

EURO AREA LABOUR MARKET BOTTLENECKS: CYCLICAL ASPECTS

In the euro area, business surveys report record-high staff shortages. They represent a headwind to growth and raise the possibility of faster wage growth and a pick-up in inflation. Thus far, growth of negotiated wages has been subdued but, given its historical relationship with labour market bottlenecks, an acceleration seems likely. Despite the difficulties of companies in filling vacancies, labour market slack has remained above pre-pandemic levels. This situation should improve in the coming months but whether this eases labour market tensions depends on companies' hiring intentions. Based on recent surveys, these should remain elevated.

The strong recovery in the euro area from the pandemic-induced recession has led to the swift reappearance of labour market bottlenecks. In the euro area, business surveys report record levels in terms of staff shortages (chart 1). From a cyclical perspective, this gives rise to two issues¹.

One, it represents a headwind to growth. The balance of opinion of industrial companies reporting "labour" as a limiting factor for their production amounted 23%. Moreover, the balance of opinion for 'shortage of material' is more than twice as high (51%, a record). In the services sector, similar trends have been observed. In particular, in the hospitality sector, enterprises have difficulty in recruiting staff after the lockdown period. Also the health care sector is confronted with staff shortages, which already has led to closures of hospital wards.

Two, it raises the possibility of faster wage growth that in turn could cause a pick-up in inflation. Such a development should, up to a certain degree, be good news. If sustained, it would enable the ECB to normalise its monetary policy by ending the net purchases of its asset purchase programme and, eventually, raising its policy rates.

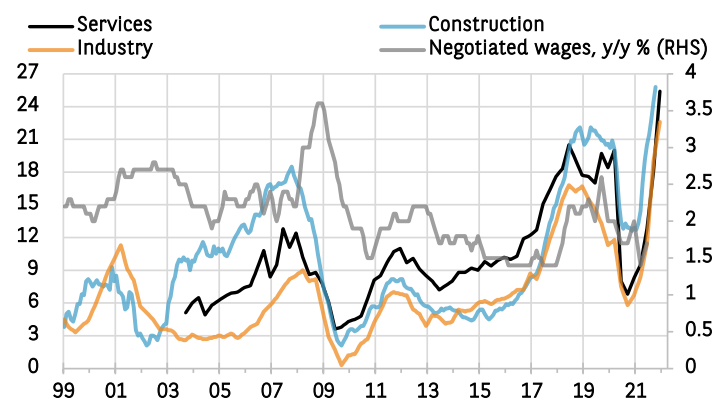
Of course, this also depends on the transmission of wage growth into consumer price inflation. In 2017-2018, when the Eurozone business cycle was reaching its cyclical peak, this transmission had been rather limited. For the time being, monetary policy normalisation is a distant prospect considering that growth of negotiated wages² remains subdued. "In the second quarter of this year, negotiated wages in the euro area grew at a rate below 2%, more moderately than in the period before the COVID-19 recession, at comparable rates of unemployment."³ According to the European Commission, the pandemic may have caused a reduction in the number of new wage agreements but limited wage growth may also reflect the staggered nature of wage contracts, which

follow with some delay developments in the labour market. Based on the historical relationship illustrated in chart 1, one would indeed expect a pick-up in wage growth in the coming quarters.

Recent inflation developments may fuel demand for higher wages but a key factor will be whether labour shortages remain elevated. This depends on hiring intentions of companies and the outlook in terms of final demand in the economy – in this respect, the outlook remains favourable judging by the record high employment expectations index of the European industry and services – but also whether vacancies will be filled more easily. At the current juncture, labour market slack remains high. According to Eurostat, in the second quarter of this year, it represented 14.5% of the extended labour force in the EU whereas the pre-pandemic level was about 13%.⁴ The European

4. "Eurostat's labour market slack indicator allows provides a broader definition of labour underutilisation than the unemployment rate. Besides the unemployed, it also includes the underemployed (persons in part-time jobs that would like to work more hours) and two categories of inactive individuals: those that are available for work but not seeking a job and those seeking a job but not available to work. The size of these groups is expressed as a percentage of the "extended labour force", which comprises the unemployed, the

EUROZONE: LABOUR SHORTAGE AND GROWTH OF NEGOTIATED WAGES



SOURCE: EUROPEAN COMMISSION SURVEYS, ECB, BNP PARIBAS

1. In an upcoming Ecoweek, the structural consequences of labour market bottlenecks will be discussed.

2. Based on data collected by the ECB, it is considered a more reliable indicator of wage developments. Traditional indicators of wage growth, such as growth in compensation per employee or growth in compensation per hour, have been strongly influenced by measures such as job retention schemes to soften the impact of the pandemic (source: ECB, Economic Bulletin, vol. 7, November 2021). The indicator is experimental however because it is based on non-harmonised sources. Although sufficiently reliable, its quality is somewhat lower than that of other ECB statistics (source: ECB).

3. European Commission, Autumn Forecast, November 2021.

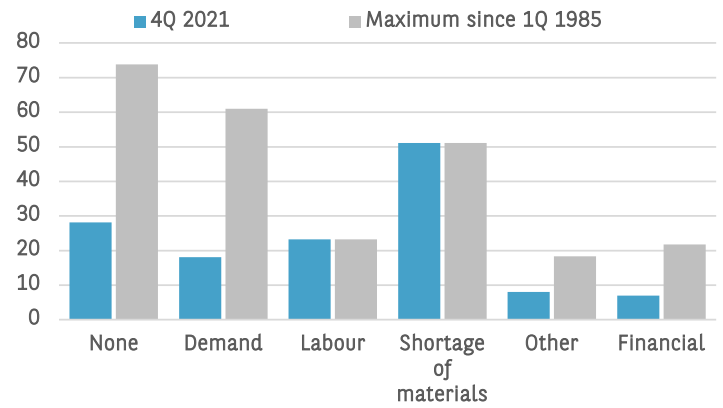
Despite the difficulties of companies in filling vacancies, labour market slack has remained above pre-pandemic levels. This situation should improve in the coming months but whether this eases labour market tensions depends on companies' hiring intentions.



Commission sees different reasons for the coexistence of labour market slack and labour shortages. Vacancy rates tend to respond faster to an upturn in the business cycle. Pandemic-related support measures may temporarily have reduced the incentive to look for a job. Some people may be reluctant to return to work for health risk reasons. One would expect that the influence of these factors will wane in the coming months, leading to an easier filling of vacancies and a decline in the unemployment rate. Another potential explanation is that the “structural labour market mismatch might be on the rise, linked to the sectoral reallocation of labour and an acceleration of changes in the relative skills demand triggered by the COVID-19 shock.”⁵ This could give rise to sector-specific rather than economy-wide wage pressures.

William De Vijlder

FACTORS LIMITING INDUSTRIAL PRODUCTION IN THE EUROZONE



SOURCE: EUROPEAN COMMISSION, , BNP PARIBAS

employed and the two categories of inactive individuals referred to above.” (source: European Commission, Autumn forecast, November 2021).
 5. European Commission, Autumn forecast, November 2021.

