10.15.25 I INVESTMENT MANAGEMENT

9/30/25 Outlook Theme #2: Data Showing Slower Labor Delivers a Rate Cut

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Throughout its rate setting process, the Federal Reserve has reiterated that it is data dependent. One of the key developments during Q3 was a softening in some labor market trends. This weakness provided the catalyst for the Fed to act, as payroll growth slowed close to 0 in July, plus the prior three months, as part of their typical process, were revised lower. On top of that, the annual data revisions for the prior March 2024 to March 2025 period showed about 75,000 fewer jobs per month were added during that period. That lower pace is reflected in the red line in Chart 1 below. The softer new data combined with the revisions spurred the Fed into action.

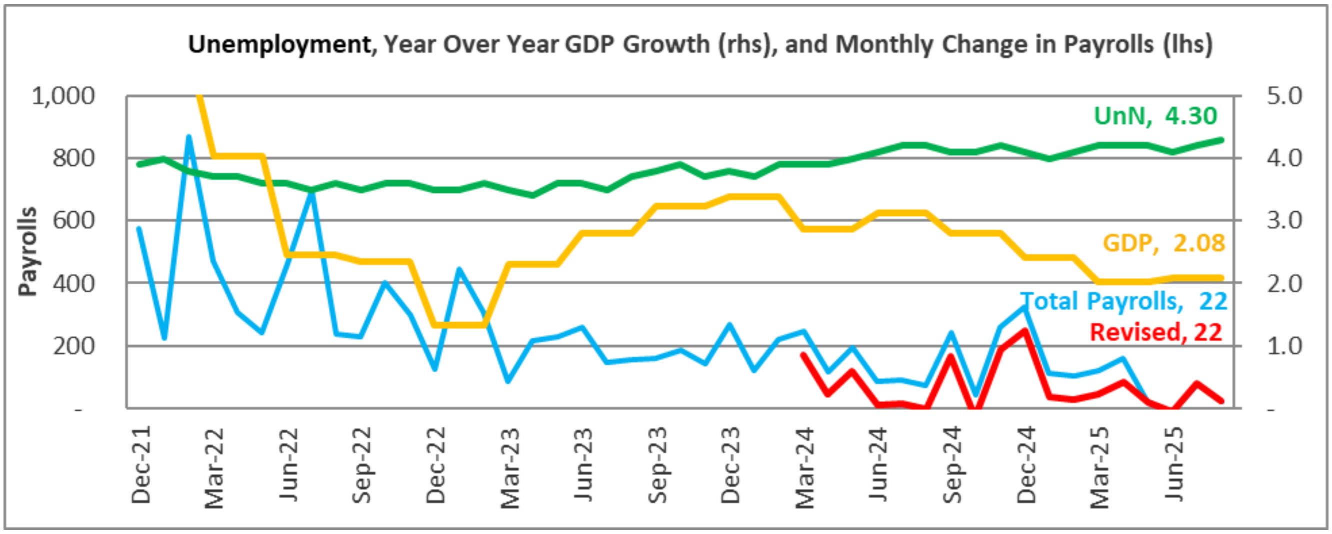

Chart 1

Going forward, that strength of the labor market relative to its potential is one key to determining where the Fed should set its policy rates. In 2022, when growth slowed to the 2% range, payroll growth was still averaging 300,000 per month and unemployment was in the mid 3% range. In 2023 and 2024, the "soft landing" saw GDP growth rise to the 3% range, while payroll growth slowed to around 200,000 per month and the unemployment rate slowly moved above 4%.

The recent deceleration in payroll growth to near 0 has come with a modest downtick in growth and modest uptick in unemployment, but compared to the prior rates of payroll growth, GDP growth and unemployment are not as bad as one would expect.

Part of this is the result of slower immigration. After global labor flows stopped in 2020, the reopening in 2021 led to a surge in immigration in 2022 and 2023, raising the "breakeven" rate of payrolls, or the pace of payroll growth relative to the growth in the overall pool of workers needed to keep unemployment steady, to over 200,000. The subsequent immigration slowdown that started in 2024 and continued into 2025 has lowered this rate to about 50,000.

While the positive news that slower payroll growth does not portend recession is positive, one risk is that if the Fed uses slower payroll growth to justify interest rate cuts, while at the same time the labor market lacks extra workers to grow, then the result would be wage inflation. A potential offset would be the ongoing rollout of AI helping to increase labor force productivity, allowing more GDP growth at modest labor growth.

Data showing a slower labor market delivered a rate cut. The market will be watching the data closely in Q4 to determine if this path of a supportive Fed and modest economic growth can continue as expected.

SEE ALSO

- 9/30/25 Outlook Theme #1: Rate Expectations
- 9/30/25 Focal Point: Is It 1997 or 1999?