US Daily: Upgrading Our GDP and Payrolls Forecasts to Reflect Elevated Immigration (Walker)

- One of the biggest puzzles of the last year has been that the labor market has continued to rebalance and the unemployment rate has increased somewhat despite surprisingly strong payroll growth and GDP growth. The explanation appears to partly be that elevated immigration has boosted labor force growth and, by extension, potential GDP growth.
- Recent studies suggest that Census data used for the household survey of the employment report understated immigration in 2023. We estimate that immigration was 1½mn above the trend of roughly 1mn per year in 2023, which implies an 80k boost to the monthly breakeven rate of job growth to 155k. We expect immigration to be about 1mn higher than usual this year, implying breakeven job growth of around 125k and a 0.3pp boost to potential GDP growth in 2024 from faster labor force growth.
- We have updated our payrolls and GDP forecasts to incorporate the ongoing boost from above-trend immigration. We now expect payroll growth to average 175k/month this year and slow to 150k/month by year-end, though we expect this to only lower the unemployment rate a touch to 3.8% by year-end. We have also raised our 2024 real GDP growth forecast by 0.3pp to +2.4% on a Q4/Q4 basis (or +2.7% on a full-year basis), mostly by upgrading consumption growth.

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Upgrading Our GDP and Payrolls Forecasts to Reflect Elevated Immigration

One of the biggest puzzles of the last year has been that the labor market has continued to rebalance and the unemployment rate has increased somewhat despite surprisingly strong payroll growth and GDP growth. The explanation appears to be that elevated immigration has boosted labor force growth and, by extension, potential GDP growth. In today's note, we estimate the impact of elevated immigration on potential job growth and potential GDP growth in 2023 and 2024.

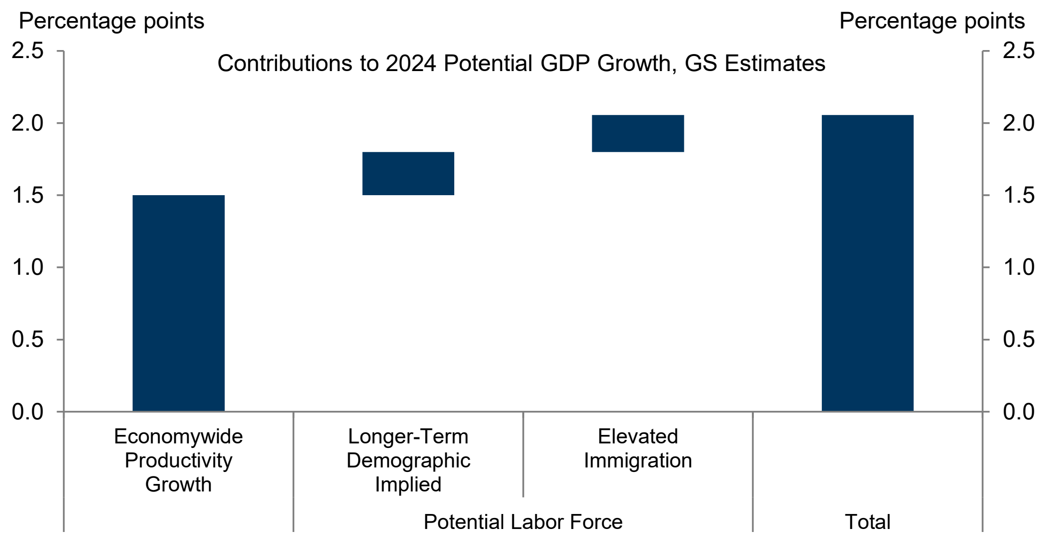
One likely reason why GDP growth was stronger in 2023 is that immigration ran well above the recent historical average, boosting the size of the labor force and potential GDP. Recent studies, including one from the Congressional Budget Office, suggest that immigration was as much as 3½mn in total or 2½mn above trend.[1] While we have less confidence in some aspects of CBO's methodology for estimating unauthorized immigration, we nonetheless estimate that immigration was around 2½mn in 2023, well above the 1.6mn level implied by the change in the foreign-born population in the household survey. We expect tighter policy to slow immigration somewhat ahead of the election and assume that it will total 2mn (or 1mn above trend) this year.

Our estimate that immigration was 1½mn above trend last year implies that the monthly breakeven rate of job growth needed to stabilize the unemployment rate was about 80k (1½mn divided by 12 months times a participation rate for recent immigrants of 66%) above the normal pace of 75k, or around 155k. Our assumption that immigration will remain about 1mn above trend this year implies that the monthly breakeven rate will be roughly 50k above normal, or around 125k. Our estimate of the normal breakeven rate assumes that the participation rate evolves in line with normal demographic trends. However, last year, the participation rate rose sharply against the modest decline implied by demographics, contributing to the increase in unemployment despite payroll gains meaningfully above our 2023 estimate of the breakeven rate that corresponds to the purely demographic participation trend.

Our estimates imply that above-trend immigration will boost potential GDP growth by 0.3pp in 2024. Together with economywide productivity growth of 1½% and a 0.3pp contribution from labor force growth implied by demographic trends and historically average net migration, we estimate that potential GDP growth will be roughly 2.1% in 2024 (Exhibit 1).

1 Wendy Edelberg and Tara Watson, "New Immigration Estimates Help Make Sense of the Pace of Employment," 2024 and Congressional Budget Office, "The Demographic Outlook: 2024 to 2054," 2024.

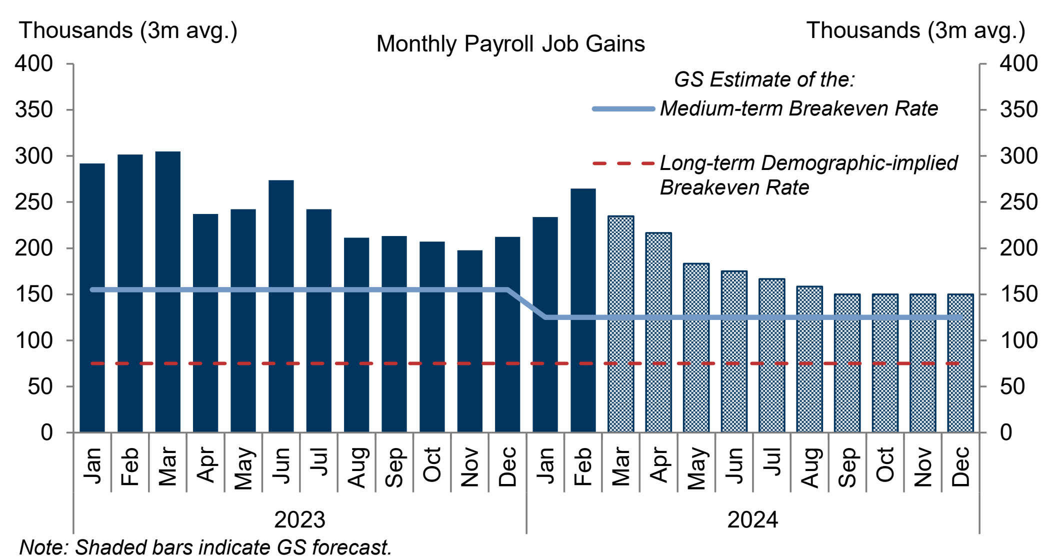
Exhibit 1: We Estimate That Elevated Immigration Will Boost Potential GDP Growth by 0.3pp to 2.1%



Source: Goldman Sachs Global Investment Research

We have updated our payrolls and GDP forecasts to incorporate the ongoing boost from above-trend immigration. We now expect payroll growth to average 175k/month this year and slow to 150k/month by year-end, though we expect this to only lower the unemployment rate a touch to 3.8% by year-end because the breakeven rate should also remain elevated.

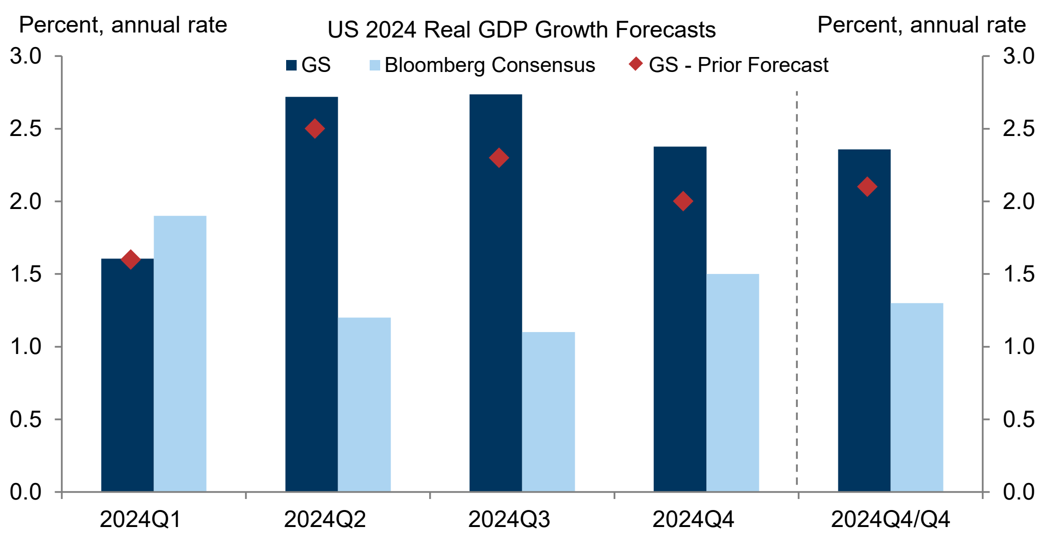
Exhibit 2: We Expect Payroll Growth to Slow to 150k/Month but Remain Above Our 125k/Month Estimate of the Breakeven Rate This Year



Source: Department of Labor, Goldman Sachs Global Investment Research

We have also raised our 2024 real GDP growth forecast by 0.3pp to +2.4% on a Q4/Q4 basis (or +2.7% on a full-year basis) to account for the boost to potential growth from increased labor supply, mostly by upgrading consumption growth. On a full-year basis, we forecast GDP growth of 2.7%. Our updated forecast broadly aligns with a simple top-down approach to estimating GDP growth, combining our updated estimate of potential growth (2.1%) with the sum of our estimates of the fiscal (-0.2pp) and financial conditions (+0.5pp) impulses for this year.

Exhibit 3: We Are Raising Our 2024 Q4/Q4 GDP Growth Forecast to 2.4%

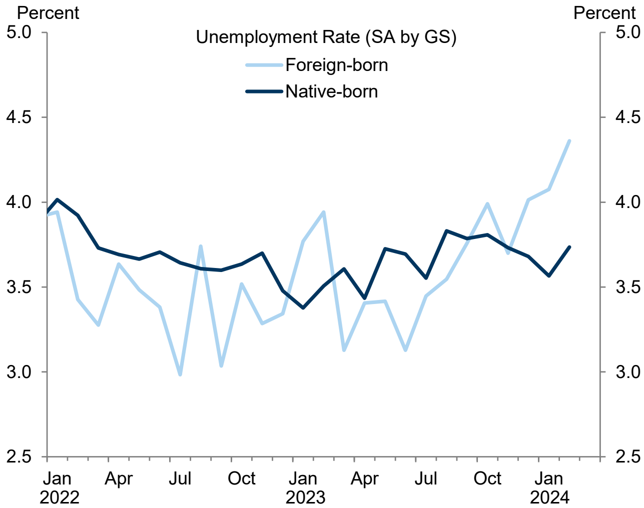


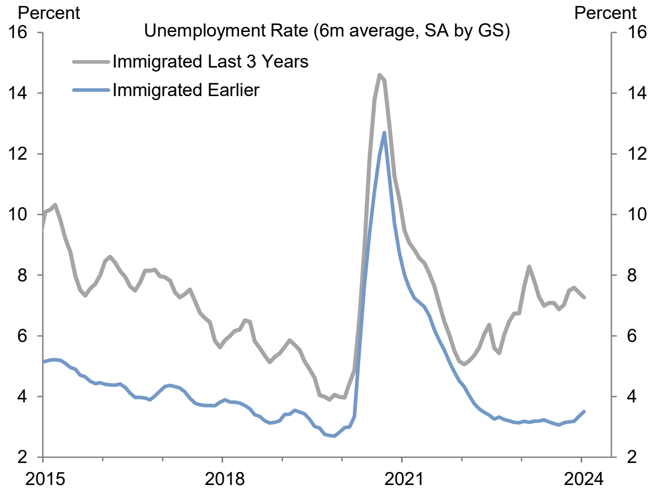
Source: Bloomberg, Goldman Sachs Global Investment Research

Increased immigration helps to explain the 0.5pp rise in the unemployment rate from last year's low, both through the boost to labor supply and through a compositional effect. The left panel of Exhibit 4 shows that the recent increase in the unemployment rate has been led by a higher unemployment rate amongst foreign-born workers, which itself likely reflects the combination of elevated immigration and a higher rate of unemployment amongst recent immigrants (right panel). This implies that the increase in unemployment over the last year mostly reflected an increase in labor supply from new immigrants, which is unlikely to trigger a vicious cycle of job loss, income loss and further unemployment that is typically associated with increases in the unemployment rate.

An increase in unemployment due to recent immigration could also potentially explain part of the divergence between unemployment in the household survey and the signal from layoff indicators—such as jobless claims and the JOLTS layoff rate—which remain low.

Exhibit 4: The Recent Increase in the Unemployment Rate Has Been Driven by Foreign-Born Workers, Especially Recent Immigrants





Source: Department of Labor, Department of Commerce, Goldman Sachs Global Investment Research

We also suspect that the recent surge in immigration has contributed to the divergence between the measures of employment derived from the household and establishment surveys. The household survey's unrealistically low estimate of immigration has likely led it to understate job creation over the last year. While the establishment survey probably provides an incomplete count of employment of unauthorized immigrants, it is less directly affected by underestimates of immigration. In any case, we suspect that both estimates of employment growth are likely too low because of measurement challenges related to elevated immigration.

Ronnie Walker

Disclosure Appendix

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We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Ronnie Walker, Manuel Abecasis, Tim Krupa, Elsie Peng and Jessica Rindels, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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