

Will the German labor market remain tight?

Even though German unemployment figures have risen due to the weak economy, labor remains scarce in many areas. This is unlikely to change fundamentally in the coming years. This is because unfavorable demographics will cause the labor supply to fall significantly, which will probably only be partially offset by higher productivity or increased immigration. As a result, wages and thus consumer prices will rise more sharply and potential growth will continue to weaken.

Dr. Ralph Solveen AC

Weak economy weighs on labor market, ...

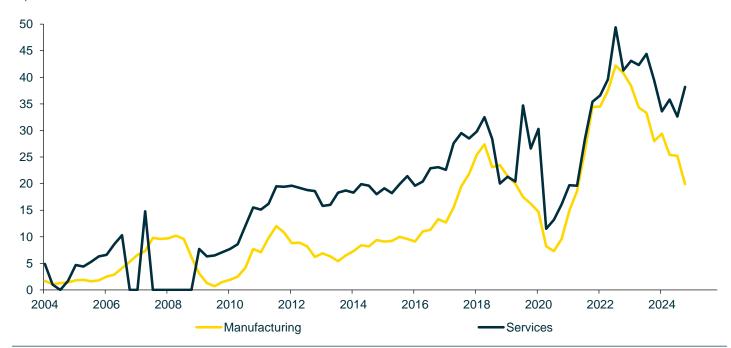
For several years, the labor shortage has been a major problem for German companies. It has probably been one of the factors why the German economy has underperformed the eurozone average in recent years. After five years with economic stagnation, the labor shortage now appears to be coming to an end. The number of unemployed has been rising gradually for almost three years and the number of people in employment has stagnated. In addition, various large companies have announced massive job cuts.

... but labor is still scarce in many areas, ...

However, labor is still in short supply in many areas. This is shown by the EU Commission's surveys. For example, the proportion of companies in the service sector where a shortage of labor is preventing an expansion of business activity has hardly fallen so far and remains well above its long-term average (Chart 1). In view of the problems in manufacturing, the labor shortage in this sector has decreased significantly over the past year and a half. But here too, it still affects more companies than for much of the past 20 years.

Chart 1 - Labor in the service sector still in short supply

EU survey, proportion of companies in Germany where a shortage of labor prevents an expansion of production or business activities, in percent



Source: S&P Global, EU Commission, Commerzbank Research

... as employment in the service sector continues to rise ...

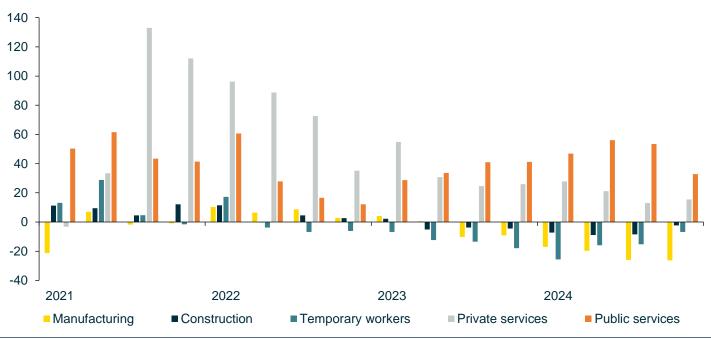
One reason for the ongoing shortage in labor is that employment in the service sector has risen until recently. This applies in particular to public administration and government-related sectors such as education and healthcare, where the demand for labor is hardly affected by the weakness of the economy. However, new jobs have also been created on balance in private services until recently



despite the rather weak economy (Chart 2). On the other hand, employment in construction and manufacturing has been falling for some time, with industrial companies probably first reducing their demand for temporary workers before cutting their core workforce.

Chart 2 - Employment in the service sector increased until recently

Number of employees subject to social insurance contributions, seasonally adjusted quarterly figures, change on previous quarter in 1000



Source: Federal agency for labor, Commerzbank Research

In the long term, employees will certainly switch between sectors with such a different employment trend. So far, however, many employees in manufacturing seem unwilling to do so, as a job in a service sector would not correspond to their skills and such a change would therefore be associated with lower wages. This is probably one of the reasons why the supply of qualified workers has not yet increased sufficiently for service companies as a result of job cuts in industry.

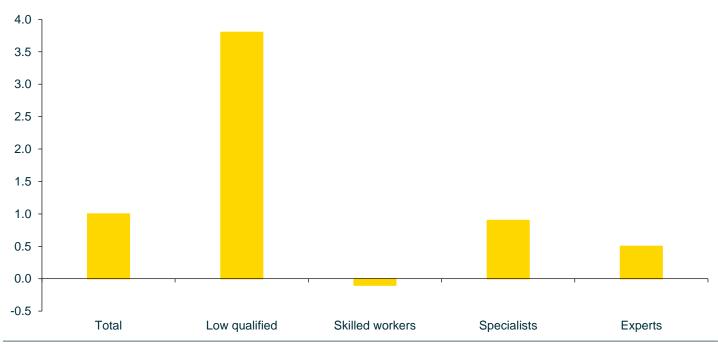
... and low-skilled workers in particular are becoming unemployed

In addition, unemployment has risen particularly among workers with low qualifications in recent years. Last year, the average unemployment rate for this group was almost four percentage points higher than in 2019, i.e. before the start of the pandemic and the prolonged economic crisis (Chart 3). However, this has not made much difference to the availability of labor, as there was no particular shortage in this area beforehand. In contrast, unemployment among highly qualified workers has increased significantly less, while the unemployment rate for "skilled workers" has even fallen slightly over the past five years.



Chart 3 - Unemployment rate increased mainly among low-skilled workers

Unemployment rate by level of qualification, change 2024 compared to 2019, in percentage points



Source: Federal agency for labor, Commerzbank Research

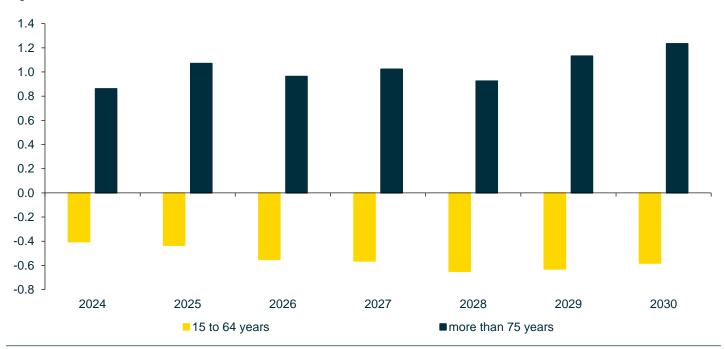
Unfavorable demographics depress labor supply, ...

In the longer term, too, there is likely to be a shortage of labor. In view of Germany's unfavorable demographics, the number of 15 to 64-year-olds, who are usually regarded as the "working age population", will decrease by more than 300 thousand or a good 0.5% per year by 2030 according to a projection by the Federal Statistical Office based on "moderate" assumptions for immigration (Chart 4).



Chart 4 - Fewer younger and more older people

Number of residents in Germany, year-on-year change in percent; projection by the Federal Statistical Office assuming moderate net migration



Source: destatis, Commerzbank Research

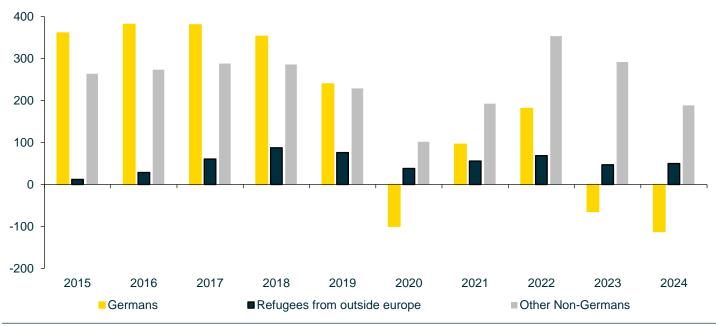
At the same time as the supply of labor is falling, the number of older people is increasing, which means that demand of private households is likely to shift towards labor-intensive services. Especially the demand for labor in the health and care sectors is likely to continue to rise massively in the coming years.

The demographic trend on the labor market is already making itself felt. This is because it has certainly contributed to the fact that the number of employees with a German passport has already fallen in the last two years. So far, this has been more than compensated for by foreign workers (including some refugees) (Chart 5). However, this reservoir is also likely to be finite in the event of a stricter migration policy.



Chart 5 - Number of German employees falls

Number of employees subject to social insurance contributions by nationality/status, year-on-year change in 1000, 2024: average January to September compared to annual average 2023



Source: S&P Global, Federal agency for labor, Commerzbank Research

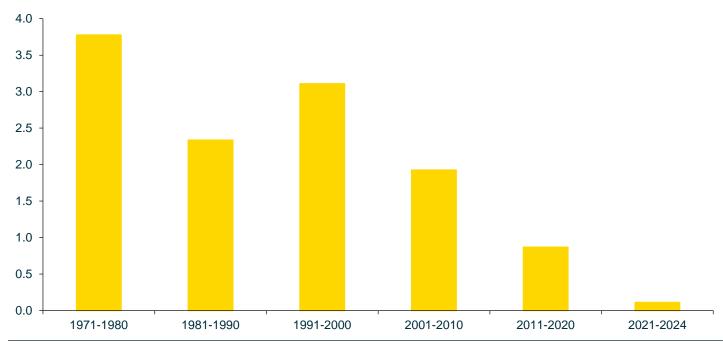
... and this can probably only be partially offset through "artificial intelligence", ...

This labor shortage is likely to be partially offset by other developments. For example, the lower labor supply could be compensated for by stronger productivity growth, with many hopes resting on "artificial intelligence". However, a look at the past offers a cautionary tale. Productivity growth has fallen significantly since the 1970s, and increasing digitalization has not fundamentally changed this trend (Chart 6). This is why "artificial intelligence" may increase productivity, but it is unlikely to compensate for the decline in the labor supply.



Chart 6 - Productivity growth has weakened significantly

Labor productivity (output per hour worked), year-on-year change in percent, average of the periods indicated; 2024: average of the first three quarters



Source: destatis, Commerzbank Research

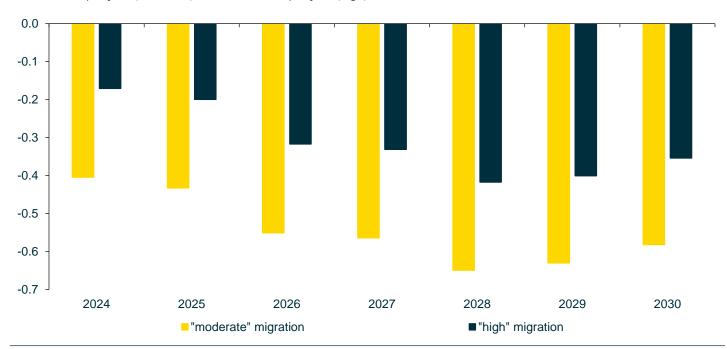
... increased migration, ...

Part of the decline in the labor force could also be offset by increased immigration of qualified workers. However, the projection presented above already assumes that annual net immigration will stabilize at around 250 thousand people p.a. in the coming years. An increase to 350 thousand would slow down the decline in the labor supply (Chart 7). To stop it completely, however, a steady net immigration of more than 500 thousand people per year would be necessary. Apart from the potential political consequences of such strong immigration, it is questionable whether Germany can attract so many qualified immigrants. After all, most other developed countries are also struggling with the same demographic problems.



Chart 7 - Significant decline in labor supply even with "high" net migration

Population aged between 15 and 64, change compared to previous year in percent; assumption. Decrease in positive net migration to 250 thousand per year (moderate) or 350 thousand per year (high)



Source: destatis, Commerzbank Research

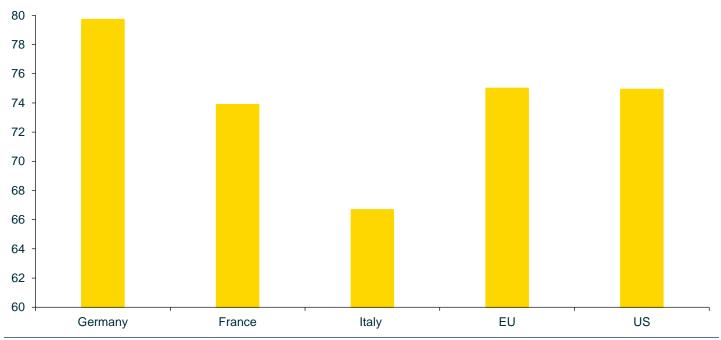
... and politics

Another way would be to mobilize more workers at home. In fact, politicians are discussing increasing the pressure on recipients of social benefits to take up employment. In addition, most election manifestos call for better childcare to make it easier for parents to take up employment. However, the participation rate in Germany is already comparatively high at just under 80% (Chart 8), and it is doubtful whether it will be possible to reduce the comparatively high part-time rate.



Chart 8 - Germany participation rate already high

Share of employees in the working-age population (15 to 64 years), in percent, figures for 2024 (EU: 2023)



Source: OECD, Commerzbank Research

Another approach would be to extend working life, which would also relieve the burden on social security systems. However, this is currently rejected by almost all parties, and it remains to be seen whether the additional incentives for pensioners to work longer being discussed can significantly slow down the decline in the labor supply.

On the other hand, the state could contribute to easing the labor market by not expanding the number of administrative employees as much as in previous years. A reduction in bureaucracy could ease the burden on the labor market, too.

The consequences: Stronger wage increases and weaker growth

The demographic decline in the labor supply may be slowed down by various measures and effects. However, this is unlikely to fundamentally change the emerging excess demand for labor. In order to bring the labor market back into balance, wages will therefore have to rise faster, which in turn argues for stronger inflation. At the same time, potential growth in Germany is likely to weaken further and approach zero in the coming years.



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