

Hot Topic - Mature Economies

March 29, 2017

Eurozone unemployment rate back to pre-crisis level in 2018

The 2007-08 financial shock and European sovereign debt crisis induced a large deterioration in the Eurozone (EZ) labor market during the past decade, with aggregate unemployment rate increasing from a trough at 7.2% in March 2008 to a peak at 12.1% in May 2013. The severity of the crisis has created a vicious circle where the size and time-duration of unemployment reduces confidence and income, thus weighing on consumption and investment, and finally reducing further the potential for growth acceleration.

EZ unemployment rate fell below 10% in 2016Q4 for the first time since 2009, and continued to decline to 9.6% in January 2017, in the background of more favorable economic conditions in the Eurozone. GDP growth grew on average by +1.9% in 2015 and +1.7% in 2016 and our datamining models foresee a GDP growth close to +2.0% in 2017 and +1.8% in 2018.

A key question for EZ outlook is therefore on the likelihood that the current growth would be enough to revert the previous vicious circle and initiate a symmetric positive acceleration process.

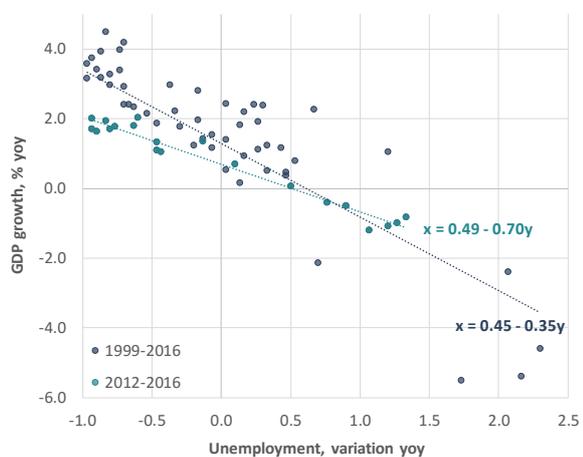
To answer the question, we use a quantitative estimation of Okun's Law for the EZ.

The Okun's Law was named after US economist Arthur Okun estimated the relation between unemployment and deviation of growth from potential in 1962.

For the EZ, this relation has substantially varied across time: the Okun coefficient – which measures the effect of a +1% change in the GDP on the unemployment rate – is estimated at -0.36 over the whole 1999-2016 period and declines at -0.70 when focusing on a more recent period, from 2012 to 2016. In other words, while the required GDP growth to stabilize unemployment rate was equal to 1.3% over the whole period, it has declined to 0.7% over the recent period. This result can partly be related to structural labor market reforms aimed at increasing labor market flexibility and reducing nominal rigidities, as in Spain and Italy.

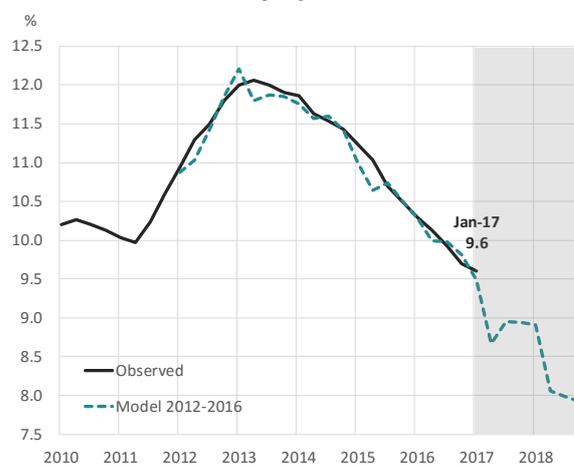
Based on our GDP growth scenarios for 2017 and 2018, the unemployment rate will significantly decline to reach a level close to 8% by end-2018, comparable to pre-crisis levels. A "virtuous" circle is plausible, potentially pushing EZ growth further up, though not yet leading to wage acceleration.

Eurozone Okun's law



Source: TAC ECONOMICS, Eurostat

Eurozone - Unemployment rate scenario



Source: TAC ECONOMICS, Eurostat