Box 6

**RECENT DEVELOPMENTS IN SECTORAL WAGE AND LABOUR COSTS IN THE EURO AREA**

This box looks at the latest developments in wage and labour costs by sectors of the economy. Monitoring euro area wage and labour costs at the sectoral level provides an in-depth perspective on overall labour cost developments. Moreover, to the extent that wage spillovers across sectors exist, it may help to gauge possible wage pressures building up in the euro area labour market.

Chart A shows that overall wage growth, as measured by the annual growth rate of compensation per employee, bottomed out at below 2% around 2005 and appears to have gradually picked up since then, reaching 2.3% on average in 2007. At the aggregate level, there was less than a 0.1 percentage point increase between wage growth in 2006 and that in 2007. This mild acceleration, however, conceals contrasting developments at the sectoral level. In particular, a significant acceleration in the annual growth rate of compensation per employee in services and, to a lesser extent, in construction was largely offset by a substantial slowdown in industry, from 3.2% on average in 2006 to 2.4% in 2007.
The more detailed breakdown available using labour cost indices makes it possible to qualify somewhat the decline in wage growth observed in industry in 2007 (see Chart B). The decline appears to have been accentuated by a very strong decline in wage growth in a few sub-sectors of industry (i.e. in energy and in mining and quarrying, which together account for 7% of total industrial compensation). Without the contribution of these two sub-sectors, the slowdown in industrial wage growth would have been more muted in 2007. Moreover, the easing of hourly labour cost growth in manufacturing reflected the influence of lower social security contributions; wage cost growth, which excludes employers’ social security contributions, remained steady (see Chart C). More generally, it seems that policy measures aimed at reducing social security contributions in several euro area countries contributed to containing labour cost developments in 2007, notably in industry.

By contrast with the industrial sector, the services sector experienced a significant increase of 2.3% in the annual growth rate of compensation per employee in 2007, compared with 1.8% in the previous year. Although common to all services sub-sectors, this acceleration is mainly attributable to financial and business services, whose contribution increased significantly in 2007 compared with previous years. This was amplified by a one-off spike in the first quarter of 2007 (see Chart D), linked to the payment of exceptional bonuses in the French banking sector. Developments in trade, hotels and restaurants, transport and communication point to a sustained increase in average wage growth in 2007 despite a clear dampening effect of reductions in social security contributions in several euro area countries contributed to containing labour cost developments in 2007, notably in industry.

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1 Euro area sectoral wage developments can be assessed using two indicators: compensation per employee (CPE) and the (hourly) labour cost index (LCI). The LCI usefully allows a more disaggregated breakdown of sectors. Two caveats should, however, be borne in mind. First, since the LCI is based on hourly data and the CPE is calculated in terms of employees, the main difference between the two series can be explained by differing movements in hours worked and employment. For example, a reduction in the number of hours worked per employee mechanically implies a lower growth rate for compensation per employee than for hourly labour costs. Second, more disaggregated data are generally prone to more volatility. Yet the two indicators tend to move broadly in line with one another, allowing useful cross-checks to be carried out. For more information, see the box entitled “Latest developments in sectoral wages and labour costs in the euro area” in the April 2006 issue of the Monthly Bulletin.
security contributions, which was particularly visible in hotels and restaurants. Finally, it is quite difficult to determine a pattern in wage growth in the non-market services sector as this series has been quite volatile over recent years. In 2007 this volatility was linked in particular to developments in the Italian public sector. Annual averages suggest that wage growth in non-market services, while staying slightly below that of market services, increased mildly in 2007.

Sources: Eurostat and ECB calculations.

Note: The categories shown correspond to the broad NACE Rev.1 groupings: whole economy (A-P), industry excluding construction (C-E), construction (F), trade, hotels and restaurants, transport and communication (G-I), financial intermediation, real estate and business services (J-K), and non-market services (L-P).
Finally, wage growth in construction also contributed to the increase in overall wage growth in 2007. The annual growth rate of compensation per employee in construction stood at 3.3% in 2007, i.e. 0.1 percentage point higher than in the previous year. In general, wage growth in construction has been dynamic since the beginning of the decade and consistently higher than in the rest of the economy.

All in all, recent sectoral developments support the picture of a mild but steady increase in overall wage growth over the last two years. However, in order to assess inflationary pressures, developments in wage growth should be viewed in conjunction with developments in productivity, i.e. in terms of developments in unit labour costs. Chart E suggests that a general pattern of moderation in unit labour cost growth was common to all sectors of the economy between 2002 and 2006. At the level of the whole economy, the rebound in productivity registered in 2006 offset the slight increase in the annual growth rate of compensation per employee, enabling growth in unit labour costs to remain constrained. In 2007, however, the notable increase in unit labour cost growth (of 1.5% on average) was mainly driven by developments in the services sector, where productivity developments were more moderate. Moreover, the combination of dynamic wage growth but only modest labour productivity developments in construction led to a strong pick-up in unit labour cost growth in this sector. By contrast, unit labour cost growth in the industry sector remained broadly constant and negative.

Combining the above information with other available labour cost indicators, it appears that labour cost growth has been increasing over the past two years, notably in the services sector and especially in recent quarters. Looking ahead, the euro area indicator of negotiated wages shows signs of a marked acceleration in 2008. The annual growth rate of negotiated wages stood at 2.7% in the first quarter of 2008, compared with an average of 2.2% in 2007. This acceleration is likely to reflect a persistently tightening labour market, the unwinding of past wage moderation in some countries or sectors (notably in the public sector) and/or the phasing-out of policy measures reducing social security contributions. In order to assess potential risks to inflation, wage developments will thus need to remain under close scrutiny in the period ahead.