

V Labour market and factor utilisation

Most labour market indicators imply that growth in labour demand has peaked but will remain strong. Total hours work contracted in Q3/2017, whereas the forecast in the August *Monetary Bulletin* provided for a continuing increase. Other indicators still imply a continued increase in demand for labour. Unemployment is still declining, and nearly a fifth of survey respondents from the corporate sector are still planning to recruit rather than lay off staff. Furthermore, the share of firms considering themselves short-staffed has remained broadly unchanged over the past year and a half, in spite of significant importation of labour. It is likely that some of the foreign workers who migrate to Iceland for temporary jobs are not included or show up with a time lag in official figures; therefore, the official figures probably underestimate job creation. This also causes an overestimation of productivity growth. Demand pressures in the labour market and in the economy as a whole remain strong. The output gap appears to have peaked, however.

Labour market

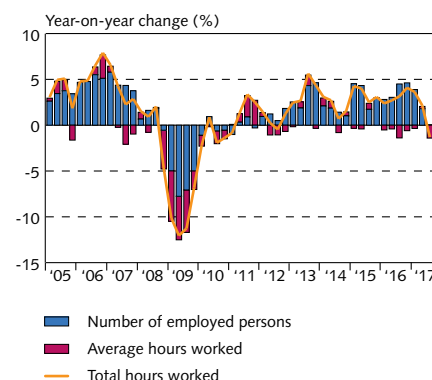
Labour force survey suggests that job creation has stalled ...

According to the Statistics Iceland labour force survey (LFS), growth in total hours worked eased in Q2, after robust growth in the quarters beforehand (Chart V-1). In Q3, the LFS showed a 1.3% year-on-year reduction in total hours worked, as the number of employed persons remained unchanged and the average work week grew shorter. This is the first time since Q3/2012 that total hours worked have declined. This is a sizeable deviation from the forecast in the August *Monetary Bulletin*, which provided for an increase of over 3%.

The labour participation rate declined year-on-year in Q2 and Q3/2017, after rising steadily since H2/2014 and reaching its pre-crisis peak at the end of 2016. The employment rate also declined, after increasing continuously since Q4/2011.

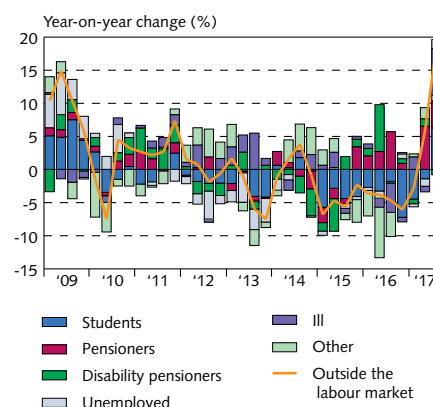
These results are somewhat at odds with other labour market indicators, all of which suggest, as is discussed below, that labour demand is still growing but at a slower rate than before. This likely reflects to some extent the fact that the LFS does not adequately cover the large number of foreign workers that come to Iceland. The increase in population aged 16-74 was about 2.5% during the quarter, or about 6,000 persons, and is well in line with National Registry figures on the rise in foreign nationals. Over the same period, however, the number of working persons was unchanged year-on-year. Given that the labour participation rate among foreigners has generally been very high, it is likely that the majority of foreign nationals who come to Iceland are working. In addition, the LFS suggests that the number of people outside the labour market rose by almost 19% year-on-year, considerably more than during the aftermath of the financial crisis. An examination of which groups outside the labour market grew most reveals that nearly half of the increase stems from a 75% rise in the number of workers who say they have left the labour market due to illness (Chart

Chart V-1
Employment and hours worked¹
Q1/2005 - Q3/2017



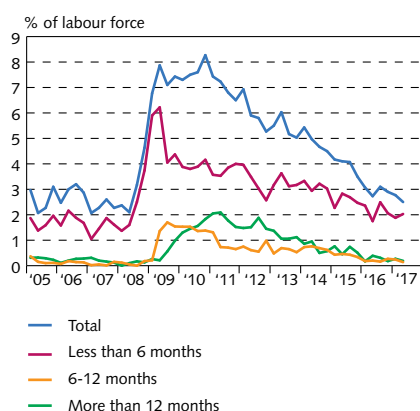
1. Quarterly averages of monthly figures.
Source: Statistics Iceland.

Chart V-2
Persons outside the labour market and breakdown by group
Q1/2009 - Q3/2017



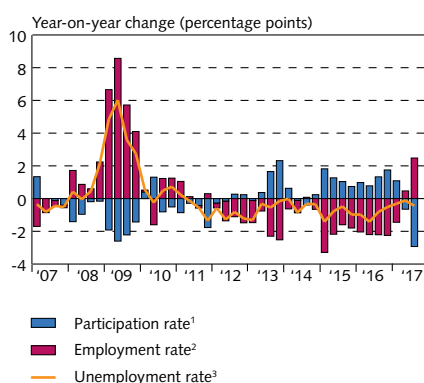
Sources: Statistics Iceland, Central Bank of Iceland.

Chart V-3
Unemployment by duration¹
Q1/2005 - Q3/2017



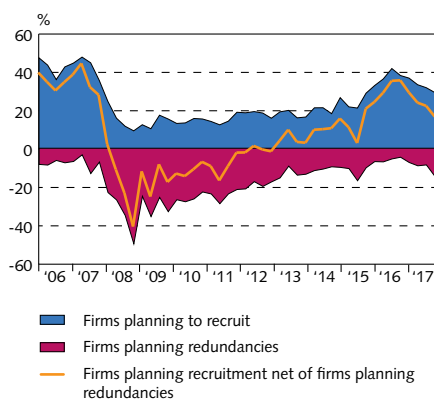
1. Seasonally adjusted data.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart V-4
Contribution to changes in unemployment rate
Q1/2007 - Q3/2017



1. Persons in the labour market as percentage of population aged 16-74.
2. Employed persons as percentage of population aged 16-74. An increase in the employment rate shows as a negative contribution to changes in unemployment. 3. Unemployed persons as percentage of labour force. May not equal the sum of its components due to rounding.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart V-5
Firms planning to change staffing levels within 6 months
Q1/2006 - Q3/2017



Source: Gallup.

V-2). Both of these factors – a larger increase in the number of persons outside the labour market than in the post-crisis period and a steep rise in the number who report leaving the job market due to illness – are implausible, and they suggest a sampling error in the LFS.

... but unemployment continues to fall

Unemployment has continued to fall to a seasonally adjusted rate of 2.3% in Q3/2017, some 0.4 percentage points less than in Q2 and 0.7 percentage points less than in Q3/2016 (Chart V-3). Unemployment fell in spite of a drop in the employment rate because the labour participation rate fell even further (Chart V-4). Short-term unemployment has also declined, and long-term unemployment has virtually disappeared.

Indicators of continued growth in labour demand

According to Gallup's autumn survey of Iceland's 400 largest firms, labour demand looks set to keep growing, as respondents planning to add on staff outnumbered those planning redundancies by 17 percentage points, after adjusting for seasonality. However, growth in labour demand will probably continue to ease, as the share of firms planning to recruit net of the share planning to lay off staff declined by nearly 6 percentage points from the summer survey. The ratio had risen rapidly from mid-2015 through mid-2016 before beginning to subside again (Chart V-5), but it was still almost 10 percentage points above its historical average.

Growth in labour demand appears to be slowing down in nearly all sectors, compared to both the summer 2017 survey and the autumn 2016 survey. In the tourism industry, however, about 40 percentage points more firms are planning to add on staff than are planning to downsize according to the autumn survey – an increase of 17 percentage points since the summer survey. Unlike the summer survey, however, there was discernible pessimism in the fishing industry, with 15 percentage points more firms interested in laying off staff than are planning to hire. Furthermore, construction companies' need to add on staff has eased markedly, probably because firms have tried to address worker shortages with imported labour.

Indicators of factor utilisation

Labour shortage still substantial ...

Although fewer construction companies now consider themselves in need of additional workers, the shortage of labour remains strongest in that sector, according to Gallup's autumn survey. Nearly half of construction company executives considered themselves understaffed, as opposed to just over one in three in the survey as a whole, only a slightly lower percentage than in the past year and a half (Chart V-6). In other sectors, this ratio lay in the 17-40% range.

... despite significant importation of labour

The share of firms considering themselves understaffed has remained broadly unchanged in the recent term, in spite of large-scale importation of foreign workers. Migration figures indicate a continued rise in

the number of foreign workers in Iceland, although the pace of the increase has eased since Q2/2017. The number of foreign nationals aged 20-59 rose by 1.2% of the total population in the same age group in Q3, whereas the increase in the first three quarters of 2017 was 3.4%, as opposed to 1.8% over the same period in 2016. Furthermore, figures from the Directorate of Labour (DoL) show continued growth in the number of people working on behalf of temporary employment agencies and foreign services firms (Chart V-7). According to DoL figures for Q3, the number of workers who came to Iceland through these companies rose by just over 700 between quarters, to 1¼% of the number of employed, up from slightly less than 1% in the previous quarter.

Official figures probably underestimate job creation and overestimate productivity growth

As is discussed above and in *Monetary Bulletin* 2017/2, the LFS probably underestimates the size of the foreign labour force in Iceland. The survey sample extends only to individuals who are in the National Register and therefore have a legal address in Iceland. Workers who move to Iceland temporarily are not listed in the National Register, however. Furthermore, it is likely that foreign nationals show up in the LFS sample with a time lag – or not at all – once they have registered an address in Iceland, which could explain why the number of employed persons has not increased in line with population growth. This underestimation has probably increased in the past two years, in line with the rapid rise in the number of foreign workers.

Estimates of productivity growth are based on the growth rate of GDP per hour worked. If growth in total hours is underestimated in the LFS, this implies that productivity growth is overestimated (for further discussion, see *Monetary Bulletin* 2017/2). According to Statistics Iceland's figures, labour productivity grew by 4.3% in 2016, whereas it was quite weak for several years before then (see *Monetary Bulletin* 2016/2). Underestimating this year's increase in total hours worked leads to an overestimation of productivity growth for this year. Productivity growth is currently estimated at 2½%, which is 1 percentage point more than was assumed in the Bank's August forecast.

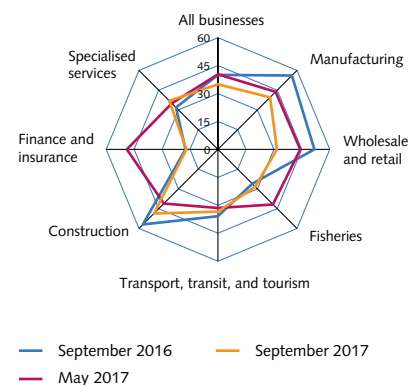
Production factors will continue to be tested in spite of weaker growth in economic activity

According to Gallup's autumn survey among executives, about half of respondents indicated that their firms would have difficulty responding to an unexpected surge in demand (Chart V-8). Although this is a somewhat smaller percentage than in the previous survey and the one conducted a year ago, it is still high, at a full 10 percentage points above its historical average.

Most indications suggest that production factors will continue to be put to the test, even though growth in economic activity has eased. Strong importation of labour and other production factors ease demand pressures in the economy. The output gap is estimated to have been somewhat larger in 2016 than was previously thought, reflecting Statistics Iceland's revision of previous years' GDP growth figures (see

Chart V-6

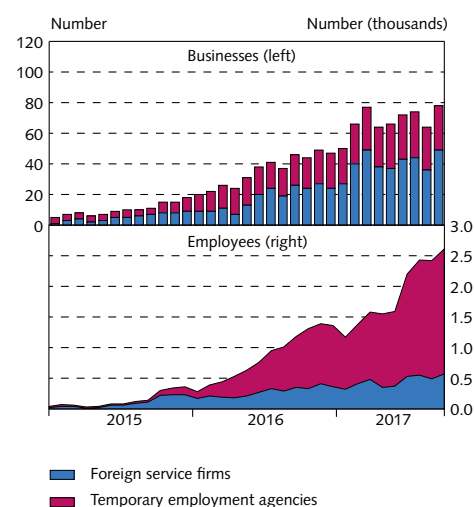
Firms considering themselves short-staffed¹
Share of businesses (%)



1. Seasonally adjusted data.
Sources: Gallup, Central Bank of Iceland.

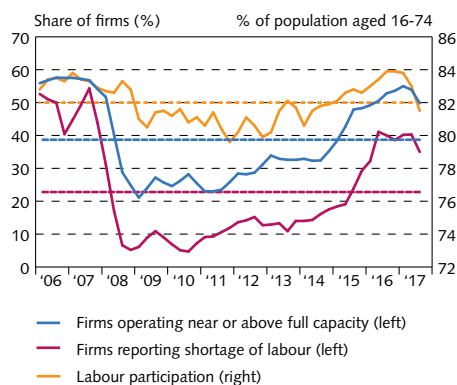
Chart V-7

Temporary employment agencies and foreign service firms and their employees
January 2015 - September 2017



Source: Directorate of Labour.

Chart V-8
Factor utilisation and labour participation¹
Q1/2006 - Q3/2017



1. Indicators of factor utilisation are from the Gallup Sentiment Survey conducted among Iceland's 400 largest companies, and labour participation data are from Statistics Iceland's Labour Force Survey. All data are seasonally adjusted. Broken lines show period averages.
Sources: Gallup, Statistics Iceland, Central Bank of Iceland.

Box 4). On the other hand, the outlook is for considerably weaker GDP growth this year than was forecast in August (see Chapter IV). Furthermore, the equilibrium unemployment rate is estimated to have fallen somewhat more than previously assumed, owing to strong labour importation. As a result, the output gap is estimated to have peaked already and is expected to measure just under 2% of potential output at the end of 2017, about 1 percentage point less than was assumed in the August forecast.