

IV Labour market and factor utilisation

Labour market

Job numbers declined year-on-year in Q3, but less than expected

According to the Statistics Iceland labour force survey (LFS), total hours worked declined by 3.7% year-on-year in Q3/2020, with the number of employed falling by 1.3% and average hours worked by 2.4%. The survey indicates, however, that total hours rose considerably between Q2 and Q3, after a steep decline between Q1 and Q2 (Chart 3 in Appendix 1). This recovery, which is much stronger than was assumed in the Bank's August forecast, is due entirely to job creation. Job numbers had been expected to fall, in line with indicators from both firms' recruitment plans and collective redundancies. According to the pay-as-you-earn (PAYE) register, job numbers also rose this summer, but much less than LFS figures suggest. The rebound was concentrated in the sectors servicing domestic demand that were particularly affected by the onerous public health measures imposed in H1, but also in real estate and in sectors that broadly consist of public services. However, no comparable uptick has been seen among foreign workers, whose numbers on the PAYE register have fallen by nearly 17% since February (Chart IV-1). Both the LFS and data from the PAYE register indicate that job numbers declined again in September, when economic activity started to slide once more (Chart IV-3).

Registered unemployment at a historical high

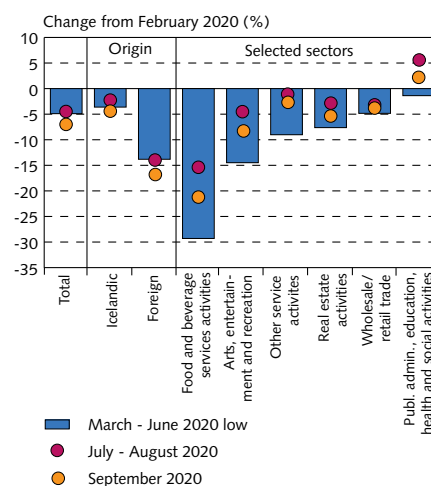
Seasonally adjusted LFS measurements indicate that labour participation rose markedly and that the employment rate rose as well in Q3, after a steep drop in Q2 (Chart 3 in Appendix 1). At the same time, the survey-based unemployment rate rose by 0.7 percentage points, to 5.8%. The seasonally adjusted registered unemployment rate excluding workers receiving part-time unemployment benefits has risen much more, however. It measured 10.1% in October, its highest since measurements were introduced in 1957 (Chart IV-2).

More than half of those on the unemployment register in October were from sectors relating to tourism and retail and wholesale trade. Imported workers and the regions of the country that rely on tourism have been hit hard: over a fifth of the foreign labour force and about the same share of workers living on the Suðurnes peninsula were unemployed during the month. The number of long-term unemployed – those who have been out of work for a year or longer – has risen as well, as economic activity was already slowing down after the recent boom by the time the pandemic struck.

Significant difference between LFS measurements and registry data

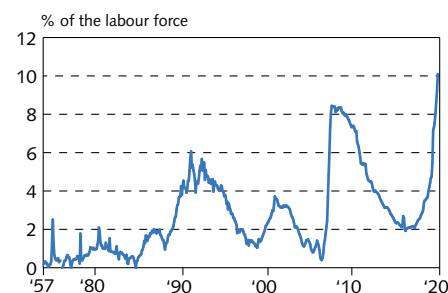
There has been a marked difference between LFS measurements and data from both employment and unemployment registers. In Q3, the LFS showed a much stronger rebound in job numbers this summer, and the LFS unemployment rate was nearly 3 percentage points lower than registered unemployment excluding part-time unemployment

Chart IV-1
Wage earners on PAYE register, by origin and in selected sectors¹



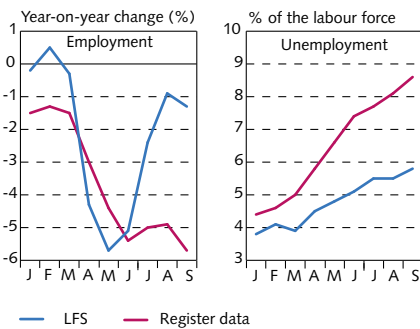
1. Seasonally adjusted figures.
Sources: Statistics Iceland, Central Bank of Iceland.

Chart IV-2
Registered unemployment 1957-2020¹



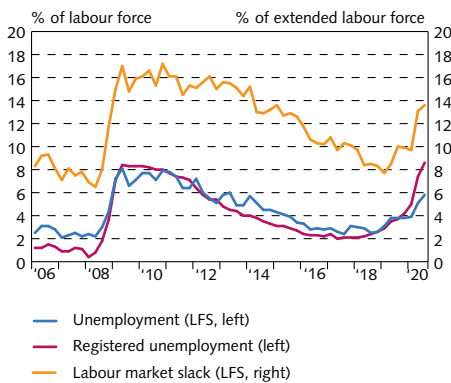
1. Annual figures for 1957-2020, and monthly figures for the period January 1980 - October 2020. Excluding persons on the partial unemployment benefit programme from March 2020 onwards. Monthly figures seasonally adjusted by the Central Bank.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart IV-3
Employment and unemployment¹
January - September 2020



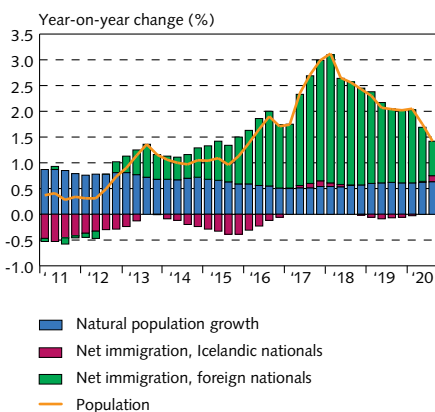
1. LFS stands for Statistics Iceland's labour force survey. Register data refer to the PAYE register for employment and Directorate of Labour unemployment register for unemployment. Unemployment is seasonally adjusted. Registered unemployment is seasonally adjusted by the Central Bank. Three month moving averages.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart IV-4
Unemployment and labour market slack¹
Q1/2006 - Q3/2020



1. The labour market slack is the sum of unemployed persons, underemployed part-time workers, and the potential addition to the labour market (persons seeking work but not immediately available and persons available but not seeking work), expressed as percentage of the extended labour force (labour force plus the potential addition to the labour market). Registered unemployment excludes persons receiving part-time unemployment benefits from Q1/2020 onwards and is seasonally adjusted by the Central Bank. Seasonally adjusted figures.
Sources: Directorate of Labour, Statistics Iceland, Central Bank of Iceland.

Chart IV-5
Population
Q1/2011 - Q3/2020



Source: Statistics Iceland.

benefit recipients (Chart IV-3). As a result, Statistics Iceland looked more closely at the responses of unemployment benefit recipients who participated in the LFS in September. That examination showed that slightly over half of those receiving benefits were classified as unemployed according to the survey, one-fourth were classified as employed, and nearly one-fifth were outside the labour market. The large share classified as employed came as a surprise, but it was expected that some of the respondents would be classified as outside the labour market, as the pandemic could affect people's ability and/or willingness to look for jobs and begin work.¹

In order to gain a more complete understanding of how a slack in the labour market can show up in the LFS data, it is possible to include those on the periphery of the job market with those classified as unemployed; in other words, to include both the underemployed and those considered a potential addition to the labour market.² Nevertheless, in Q3, both unemployment and this LFS measure of the slack in the labour market were still considerably below their post-financial crisis peak a decade ago, whereas registered unemployment was higher in Q3 than in the post-crisis period (Chart IV-4). Statistics Iceland's study also revealed that the response ratio among those on the Directorate of Labour's unemployment register was 13.5 percentage points lower than among other respondent groups. This might be related to foreign workers, for it has proven difficult to capture the foreign labour force in the LFS, as is discussed in *Monetary Bulletin 2017/2*. It is therefore considered likely that the survey-based unemployment rate is underestimated due to a non-response error.

Foreign labour force growth has slowed in the wake of the pandemic
Year-on-year population growth measured 1.4% in Q3, including 0.7 percentage points due to immigration of foreign nationals (Chart IV-5). Although growth in the foreign labour force has slowed in the past two years, it has slowed even more sharply since the pandemic struck. Net migration was positive in Q3 but negative in the quarter beforehand. There is some uncertainty about migration in the coming term, but in view of the slack in the domestic economy and the weak employment situation among foreign nationals, net migration could temporarily turn negative.

Lower unemployment forecast for this year, but the employment outlook is still bleak

It appears that demand for labour was stronger this summer than was assumed in the Bank's August forecast. Furthermore, the revision of the forecast for this year is also affected by LFS figures, which show a stronger labour market recovery in Q3 than can be considered plausible. On the other hand, the outlook for next year has deteriorated,

1. In order to be considered unemployed, a person must be looking for a job and ready to begin work within two weeks. Otherwise, the respondent is classified as outside the labour market.
2. Underemployed workers are those with part-time jobs who would like to work more. The potential addition to the labour market comprises two groups outside the market: job-seekers who are not ready to begin work and non-job-seekers who are ready to begin work.

and it appears that job numbers fell again at the beginning of this autumn. In addition, about a third of executives are still planning to reduce staffing levels in the coming term, and only a tenth are interested in recruiting, according to Gallup's autumn survey among Iceland's 400 largest firms. Total hours worked are projected to decline in 2020 by almost 6% year-on-year, which would be the largest drop in a single year since 2009. Job losses are forecast at just over 3%, but if the forecast is extrapolated to the number of jobs according to PAYE data, the decline could be nearly twice that size.

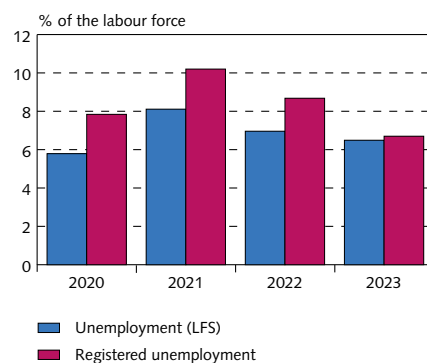
The baseline forecast assumes that unemployment will rise somewhat in Q4 and will average roughly 6% this year, according to the LFS. It will not peak, however, until H1/2021, when seasonally adjusted unemployment is projected to overtake the post-crisis peak. It will then start to fall in H2 and continue declining throughout the forecast horizon. Registered unemployment will be considerably higher during the year, however, averaging 7.9% this year and close to 10% in 2021 (Chart IV-6). The difference between the two measures of unemployment will then gradually narrow as the forecast horizon progresses. Due to a more favourable outcome this summer and measurement problems with the LFS, unemployment will be somewhat lower this year than was forecast in August (Chart IV-7). It looks set to be broadly in line with the August forecast in 2021, however, although it is now expected to fall more slowly in the latter half of the forecast than was previously projected.

Indicators of factor utilisation

Outlook for a sizeable output slack, peaking in late 2020

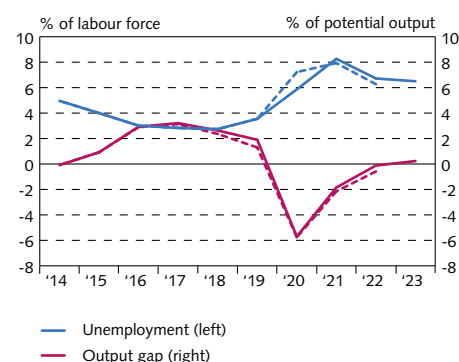
In Gallup's autumn survey, fewer executives responded that their firms would have difficulty responding to an unexpected increase in demand, and the share who considered their firms understaffed was close to its historical low. The resource utilisation (RU) indicator declined in Q3, for the fourth quarter in a row, and was roughly back to the level seen in the aftermath of the financial crisis (Chart 3 in Appendix 1). The outlook is for population growth to slow significantly in the coming term, owing to reduced inward migration by foreign nationals and for productivity growth to be historically low during the forecast horizon (see Box 1). Furthermore, equilibrium unemployment is expected to rise this year and next, as unemployment drags on. As a result, growth in potential output will ease in the first half of the period, but demand will contract more, and a sizeable slack will develop in the economy. The slack in output is projected at almost 6% of potential output this year (Chart IV-7). It will gradually narrow from early 2021 onwards but is not expected to close until H2/2022. This assessment is highly uncertain, however (for further information, see Box 1). The most important uncertainties lie in the path of the pandemic itself and the development of medical treatment or a vaccine. Another important factor is the strength and persistence of the pandemic's impact on Iceland's potential output.

Chart IV-6
Unemployment 2020-2023¹



1. Registered unemployment excludes persons receiving part-time unemployment benefits. Central Bank baseline forecast. Source: Central Bank of Iceland.

Chart IV-7
Unemployment and output gap 2014-2023¹



1. Central Bank baseline forecast 2020-2023. Broken lines show forecast from MB 2020/3. Sources: Statistics Iceland, Central Bank of Iceland.