The Daily Dish

Fed’s Labor Market Assumption Surprise

FRED ASHTON | JANUARY 8, 2026

The Federal Reserve’s policy rate decision in December was largely a non-event. The policy rate was cut by 25 basis points to 3.5–3.75 percent, with three members of the Federal Open Market Committee (FOMC) dissenting. Stephen Miran, President Donald Trump’s newest appointee, argued for the third-straight meeting for a larger 50-basis point cut. Austan Goolsbee and Jeffrey Schmid wanted to hold the policy rate steady.

Fed Chair Jerome Powell used his press conference to discuss inflation and highlight the gradually cooling labor market. Nothing new. Powell noted that the unemployment rate was up three-tenths of a percent from June to September, and that payrolls averaged 40,000 per month since April. This came in response to a question about the decision to cut rates in December rather than wait for the January meeting.

But there was one surprise. Chair Powell – in an unusually dismissive tone – commented that the Committee thinks the monthly jobs data are overstated by about 60,000. In other words, the Committee believes payrolls have slumped by 20,000 per month since April.

Powell explained that “there’s been something of a systematic overcount,” pointing to the preliminary revisions released by the Bureau of Labor Statistics (BLS) in September. These revisions showed 911,000 fewer jobs were created in the year ending March 2025 than were originally counted.

This is consistent with Powell’s emphasis on the unemployment rate, when (back in July) he described it as the “main number” to assess the labor market, as both demand and supply continued to decline.

It is unclear whether the Fed will maintain this framework as it contemplates the future path of interest rates. This approach could complicate matters. Recent changes to immigration policy and demographic shifts have likely lowered the employment replacement rate to about 30,000–50,000 per month. Taking the chair at his word, the Fed's current assumption would suggest the economy will be shedding jobs each month if the current rate of job creation continues in 2026. That would bias Fed decision-making toward more rate cuts.

There is hope. The BLS has laid out plans to address the systematic overstatement of job creation by making changes to its business birth-death model. Beginning with the release of the January 2026 Employment Situation in February, the new birth-death model will be incorporated and will likely improve the monthly estimates.

FREDDY'S FORECAST: DECEMBER JOBS

We're back. The December jobs report will be the first "normal" report since the government shutdown delayed and disrupted data for October and November.

The combined October and November report showed a decrease in payroll employment of 41,000 (-105,000 in October and +64,000 in November) while the unemployment rate ticked up from 4.4 percent in September to 4.6 percent in November. The unemployment rate was not available in October because of the government shutdown. Employment growth was – as it has been for most of 2025 – concentrated in the health care and social assistance sector. The deferred government layoffs finally hit the jobs data as the sector cut 157,000 jobs in October and another 5,000 in November.

Since the last report, data from ADP showed that private employers reversed course in December, adding 41,000 workers after cutting 29,000 in the prior month. Gains were isolated to the education and health services and leisure and hospitality sectors. Manufacturers cut 5,000 jobs.

Data from the Institute for Supply Management were mixed in December. The manufacturing sector suffered its 10th consecutive monthly contraction. While the overall index showed a faster slowdown than in November, the new orders, employment, and export orders subindexes improved. The services index grew faster in December than in November as new orders, employment, and export orders jumped.

The Job Opening and Labor Turnover Survey data from BLS were weak and further confirmation that the low-hire, low-fire job market continues. The rate of hiring in November was its lowest since early 2011, excluding the depths of the pandemic. The rate of hiring is consistent with an unemployment rate closer to 8 percent compared to the current 4.5 percent. This likely means that young workers are still having a difficult time landing a job. Job openings also slumped to 7.146 million in November from 7.449 million in October, the lowest level in more than a year.

Initial jobless claims remained muted at 208,000 for the week ending January 3, a slight increase (+8,000) from the prior week. Continuing claims moved higher, back above 1.900 million during the week ending December 27 to 1.914 million. The four-week moving average, which smooths out weekly volatility, remained near the lows not seen since May 2025 at 1.892 million.

For the December report, expect payroll growth of 70,000 and the unemployment rate to tick down to 4.5 percent as government-shutdown-related distortions are revised. The slowdown in average hourly earnings growth of 0.1 percent in November will likely prove temporary and rebound to 0.3 percent for a 3.6 percent annual gain.