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Newsletter

The Estonian Economy

Watch out for the growth in job vacancies

- Job vacancy rate just above average, but annual growth amongst highest in the euro area
- Unemployment and vacancy rate curve suggests no crisis yet...
- ...but job vacancy rates likely to increase further

Annual growth of vacancy rate second highest in the euro area

In the first quarter of 2017, the rate of vacant jobs in Estonia was slightly above the euro area average, but the annual growth of the vacancy rate was the second highest among 19 countries. This raises the question of whether there is a boom in the labour market that could drive excessive wage growth and a possible loss in export competitiveness. In 2015, the vacancy rate in state-offered positions started to increase, and, since the beginning of 2016, the rate for private entities followed. Foreign-owned companies and the state have the highest job vacancy rates. As foreign entities pay up to 33% more and mainly produce complex products for export, there is a possible skills mismatch.

Beveridge curve suggests no major crisis yet

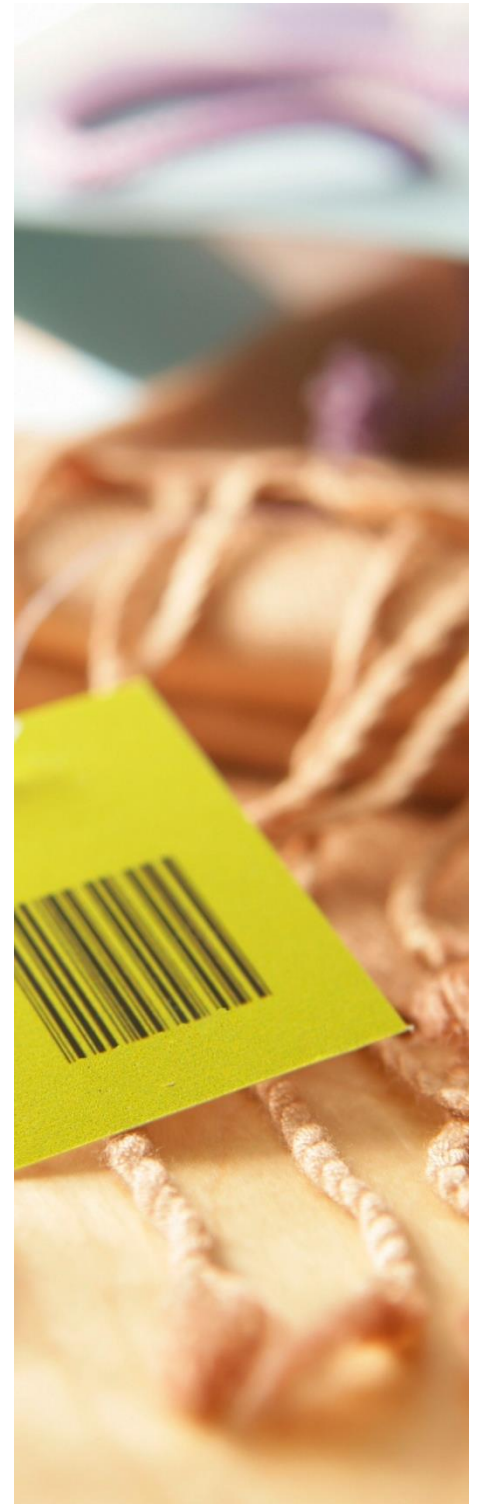
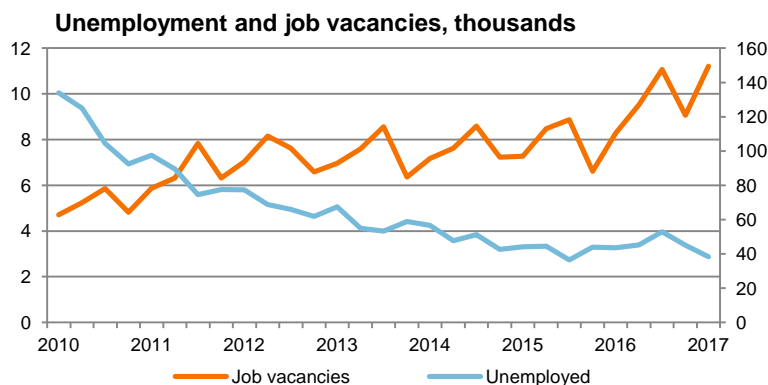
Although the job vacancy rate has noticeably increased and shifted the curve upwards, there is no reason yet to believe that we are close to the next crisis. In 2007, wage growth was over 20%, while the job vacancy rate rose to 3.5%, much higher than the 2% we witnessed in the beginning of 2017. Currently, Estonia is situated in a cluster of countries experiencing low unemployment and a medium job vacancy rate.

Service-related activities take a hit

A comparison of different sectors with their medium-term average level indicates that the situation in service-related activities, especially in administrative/support, accommodations, and food service activities, has worsened the most. The job vacancy rate for the total economy grew from 1.3% in 2010-2015 to 2% in the first quarter of this year.

Job vacancy rates likely to increase further

In Estonia, the unemployment level is rather low and below the natural rate of unemployment. At the same time, the labour force participation rate and employment rates are high. Therefore, all the existing resources have already been more or less utilised and the labour market is tight. In an economic upswing, job vacancy rates are liable to increase further.



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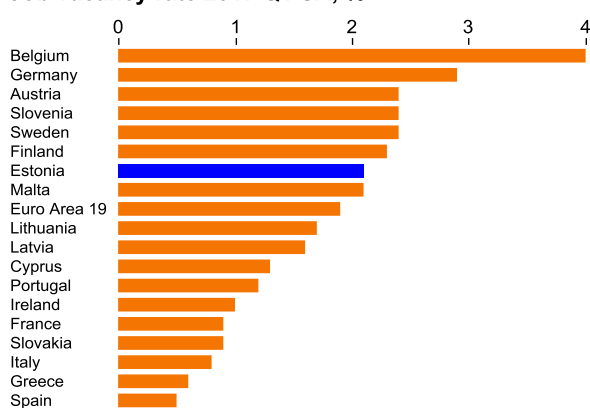
Watch out for the growth in job vacancies

Since the end of the previous economic crisis, the rate of unemployment has gradually decreased and the number of job vacancies increased. Although this is normal during an economic upswing, job vacancies have lately increased much faster than unemployment has decreased. In fact, unemployment even slightly increased in 2016 before dropping to the rather low level of 5.6% in the first quarter of this year. This indicates a potential mismatch between the supply and demand of labour. This edition of the *Estonian Economy* offers an insight into the supply-demand framework of the labour market across different sectors.

Annual growth of vacancy rate second highest in the euro area

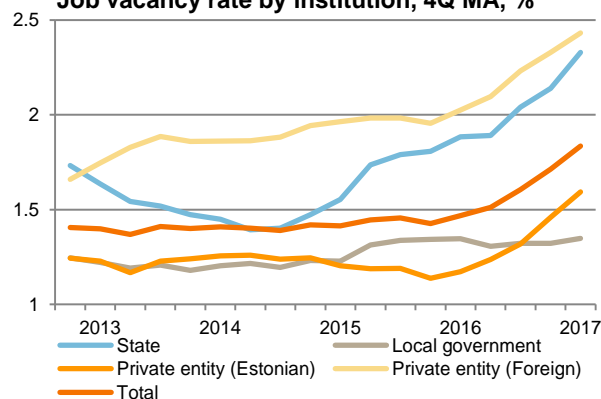
The rate of job vacancies is measured as the share of vacant positions in the total number of jobs in a specific sector or the overall economy. In the first quarter of 2017, the rate of vacant jobs in Estonia was slightly above the euro area average, but the annual growth of the vacancy rate was the second highest among 19 countries. While the annual growth of the vacancy rate in the euro area was 12%, Estonia had 35% more vacant positions than a year ago, indicating that the expansion of its economy could be much faster or production in Estonia is less capital intensive. According to Statistics Estonia, there were 11,200 vacant positions in the first quarter of 2017, the highest number since the economic crisis. In the third quarter of 2008, there were 16,000 vacant positions, but this quickly dropped to just 5,000 when the crisis hit in the beginning of 2009. This raises the question of whether there is a boom in the labour market that could drive excessive wage growth and a possible loss in export competitiveness. The labour market in Estonia is currently very tight.

Job vacancy rate 2017 Q1 SA, %



Source: Swedbank Research & Macrobond

Job vacancy rate by institution, 4Q MA, %



Source: Statistics Estonia

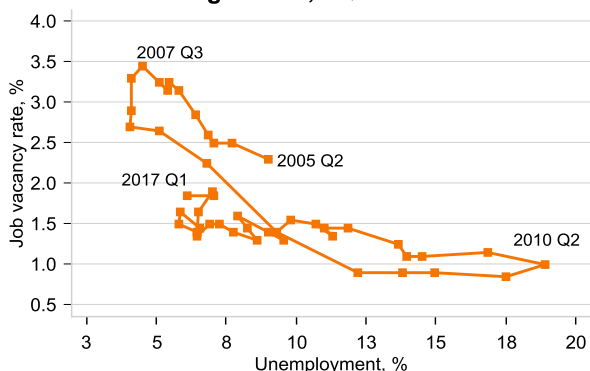
A hunt for the source of vacancies reveals that Estonian local governments have had relatively stable job vacancy rates; this is understandable, as local governments provide the same services despite economic fluctuations. In 2015, the vacancy rate in state-offered positions started to increase, and, since the beginning of 2016, the rate for private entities followed. As private entities make up about 75% of total engaged employees, a rise in the vacancy rate there immediately affects total statistics. Foreign-owned companies have substantially higher vacant jobs rate than Estonian private entities but employ only 21% of the engaged workforce. Interestingly, wage data tell us that, as an average of the last four quarters, state and foreign-owned entities pay 33% more than Estonian private enterprises based on local capital. The reason why foreign entities have higher job vacancy rates might be because they require a more skilled workforce, which is harder to find. Enterprises owned by foreigners are mainly export oriented and produce goods and services that are more complex in nature. This implies some skills mismatch in the labour market.

Beveridge curve suggests no major crisis yet

In order to assess the situation in the labour market, it is necessary to look at the supply side of labour as well. The Beveridge curve offers an insight into the supply-demand dynamics of the labour market, plotting together unemployment and the rate of job vacancy. There is a naturally negative relationship between unemployment and job vacancies (see graph on the front page). During an economic expansion, there is a low rate of unemployment, together with a high rate of job vacancies and vice versa in times of crisis.

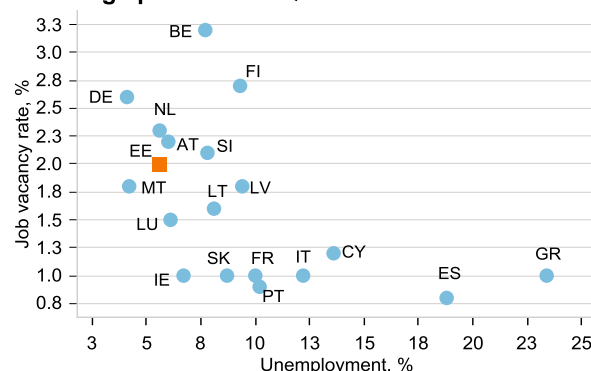
Although the job vacancy rate has noticeably increased and shifted the curve upwards, there is no reason yet to believe that we are close to the next crisis. In 2007 wage growth was over 20% while job vacancy rate rose to 3.5%, much higher than the 2% we witnessed in the beginning of 2017.

Estonian Beveridge curve, 2Q MA



Source: Swedbank Research & Macrobond

Beveridge points 2017 Q1



Source: Swedbank Research & Macrobond

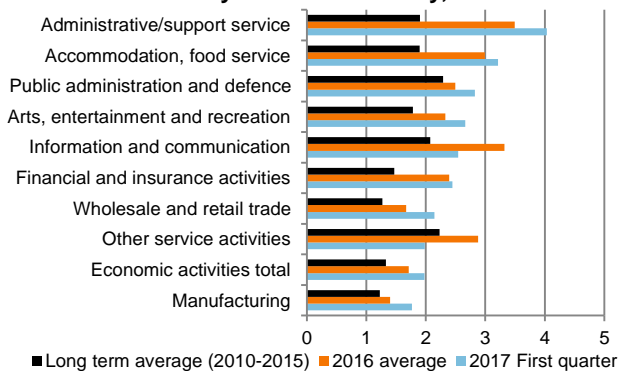
During the last year, we also witnessed a rather high growth of wages--which can also refer to a skills mismatch in the labour market. This would mean that the Beveridge curve would be shifted outwards from origin. However, in the first quarter of 2017, unemployment decreased, together with wage growth, shifting the curve inward and therefore reducing the possibility of a widening skills mismatch.

Plotting the countries on an unemployment-job vacancy rate matrix gives an indication of the efficiency of job matching in different countries. Estonia sits in a cluster of countries having low unemployment and a medium job vacancy rate. This suggests that, in the bigger picture, there should be no major matching problems on the labour market and, therefore, the efficiency of the matching process in Estonia can be considered as mediocre. This does not mean that the same situation exists in all sectors of the economy. Some sectors are always having more trouble than others in finding labour with the necessary skills at an acceptable cost. Therefore, we take a look at job vacancies across different sectors in Estonia.

Service-related activities take a hit

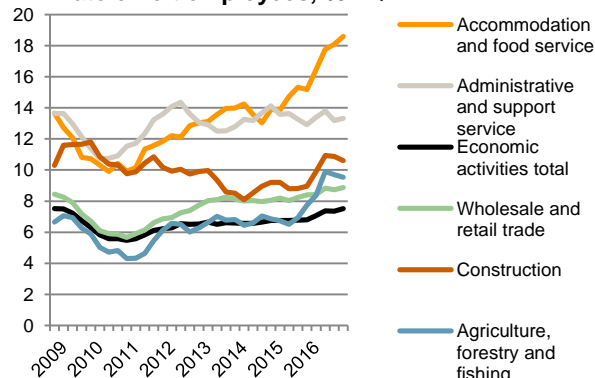
A comparison of different sectors with their medium-term average level indicates that the situation in service-related activities, especially in administrative/support, accommodations, and food service activities, has worsened the most. The medium-term (2010-2015) average shows about a 2% job vacancy rate in those sectors, whereas current numbers are much higher. For example, in administrative and support service activities the job vacancy rate rose to 3.5% in 2016, and first-quarter data for this year show a jump in this to 4%. Administrative and support service activities include renting, travel agencies, security, and property management. The job vacancy rate for the total economy grew from 1.3% in 2010-2015 to 2% in the first quarter of this year. The lowest levels of job vacancy (about 1%) are in the water supply & waste management, mining, and real estate sectors. Also, it is noticeable that the first-quarter data show some release of pressure in job vacancies in the information and communications sector job vacancies. The job vacancy rate in that sector has been higher than average even though the the average wage in the sector is almost twice the average of the total economy.

Job vacancies by economic activity, %



Source: Statistics Estonia

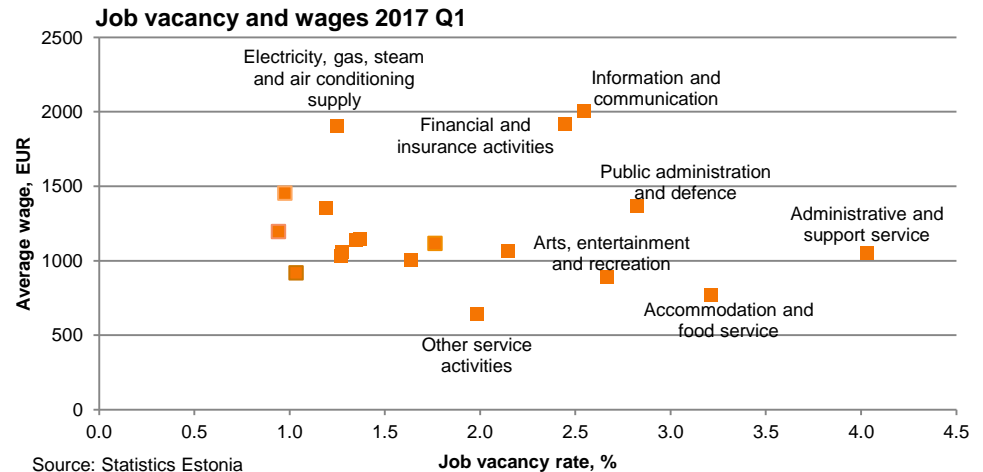
Rate of left employees, % 4Q-MA



Source: Statistics Estonia

In order to understand why job vacancies are high, the rate of left employees must also be considered: job vacancies can be high because employees are constantly moving around

inside the sector, looking for better work conditions. In the case of accommodations and food service activities, there is a clear correlation between the increasing rate of employees left and the job vacancy rate. The same can be observed in the whole- and retail sale sector. Wages in accommodations and food service activities also are among the lowest in Estonia, which clearly indicates why, from an individual viewpoint, it is important to constantly keep an eye on vacant positions. The plot of the job vacancy rate and average wage on the graph below shows that a high vacancy rate is not explicitly associated with a low level of wages. From the graph below, several clusters can be distinguished.



There are sectors that offer close-to-the-average wage and feature lower-than-average vacancy rates. Sectors in that cluster are most efficient in the matching process. Electricity, gas, steam, and the air conditioning supply sector seems to be slightly overpriced, as it has a lower-than-average job vacancy rate, but very high wages. On the other hand, jobs in this sector are dangerous and require extensive training.

Information and communications, together with financial and insurance activities, are two of the most highly paid sectors, but still face job vacancy rates above average. In cases where wages and vacancy rates are relatively high, but the rate of left employees is low, we can suspect a problem of skills mismatch.

Sectors that have wage levels below the average, while accompanied by a rather high rate of employees left should think about increasing wages to push down the high job vacancy rate.

Job vacancy rates liable to increase further

In Estonia, the unemployment level is rather low and below the natural rate of unemployment. At the same time, the labour force participation rate and employment rates are high. Therefore, all the existing resources have more or less already been utilised and the labour market is tight. In the case of an economic upswing, this means that job vacancy rates can only increase, unless some sort of a solution can be found.

The solution could be a more efficient use of labour. On the one hand, this means more automation and investments to reduce labour demand, while on the other hand, keeping the labour-matching process as efficient as possible. This puts extra pressure on the education system to produce a labour force that can be used efficiently in the economy. However, increasing the efficiency of the education system and automation might not be enough, as Estonia is also faced with the problem of an aging population. Therefore, skilled labour should be imported in cases where it is necessary to avoid labour market overheating.

The Estonian government has set a quota on immigration for third-country nationals that is 0.1% of the permanent population of Estonia annually. In addition, employers must pay at least the average wage, or more, depending on circumstances. Certain sectors and professions are exceptions to the quota, but this year the quota has already been surpassed. These conditions make it hard for employers to import the labour they need; therefore, a discussion has been started in the government to drop or ease the quota. Decisions must be made responsibly, though, in order to ease the labour shortage and not increase tensions further by allowing very cheap, unqualified labour into the market.

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