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Investment Insight

US Employment on Solid Footing Before Tariff Bite

Morningstar Investment Management LLC
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Key Takeaways:

- US nonfarm payrolls increased by 139,000 in May, modestly above the 126,000 estimate, but down from April's 147,000.
- The unemployment rate held steady at 4.2%, matching April and reflecting a narrow range since May 2024.
- Average hourly earnings rose by 0.4% for the month and 3.9% year-over-year, slightly above expectations.
- Fed futures now imply negligible odds of a June rate cut and have shifted the first expected cut to September (over 90% probability), reflecting a more resilient labor market.

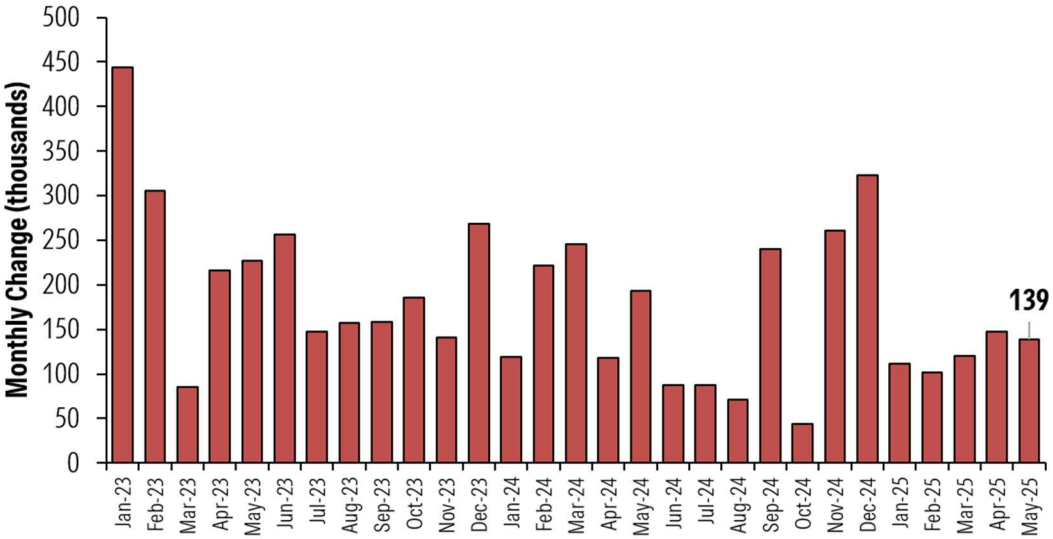
Summary

The Bureau of Labor Statistics (BLS) reported that total nonfarm payroll employment **rose by 139,000 in May** 2025, slightly exceeding consensus expectations of 126,000 and marking a slowdown from April's revised gain of 147,000. The **unemployment rate remained unchanged at 4.2%,** highlighting the continued tightness in the labor market. **Wage growth continued to outpace inflation**, with average hourly earnings rising 0.4% over the month, and 3.9% year-over-year, slightly stronger than forecasts.

However, revisions trimmed prior months' gains: March's figure was lowered by 65,000 (from 185,000 to 120,000) and April's by 30,000 (from 177,000 to 147,000). Together, those cuts reduce the prior two-month payroll tallies by 95,000 jobs. After factoring in these adjustments, the three-month average has fallen to 135,000 and the 12-month average now sits at 124,000—**the lowest 12-month average since early 2023.**

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Monthly US Job Creation

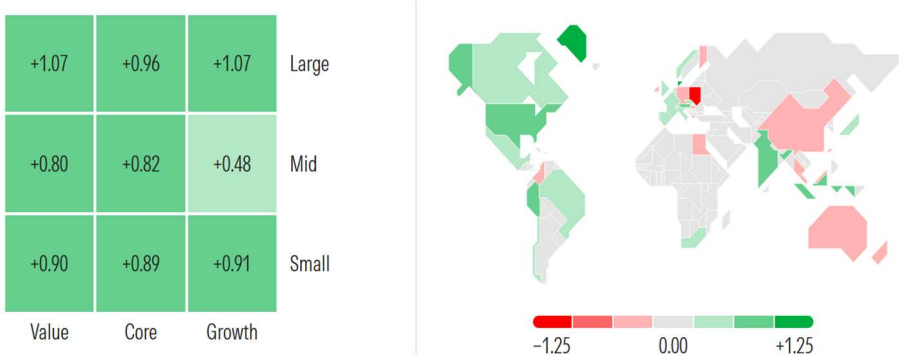


Source: Bureau of Labor Statistics via FRED

Market Reaction

Global equity markets rallied Friday as of 9am central on a mix of relief that hiring held up and optimism around a potential thaw in trade tensions—implying that good news is good news for the equity markets. US stock futures jumped immediately following the report, extending gains from Asian and European markets, which rallied overnight on reports that China may engage in trade talks with the US.

Stocks Rally

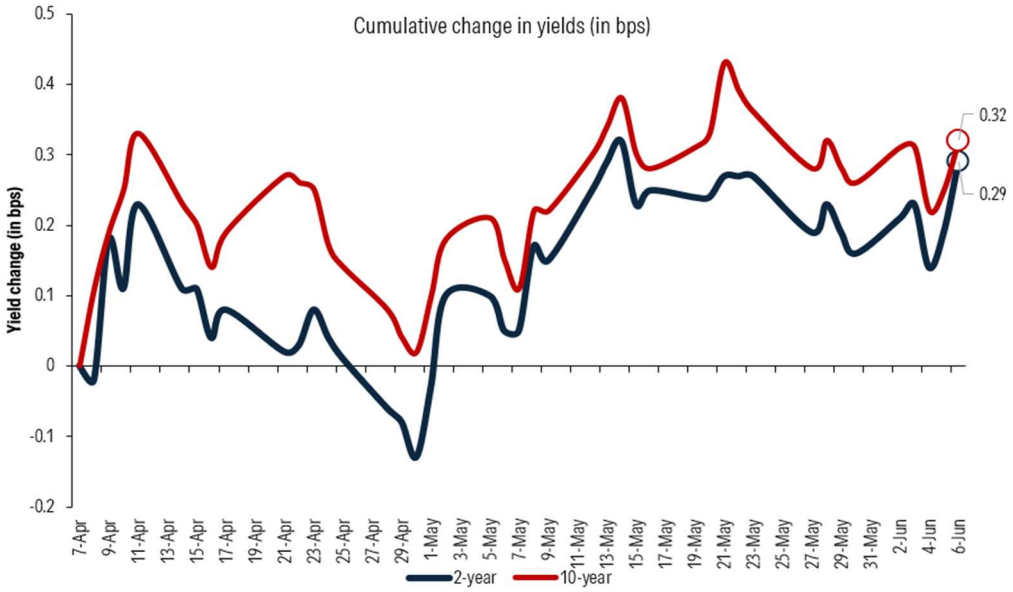


Source: Morningstar.com

Treasury yields ticked higher across the curve; the 10-year yield climbed to 4.47%, up from 4.38%, though staying in its tight range of 4.35-4.50% witnessed over the past month. Investors continue to wrestle with the prospects of a still resilient domestic economy combined with fears of ballooning debt and increasing budget deficits. This has resulted in heightened volatility in long bonds and upward pressure on yields. The rest of the curve followed suit this morning, as short-term yields rose on the prospects of delayed rate cuts, with the 2-year yield up 9 basis points to 4.02% this morning. Thus,

market participants may be interpreting the stronger-than-forecast wage growth and stable unemployment as constraining the Federal Reserve's (Fed) ability to cut rates imminently.

US Treasury Yields Resume Upward Trajectory



Source: US Treasury Department, Morningstar Investment Management

Fed futures illustrated this shift in sentiment: the probability of a June rate cut dropped to near 0%, versus roughly 40–50% odds prior to the release. For September, the implied chance of a first cut now exceeds 90%, a substantial change from expectations just a week earlier.

Breaking Down the Headline Number

Per the BLS, the healthcare sector continues to lead the way higher in job creation (+62,000). Federal government positions continue to lead the declines as efforts from the Department of Government Efficiency stymie job growth. Federal government payrolls declined by 22,000 in May. Further, manufacturing and retail exhibited weakness as trade-related uncertainty and tepid prospects for consumer spending limit hiring in these sectors.

Looking Ahead

May's report underscores the resilience of the US labor market but also hints at emerging soft spots. The drop in the labor force participation rate to 62.4% (down from 62.6% in April) and the employment-population ratio sliding to 59.7% highlight lingering slack despite headline strength. With tariff-induced headwinds still unfolding, especially given that many levies implemented in late April and May were delayed by 90 days, the full impact on hiring may not be evident until the second half of 2025.

From a policy perspective, the Fed gains latitude to remain patient. While the labor market is still adding jobs at a healthy clip, the pace is slowing, wage growth is holding around 3.9% year-over-year, and inflation readings have decelerated modestly. Unless the labor market shows renewed strength or inflation reaccelerates, the Fed is unlikely to pivot until September, consistent with market pricing.

However, if trade tensions deepen again or consumer spending falters, the Fed may reevaluate its stance.

In summary, May's employment data signals that the US economy is growing at a moderate pace without obvious overheating. The labor market's durability in the face of tariff uncertainty provides the Fed with breathing room but does not eliminate downside risks. Investors and policymakers will scrutinize June and July readings for clearer direction on the trajectory of growth and inflation amid lingering crosscurrents in trade and broader global conditions.

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