Ahead of the Curve
How U.S. immigration changes could impact inflation and the Fed

From the Field

Key Insights

- Immigration restrictions may reduce the U.S. labor force by 2.1 million people, which could cause upward wage pressure and push inflation higher.
- We expect new immigration restrictions to impact the labor supply quickly, likely by the middle of 2025.
- Resurgent inflation would, in turn, influence Federal Reserve decisions on interest rates.

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Although we're still awaiting more detail on a number of the Trump administration's policy changes, including long-term tariff plans and fiscal policy, it's already obvious that the administration will reduce the number of immigrants in the U.S. While the market has been obsessing about the potential inflation impact of tariffs, creating a huge amount of noise and volatility, I have long suspected that the main policies we should be focusing on involve fiscal measures and immigration.

I recently discussed the implications of slower immigration for the U.S. labor force with Blerina Uruçi, our Fixed Income Division's chief U.S. economist. What's clear from our chat is that the impacts could be quite far-reaching with meaningful effects on inflation, which, in turn, will influence Federal Reserve (Fed) monetary policy and the direction of U.S. Treasury yields.

How has increased immigration interacted with demographics in the U.S. labor market?

The effects of an aging population, which is removing workers from the labor market, has been the dominant trend in U.S. employment for years. A decline in the labor force means that one of the key inputs into production—labor—is now holding back the growth and supply capacity of the economy. As a result, when a positive demand shock comes along, supply cannot expand fast enough, leading to higher inflation. In more practical terms, it also means that the economy needs to add fewer jobs to maintain the same level of unemployment.

However, in 2022 and 2023, rising numbers of migrants—estimates of numbers vary widely—led to a strong rebound in the labor supply. The rise in labor supply came at a time when the labor market was very tight and the number of job vacancies in the economy was very high, thus allowing the new workers to be matched with jobs relatively quickly. This is also credited with reducing inflationary pressures in the labor market.

When do you think the Trump administration's immigration policies will impact the labor force and economy?

Actually, we're already seeing the effects of an executive order from former President Joe Biden in June 2024 that tightened border enforcement, so we expect further immigration restrictions to impact the economy just as quickly. Crossings at the southern border halved in the second half of 2024 compared with the first half of the year, suggesting these executive orders can have a rapid effect.

In addition, we are able to see some changes in the monthly labor market data published by the Bureau of Labor Statistics. The foreign-born labor force shrank 0.8% in the second half of 2024 after growing at a 5.2% rate in 2023. Between June and December 2024, the labor supply of migrant workers fell by 45,000 per month. These numbers also correspond closely to the slowdown in jobs growth of an average of 50,000 per month in the Labor Department's nonfarm payrolls report during last year's second half.

The quick impact in the labor force data could also be attributed to the "chilling effect," meaning that undocumented migrants already in the country opted out of the labor force because of the perceived higher deportation risks. The Trump administration's well-publicized deportations and stricter immigration policies could further reinforce this effect. I expect to see the impact of these policies on the labor supply by mid-2025.

For the economy, the dwindling labor supply can feed through to higher inflation if workers demand higher wages and employers pass along higher labor costs to their customers by raising prices. Having battled hard to lower inflation toward its 2% goal, the Fed would then be compelled to adjust monetary policy in reaction to higher inflation risks and bring about an early end to this monetary policy easing cycle.

Are there any estimates of the number of workers that the Trump administration's policies could remove from the labor force?

If we assume there are about 1 million immigrants with an existing deportation order who are still in the U.S. (again, estimates vary widely) and apply a labor force participation rate of 61.5%,[1] removing them would reduce the labor supply by 615,000 workers. Ending deportation protection for migrants on temporary protected status, humanitarian parole from countries such as Cuba and Ukraine, and deferred action for childhood arrivals (DACA) could subject approximately 2.5 million immigrants to removal by 2027—even if the Trump administration doesn't accelerate deportation in other ways. This would cut the labor supply by more than 1.5 million people using the same labor force participation rate.

This would mean a combined total reduction in the supply of labor of approximately 2.1 million workers. As of December 2024, the Bureau of Labor Statistics estimated the total civilian labor force at 169 million, so the deportations would result in almost 1.3% of the labor supply exiting the job market. That doesn't incorporate the effects of slower visa and green card issuance to legal immigrants or reductions in work authorization renewals for immigrants who are currently working.

A reduction of this magnitude in the size of the labor force could have impactful economic consequences, such as renewed upward pressure on wages, which could push inflation higher. And that doesn't even consider the negative supply chain effects in industries like agriculture that rely heavily on migrant labor. There is the potential for these dynamics to trigger supply-side inflation similar to what we experienced during the coronavirus pandemic.

[1] Bureau of Labor Statistics.

Blerina's analysis of the labor market further underpins my expectation for higher longer-maturity U.S. Treasury yields. With Fed rate cuts seemingly on pause after its January meeting as it monitors economic data, any inflationary pressure resulting from the new administration's immigration policies would make the Fed even more hesitant to reduce rates further.

With the federal funds rate likely pinned at the current level, I expect any labor market tightness and higher inflation to manifest in the form of higher yields at the long end of the curve. In addition, the 2.45% level of 10-year U.S. inflation breakevens in mid-February[2] make Treasury inflation protected securities (TIPS) a well-priced, attractive hedge against inflation risk.

[2] Bloomberg Finance L.P.

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> Head of Fixed Income and Chief Investment Officer, Fixed Income

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