Economic Research:

This Time, Europe Is Set To Stage A Jobs-Rich Recovery

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Key Takeaways

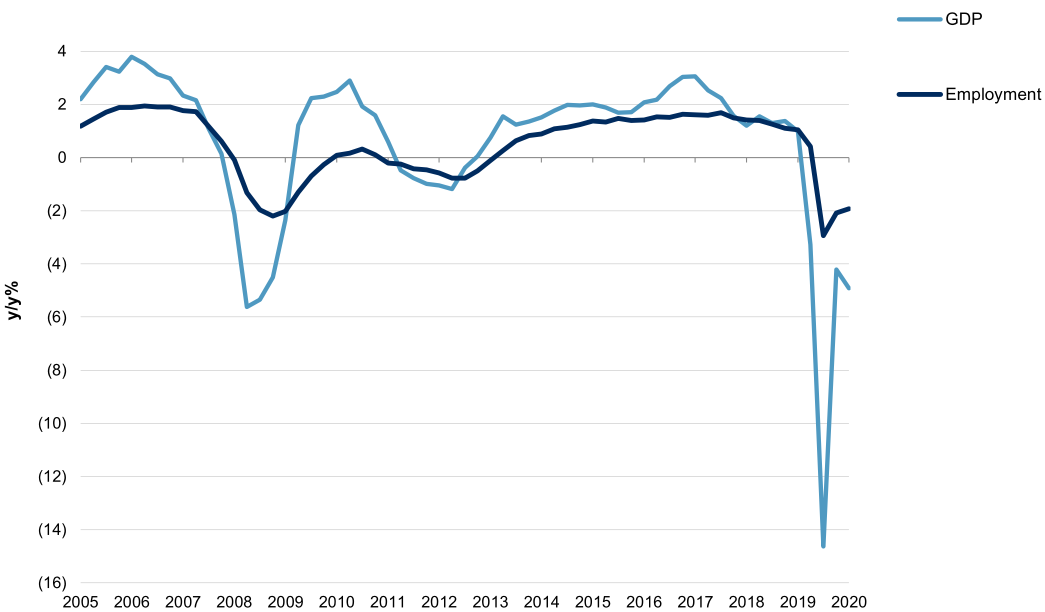
- The employment recovery should be faster than after the global financial crisis. That's because job losses in 2020 were not linked to economic imbalances and are less skills-specific than manufacturing jobs lost in 2008-2009.
- Short-time work schemes have worked well at cushioning the European labor market.
- Plus, structural reforms over the past 10 years have also made labor markets more responsive to growth in Europe--especially in Spain, but also in France and Italy.
- We think wage growth is unlikely to decline by much in a fast jobs recovery but is likely to hit a ceiling because of the shock to firms' productivity.

Short-time work schemes and bankruptcy filing delays in Europe have cushioned the impact of the pandemic on the labor market. Employment in the eurozone was about 60% less sensitive to the COVID-19 crisis than the financial crisis (see chart 1).

Despite a steeper contraction in economic activity, the European labor market has fared similarly to the U.S. This is true when comparing unemployment rates and participation rates, but also if we assume that short-time work is hidden unemployment. The initial increase in the eurozone's unemployed and short-time workers combined was similar to that of U.S. unemployed, but the eurozone recovery was a bit faster (see the deviation from February in chart 2). By September 2020, the increase in the unemployment rate since the onset of the crisis was still higher in the U.S. than in the eurozone, even though the U.S. economy was just 2.8% smaller than before the pandemic in third-quarter 2020, compared with 4.3% for the eurozone.

Chart 1

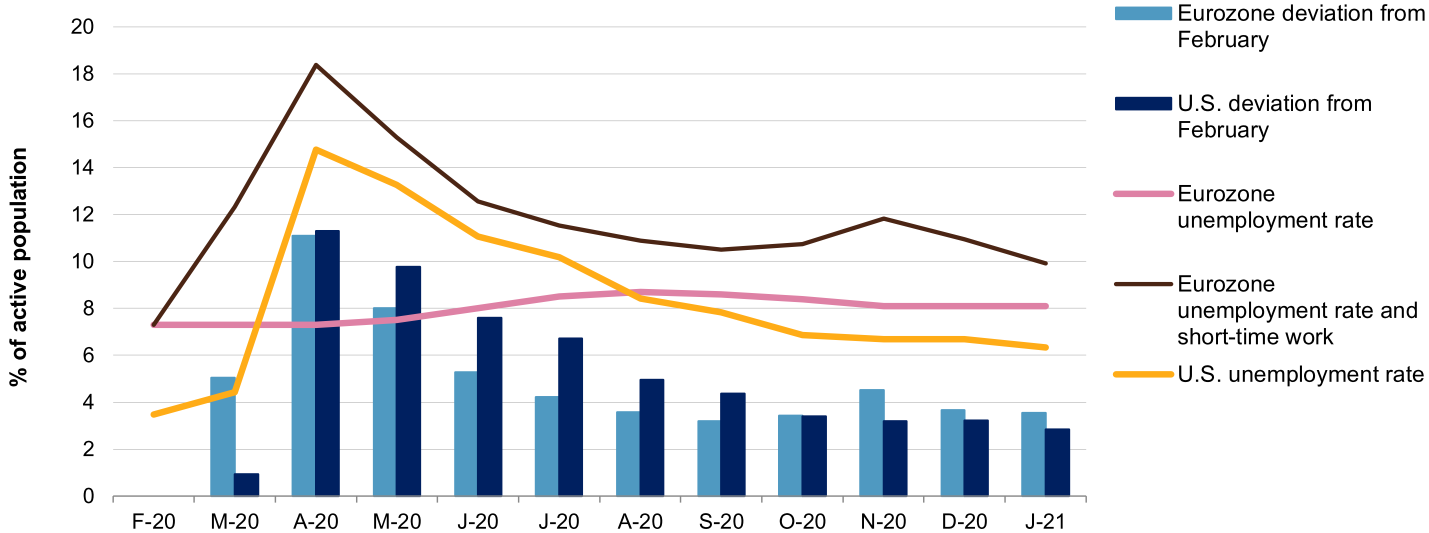
Eurozone Employment Held Up Well Compared To The Fall In GDP



GDP--Gross domestic product. Sources: Eurostat, S&P Global Ratings.

Chart 2

European Short-Time Work Schemes Have Better Cushioned The Labor Market Than In The U.S., Despite A Much Bigger Contraction Of Economic Activity

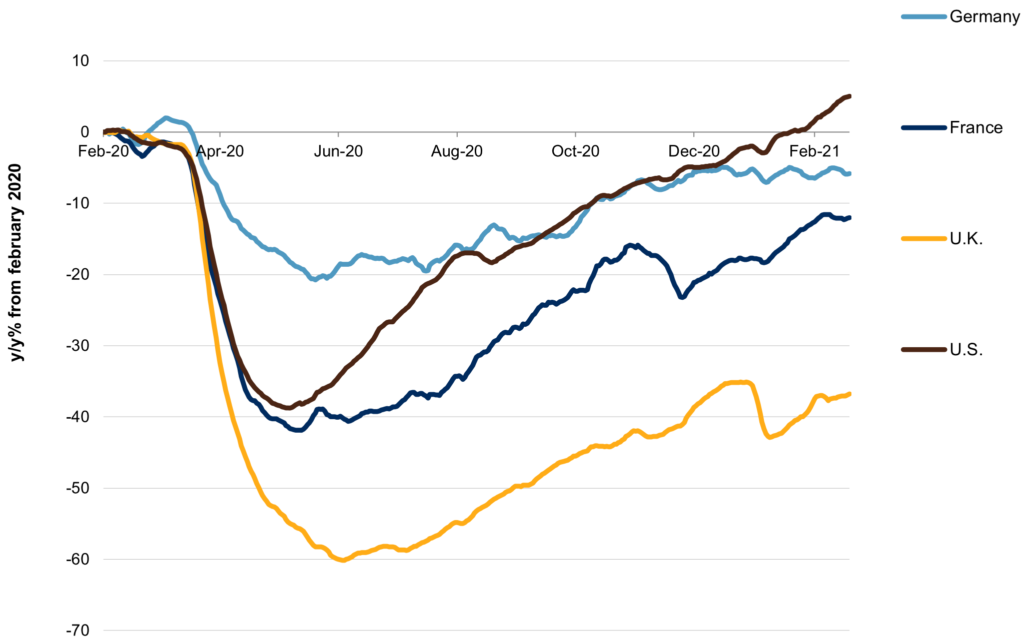


Sources: Eurostat, BLS, National ministries of Labor and statistical offices, S&P Global Ratings estimates.

Admittedly, the use of short-time work means the recovery in European labor markets will take more time to show on the unemployment rate than in the U.S., something that is already visible in the new job posting data (see chart 3). As activity recovers, firms are moving workers out of short-time work back to full-time--before looking for new hires. This dynamic was clear in third-quarter 2020. Hours worked recovered at a similar pace than GDP in the eurozone, while employment increased much less (see chart 4). By September 2020, when the recovery from the first COVID-19 lockdowns likely peaked, there was still some 2% of the European workforce on short-time work (see chart 5). It has since increased to about 3% in January on the back of renewed lockdowns. All in all, the 2020 absorption rate of short-time workers back into work suggests firms are likely to take two to three quarters to absorb this excess labor supply as the health situation normalizes and the economy recovers. In our December baseline, this means that employment will move back to the pre-pandemic level at the start of 2023, three quarters after GDP recovers (see "The Eurozone Can Still Rebound In 2021 After Lighter Lockdowns" Dec. 1, 2020).

Chart 3

Job Postings Have Recovered More Quickly In The U.S., While European Firms Are First Moving Short-Time Workers Back Into Full Time
Change in online job postings



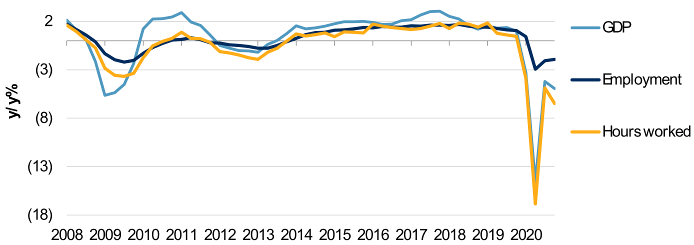
Sources: Indeed Hiring Lab, S&P Global Ratings.

On The Positive Side, The Scope For Much Higher Unemployment Is Also Limited

Even if short-time work schemes are phased out quickly--which does not seem to be the case--the unemployment rate would likely go up by about 2 percentage points or less. This is the equivalent of short-time work, when the economy was running at around 96% of its pre-COVID-19 levels in September.

Chart 4

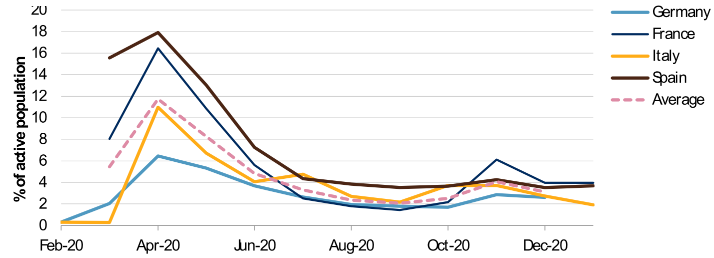
Short-Time Workers Have To Go Back Full Time Before Firms Look For New Hires



GDP--Gross domestic profit. Sources: Eurostat, S&P Global Ratings.

Chart 5

Short-Time Work Decreased To About 2% Of Employment By September 2020, 10 Percentage Points Below Its April Peak



The statistics are not entirely comparable by country so it should be read as an estimate. For Italy, we estimate that only 50% of authorized short-time working hours are actually used. The eurozone average shown here is a weighted average of the four largest eurozone economies.

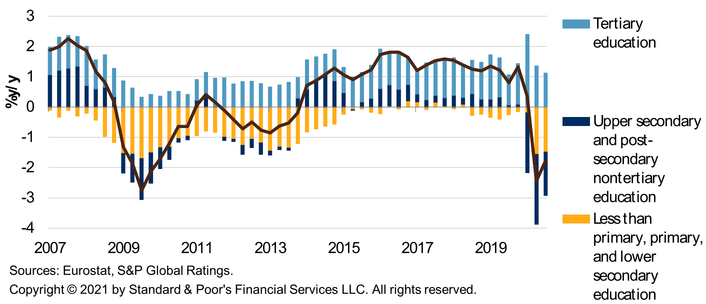
Sources: Eurostat, BLS, National Ministries of Labour and statistical offices, S&P Global Ratings estimates.

Job losses from the COVID-19 crisis are not very skills-specific and should be easier to fill once demand returns. Besides short-time work, the kinds of jobs affected by the current crisis are also likely to lead to a swifter recovery in employment than after the financial crisis. To start with, the crisis was driven by an exogenous health shock and not related to economic imbalances. This means that most jobs lost or put on hold through short-time work are viable jobs, unless restrictions to mobility become permanent. These are also mostly services-based jobs in leisure, tourism, transport, and trade activities. In contrast, manufacturing employment plunged following the financial crisis. As jobs in food services and tourism are less skills-specific than in manufacturing and those sectors are also less capital intensive, job openings should fill quickly once demand returns (see chart 6).

Additionally, the structural changes unfolding with this crisis have actually seen some sectors adding to their workforce. Information and telecommunication, utilities, real estate, and finance all employed more workers in third-quarter 2020 than a year earlier (see chart 6). These sectors have fared better throughout this crisis, especially the information and telecommunication sector, which was 2% bigger in third-quarter 2020 than a year earlier, suggesting job creation is likely to be permanent here.

Chart 6

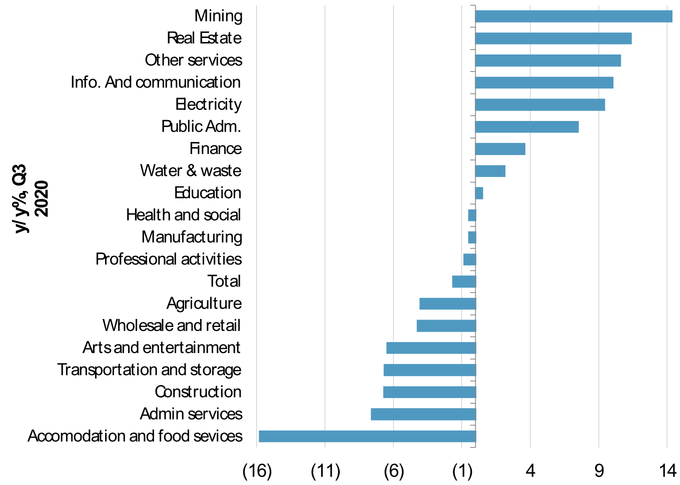
There Have Been More Job Losses Among Workers With Lower Educational Attainment



Sources: Eurostat, S&P Global Ratings.

Chart 7

Employment Has Increased In Real Estate, Information And Telecommunication, And Utilities



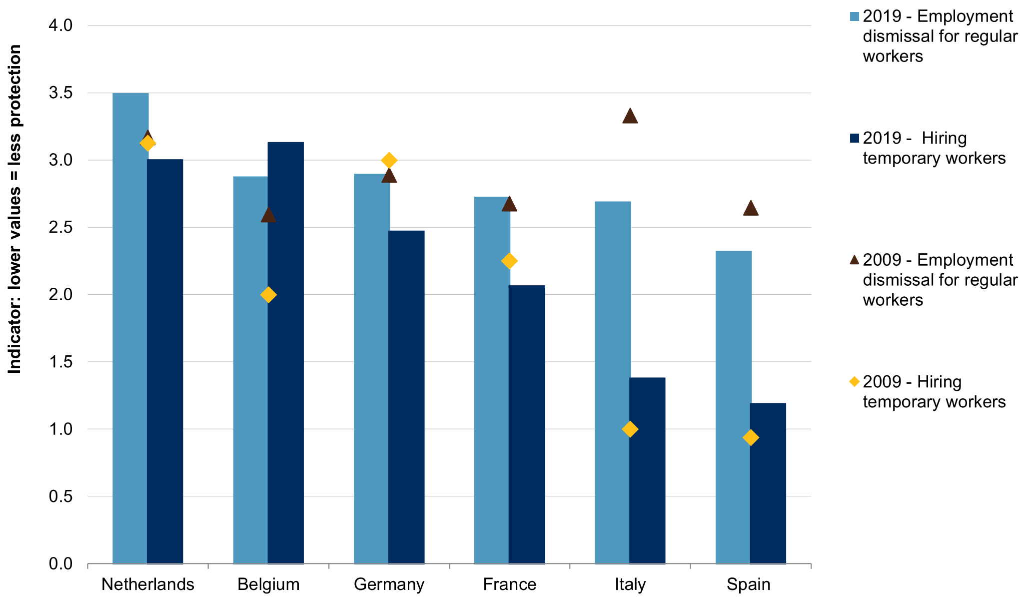
Sources: Eurostat, S&P Global Ratings.

Labor market reforms suggest job creation should be quicker as activity recovers

Structural reforms over the past 10 years have made labor markets somewhat more flexible in Europe. This means firms will be faster at creating jobs as their business expands again. This is especially true in Spain, as a result of more sweeping labor market reforms than elsewhere (see charts 8 and appendix). We find that labor market policies have more than tripled Spanish employment's responsiveness to GDP (see chart 9). The same doesn't appear to be true for the other largest EU countries, but this is partly linked to a later enactment of labor market policies in our sample. As such, there is some evidence that the rigidity of France's and Italy's job markets has decreased. The Banque de France finds that about one-fourth of job creation in France was linked to the government's tax credit for employment and competitiveness between 2015 and 2019. In Italy, employment protection for dismissal has also decreased with the 2014 Jobs Act but is taking more time to show in employment numbers as old contracts are still protected by grandfathering rights. Only Germany seems to have created relatively fewer jobs for each unit of output generated over the last decade. While some of this is linked to few changes in labor law, it also partly reflects the introduction of a minimum wage since 2015 and significant labor shortages prior to the pandemic, making it difficult for firms to hire workers.

Chart 8

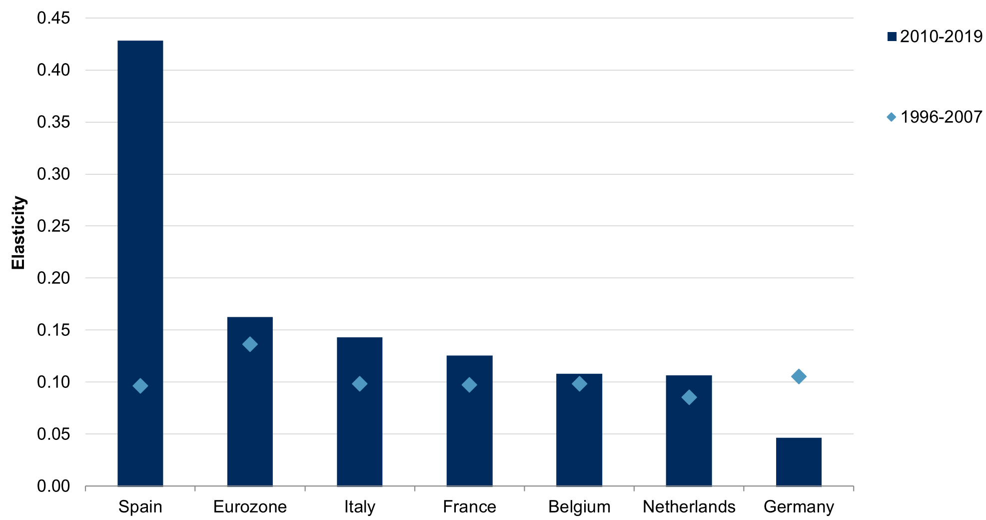
Employment Protection Has Decreased Across Most European Countries Over The Past 10 Years



Sources: OECD, S&P Global Ratings.

Chart 9

European Labor Markets Are More Responsive To Growth Than Before The Financial Crisis
Responsiveness of employment to growth



Coefficients of the Okun's law: Employment growth is estimated as a function of GDP growth and a lag of employment growth. We exclude data around the financial crisis and from 2020 to avoid introducing noise in the estimation and capture the post-crisis reform years. Source: S&P Global Ratings calculations.

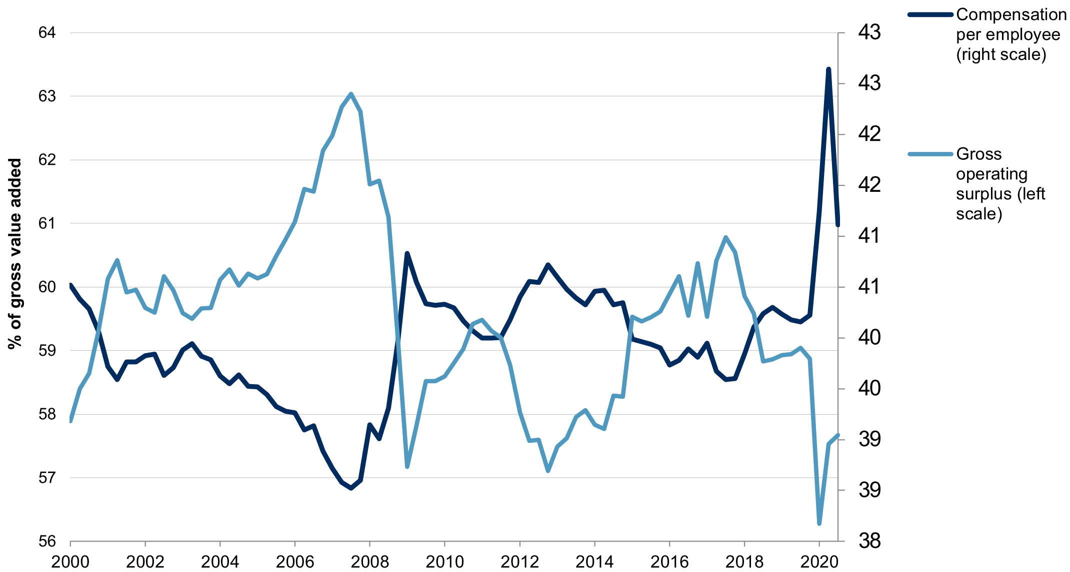
Fewer downward pressures on wages than after the last crisis as employment recovers more quickly

For now, the labor market recovery is still constrained by the pandemic as large parts of the eurozone are still subject to social-distancing measures or partial lockdowns. There are roughly 3 million more workers available to work than before the pandemic, putting downward pressure on wages. As such, negotiated wages have already adjusted downward, rising at their slowest pace in three years at a nominal 1.8% in 2020. This is why, even if inflation has picked up some steam in the past few months, owing to VAT hikes, a recovery in energy prices, raw material shortages, and a few other one-off factors, underlying inflationary pressures are weak and will likely remain so until employment recovers, sometime at the end of 2022 or beginning of 2023.

Even if we expect a faster rebound in employment than following the financial crisis, companies may want to restore profit margins before they start rewarding employees with higher compensation. As such, the sharp fall in revenues resulting from the crisis is not yet fully showing up on the payroll, with most workers being put on short-time work (see chart 10). This negative productivity shock in an environment of weak demand means that firms will have to restore their financial health by keeping labor costs in check, since it will be difficult for them to raise prices without losing market share. This supports our view that underlying inflationary pressures are set to remain much below the European Central Banks's "close to, but below 2% target" in the next three years.

Chart 10

Eurozone Firms Have Spent Much More On Compensating Workers Through This Crisis As They Remained On The Payroll, Leading To Very Low Profit Margins



Sources: Eurostat, S&P Global Ratings.

Appendix: Labor Market Reforms Of The Last Decade

Table 1

Key Reforms To Labor Markets In Spain, Italy, France, and Germany (2009 -2018)

Spain	Italy
1. Enhancing firm-level flexibility. • Firm-level collective agreements (e.g., wages and working hours) allowed to prevail over industry-level agreements (2012).	1. Reducing firing costs and labor market dualism. • Fornero reform (2012) rebalanced protection among contracts and strengthened the unemployment benefit system. • Jobs Act (2015) reduced firing costs for the new permanent contract, enlarged coverage of the unemployment benefit, and established a national agency to coordinate active labor market policies.
2. Reducing firing costs and labor market dualism. • Employment protection for permanent workers scaled back (2012).	2. Increasing labor force participation by women and older workers. • Parental benefits reviewed and more flexible work arrangements introduced as part of the Jobs Act (2015). • Compulsory parental leave for male workers was introduced in the 2017 Budget Law. • Compulsory parental leave for male workers was introduced in the 2017 Budget Law. • Fornero reform of pensions (2011) increased the retirement age.
3. Increasing labor force participation by older workers. • Pension reforms (2011, 2013): increase in the retirement age, restricting access to early and partial retirement, and a sustainability factor curtailing the initial pension benefit.	3. Collective bargaining framework reform - Patto per la Fabbrica (2018). • Develop collective bargaining on nonwage issues including welfare benefits, training and skills, workers' involvement in firms' management, etc.
4. Retraining workers to reduce labor market duality. • Youth guarantee eligibility criteria extended (December 2016). • Promotion of vocational training and apprenticeships (2015). • Promotion of vocational training and apprenticeships (2015). • Strengthen job search support to the long-term unemployed (December 2016).	4. Active labor market reform (2018). • Citizenship income scheme. • Increased financial resources for the Public Employment Services and National Agency for Active-Labor Policies. • Increased financial resources for the Public Employment Services and National Agency for Active-Labor Policies.
5. Action Plan for Youth Employment (2018). • Labor market integration of young people, focusing on digital skills and adaptation to tech change.	5. Proposed termination of the 'quota 100' pension scheme that originally reduced retirement age (2020).
6. Introduction of the 2019-2021 ReincorporaT plan. • Additional resources to Public Employment Services. • Age threshold for eligibility for the unemployment assistance scheme for older unemployed persons was reduced.	
7. Changes to labor market regulation - collective bargaining system. • Reinstatement of the priority of sectoral collective bargaining over firm-level agreements. • Promote permanent contracts as the prevalent form of contract, including combating abuse of temporary and part-time contracts.	
France	**Germany**
1. Enhancing firm-level flexibility. • Expanding the areas negotiated at the firm level (but excluding wages) (September 2017).	1. Increasing labor force participation by women (on full-time basis) and older workers. • The federal government increased financial support for the expansion of childcare from €0.5 billion in 2014 to €2.5 billion by 2016. • Pension reform in 2016 incentivized longer working lives.

Table 1

Key Reforms To Labor Markets In Spain, Italy, France, and Germany (2009 -2018) (cont.)

2. Reducing firing costs and labor market dualism. • Capping compensation for unfair dismissals, reducing time for labor court appeals, and simplifying the rules for collective dismissals (September 2017). This encourages hiring via permanent contracts by removing legal uncertainties.	2. Liberalizing some regulated professions. • 2016 National Action Plan on access to and practice of regulated professions.
3. Liberalizing some regulated professions and working hours. • Macron Law (2015).	3. Brückenteilzeit (the right to part-time work for a temporary period of time) came into force (2019). • Workers with at least six months of service can apply for a 1-5 year temporary period of part-time work.
4. Streamlining social discussions. • Rebsamen Law (2015).	5. More funding provided for the integration of the long-term unemployed into the labor market (2020).
5. Increasing labor force participation by older workers. • Pension reforms: increase in the retirement age (2010) and longer contribution period for full pension (2014).	6. Improving basic pensions (2020). • Introduction of a basic pension (Grundrente).
6. Boost jobs creation specifically in low-skilled category (2019). • Conversion of CICE (tax credit for competitiveness and employment) into a cut in employer social security contributions. • Further cuts on those payable on the SMIC minimum salary.	
7. Enhancing job flexibility and security (2019). • Changes to labor code, vocational training and apprenticeships, and unemployment insurance.	

Sources: European Commission, IMF, S&P Global Ratings.

Related Research

S&P Global Ratings research

- The Eurozone Can Still Rebound In 2021 After Lighter Lockdowns, Dec. 1, 2020
- European Short-Time Work Schemes Pave The Way For A Smoother Recovery, May 20, 2020

Other research

- Aldama, P., Cochard, M., Ouvrard, J.-F. (2020), Les politiques économiques ont contribué aux fortes créations d'emplois en France de 2016 à 2019, Le Bulletin de la Banque de France, No. 231: Article 6
- Bossler, M. and Gerner, H.-D. (2019), Employment Effects of the New German Minimum Wage: Evidence from Establishment-Level Microdata, Sage Journal, Vol. 73, Issue 5, 2020