

## The great eurozone split – and why southern jobs are booming

Since early 2023, countries in Southern Europe have seen strong declines in unemployment, while those in the north have seen increases. This is helping eurozone convergence, adding to tighter government bond spreads in the eurozone, and is ultimately making life easier for the European Central Bank

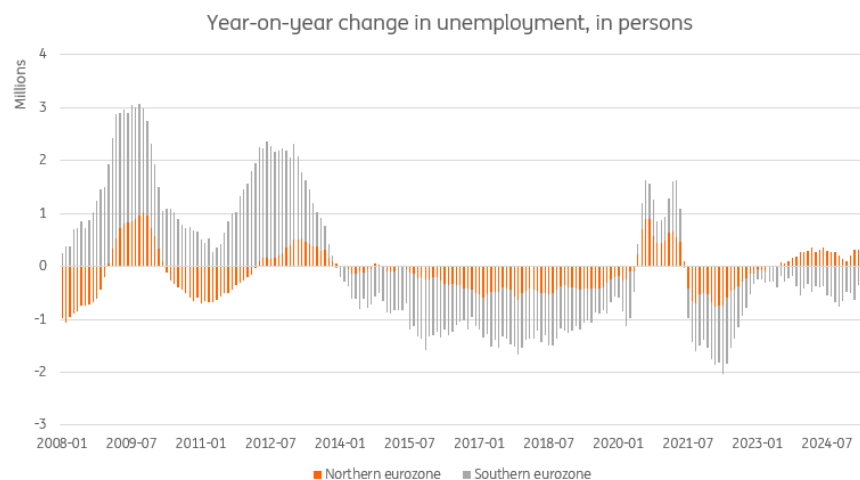


Southern European countries have experienced strong job growth since early 2023, including in retail

The eurozone labour market has been incredibly resilient to economic weakness and uncertainty in recent years. The unemployment rate has fallen to new lows, just above 6%. And while things appear to be cooling somewhat when looking at vacancy rates or recruitment plans, labour shortages remain across the eurozone and seem to be here to stay for some time to come.

But since 2023, eurozone labour market strength has seen a stark geographical divide. While northern eurozone job markets have cooled and started to see increases in unemployment, southern eurozone labour markets have continued to see unemployment decrease, along with strong job growth. In this note, we dive into the divide.

## Unemployment paths have started to diverge between the north and south in recent years



Source: Eurostat, ING Research calculations

Northern eurozone includes Austria, Belgium, Germany, Finland, France and Netherlands. Southern eurozone includes Croatia, Cyprus, Greece, Italy, Portugal, Slovenia and Spain.

### Divided recovery: the south's surprising job market surge

The divergence in unemployment developments is stark. Spain, Greece, Portugal and Italy have seen large relative declines in unemployment (between -0.8 and -2.6 percentage points since early 2023), while Germany, the Netherlands, Belgium and Austria have seen their unemployment rates creep up (up to 0.8ppt in Belgium). The stronger jobs market is also reflected in job creation.

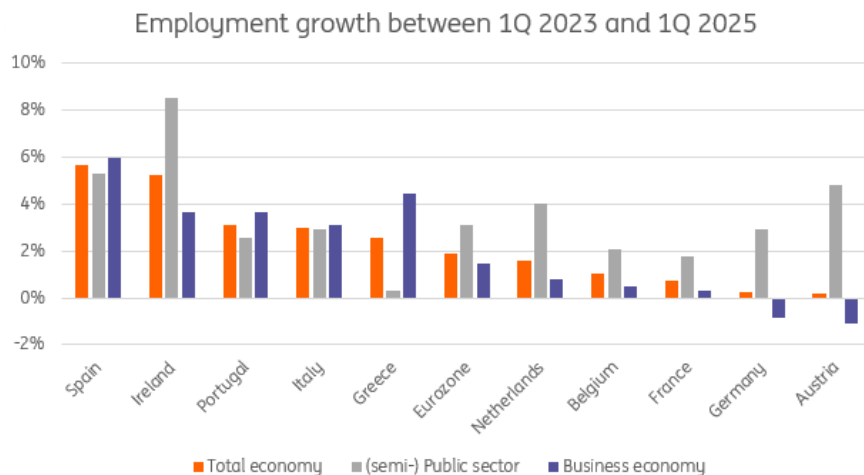
While southern eurozone countries have continued to see solid job growth in the private sector over the past two years, this has completely dwindled in the north. In Spain and Italy, for example, the most robust job growth has been seen in the wholesale and retail sector, with construction experiencing a similar impact. Professional and scientific services have also emerged as a strong job growth engine. No broad sector has seen job declines in Italy, while in Spain, there were very small declines in finance and agriculture.

### Public sector keeps job growth positive in the north

In the north, though, job growth in the private sector has been very weak. In Germany, manufacturing has actually seen strong employment declines while construction and professional services have experienced a notable drop in jobs. France's labour market has been a bit more of a mixed bag as wholesale and retail trade and manufacturing added jobs, but losses were seen elsewhere in the private sector.

A common theme in both Northern and Southern Europe is a strong increase in (semi-) public sector employment. This has been accompanied by strong private sector job growth in the south, while the north has seen the (semi-) public sector as the main positive contributor to job growth. This means that corporates have already started to shrink employment in the north, pressured by high wage growth and weak economic activity.

## Job growth in the north has been strongly supported by the (semi-) public sector

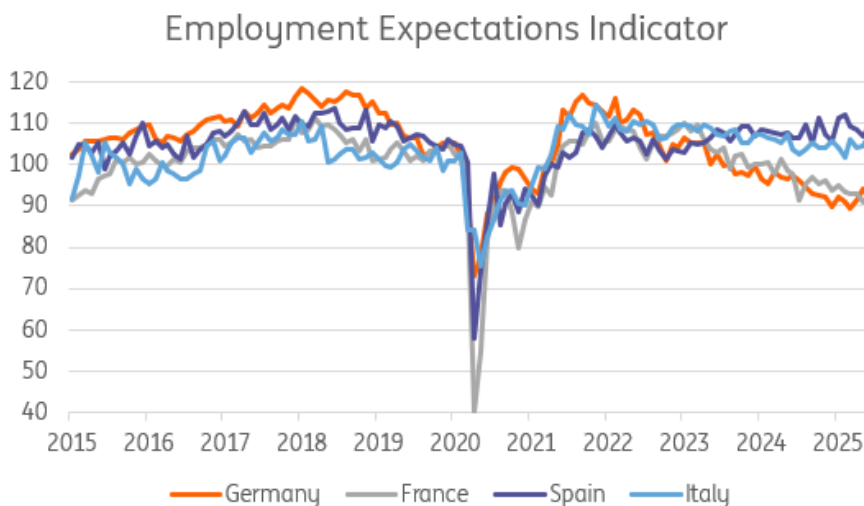


Source: Eurostat, ING Research calculations

For business economy we use NACE categories C-N, R and S. For (semi-) public sector we use sector O.

For the months ahead, we think this story is set to persist. When looking at job growth expectations for services and industry, surveys show that employment expectations for the south are consistently better than for the north, with the exception of the Netherlands. Even though the Dutch labour market has seen employment drop in recent quarters, business expectations still show decent hiring intentions.

## Employment expectations continue to diverge between the large northern and southern countries in the eurozone



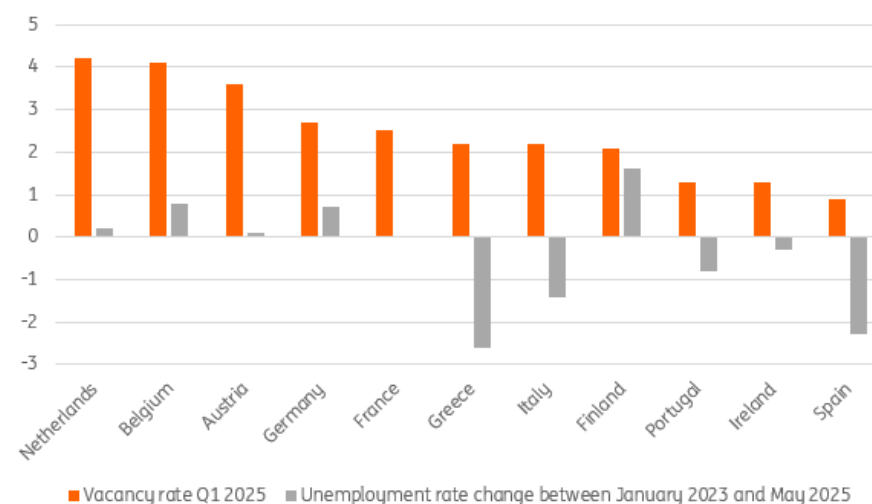
Source: European Commission DG ECFIN

## A new era of labour market convergence

There are several (possible) reasons for the stark difference in private sector employment, and it all starts with the differences in economic momentum. Southern Europe has seen stronger economic growth over the past two years due to NextGenEU, a post-Covid boom in (tourism) services and less industry dependence than in the north, which is now also showing in the labour market. Another reason could be the structural weakness in manufacturing affecting countries in Northern Europe more than it is in Southern Europe. And, finally, automation and the use of artificial intelligence (AI) could be another explanation for diverging labour market developments.

In any case, the eurozone is currently finally experiencing a long-awaited convergence, as the higher unemployment rates of the southern countries are coming down and the low rates of the north are increasing. The convergence is quite positive as so far southern rates have come down faster than northern rates have gone up. With labour shortages seemingly becoming a structural feature of the northern eurozone, it is positive that markets with the highest vacancy rates are cooling off a bit while the ones with higher structural unemployment have gained labour market momentum.

## Labour markets converge as tight labour markets see unemployment rise and vice versa



Source: Eurostat, ING Research calculations

## Different structural behaviours in the eurozone

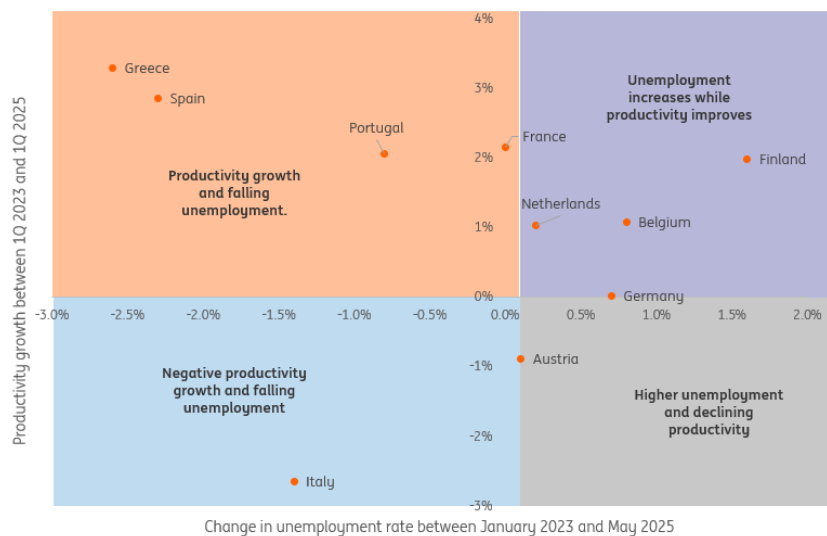
However, as is so often the case, the devil is in the details. Not all southern eurozone countries have seen growth outperforming that of northern countries. The narrative differs by country. The chart below shows a scatterplot with developments of productivity and unemployment.

Countries in the top left quadrant, like Spain and Greece, have seen strong job growth accompanied by productivity gains. This is the healthiest situation from an economic perspective as it boosts domestic demand in the short run and helps long-run efficiency gains in the economy. The top right quadrant has seen job losses which come with productivity gains, especially for countries with tight labour markets. This suggests that businesses are improving efficiency as labour markets remain tight and wages have increased significantly, and comes on the back of a

period of labour hoarding and productivity slacking in the aftermath of the pandemic.

The bottom half of the graph shows countries that experienced weak productivity performance. In Italy, this has come with strong declines in unemployment. Businesses are relying more on labour for output. For the short run this is positive as it boosts Italian household incomes, but given its weak demographic profile, the question remains as to whether this is sustainable. The bottom right quadrant, including Austria and with Germany close by, sees unemployment increase and productivity weaken. This is essentially a sign of weak cyclical performance.

## Some countries improve productivity as unemployment increases, but not all



Source: Eurostat, ING Research calculations

## Eurozone labour market convergence eases policy trade-offs

While underlying labour market developments differ by country, the aggregate developments are positive from a single labour market perspective. There is clear convergence in terms of unemployment, with the biggest moves coming from the countries that are reducing their high unemployment rates. The countries with structurally tight labour markets are experiencing some easing, which is far from resulting in structural unemployment increases. A decade ago, in the aftermath of the euro crisis, we had hoped for developments like this.

All in all, the eurozone is finally experiencing a long-awaited convergence. This is partly due to economic weakness in the north, but partly due to outright strength in the south. This convergence could be another important reason for relatively narrow government bond spreads in the eurozone and should also make the European Central Bank's life easier. In the past, the ECB's one-size-fits-all monetary policy quickly reached boundaries due to diverging economic trends across the eurozone. With the current convergence and monetary policy at the verge of turning accommodative, the new convergence is a blessing – it could bring some relief for suffering northern economies, without doing any harm in the south.

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