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ECONOMIC RESEARCH – DECEMBER 2025

INVESTMENT INSIGHT USA

- ✓ Leading indicators remain positive in services
- ✓ Unemployment rises to 4.6% and underemployment to 8.7%
- ✓ Fed cuts rates close to neutral level
- ✓ Risks of sharp rebound in inflation in Q1 2026

2026 START VERY UNCERTAIN IN THE UNITED STATES

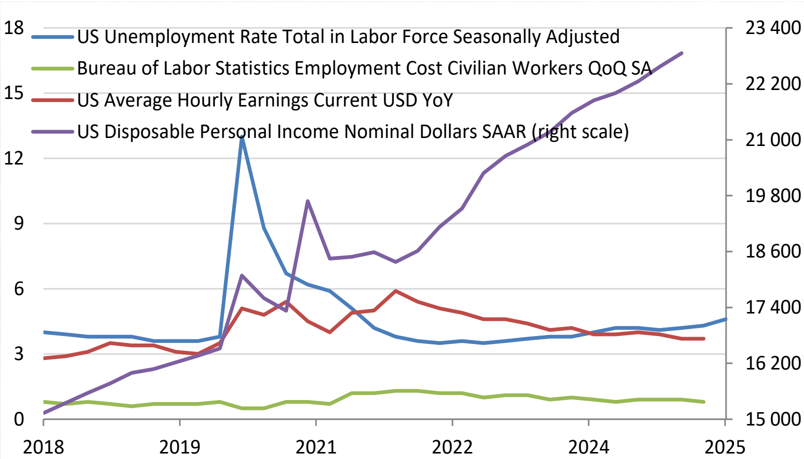
Sectoral divergence and manufacturing contraction

The latest leading indicators highlight a persistent two-speed economy. The ISM manufacturing index slipped to 48.2 in November, with new orders falling to 47.4, signaling an accelerating deterioration in industrial demand. While the services index showed resilience at 52.6, industrial employment hit yearly lows as factories reduced headcount to protect margins. This divide confirms that the services engine is increasingly burdened by a manufacturing sector searching for its bottom.

Rising unemployment and labor market fragility

The US labor market has transitioned from a period of excess demand to one of distinct vulnerability. In November 2025, the unemployment rate climbed to 4.6%, its highest level since 2021. While October was obscured by statistical fog, November data revealed only 64,000 job creations—well below the threshold for natural force renewal. The resignation rate has plummeted to 1.8%, indicating employees are now hesitant to leave current roles. This shift from a "tight" to a "fragile" market represents a significant risk to consumer confidence as we head into the first quarter of 2026.

Unemployment rate, income, labor costs, wages



Sources : Bloomberg, BBGI Group

Underemployment and shift in corporate hiring behavior

An alarming jump in the underemployment rate to 8.7% in December underscores a quiet deterioration in job quality. While mass layoffs have not yet materialized, companies are aggressively reducing working hours, as evidenced by the rise in part-time employment for economic reasons. Despite JOLTS data showing 7.7 million openings, the actual hiring rate has stalled at 3.2%. Job creation (NFP) averaged a mere 30,000 per month in Q4, a staggering decline from the 200,000-plus monthly additions seen at the start of the year, signaling that the labor engine has effectively stalled.

The Fed's pivot to risk management

On December 10, 2025, the FOMC cut the federal funds rate by 25 basis points to a range of 3.50% to 3.75%, marking a formal abandonment of its "restrictive" stance. Fed Chair Jerome Powell emphasized a symmetrical approach to risk management, noting that risks to employment now equal or exceed those of inflation. With the unemployment rate crossing the threshold of theoretical full employment, the Fed is attempting to bring the real rate back toward a neutral level, currently estimated between 3.25% and 3.50%. This pivot aims to prevent a hard landing while acknowledging that wage pressures have sufficiently eased.

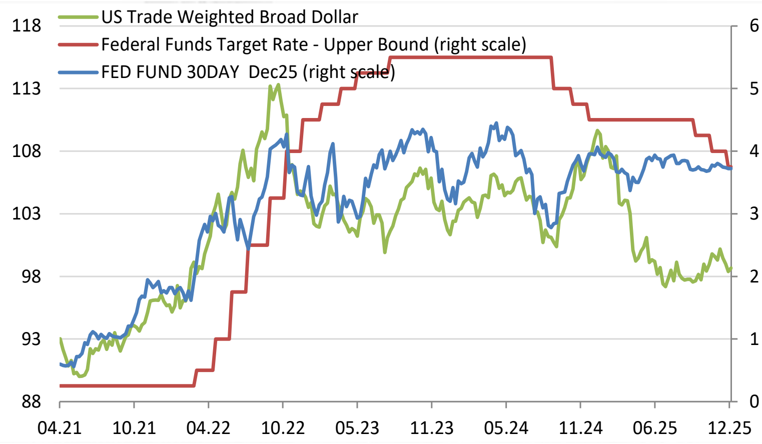
Monetary normalization and balance sheet adjustments

In a significant policy shift, the Fed has halted its quantitative tightening program, citing ample bank reserves of $6.5 trillion. To support growth, the central bank will now purchase approximately $40 billion per month in short-term Treasury securities. While the FOMC remains divided—evidenced by three dissenting votes—the baseline expectation is for a slower pace of decline in 2026. This dual stance of supporting growth while maintaining caution on inflation suggests the Fed is nearing its normalization target, though it remains prepared to adjust should post-shutdown catch-up effects prove more volatile than anticipated.

Tariff pressures and the risk of inflationary rebound

Despite official November inflation slowing to 2.7%, underlying data reveals a more complex and concerning reality. The "housing" component was technically suppressed due to shutdown-related collection difficulties, while retail discounts artificially depressed core figures. Upstream, the cost of imported goods is soaring; the average tariff rate now stands at 15.8%, a peak not seen since 1943. With the ratio of tariff transmission to final prices nearing 90% in key sectors, we anticipate a mechanical rebound in inflation to the 3.2%–3.5% range in Q1 2026, potentially catching the Fed off guard.

Fed funds, key interest rates, and USD (trade weighted)



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