Working Papers Economics - Labor Informality and Macroeconomic Volatility

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Labor informality, through its interaction with wage rigidities, productivity differences, and household financial constraints, acts as a powerful amplifier of macroeconomic volatility in consumption and investment, despite its traditional role as an employment stabilizer in emerging economies.

Publication Date: Monday, 23 of February 2026 **Approach**
This document examines the impact of labor informality on macroeconomic volatility in a small open economy, drawing on the Colombian case. First, it conducts an empirical exercise using data from 60 countries to identify stylized facts linking informality to aggregate volatility and to access to financial markets. Based on this evidence, it develops a DSGE model featuring heterogeneous households, a segmented labor market with differentiated wage rigidities, and productivity gaps across sectors. The model is then used to assess shortterm macroeconomic dynamics and to perform counterfactual simulations under different levels of informality.

Contribution
The document addresses the apparent paradox of labor informality: although it acts as a buffer for employment and labormarket dynamics, it also amplifies macroeconomic volatility. In contrast with previous studies focusing on informality at the firm level, this paper introduces an analytical framework based on heterogeneous households, where labor supply is segmented between skilled and unskilled workers. The model jointly incorporates wage rigidities, financial exclusion, and productivity differentials. As a result, it captures households' ability to substitute between formal and informal employment and shows how these frictions shape the transmission channels of macroeconomic shocks.

Results
The results indicate that higher informality increases the volatility of consumption and investment, in line with international empirical evidence and in contrast with the traditional view that considers it an employment stabilizer. This effect stems from wage rigidities in the formal sector, which induce adjustments in labor demand and in household income.

At the same time, financial exclusion limits informal workers' ability to smooth consumption, thereby amplifying fluctuations in aggregate demand. Quantitatively, the model accounts for 36% of the relationship between informality and consumption volatility, and 60% of the relationship in the case of investment. Finally, although informality mitigates employment volatility by absorbing workers displaced from the formal sector, it

increases inflation volatility, with direct implications for the transmission of monetary policy.

Fuente: https://www.banrep.gov.co/en/publications-research/working-papers-economics/labor-informality-macroeconomic-volatility