QNB Economics
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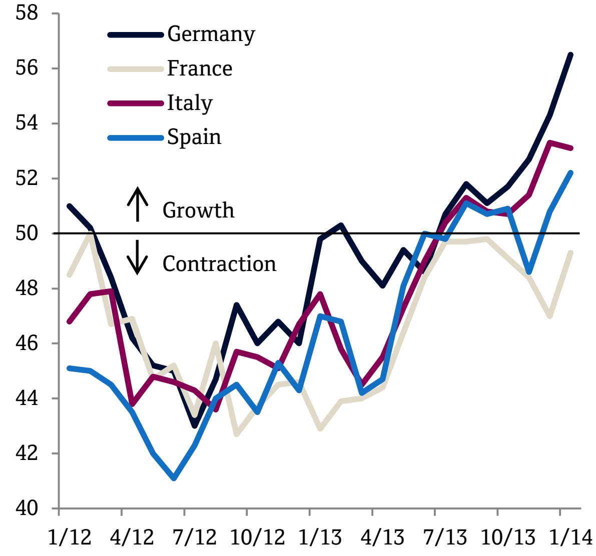
Higher Growth and Lower Unemployment Will Be Essential for the Future of the Eurozone

The Eurozone is finally coming out of recession. After the Great Recession of 2009-10 and a second recession in 2011-13, most indicators point to a gradual recovery of economic growth in 2014. However, the last two recessions have resulted in some of the highest unemployment rates on record in a number of Eurozone countries. Without higher growth and lower unemployment, the future of the Eurozone may be in jeopardy as the social fabric keeping the Eurozone together may unravel.

The latest numbers from the Eurozone have been encouraging. Real GDP growth was 0.3% in Q4 2013, following positive readings in the previous two quarters. Furthermore, the purchasing managers' indexes (PMIs) for the manufacturing sector of the largest economies in Europe all signaled stronger growth in January 2014, with the exception of France. The good news is that the higher growth momentum includes periphery countries like Spain, which was on the brink of a financial crisis in 2011-12. Accordingly, QNB Group projects economic growth for the Eurozone of 0.5%-1.0% in 2014, with somewhat stronger growth (1.0%-1.5%) in 2015.

The last two recessions, however, have left a long scar in the social fabric of selected European economies. Overall, the Eurozone unemployment rate reached the highest level on record in October 2013 at 12.2%, according to Eurostat. Almost half of those without a job have been unemployed for more than a year. In addition, nearly a quarter of Europeans under the age of 25 are without a job. In Italy and Portugal, more than a third of under-25s are unemployed. In Greece and Spain, that numbers is more than one half. Without a resolution of this job crisis in Greece, Italy, Portugal and Spain, the social stability of the Eurozone is likely to come under pressure.

Selected Eurozone PMIs, 2012-14
(Index)



Source: Markit Economics

What can be done to address this Eurozone job crisis? The short answer is higher and more labor-intensive growth. With higher economic growth, the economies in the periphery of the Eurozone will be able to create jobs and start reducing the large pool of the unemployed. More importantly, if those jobs are in labor-intensive industries, like services, for each percentage points of higher growth, there will be a large number of jobs being created.

Higher and more labor–intensive growth in the periphery of the Eurozone cannot be achieved though through higher government spending. So often in the past, the governments of Greece, Italy, Portugal and Spain, expanded their government payroll in order to reduce unemployment. This led to an inefficient bureaucracy and high government debt. This time around, instead, the private sector can be the only engine of growth as the public sector is forced to reduce public spending under EU stability rules to keep debt sustainable.

The German experience during the last decade provides an important lesson on how to fight unemployment for the Eurozone periphery. Following reunification, Germany faced significant economic challenges. It had lost competitiveness to Eastern Europe and its labor markets were too rigid to respond to the changing economic landscape. The German government responded to this challenge by instituting far-reaching labor-market reforms (the so-called Hartz IV reforms) starting in 2005 that reduced unemployment benefits, made labor contracts more flexible and forced the unemployed to accept any type of legal job. The results of these reforms have been a dramatic fall in the cost of labor in Germany, making the economy more competitive within Europe and globally, and a significant reduction in general and youth unemployment. The results today speak for themselves. In December 2013, Germany recorded one of the lowest unemployment rates (5.1%) in the region according to Eurostat, notwithstanding a large influx of job seekers from other regions of Europe. At the same time, the German economy remains the main engine of growth in the Eurozone.

Similar reforms are now essential also for the periphery of the Eurozone. Without such reforms, economic growth will remain low and unemployment high. Over the medium term, this is unlikely to be sustainable on a social level and may lead to the unraveling of the economic and social ties that keep the Eurozone together.

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