

## V Labour market and factor utilisation

Total hours worked declined year-on-year in Q3, in line with the Bank's August forecast. Both the employment rate and the labour participation rate fell, while the unemployment rate was broadly unchanged after a sharp increase in Q2. The results of the Gallup survey among Iceland's 400 largest firms suggest that job numbers will continue to fall in the next six months, yet pessimism among executives appears to have receded. Total hours worked are expected to decline this year instead of increasing, as was assumed in the August forecast, but the outlook for developments in unemployment is broadly unchanged. The number of firms considering themselves understaffed rose for the first time since the spring 2018 survey, and there are signs that factor utilisation is gradually firming up after the slack that opened up in the wake of recent economic setbacks.

### Labour market

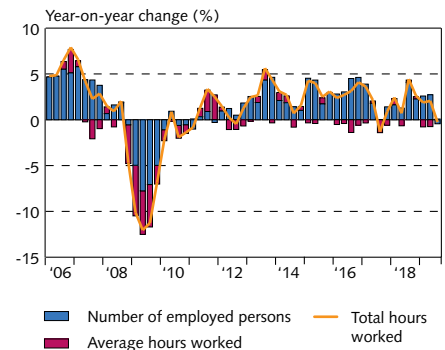
#### Total hours worked fell in Q3 ...

According to Statistics Iceland's labour force survey (LFS), total hours worked fell by 0.4% year-on-year in Q3/2019, in line with the Bank's August forecast. The number of employed persons also declined by 0.4% year-on-year, but the average work week was broadly unchanged from Q3/2018 (Chart V-1). A similar trend can be seen in the number of wage-earners on the pay-as-you-earn (PAYE) register, which shows that the number of employed persons (excluding the self-employed and those on childbirth leave) fell by 1.3% year-on-year in August. The decline in job numbers appears to affect most sectors, yet on the other hand, public service jobs – i.e., in public administration, education, healthcare, and social services – have increased significantly in number. Public sector job numbers began to rise in early 2017, around the time job growth in tourism-related sectors began to ease. In August, the year-on-year increase was roughly equal to the decline in tourism-related jobs over the same period (Chart V-2). Public sector job creation has therefore offset the loss of private sector jobs, although it is uncertain how long this can last.

#### ... and unemployment has risen markedly year-to-date

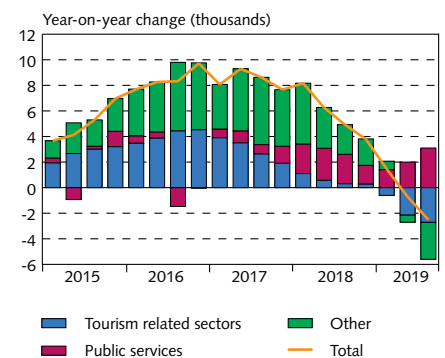
The drop in job numbers in Q3 came to the fore in a decline in the employment rate. The outlook is for a 1½ percentage point decline this year, making 2019 the third consecutive year with a falling employment rate. According to seasonally adjusted LFS data, the employment rate was 77.7% in Q3, a reduction of 0.5 percentage points between quarters. At the same time, the labour participation rate fell by 0.4 percentage points, to 80.9%. Both the employment rate and the labour participation rate were 1 percentage point below their long-term averages during the quarter. Seasonally adjusted unemployment fell by 0.1 percentage point since Q2, to 3.7%. However, it had risen by 0.6 percentage points since Q1, before airline WOW Air failed. Registered unemployment also measured 3.7% in Q3 after adjusting for season-

Chart V-1  
Employment and hours worked<sup>1</sup>  
Q1/2006 - Q3/2019



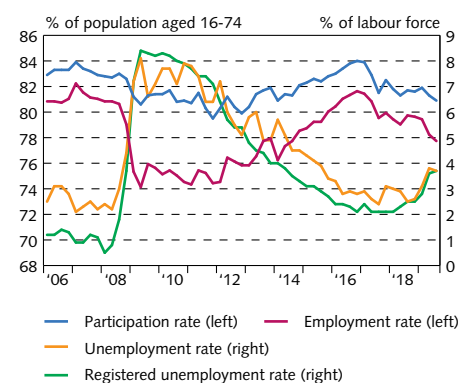
1. Quarterly averages of monthly figures.  
Source: Statistics Iceland.

Chart V-2  
Number of employed persons according to PAYE-register<sup>1</sup>  
Q1/2015 - Q3/2019



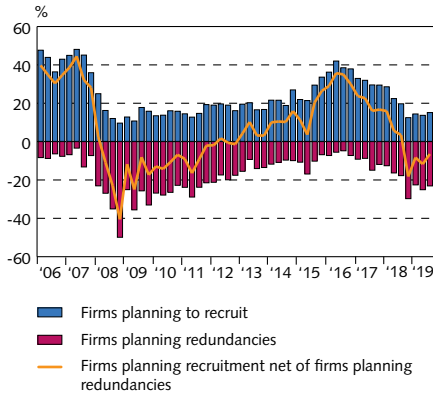
1. The number of persons of all ages on the pay-as-you-earn (PAYE) register, excluding the self-employed and those on childbirth leave. Public services comprises public administration, education, healthcare, and social services. Q3/2019 figures are August values. The most recent figures are preliminary.  
Source: Statistics Iceland.

Chart V-3  
Unemployment, employment, and labour participation<sup>1</sup>  
Q1/2006 - Q3/2019



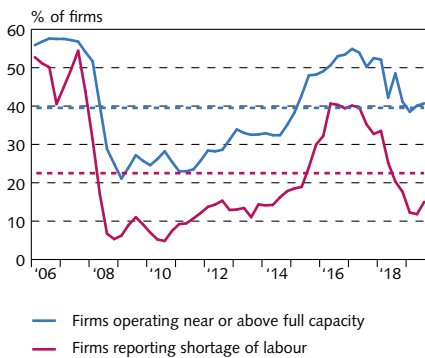
1. Seasonally adjusted figures. The registered unemployment rate is seasonally adjusted by the Central Bank.  
Sources: Directorate of labour, Statistics Iceland, Central Bank of Iceland.

Chart V-4  
Firms planning to change staffing levels  
within 6 months<sup>1</sup>  
Q1/2006 - Q3/2019



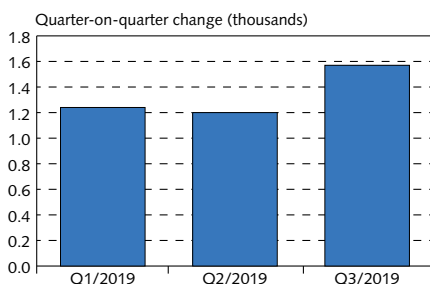
1. Seasonally adjusted figures.  
Sources: Gallup, Central Bank of Iceland.

Chart V-5  
Capacity utilisation<sup>1</sup>  
Q1/2006 - Q3/2019



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-6  
Foreign nationals residing in Iceland<sup>1</sup>  
Q1/2019 - Q3/2019



1. Calculations based on quarter-end figures for foreign nationals.  
Source: Registers Iceland.

ality, slightly more than in Q2 (Chart V-3). It rose by just over 1 percentage point in the first five months of the year, although nearly  $\frac{2}{3}$  of the increase occurred after WOW Air's collapse. From May through September, however, registered unemployment remained unchanged. The outlook for the remainder of 2019 is broadly unchanged from the August forecast. According to the baseline forecast, it will rise above 4% late this year and then begin to taper off again as 2020 progresses. As in August, it is expected to average 3.7% this year.

### Job numbers set to keep falling, but pessimism among executives has receded

According to the seasonally adjusted results of the Gallup survey carried out this autumn among Iceland's 400 largest firms, the balance of opinion on staffing plans (i.e., firms planning to recruit as compared with those planning redundancies) was negative by 7 percentage points (Chart V-4). Therefore, survey respondents were somewhat less pessimistic than in the summer survey, when the same balance of opinion was negative by 12 percentage points. Sentiment improved markedly between surveys in the fishing industry and in transport, transit, and tourism. In the summer survey, the balance of opinion was negative by 19 percentage points in the fishing industry and by 16 percentage points in transport, transit, and tourism. In the autumn survey, however, the balance of opinion on staffing plans was broadly neutral in both sectors. Executives in construction and utilities and in wholesale and retail trade were more pessimistic than in the summer. The outlook is for a potentially steep decline in job numbers in these sectors, as well as in the financial sector, where the balance of opinion was negative by 25-28 percentage points.

Overall, the baseline forecast reflects the results of Gallup's autumn survey. According to the forecast, job numbers will fall through this year and then begin to recover in 2020. The forecast also assumes that firms will attempt to streamline by cutting their employees' working hours. Total hours worked are therefore set to fall this year by 0.1% year-on-year, as opposed to rising by 0.2%, as was forecast in August.

### Indicators of factor utilisation

#### The share of understaffed firms has risen but is still below its historical average

After adjusting for seasonality, 15% of executives considered themselves short-staffed – a slightly higher percentage than in the summer survey (Chart V-5). This is the first time since the spring 2018 survey that the number of firms considering themselves understaffed has risen between surveys. The reported shortage was largest in miscellaneous specialised services, where a fourth of firms considered themselves understaffed. It was second-largest in the fishing industry, where the share of executives considering themselves short-staffed rose by 17 percentage points between surveys, to 21%. Only a few respondents in wholesale and retail trade reported staff shortages, and no one in the financial and insurance sector did so. The share of firms with staffing shortages was below its long-term average in all sectors except fishing.

### Foreign labour force still growing despite fewer jobs

Figures from Registers Iceland on the number of foreign nationals living in Iceland suggest that the foreign labour force continues to expand. The foreign population grew by nearly 1,600 quarter-on-quarter in Q3, somewhat more than in the previous two quarters (Chart V-6). Workers from temporary employment agencies and foreign services firms have increased slightly in number, to just under 1,300, or 0.6% of the labour force, by September. Issuance of new temporary work permits has continued to lose pace, however, with the number of new permits down by nearly 80 year-on-year in the first nine months of 2019.

### Labour productivity broadly unchanged year-on-year

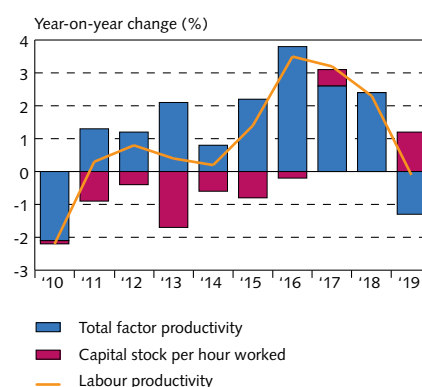
The national accounts revision in September led to a marginal change in historical GDP figures and a correspondingly small change in productivity growth data. Even though the GDP growth outlook for 2019 is unchanged, the outlook is for productivity to develop somewhat more favourably than was forecast in August, owing to the above-described revision of total hours worked. Labour productivity is now projected to decline by 0.1% this year instead of 0.4%, as was forecast in August (Chart V-7). The ratio of the capital stock to total hours worked in 2019 is similar to the August forecast; therefore, the difference is largely due to a less negative contribution from total factor productivity.

### Small output slack to open in 2019 and close in 2020

According to the Gallup autumn survey, 41% of executives reported that they would have difficulty responding to unexpected demand, after adjusting for seasonality. This percentage was broadly unchanged from the summer survey and has been close to its long-term average since the autumn 2018 survey. Nearly three out of five executives in the specialised services sector reported that they would have difficulty responding to unexpected demand, as opposed to only a fourth in retail and wholesale trade, financial services, and the transport, transit, and tourism sector.

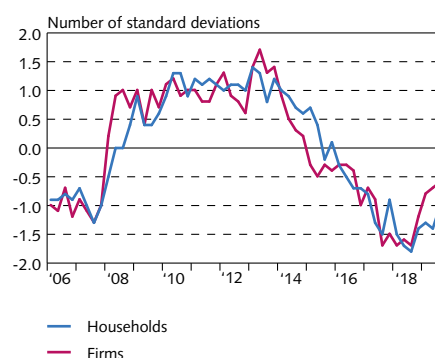
It appears as though the downbeat sentiment that developed in the wake of the recent setbacks is gradually receding. The difference between households' and businesses' economic expectations six months ahead and their assessment of the current situation has narrowed somewhat year-to-date (Chart V-8). Furthermore, the resource utilisation (RU) indicator, which combines various indicators of factor utilisation, rose somewhat in Q3 for the second quarter in a row (Chart V-9), a sign that the economic contraction could be relatively brief. As in August, the output gap is estimated to have closed, and a modest slack is expected to develop by the end of this year. The slack is projected to peak in mid-2020 and close before the year-end.

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



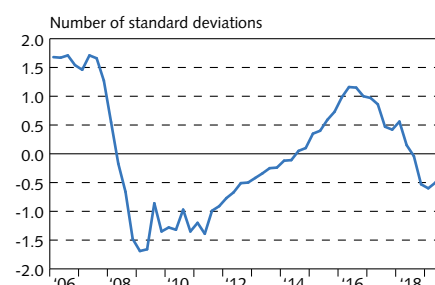
1. Labour productivity is calculated as GDP per total hours worked. Total factor productivity is calculated as the deviation of GDP from the output level obtained with full factor utilisation using the production function in the Bank's macroeconomic model. Central Bank baseline forecast 2019. Sources: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

Chart V-8  
Difference between expectations 6 months  
ahead and assessment of the current situation<sup>1</sup>  
Q1/2006 - Q3/2019



1. Measurements of household expectations, taken from the monthly Gallup Consumer Confidence Index, show the position of the end of the quarter. Corporate expectations are taken from Gallup's quarterly survey of Iceland's 400 largest firms. The index for the assessment of the current economic situation is deducted from the index of expectations six months ahead. Deviation from period average. Source: Gallup.

Chart V-9  
RU indicator<sup>1</sup>  
Q1/2006 - Q3/2019



1. The resource utilisation (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.