CHIEF ECONOMIST UPDATES

The Economic Data Fog Will Clear Slowly

November 18, 2025
Author: Stephen Douglass



The longest government shutdown in U.S. history is over. The BLS will resume publication of economic statistics this week, but the fog that has clouded economists' view will lift only slowly. Most importantly for fixed income investors, the FOMC will still be missing key data points when they next meet on December 9-10. Here is how we see the sequence of key data releases playing out over the next few months.

First out of the gate will be the September payrolls report on Thursday. This report was collected and largely processed before the shutdown, so the contents will not be polluted by the shutdown. This will probably be the single most important data release for determining the outcome at the December FOMC meeting. Though the information will be a bit stale, it will be the last clean read on the state of the labor market that will arrive before the Fed meets.

The October payrolls report, on the other hand, will be polluted by the shutdown as well as other labor market developments. Recall that the Employment Situation Report (as it is formally titled) consists of two separate surveys: the household survey and the establishment survey. The household survey was not conducted in October. If it is conducted retroactively (the White House has suggested it will not be, but the BLS has not confirmed), the results will be less reliable given the challenges of surveying individuals about their employment status a month earlier. The

establishment survey results for October will be less corrupted by the delay because it is reasonable to assume that employers keep accurate records of their existing headcount and payroll. Indeed, responses to the establishment survey routinely arrive a month late to produce the most accurate version of the report.

That said, the temporary furlough of hundreds of thousands of federal workers will be reflected in the establishment survey results. To muddy the waters even further, we expect federal payrolls to permanently decline by more than 150,000 workers in the fourth quarter as the DOGE deferred resignation program takes effect. We will therefore focus our attention on private employment in October, but even this will be impacted by the disruption to government-adjacent private companies (think restaurants located near national parks).

These distortions will make it easy to dismiss an outlier result in either direction, so the October report is unlikely to tip the scales at the FOMC meeting even if it is reported in time. The November payrolls report was originally scheduled for publication on December 5, but it seems unlikely the BLS will be able to clear their backlog in time to meet that original deadline. Even if they do, the November report will contain the same distortions as the October report, though to a lesser extent since the shutdown ended in the second week of this month. The first truly clean read on the state of the labor market therefore won't arrive until the December report is published in early January.

As bad as that sounds for the labor data, the inflation data will be even more disrupted by the shutdown. BLS price collectors are usually out in the field every day of the month surveying both in-store and online prices to produce the CPI report. That data collection did not happen in October, so it is an open question whether BLS will be able to produce any CPI report for the month. We hope they do, even if it means cobbling together a report that is little more than an extrapolation from prior months, if for no other reason than to avoid the hassle of resorting to fallback provisions in the TIPS and inflation swaps markets. We are optimistic that the BLS will be able to do so, considering they have never missed a single month of CPI publication since the inception of the index in 1921. The November CPI report will be somewhat less distorted but will not arrive until after the December FOMC meeting. As with payrolls, we'll have to wait until mid-January for a clean read on price dynamics.

The primary justification for cutting rates twice this fall even as inflation remains above target was to insure against downside risks to the labor market. Other data releases beyond payrolls and inflation will arrive in the weeks ahead, but payrolls and CPI will be the most important for resolving the tension between the two sides of the Fed's mandate and settling the contentious debate about a possible third rate cut at the December meeting. Short rate markets are currently pricing a bit less than a 50% chance of that cut being delivered on December 10. Unfortunately for the FOMC, they will still be lacking in reliable data as they make that decision.

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