

The recent strength of the labour market and its impact on workers' consumption

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Rationale

Since the pandemic, the Spanish labour market has shown considerable strength, which has been conducive to a decline in the perceived probability of job loss among workers. This article evaluates the extent to which this may have had a positive impact on consumption (by reducing precautionary saving).

Takeaways

- The strength of the labour market and the rising share of permanent contracts have helped reduce workers' perceived probability of job loss. This lowers precautionary saving and raises household spending levels.
- Uncertainty regarding future labour income has a particularly strong impact on spending on durable goods, and an albeit smaller impact on other non-essential expenditure.
- The households whose spending on durables is most responsive to changes in uncertainty about future labour income are those that lack a minimum buffer of liquid assets to withstand a drop in income. This is observed most frequently among low-income and young households.

Keywords

Consumption, employment, uncertainty, precautionary saving.

JEL classification

D12, D14, E21.

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THE RECENT STRENGTH OF THE LABOUR MARKET AND ITS IMPACT ON WORKERS' CONSUMPTION

The Spanish labour market has shown considerable strength following the pandemic. The unemployment rate declined substantially between early 2021 and mid-2022, and has since tended to stabilise at levels below its historical average. Since late 2021 the reduction in unemployment has also moved in step with a rising proportion of workers on permanent contracts, a development apparently driven by the latest labour reform (see Chart 1).

The recent decrease in the unemployment rate and in the temporary employment ratio has helped reduce workers' uncertainty regarding their employment prospects. According to the results of the Consumer Expectations Survey (CES), conducted each month by the European Central Bank,¹ since early 2021 the average perceived probability of job loss among individuals in Spain has declined (see Chart 2). Although broad-based, this trend has been more pronounced among lower-paid, younger and female workers. Relative to wage-earners overall, temporary contracts, which are in turn associated with a higher probability of transition from employment to unemployment, are usually more prevalent among these groups.

The drop in the perceived probability of job loss since 2021 was initially due to the decline in the unemployment rate (fuelled, in turn, by the gradual normalisation of economic activity following the worst of the pandemic). However, more recently (since late 2021) the rising share of permanent contracts in total employment (up by 8.1 percentage points (pp) between end-2021 and March 2023) appears to have been a driving force behind this decline in the subjective probability of becoming unemployed.²

These labour market developments affect household spending decisions through adjustments in precautionary saving (see, for example, Carroll, Hall and Zeldes (1992) or Benito (2006)). In particular, when individuals perceive a higher probability of job loss (and, therefore, are more uncertain about their future income), they may opt to delay certain non-essential spending with a view to building up a savings buffer to help sustain their consumption levels should they lose their job and see their income decline. Conversely, a reduction in the perceived probability of job loss, such as the one observed in recent quarters, supports household spending by reducing workers' desired volume of precautionary saving.

The CES data can be used to analyse how the recent decline in the perceived probability of job loss has affected consumption. To this end, several estimates have been made for the period October 2020-April 2023 to explore the link between household consumption to income ratios for various expenditure items and a number of explanatory variables. Three such items are considered:

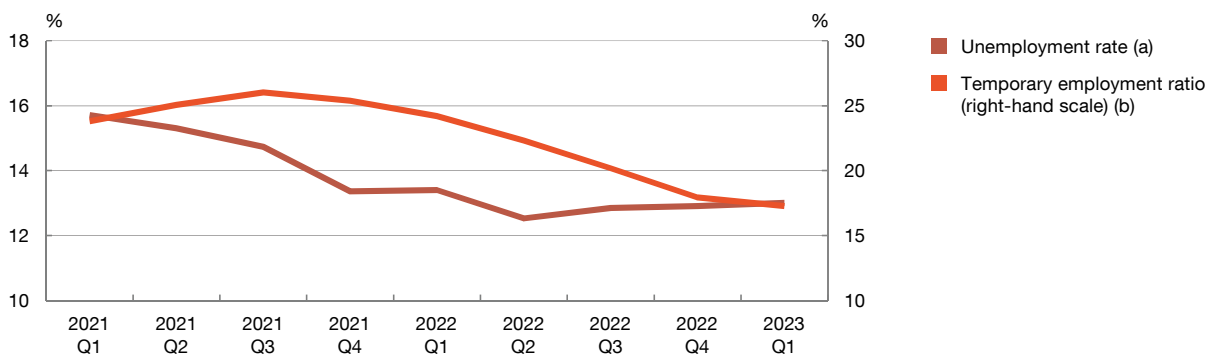
1 Although the survey is conducted monthly, some variables, such as the perceived probability of job loss, are reported quarterly. For more information on the survey, see Bańkowska et al. (2021) and Georgarakos and Kenny (2022).

2 It should be noted that permanent seasonal contracts accounted for a relatively high share (approximately 25%) of the increase in permanent contracts in 2022. These contracts entail a higher probability of transitioning to unemployment and, therefore, are associated with greater income uncertainty. For an analysis of how the transition from temporary to permanent contracts affects consumption, see Anghel, Barceló and Villanueva (2023).

Chart 1

Recent labour market developments

1.a Unemployment rate and temporary employment ratio



SOURCE: INE.

a Not adjusted for temporary layoffs.

b Percentage of total workers on temporary contracts.



(i) durable goods; (ii) hospitality, travel and transport services; and (iii) other consumption (which is more essential spending than the first two categories). The explanatory variables are the level of household income, the worker's age and their perceived probability of job loss. Controls are also included for household and time fixed effects.³

The findings, illustrated in Chart 3.a, confirm the existence of a negative correlation between the probability of job loss and household consumption to income ratios. Consumption adjusts to changes in uncertainty about future income, but not uniformly across expenditure items. Rather, changes in consumption patterns are concentrated on less essential items: non-essential services and also durable goods (a heading through which total consumption can be adjusted without entailing major changes in levels of well-being).⁴ In particular, in the face of a 10 pp reduction in the probability of job loss, the consumption to income ratio increases by 0.4 pp. Almost 45% of this increase is concentrated on spending on durable goods (0.17 pp), even though this amounts to a small percentage of total expenditure (10%, on average, between January 2022 and April 2023 in the sample used in this analysis). By contrast, spending on non-durables excluding spending on non-essential services, which accounts for the bulk of total expenditure (on average, 70% in the period analysed), is barely responsive to changes in job uncertainty. Indeed, in the face of such changes, adjustments in spending on non-durables (excluding spending on non-essential services) are not statistically different from zero for the usual confidence levels (90%-95%). Accordingly, the bulk of the impact of fluctuations in job uncertainty is

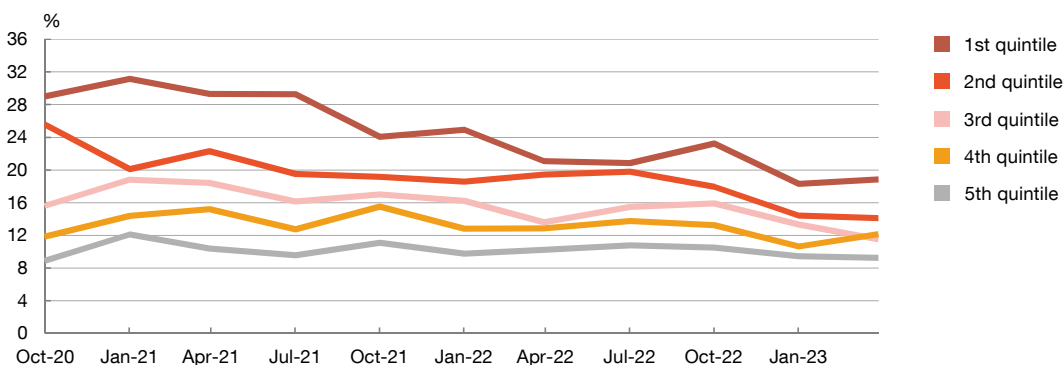
3 The CES only has data on a household's income level for the period in which it first takes part in the survey. Subsequent income developments are approximated based on changes in the respondent's labour income (in other words, the household income reported in the respondent's first round of the survey is adjusted based on changes in that household member's labour income). To avoid any potential distortion of the results, filters are applied to eliminate those observations corresponding to individuals who are, in all likelihood, not the household reference person.

4 In the case of consumer durables, which have a long lifetime, households can postpone their decisions to replace them without this having a major impact on their utility. Accordingly, this was the expenditure item that decreased the most during the 2008-2012 crisis, especially among those households whose reference person faced the greatest job insecurity, which led them to increase their precautionary saving at the start of the crisis. See Banco de España (2016).

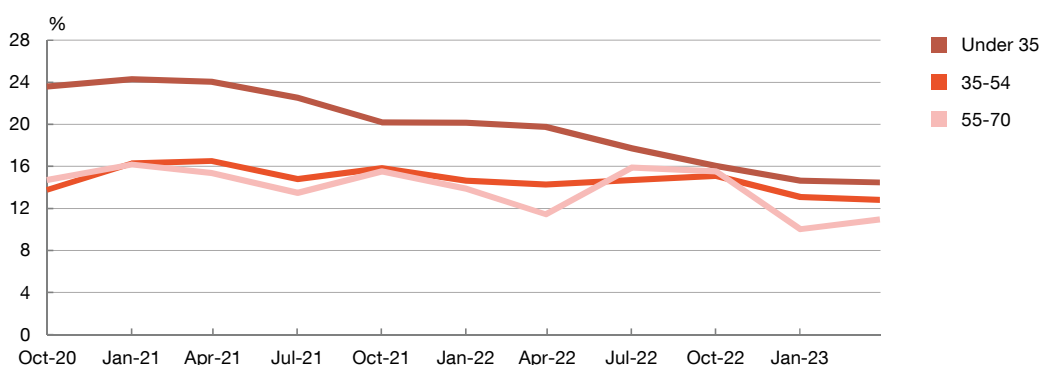
Chart 2

Perceived probability of job loss in the next three months. Average

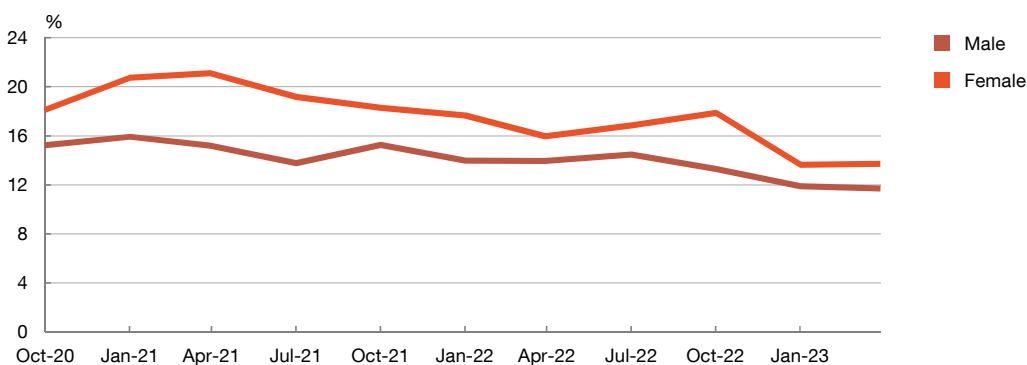
2.a By income quintile



2.b By age group



2.c By gender



SOURCE: Consumer Expectations Survey (ECB).

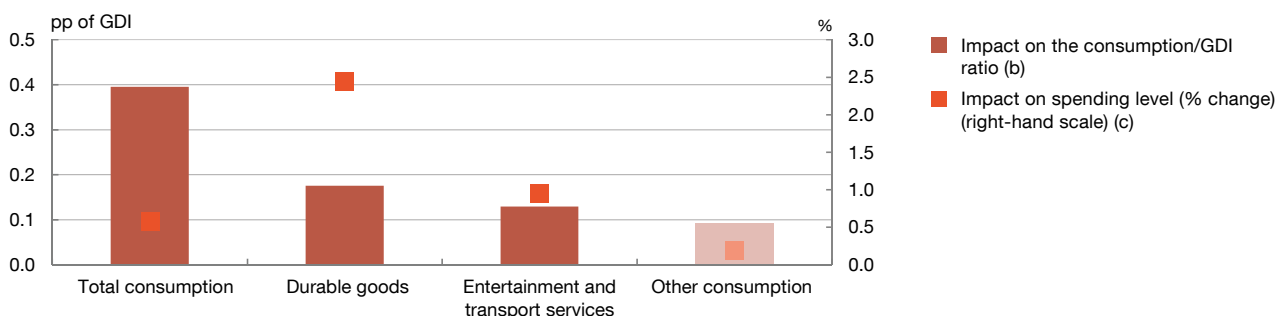
concentrated on spending on durable goods when the change in expenditure is analysed in absolute terms (expressed as a proportion of gross disposable income (GDI), depicted in the chart by the copper bars), and especially when it is calculated in terms of a percentage change in expenditure (depicted in the chart by the orange squares).⁵

⁵ Assuming that changes in the probability of job loss do not entail changes in household income levels, percentage changes in spending can be proxied by dividing the absolute impacts (relative to GDI) by the average ratio of consumption to GDI for all households in the sample where the respondent is working. The period between January 2022 and April 2023 was taken to

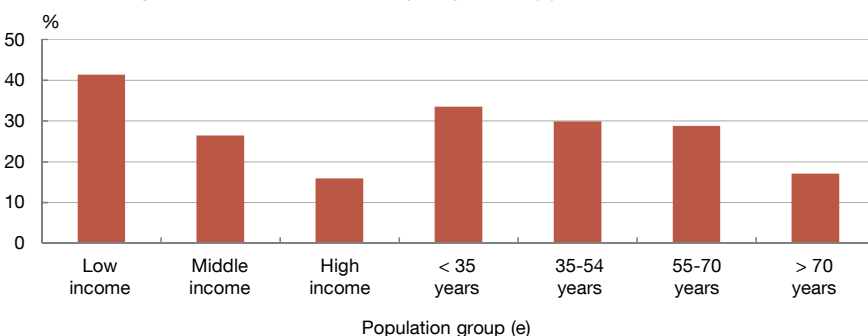
Chart 3

Impact on household consumption of a 10 pp reduction in the perceived probability of job loss. Total households and breakdown by population group

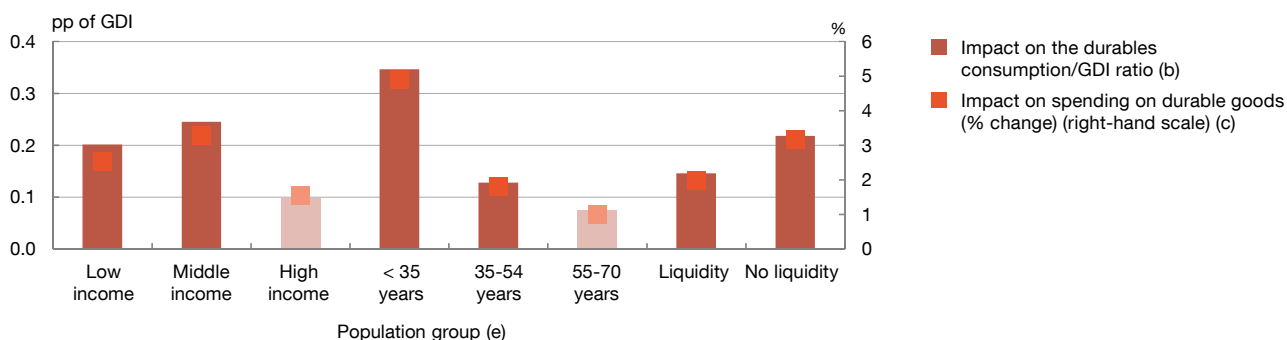
3.a Impact on household consumption of a 10 pp reduction in the probability of job loss perceived by the respondent (a)



3.b Percentage of households with no liquidity buffer (d)



3.c Impact on spending on durable goods of a 10 pp reduction in the probability of job loss perceived by the respondent (a) (d)



SOURCES: Consumer Expectations Survey (ECB) and Banco de España calculations.

- a Calculated using a model in which the explained variable is the consumption to income ratio (for the different spending items considered) and the explanatory variables are the household's income level, the worker's age and their perceived probability of job loss. The bars and squares are lighter shaded when the associated coefficients are not statistically significant with a 90% confidence level. Controls are also included for household and time fixed effects. Standard deviations are grouped at household and time level. The CES only has data on a household's income level for the period in which it first takes part in the survey. Subsequent income developments are approximated based on changes in the respondent's labour income (in other words, the household income reported in the respondent's first round of the survey is adjusted based on changes in that household member's labour income). To avoid any potential distortion of the results, filters are applied to eliminate those observations corresponding to individuals who are, in all likelihood, not the household reference person.
- b Gross disposable income.
- c Calculated in relation to the average spending on the items analysed for households where the respondent member is working (see Chart 3.a) or for the subgroup of households analysed (see Chart 3.c).
- d Households with liquidity are those that, according to the respondent member, have sufficient resources to meet unexpected expenses equal to one month of household income (or can obtain that amount, for instance through bank loans or loans from relatives). Those in the "No liquidity" group have no resources or insufficient resources to cover such a payment.
- e Low (high) income denotes households with an income below (above) the 40th (60th) percentile. Middle income denotes income between the 40th and 60th percentiles. Breakdown by age group based on the respondent's age. See note d) for a description of the households with and without liquidity.



Economic theory suggests that the scale of the consumption adjustment to changes in the probability of job loss is not uniform across households, but that it differs according to various additional factors relating to the financial resources available to households to cushion the impact of potential job loss on their spending.⁶ Given that, on average, households with a young reference person and lower-income households have fewer assets to withstand a temporary fall in income (see Chart 3.b), their level of consumption (especially their durable goods consumption, which is the most sensitive to these changes) will foreseeably be more responsive to changes in uncertainty regarding their future income than in the case of other households. The results obtained from testing this hypothesis, depicted in Chart 3.c, point in this direction: the consumption response to changes in uncertainty regarding future labour income is greater among medium and low-income households and those with a young reference person than among high-income and older households. Similarly, if the analysis is made according to the amount of households' disposable liquid assets,⁷ the findings confirm that households that have fewer such assets adapt their spending on durable goods more sharply when faced with changes to the probability of job loss among household members.

The results obtained suggest that the decline of 3 pp observed since early 2022 in workers' average perceived probability of job loss has helped contain precautionary saving and has driven up the average ratio of household consumption to income by 0.12 pp, partly countering the negative impact that other factors (in particular, higher borrowing costs and higher prices) have had on household spending. Assuming income stability and in the absence of other changes in all other expenditure determinants, this implies an increase in consumption of 0.2 pp. More than 40% of this increase is concentrated on spending on durable goods, which would be 0.7 pp higher on account of the decline in perceived job insecurity. The impact appears to have been especially noticeable on medium and low-income households and on those with a young reference person, whose spending on durable goods responds most sharply to changes in job uncertainty and which, moreover, have seen a greater decline in their job insecurity.

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calculate these average values. To obtain a better proxy of usual average consumption levels, no account is taken of the previous quarters available in the sample, as spending in these quarters was severely impacted by the effect of the pandemic.

- 6 Benito (2006) shows that there is a greater correlation between the probability of job loss and non-durable goods consumption among younger workers and those with no non-labour income, while Browning and Crossley (2001) and Carroll and Dunn (1997) estimate that consumption is more responsive among less affluent and more indebted households, respectively.
- 7 Using the question in the survey that asks whether or not households have sufficient financial resources to meet unexpected expenses equal to one month's income (or can obtain that amount, for example through bank loans or loans from relatives).

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