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Job Creation Recovery and Financial Determinants for Business Labor Demand during the Pandemic

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The Labor Market Report (*Reportes del Mercado Laboral (RML)*) series is a quarterly publication of the Labor Market Analysis Group (GAMLA, in Spanish) at *Banco de la República*, which was created in 2017.

The purpose of this series is to broaden the discussion and understanding of the situation of the Colombian labor market and to provide relevant information for the general public. In addition, this series seeks a better approach to different audiences regarding valuable results from recent research on this topic that is relevant to *Banco de la República's* work, such as issues related to labor market fluidity, the structural unemployment rate, the impact of payroll taxes, forecasts on the unemployment rate, and leading labor market indicators, among others.

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After being stagnant for the first half of the year, employment grew again in July and August. This upturn in employment has been particularly marked in the intermediate municipalities and rural areas. Going by segments of national employment, non-wage employment—which had slowed down in the second quarter due to the effects of the Covid-19 peaks and the country's public order situation—began to grow again. Meanwhile, salaried employment remained stable. In contrast, the formal sector boosted job creation in the main cities, and this translated into a reduction in the urban informality rate. The growth of formal employment was confirmed by other indicators from administrative records and is in line with the performance of job opening indices and surveys of expectations of personnel increases, both of which showed notable improvements in the third quarter. Significant variations can be seen across sectors, with the recreation and manufacturing sectors lagging the furthest behind in their recovery. Labor productivity, in turn, returned to pre-pandemic levels after its abrupt growth in 2020, which resulted from the drop in hours worked. However, this latest aggregate result hides a large sectoral variation in productivity.

Meanwhile, in the absence of mobility restrictions and the gradual reopening of educational and health care institutions, there was a rebound in labor participation after its fall in the second quarter. Due to the greater increase in employment, unemployment rates (UR) continued to fall and reached their lowest level since the beginning of the pandemic in August. Nevertheless, significant differences persist between the URs for the city and population groups, and the gender gap is particularly notable in the latter category. In addition, reductions in the UR have been modest relative to increases in job openings. In accordance with the Beveridge curve, this suggests a slack labor market that will not put upward pressure on inflation via wage costs. This is confirmed by the measurements of hourly income, especially in the non-wage-earning segment where they remain below the measurements at the beginning of 2020. Given all the above, the estimate in this report is that the UR will continue falling for what remains of 2021 and in 2022, albeit gradually. The national UR is expected to stand between 11.2% and 13.3% in the fourth quarter of 2021, and between 10% and 13%, on average, in 2022. Given

these forecasts, the estimates for a long-term UR consistent with stable inflation (Nairu) point to an urban UR gap that will probably go from around 2.6 percentage points (pp) in 2021 to 1.0 pp in 2022. This suggests that, although the gap will be closing, the labor market will probably remain slack over the forecast horizon.

This report is divided into two sections. In the first one, the above-described economic facts of the labor market are discussed in depth. In the second, the effect of the health crisis on the number of formal companies and the employment they generate is studied, while emphasizing its heterogeneity by sector and size. Furthermore, for large companies where it is possible to analyze the evolution in their labor demand based on their financial performance prior to the pandemic, the mixed effects of the crisis depending on said financial conditions are studied. The conclusion is that while formal companies experienced both closings and reductions in their payrolls, the latter adjustment prevailed in the largest ones. The largest cuts in personnel in these companies are registered in those with lower levels of productivity (measured by average salary), liquidity, and profitability margin as well as in those with higher levels of indebtedness. These results highlight the fact that the financial health of companies is one of the critical factors when it comes to understanding the impact of the pandemic on labor demand.

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