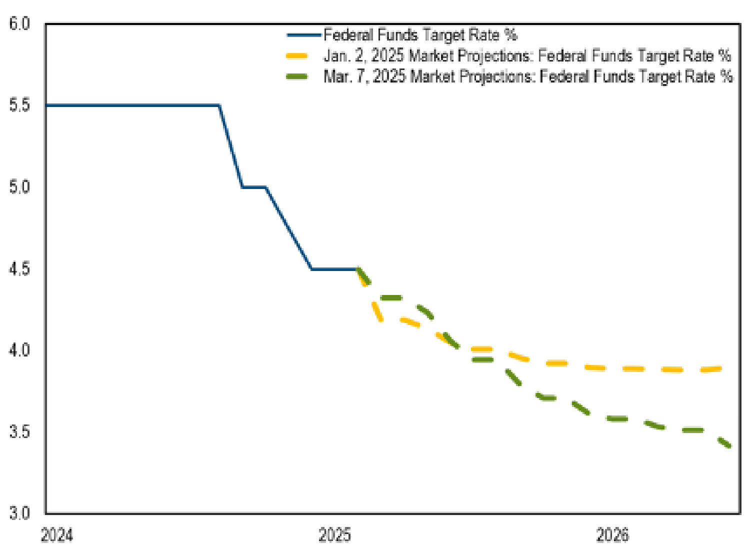
Economic INSIGHT

After holding on the sidelines for 13 months, the Federal Reserve (Fed) opted to take the outsized step of lowering interest rates 50 basis points (bps) in September of last year. This was followed by two more 25 basis points reductions before year-end. The motivation for the change in policy direction was the fear of emerging weakness in the U.S. labor market. However, excluding a temporary dip in topline hiring following hurricanes Helene and Milton, such softness failed to materialize. Subsequently, the Federal Open Market Committee (FOMC) moved back to the sidelines, conceding the unemployment rate had *"stabilized"* at a low level and *"progress"* on inflation had stalled.

"Recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated."

–January 29 FOMC Statement

More recently, concerns of a slowdown in the labor market and broader-based economic activity have re-emerged. Hiring in the U.S. dipped at the start of the year, largely the result of weakness in areas hit by extreme weather conditions that included winter storms in the Mid-Atlantic and East Coast as well as wildfires in California. There was also a noticeable slowdown in services hiring in recent months, which could be a reflection – at least in part – of the effort by the White House to reduce the number of federal employees and sever government contracts, as well as trepidation surrounding new layers of international tariffs.



Source: Bloomberg/Bureau of Economic Analysis/Federal Reserve Board

While one, or even two, data points do not make a trend, the clear rise in hiring hesitancy for a plethora of reasons coupled with declining

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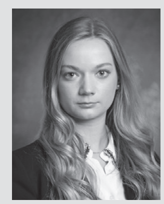

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confidence, a recent pullback in consumer spending and a slowing pace of business investment have some investors raising the probability of a downturn – or even an outright domestic recession – and increasing bets of further Fed policy relief sooner than later. Of course, with price pressures still elevated nominally and several months of acceleration, policy makers still appear firm in their position on the sidelines, for now. Like other market participants, the Committee is seemingly waiting – patiently – for further clarity as the data evolves, affording it a better ability to understand and assess the impact of fiscal policy, including additional tariffs, coming down the pipeline.

This week, we take an updated look at the latest round of labor market data, still showing a broadly positive but somewhat mixed picture of conditions.

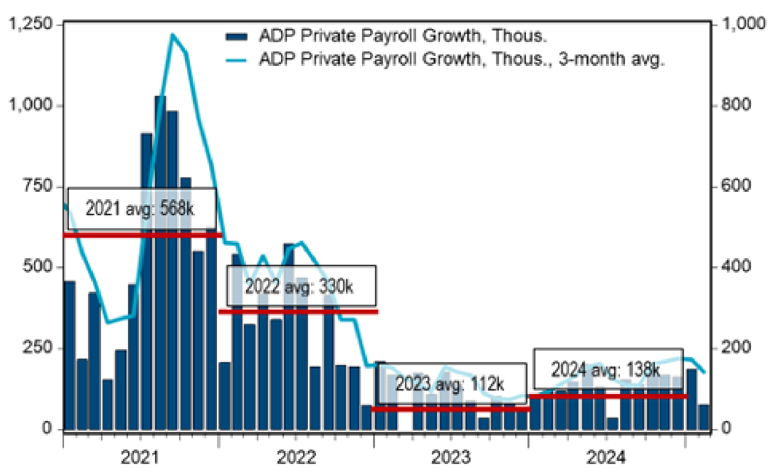
JOBLESS CLAIMS

In the week ending February 22, initial jobless claims jumped 22,000 to 242,000, the highest level this year. The rise coincided with growing reports of staff reduction plans at both private corporations, including Starbucks and Southwest Airlines, and federal agencies as the White House ramped up pressure for reductions in federal staff. The larger-than-expected increase, meanwhile, was seemingly offset with a near-equal 21,000 claim reduction the following week. This kept the four-week moving average steady at 224,000. Furthermore, despite the pop at the end of February, continuing claims, a proxy for the total number of people receiving benefits, decreased to 1.86 million before rising more recently to 1.90 million, the highest level in nearly three years.

Source: U.S. Department of Labor/Bloomberg

ADP PRIVATE-SECTOR EMPLOYMENT

According to ADP, private sector hiring in the U.S. rose by just 77,000 in February, down from a revised 186,000 in January. Falling significantly short of the 140,000 gain expected, the latest read marks the smallest monthly increase since July of last year. According to the details of the report, the weaker-than-expected rise



Source: ADP Research Institute/Haver Analytics

GLOSSARY

ADP – Automatic Data Processing

FOMC – Federal Open Market Committee

ISM – Institute for Supply Management

NFP – Nonfarm Payrolls

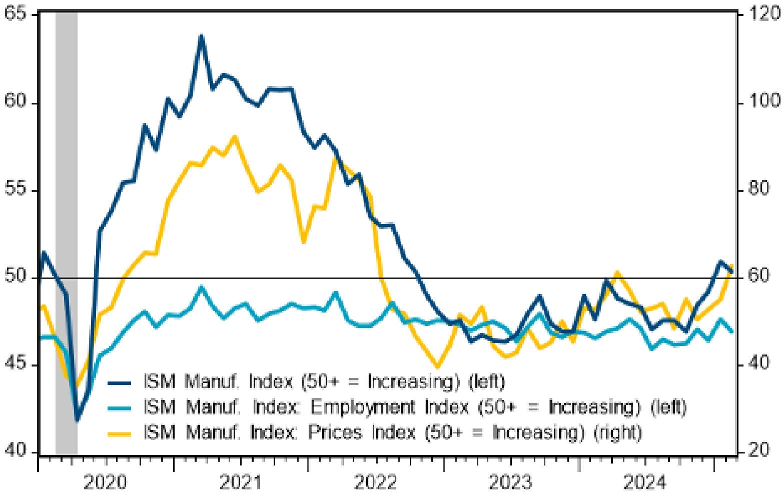
SA – Seasonally Adjusted

was largely a reflection of job cuts in the service sector as well as inclement weather tamping down hiring, specifically in the Southern and Western regions of the United States with both posting outright reductions in headcount. Service-sector reductions, meanwhile, totaling 75,000, were concentrated in trade, transportation, and utilities, with education and health care down 28,000 and information services dropping 14,000. Goods-producing employment, meanwhile, rose by 42,000 in February, the most since October 2022.

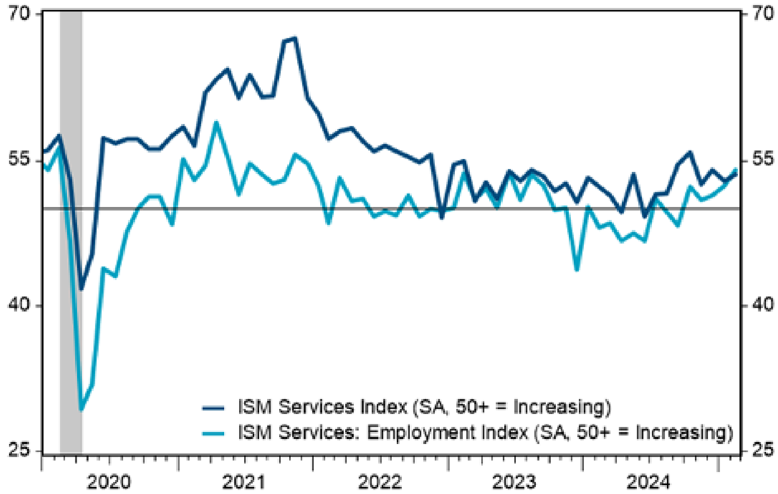
"*Policy uncertainty and a slowdown in consumer spending might have led to layoffs or a slowdown in hiring last month … Our data, combined with other recent indicators, suggests a hiring hesitancy among employers as they assess the economic climate ahead.*" – February ADP Report, Released March 5, 2025

ISM SERVICES EMPLOYMENT

The Institute for Supply Management (ISM) Services Index rose from 52.8 to 53.5 in February, surpassing economists' expectations and offering a welcome indication of growth in the domestic economy against a fear of increasing weakness. All major components including business activity, new orders, supplier deliveries, and *employment* held steady in expansionary territory with a reading above 50. Employment, specifically, rose 1.6 points in February from 52.3 to 53.9, the third consecutive monthly increase and the highest reading since December 2021. Furthermore, while the report indicates businesses remain concerned regarding bad weather, a reduction in federal assistance, and tariffs, the *uncertainty* regarding the implementation and scope of the latter appears to be weighing far more on businesses in the near term than it is creating a lingering concern of resulting sustained weakness or elevated prices that would otherwise force a more permanent reduction in hiring.



Source: Institute for Supply Management/Haver Analytics



Source: Institute for Supply Management/Haver Analytics

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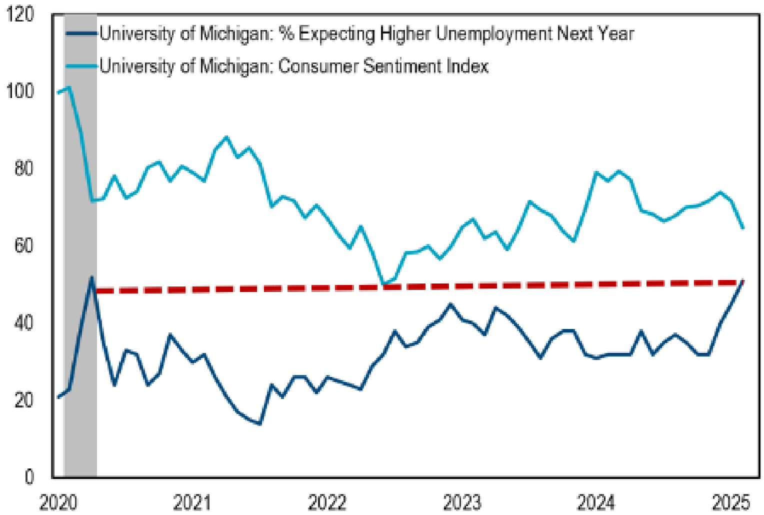
ISM MANUFACTURING EMPLOYMENT

The ISM headline decreased from 50.9 to 50.3 in February, driven down primarily by a loss of activity in orders and production, while prices paid rose to the highest level since mid-2022, suggesting manufacturing firms continue to see input costs rise rapidly, including labor costs. The employment component, meanwhile, declined from 50.3 to 47.6 in February, the first month of contraction (sub-50) and the weakest nominal reading since December. Ongoing inflation pressures and uncertainty regarding tariffs will likely keep pressure on manufacturers to continue to make efforts to pass along cost increases to consumers while paring back employment to help offset surging prices.

THE UNIVERSITY OF MICHIGAN CONSUMER SENTIMENT INDEX

The University of Michigan Consumer Sentiment Index unexpectedly fell from 67.8 to 64.7 in the final February print, marking a more than 7 point drop in just three months to a 15-month low. According to the median forecast, the index was expected to be unrevised. In the details of the report, a gauge of current conditions was revised down three points to a reading of 65.7, a three-month low, and a gauge of future expectations was revised down 3.3 points to a reading of 64.0, the lowest reading since November 2023. Meanwhile, consumers' inflation expectations over the next year were unrevised at 4.3% in the final February report, still however marking a 100 basis points increase from January.



Source: University of Michigan

Aside from underscoring consumers' fears of upside inflation risks near term, the monthly university survey also showed consumers are increasingly concerned about a rise in unemployment over the next year. According to the report details, more than half of consumers expect the unemployment rate to rise – potentially meaningfully – over the next year, the most since 2020 when the U.S. economy was in the midst of the COVID recession.

NONFARM PAYROLLS

Nonfarm payrolls rose by 151,000 in February, falling short of the 160,000 gain expected, albeit still marking a two-month high. The three-month average, however, fell from 236,000 to 200,000, the weakest pace since December reflecting a declining pattern of hiring which emerged at the start of the year. While still positive, a weaker trend in hiring coupled with a – minimal – rise in the unemployment rate reinforces concerns of a potentially more persistent downturn in the U.S. labor market and more broadly, in the domestic economy.

Household employment fell by 588,000 in February, while the labor force decreased by 385,000, potentially a reflection of more stringent policies at the U.S. southern border

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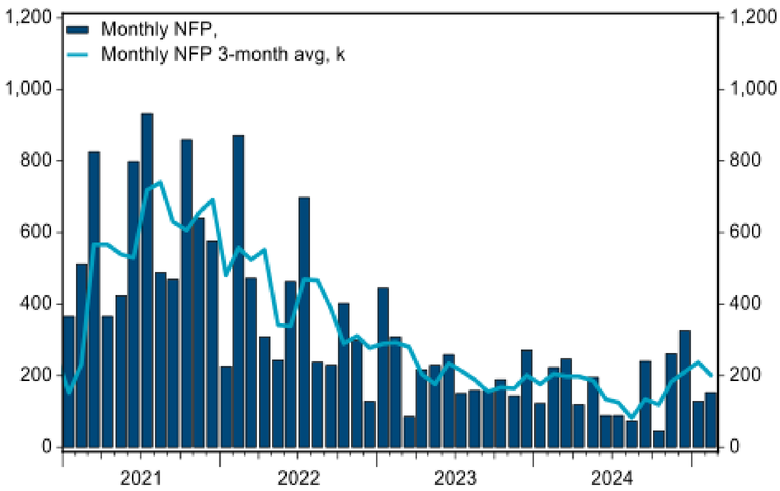
limiting the flow of undocumented workers, which accounted for a sizable portion of the labor force growth last year. As a result, the unemployment rate unexpectedly ticked up a tenth of a percentage point to 4.1% in February, a two-month high, albeit still well below the Fed's full employment range designated as 4.7% to 5.8%. Additionally, the labor force participation rate unexpectedly ticked down two-tenths of a percentage point from 62.6% to 62.4% in February, a more than two-year low.



Source: Bureau of Labor Statistics/Haver Analytic

Additionally, average hourly earnings rose 0.3% in February, as expected and following a 0.4% increase in January. Year-over-year, wages increased 4.0%, a two-month high, perpetuating pressure on businesses struggling to shoulder an increased – labor – cost burden.

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