US Labor Market Watch

Labor Force and Immigration Upheaval: Will It Cause Worker Shortages and Drive Up Wages?

Javier Amador / David Cervantes

January 28, 2025

How Labor Supply and Immigration Measures Could Reshape Inflation and Growth

December's data showed a stronger-than-expected uptick in employment, with a 256K increase in nonfarm payrolls along with a decline in the unemployment rate to 4.1%. Alongside the revised figures for October (12k) and November (a downwardly revised yet strong 227k), this pushed the average job creation for the last quarter of last year to around 170K, which nevertheless remains below the average pace seen in 1H24 and 2023. Most of these new positions were concentrated in private services, which accounted for 90.2% of December's job growth, suggesting the labor market may be gaining momentum. Notably, 43.3% of those positions fell outside the healthcare sector—a key driver of employment in recent two years—potentially signaling that cyclical employment growth is strengthening.

Regarding the unemployment rate, the household survey indicates that the rise in employment (399k) exceeded the expansion of the labor force (243k), prompting a 0.1-percentage-point drop to 4.1%. Consequently, the average unemployment rate for the fourth quarter stood at 4.1%, which aligns with the longer-term equilibrium level.

Despite this solid performance, there are still signs of weakness in the manufacturing sector, whose revival will be crucial for bolstering cyclical employment and benefiting economies like Mexico, which are closely linked to this industry.

November's JOLTS data was consistent with the labor market strength depicted by the payrolls data and showed that job openings increased to 8.10 million (from 7.84 million in October). However, this strength should not raise worrying concerns about inflation since the private quits rate continued to fall to its lowest since the pandemic's onset, suggesting that wage growth has room for a further slowdown. In fact, on the wage front, average hourly earnings growth moderated slightly to 3.9% year-over-year from 4.0% the previous month, and the three-month annualized rate also declined by 0.2 percentage points to 4.1%, which at 4.1% stands well within the central-tendency FOMC participants' estimated longer-run level (3.9-4.3%). This moderation provides some relief for the Federal Reserve, but in any case, the wage growth trend warrants close monitoring by the Fed, as Trump's immigration curbs could contribute to broader inflationary pressures in 2H25.

A Solid Labor Market, But How Sustainable?

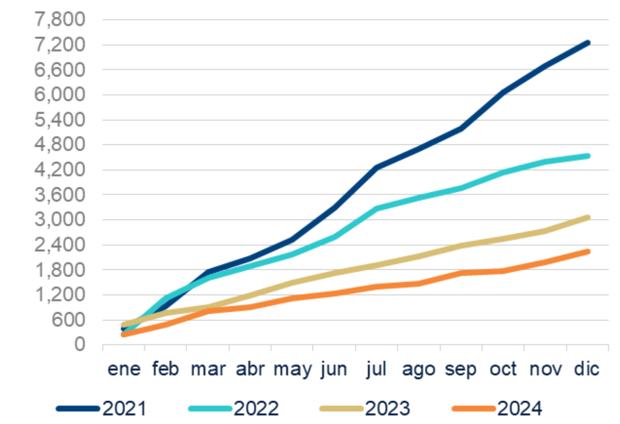
Maintaining this balance—particularly if the U.S. economy embarks on a new trajectory of steady job growth—largely depends on increasing labor force participation. Otherwise, persistently strong employment gains could lead to heightened wage-driven inflationary pressures.

Since labor force dynamics are crucial, recently announced measures on undocumented immigration take on added significance. Estimates suggest that around 10 million undocumented workers reside in the United States, representing roughly 6% of the total workforce. In a near–full employment setting—where the unemployment rate hovers around 4.1%, close to its natural level—a large-scale deportation program would likely create severe imbalances, not only in the labor market but also across the broader economy. According to our analysis, this scenario would trigger a recession stemming from the sudden loss of the labor force and push inflation upward more permanently by exerting pressure on wages.

Albeit BBVA Research deems such mass deportations unlikely and does not anticipate drastic changes in migration flows unrelated to economic cycles and labor demand, there may still be a chilling effect. Fear of potential deportations could reduce participation by undocumented workers in the labor market, with short-term negative implications. This, in turn, would introduce an upside bias for both wages and inflation. These effects could be partly offset by policies aimed at boosting investment and reducing regulations, which would help mitigate adverse impacts on labor supply and overall growth, but the potential positive impact of these measures would take more time. Even so, the outlook is not without risks. Against a backdrop of robust employment, the interplay of these factors suggests a period of heightened economic uncertainty and probably even increased volatility in month-to-month readings. For now, we expect the Fed to hold rates steady this week; our focus will be on any signals pointing to a more long-lasting pause and, thus, a likely delay of the rate cut cycle we currently expect (for more see).

Job creation remains solid, but growth is running well below the average pace in 1H24 and 2023

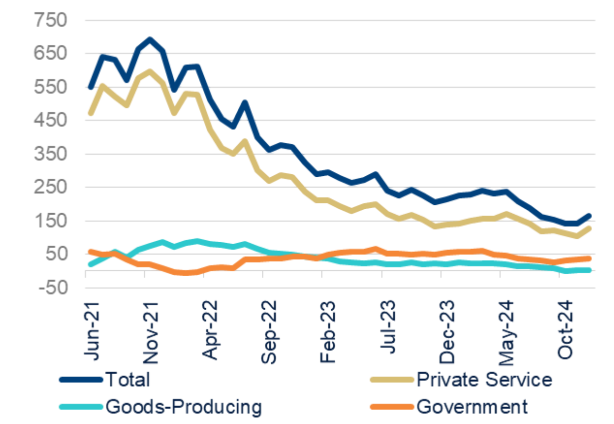
Figure 1. **NONFARM PAYROLL EMPLOYMENT (THOUS, CUM. MoM, SA)**



Source: BBVA Research based on data by Haver Analytics.

An uptick in private services employment suggests the labor market is gaining momentum

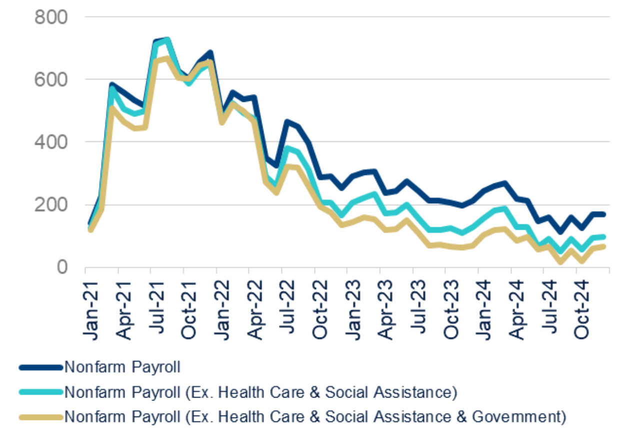
Figure 2. **NONFARM PAYROLL EMPLOYMENT (THOUS, MOVING AVG. 6 MONTHS, SA)**



Source: BBVA Research based on data by Haver Analytics.

Yet, cyclical employment growth was not particularly strong throughout 2024…

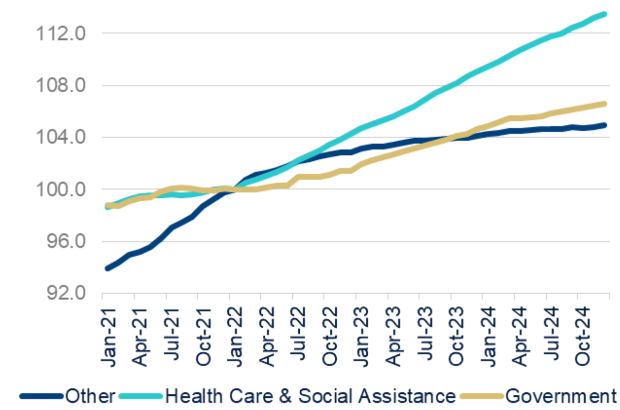
Figure 3. **NONFARM PAYROLL EMPLOYMENT**
(MoM, THOUS, SA 3MMA)



Source: BBVA Research based on data by Haver Analytics.

… and a government hiring freeze could weigh in the short-term.

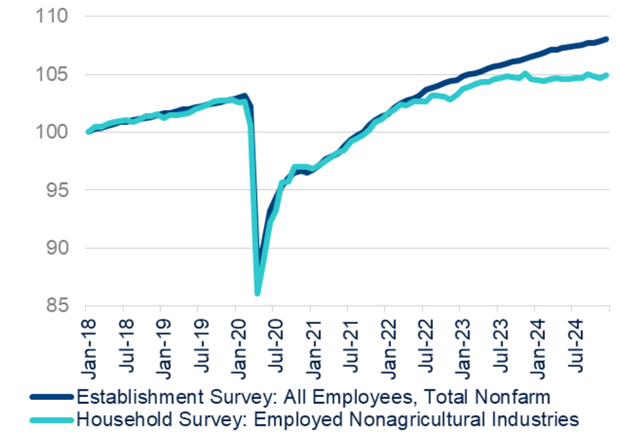
Figure 4. **NONFARM PAYROLL EMPLOYMENT**
(INDEX JAN/2022=100, SA)



Source: BBVA Research based on data by Haver Analytics.

There's still a large gap between the two labor market surveys.

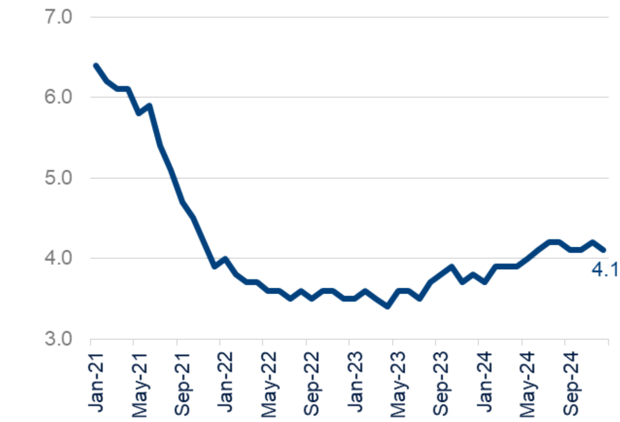
Figure 5. **TOTAL EMPLOYMENT**
(INDEX JAN/2018=100, SA)



Source: BBVA Research based on data by Haver Analytics.

The UR has been hovering around a narrow range close to the steady-state level.

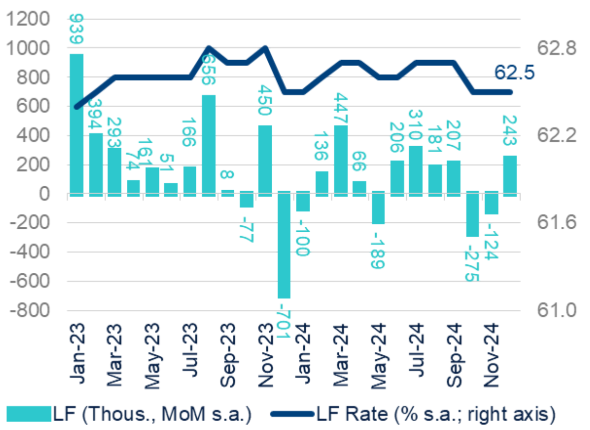
Figure 6. **UNEMPLOYMENT RATE**
(% OF LABOR FORCE, SA)



Source: BBVA Research based on data by Haver Analytics.

Continued labor force growth is key to avoiding unwanted wage pressures ahead.

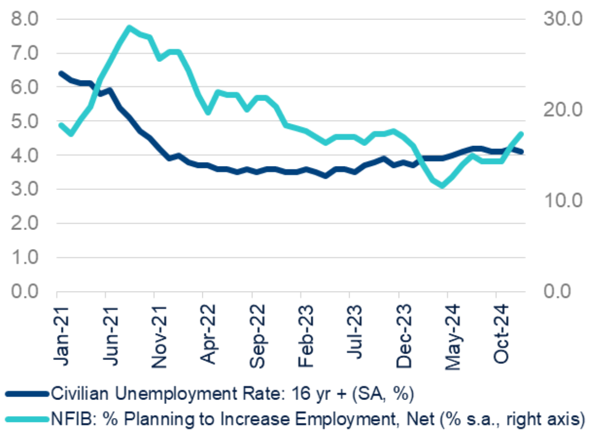
Figure 7. **LABOR FORCE**
(NET VARIATION AND % OF LABOR FORCE, SA)



Source: BBVA Research based on data by Haver Analytics.

The small business survey also points to gaining momentum in the private sector-related jobs…

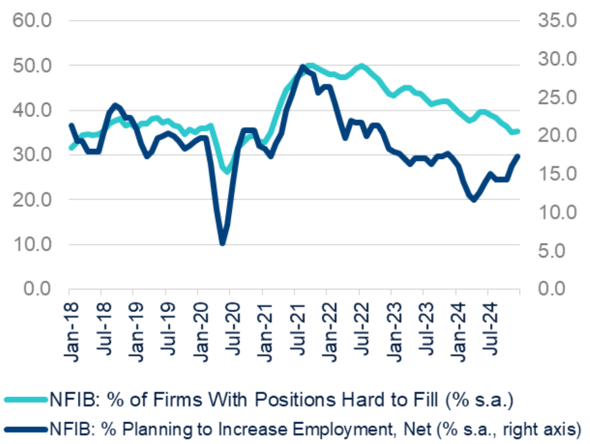
Figure 8. **UNEMPLOYMENT RATE AND NFIB: SMALL BUSINESS ECONOMIC TRENDS**
(% OF LABOR FORCE AND %, MOVING AVG. 3 MONTHS SA)



Source: BBVA Research based on data by Haver Analytics.

… but firms seem to be (still?) able to fill jobs with relative ease

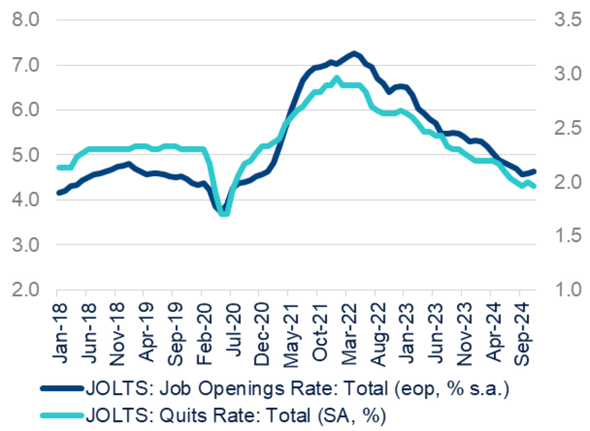
Figure 9. **NFIB: SMALL BUSINESS ECONOMIC TRENDS** (%, MOVING AVG. 3 MONTHS)



Source: BBVA Research based on data by Haver Analytics.

There was an uptick in job openings, but the quits rate is at its lowest since the pandemic

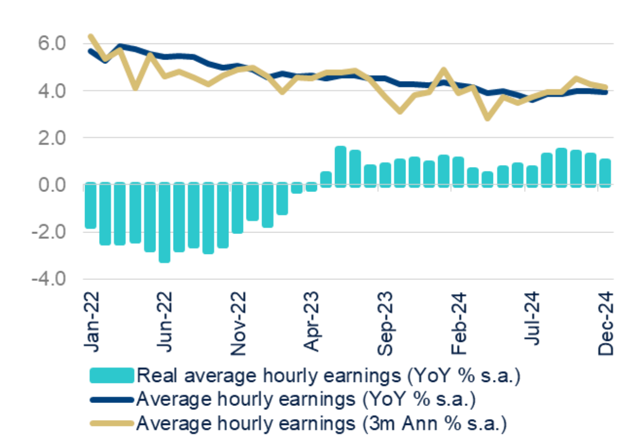
Figure 10. **JOB OPENINGS AND QUITS RATE**
(%, MOVING AVG. 3 MONTHS)



Source: BBVA Research based on data by Haver Analytics.

Signs point to somewhat lower wage growth ahead, but significant upside risks might arise if labor supply is impacted by deportations.

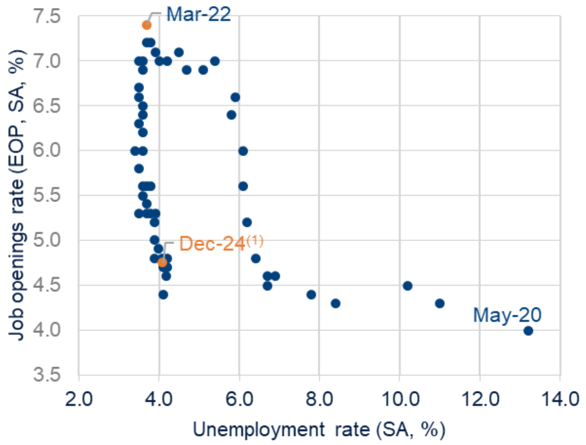
Figure 11. **AVERAGE HOURLY EARNINGS (ANNUAL VAR. %, SA)**



Source: BBVA Research based on data by Haver Analytics.
* Weighted Overall: 3-MMA of Median Wage Growth (NSA, Y/Y %Chg)

The very positive rebalancing in the labor market continues without a sharp rise in the UR

Figure 12. **THE BEVERIDGE CURVE (%, SA)**



Source: BBVA Research based on data by Haver Analytics.
(1) Forecast

DISCLAIMER

The present document does not constitute an "Investment Recommendation", as defined in Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse ("MAR"). In particular, this document does not constitute "Investment Research" nor "Marketing Material", for the purposes of article 36 of the Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (MIFID II).

Readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data or opinions regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

ENQUIRIES TO:
BBVA Research: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600 Mexico City, Mexico.
Tel.: +52 55 5621 3434
www.bbvaresearch.com