



MACRO MORNING BRIEFING

iFlow

February 10, 2025

Slowing Labor Market, Rising Short-term Inflation Expectations

- The labor market data mixed, some slowing but not teetering
- Surveys and market implied inflation expectations reflect tariff risk
- We think the Fed will look through the short-term inflation pop from potential tariffs

A subtle slowing in the labor market

Last Friday's jobs report was mixed. In addition, we received a downbeat University of Michigan consumer sentiment report – off due to increasing fears of near-term inflation. The market seems to be concerned primarily about tariff risk. Yes, the economy – at least via the labor market lens – looks to be cooling, but not worryingly so (yet). We don't think it changes much about the near-term outlook, nor do we think the Fed will be cutting rates in March. It's still about the tariffs.

Payrolls were up 143k last month, below the expectation of 175k. The unemployment rate fell to just 4%, the lowest it's been since last May – even with the labor force participation rate rising. Downward revisions to last year's data suggest that the jobs market wasn't as hot in 2024 as initially thought, but still, it's not correct to say this labor market is slowing but not teetering.

We have noticed that the pace of growth of jobs in cyclical sectors like leisure and hospitality, manufacturing, finance and trade, among others is falling behind growth in non-cyclical sectors – such as government, business and professional services and education (see Exhibit #1). The relative rates of job growth crossed each other early in 2023, and since then the non-cyclical sectors have been rising faster than the cyclical sectors – a subtle suggestion that

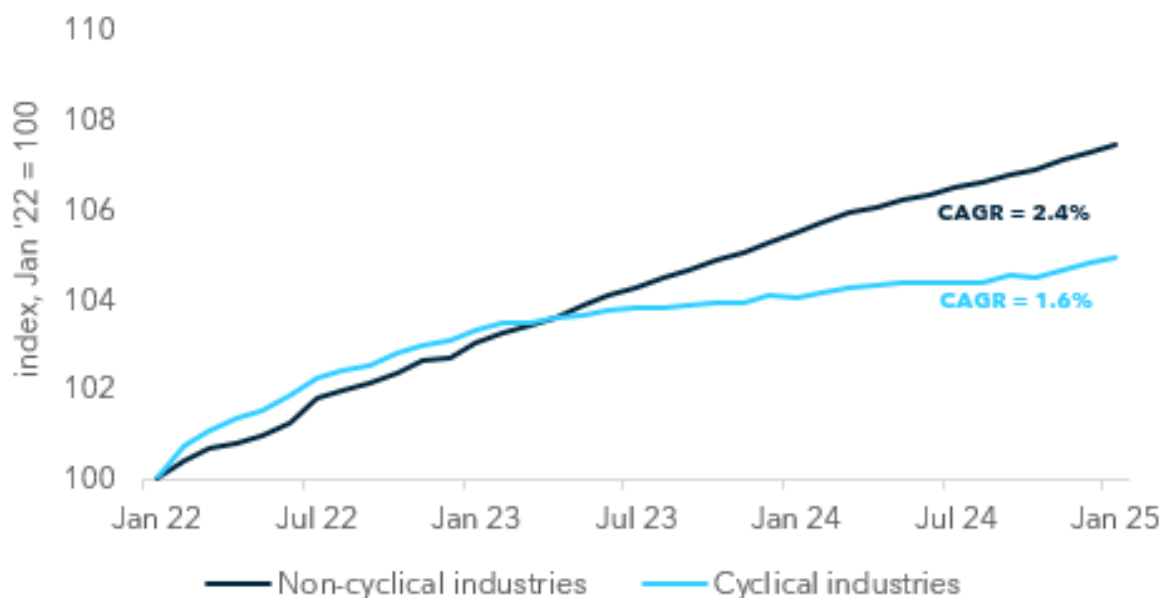
demand is slowing in the economy.

In addition, total hours worked across the economy have also started to slowly fall. Multiplying hours worked and the total number of employees, we come up with a very rough proxy for US activity. After peaking in November, this measure has fallen in two straight months, as shown in Exhibit #2.

The conclusion: Like the data, mixed. We still don't know the effects of immigration policy on the data over time, as the sample week for January was the week before the new administration was in place. The Bureau of Labor Statistics reports no outsized effects from the cold winter weather during the survey week, nor from the California wildfires. We think there is nothing amiss with the labor market other than a gradual slowing.

Exhibit #1: Cyclical Hiring Slow Compared to Non-cyclical

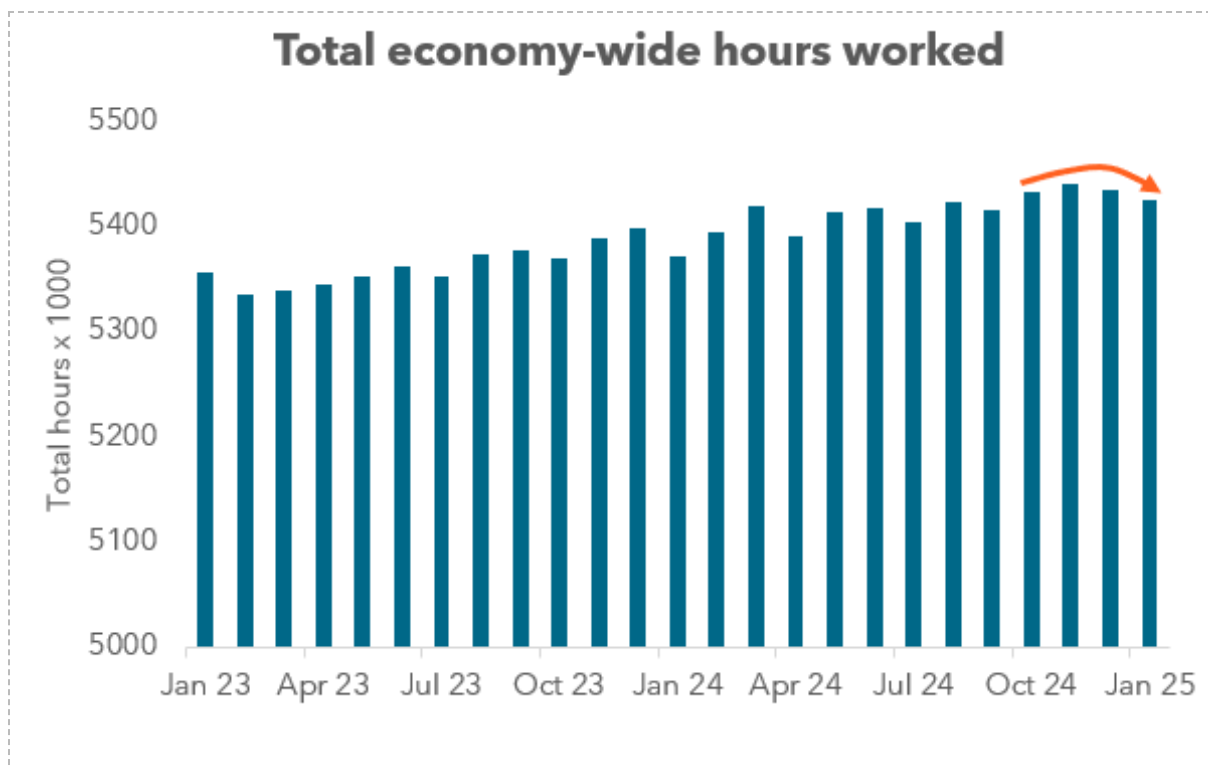
Cyclical and non-cyclical job growth*



Source: BNY Markets, Bureau of Labor Statistics

*Cyclical sectors: Mining and Logging, Construction, Manufacturing, Information, Finance, Leisure and Hospitality. Non-cyclical sectors: Government, Professional and Business Services, Education

Exhibit #2: Production Proxy Slides



Source: BNY Markets, Bureau of Labor Statistics

Inflation expectations show tariff risks

Then we come to the Michigan survey. The overall sentiment index dipped from 71.1 to 67.8 (expectations were for it to rise to 71.8). The deterioration of near-term inflation expectations was likely driving the drop in the headline indices. As can be seen in Exhibit #3, the one-year ahead expectation increased by a full percentage point from 3.3% to 4.3%, while 5-10 years out, the survey saw a more modest pop.

The fact that near-term expectations rose sharply while longer-term expectations were more modest, suggests to us that tariff risk is driving consumer attitudes. Expectations of higher inflation expected in the years ahead (due to potential tariffs) but not in the years beyond that are signs of an anticipated price shock.

It's interesting that we see the same behavior among investors, i.e., the expectation that near-term inflation will cool in a few years. Exhibit #4 shows the term structure of breakeven inflation measures derived from the TIPS market. We start at a 1-year horizon and increase that by a year at a time for up to ten years, plotting the BE inflation at each interval. We show the data as they were in June 2024, the end of the year, and last Friday. Note that back in June, inflation expectations for the next year were about 1.5%, whereas at the end of last week, they were much higher, at 3.5%. While the term structure was upward sloping back in June, it's now inverted – much higher inflation next year slowly declining until it flattens out in

about five years from now. In fact, the 10y breakeven is practically the same now as it was last summer. The bond market thinks something is going to drive up prices in the near term, but that shock will peter out in a few years. This is highly suggestive of tariff risk – much like the consumer survey.

We have argued that the Fed won't necessarily raise rates if it sees the impact of any hypothetical tariffs hitting consumer prices (see [here](#)). After all, how does tightening monetary policy offset the effects of what is effectively a tax hike? The data we discussed above show that consumers and traders believe there will be a near-term price impact from any tariffs that might go into effect, but they do not think it will extend too far out after that initial price level rise. We think the Fed will see it the same way.

Exhibit #3: Near-term Inflation Expectations Pop

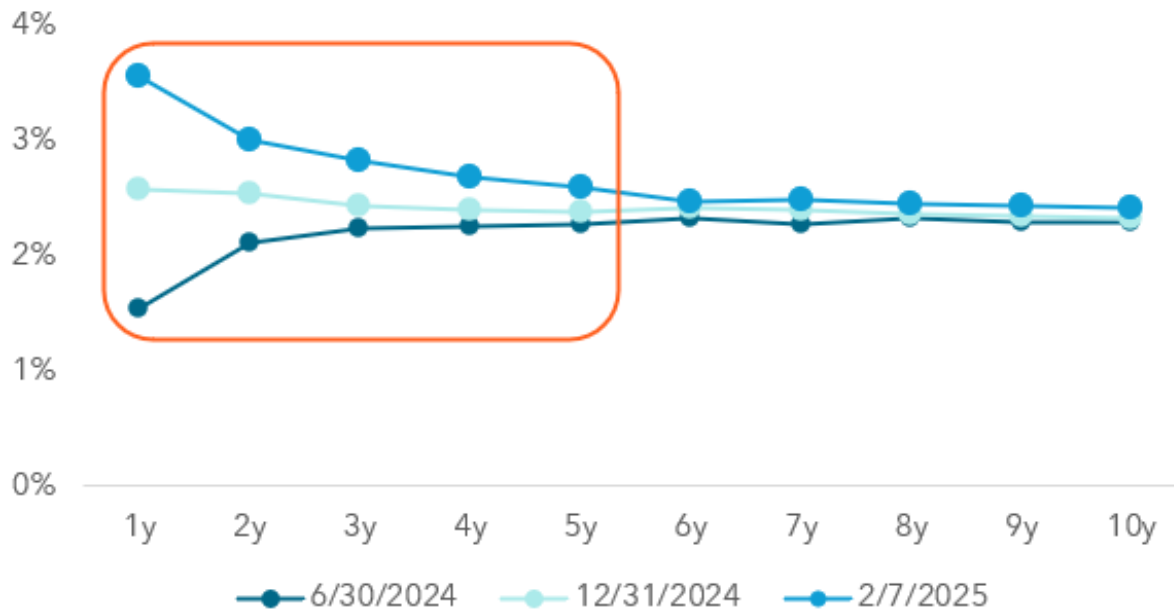
U Michigan inflation expectations



Source: BNY Markets, University of Michigan, Bloomberg

Exhibit #4: Inflation Term Structure Is Now Inverted

Term structure: Breakeven inflation



Source: BNY Markets, Bloomberg

Please direct questions or comments to: iFlow@bny.com

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