

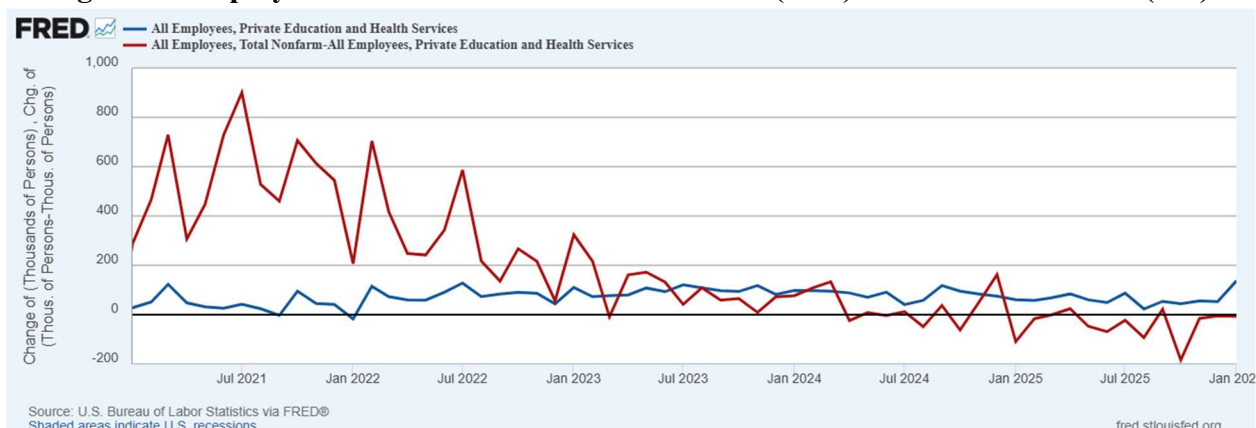
February 11, 2026

The Labor Market Remains Frozen

We agree with half of the enthusiastic response to the January BLS employment report. **The household survey is undeniably excellent.** Headline unemployment fell from 4.4% to 4.3%. More importantly, underemployment (part time for economic reasons), which surged from 4.6 million to 5.5 million in November, fell back to 4.8 million in January. The U-6 measure of unemployment, which includes underemployment, fell from 8.4% to 8.0%. This is a sign that unemployment is stabilizing.

The problem is that all the other evidence from the labor market is pointing in the wrong direction. This includes the establishment survey which beat expectations by showing job growth of 130,000. Once again, more than 100% of this growth came from private education and healthcare, which grew by 137,000 jobs. We reiterate that private education and healthcare are historically recession proof. Their job growth was the highest since 2020 (blue in Figure 1) and will almost surely prove to be a blip. **Employment in the rest of the labor market has now declined for eleven of the past thirteenth months with a y/y decline of 414,000.** January's decline of 7,000 will likely be revised higher. Last week's ADP data told the same story. Education and healthcare are about one-sixth of the labor market and a lasting recovery of hiring must be broader based.

Figure 1: Employment on Education and Healthcare (blue) vs All Other Sectors (red)

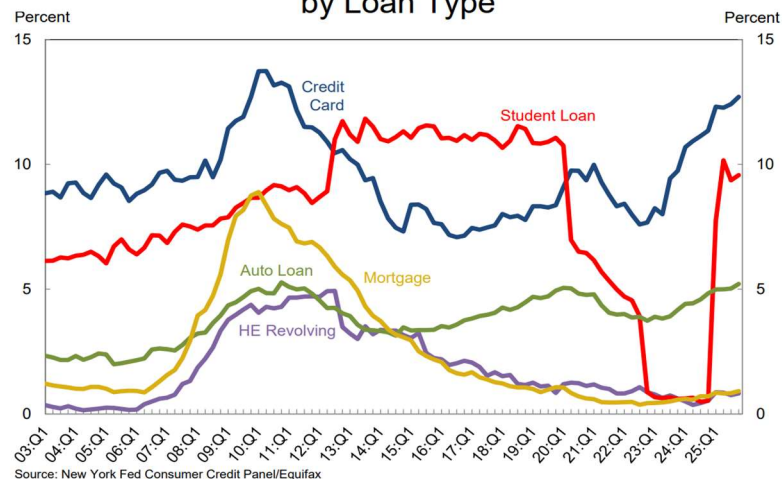


The labor market, and overall outlook, remains a waiting game between whether hiring or layoffs will pick up. There have been some signs of rising layoffs, including last week's Challenger survey showing 108,000 announced layoffs in January and last week's jobless claims jumping from 209,000 to 231,000, although the latter may be weather related. **The household survey effectively pushes back against these signs and instead suggests a continuation of the low-hire, low-fire economy that has persisted for several months.** The wait continues. The drop in unemployment, however, does push us to lower our recession odd from 60% to 55%.

Other Developments in Macroeconomics:

1. The FOMC wants to hold interest rates steady and the BLS report gives them the rationale to do so. Barring very poor February employment data, the Fed will hold steady in March. By April, for Chairman Powell's last FOMC meeting, the recent dip in unemployment will likely have reversed and a rate cut is very much in play; we put the odds at 50%. Longer term, **the economic fundamentals of fading inflation and a labor market somewhat below full employment best fit a Federal Funds rate of 250-275 bps and we expect the Fed to end up there by 1Q2027.**

Figure 2: Delinquency Rates on the Rise
Percent of Balance 90+ Days Delinquent
by Loan Type



2. Households' balance sheets tell a similar story as the labor market. Headline figures remain decent, but they have trended in the wrong direction and are likely to continue to do so. **Furthermore, there is heterogeneity within the data that makes the situation somewhat worse than the topline figures suggest.** The New York Fed's new 4Q2025 survey of household credit shows a broad increase in delinquency rates across all types of loans. The most concerning loan classes are credit card delinquencies, at 13%, and car loans, at 5%, which are both near their 2010 peaks. This indicates growing financial

distress among low-middle income households, which is also shown by a zip-code level analysis of the data. Although mortgage delinquencies are rising, they are still low and an indicator that middle-upper income households remain in better shape. This is fortunate given that the rest of the housing data remains poor. It is inevitable that these indicators will continue to weaken as long as consumption growth remains strong in the face of a mediocre labor market. We do note, however, that the weak December retail sales data, especially given poor consumer confidence, could be an indicator that consumption growth is finally starting to slow.

3. It was only a few years ago that we warned readers that an inverted yield curve was no longer predictive of an upcoming recession. **We are equally confident that the widening 10-2 year Treasury spread is also not useful at forecasting the U.S. economy.** It mostly reflects a series of President Trump's policies (*e.g.* geopolitical tensions, the Warsh appointment, etc.) that have elevated term premiums and kept yields higher for longer than we initially expected. More broadly, the Fed's switch to a large balance sheet with ample reserves has permanently reduced the yield curve's usefulness. False positives like 2022 will be more common, as will false negatives where a steep yield curve does not indicate good times ahead. Housing is instead the best remaining leading economic indicator. Its weak state remains one of our primary reasons for pessimism.

-Paul Shea

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