

## Eurozone labour market: From short-time to shortfalls

Don't expect labour market slack to return quickly as labour supply is already at a record high and mismatches seem set to persist. Only a deeper-than-expected economic downturn could be a game changer for the eurozone job market



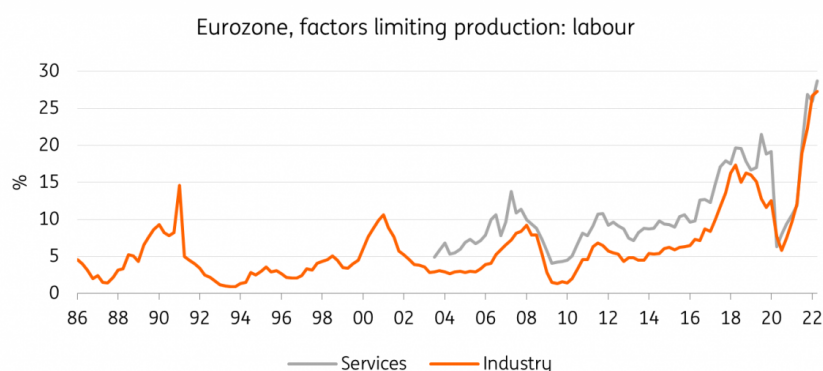
Shortages have rapidly become a pressing problem in the eurozone economy. This is not because the pandemic has caused people to turn away from the job market. There are more people active in the labour market than ever and more people are working than ever before. Besides that, we see increased mismatches as the pandemic has caused shifts in the job market that add to a tight labour market. Don't expect labour market slack to return soon, even though a recession could be around the corner.

## Short-time work schemes bridged the gap of low economic activity

The historic decline in GDP in early 2020 was met by unprecedented fiscal support in the form of short-time work schemes that were widely used across economies. In fact, in May 2020, roughly 15% of employees were subsidized by governments through furlough schemes according to our own estimates. That made it one of the anchors of fiscal support in the eurozone during the pandemic. Unemployment increased shortly, but then fell to historic lows, and incomes remained fairly stable, boosting the economic recovery.

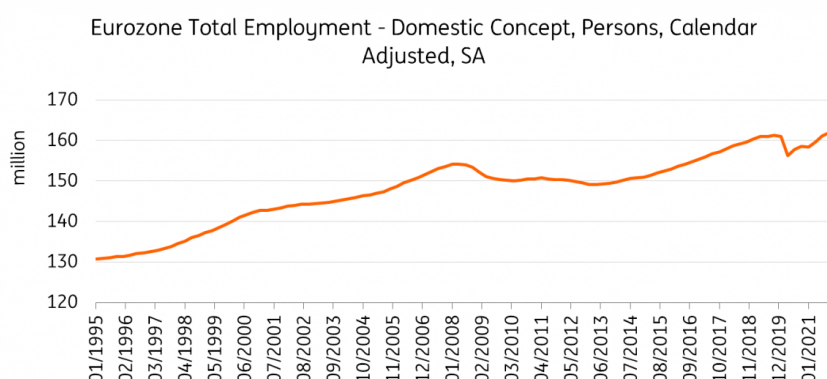
The labour market's quick recovery from the crisis – in part due to large fiscal and monetary support – has been surprising. Lately, the use of short-time work schemes has fallen to negligible percentages of employment over the eurozone. At the current juncture, job retention schemes no longer play a large role in labour market dynamics. Instead of rising unemployment, the eurozone is currently facing labour shortages. The shortages had actually already emerged prior to the start of the pandemic. Job vacancies have shot up and businesses indicating that labour shortages are hindering their output has hit historic highs for both services and industry. At the same time, the total number of people employed has also reached new all-time highs.

### Chart 1: Businesses indicate that labour has never been such a pressing issue as now...



Source: Eurostat

## Chart 2: ... as eurozone employment has reached an all-time high



Source: Eurostat

## Where are the shortages?

The shortages that have emerged in the labour market seem broad, but in reality there are quite a lot of mismatches occurring. Geographically we see that the countries that traditionally deal with high labour market slack are also the ones that still have low vacancy rates and elevated unemployment rates. Spain and Greece see vacancy rates below 1%, while labour markets are very tight in the Netherlands, Belgium, and Germany at the moment. Even though the EU has a single labour market, we have seen over recent years that it does not function in practice as such with high barriers to internal migration to fill jobs where shortages emerge.

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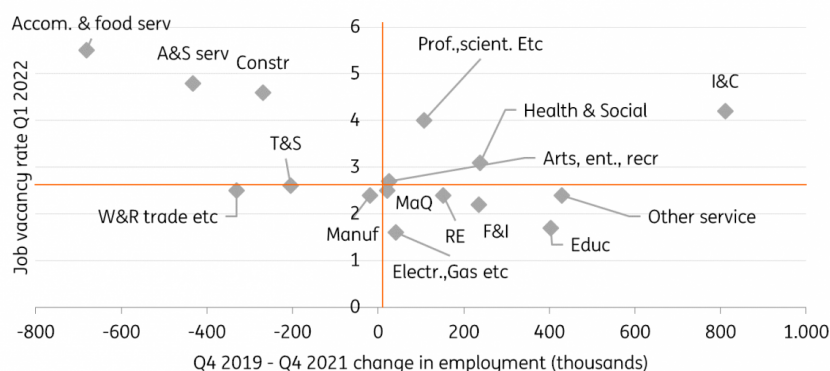
*The biggest sectoral changes in the labour market have been coming from the asymmetric shock to sectors from Covid-19*

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But also by sector, differences are large. We can generally say that the biggest sectoral changes in the labour market have been coming from the asymmetric shock to sectors from Covid-19. Sectors that saw the largest declines in employment over the course of the pandemic are the ones that generally have the highest vacancy rates at the moment (see chart 2). Think of hospitality that had been locked down for a much longer period of time than industry while other sectors like ICT never closed. Indeed, about 600,000 less people now work in the accommodation and food service sector than before the pandemic, while about 800,000 extra people work in ICT. Shifts between sectors as people changed jobs from closed to open sectors are a logical explanation for that trend and explain shortages emerging in sectors that have reopened later and are now recovering from the pandemic shock.

It's not just that though. Some sectors that have boomed over the pandemic years, most notably ICT, also struggle significantly to find the right workers. Besides that, specific occupations are in particularly high demand, which is an issue that plays out across sectors. All in all, the labour market is experiencing significant pressure overall, with some mismatches between countries and sectors exacerbating the problem.

## Chart 3: Vacancies are high where employment dropped, and in ICT...



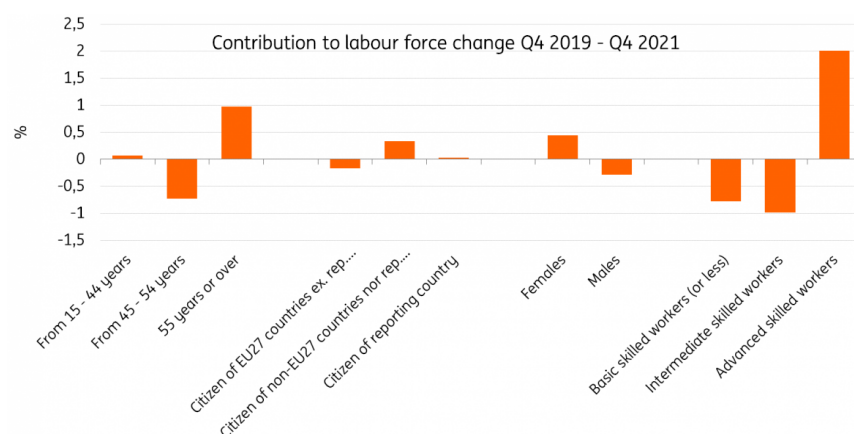
Source: Eurostat, ING

## Is there still room for extra labour to emerge?

It's not like there are that many Europeans on the sidelines still. Just like employment, labour participation (the number of people that are employed or looking for work) is at an all-time high. Broader measures of unemployment – this includes people who want to work but are not looking and people who are working part-time but would like to work more – are also falling rapidly. The eurozone labour market slack indicator has fallen to new historical lows. So, for the eurozone as a whole, this is not a problem of people having retired like in the US or waiting to return to the job market because of Covid. Labour supply has actually increased, but demand for employment has returned even more strongly.

But also in labour supply mismatches have developed since the start of the pandemic. Even though overall we see an increase in the active population in the eurozone, some groups have seen overall declines in participation. In fact, there is a large surge in labour market participation from advanced skilled workers, while low- and medium-skilled participation is still below pre-pandemic levels. We also see that male workers are still missing, and that people aged 45-54 are still far from their pre-pandemic participation levels. With detailed occupational data lacking at the eurozone level it is hard to get finite answers about how certain shortages have come about, but the differences between gender, age, and educational level in terms of participation does indicate that mismatches in terms of labour supply do play a role in current shortages.

## Chart 4: The active population recovery sliced and diced



Source: Eurostat, ING

## What will the cooling economy do?

With firms' employment expectations remaining historically high for the moment, it seems like the tightness in the market is therefore set to continue. Not that much more can be expected from increased participation at this point and businesses continue to demand more workers to meet employment needs.

If anything is set to budge in the short-run, it seems to be labour demand. The economy is already slowing significantly at the moment and employment expectations are coming off recent peaks. We expect the economy to fall into recession towards the end of the year, which would likely have a larger impact on labour demand.

At the same time, we don't expect unemployment to increase markedly though. With labour markets as tight as they are, we expect labour hoarding to occur, where businesses hang on to employees despite weaker demand to ensure they do not run into problems rehiring when the downturn ends. So if – as we expect – a shallow recession is to happen, the labour market impact is likely to be modest. That means that tight labour markets are not likely to become a thing of the past anytime soon.

## Chart 5: Employment expectations are starting to turn



Source: Eurostat

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