

Laboring Under Pressure: Are Labor Supply Trends Breeding Long-Term Stagflationary Conditions? Q3 2024 Market Outlook

October 2024

As risk-on traders take a victory lap amid surging equity markets and now renewed monetary policy accommodation, the expectations for a soft landing in the U.S. economy now form the base case scenario for a preponderance of U.S. investors. We remain more cautious, seeing growing cracks in the economic foundations of the U.S. economy, especially in the labor market. Of most imminent concern is the diminished demand for labor (see [Chart 1](#)), which is also evidenced in rising part-time workers who would prefer to work full-time, the Sahm rule, and increases in the portions of the unemployment rate due to raw job losses. Such fast-moving changes in labor demand are well-covered by several economic analysts. Less discussed, but also concerning, is what has heretofore been an absolute strength of the U.S. economy, an unexpected surge in high quality labor supply. This strength has the potential to quickly turn to a weakness that brings forward a long period of stagflationary wage pressures in the U.S.

As we discussed in our [January 2022 outlook](#), the U.S. emerged from the pandemic with a supply deficit of 3.5 million workers, of which the combination of early retirements and increased mortality would prove long-lasting. Thus, the only way to arrest the gap would need to come from a precipitous drop in labor demand or a material loosening of immigration policy. [Chart 1](#) shows that labor demand has indeed dropped meaningfully over the past 7 quarters such that the supply gap of workers now rests at less than 1 million persons (see [Chart 2](#)). However, labor supply has also increased by more than prior estimations, given the lack of any meaningful change in immigration policy over that time. Where did this new supply come from and what does its composition mean for the U.S. economy?

The Job-Workers Gap Has Shrunk Significantly

Chart 1 U.S.: Labor Demand vs. Labor Supply

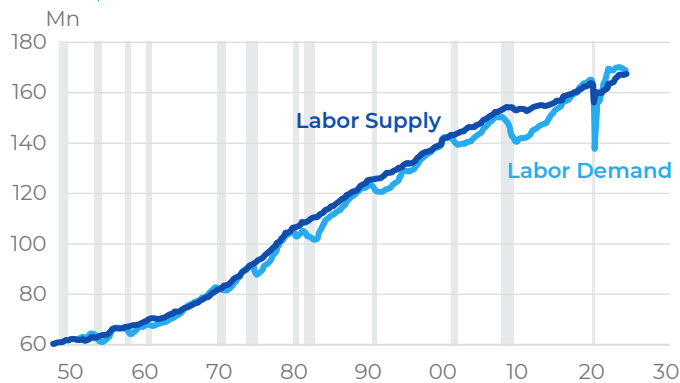
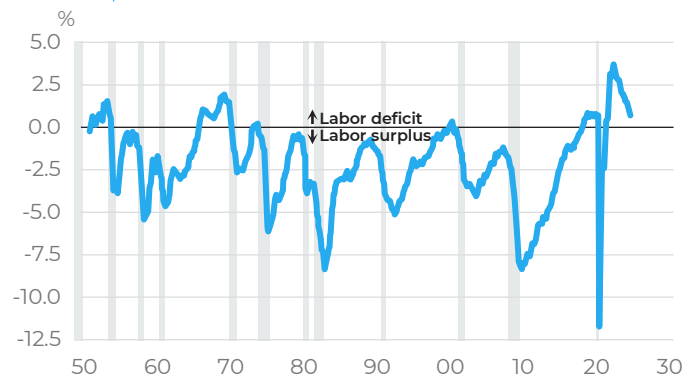


Chart 2 Job-workers Gap*



*Jobs-workers Gap is the difference between labor demand and labor supply as a percent of labor supply.

NOTE: Labor demand is the sum of job openings and civilian employment, while labor supply is the civilian labor force. Historical job openings data are extended using the composite help-wanted index estimated in Regis Barnichon, "Building a Composite Help-wanted Index", economics letters volume 109, issue 3, (December 2010). Job openings since June 2022 are based on BLS jolts job openings, and estimates using Linkup and Indeed job postings index.

Shaded areas denote NBER-designated recessions.

Source: ©BCQ Research 2024

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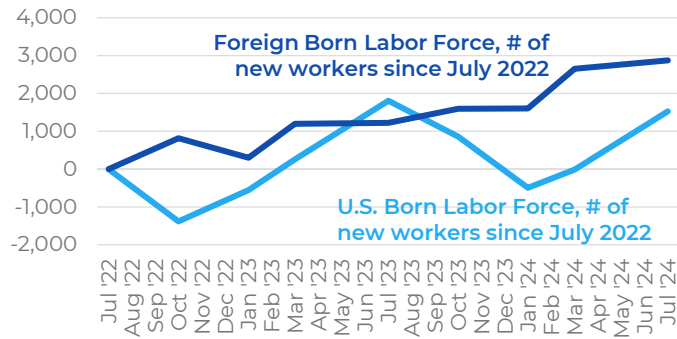
CEO & CIO | Founder





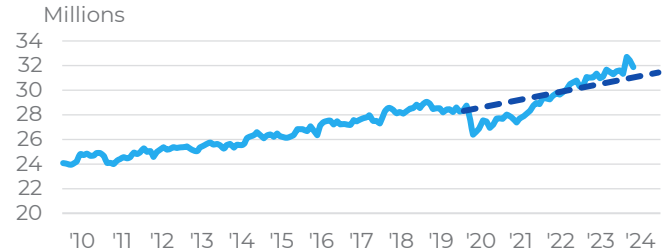
All this increase in the labor force has come from immigrants, despite the lack of policy change (see [Chart 3](#)).¹ Moreover, it has come from a surge of immigration that is well above both the immediate pre-pandemic and the long-term trend growth in the foreign-born labor force (see [Chart 4](#)).

Chart 3 Immigrants Have Driven All of the Non-Seasonal Labor Force Growth Since the Post-Pandemic Labor Market Normalization (July 2022)



Source: Bureau of Labor Statistics

Chart 4 Foreign-born Labor Force Surpasses Prepandemic Trend Growth

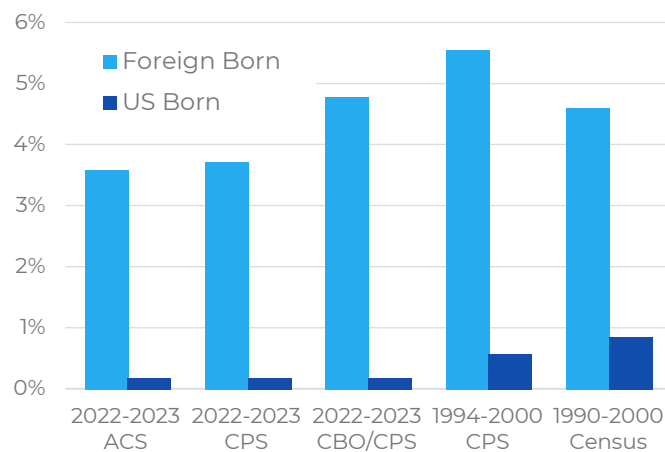


NOTE: The projected labor force assumes 2000-19 trend (2.2 percent) annualized growth beginning in January 2020. Data are through April 2024.

Source: Current Population Survey, Federal Reserve Bank of Dallas

Contrary to the rhetoric of certain American politicians, this surge in net migration is not unprecedented. Data compiled through the end of 2023 by the [Economic Policy Institute](#) shows multiple estimates of annual immigration, through the end of 2023 are still below modern peaks in the 1990s (see [Chart 5](#)). The above trend increases in immigration through today may have pushed that growth rate in line with the 1990s, but by no reasonable measure is today's immigration surge "unprecedented".² Further estimates by the [Pew Research Center](#) also shows that only in 2022 did the share of undocumented workers in the U.S. labor market approach the earlier highs reached prior to the GFC (see [Chart 6](#)).

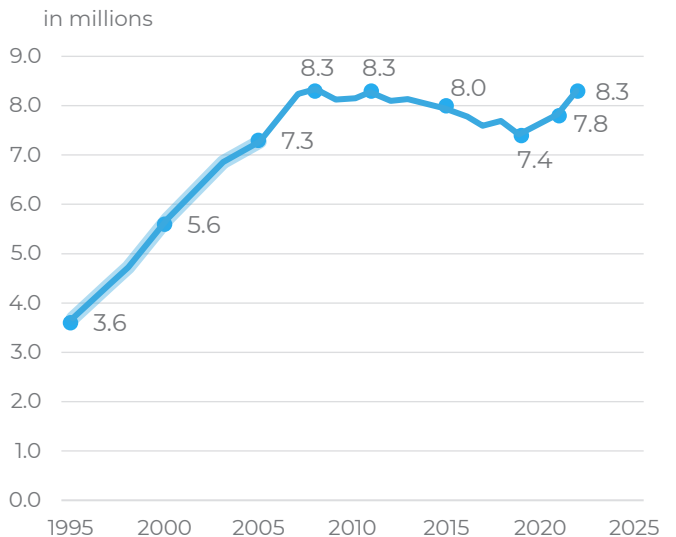
Chart 5 Immigrants Have Driven All of the Non-Seasonal Labor Force Growth Since the Post-Pandemic Labor Market Normalization (July 2022)



NOTE: Annual foreign-born and U.S.-born growth is the annualized change in the population levels over the given time period. ACS, CPS, CBO stand for American Community Survey, Current Population Survey, and Congressional Budget Office, respectively.

Source: 2023 and 2023 ACS population levels from the one-year American Community Survey estimates retrieved from <http://data.census.gov> on September 12, 2024. 1994, 2000, 2022, and 2023 CPS population levels from EPI analysis of the Current Population Survey Basic Monthly microdata, EPI Current Population Survey Extracts, Version 1.0.52.

Chart 6 The Number of Authorized Immigrants in the U.S. Workforce Grew Rapidly from 2019 to 2022. Unauthorized immigrants in the U.S. who are working or looking for work



NOTE: Shading shows the range of the estimated 90% confidence interval. The data points labeled are 1995, 2000, 2005, 2008 (peak), 2011, 2015, 2019, 2021, and 2022.

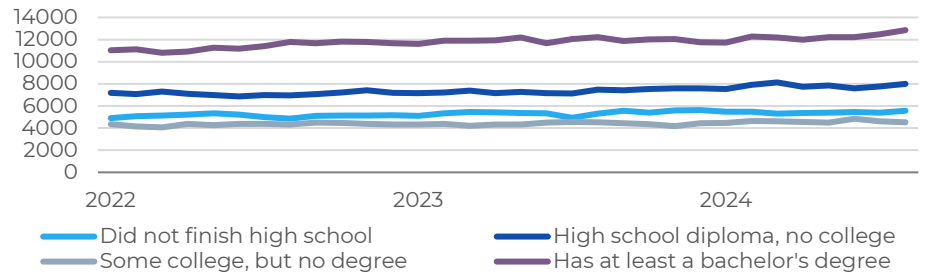
Source: Pew Research Center estimates based on augmented U.S. Census Bureau data.



Also contrary to recent political rhetoric, America's foreign-born labor force is not primarily comprised of the "teeming masses" of uneducated refugees depicted in 30 second political adverts. The majority of America's foreign-born labor force has some college experience and the largest cohort, by far, has a college degree (see **Chart 7**). Indeed, the share of the foreign-born labor force with a college degree lags its U.S.-born counterpart by only a few percentage points (41% vs 45%, respectively). Meanwhile the total population of foreign-born workers without a high school degree has been trending lower for decades and remains below its pre-pandemic levels (see **Chart 8**).³

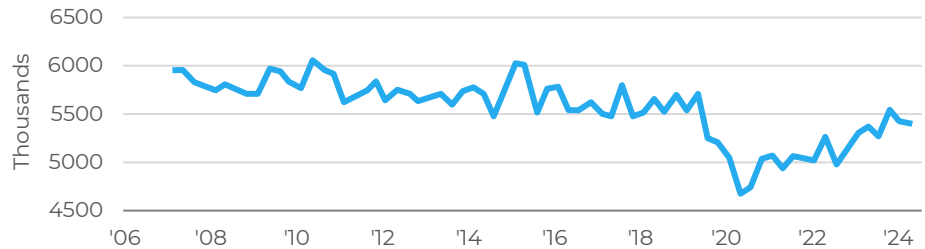
As with the overall foreign-born labor force, the largest cohort of new workers is of college-educated immigrants, followed by those with a high school degree. But as **Chart 7** illustrates above, that cohort was already increasing at a faster rate prior to the pandemic (4.6% vs 2.4%), so normalizing for pre-pandemic trends paints a more nuanced picture (see **Chart 9**). We see here that the labor market has taken in almost 1 million new entrants since the post-pandemic labor market normalization that were "unexpected" given historical trends. Roughly 80% of both the absolute number and the above trend increase in those with high school diplomas are classified by the Bureau of Labor Statistics (BLS) as Hispanic. However, the largest cohort of those with college degrees are Asian, then non-Hispanic White, Hispanic, and non-Hispanic Black (see **Chart 10**), with the bulk of the recent growth coming from Asia and Latin America.

Chart 7 | The Bulk of the U.S. Foreign-Born Labor Force Is Well-Educated



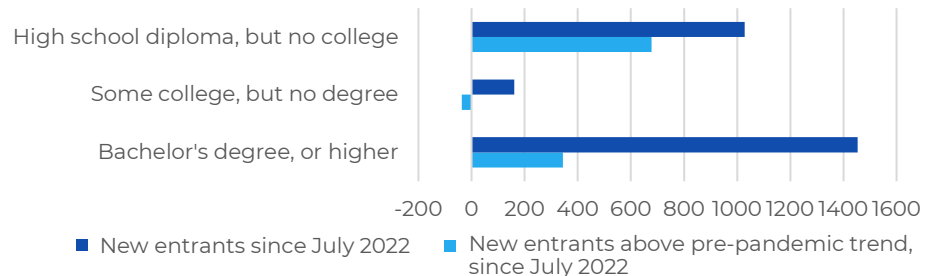
Source: Bureau of Labor Statistics. Data for foreign-born labor force population, ages 25+.

Chart 8 | Foreign-born Laborers Without a High School Diploma Has Trended Down Over 20 Years



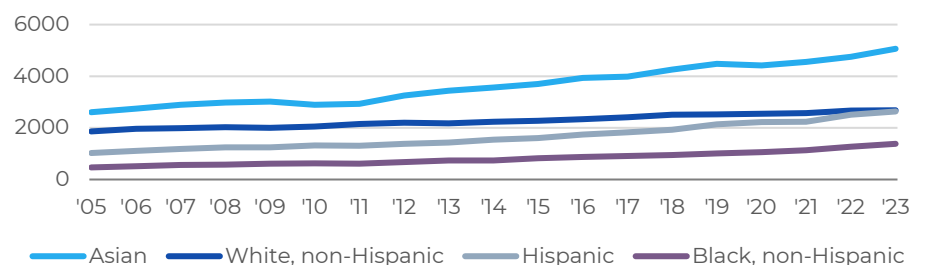
Source: Bureau of Labor Statistics. Data for foreign-born labor force population, less than a high school diploma, ages 25+.

Chart 9 | Foreign-Born Labor Force Change Since Post-Pandemic Labor Force Normalization July 2022 – August 2024



Source: Bureau of Labor Statistics

Chart 10 | College Educated Foreign-Born Labor Force by Ethnicity

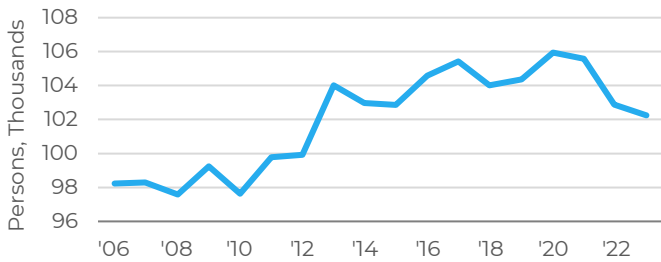


Source: Bureau of Labor Statistics



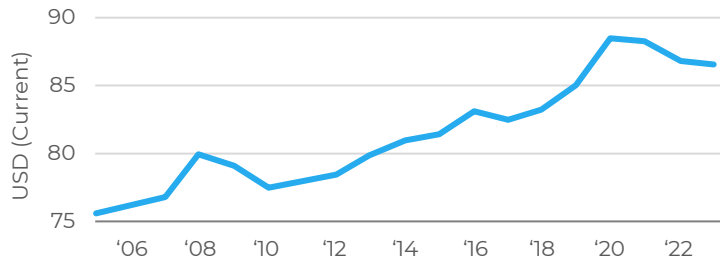
That all of America's labor force growth has been coming from immigration, is not news. Nor is it especially newsworthy that all the future labor force growth is expected to come solely from immigration, with the U.S.-born population depressing labor growth within a decade. But the increasing composition of this labor force as being college educated, is both a strength and a weakness for the U.S. economy. That the U.S. remains an attractive market to educated workers worldwide is a sign of market strength. But these highly educated workers are not without options. They could easily stop choosing to come to the United States, opting to pursue their careers in other markets or just staying home. Already, foreign-born college educated workers are employed in the U.S. only at a premium wage to their U.S.-born, college-educated counterparts (see [Chart 11a](#)). Foreign-born workers' wages have also been closing the gap with their U.S.-born counterparts over the past twenty years (see [Chart 11b](#)) as global wage growth, especially in China and India, has outpaced the U.S.

Chart 11a | College Educated Immigrants Cost More Than U.S.-Born Counterparts



Source: Bureau of Labor Statistics. Data for foreign-born labor force population, bachelor's degree or higher, ages 25+.

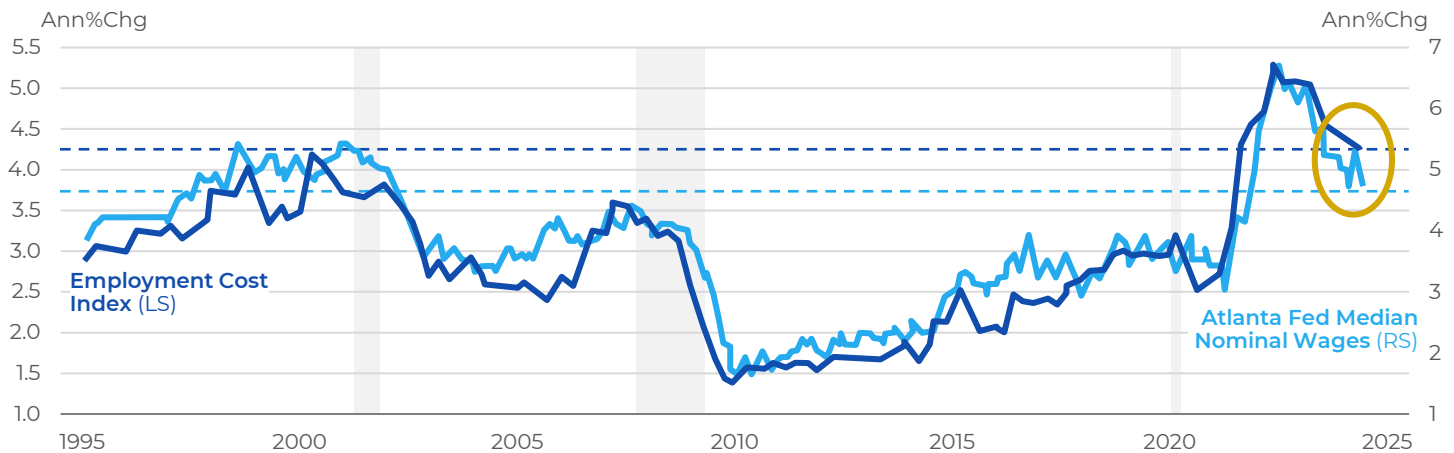
Chart 11b | Aggregate Foreign-born Workers' Wages Have Been Closing the Gap With U.S.-Born Workers



Source: Bureau of Labor Statistics. Median usual weekly earnings, in USD (second quintile)

The dependency on increasingly expensive foreign-born labor for economic growth, leaves the U.S. in a potentially tight squeeze. As long as living and working in the U.S. stays in demand globally, the U.S. has the option to increase growth, but only through increasingly expensive labor. This "growth at a price" labor dynamic portends higher wage inflation, stickier overall inflation, and thus higher interest rates than what we have seen for the past decade. Indeed, the current data already confirms this story, with wage growth that is still much higher than the Fed's CPI targets (see [Chart 12](#)).

Chart 12 | Wage Growth Remains Elevated



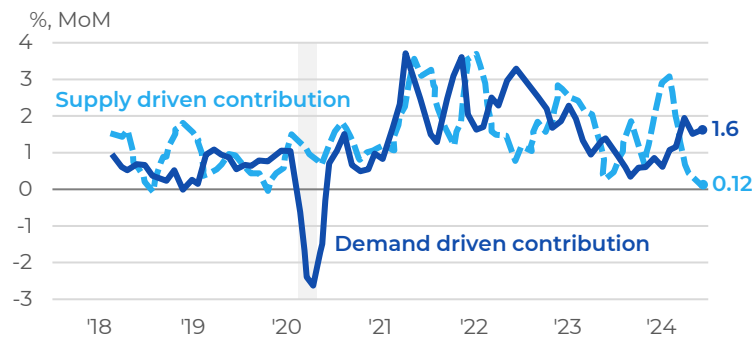
Source: Bureau of Labor Statistics (LS), Federal Reserve Bank of Atlanta (RS), ©BCQ Research 2024
 Note: Shaded for NBER-designated U.S. recessions.



The slowdown in inflation that supported the Fed’s recent rate-cut has primarily emanated from lower goods inflation as pandemic-related supply pressures have eased. (see [Chart 13](#)).

Thus, attempts to further reduce the availability of foreign-born workers through new immigration policy would be expected both reduce economic growth, as well as increase labor costs. Should labor conditions (and wages) improve in India, China, Mexico, Venezuela, the Philippines, and Brazil (the top 6 countries of origin for college-educated immigrants from 2018-22)⁴ the key labor markets of college-educated immigrants, labor costs could increase further or labor availability drop. The exception to this trend would be a significant economic slowdown and demand shock. Both scenarios are not particularly bullish for U.S. risk assets, especially at current valuation levels. Sticky interest rates, and more importantly the potential for much higher interest rate policy volatility over the coming years, makes the possibility of market shocks like what we saw in 2022 more probable. For asset allocators, the implications here are to limit duration risk in their equity portfolios, adopt more flexible asset allocation policies, and increase the liquidity of their portfolios to take advantage of market volatility. For equity portfolios, we think the use of more opportunistic investment processes that stay disciplined to the potential for whipsawing valuations, could outperform their slower, low volatility-benefiting counterparts.

Chart 13 | Recent Disinflation Has Come Entirely From Goods, While Services (Wages) Remain Elevated



Source: PGM Global (SF Fed data via Bloomberg). Shaded areas = U.S. recessions

¹ Bureau of Labor Statistics Data does not provide seasonally adjustments in their monthly releases that also include breakdowns of “foreign born” and “native born” labor force statistics, adjustments that are accounted for in the data in Charts 1 and 2. The oscillation of the “native born” labor force data in the summer months is in-line with historical seasonal oscillations and is expected to revert to near zero in the coming months.

² Leaving aside completely prior much larger surges in immigration in the 19th and early 20th centuries.

³ The difference also does not owe to any change in the labor force participation rate, which is actually slightly higher in 2023 (57.7%) than in 2019 (57.2%). Source: Bureau of Labor Statistics.

⁴ Source: U.S. Census Bureau. These six countries accounted for 45% of the total of college-educated immigrants arriving in that time period, with these shares: India (19.6%), China (7.6%), Mexico (5.9%), Venezuela (4.7%), the Philippines (4.2%), Brazil (3.5%).

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