

Eurozone: a labour market in surprisingly good shape ahead of the second wave

Too good to be true or merely another weird feature of the extraordinary downturn that the coronavirus has caused? Thanks to government support, significant unemployment increases have been avoided up to now. However, with the second lockdown wave in full play and a looming wave of insolvencies, unemployment looks set to increase in 2021



A worker at a car factory in northern France

Short-time work schemes do what's on the ticket

According to the latest data for October, unemployment in the eurozone has been declining since July. What is quite remarkable for a shock this unprecedented is that the unemployment rate was just 8.4%, up just 1.2 percentage points from February 2020. For a labour market that is known to experience peaks in unemployment in excess of 10%, this is extraordinary and provides a strong buffer for the impact from the second wave.

To explain the modest impact on unemployment so far, it is important to take a closer look at short-time work developments. Short-time work schemes across the eurozone have caused large labour market distortions as they have subsidised a very sizable amount of employment. See table








1 below for the current state of short-time work schemes, which indicates that around 5% of total employment is still covered by short-time work. The share of total employment covered by the schemes has fallen dramatically since May though as economies have been recovering. As unemployment has not increased much since then, the schemes have been quite successful in mitigating job losses in times of economic shock.

With still relatively large numbers of jobs supported by the schemes, the question is how long the schemes will continue now that the second wave is hitting, and new lockdowns cause a similar situation compared to the difficult first wave. According to the latest data out of Germany, the number of people in short-time work increased again in November and December.

Most short-term work schemes have been extended until the end of 1Q21

For many countries this is not an imminent issue as most short-time work schemes had already been extended until the end of 1Q21. Only Spain stands out as a worrying case, where the short-time work scheme is due to expire at the end of the month, but it has already been announced that talks about an extension of the scheme would take place on 8 January. A lengthening seems necessary to avoid a further sizeable increase in unemployment. However, the longer the lockdowns last, the higher the risk of companies going bust. In such a scenario, unemployment would increase independent of government support schemes.

Short-time work schemes, where are we?

							
% of employment on ST work as of now	5% (Oct.)	6% (Oct.)	5% (Oct.)	4% (Nov.)	4% (Nov.)	5% (Oct.)	3% (Oct.)
% of employment on ST work as of May	14%	27%	19%	14%	21%	19%	33%
Duration of ST work in months from January 2021 ¹⁾	12	17	3	1 ^{**)}	6	3	3 ^{**)}

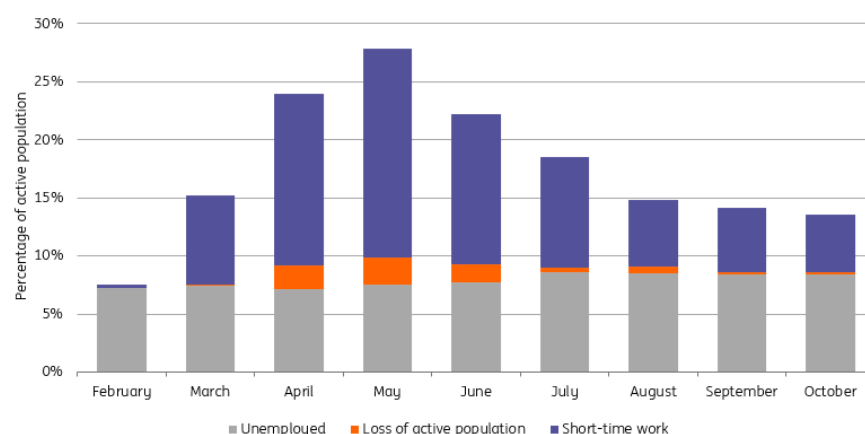
Those extensions of the scheme often include somewhat less favourable conditions than at the start of the crisis. France, at 6%, is still high on the list of large eurozone economies leaning on short-time work, and is expected to make conditions less attractive at the end of the month – increasing the employer contribution from 15% to 40% of the benefit. All in all, short-time work is likely to continue to support the labour market through the difficult second wave in most large economies but take-up could become smaller under less favourable conditions.

Broad measures of unemployment show strong recovery after lockdown 1

To get a better sense of actual labour market workings during the coronavirus crisis, we use a broader measure of unemployment to look at how the labour market has developed. We add our estimate of the number of people on short-time work schemes to the number of unemployed and take an estimate of the monthly change in the active population to account for labour market dropouts (people not looking for work anymore and therefore not counted as unemployed). The latter is a very rough measure, but the best we can do using monthly eurozone data.

What we find is that the peak in combined inactive people was between 25% and 30% of the labour force in May, after which a rapid decline occurred to about 15% in October. The curve has flattened over recent months. This still leaves a sizeable amount of the labour force on short-time work, but at the same time unemployment has also been declining significantly and the increased number of inactive people has vanished as the labour force is almost back to February levels. This is a remarkable recovery given the historic economic shock we experienced in the first lockdown last spring.

Broad labour market measures show a quick recovery from the first wave



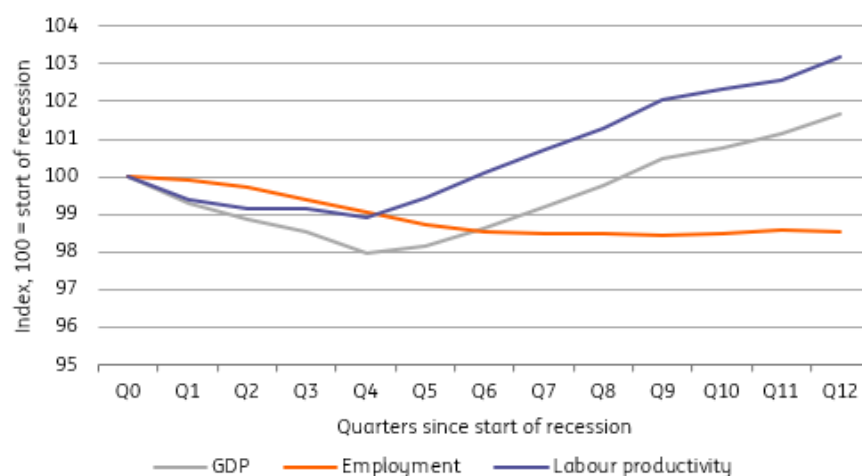
Source: ING Research, Eurostat, national sources on short-time work

Is this first wave impact too good to be true?

While many comparisons with prior recessions fall flat, it is interesting to keep in mind how employment developed in the aftermath of past eurozone recessions. Chart 3 shows the development of GDP, employment and productivity per worker over the course of the past five recessions in the eurozone. This shows continued employment declines until after labour productivity has recovered to the pre-crisis level.

We were still far from that level in the third quarter – partly the flipside of the short-time work schemes – with productivity some 2% below its pre-crisis peak. Consequently, additional employment drops are still on the cards. Even though this is no ordinary recession and even without the impact from the second lockdown and the structural impact from insolvencies, historic comparisons suggest that we are set for a sluggish job growth performance in 2021, at best.

Eurozone employment usually doesn't recover until labour productivity has reached pre-crisis levels



Source: ING Research calculations, CEPR Euro Area wide model, Eurostat Note: average of the 1974, 1980, 1992, 2008 and 2011 recessions

Unprecedented crisis – also for the labour market

Unfortunately, this is a crisis unlike any other. There are two important factors complicating any forecast for the eurozone labour market: the second lockdown and the uncertain lasting impact of the first. The massive amount of stimulus that governments have provided has in part averted economic misery. However, some argue that elements of the misery have only been delayed. When businesses come off short-time work schemes, some workers will still be laid off as businesses restructure, but perhaps more importantly: bankruptcies have also been massively suppressed by many support measures like deferred taxes or loan moratoria. That has pushed many financial obligations out to 2021, causing bankruptcies in 2020 to be far lower than even in good economic years. That makes it more than reasonable to assume a catch-up in bankruptcies once support measures are withdrawn, leading to higher unemployment.

The impact of the second wave on the labour market is hard to quantify as countries are still in the process of extending or deepening restrictive measures to contain the virus as we speak. Even if the performance of the eurozone labour market in 2020 was encouraging, successes of the past are unfortunately no guarantee of future success.

Although a recovery is set to take firm hold from 2Q onwards, mild increases in unemployment are still expected

While the recovery is set to take a firm hold of the economy from the second quarter onwards, mild increases in unemployment are still to be expected due to the delayed labour market impact of several economic shocks. In particular, a rise in insolvencies is probably the biggest threat to the labour market in 2021. Judging from previous experiences, we would be surprised if unemployment runs as high as during the euro crisis. However, if only 33% of all people currently working under short-time work schemes were to lose their job, this would push eurozone

unemployment above the 10% mark. Needless to say, governments will try everything they can to prevent such a scenario.

Authors

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Franziska Biehl

Economist, Germany

Franziska.Marie.Biehl@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.