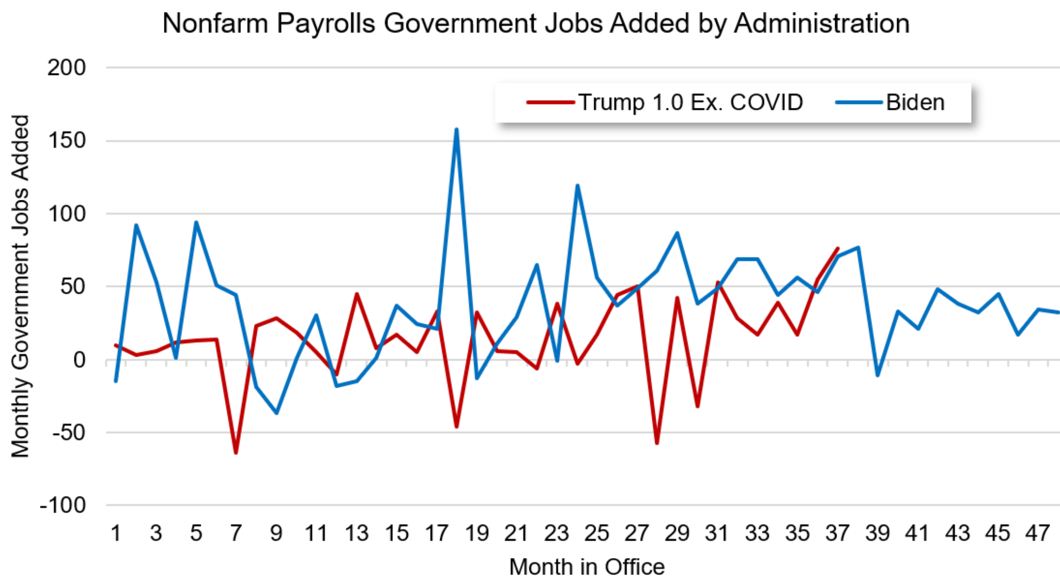
Analyzing the Economic Ripple Effects of Federal Layoffs

The newly established Department of Government Efficiency (DOGE), led by Elon Musk, has been active in scouring the federal government for inefficiencies and ways to cut back on unnecessary spending since day one of the new administration. Musk seems to be applying a similar playbook to his acquisition of X (formerly known as Twitter) in restructuring employment in the federal government: slashing a majority of the workforce quickly and early, then rebuilding employment from the ground up if necessary. While the intention may create more streamlined and efficient government operations and spending, the rapid and erratic manner in which it is being conducted can have significant consequences for markets and the broader economy. We explore the potential implications of these actions below.

Soon after Trump took office, the White House began sending buyout offers to approximately 2 million federal employees, encompassing nearly the entire full-time federal workforce except for military personnel, USPS employees, and those with duties related to immigration enforcement and national security. The offer had an expiration date of February 6, 2025, and included full salary and benefits up until September 30, 2025. By the time the deadline was reached, only approximately 77,000 offers had been accepted, likely due to uncertainty around the legitimacy and legality of such unprecedented action. Having received far fewer acceptances than originally anticipated, Trump responded in the weeks following with a slew of layoff announcements across multiple agencies as part of a large-scale reduction in the overall federal workforce, targeting probationary employees with less than one to two years of experience in their role due to fewer job protections. According to the Office of Personnel Management, there were about 220,000 probationary federal

employees with less than one year of experience as of the most recent public data from March 2024. While there is no official count of the total number of layoffs to date, it could surpass 100,000, including those who accepted the original buyout offer. A few notable announcements so far include plans to reduce 5% to 8% of the Pentagon's civilian workforce, starting with over 5,000 probationary employees at the Department of Defense, over 6,000 layoffs of probationary employees at the IRS, and about 10,000 employees at the United States Agency for International Development (USAID) who were placed on administrative leave.

Given the speed and magnitude of these layoffs at the federal level, we delved deeper into federal labor dynamics to identify the potential implications for markets and the broader economy. Taking a step back to look at the larger fundamental picture, there are 3 million individuals on payroll in the federal government, which is just under 2% of the civilian labor force in the U.S. After stripping out the approximately 600,000 USPS workers who are included in that figure but are under an independent agency with semiautonomous status, the share of workers that DOGE initiatives are potentially targeting represents ~1.5% of the labor force. We assume Trump is targeting probationary employees due to the relative ease of firing in the first year or two of a government employee's "trial period." If half of all probationary employees at the federal level were to be removed from service (~110,000), this would equate to under 5% of total federal employees (excluding USPS workers) and just under 0.07% of the total U.S. workforce.

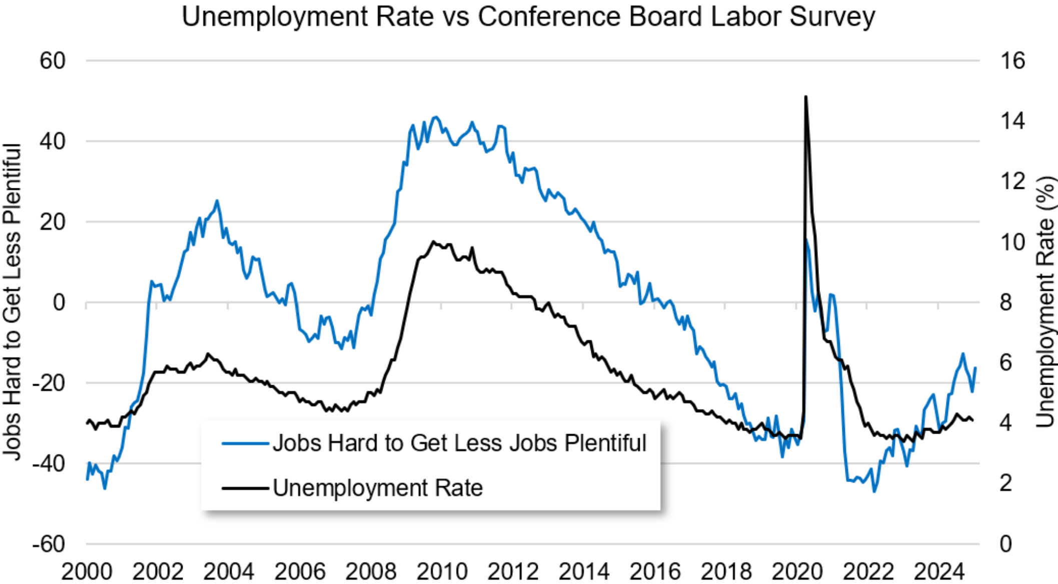


Source: Smith Capital Investors, Bloomberg (2/21/25)
**Presidency date ranges. Trump: January 2017 – January 2021. Biden: January 2021 – January 2025.*

Examining this from the lens of job gains under Trump's first term and Biden's term (excluding COVID outliers), federal employment accounted for under 1% of total job gains for both administrations. **Overall government employment gains were both a larger absolute and relative driver of nonfarm payroll gains under the Biden**

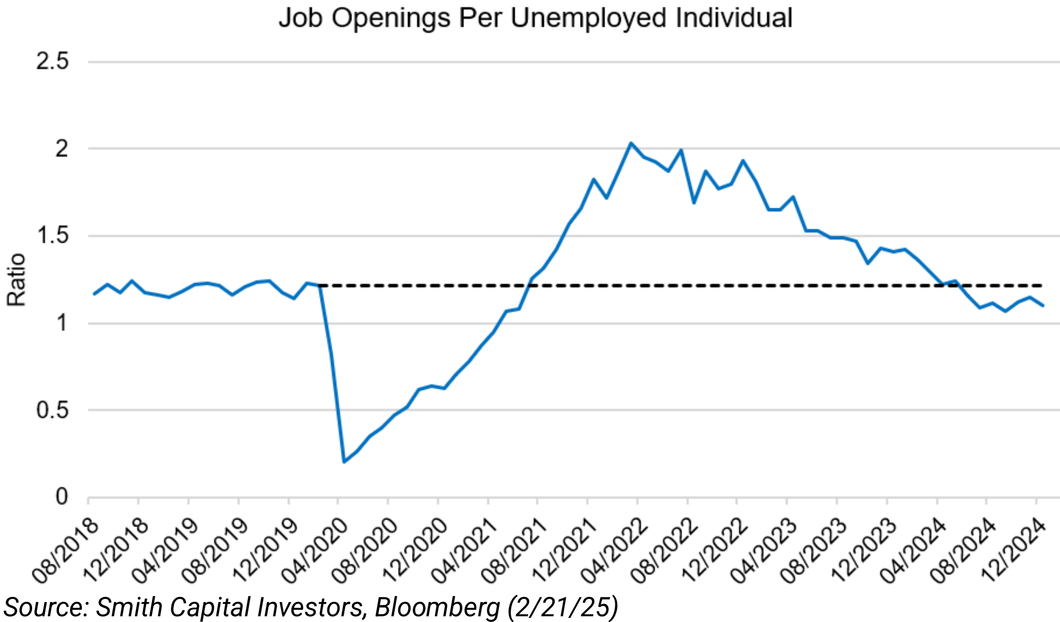
administration, due almost entirely to local government hiring. Under Trump's first term (excluding the final months impacted by COVID), just under 6.7 million total jobs were added to nonfarm payrolls. Approximately 8% of these jobs came from government hires with an average pace of 14.6 thousand jobs per month. Under Biden, roughly 16 million jobs were added to nonfarm payrolls and 11.2% of these additions came from government jobs at an average monthly pace of 37.7 thousand additions. Some of this discrepancy is likely due to the swift economic recovery following the COVID pandemic disruption, but isolating the trends to solely 2024 highlights the importance of government hiring under the Biden administration: 22.6% of overall nonfarm payroll additions came from government hiring. If hiring trends under Biden were not only slowed but also fully reversed due to the recent layoff announcements, it would pose a headwind to nonfarm payroll gains going forward. Twenty percent of total federal workers are in Washington, D.C., and neighboring Maryland and Virginia areas. We remain focused on monitoring initial jobless claims in these jurisdictions to garner timely insights into the potential ramifications of the layoff announcements with respect to broader labor market data.

After a string of robust job gains to end 2024 and kick off 2025, the Fed has shifted focus back to addressing risks related to price stability and inflation expectations. Recent commentary has shown strong alignment in wanting to pause any further rate cuts until there is greater confidence that inflation expectations are not becoming unanchored and the full extent of tariff and labor market policies implemented by the new administration can be evaluated.



Source: Smith Capital Investors, Bloomberg (2/21/25)
**The Conference Board Labor Survey is a monthly survey that assesses consumer perceptions of the labor market. It includes metrics such as the ratio of jobs being "hard to get" versus "plentiful," providing insights into consumer confidence and labor market conditions.*

Current labor market dynamics can be categorized as healthy but supported primarily by low firing rates. Companies are hiring at slower paces, and individuals are finding it increasingly difficult to find a new job if they quit or are fired, as highlighted by the rise in the relationship between jobs being “hard to get” versus “plentiful” in the Conference Board consumer survey results. The ratio of job openings per unemployed individual has also been below the level prior to the pandemic since May 2024, but it has plateaued and remains within a normalized range. With respect to the increase in layoffs in the federal government, we highlight these dynamics to understand the risks to overall employment and growth if large-scale job losses in the public sector are not absorbed by an increase in private hiring dynamics. If the magnitude of these actions becomes large enough to begin negatively impacting perceived labor market health by the Fed, the committee has set the precedent with the 50bp rate cut in September 2024 that they can act quickly to mitigate downside threats to economic activity.



Source: Smith Capital Investors, Bloomberg (2/21/25)

Trump’s first month in office has been extremely dynamic and volatile for markets. The recent layoff announcements have the potential to disrupt a crucial driver of economic activity over the past few years. These actions, however, are only a portion of the top focus items for the new administration. Other key elements we continue to monitor closely include tariffs, immigration, deficit management, deregulation, and Treasury issuance. All these themes can have significant impacts on markets and the economy.

We believe that this kind of volatile environment can provide extraordinary opportunities for active management to potentially deliver better than average results, and we remain attentive to managing the multitude of potential risks on the horizon.

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