

EDITORIAL

THE LONG SHADOW OF UNEMPLOYMENT

Recent economic data have improved on the back of the easing of lockdowns. This may create a feeling of false comfort. The effects of the severity of the crisis will make themselves felt well into the future. A key factor is the rise in unemployment and in unemployment expectations. Both weigh on household spending, due to related income losses and increased precautionary savings. The major national central banks of the Eurosystem expect unemployment to increase in 2021, despite the economic recovery. When visibility remains limited and the pressure on profits high, many companies have no other option than to reduce their labour force.

Having a swim in the Mediterranean sea often comes with a surprise: the water temperature may be pleasant on the surface but the undercurrents are cold. This description fits the current feeling about the economy quite well. The impact of the easing of lockdown measures taken to fight the Covid-19 pandemic is increasingly visible in the economic data. This may create a feeling of false comfort. Indeed, it is very likely that the effects of the severity of the crisis will make themselves felt for many months to come. Different factors are at work such as pervasive uncertainty, high levels of corporate debt which acts as a headwind during a recovery<sup>1</sup>, a worsening of the labour market.

In their latest projections, several national central banks of the Eurosystem, expect the unemployment rate next year to be higher than today<sup>2</sup>. Such a scenario implies a subdued increase in real disposable income, weighing on household consumption and GDP growth (chart 1)<sup>3</sup>. Expectations also play a role. A study made before the Covid-19 crisis found that Dutch households with higher job loss expectations are less likely to buy new cars. They also tend to switch to cheaper ones and increase their savings<sup>4</sup>.

At the aggregate level, the crisis has caused a huge jump in unemployment expectations of eurozone households. Chart 2 shows that, historically, these expectations are quite correlated with the growth of household consumption. There is also a close relationship with the assessment of the employment outlook in the purchasing managers' surveys: the views of employers and employees are very much aligned. One could argue that in a post-lockdown world, the pick-up in activity will lead to an improvement of sentiment data. This has already started, with numbers for May being less bad than for April. However, the still very low sentiment level implies that spending growth should be anything but dynamic, all the more so given recent announcements of significant job cuts at major European companies.

The latter are a reminder that unemployment is a lagging indicator. Companies may in a first instance prefer to hold on to their labour force and use short-time working schemes, but if in their assessment the outlook remains bleak and highly uncertain, eventually they will decide to reduce staffing levels. This not only weighs on consumption decisions for those who lose their job but also for others. In Spain, during the Great Recession households where the primary earner still had a job nevertheless reduced their consumption by 0.7 % per point of increase in the unemployment rate. "We find that the explanation does not lie

in a drop in contemporaneous household income. Instead, aggregate unemployment casts a shadow on future income expectations."<sup>5</sup> This shows the overriding impact of psychology on economic decisions with companies and households mutually influencing each other.

William De Vijlder

EUROZONE: CHANGE IN UNEMPLOYMENT RATE & DISPOSABLE INCOME

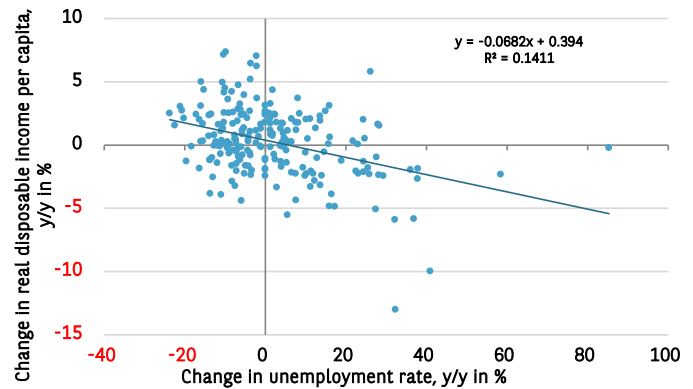


CHART 1

SOURCE: EUROSTAT, EUROPEAN COMMISSION, BNP PARIBAS

HOUSEHOLD CONSUMPTION GROWTH, UNEMPLOYMENT EXPECTATIONS AND EMPLOYMENT PMI

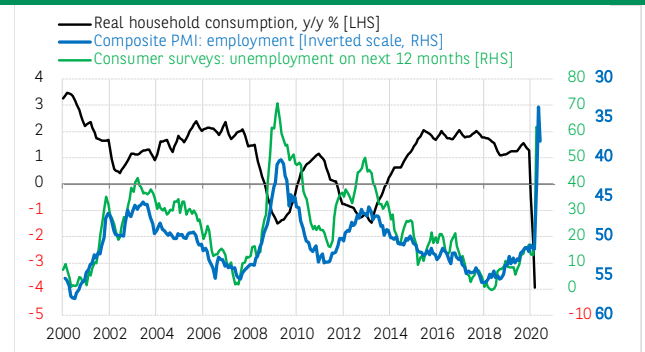


CHART 2

SOURCE: IHS MARKIT, EUROPEAN COMMISSION, BNP PARIBAS

1. Corporate leverage as a headwind during the recovery, Ecoweek, BNP Paribas, 12 June 2020  
 2. The Banque de France, the Bundesbank, the Banca d'Italia and the Banco de Espana  
 3. This chart is based on annual data for the period 2001-2019 for the following countries: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain  
 4. Source : Yuri Pettinicchi and Nathanael Vellekoop, Job Loss Expectations, Durable consumption and household finances: evidence from linked survey data, SAFE Working Paper No. 249, 2019

5. Rodolfo G. Campos and Iliana Reggio, Consumption in the shadow of unemployment, Banco de Espana working paper 1411, 2014

