

V Labour market and factor utilisation

Most labour market indicators imply that growth in labour demand has peaked. Total hours worked increased in Q1/2018 and unemployment continues to decline. Nearly a fifth of survey respondents from the corporate sector are still planning to recruit rather than lay off staff, thus indicating continued strong growth in labour demand. Furthermore, the share of firms considering themselves short-staffed has remained broadly unchanged over the past year and a half, in spite of large-scale importation of labour. A sizeable output gap exists but appears to have peaked.

Labour market

Strong labour demand in Q1/2018 ...

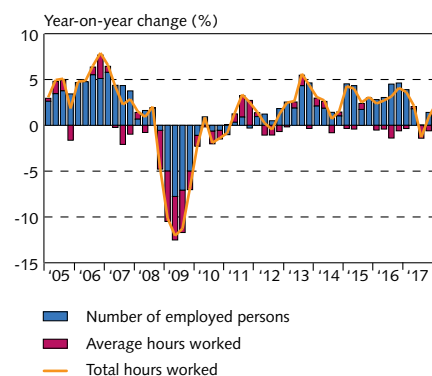
According to the Statistics Iceland labour force survey (LFS), total hours worked increased in Q1 by 2.3% year-on-year, broadly in line with the average since the labour market recovery began. Growth eased in spring 2017, and total hours worked declined in Q3, according to the survey (Chart V-1). As is discussed in *Monetary Bulletin* 2017/4, it is considered likely that this was due to measurement problems rather than an actual development in the labour market. Strong growth in Q1/2018 and other indicators from the labour market support this assessment. The increase in total hours in Q1 reflects a 1.6% rise in the number of employed persons and a 0.7% increase in the length of the average working week, which had grown shorter nearly without interruption since autumn 2014. The seasonally adjusted labour participation rate measured 82% during the quarter, slightly below the previous quarter's figure but in line with the long-term average.

... and unemployment continues to fall

According to the LFS, seasonally adjusted unemployment measured 2.6% in Q1, which is broadly unchanged year-on-year but down 0.5 percentage points from the preceding quarter. It has fallen by almost 6 percentage points from the winter 2010 peak and is now about 1½ percentage points below its long-term average (Chart V-2). Although unemployment has fallen steeply and is probably below the level consistent with price stability (further discussed later in this chapter), it could overestimate the demand pressures in the labour market. For example, some of those employed may want to work more hours than are available to them, and it is also possible that there are some who are willing to work but are not actively looking for a job. This potential addition to the labour force has also declined in recent years, however (see Chart V-2); furthermore, in recent years the number of part-time workers who would like to work more has declined in line with falling unemployment and is now close to the 2003-2007 average (Chart V-3).¹

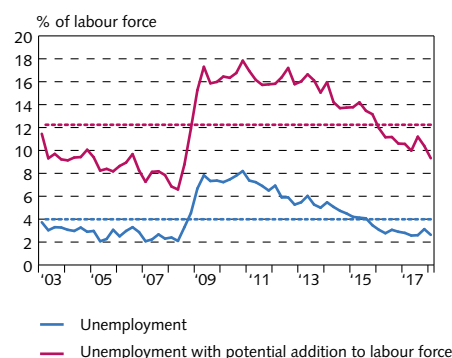
1. For further discussion of the potential addition to the labour force, see Box 3 in *Monetary Bulletin* 2015/2.

Chart V-1
Employment and hours worked¹
Q1/2005 - Q1/2018



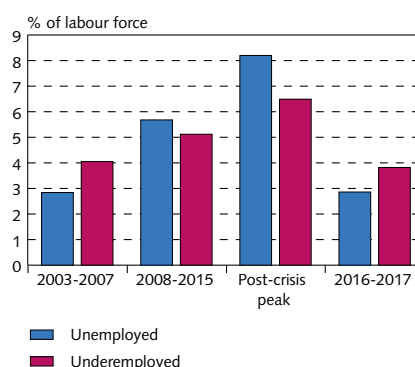
1. Quarterly averages of monthly figures.
Source: Statistics Iceland.

Chart V-2
Unemployment and potential addition to the labour force¹
Q1/2003 - Q1/2018



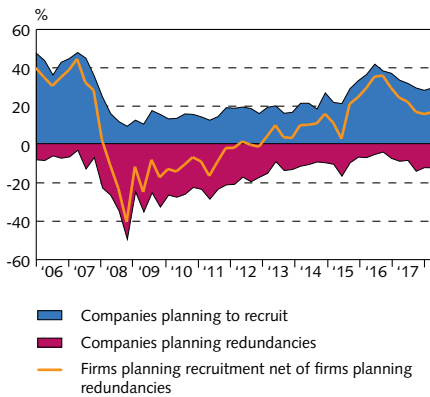
1. The potential addition to the labour force includes those who are available but not seeking work, those who are seeking work but not immediately available, and underemployed part-time workers. The broken lines show the period average for unemployment with the potential addition to the labour force and the 1991-2017 average for unemployment. Seasonally adjusted figures.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart V-3
Unemployment and underemployment¹



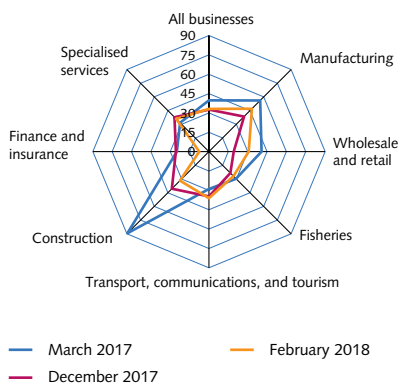
1. Underemployed workers are part-time workers who would like to work more. Seasonally adjusted figures.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart V-4
Companies planning to change staffing levels within 6 months¹
Q1/2006 - Q1/2018



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

Chart V-5
Firms considering themselves short-staffed¹
Share of businesses (%)



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

Executives continue to expect increased staffing levels

According to Gallup's spring survey of Iceland's 400 largest firms, the outlook is for continued growth in labour demand in the next six months. The share of respondents planning to add on staff exceeds the share planning redundancies by 17 percentage points, after adjusting for seasonality (Chart V-4). This share has held steady at this level in the past three surveys, after having fallen in the three surveys preceding. It remains about 8 percentage points above its historical average, indicating continued strong labour demand.

Executives in the retail and wholesale sector were more interested in recruiting than they were in the winter survey, and the share planning to add on staff net of the share planning redundancies increased by 7 percentage points between surveys. On the other hand, tourism companies' need for additional staff has eased, and the ratio of planned recruitment net of planned redundancies declined by 20 percentage points. In spite of this, tourism was the sector where most respondents said they needed to add on staff, as the share of firms planning to recruit exceeded the share planning to reduce staffing levels by 24 percentage points. As before, the share of executives planning redundancies was largest in the fishing industry, although it had fallen since the winter survey. The fishing industry was the only sector where a larger share of companies were planning to reduce staffing levels rather than to recruit.

Indicators of factor utilisation

Firms are still having difficulties filling jobs ...

About a third of firms are still having trouble filling available jobs, according to Gallup's spring survey (Chart V-5). This ratio has been broadly stable since the autumn 2017 survey and is still about 10 percentage points above its historical average. The share of companies that consider themselves understaffed increased proportionally the most in manufacturing and retail and wholesale sectors. It is now largest in manufacturing, where nearly half of survey participants consider it difficult to fill available jobs. The significant shortage of construction workers appears to have been addressed with imported labour last year, but in the spring survey nearly a third of executives in the sector still considered their firms understaffed, about the same as in other sectors that have grown rapidly with the surge in tourism; i.e., trade, transport, transit, and tourism itself, as well as various specialised services.

... despite significant importation of labour

2017 was a record year in terms of net inward migration. In the 20-59 age group, the number of immigrants net of emigrants was positive by 3.8% of the population. Migration figures for Q1/2018 indicate that labour supply is still increasing with the arrival of foreign workers, as the migration balance of this same group was positive by 0.8% of the population. Directorate of Labour figures on the number of workers employed through temporary employment agencies and foreign services firms also indicate that labour importation remains strong (Chart V-6). This group of workers grew markedly in summer 2017,

both in the construction sector and during the peak tourist season, but declined again over the second half of the year. It is likely that employers were able to some degree to find permanent employees, thereby reducing the need to hire workers through employment agencies. The decline could also reflect seasonal fluctuations. The number of agency-based employees increased again in 2018 to date, and including employees from foreign services firms they constituted 1.1% of employed individuals in March. The number of issued work permits rose by 15% in Q1, the same as in all of 2017.

As has been discussed in previous issues of *Monetary Bulletin*, it is considered likely that the LFS does not adequately cover the growth in the labour force due to strong growth in labour importation, partly because the survey sample is based on those with a legal address in Iceland. Statistics Iceland's recent publication of labour force figures based on pay-as-you-earn (PAYE) data and Registers Iceland's population figures support this hypothesis. According to PAYE data, the number of workers with a foreign legal address has increased markedly in the past two years (Chart V-7), to 3.2% of the PAYE register, about the same as in 2008. The share of workers with a foreign legal address peaked in 2007 at 3.9%.

Productivity growth normalises

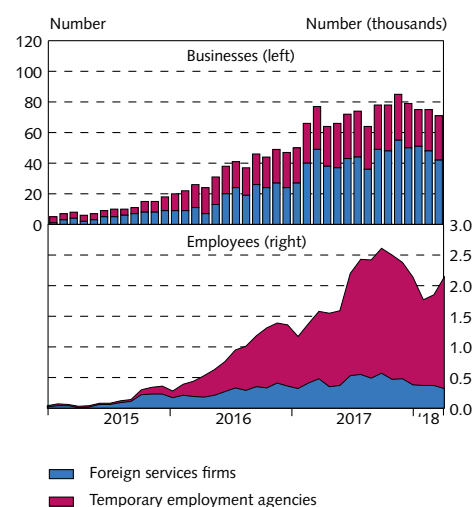
Labour productivity, measured as the ratio between GDP and total hours worked according to the LFS, rose sharply in 2016-2017, or by an average of 3½% per year, well above its historical average and the post-crisis level both in Iceland and in other advanced economies. As has been discussed in previous issues of *Monetary Bulletin*, this is probably an overestimation stemming from the aforementioned underestimation of job creation in the LFS.² Productivity growth is not expected to be as strong in 2018. It is expected to measure just over 1%, somewhat below its historical average.

Strain on production factors even though pressures seem to be easing

The share of firms that expect to have difficulty responding to unexpected demand is still high, at over half, according to Gallup's spring survey (Chart V-8). This share was 13 percentage points above its historical average and has fallen very little, despite large-scale labour importation and investment in recent years.

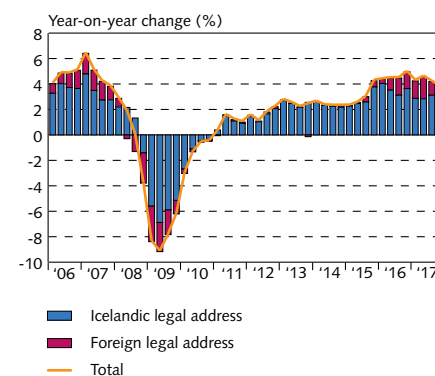
Chart V-9 shows the resource utilisation (RU) indicator, which combines various indicators of factor utilisation into a single measure. The RU indicator is estimated based on information from Gallup's survey of Iceland's 400 largest firms and selected indicators from the labour market. As is discussed in Box 3, it appears to capture the business cycle quite well. It could also be a leading indicator of developments in the labour market; e.g., in a downturn, if firms choose to retain staff in whom they have invested even though their demand eases temporarily. In this case, unemployment may remain low for a

Chart V-6
Temporary employment agencies and foreign services firms and their employees
January 2015 - March 2018



Source: Directorate of Labour.

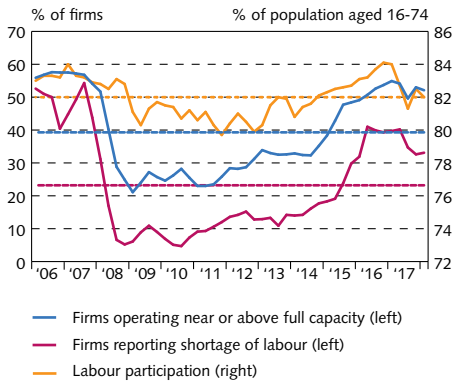
Chart V-7
Number of employed according to PAYE register data¹
Q1/2006 – Q4/2017



1. Individuals aged 16-74 who received employment income included in the Director of Internal Revenue's pay-as-you-earn (PAYE) register, including individuals on childbirth leave and self-employed persons.
Sources: Statistics Iceland, Central Bank of Iceland.

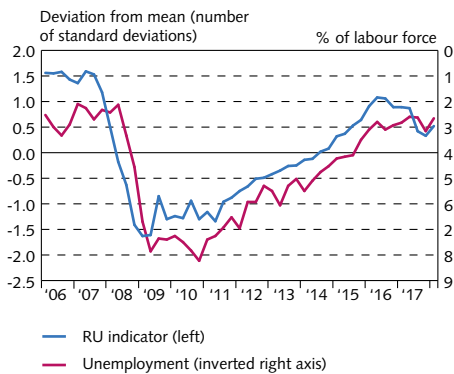
2. As is discussed in Box 2, Statistics Iceland has begun publishing new labour market data based on the national accounts. It is hoped that this will give a more reliable indication of productivity growth.

Chart V-8
Capacity utilisation and labour participation¹
Q1/2006 - Q1/2018



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.

Chart V-9
Resource utilisation and unemployment¹
Q1/2006 - Q1/2018



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. Unemployment is seasonally adjusted. Sources: Statistics Iceland, Central Bank of Iceland.

period, giving the impression that capacity utilisation in the economy is still high.

The RU indicator shows that resource utilisation was significantly above average until the end of 2007, when it began to fall. Unemployment remained low until the financial crisis struck, however, whereas resource utilisation as measured by the RU indicator was already below average. The indicator implies that the slack peaked in early 2009, and from mid-2011 it indicates that resource utilisation increased again concomitant with a decline in unemployment. It also indicates that resource utilisation overtook capacity again in mid-2014, about half a year before the Bank's assessment of the business cycle indicated that the output gap had opened up again. The RU indicator peaked in mid-2016 but has fallen slightly since then, concurrent with the slowdown in GDP growth. In accordance with other indicators, the most recent RU indicator values suggest that there is still considerable strain on production factors.

Most indicators suggest that production factors will continue to be put to the test, and the RU indicator could imply that the strain is increasing again, even though growth in economic activity has eased. Strong growth in demand has been addressed with importation of labour and other inputs, which has reduced demand pressures in the economy. On the whole, the output gap is considered to have been wider in 2017 than previously thought, which reflects Statistics Iceland's revision of previous estimates of stronger output growth in 2014-2016 (see Chapter IV). The outlook is for output growth to be slightly stronger in 2018 than was forecast in February. Furthermore, the equilibrium unemployment rate is estimated to have fallen somewhat more than was assumed then, owing to strong labour importation. As a result, the output gap is projected to be slightly wider for most of the forecast horizon than was forecast in February. It is expected to measure 1.2% of potential output at the end of 2018 and then narrow gradually until it virtually closes by end-2020.