Eurozone labour market builds up steam

Eurozone unemployment rate continues its decline, reaching its lowest level since January 2009. Anecdotal evidence suggests wage growth might start to climb higher

Eurozone unemployment rate fell in November to 8.7%, from 8.8% in October. The unemployment rate has now been declining continuously since May 2013 to reach the lowest level since January 2009.

Looking at the hiring intentions published in the European Commission's Economic Sentiment Survey, this decline is bound to continue. In December, employment plans reached the highest level in 30 years in the industry, while they also improved in construction (to a 10-year high) and services.

The unemployment rate is, therefore, most likely to fall below 8% by the end of this year. That said, there is still a wide divergence between the different member states with the unemployment rate in Germany currently at 3.6%, while it still stands at 16.7% in Spain and more than 20% in Greece.

While falling unemployment should further boost consumption, thereby contributing to the self-sustaining character of the recovery, the key question for the ECB is when the unemployment level will start to affect wages. As the ECB showed in its Bulletin last year, the level of labour market slack remains much more significant than the unemployment figure suggests, which might explain why the traditional Phillips curve relationship between lower unemployment and higher wages has not been visible until now.

However, with the percentage of companies mentioning the scarcity of labour as a factor limiting production now at the highest level since the start of the monetary union, wage growth should start to pick up.

Annual growth in compensation per employee has already risen from a low of 1.1% in the second quarter of 2016 to 1.7% in the third quarter of 2017, and we believe that this trend will become stronger in 2018. In Germany IG Metall, the trade union for the metal and electrical industries started a nation-wide "warning strike" to support its demand for a 6% pay-rise and a 28-hour working week.

ECB thinks there is more slack in the labour market than the unemployment rate suggests

> The gradually rising wages in the Eurozone are likely to push core inflation higher, though we doubt that it will surpass 1.5% this year.

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