FOCAL POINT

US labour market: better than expected but cracks appear

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Our Focal Point series explores topical issues on macro, markets and investment

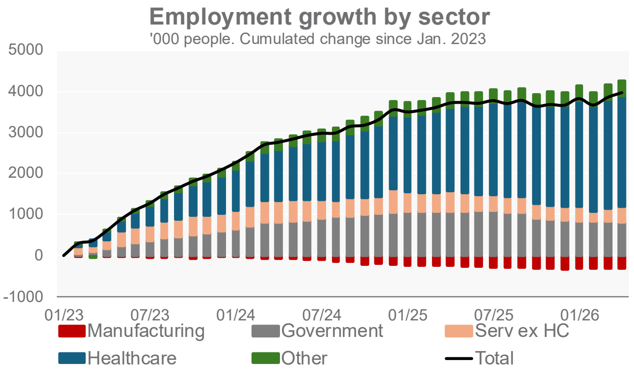
- **US headline employment data remain resilient, but underlying labour-market conditions look fragile. Payrolls have increased and unemployment is stable, yet weak hiring, low quits, and poor job-finding rates point to emerging risks. The impact of AI on employment remains limited and visible only in few sectors.**
- **Longer term, with slower labour-force growth, modest job creation can now maintain unemployment at historically low levels but keep the labour market tight. Stronger productivity growth will be needed to avoid renewed inflation pressure.**
- **High inflation remains the Fed's biggest concern, and evidence of labour market resilience strengthens the case for a long pause in rate cuts but is not enough to eliminate the easing bias. We move from December to Q1 2027 the date of the final rate cut – contrasting market pricing of a hike as the next move.**

The latest US labour-market data continue to show resilience in headline indicators, suggesting that the cooling in job creation visible since mid-2025 may have paused. Payroll growth again surprised on the upside in April. However, a more detailed look at employment composition and from labour-flow data suggests that the picture is less reassuring than the headline numbers imply. Labour-market dynamics still point to a "no-hire, no-fire" equilibrium in which firms are reluctant both to expand headcount and to shed labour. This equilibrium keeps unemployment low in the short run, but it also masks a deterioration in labour-market quality that could leave the economy vulnerable to a sharper adjustment if demand weakens, particularly if the oil-price shock to disposable income proves stronger and persistent. This is the main reason why, although we push the next rate cut to Q1 2027, we think the Fed will retain an easing bias – at least if the US/Iran tensions start to finally ease over the coming weeks, as we assume in our base scenario. Longer term, sharply slower labour-force growth could structurally tighten the labour market, requiring much stronger productivity growth to prevent inflation from becoming entrenched.

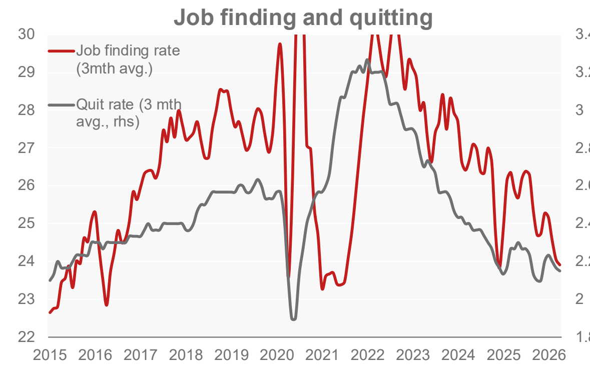
The latest data: good but not great

Headline employment growth has remained robust. Non-farm payrolls increased by 185k in March and 115k in April, roughly double market expectations in both months and the strongest back-to-back gains since late 2024. In the first four months of the year, monthly job gains averaged a solid 76k, around 15–20k above the estimated breakeven rate needed to keep unemployment stable. Hiring has also been relatively broad-based, with 53% of industries expanding employment in April, the fourth consecutive month above the 50% threshold. The unemployment rate has remained anchored at 4.3%, moving by no more than one-tenth of a percentage point since mid-2024.

However, employment growth continues to rely heavily on non-cyclical sectors such as healthcare and education (left chart below). Beyond payrolls, labour-market flows point to underlying fragility, too. The job-finding rate (chart on the right) is near its lowest level since 2015 outside the pandemic period, indicating that unemployed workers are finding it increasingly difficult to secure new jobs. At the same time, voluntary quits have fallen to historically low levels.



Source: BLS, GenAM



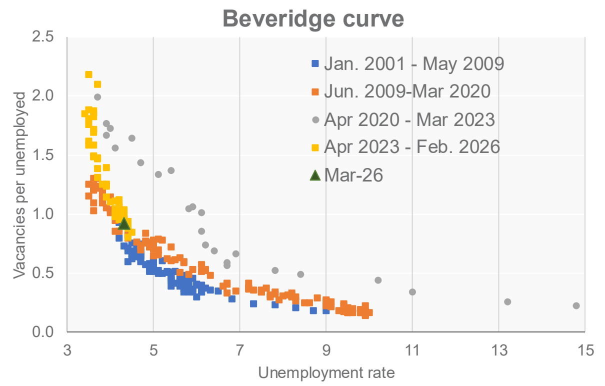
Source: BLS, GenAm

The other JOLTS data for March continue to show that softer hiring has not been accompanied by a meaningful rise in layoffs, and initial jobless claims have stayed contained.

Signals from business surveys, most notably the ISM, have recently been encouraging, but the durability of this good—though not great—employment backdrop depends on the ultimate impact of the Gulf war on the US economy. Prolonged uncertainty or an outright weakening in activity could trigger an increase in job destruction. Over the next six months, the most likely outcome remains gradual cooling rather than an abrupt downturn, and we do not expect the unemployment rate to rise by more than 0.2–0.3 percentage points by year-end. However, risks are asymmetric: if labour hoarding ends, unemployment could increase quickly. Furthermore, a significant prolongation of the Gulf war or a renewed escalation of the conflict would inflict rising damage to confidence and demand.

The drop in demand has quickly brought labour-market tightness back towards its historical norm, and its relationship with the unemployment rate is now broadly consistent with the long-term history (see left chart on the next page).

Average hourly earnings rose by just 0.2% month on month in April, and three-month annualised wage growth has slowed to around 2.8%, the weakest pace since late 2023. More comprehensive and less volatile Q1 data from the Employment Cost Index show total compensation growing at a healthy 3.4% year on year (chart on the right), well below the post-COVID peak but still around 0.5 percentage points above the pre-COVID norm. Assuming a conservative estimate of 1.5% trend productivity growth, wage increases are now broadly consistent with core inflation at the 2% target. That said, signs of stabilisation at a somewhat higher level than in the past may still point to a structurally tighter labour market.



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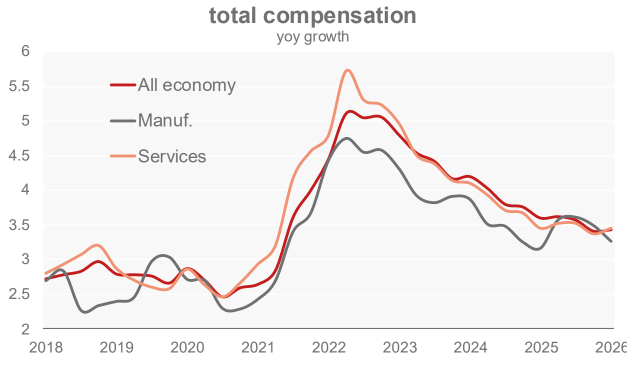
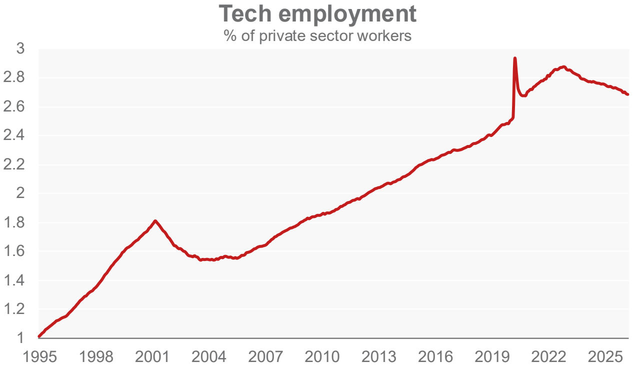
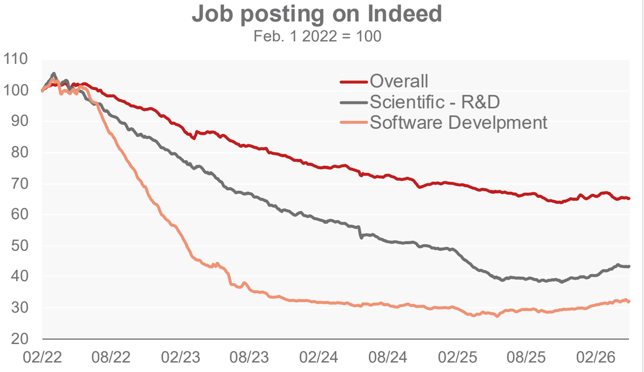


Source: BLS, GenAM

The diffusion of AI is causing job losses in information and other tech-related activities. These sectors have shed more than 300k jobs since peaking late last year. Still the overall impact has been so far mild. Many displaced workers appear to have found employment in non-tech firms seeking to accelerate AI adoption. Unofficial data like online job posting (chart on the right) indicates that after a sharp fall, offers for tech-related jobs are stabilising The latest Business Trends and Outlook Survey by the Census, provide quite a reassuring view on the employment impact of AI: 97% of firms report no impact of AI on employment and only 4% are using it for tasks previously performed by an employee.



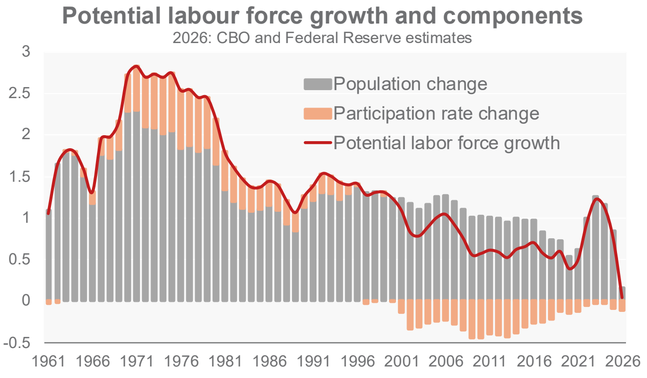
Source: BLS, GenAM



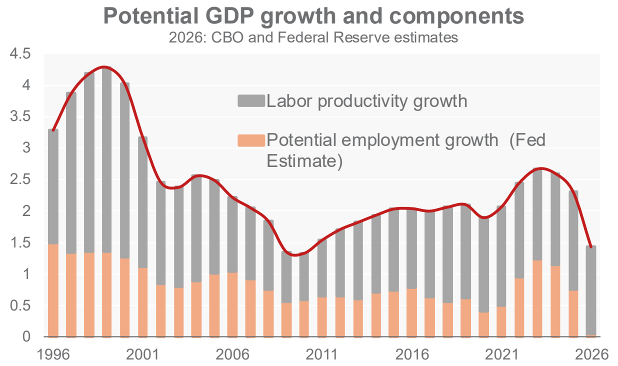
Source: Indeed HiringLab, GenAM

Labour supply constraints start to bite

A stable, historically low unemployment rate may overstate the health of the labour market. Labour-force growth has slowed markedly, reflecting weaker immigration and population ageing. While prime-age participation remains high, participation among other age groups has deteriorated. These supply-side dynamics mean that even modest job creation is sufficient to stabilise the unemployment rate, masking cyclical weakness in labour demand. Recent research from the Federal Reserve shows how tighter immigration constraints are interacting with population ageing to depress labour-force growth. According to those estimates, the civilian working-age population could grow in 2026 at the slowest pace since 1951, while labour-force participation continues to decline. As a result, the number of new jobs needed to stabilise the unemployment rate may fall from the roughly 80k per month prevailing before COVID and in 2024–25 to around 20k, though that estimate sits near the lower bound of market expectations. Given the uncertainty around these estimates, a near-zero breakeven pace of job creation implies that payrolls could decline even if the economy grows at around potential. More importantly, the Fed study combines its measure of trend labour-force growth with the Congressional Budget Office's estimate of potential growth to show that, in 2026, the contribution of labour to potential growth will diminish and will need to be offset by stronger productivity growth. As a reversal in immigration policy appears highly unlikely in the short term, this implies that with near-zero labour-force growth, high productivity growth driven by capital deepening and efficiency gains would be needed to prevent a structurally tighter labour market from generating inflationary pressures.



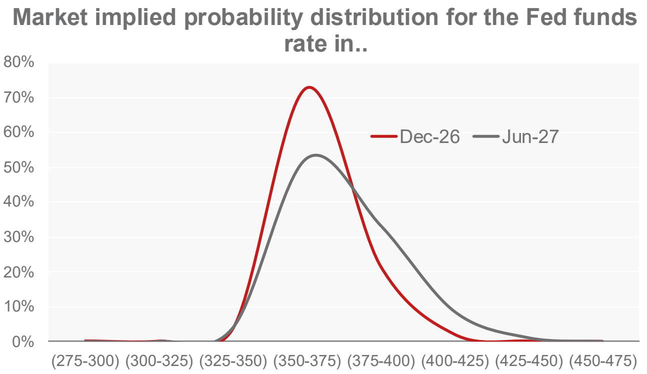
Source: CBO, Federal Reserve, GenAM



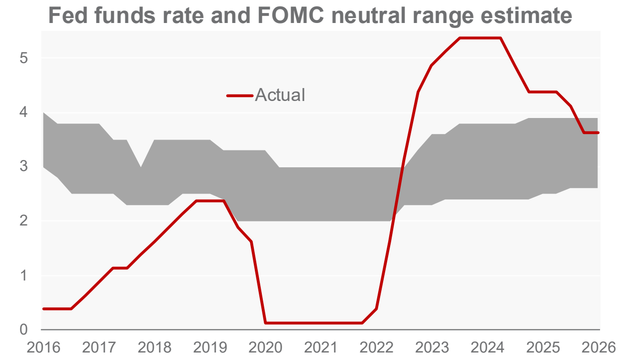
Source: CBO, Federal Reserve, GenAM

Good job data keep the Fed focused on inflation

With core PCE inflation expected to go back to 3.3%, the Fed has ample reason to remain cautious on further rate cuts, even under its new Chair Warsh who has been advocating them. We think the latest employment data will further strengthen the hawkish wing of the FOMC. However, unlike markets, which currently see a rate hike as more likely than a cut, we stick to our easing bias, because parts of the economy look fragile and the current federal funds rate remains at the upper end of the neutral range. Therefore, we now push the timing of the next—and final—rate cut from December to Q1 2027.



Source: CME, GenAM



Source: Federal Reserve board, GenAM

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