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# Eurozone Watch

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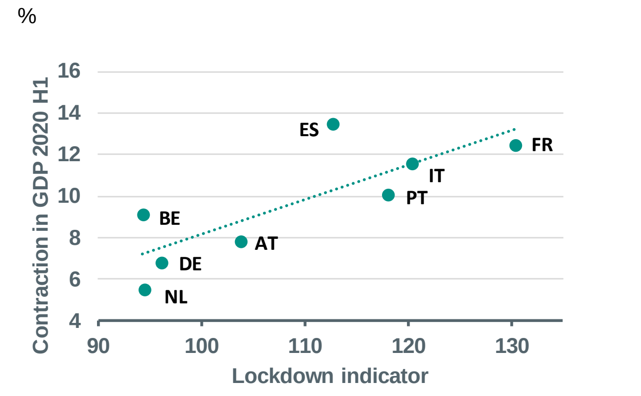
## Recovery Fund repairs only a bit of the blow to the labour market

- **The eurozone labour market has deteriorated at an unprecedently fast pace during the pandemic…**
- **… with the rise of the unemployment rate reflecting only a small part of the underlying deterioration in the labour market**
- **Broader indicators of labour market slack are rising much faster than the unemployment rate, while inactivity has increased**
- **On top of that, a large proportion of employed people currently are in temporary unemployment schemes and could still lose their jobs eventually**
- **Supporting economic growth and job creation is a major motivation behind the design of the EU Recovery Fund, with its allocation key largely based on past levels of GDP per capita and the unemployment rate**
- **Our calculations suggest that the current allocation under the Recovery Fund will support the economies in the periphery of the eurozone the most …**
- **…. yet, the funds are expected to heal only a fraction of the blow that the pandemic has given to the eurozone labour market**

### The blow to the labour market

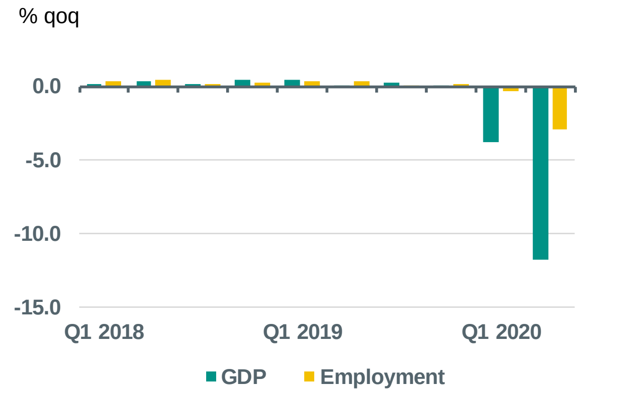
The eurozone economy tumbled into a deep recession in the first half of this year. GDP contracted by 3.7% qoq in Q1 and by another 11.8% in Q2. The size of the collapse in the various member states was largely driven by the strictness of the lockdown measures during the Covid-19 crisis (see graph below). Meanwhile, employment shrank by 2.9% qoq in Q2, following -0.3% in Q1. This implies that during the first half of 2020, more than 5 million jobs were lost in the eurozone. The fact that employment was much more resilient than GDP implies there was an exceptionally large drop in production per employee during the economic downturn. To compare, if GDP per employee had remained constant during 2020Q1-Q2, around 19 million jobs would have been lost. This drop in GDP per employee can partly be explained by the wide use of government subsidised short-time work schemes (STW). STW is designed to allow companies to temporarily reduce the number of working hours of employees (often to zero) while keeping them on the payroll. The government reimburses the companies what they have paid to these employees, which often is around 70-80% of their normal hourly pay. According to the methodology used by national statistics bureaus, all persons that are in STW are recorded as being employed, even when working zero hours.

**Lockdowns and contraction in GDP in 2020 H1**




Source: Thomson Reuters Datastream; Eurostat; Oxford Stringency Index

**Employment and GDP growth**

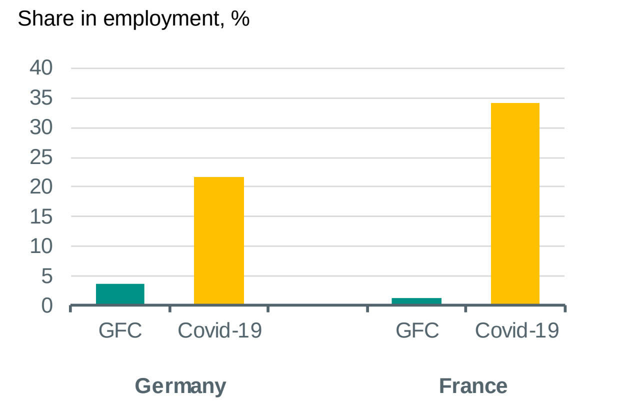



Source: Thomson Reuters Datastream, ABN Amro Group Economics

## Short-time work schemes have cushioned the drop in employment

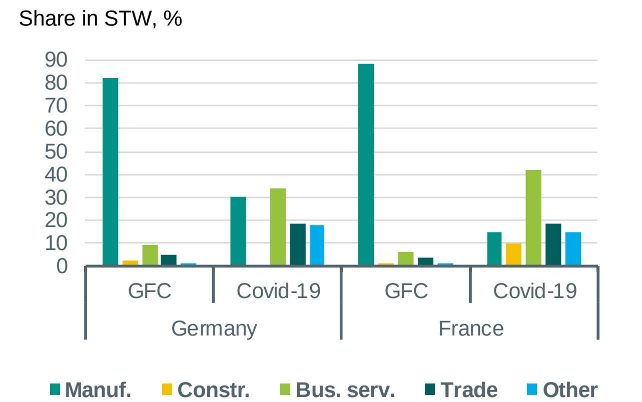
Data and estimates from national statistical bureaus, the OECD and the ECB show that at during the peak of the Covid-19 crisis (April-May) roughly 20% of all employed people were in STW in Germany and Spain, while in Italy and France this share was even around twice as high (35-40%). In numbers, this means that in these four largest eurozone countries in total more than 25 million people were in STW in April-May. In Germany, the share of STW in total employment during the Covid-19 crisis was around five times higher than during the peak of the Global Financial Crisis (GFC), while in France only around 1% of total employment was in a STW during the GFC, versus around 35% during Covid-19. Another major difference between the GFC and Covid-19 is that during the GFC almost all short-time workers were employed in the manufacturing sector, whereas during Covid-19 this was much more equally spread between manufacturing and services.

**Short-time work schemes versus GFC**




Source: Ifo Institute, DARES, OECD, ABN Amro Group Economics

**STW per sector, GFC versus Covid-19**




Source: OECD, ABN Amro Group Economics

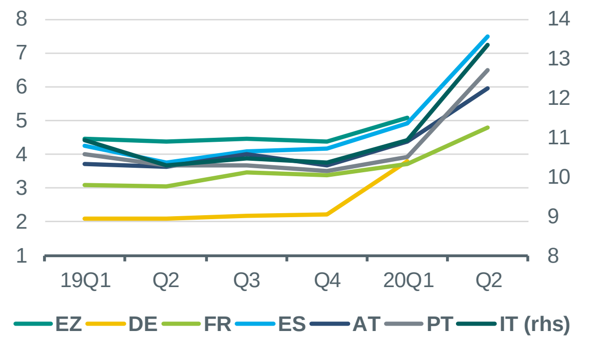
Since the end of the hard lockdown (which was around mid-May in most eurozone countries), the number of people in these schemes has declined. Nevertheless, recent data from Germany's Ifo Institute and France's DARES show that in Germany 11% of all employees (3.7 million people) still were in STW in September (21% of all employees in industry and 12% of all employees in services). In France the share of employees in STW still was around 9% in July (2.4 million people). The break-down into detailed data in Germany and France shows that the share of STW in total employment was large in the services sector as well as in manufacturing in the months following the end of the lockdown. The sector with one of the highest shares of employees in STW was hospitality (in each country around 35% of all employees in the sector), which is no surprise as activity in this part of the economy has remained depressed by social distancing measures and/or restrictions on international travel even after the strictest lockdown measures were lifted. However, large shares of STW could also still be found in car manufacturing (around 30% of employees in Germany and around 40% in France) and transport & storage (around 15% in Germany and around 20% in France). In Germany's metal industry more than 40% of all employees were in STW in August and in mechanical engineering 31%. The fact that STW schemes were still widely used in these parts of Germany's manufacturing sector, which have neither been subject to strict lockdown measures nor are limited by social distancing or limitations to international travel, suggests that the use of the STW represents some hidden unemployment. This means that there is a high probability that a significant proportion of these employees will lose their jobs after all in the coming months.

## Broader definition of labour market slack has jumped higher

Another source of hidden unemployment in the eurozone consists of people that are without a job but do not meet the strict definition of unemployment that is used by statistical bureaus in the eurozone and by Eurostat (people that are without work, *and* are available to start working withing the next two weeks *and* have also actively searched for work in the last four weeks). Not all major countries have reported a full set of labour market data for Q2, but in the ones that have (e.g. France, Italy, Spain, Austria and Portugal), the number of people that are without a job and do not meet both the strict conditions to be registered unemployed (searching *and* available) but only one of the two has jumped higher in the first half of this year. These people are marginally attached to the labour market and very close to officially being registered as unemployed. As a share of the labour force, the share of marginally attached persons increased by 1.4 percentage points (almost 400,000 people) in France between 2020Q2 and 2019Q4, by 3pps in Italy and Portugal, by almost 3.5pps (800,000 people) in Spain and 2.5pps in Austria. People that are marginally attached to the labour market represent an important part of labour market slack. Including the marginally attached to the official eurozone unemployment rate would raise this rate from its current level of close to 8% to approximately 10.5% according to our calculations.

**Marginally attached to the labour market**

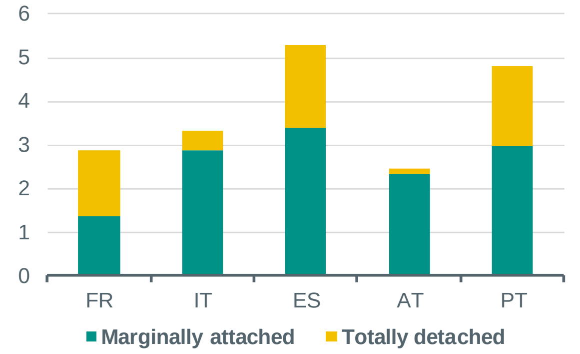
% extended labour force




Source: Ifo Institute, DARES, OECD

**Inactivity has jumped higher during the pandemic**

% of labour force, change 2019Q4-2021Q1 in pps




Source: Thomson Reuters Datastream

## Rise in unemployment has been limited by people leaving the labour force

A final source of labour market slack is that a large number of people have actually left the labour market and have become totally detached, i.e. they are neither working, *nor* unemployed, *nor* marginally attached to the labour market. For instance in

France around 400,000 people have left the labour market and in Spain around 450,000. If these people do not re-join the labour market to become employed, income per capita in that country will have become permanently lower.

## EU Recovery Fund for sustainable and resilient recovery and job creation

On July 21st, EU-leaders reached agreement on a Recovery Fund of EUR 750bn. Its main component is the Recovery and Resilience Facility (RFF), consisting of EUR 312.5bn in grants and EUR 360bn in loans, which will be directly distributed to European sovereigns. The remaining EUR 77.5bn will be distributed via EU-programmes. The Recovery Fund's aim is to set the EU on the path to a sustainable and resilient recovery, and to create jobs.

The Recovery Fund, part of the EU's multiannual budget for 2021-2027, will be frontloaded, meaning that the majority of funds will be allocated within the next few years. For EUR 312.5bn in grants under the RFF, the EU agreement includes a strict timeline: 70% of the grants will be committed in 2021 and 2022 and the remaining 30% in 2023. Member states need to submit national reform plans for 2021-2023 on 30 April 2021 the latest, and financial support will be disbursed upon completion of the set targets and milestones. Although no timeline has been agreed for the additional EUR 77.5bn in grants and EUR 360bn in loans, we assume that these additional grants and loans will be frontloaded accordingly.

**Estimated grant allocation and loan take-up Eurozone under EUR 750bn Recovery Fund**

*Grants*

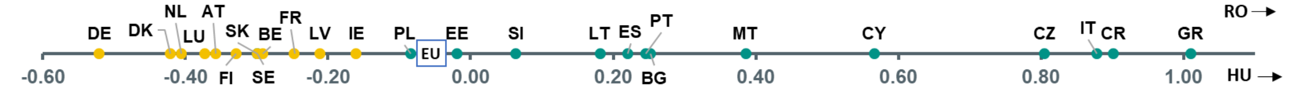
70% of the grants under the RFF will be committed in 2021 and 2022 based on an allocation key consisting of population and GDP per capita in 2019, and the average unemployment rate over 2015 to 2019. 30% of the grants under the RFF, committed in 2023, will be allocated according the EC's key, but with 'the unemployment criterium replaced, in equal proportion, by the loss in real GDP observed over 2020 and by the cumulative loss in real GDP observed over the period 2020-2021 and will be calculated by 30 June 2022', according to European Council's conclusions. To estimate the potential allocation of grants in 2023, we have created an allocation key with expected real GDP losses according to the EC Spring Forecast, to proxy real GDP loss over 2020 and accumulated real GDP loss over 2020 and 2021. We apply this method to the full EUR 390bn in grants under the Recovery Fund, and judge that EUR 303bn of the grants will be allocated to the Eurozone.

*Loans*

When the EU accesses the capital market to raise funding to finance the EUR 750bn Recovery Fund, it benefits from its triple-A credit rating. The EU plans to issue in different maturities, ranging from 3y to 30y, with its current 10y yield at around -0.18%. Funds are subsequently lent to member states against almost the same favorable terms. RFF regulation states that 'costs related to the borrowing of funds for the loans ... shall be borne by the beneficiary member states', meaning that the EU will likely, just as ESM, add a service fee, covering its operational costs, margin and commitment fee to its base rate, with the latter being the interest rate against which the EU can fund itself in the market. As a result, we expect the effective 10y interest rate charged to borrowing member states to be several basis points above -0.18%, making it only attractive for 14 out of the 27 member states to make use of Recovery Fund loans. In addition, we assume that those member states will each borrow the maximum allowed amount of 6.8% of their GNI. This results in total usage of about 81% of all available Recovery Fund loans across the EU, of which we expect EUR 244bn to be requested by the Eurozone.

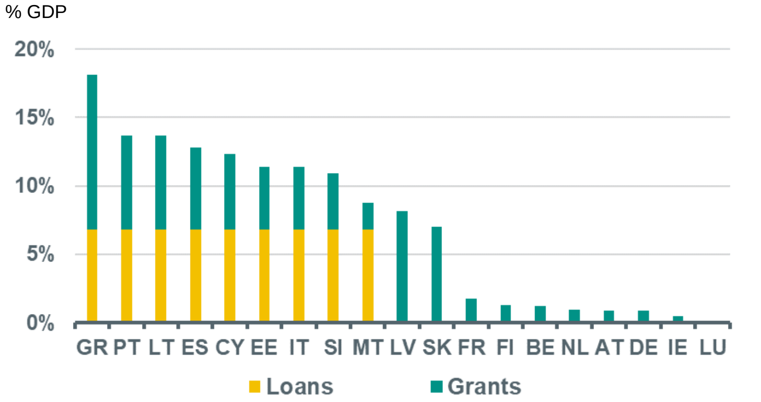
**We expect only 14 out of 27 EU member states to request Recovery Fund loans**

% yield on 10y government bond




Source: ABN AMRO Group Economics, Bloomberg

Gross grant and loan allocations for Eurozone countries




Source: ABN AMRO Group Economics, European Commission

## Number of reasons to be cautious on Recovery Fund growth impact

Our estimates clearly show that the periphery (e.g. Greece, Portugal, Spain, Italy) will be supported most by the Recovery Fund. For instance, as a percentage of GDP, Greece will receive 18%. However, we judge that there are several reasons to be cautious on economic growth expectations triggered by the Recovery Fund. For example, our analysis of the loan take-up, as set out in the box above, results in a loan take-up of 81% of all available loans. In addition, recent developments suggest that a significant part of the allocation of the Recovery Fund will be used to finance existing plans. Germany and France, the member states that took the lead in shaping the Recovery Fund, already gave an insight into their use of the funds. Indeed, at the end of August, Germany announced it will use its allocation (in the form of grants in this case) to finance measures that were part of Germany's earlier announced recovery plan, which would reduce the extent of the rise in its public debt. In addition, on September 3, France revealed a EUR 100bn fiscal stimulus, of which EUR 40bn will be financed by Recovery Fund receipts (again grants). Of this EUR 100bn stimulus, EUR 20bn will be spent on corporate tax cuts, and of the EUR 25bn used for supporting jobs and training, part will be used to expand a short work scheme, which would safeguard income for workers required to work part-time. Finally, we judge that national reform plans will only potentially impact a small proportion of the allocation to member states. The EC states that it will only disburse allocations once member states have satisfactorily implemented the milestones and targets set out in the reform plans. However, Germany and France have already signaled that this condition is not seen as a strict condition. More generally, it is unclear to what extent the funds will be used in an efficient way.

## We expect Recovery Fund to lift Eurozone GDP by around 1.1% by 2024 …

Because of previously mentioned reasons, we expect the additional impact of the Recovery Fund on economic growth in the eurozone to be moderate. From the EUR 390bn in grants and EUR 360bn in loans, we expect that EUR 303bn and EUR 244bn, respectively, will be allocated to the eurozone by end 2023. We estimate 0.4%, 0.4% and 0.3% additional annual economic growth in 2021, 2022 and 2023, respectively, or around 1.1% by 2024.

## … which would result in around one million extra jobs

The historical pattern of GDP growth and employment growth shows that during a longer period without any significant economic shocks, GDP tends to grow somewhat faster than employment growth (by around 0.6pps per year on average). If we assume that productivity growth is in line with this historical average during the years 2021-2023, the extra GDP growth that would result from the Recovery Fund, should result in extra employment growth of merely around 1 million jobs. This amount of extra job growth is roughly equal to the number of jobs that on average were created in total during two consecutive quarters in the past couple of years.

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