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Eurozone labour shortages not as clear cut as you might think

The labour market seems to be about as tight as it was at the end of 2019, which is remarkable given the deep economic shock of 2020, but extreme tightness is only found in a few parts of the eurozone economy

Labour shortages are a particular problem in the Netherlands. Pictured, shoppers in Rotterdam

Labour shortages are reported to be limiting production more than ever in the eurozone, according to a business survey by the European Commission. This suggests that vacancies are hard to fill, resulting in supply problems. When you look at vacancy rates across countries and sectors, we find bottlenecks in a few areas and there are some nations which really stand out, but on average the labour market seems to be about as tight as it was at the end of 2019. Back then, labour shortages did not lead to supply problems or a huge jump in wages. Looking ahead, those bottlenecks in the labour market could worsen if labour demand continues to recover quickly and that could eventually lead to more upward pressure on wages.

Where do shortages stem from?

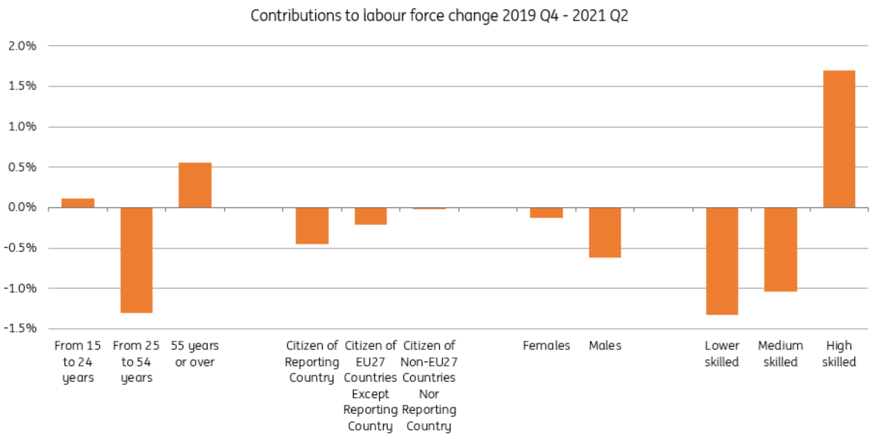
The active population is smaller, who do we miss?

One reason for the current labour shortage could be a shrinking active population. In the eurozone, the active population is now 0.7% smaller than in 4Q 2019, while in the US it was down 1.5% in November compared to February 2020.

In the eurozone, the decline can largely be seen among prime-age men. This sounds worrying as it could have long-term ripple effects if people have left the workforce permanently. The decline in active population for people aged 25-54 was -1.8%, which the number of older workers actually increased.

This is the exact opposite of the retirement effect seen in the US, as older workers in the eurozone have actually seen an increase in participation. That is probably due to higher retirement ages and larger cohorts of older workers.

The active population drop sliced and diced



Source: Eurostat, ING Research

The drop in the active population in the eurozone is also caused by low- and medium-skilled workers. High-skilled workers have seen their participation increase during the pandemic, but significantly fewer low and medium-skilled workers are currently active. This confirms the difficulty in hiring lower-wage workers that some eurozone businesses have reported

There has also been a disproportionate drop in non-nationals in the active population, especially from other EU countries. This is in line with the narrative of people returning home to their families elsewhere in the EU as work stopped and borders were closing. Now those borders have reopened and demand for employment has returned, there seems to be a reluctance for people from other European countries to go back to where they were pre-pandemic. Migration data for 2020 indeed confirms a large drop in people with other EU nationalities working in eurozone countries. This is mainly the case for medium-skilled people, for which there has been an 8% drop.

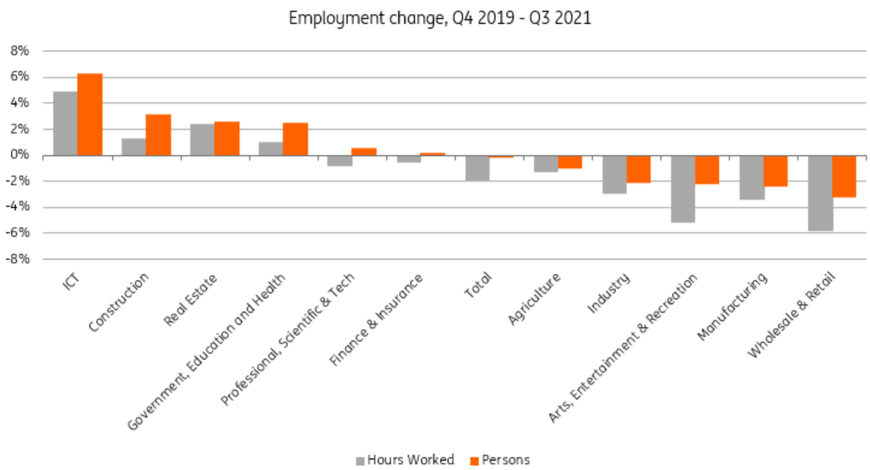
It's a little bit of characterisation but the eurozone is lacking prime-age medium-skilled men who have in part moved back to other countries.

Mismatches also play an important role in the pandemic job market

It is not just the lack of labour supply that is causing the current shortages. Despite furlough schemes still remaining, unemployment is still higher than before the pandemic hit. That means that post-pandemic mismatches play a significant role in current labour shortages. This is confirmed by the Beveridge curve shifting out over the past few quarters. The relationship between unemployment and the vacancy rate shows higher vacancies at similar unemployment rates than before the crisis, which is a common indication for increased labour market mismatches.

This is partly because some sectors were hiring well more than before the crisis; think of ICT, Information and Communications Technology where hiring is well above pre-crisis levels, while arts and recreation or hospitality are still well below levels seen prior to the pandemic. It does seem logical – supported by anecdotal evidence – that people have switched from sectors hard hit to sectors less stretched over the course of the pandemic. This leads to short-term mismatches now that demand for labour is returning to the hardest-hit sectors.

Big differences in sector employment show mismatches in the pandemic labour market



Source: Eurostat, ING Research

So where are shortages most pressing?

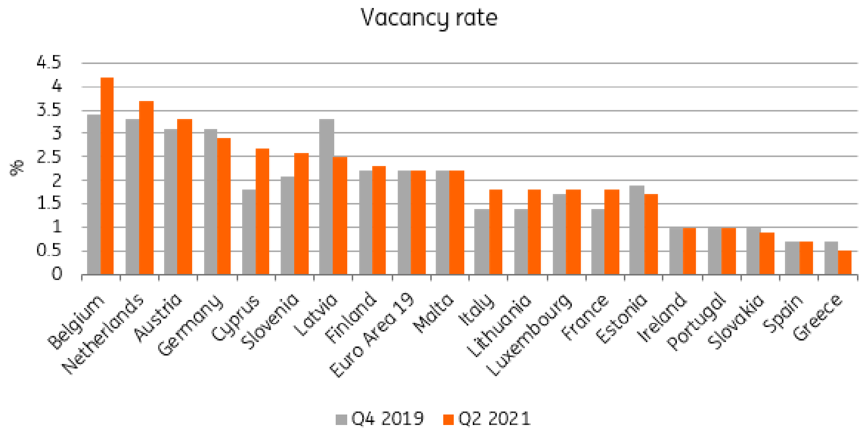
Shortages are most acute in the Netherlands and Belgium

The increased mismatches in the labour market are causing labour market pressures and have resulted in labour shortages returning far quicker than initially expected. With more manufacturing businesses than ever mentioning labour as a key factor hindering production in the eurozone, the situation sounds quite alarming. The question is whether this is because of bottleneck jobs causing problems or whether it is a widespread labour market issue. We think it’s the former for most countries, but not all.

When looking at vacancy rates by country, we see that only a few have significantly higher vacancy rates than before the pandemic. The Netherlands and Belgium are notable cases which have seen vacancy rates jump. These countries show more signs of a very heated labour market as they have also seen the active population increase and employment has recovered to above pre-pandemic levels. To a smaller degree, this also holds true for France. This is a situation that is different from the eurozone average and is also related to a quicker-than-average economic recovery from the pandemic.

Germany has a smaller active population, but also a slightly lower vacancy rate than before the pandemic. The German labour market was getting rather tight prior to the pandemic, so it is not like the pressure is off in Germany, but labour shortages are not as bad as they were at the end of 2019. Italy has seen vacancy rates increase and fewer people becoming active, but at quite low vacancy rates while Spain has vacancy rates that are overall so low that there seems to be ample slack in the market still.

Vacancy rates show that issues are the most pressing in Netherlands and Belgium



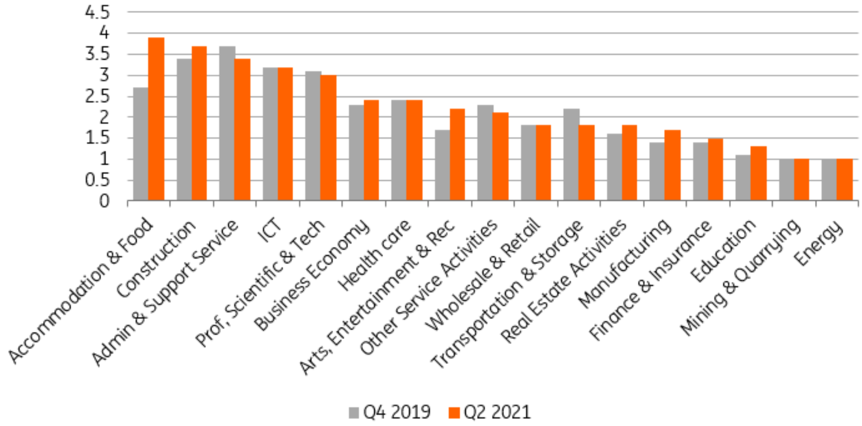
Source: Eurostat, ING Research

Overall, most eurozone countries have vacancy rates similar to pre-pandemic levels when the labour market in quite a few eurozone countries was already tight, but many southern eurozone labour markets are lagging when looking at vacancy rates at the moment.

By sector, things look a lot like 4Q 2019 except for hospitality

When looking at vacancy rates by sector, we see a similar pattern emerging for countries. Most sectors have seen labour markets tighten to levels comparable to 4Q 2019, but not much beyond that. The most notable exception is the hospitality sector. There we have seen vacancy rates shoot up to the highest levels on record, surpassing all other sectors. Outside hospitality, vacancy rates remain high in construction where activity has boomed, in IT and admin support, which are sectors which were already dealing with tight labour markets before the pandemic. Vacancy rates in manufacturing remain pretty low despite a historically high number of businesses naming labour as a key constraint. This shows that some bottleneck occupations are driving problems at the moment.

By sector, hospitality stands out with a notable increase in vacancy rates



Source: Eurostat, ING Research

Tight labour markets will contribute to a rebound in wage growth next year

All in all, we find that the labour market is roughly as tight as it was right before the pandemic, which is surprisingly quick given the historic economic shock the eurozone experienced. Still, shortages seem to be somewhat less dramatic than often portrayed in the media. That is outside of the Netherlands, Belgium and some smaller economies where shortages are worse than pre-pandemic. Real sector-wide tightness seems to be found mainly in hospitality. Some key occupations in other sectors are also causing problems for total production, but that does not mean that entire sectors are likely to see wage pressures boom.

In the months ahead, we do expect a further recovery of the active population as prime-age inactivity should decline given the strong employment demand from businesses. Also, as furlough schemes end, there should be some additional labour supply on the back of restructuring. We don't expect this to drive unemployment higher given the positive job market outlook but instead, it should pause the steady rise in vacancy rates seen in 2021.

Nevertheless, overall labour markets are already as tight as they were at the peak of the previous cycle and are set to become tighter if labour demand remains as buoyant as it is right now. That will translate into increased wage pressures over the course of next year, but keep an eye out for the laggards. Countries such as Spain, Greece and probably also Italy are set to have quite some slack in the labour market for a while to come. That makes the picture more diluted than headline figures suggest, but do look for stronger wage growth on average.

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