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On the December Jobs Report, and How the Fed is Trumping Itself

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Donald Luskin

The Fed doesn't care about jobs now. Instead it is diving down a Trump tariff rabbit-hole.

FIRST, JOBS Today's December 2025 Employment Situation Report with 256,000 net new payrolls is a beat versus consensus expectations for 165,000, but shouldn't be especially controversial. Revisions to the prior two months were minor, 15,000 lower for November and 7,000 higher for October. Weather had no effect. With a gain of 478,000 jobs in the "Household Survey," the out-of-pattern job losses it has shown for the last two months have vanished – indeed reversed. We don't have any particular comments we want to make about other internals (but see "Data Insights: Jobs" January 10, 2025 – we've got all the internals you could want).

NOW, THE FED After a bit of a false alarm at the September FOMC when the Fed inaugurated its easing cycle with a 50 bp rate cut, there hasn't been much concern that the labor market is at risk (see "On the September FOMC" September 18, 2024). Jobs haven't really been part of their thinking since then (see "On the November FOMC: What, Me Political?" November 7, 2024, and "On the December FOMC" December 18, 2024).

- *So the sharp risk-off move after the payroll report, with the fed funds futures market moving the first fully-expected rate cut back from the June FOMC to the October FOMC, is surely overdone and ripe for reversal*.
- No… the Fed has moved on from worrying that the labor market will fall apart in this productivity-led post-pandemic boom. And they've moved on from worrying that a "tight" labor market causes inflation. *They've found something new to be wrong about.*

The Fed staff and the FOMC have infected themselves with a version of Trump Derangement Syndrome, altering their policy outlook and present policy stance in anticipation of tariffs and other measures that may never materialize, and would have uncertain effects on the Fed's mandate in any event.

At the December FOMC Fed Chair Jerome Powell stammered out hundreds of words to almost sort of not quite kind of *deny that, by pausing rate cuts and raising inflation forecasts, the committee had already altered its policy stance in anticipation of new tariffs* to be implemented by President Donald J. Trump (again, see "On the December FOMC"). *The*

Update to strategic view

US MACRO, FEDERAL RESERVE: 256,000 net payrolls is a beat, and further confirmation of a productivity-led post-pandemic boom. Stronger gains in the "Household Survey" reverse two months of contradiction with payrolls. The Fed is no longer worried about either labor market weakness or tightness. They have moved on to worrying about the inflationary effects of tariffs, holding present policy tighter than it would be otherwise. Despite Powell's denial of this at the December FOMC, the minutes of the meeting reveal that both staff and participants have "placeholders" in their forecasts – assumptions here and now that there will be tariffs, and moreover that they will be inflationary. They have no idea whether or not there will be tariffs, and they seem ignorant of the fact that when tariffs were imposed in 2018 and 2019 inflation fell. We think the policy posture is generally correct, but only by accident. Today's risk-off reaction is ripe for reversal.

[Strategy dashboard]

minutes of the meeting released Wednesday *expose this as a lie* (see "Data Insights: FOMC Minutes" December 8, 2025).

- In the post-FOMC presser, Powell said:

> "…this is not a question that's in front of us right now. …we don't know when we'll face that question. What the Committee's doing now is, is discussing pathways and understanding…how to think about that. …we need to take our time, not rush, and make a very careful assessment, but only when we've actually seen what the policies are and how they're implemented. And, you know, we're just – we're just not at that stage."

- But in the minutes, we find *the Fed staff has erased its prior forecast that inflation would improve in 2025 – and is now assuming no progress at all – and it's because of tariffs*:

> "Inflation in 2025 was expected to remain at about the same rate as in 2024, as the effects of the staff's placeholder trade policy assumptions held inflation up."

- It is revealing that the staff pretends to admit uncertainty on this, but it extends only to the possibility that Trump's tariffs could be even worse than they think:

> "The risks around the inflation forecast were seen as tilted to the upside, as…the effects of trade policy changes could be larger than the staff had assumed."

- It's not just the staff – *it's the FOMC members themselves, some of whom overtly admitted building tariff assumptions into their policy frameworks*:

> "…participants expected that inflation would continue to move toward 2 percent, although…the effects of potential changes in trade and immigration policy, suggested that the process could take longer than previously anticipated. …A number of participants indicated that they incorporated placeholder assumptions to one degree or another into their projections. Other participants indicated that they did not incorporate such assumptions, and a few participants did not indicate whether they incorporated such assumptions."

- Don't let this term of art, "placeholder," used by both staff and participants, fool you. It's just a model input like any other. *Make no mistake: staff and participants, with this "placeholder," are building their policy models on an explicit assumption that tariffs will come and that they will be inflationary, as what amounts to a tax on American importers gets passed on to customers.*
- We can think of no precedent for this. For example, we find not a word to suggest that staff or participants were even thinking about

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the potential inflationary effects of the $4 trillion in tax hikes in the Build Back Better program promoted by President Joseph R. Biden in 2021. Was there something about *those* tax hikes that wouldn't have gotten passed through when *these* tax hikes will? Or was there something about *that* president that is different than *this* president?

- *And we wonder if the staff or participants are aware of our research showing that inflation actually fell slightly in 2018 and 2019 when Trump imposed them in his first term* (see "Predictions for 2025: Tariffs" January 3, 2025)?
- All that said, what can we guess about the nature of these forecast inputs disguised as "placeholders"?
- With the "dot plots" in the December FOMC Summary of Economic Projections having moved 2025 inflation expectations to 2.5% from 2.2% in the September SEP, *we can infer (based on the import share of personal consumption) that the median "placeholder" was a tariff of 1.8%, on average, across all imports*. This assumes the tariffs are in place all year, and that they are entirely passed through to consumer prices. Relaxing either of those assumptions makes the implied "placeholder" tariff rate proportionately higher.

For all this silliness at the Fed, it is probably the case that nevertheless policy is approximately optimal anyway. We don't think the economy needs a lot of rate cuts here – we disagree with the Fed's judgment, expressed in the December minutes, that policy is "still meaningfully restrictive." We think it's about right (see "On the December FOMC" December 18, 2024). The Fed often does the wrong thing. Maybe this time they are doing the right thing by accident.

Bottom line

256,000 net payrolls is a beat, and further confirmation of a productivity-led post-pandemic boom. Stronger gains in the "Household Survey" reverse two months of contradiction with payrolls. The Fed is no longer worried about either labor market weakness or tightness. They have moved on to worrying about the inflationary effects of tariffs, holding present policy tighter than it would be otherwise. Despite Powell's denial of this at the December FOMC, the minutes of the meeting reveal that both staff and participants have "placeholders" in their forecasts – assumptions here and now that there will be tariffs, and moreover that they will be inflationary. They have no idea whether or not there will be tariffs, and they seem ignorant of the fact that when tariffs were imposed in 2018 and 2019 inflation fell. We think the policy posture is generally correct, but only by accident. Today's risk-off reaction is ripe for reversal.