

## EUROZONE: DYNAMISM AND TENSIONS OF THE LABOUR MARKET

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Abundant job creations in the Eurozone helped bring down the unemployment rate to a historically low level in 2021, but this has also led to hiring difficulties and labour shortages.

Labour shortages seem to be having the most restrictive impact in Germany (in all sectors), given the already low unemployment rate. They seem to be weakest in Italy where the job market is less dynamic, and this hierarchy was confirmed regardless of the sector.

In France, labour market tensions are the highest in the construction, and comparatively less important in the manufacturing and services sectors.

Production constraints due to labour shortages have reached a record high in the services sector, especially in Germany.

Labour market pressures can be seen as a good sign, as the corollary of the rapid recovery in growth and employment. Yet they must be monitored for two reasons: they can constrain production and fuel inflation.

EUROZONE UNEMPLOYMENT RATE

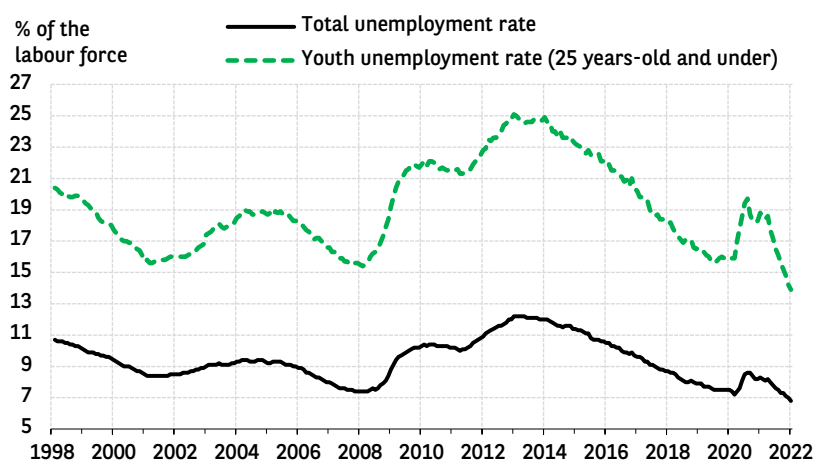


CHART 1

SOURCE: EUROSTAT, BNP PARIBAS

This article reviews the remarkable dynamics of the Eurozone labour market in 2021. We begin with a brief description of the current situation and provide the main explanations for a development that has led to a historically-high job vacancy rate, hiring difficulties and labour shortages. In part two, we evaluate the extent of these pressures on a sector basis for the Eurozone's four big economies, while in part three we look at the implications in terms of growth, inflation and monetary policy.

### A SIGNIFICANT LABOUR MARKET RECOVERY IN 2021: THE HOW AND WHY

At year-end 2021, Eurozone employment had not only caught up with the pre-crisis level, but it had surpassed it by nearly 600,000 jobs<sup>1</sup>. The unemployment rate in the euro area dropped below the 7% threshold in December 2021, for the first time since the creation of the euro in the early 2000s (see chart 1). The youth unemployment rate (25 and under-age group) also declined to an all-time low of 14.9% in December 2021.

By the end of last year, 11 of the 19 Eurozone member countries reported unemployment rates below those prevailing prior to the outbreak of the Covid-19 crisis. In countries such as Greece and Spain, unemployment rates continued to hold at very high levels. Nonetheless, the average decline shows that most of the Eurozone economies have managed to recover rather quickly from the health crisis, even though the risks have yet to completely disappear.

<sup>1</sup> Source: Eurostat.

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Over the past two years, active populations have recovered at different speeds depending on the country, and this has had an impact on unemployment trends. France and Spain reported significant increases in their active populations in 2021. However, this was not the case in Germany and Italy, where the active population was still below the 2019 level at the end of last year.

Virtually all of the Eurozone countries implemented exceptional job retention measures during the lockdown periods<sup>2</sup>. These measures considerably reduced job destructions. Indeed, although Eurozone GDP contracted by an average annual rate of 6.5% in 2020, employment declined by “only” 1.4%. The easing of restrictive measures in the Eurozone (and around the world) then triggered a catching-up effect for demand in 2021.

Employment recovered rather quickly in 2021, mainly due to an exceptionally strong increase in labour demand. The number of job vacancies in the Eurozone rose 15% at the end of last year compared to year-end 2019. At year-end 2021, the Eurozone as well as eleven member countries reported a record high number of job vacancies<sup>3</sup>.

The job vacancy rate measures job vacancies as a share of total jobs (filled and unfilled). In the Eurozone<sup>4</sup>, the job vacancy rate hit 2.7% in Q4 2021, which is higher than the 2019 average of 2.4% (see chart 2). Two conclusions are possible: low vacancy rate reflects the strength of the recovery but it also reflects hiring difficulties, which need to be addressed because otherwise they will act as a speed limit on growth and could trigger a wage-price spiral.

Eventually, the upturn in the job vacancy rate should have a positive impact on the level of employment and cause a decline in the unemployment rate. The relationship between the vacancy rate and the unemployment rate, known as the Beveridge curve, is downward-sloping, but it is not perfect and varies from one country to the next. For the same unemployment rate, the job vacancy rate can differ widely depending on labour market rigidities and the degree of matching of labour market supply and demand (see box page 4).

## DIFFERENT LEVEL OF TENSIONS BETWEEN COUNTRIES AND SECTORS

In France, hiring problems are frequently highlighted (61% of industrial companies reported hiring difficulties in Q1 2022) despite an unemployment rate, which paradoxically, is still significant (7.4% in Q4 2021). Yet it is one thing to report hiring troubles and another to quantify their impact. We used the European Commission business survey to conduct a comparison at the European level of the size of production constraints caused by labour shortages.

Our first observation is that production constraints caused by labour shortages depend on the cyclical environment and are correlated with the level of unemployment. This is especially striking for Germany, where the percentage of companies reporting production constraints due to labour shortages is the highest among the major EU countries.

<sup>2</sup> For a more detailed presentation of job protection measures taken by the European countries, see the European Trade Union Institute (ETUI) article: Job retention scheme in Europe, a lifeline during the Covid-19 pandemic, July 2021.

<sup>3</sup> Belgium, Ireland, Spain, France, Luxembourg, the Netherlands, Austria, Portugal, Finland, Slovenia and Lithuania.

<sup>4</sup> According to Eurostat, “a job vacancy is defined as a newly created paid position that is vacant or about to become vacant”.

<sup>5</sup> The Big Quit is a current economic phenomenon that emerged during the Covid-19 crisis in which many employees resigned from their jobs as a result of multiple factors (low wage positions, job dissatisfaction, early retirement, etc.)

### EUROZONE JOB VACANCY RATE (%)

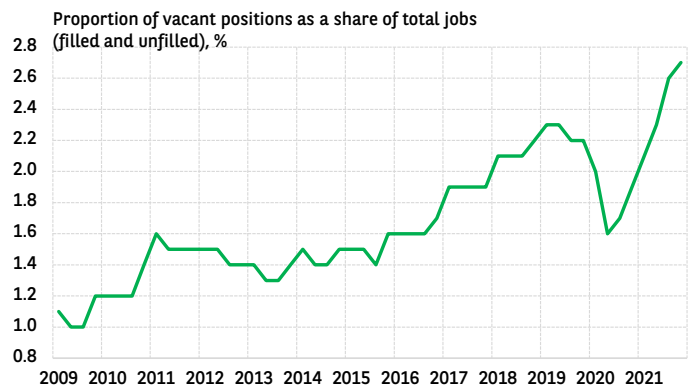


CHART 2

SOURCE: EUROSTAT, BNP PARIBAS

During previous phases of strong growth, such as in the early 2000s and in the 2010s, Germany’s unemployment rate had not fallen back yet to a situation of quasi-full employment, as it has for the past five years. Consequently, for companies, this is the first time that labour shortages have had such a large impact on production. These conclusions are confirmed in both industry and services (see charts 3 and 4). Most sectors of German industry have been hit, especially those benefiting from the upturn in household and corporate demand in Europe: computers, electronics, electrical equipment, plastics and rubber.

The labour shortages in France, Italy and Spain are not as intense as in Germany, with the exception of those in the electrical equipment sector. Labour shortages have increased recently in France, but they are still lower than the peak of twenty years ago, and much lower than the European average. In Spain and Italy, labour shortages have had a relatively marginal impact on production. In both countries, although the jobless rate has declined recently, the labour market is not tight enough to limit the capacity of companies to recruit, which would, in turn, act as a constraint on production growth capacity.

Labour shortages have currently reached record highs in the services sector, except in France, where it is still not far from the 2017 peak (see chart 4). This common characteristic is probably due to currently high demand (post-Covid catching-up effect), which has led to a big increase in job creations in the sector. Another trend could also explain the labour shortages in the services sector: an increasing number of workers are turning away from service sector jobs that offer difficult working conditions and low pay. This phenomenon is hard to quantify; it is particularly strong in the United States (“the Big Quit”<sup>5</sup>), but, based on anecdotal evidence, it is likely to exist in Europe as well.



This specificity of the services sector seems to be most visible in Spain and Italy, two countries that face very few constraints in industry. All across Europe, accommodation and catering activities are strapped by labour shortages. To a lesser extent, labour shortages are also being felt in the land transport sector, information technology, R&D and temporary employment services. In Germany, there are also substantial labour shortages in the real estate sector.

In France, the most critical labour shortages are in the construction sector (see chart 5). Although they are currently at an all-time high, the historical average is also higher than in other major EU countries. France must deal with chronic labour shortages in this sector, as the percentage of construction companies reporting hiring problems constraining their output rarely drops below 5%, even during periods of recession. In Germany, the shortage of construction workers intensified recently (with a temporal profile similar to other sectors), which also seems to be linked to a lower unemployment rate. In Spain and Italy, pressures are milder and rarely more than 5% of construction sector companies report production constraints related to hiring difficulties. In Italy, the proportion of companies increased slightly towards this threshold at the very end of the period, showing that activity is becoming more dynamic.

### A GOOD SIGN, BUT IT NEEDS TO BE MONITORED

Labour market tensions have increased strongly in the four big Eurozone economies since early 2021, and we tend to look at this as good news. Hiring difficulties and labour shortages are the flip side of a vigorous recovery in economic activity and employment. Although hard to evaluate, these tensions probably have also a structural dimension due to a persistent mismatch of the labour market between the available and necessary skill sets. In any case, quality skills matching will be a major challenge in the years ahead given the far-reaching economic transformations that will arise with the energy transition, digital revolution and aging demographics. Hopefully, training and career reconversion efforts will be up to the task.

The other problem with labour shortages is that they tend to feed wage inflation and could eventually trigger an excessive price-wage spiral against a backdrop of rising inflation. For the moment, proof of wage pressures is still anecdotal in the Eurozone (unlike in the United States). A hefty 16% wage increase was announced in the hotel and restaurant industry in France, and other collective bargaining talks are underway in other sectors. Meanwhile, a recent ECB survey indicated that most companies surveyed expected "wage growth to pick up somewhat this year"<sup>6</sup>. However, it is still too early to say whether these trends will expand, resulting in big, widespread wage increases. The lessons of the 2015-2019 period also argue for caution: rising labour constraints at the time did not result in a significant rise in wages (see chart 6). It is true, however, that inflation was much lower than it is today.

All in all, wage inflation is more likely to be contained rather than surge. We consider 3% to be a good pace for wage increases: neither too fast nor too slow, but compatible with the European Central Bank (ECB)'s 2% inflation target and with productivity gains of about 1%. According to the most recent data, negotiated wages were up 1.5% year-on-year in Q4 2021, which shows there is still some room on the upside.

<sup>6</sup> See Main findings from the ECB's recent contacts with non-financial companies, ECB Economic Bulletin, January 2022

#### PERCENTAGE OF COMPANIES WITH LABOR QUOTED AS LIMITING PRODUCTION: MANUFACTURING

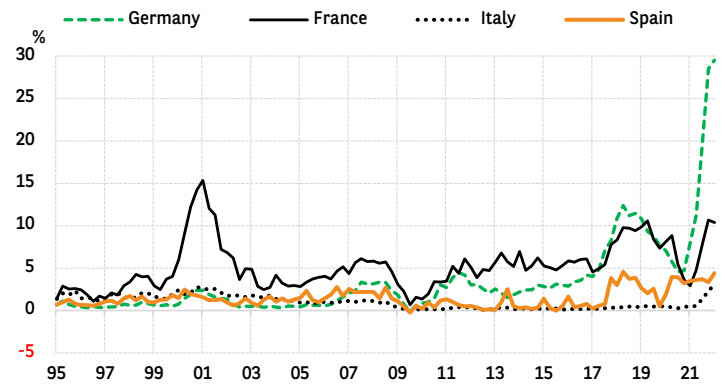


CHART 3 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS CALCULATIONS

#### PERCENTAGE OF COMPANIES WITH LABOR QUOTED AS LIMITING PRODUCTION: SERVICES

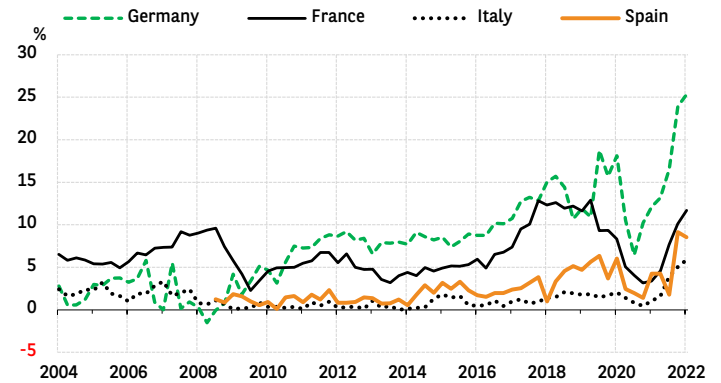


CHART 4 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS CALCULATIONS

#### PERCENTAGE OF COMPANIES WITH LABOR QUOTED AS LIMITING PRODUCTION: CONSTRUCTION

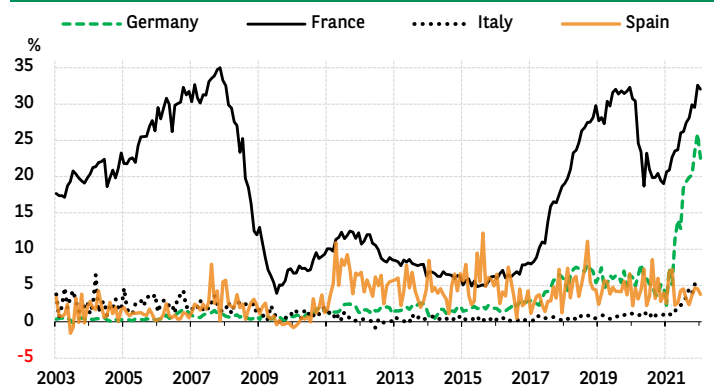


CHART 5 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS CALCULATIONS

Note: the indicator shows the proportion of companies reporting labour-related constraints as a percentage of the proportion of companies reporting one or more difficulties. For example, 15% of German companies did not signal any difficulties, and of the remaining 85%, 35% indicated having labour-related problems. Consequently, 30% of German companies participating in the survey reported labour-related problems.



**EUROZONE: LABOUR SHORTAGE AND WAGES**

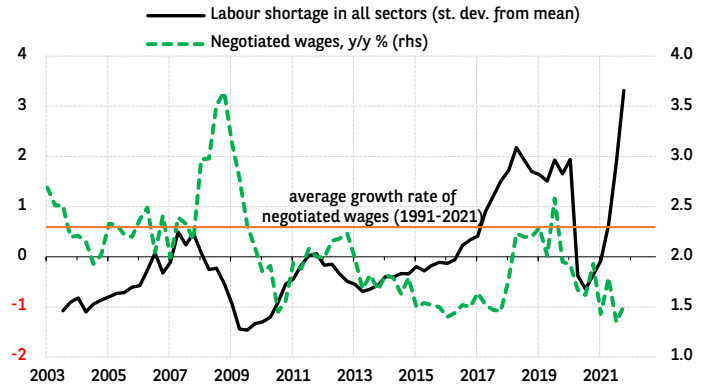


CHART 6 SOURCE: ECB, EUROPEAN COMMISSION, BNP PARIBAS CALCULATIONS

Even so, the ECB is monitoring the situation closely. It is part of its role to show that it is potentially concerned about triggering a price-wage loop, if the situation were to degenerate into uncontrolled, excessively high inflation. Yet such a scenario seems a distant possibility, although the risk will increase as inflation is likely to continue to rise as a result of the current surge in commodity prices. Moreover, a little more inflation combined with slightly higher wages would be an opportune development, if it enables inflation to finally reach the ECB's target.

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**BEVERIDGE CURVE IN THE EUROZONE**

The Beveridge curve (1944) describes the negative relationship between the job vacancy rate and the unemployment rate. During periods of economic prosperity, strong labour demand leads to an increase in the job vacancy rate and underpins a decline in the unemployment rate. To the contrary, during economic downturns, labour demand declines (the number of job vacancies falls), which causes an upturn in unemployment. Moreover, the closer to the origin of the curve, the better it is, as it indicates an efficient labour market matching process, that is the matching between the job offers and the skills set of job seekers.

Structural factors can cause a shift in the Beveridge curve. They can be positive, such as more efficient training policies, job market flexibility, or greater labour mobility, in which case the curve moves downwards – a low unemployment rate is associated with a lower vacancy rate than previously - or negative (increase in long-term unemployment, etc.), in which case the curve moves upwards.

This dynamic can be seen fairly clearly in the Eurozone labour market. During the crisis years of 2009-2013, the curve was essentially flat (red part of chart A): during this period, the unemployment rate rose while the job vacancy rate held flat. That said, the various European countries reported very disparate situations (chart B). In Germany, the ongoing decline in the unemployment rate since 2009 occurred at a time when the job vacancy rate was high, and one of the highest in the EU. By contrast, in Spain, the jobless rate is much higher, and job vacancy rates are lower. In France, the slope of the Beveridge curve is close to that of the Eurozone as a whole, although it has held somewhat closer to the original positioning.

From year-end 2013 through 2019, the labour market situation gradually improved in the Eurozone: the Beveridge curve steepened somewhat again during these recovery years (blue area on chart A). In France and Germany, the reduction in the unemployment rate went hand in hand with the increase in the job vacancy rate (shift along the same Beveridge curve). In Spain, in contrast, the curve seems to be shifting downwards. The decline in the job vacancy rate could signal a better matching of labour supply and demand, thanks possibly to reforms that helped redirect construction sector workers towards sectors with stronger labour demand.

The Covid-19 crisis has left its mark in 2020, as the unemployment rate fell and the job vacancy rate declined. However, the job vacancy rate bounced back in 2021. In Q3 2021 (the most recent data point available), it was about one point higher than in Q2 2020, while the unemployment rate was nearly unchanged. This could signal a deterioration in the quality of labour market matching (whether temporary or lasting, it is too early to say), which is a possible explanation for current hiring difficulties.

**BEVERIDGE CURVE FOR THE EUROZONE 2009-2021**

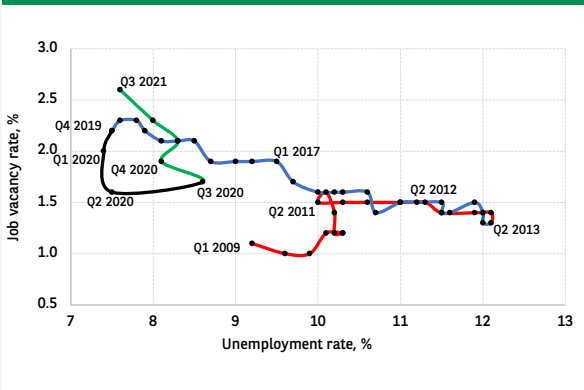
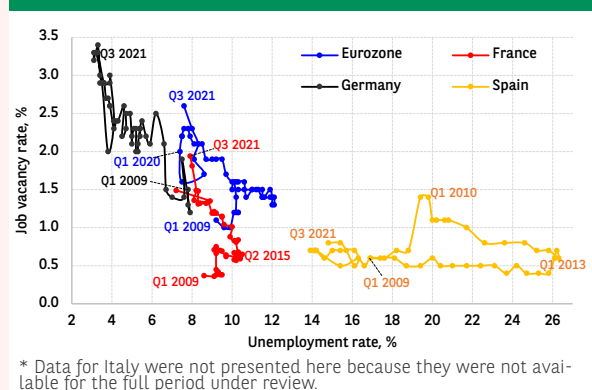


CHART A SOURCE: EUROSTAT, BNP PARIBAS

**BEVERIDGE CURVE 2009-2021\*: EUROZONE, GERMANY, FRANCE, SPAIN**



\* Data for Italy were not presented here because they were not available for the full period under review.

CHART B SOURCE: EUROSTAT, BNP PARIBAS

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