WHERE IS THE LABOR MARKET HEADING?

The labor market is correcting the excessive growth that was inconsistent with the pace of economic expansion. The question is whether policies to curb inflation and wage increases may adversely affect the gradual accommodation of the labor market and bring about deterioration in incomes, employment, and confidence.

Solange Monteiro, *Rio de Janeiro*

ALTHOUGH IN RECENT YEARS, BRAZIL HAS MAINTAINED full employment despite the economic downturn, in the first half of 2013 the labor market began to show clear signs of exhaustion, and projections for the whole of 2013 are now less favorable. Currently, although at 5.5% the unemployment rate is the same as in 2012, the numbers behind the percentage suggest that the labor market is indeed worsening.

The adjustment of the labor market, although expected, still raises questions. Carlos Henrique Corseuil, deputy director of social studies and policies, Institute of Applied Economic Research (IPEA), says that "on one hand, employment and wages are stagnant. This means that we cannot rely much on wages as an engine for growth and expansion of future employment. On the other hand, quarterly GDP growth seems to indicate a recovery of economic activity. With these forces pulling in opposite directions, it is difficult to make a definitive forecast." Fernando de Holanda Barbosa Filho, researcher, Brazilian Institute of Economics (IBRE), sings a similar tune: "The decline [in employment] may well be accompanied by a cyclical downturn—how deep or how long it will last is difficult to predict as yet." Although the labor market slowdown will increase the number of people without jobs, it will help curb inflation, which erodes the purchasing power of Brazilians.

GRADUAL CHANGE

The change in the labor market is not sudden. Job vacancies have been declining since mid-2011. However, in recent months, data on key indicators of industry have revealed two major imbalances. The first was a reduction in real wages for hiring and firing, as well as average real income in the first half of the year. "This was partly due to rising inflation," says economist Fernanda Guardado of Brazil Plural bank. "In this context, wage recovery will also be affected. Actual gains of the order of 3–4%, as in the past year, will be much harder," she says.

The second indicator shock occurred in June and July, when for two consecutive months the labor supply (= the economically active population) grew faster than job vacancies, interrupting the dynamic that had been helping to support high employment despite low economic growth. Guardado points out that between 2004 and 2008 the labor supply grew 1.7% a year but job vacancies increased 2.7% a year, which meant a significant reduction in unemployment. "To maintain stable employment, the country needs to generate 62, 000 formal jobs. Today, however, it is generating only 47,000," she says.

Two IBRE surveys have also showed labor market conditions worsening. The employment leading indicator (IAEmp) fell by 5.7% in July, the largest decline since November 2008. Meanwhile, the coincident unemployment indicator (ICD), which reflects consumer concern about unemployment, went up 7.2%.

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Flávio Castelo Branco, executive manager of economic policy, National Confederation of Industries (CNI), points out that "In recent CNI surveys, job creation was down 50 points, which we consider negative. The trend for the next six months shows a slight improvement at 51 points in August, but that does not suggest much strength." Castelo Branco notes that some sectors, such as textiles, leather, and footwear, are more exposed to international competition; and for others the problems are more related to the economic cycle of investment, such as machinery and equipment. Both groups have reported job losses. Castelo Branco also points out that the payroll tax relief given by the government has not met expectations.

The Institute for Studies in Industrial Development (Iedi) points out that in the first six months of the year, industrial production grew by 1.9% but employment in manufacturing fell 0.7%, indicating a mismatch between production and employment. This could be partly due to an automation trend in industry, according to Júlio Gomes de Almeida, Iedi consultant. He believes that the 3.8% increase in

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employment in the construction sector may be offset by lower employment growth in the service sector.

Driven by consumption expansion in recent years, services have been the major force for hiring. "[The sector] was growing at 10%, but now the sector is reaching maturity, matching GDP growth," says Fabio Pina, economic adviser to the Federation of Commerce in Goods, Services and Tourism of São Paulo state (Fecomércio). In the second quarter, in fact, services registered growth of only 0.8%, while GDP grew by 1.5%. Since it is "no longer able to absorb as many of the 1.5 million people who enter the labor market annually," Pina says, "lower hiring in the service sector will certainly increase unemployment." Conversely, less hiring for services will reduce the pressure on industrial wages. Part of industry's loss of competitiveness was due to rising wages based on growth in the service sector.

EYE ON INFLATION

Despite future uncertainty, at least in the short term a higher unemployment rate should not be so intense as to cause social unrest. The expectation is that the labor market is correcting excessive growth that was inconsistent with the pace of economic expansion. "If you want to control inflation, which in Brazil is primarily service sector inflation, unemployment will have to increase," says José Marcio Camargo, of Opus Investment Management. The question, however, is how to calibrate the cooling of the economy with wages, since the recent step exchange rate devaluation has caused an inflationary shock that may adversely affect the gradual accommodation of the labor market, bringing about deterioration in incomes, employment, and confidence. In general, analysts think that for 2013 the government will allow unemployment to increase and leave the Central Bank free to increase the interest rate. The government objective would be to stabilize inflation before the presidential elections in 2014.

The government's focus should be on controlling inflation and increasing productivity to ensure sustainable employment. "Our problem, especially for industry, is high costs. If the exchange rate devaluation holds and there is a change in relative prices, you might see an improvement in competitiveness, but this is not a very stable framework," says Castelo Branco. "We need shocks of competitiveness and productivity . . . a

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supply shock through investments," he says, noting that a productivity gain can offset increases in wages.

According to Iedi's Almeida, sustaining more robust growth, as was recorded in the second quarter, would be a good start. Controlling inflation better and avoiding excessive exchange rate volatility would also help. And "a good private sector response to the auction of deep sea oil and concessions for infrastructure would also boost business confidence." The government should avoid boosting domestic consumption to reduce unemployment. "We need a competitive shock through more structural reforms, not policies that encourage more consumption, like those in the last two years," Castelo Branco says.

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