Weekly economics podcast: A tale of two Labour Markets

By Perpetual Corporate Trust

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By Stephen Roberts

Labour market conditions have softened more in the United States than in Australia in 2025 so far and that provides some leeway for the Federal Reserve to cut the Federal Funds rate at the policy meeting this week, but little or no room for the RBA to cut the cash rate in the near term. Over the next few months, we see the current 90bps gap between the current 4.50% US Federal Funds Rate and the RBA's 3.60% cash rate narrowing. The likely narrowing of the gap between US and Australian official interest rates should contribute to the Australian dollar appreciating further against the US dollar and a more steeply positively shaped bond yield curve in the US than in Australia.

Back in 2024, both the US and Australia experienced very tight labour market conditions. In the US, nonfarm payrolls grew an average 167,000 per month whereas in Australia total employment grew an average 33,000 per month. These two measures of employment are only loosely comparable because of the very different survey methods used to collect nonfarm payroll data in the US and employment data in Australia. Nevertheless, total nonfarm payrolls in the US around 159 million at the end of 2024 against Australian total employment around 14.5 million mean that the US workforce was around eleven times bigger than the Australian workforce at the end of 2024.

Average monthly growth in employment in the US through 2024, however, was only five times greater than average monthly growth in Australian employment. This rough comparison of employment growth in the two countries implies that if the US labour market was deemed tight, the Australian labour market was even tighter.

However, it is necessary to allow that labour supply conditions were different in the two countries as well. Through 2024, net immigration was growing the labour force in both countries, but much more so in Australia than in the US. Also, the labour force participation rate lifted more in Australia than in the US.

Because of the faster growth of labour supply in the Australia than in the US through 2024, relatively faster growth in employment in Australia translated to the unemployment rate in Australia being only slightly lower than in the US.

Australia's unemployment rate averaged 4.0% through 2024 and ended the year at 4.1%, whereas the US unemployment rate averaged 4.1% and ended the year at 4.2%. Judged by unemployment rate, labour market conditions were a touch tighter in Australia than in the US and in both countries were tight enough to make their respective central banks cautious about cutting official interest rates.

Moving into 2025, labour market conditions have become less tight in Australia and are starting to look weak in the US, especially since President Trump's tariff announcement back in April. In the five months April through August average monthly growth in nonfarm payrolls has been only 54,000, less than a third the average monthly growth through 2024. Labour supply has been cut sharply in the US too with the deportation of illegal immigrants. Nevertheless, the unemployment rate has edged up to 4.3% in August.

In Australia, employment growth has slowed too. Over the most recent 5-month period ending July, employment growth has averaged 22,000, around two-thirds the rapid average monthly growth pace recorded through 2024. However, the slowing employment growth pace is much less pronounced than in the US. Supply of labour in Australia is still growing, but at slower pace than in 2024 with net immigration still running, but not quite as fast, and the labour force participation rate stabilising.

The Australian unemployment rate has lifted only marginally from 4.1% at the end of 2024 to 4.2% in July. Australia's recent labour force experience points to little change in the unemployment rate over coming months, whereas the US labour market data points to risk of a rising unemployment rate. That alone implies greater likelihood of rate cuts from the Federal Reserve than from the RBA, especially as the Fed has held its Funds Rate steady at 4.50% over several meetings whereas the RBA has cut the cash rate three times this year taking the cash rate down from 4.35% to 3.60%.

Of course, the inflation outlook is a key factor determining what each central bank will do with rates. The US CPI inflation rate was 2.9% y-o-y in August, whereas Australia's CPI inflation rate was 2.8% y-o-y in July. Inflation is under upward pressure from tariff changes in the US and is under upward pressure in Australia as government cost-of-living measures end. Whether the Fed and the RBA can look through these near-term 'one-off' inflation pressures depends upon whether demand in the two respective economies is likely to be sufficiently strong in each economy to underpin inflation a year down the track. The answer is moving towards no for the US and yes for Australia in our view.

So, the tale of two labour markets, still tight in Australia but weakening in the US, is adding to factors relating to the inflation outlook in the two countries that make it likely that the US Fed can cut the Funds Rate this week and possibly deliver two or more cuts in meetings beyond, whereas the RBA is running out of room to cut. We see the US Fed funds rate (4.50%) and the RBA's cash rate (3.60%) converging around 3.50% over the next few months.

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