



AOR Update: Labor Market Bending, Not Broken

September 2, 2025

Key Takeaways

- ▶ The labor market is in focus as negative revisions to recent jobs reports have increased the likelihood of modest interest rate cuts. A sharp drop in immigration has slowed employment growth while a modest uptick in layoffs suggests a “low churn” environment.
- ▶ The three key measures we track paint a mixed picture of labor market health: Job Sentiment is currently flashing a recessionary red signal, while Jobless Claims and Wage Growth remain in healthier expansionary green territory and in line with the overall green signal for the ClearBridge Recession Risk Dashboard.
- ▶ Waning uncertainty on tariffs, passage of major fiscal legislation and a positive outlook for corporate earnings cause us to remain optimistic that the labor market will firm up from here, even if the pace of hiring is slower.

Slowing Immigration a Key Consideration for Future Job Growth

Over the past several months, the health of the labor market has emerged as a key debate for financial markets. Just how close the economy is to maximum employment is a crucial consideration for monetary policy, particularly with the threat of a pickup in inflation over the coming months as companies increasingly pass through the costs of higher tariffs to consumers. A weaker labor market would allow the Federal Reserve to modestly lower interest rates even as inflation risk increases because tariff-driven inflation is not expected to persist. Any such inflation is expected to act more as a one-time price adjustment that would lower disposable income, aggregate demand and thus overall inflation after an initial move higher.

However, inflation is not the only part of the Federal Reserve’s dual mandate adjusting to a new regime: the labor market is also facing an adjustment as the pace of immigration into the U.S. has slowed considerably over the past several months. Border encounters have been running between 25,000 and 30,000 per month in each of the past six months according to U.S Customs and Border Protection data, well below the 225,000-250,000 average per month during the same six months in each of the previous three years. Although it takes several months for newly arrived immigrants to receive work permits, the 90% reduction in border encounters suggests that the incremental supply of workers has dramatically slowed in 2025.

The impact of immigration on the labor market is not a new phenomenon; in fact, it was one of the key drivers of the rise in the unemployment rate that triggered the Sahm rule in 2024. [As we wrote about at the time](#), the surge in immigration was the primary reason why the elevated unemployment rate was overstating the degree of labor market softness, something the rule’s namesake Claudia Sahm herself noted at the time

as well. While this is no longer an issue, the unemployment rate falling over the past year highlights how shifts in immigration can impact the metrics commonly used to gauge labor market health.

When assessing the health of the labor market, we tend to focus on three key measures: Jobless Claims, Job Sentiment and Wage Growth. All three are a part of the ClearBridge Recession Risk Dashboard, which experienced no signal changes this month and remains in overall green expansionary territory. Job Sentiment is currently flashing a recessionary red signal, while Jobless Claims and Wage Growth are both in healthier green territory.

Exhibit 1: U.S. Recession Dashboard

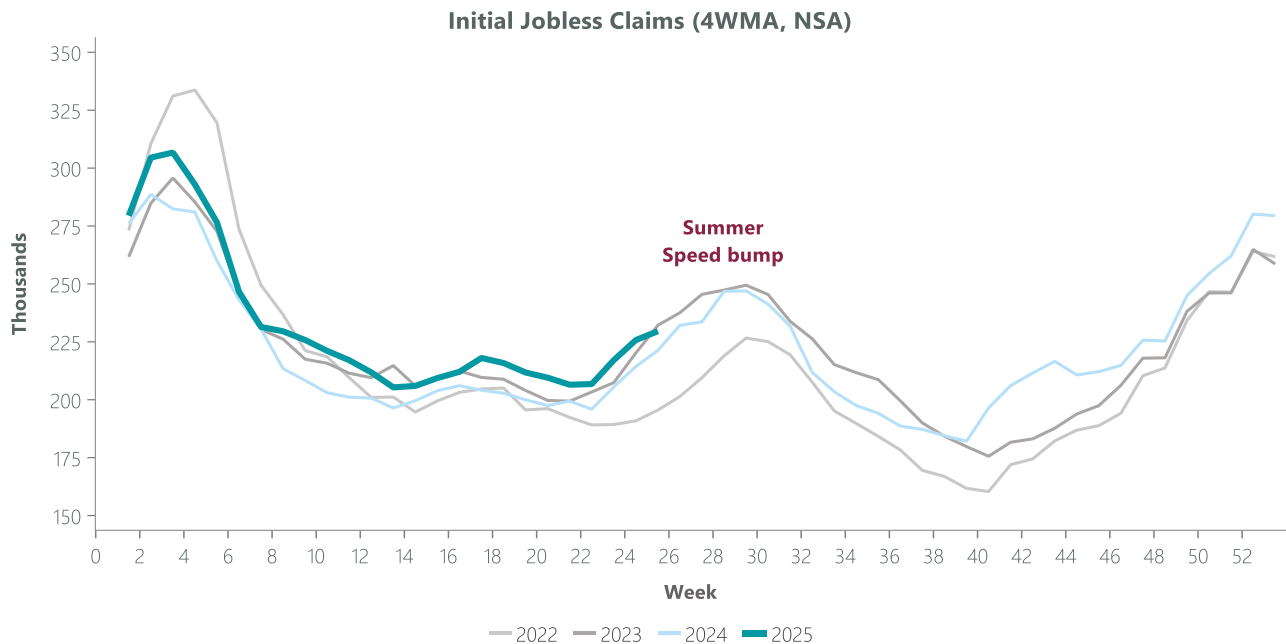
		August 31, 2025	June 30	March 31	December 31
Consumer	Housing Permits	↑	↑	↑	↑
	Job Sentiment	×	×	×	×
	Jobless Claims	↑	↑	↑	↑
	Retail Sales	↑	↑	↑	↑
	Wage Growth	↑	↑	↑	↑
Business Activity	Commodities	↑	↑	↑	↑
	ISM New Orders	×	×	×	●
	Profit Margins	●	●	↑	↑
	Truck Shipments	↑	↑	●	●
Financial	Credit Spreads	↑	↑	↑	↑
	Money Supply	↑	↑	↑	●
	Yield Curve	●	●	×	●
Overall Signal		↑	↑	↑	↑
		↑ Expansion	● Caution	×	Recession

Data as of August 31, 2025. Sources: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, Bloomberg, CME, FactSet and Macrobond. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

The Job Sentiment indicator comes from data in the Conference Board’s Consumer Confidence report, specifically the difference in the share of individuals reporting that “jobs are plentiful” versus “jobs are hard to get.” Deteriorations in consumer perceptions of the labor market tend to presage slowdowns in consumption as individuals hold off on marginal purchases given less confidence in their ability to find work if needed. This metric has been in red territory for over two years, which would traditionally be concerning. However, we believe this indicator has suffered from the post-pandemic “vibecession” where many sentiment surveys have been biased negatively without translating into actual changes of behavior.

By contrast, the other two labor-related dashboard indicators look much healthier. [Wage Growth has stabilized](#) around 4% over the past year and a half—something of a goldilocks level consistent with both a green indicator signal and the Fed’s 2% inflation target when productivity gains (of ~2%) are considered. Jobless Claims — [our economic canary in the coal mine](#) — have moved through their typical summer swoon and begun to normalize. Initial jobless claims indicate only a minimal pickup in layoffs and/or deterioration in labor conditions at present, a positive dynamic.

Exhibit 2: Initial Jobless Claims Indicate Only Minimal Weakness



Note: 4WMA stands for four-week moving average, and NSA stands for non-seasonally adjusted. Sources: U.S. Department of Labor, Macrobond. Data last updated on June 26, 2025, latest available as of June 30, 2025.

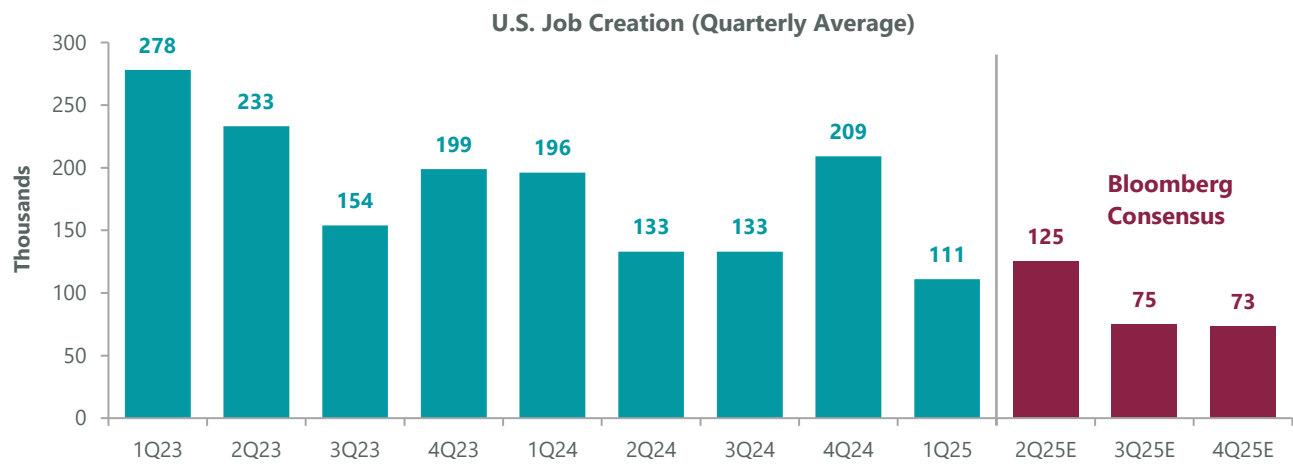
Beyond these three indicators, we also keep tabs on an array of labor data including job openings and the quits (and hires) rate, among others. This data helps round out the picture of the labor market and currently paints an image of “low churn” with few firings but also less hiring occurring. After peaking above 12 million in 2022, the number of job openings as measured by the Job Opening and Labor Turnover Survey (JOLTS) has leveled off around 7.5 million over the past 12 months, suggesting employers are looking to keep hiring steady.

The quits rate — also from the JOLTS report — has been steady around 2% over the past year after peaking at 3% in 2022, suggesting fewer workers are voluntarily leaving their jobs. This is consistent with a softer hiring environment, which is backed up by the hires rate similarly declining from its recent peak but holding steady over the past year. One thing we focus on is the ratio of hires to separations (quits and layoffs), which has been steady just above 1.0 and indicates a modest pace of net job creation, consistent with a low-hire, low-fire environment.

The July jobs report showed a slowdown in hiring that was not unexpected directionally, but was larger and quicker than many anticipated, including us. [At mid-year, we highlighted](#) how the pace of job creation was expected to fall below 75,000 per month in the second half of this year. What was most surprising in last month’s job report was not the July job print itself but the revisions to the prior two months, with May and June job creation revised lower by a whopping 258,000 jobs in total. This was the largest two-month revision since 1968 outside of NBER-defined recessions.

The silver lining, however, is that the pattern over the past few months appears to indicate that job creation could hold steady or even pick up in the coming months. While any single month can be volatile and revisions can further change our understanding (as they did last month), hiring appears to have ground to a halt in May and June in the uncertain aftermath of the Liberation Day tariff announcements. However, July showed a resumption of hiring as visibility began to improve, and consensus expectations are for a similar pace of monthly hiring over the balance of the year.

Exhibit 3: Labor Slowdown Ongoing



Note: Quarterly average change in non-farm payrolls. As of June 30, 2025. Sources: Bloomberg, U.S. Bureau of Labor Statistics (BLS), Macrobond.

Looking ahead, the hiring backdrop appears healthier given reduced uncertainty. Trade policy concerns have diminished over the past two months as a series of trade deals have been struck, and a loose template appears to be emerging that includes the use of import/export quotas and investment agreements alongside tariffs to achieve the administration’s trade policy agenda. Importantly, the “state of play” now has a much narrower range of outcomes, which should give greater comfort for corporate decision makers.

Uncertainty has also been reduced by the passage of the One Big Beautiful Bill in July, which clarifies questions around tax policy and provides incentives for corporations to invest while also boosting their free cash flow generation in many cases. The combination of incentives to invest and more cash to do so should ultimately lead to job creation, although this process does not typically play out overnight.

The labor backdrop has been muddy over the past several years, dating back to the pandemic shock and then the impacts of elevated and now reduced immigration. Going forward, we believe aging demographics, declining participation and new immigration policies should slow labor force growth, pushing down the breakeven level of job creation below 100,000 per month. While this is a change from recent years, we remain optimistic that the labor market will firm up from here, even if the pace of hiring is slower.

Unemployment insurance claims — both initial and continuing — do not point to a surge in job losses. Corporate profit growth remains strong, and layoffs typically spike only when companies face significant financial pressures given the high costs of both hiring and firing workers. At present, S&P 500 Index earnings expectations are improving on the back of a budding pickup in corporate confidence. With profits set to continue to grow, a major deterioration in the labor market is unlikely. Our belief is that the underlying health of the labor market remains solid, despite the recent shocks. As the impacts from these shocks fade, we believe the resilience of the U.S. economy will once again shine through as we move into 2026 in the form of a pickup in job creation.

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