

## V Labour market and factor utilisation

Total hours worked grew more slowly in Q1/2019 and the outlook is for a contraction in Q2. Unemployment inched upwards in Q1 and is expected to increase significantly over the course of the year, in the wake of the shocks that have hit the economy recently. Immigration of foreign labour continues to ease as the number of understaffed firms declines. The number of firms reporting difficulty responding to an unexpected increase in demand has fallen as well, and the share of such firms is close to its historical average. The outlook is for labour productivity to fall in 2019 and for the output gap to close and an output slack to open up.

### Labour market

#### Growth in total hours has eased ...

According to the Statistics Iceland labour force survey (LFS), total hours worked increased by 1.8% year-on-year in Q1/2019, in line with the Bank's February forecast. This is due to a 2.6% increase in the number of employed persons, offset by a nearly 1% shortening of the average work week (Chart V-1). It appears that growth in total hours has begun to slow down: the Q1 growth rate was 0.7 percentage points lower than in Q4/2018 and nearly 1 percentage point below the average of the last six years. In the past two years, the increase in total hours has largely reflected growth in the working-age population. As a result, growth in total hours could weaken even more in the quarters to come if immigration of foreign workers continues to ease. A clearer sign of slower job growth can be seen in pay-as-you-earn (PAYE) data. According to the PAYE register, the year-on-year increase in employed persons has slowed all but continuously since mid-year 2017 and appears to have continued to slow in Q1/2019 (Chart V-2).

#### ... and unemployment has risen

According to the LFS, the labour participation rate and the employment rate were broadly unchanged year-on-year in Q1/2019. At the same time, unemployment rose slightly between years, or by 0.2 percentage points, measuring 3% after adjusting for seasonality. The underemployment rate (part-time workers who would like to work more) remained low during the quarter, as did long-term unemployment. Registered unemployment had risen slightly more, however. It began to ease upwards in mid-2018 and, by Q1/2019, was 0.7 percentage points higher than in the same quarter of 2018. After adjusting for seasonality, however, it rose only slightly from the previous quarter, measuring 2.8%. The layoffs following airline WOW Air's collapse are not reflected in Q1 unemployment figures. They were reflected in the registered unemployment figures for April, however, as the number of persons on the unemployment register rose by 841 during the month. Seasonally adjusted registered unemployment measured 3.5% in April, an increase of 0.8 percentage points from the Q1 figure (Chart V-3). Thus the outlook is for a significant rise in unemployment both in

Chart V-1  
Employment and hours worked<sup>1</sup>  
Q1/2005 - Q1/2019

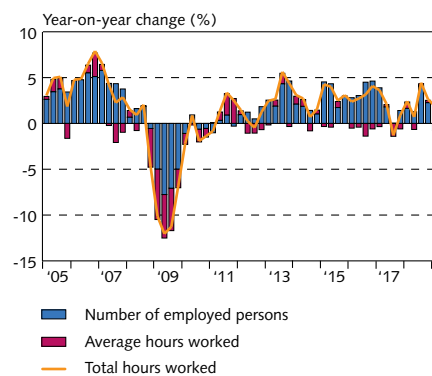


Chart V-2  
Number of employed persons<sup>1</sup>  
Q1/2006 - Q1/2019

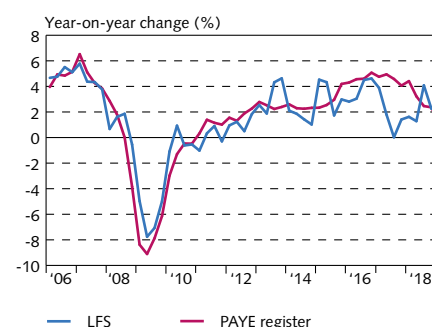


Chart V-3  
Unemployment<sup>1</sup>  
Q1/2006 - Q2/2019

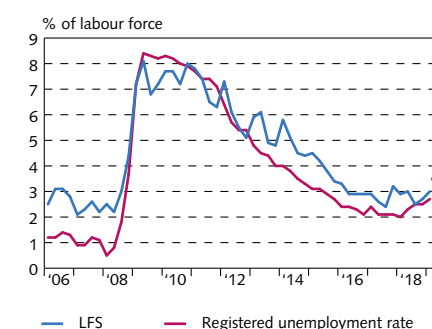
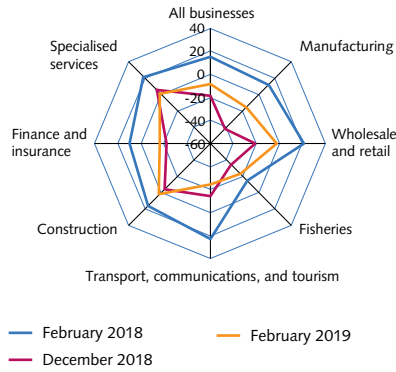
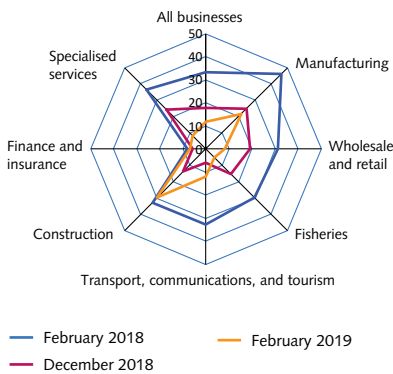


Chart V-4  
Firms planning recruitment net of firms  
planning redundancies within 6 months<sup>1</sup>  
Share of businesses (%)



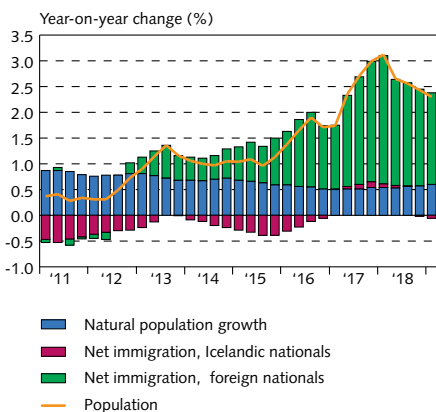
1. Seasonally adjusted figures.  
Sources: Gallup, Central Bank of Iceland.

Chart V-5  
Firms considering themselves  
short-staffed<sup>1</sup>  
Share of businesses (%)



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

Chart V-6  
Population  
Q1/2011-Q1/2019



Source: Statistics Iceland.

Q2 and in 2019 as a whole. It is uncertain whether the repercussions of WOW Air's collapse have come fully to the fore, and in addition, other factors pull in the same direction. The outlook is for an economic contraction this year, owing partly to poorer external conditions, the failure of the capelin catch, weaker domestic demand, and a poorer competitive position because of contractual wage increases. As a consequence, unemployment could rise further. On the other hand, workers could exit the domestic labour market or firms could offer reduced working hours or lower pay, as they did following the financial crisis. According to the current baseline forecast, the outlook is for considerably higher unemployment this year than was forecast in February. Seasonally adjusted unemployment is projected to rise above 4% in H2 and measure 3.9% for 2019 as a whole. This is 0.8 percentage points above the February forecast, as well as being above the level considered consistent with stable inflation.

### Outlook remains for reduction in job numbers in the next six months

According to the seasonally adjusted results of Gallup's spring survey among executives from Iceland's 400 largest companies, 14% of firms were planning to recruit, while 23% were planning to downsize. The balance of opinion was therefore negative by 9 percentage points, whereas in the winter survey it was negative by 19 percentage points (Chart V-4). The difference was greatest in transport, transit, and tourism, although the survey results were probably affected by strikes announced in tourism-related sectors at the time the survey was conducted. The outlook was for a slight increase in staffing in construction and utilities, as well as in miscellaneous specialised services, where the balance of opinion was positive by 2-3 percentage points. The difference was below its historical average in all sectors.

In line with the Gallup survey results, the baseline forecast assumes that seasonally adjusted job numbers will fall in Q2. The decline is smaller than it would be otherwise, however, as the economic contraction is expected to be relatively brief. Under such circumstances, it is likely that some employers will choose to maintain staffing levels even though their earnings might suffer in the short run. It is also assumed that firms will seek to streamline further by cutting back on working hours. Therefore, the decline in total hours worked will exceed the drop in job numbers. Even though total hours are assumed to continue to fall over the course of the year, the annual average will be unchanged between years, owing to base effects from 2018. This is a significant change from the February forecast, which assumed a 1.4% increase this year.

### Indicators of factor utilisation

#### Staff shortages not a major problem

After adjusting for seasonality, 12% of executives surveyed considered themselves short-staffed, a decline of 6 percentage points since Gallup's winter survey. This share has fallen in the last four surveys and was 11 percentage points below its historical average this spring. The

percentage of executives considering themselves understaffed was largest in the construction and utilities sector, at 30%. On the other hand, only 5-8% of executives in fishing, financial services, miscellaneous specialised services, and retail and wholesale trade reported staffing shortages (Chart V-5).

### Labour immigration has eased

Net migration figures for Q1/2019 show that Iceland's foreign work force continues to grow, but at a slower pace than in the past year. The population increased by 1.8% year-on-year during the quarter due to migration of foreign nationals, down from 2.5% in Q1/2018. Population growth has therefore eased since peaking at 3.1% in Q1/2018 (Chart V-6). Employees of temporary employment agencies and foreign services firms have continued to decline in number. They counted 1071 employees in April, down by 401 since year-end 2018. There has also been a slowdown in issuance of new temporary work permits.

### Outlook for declining productivity in 2019

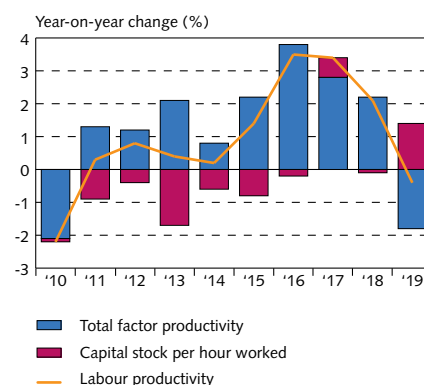
After the new national accounts were published in March, productivity growth figures for 2015-2017 were revised and preliminary figures for 2018 were published for the first time. Overall, developments were broadly in line with the February forecast, but labour productivity (measured as GDP per hours worked) is now estimated to have grown by 2.6%, on average, in 2015-2018, well above its historical average. However, because the outlook is for an economic contraction this year and virtually no increase in total hours, labour productivity is expected to contract by 0.4% from last year, whereas the February forecast assumed a corresponding rise in productivity. The outlook for the capital stock per hour worked is broadly unchanged since February; therefore, this development indicates primarily that the contribution of total factor productivity to productivity growth will be more negative than in the February forecast (Chart V-7). If the forecast materialises, 2019 will be the first year since 2010 to see a year-on-year contraction in labour productivity.

### Output slack to open up in late 2019

According to the Gallup survey, 38% of firms reported difficulty in responding to unexpected demand. This is somewhat less than in the winter survey and close to the historical average. The percentage of executives reporting such difficulties was largest in the fishing industry, at 57%, possibly reflecting capacity constraints due to quotas. The strain on production factors was least in the wholesale and retail trade sector, where 21% of executives said they would have difficulty responding to increased demand.

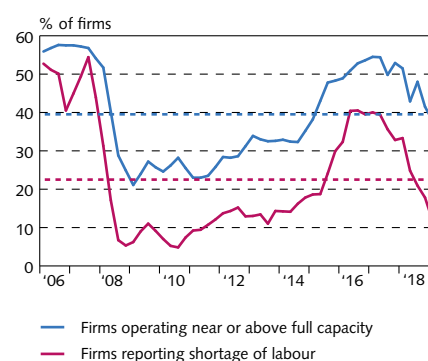
The resource utilisation (RU) indicator, which combines various indicators of factor utilisation, implies that the strain on production factors is easing rapidly. It fell even further in Q1/2019, albeit more slowly than in the past year (Chart V-9). The output gap of the past few years therefore appears to be closing rapidly. After averaging an estimated 2½% of potential output over the past three years, it is expected to fall to about 1% by mid-2019. The output gap is projected

Chart V-7  
Labour productivity and its sub-components  
2010-2019<sup>1</sup>



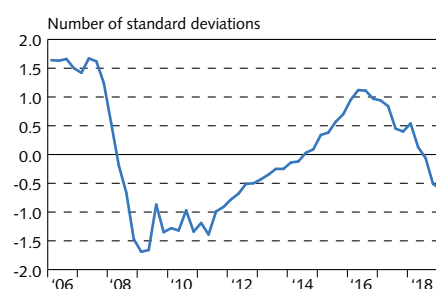
1. Labour productivity is given as GDP per total hours worked. Total factor productivity is given as the deviation of GDP from the output level obtained with full factor utilisation using the production function in the Bank's macroeconomic model. Central Bank baseline forecast 2019.  
Sources: Statistics Iceland, Central Bank of Iceland.

Chart V-8  
Capacity utilisation<sup>1</sup>  
Q1/2006 - Q1/2019



1. Indicators of factor utilisation are from the Gallup Sentiment Survey conducted among Iceland's 400 largest companies. Seasonally adjusted figures. Broken lines show period averages.  
Sources: Gallup, Central Bank of Iceland.

Chart V-9  
RU indicator<sup>1</sup>  
Q1/2006 - Q1/2019



1. The resource utilisation indicator (RU indicator) is the first principal component of selected indicators of factor utilisation; it is scaled so that its mean value is 0 and the standard deviation is 1. A more detailed description can be found in Box 3 in MB 2018/2.  
Source: Central Bank of Iceland.

to close later in the year with an output slack to open by the year-end and then gradually close over the course of 2020. This is a significant change from the February forecast, which assumed that the output gap would not close until early 2021.