

# ECO FLASH

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## Eurozone economic slowdown: what if employment holds up?

Louis Boisset

- Eurozone GDP growth is causing concern, but the relative resilience of employment continues to surprise.
- This trend is nothing new. The negative impact on employment of previous crises has been fairly restrained.
- Despite considerable difficulties in the sector, manufacturing employment is holding up particularly well.
- The slowdown in productivity gains could, in the short term at least, help drive the growth in jobs.
- Slower growth in hours worked and low-skilled jobs: a possible labour hoarding phenomenon is under way in Eurozone companies.

Since the end of 2017, economic growth in the Eurozone has decreased significantly. From 0.8% (q/q), GDP growth has dropped to just 0.2% in recent quarters. The manufacturing sector, which went into recession in the second half of 2018, is the main source of concern. Although activity in the services sector has slowed, it is still holding up. The resilience of employment against this background is crucial and continues to surprise. Although it has slowed, growth in total employment in the Eurozone has remained relatively robust and above its long-term average (Figure 1). In Q3 2019, total employment grew by 1.0%<sup>1</sup> (year-on-year, after 1.2% and 1.4% in Q2 and Q1 2019 respectively), from an average of 0.7% since 2011. Is this limited and slow adjustment of employment unprecedented in the Eurozone? Are different sectors seeing specific developments? How can we explain such resilience? Can this situation last? We will attempt to answer all of these questions.

<sup>1</sup> Figures are based on thousands of employees. In terms of hours worked the situation is similar: growth in employment has slowed gradually since mid-2018. In Q2 2019, however, the slowdown has been steeper (see below).

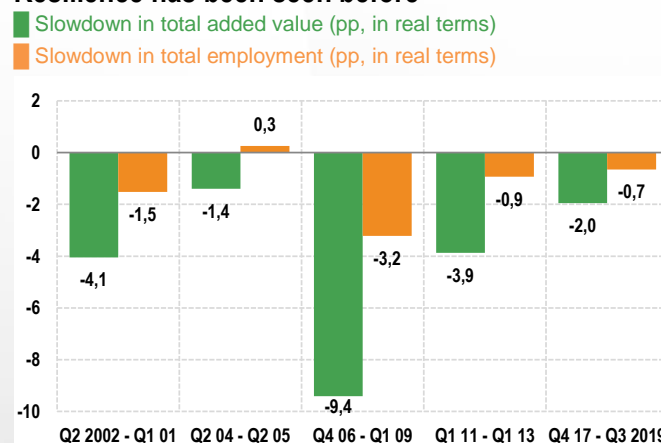
### GDP slows, but employment resists



Figure 1

Source: Eurostat

### Resilience has been seen before



Note: This chart shows the difference between peak and trough growth rates. For example, between Q4 2006 and Q1 2009, growth in added value fell by 9.4 points.

Figure 2

Source: Eurostat



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## The situation is not as unusual as all that

Despite the fairly substantial slowdown in growth, employment trends have held up in the euro area since the end of 2017. This resilience in employment might be seen as surprising. This said, the limited response of employment to a negative shock in economic activity is not a new phenomenon. During previous periods of slowing growth or recession in the Eurozone, the slowing of employment dynamics has not been significantly sharper. We have identified five phases between 2000 and today. These correspond to the periods separating peaks and troughs of growth in total added value in the Eurozone (year-on-year, in real terms): Q2 2000-Q1 2002 (internet bubble), Q2 2004-Q2 2005 (modest slowdown), Q4 2006-Q1 2009<sup>2</sup> (global financial crisis), Q1 2011-Q1 2013 (sovereign debt crisis) and Q4 2017-Q3 2019 (current slowdown). As shown in Figure 2, compared to negative shocks to economic activity, the slowdown in employment observed in the past has not been especially greater than at present.

## The manufacturing employment resists, despite the difficulties

The deterioration in activity within the manufacturing sector has been particularly marked since the end of 2017. Growth in manufacturing added value (in real terms) fell from 4.7% in Q4 2017 (y/y) to -1.1% in Q3 2019. However, the negative effect on employment has been relatively contained so far, with growth dropping from 1.4% to 0.7% over the same period. Meanwhile, added value in services<sup>3</sup> has seen a much smaller deceleration in growth (from 2.8% to 1.7%), whilst the relative effect on employment growth has been significantly higher (employment growth has fallen by 0.7 points).

Within the short economic history of the Eurozone, this is not a new situation. In previous periods of slowdown or recession, employment in services has been significantly more affected by the decline in growth of this sector, than it was the case in manufacturing (see Figures 3a and 3b).

## How can we explain this situation?

*Structural changes: demographic shifts, slowdown in labour productivity growth, capital intensity*

Labour productivity gains in the Eurozone have been really subdued since the end of 2018 (Figure 4). This has been particularly noticeable in Italy and Germany. The productivity cycle has been very marked in recent times, reflecting the limited adjustment of employment in the short term to the slowdown of activity. However, these performances lie in a broader context of a declining trend in Eurozone productivity, which is also being seen in many developed countries. This implies that the minimum threshold of economic growth, above which jobs are created, is now lower. In addition, the Eurozone is experiencing major demographic changes. Slowing active population since the beginning of the 2000s in particular has facilitated the stabilisation of unemployment.

Moreover, the manufacturing sector is considered to be capital intensive (as are certain service sectors such as telecommunications), which could help explain the limited

## Manufacturing employment remains impassive

■ Slowdown in manufacturing added value (pp, in real terms)  
■ Slowdown in manufacturing employment (pp, in real terms)

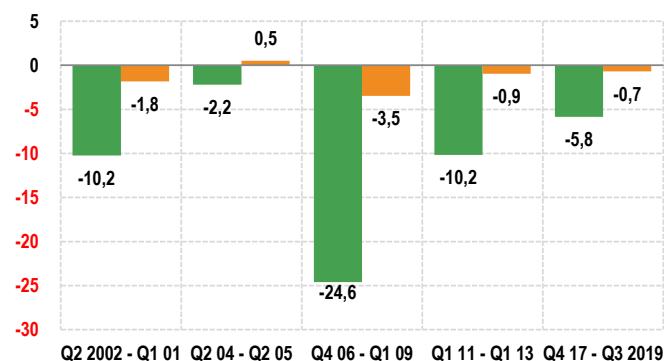


Figure 3a

Source: Eurostat

## Services have resisted so far

■ Slowdown in services added value (pp, in real terms)  
■ Slowdown in services employment (pp, in real terms)

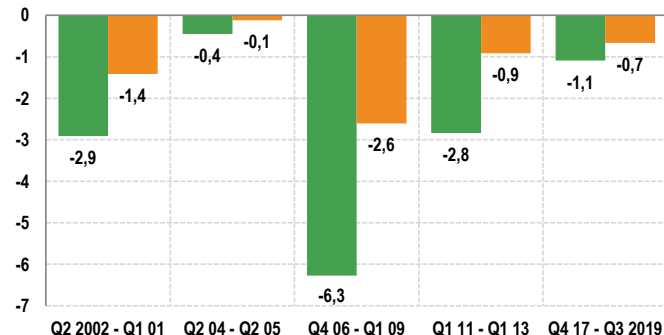


Figure 3b

Source: Eurostat

## The background: slowdown in productivity gains

— Growth in productivity per person employed (year-on-year)  
— Average by sub-period

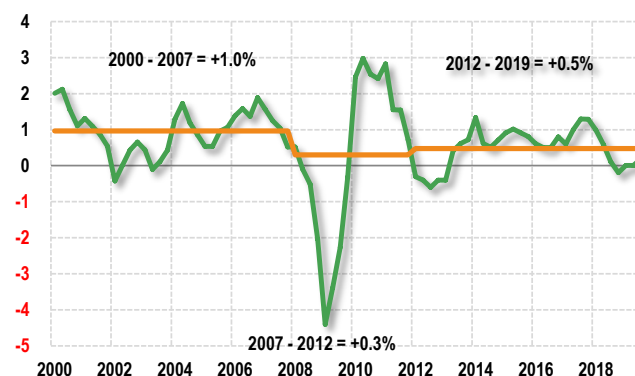


Figure 4

Source: Eurostat

<sup>2</sup> Although the recession didn't come until 2008, the slowdown started at the beginning of 2007.

<sup>3</sup> We have included all services – merchant and non-merchant – here.

reaction of employment in this sector, given the sharp slowdown in activity. Adjustments may take place at the investment level instead. Here, whilst investment in machinery and equipment in the Eurozone has admittedly slowed since late-2017, growth has remained positive.

#### Labour hoarding by companies

Given the slowing activity and demand, companies may choose to retain part of their workforce, at the cost of margins erosion. "Labour hoarding" can thus be defined as the proportion of the labour factor that is not fully utilised by the company during the production process at any given point in time. From the company's point of view, retention of part of the workforce can be optimal given the fixed costs associated with adjustments to employee numbers<sup>4</sup>. These costs depend on specific national institutional and legislative features of labour markets<sup>5</sup>.

We have seen this labour retention phenomenon in the Eurozone before. During the crisis of 2008-2009, between the peak and trough of activity, and despite the severe contraction of GDP, reductions in job numbers were relatively limited<sup>6</sup>. The retention of workers limited the impact of the crisis on employment and unemployment. In some countries, this took the form of a greater reduction in the volume of hours worked and the expansion of part-time contracts. This said, trends in labour markets have varied from one member state to the next, with unemployment increasing significantly in Spain between late 2007 and late 2011, whilst it fell in Germany.

Arguments for the retention of labour may now be under way in the euro area, amplified by the recruitment difficulties reported by companies. The volume of hours worked has in this framework slowed since the peak of late 2017 and even more sharply in Q2 and Q3 2019 (Figure 5). In Q3 2019, growth in hours worked in the Eurozone decreased to 0.7%, from 1.6% in Q1 2019. This was even more marked in manufacturing. In the latter sector, there are still differences between countries. Since the beginning of 2019, Germany and the Netherlands have reduced the growth of hours worked whereas it has remained stable in France.

Moreover, as in the past, the slowdown seems to be having a greater effect on the employment of people with low levels of education. On an aggregated level, employment for people with low levels of education has been falling since early 2018, while it continues to rise for those with high levels of education (Figure 6). This divergence is particularly marked in France.

#### What should we expect over the next few quarters?

GDP growth in the euro area stabilised in Q3 2019 (0.2% q/q) whilst employment growth continued to slow down (1.0% y/y from 1.2%). Over the next few quarters, trends in the labour market will be crucial, given its influence on households' consumption. A number of factors warrant to remain rather confident.

<sup>4</sup> ECB, *Labour hoarding in the euro area*, monthly bulletin, box 4, July 2013

<sup>5</sup> Companies may also seek to reduce the volume of work consumed by reducing hours worked.

<sup>6</sup> BCE, *Euro area labour markets and the crisis*, Occasional Paper Series, n°138, October 2012

#### Adjustments in working hours by companies

Growth in hours work in manufacturing (y/y)

■ Q3 2018 ■ Q4 2018 ■ Q1 2019 ■ Q2 2019 ■ Q3 2019

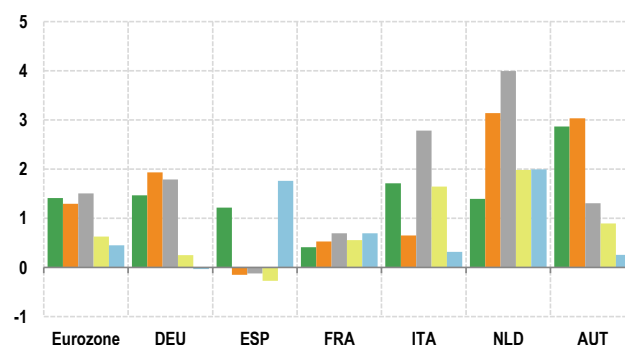


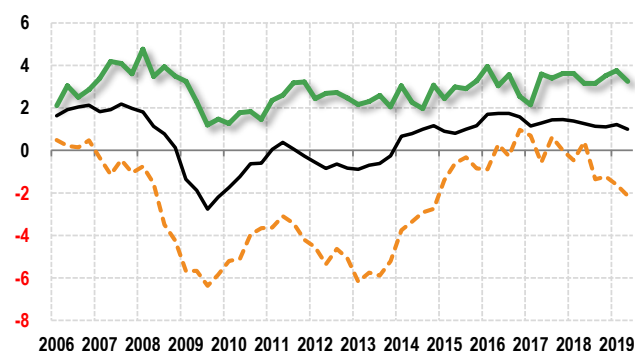
Figure 5

Source: Eurostat

#### Targeted labour hoarding

Employment growth by educational level (population aged 15 to 64, y/y)

--- Level 0-2 — Level 5-8 — Total



Note: (i) level 0-2 = Less than primary education, primary education and first cycle of secondary education; and (ii) level 5-8 = Further education

Figure 6

Source: Eurostat

First, domestic demand has held up and helped to offset the sluggishness of external demand. Although net exports (i.e. exports less imports) have on average made a negative contribution to growth since early 2018, growth has been supported by investment and private consumption. This augurs well: domestic demand, and particularly household consumption, creates more jobs than exports<sup>7</sup>. Private consumption is largely made up of highly labour-intensive services, in contrast to the exporting manufacturing sector. For example, during the Eurozone sovereign debt crisis, private consumption was hit harder than exports. At that time unemployment increased significantly relative to the slowdown in economic activity. During the recession of 2008-2009 it was exports that suffered more. Thus, although unemployment rose, the increase was fairly contained relative to the fall in GDP growth. Since the end of 2017, the euro area unemployment rate has fallen by around 1 point.

<sup>7</sup> R. Anderton et al. *Disaggregating Okun's law-Decomposing the impact of the expenditure components of GDP on euro area unemployment*, ECB, Working Paper Series n°1747, December 2014

Next, aggregate fiscal and monetary policy in the Eurozone are likely to continue to boost domestic demand and growth overall. On the monetary policy side, the latest announcements indicate that financing conditions will remain very accommodative for quite some time to come. When it comes to fiscal policy, this is likely to be slightly expansionary, on aggregate, in 2020<sup>8</sup>.

Lastly, despite having fallen by around 2 points of added value since Q2 2017, non-financial companies' margins remain fairly comfortable in the euro area (more than 39% of added value in Q2 2019). However, labour hoarding is weighing on firms' profitability and thus cannot continue endlessly, particularly if the slowdown persists or worsens.

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<sup>8</sup> European Commission, *European Economic Forecast*, Autumn 2019



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