

## EUROZONE: THE SURPRISING RESILIENCE OF THE LABOUR MARKET, WILL IT LAST?

Since the start of this year, the European Commission's industry sentiment survey has seen a significant decline, yet companies continue to report that labour remains a key factor limiting production. This is probably due to order books that remain at record high levels in terms of duration of assured production. Through their impact on the growth of employment and wages, labour market bottlenecks should provide some resilience to consumer spending when the economy is turning down. This support will probably not last however. Hiring intentions of companies have started to decline, which should ease the bottlenecks through a slowdown of employment growth.

At first glance, there seems to be a disconnect between developments in the Eurozone economy in general and what is happening in the labour market. Despite the significant decline since the start of this year of the European Commission's industry sentiment survey, companies in that sector continue to report that labour remains a key factor limiting production (*chart 1*). Services and construction are confronted with a similar issue. This apparent anomaly can be explained easily: labour market bottlenecks develop when order books are getting filled.

Following the Covid-19 lockdowns, the latter have skyrocketed. Companies have responded by hiring more staff -the unemployment rate has dropped and the participation rate has increased-, but lately this has become more and more difficult. This is well illustrated by order book levels -measured by the number of months of assured production- and labour market bottlenecks which are at record highs in industry (*chart 2*).

This situation has fueled inflation and continues to do so, by boosting the pricing power of companies and via higher wage increases. On the other hand, through the impact on disposable household income, the labour market tensions should also provide some resilience to consumer spending when the economy is turning down.

Will this support last? Probably not. Historically, if we focus on the industry sector, employment expectations -which represent companies' hiring plans for the next three months- have started to weaken when the order book assessment was deteriorating (*chart 3*)<sup>1</sup>. This is also what we observe since the spring of this year, although there are notable sector differences within industry (*chart 4*).

Between January and October of this year, the consumer durables and intermediate goods sectors have seen the largest decline of the order book assessment and employment expectations. The investment goods sector has seen a more limited decline, in particular in terms of order books. Finally, consumer non-durables and food and beverages have seen the smallest decline of employment expectations. The latter has even witnessed a small improvement of order book levels.

Employment expectations are a leading indicator of labour market bottlenecks so, given the declining trend in recent months of the former, labour should become less of a constraint on production (*chart 5*). Eventually this should slow down employment growth or even cause a decline in employment levels (*chart 6*), which in turn should weigh on household confidence and spending.

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1. The survey question is: "Do you consider your current overall order books to be...? + more than sufficient (above normal) = sufficient (normal for the season) - not sufficient (below normal) (source: The Joint Harmonised EU Programme of Business and Consumer Surveys, User Guide (updated May 2022), European Commission).

### EUROZONE: LABOUR SHORTAGES AND SENTIMENT IN INDUSTRY

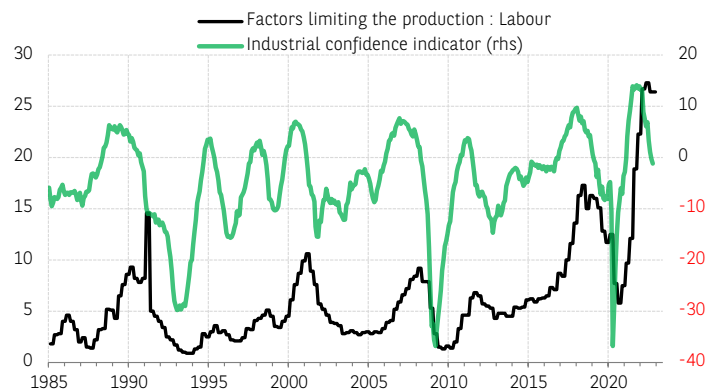


CHART 1

SOURCE:EUROPEAN COMMISSION BUSINESS SURVEY, BNP PARIBAS

### INDUSTRY: LABOUR MARKET BOTTLENECKS AND DURATION OF PRODUCTION ASSURED BY ORDER BOOKS

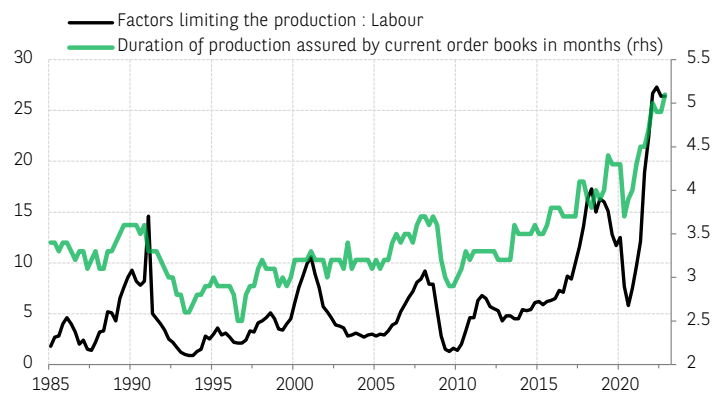


CHART 2

SOURCE:EUROPEAN COMMISSION BUSINESS SURVEY, BNP PARIBAS



**INDUSTRY: ORDER BOOK LEVELS AND EMPLOYMENT EXPECTATIONS**

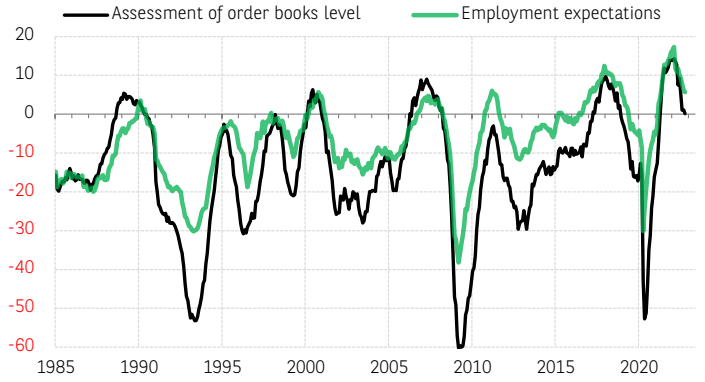


CHART 3 SOURCE:EUROPEAN COMMISSION BUSINESS SURVEY, BNP PARIBAS

**ORDER BOOK LEVELS AND EMPLOYMENT EXPECTATIONS IN DIFFERENT INDUSTRY SUB-SECTORS: JANUARY VERSUS OCTOBER 2022**

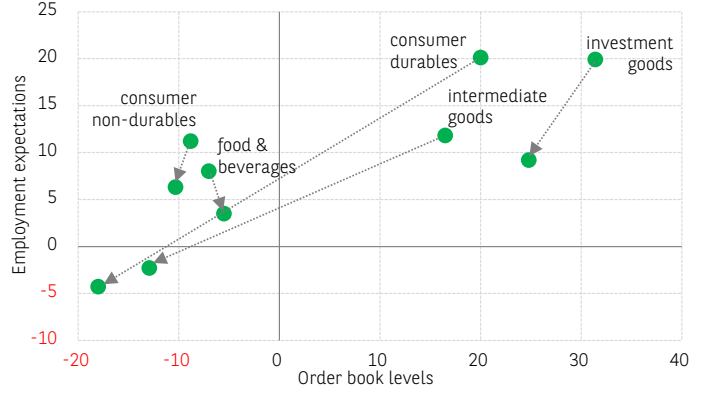


CHART 4 SOURCE:EUROPEAN COMMISSION BUSINESS SURVEY, BNP PARIBAS

**INDUSTRY: LABOUR MARKET BOTTLENECKS AND EMPLOYMENT EXPECTATIONS**

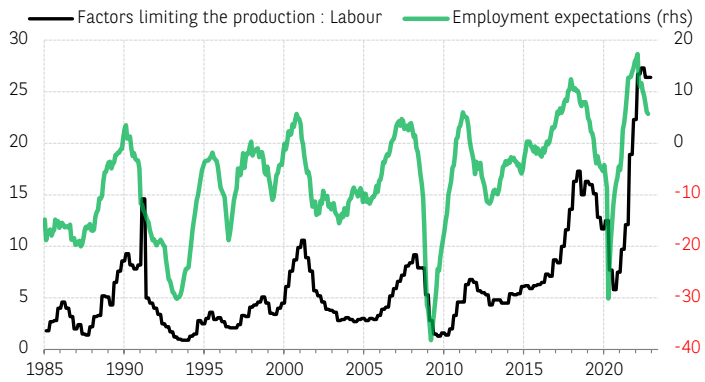


CHART 5 SOURCE:EUROPEAN COMMISSION BUSINESS SURVEY, BNP PARIBAS

**INDUSTRY: LABOUR MARKET BOTTLENECKS AND EMPLOYMENT GROWTH**



CHART 6 SOURCE:EUROPEAN COMMISSION BUSINESS SURVEY, BNP PARIBAS



Employment expectations are a leading indicator of labour market bottlenecks. Given the declining trend of the former, labour should become less of a constraint on production and employment growth should decline or even turn negative.