THE COVID-19 PANDEMIC AND THE LABOUR MARKET

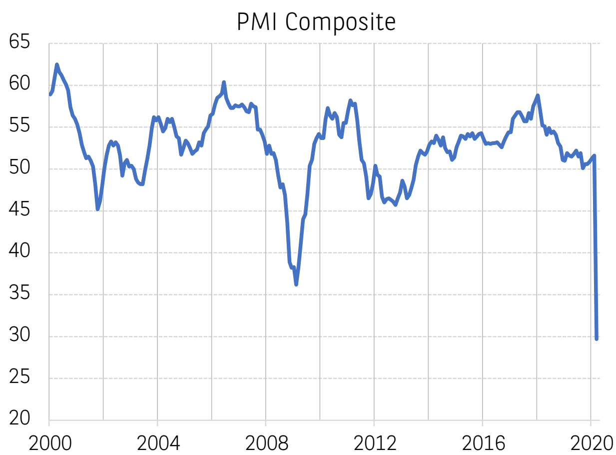
In March, the employment component of the purchasing managers indices for the eurozone declined, whereas in the US, initial jobless claims skyrocketed. Companies need flexibility to manage their cost base but households suffering from an unemployment-related income loss would act as a headwind to the recovery. In the US, the Federal government will top up unemployment benefits, which vary from state to state. In Europe, short-time work schemes allow employers to adapt their workforce without having recourse to costly lay-offs.

The economic consequences of the COVID-19 pandemic are becoming increasingly visible by the day. This week, the IHS Markit PMI composite output index for the eurozone recorded the biggest monthly drop ever, reaching an all-time low of 29.7. The big decline in the services sector is pulling down the overall number, considering that manufacturing shows some resilience. The employment sub-series of this indicator shows a sharp decline, the biggest since June 2009[1]. This is a matter of concern given its correlation with employment data and, with some delay, household spending. In the US, the labour market conditions are deteriorating very quickly. After last week's initial jobless claims of 3 million, this week's number skyrocketed further, reaching 6 million. The US Congressional Budget Office (CBO) expects a sharp contraction of the economy in the second quarter with an unemployment rate that would exceed 10 percent. Loretta Mester, the President of the Federal Reserve Bank of Cleveland, has said that US unemployment could be between 10% and 30%. Although this would already represent a spectacular increase from the 4.4% reached in March, certain estimates are far bleaker: a back-of-the-envelope estimation by the Federal Reserve Bank of St Louis[2] based on how different sectors and job categories could be affected by the lockdown, shows that in the second quarter, 47 million people could lose their job and the unemployment rate could reach 32%.

Nobel Prize winner Paul Krugman considers that "*we're going into the economic equivalent of a medically induced coma, in which some brain functions are deliberately shut down to give the patient time to heal.*[3]" However, in the meantime bills and wages still need to be paid. As aptly put by Larry Summers: "economic time has stopped, but financial time has not been stopped"[4] . Applying this to companies, in a lockdown, their revenues decline or stop altogether and the same applies to variable costs. Eventually, because of financial constraints, they may be forced to reduce the fixed costs base, including shedding jobs. Household spending behaviour during lockdown but also once things get back to normal, will very much depend on whether they still have a job and can expect to hold on to it in the months ahead. Rising unemployment and the fear of job loss may imply that a temporary health crisis ends up having a longer-lasting negative impact on the economy.

Even in a normal recession, the labour market dynamics can explain why recoveries end up being very sluggish. One way to address this is having recourse to short-time work. This saw a significant pick-up during the 2008-2009 recession in several European countries although the absolute level remained low: about 3% in Germany and Italy, less than 1% in France. In the US, where dismissals are less costly for the employer, the percentage of employees in short-time work schemes remained negligible. Short-time work offers the advantage that people hold on to their job which, apart from the financial impact, has the advantage of reducing uncertainty. In addition, companies can scale up activity smoothly when things improve without having to spend time and costs on searching for new staff.

EUROZONE: COMPOSITE PURCHASING MANAGERS INDEX



SOURCE: MARKIT, BNP PARIBAS

1. Source: IHS Markit Eurozone Composite PMI® – final data, press release, 3 April 2020.
2. *Back-of-the-Envelope Estimates of Next Quarter's Unemployment Rate*, Miguel Faria-e-Castro, Federal Reserve Bank of St Louis, March 2020
3. Paul Krugman, Notes on Coronacoma Economics, 31 March 2020.
4. Larry Summers on Bloomberg TV, 6 March 2020

> It is difficult to envisage a lasting acceleration of growth once the lockdown has ended when a large number of households would suffer a big income loss compared to the pre-pandemic situation.

In the current crisis, this approach is again very much adopted in Germany. In March, the Federal Employment Office (FEO) has received short-time work applications from around 470,000 enterprises. This means that 13.5% of registered enterprises have applied for it. In 2019, an average of around 1,300 companies per month reported short-time work. In February 2020, the number of short-time work applications was 1,900. Faced with high demand, the FEO has adapted its processes in order to enable a rapid granting of short-time allowance, unemployment benefits and basic security.

Several other European countries have taken measures to facilitate recourse by companies to part-time or temporary unemployment whilst providing income support to households[5]. In the US, the Coronavirus Aid, Relief, and Economic Security Act (CARES), will transfer roughly USD 630 bn to American households through tax credits or extended benefits. Using a means-tested system, each American household will receive a check from the Treasury for a maximum amount of USD 3,000 each. The Federal government will also top up unemployment benefits, which vary from state to state but which average roughly USD 300 a week, by USD 600 a week during the 4-month period ending 31 July 2020. Should the lockdown last longer than expected or should job creation take time to kick-in post lockdown, more support will be needed: it is difficult to envisage a lasting acceleration of growth when a large number of households would suffer an income loss compared to the pre-pandemic situation.

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5. An overview of these and other measures is provided in COVID-19: Key measures taken by governments and central banks, Ecoflash, BNP Paribas.