FÁS Quarterly Labour Market Commentary

Third Quarter 2007

Executive Summary[1]

The Irish labour market appears to be entering a transition phase as the era of rapid employment growth subsides and is replaced by more modest job creation. While employment growth remained extremely strong in the first half of the year, a host of economic and labour market indicators would suggest that a more moderate rate of growth can be expected in the second half, followed by a more pronounced deceleration in 2008. The sensitivity of migration to fewer job opportunities will partly determine the impact of the deceleration on unemployment.

So far this year employment growth has grown by 3.9% (+78,400) year-on-year. The fastest rate of growth has been in the financial, business & insurance services sector. The manufacturing sector has continued to recover from a poor employment performance in the first half of the decade. By contrast, the anticipated fall in construction employment has finally begun, ending five years of continuous growth.

The unemployment rate continues be low by EU standards, although it has been edging upwards in recent months, reaching 4.7% in September. Meanwhile, unemployment has been falling across the rest of the EU, especially in the newer Member States.

However, the difference between conditions in the Irish and Central European labour markets continues to be sufficiently wide to encourage large scale inward migration. Since the start of the year over 90,000 PPS numbers have been issued to EU10 nationals bringing the total past the 400,000 mark. That said, the rate of inflow has begun to decelerate after peaking in late 2006.

Year-to-date vacancy data would suggest that labour demand in the services sector remains buoyant. However, labour demand indicators in the construction sector continue to point to a weakening in demand as evidenced by a fall in construction-related vacancies and apprentices in the third quarter.

Earnings growth so far this year has been broadly in line with inflation, averaging just over 5%. As a result, there has been very little growth in real earnings.

While the labour market has performed extremely well so far this year, all the indicators suggest that recent growth rates will not be sustainable in the short to medium-term. Since the last *Quarterly* was published, the short-term outlook for the economy has become less favourable, reducing the potential for job creation. In particular, the construction sector, which has been one of the primary conduits of jobs growth, is expected to act as a

[1] Brian McCormick, an economist working in the Planning and Research Department of FÁS, prepared this Commentary.

major drag on employment growth as new house-building declines. And while other construction activity is expected to take up some of the slack, we still expect net job losses to be in the region of 25,000 over the forecast period.

Fortunately, employment growth in the services sector is expected to remain relatively strong in 2008, reflecting the sectoral shift in the economy. However, the precise rate of services jobs growth will depend on the impact of the forthcoming budget on public sector recruitment and on the credit crisis in the financial services sector. A modest increase in employment is forecast for the manufacturing sector. In the round, we are forecasting total employment to grow by 3.4% (+70,000) in 2007 before slowing significantly to just 1.0% (+21,000) in 2008.

We take the view that migration will be sensitive to the employment slowdown and are forecasting migratory inflows to halve in 2008. Reduced migration, along with a decline in the participation rate, should lessen the impact of slower jobs growth on unemployment. Nevertheless, we are still forecasting the unemployment rate to increase from 4.6% in 2007 to 5.3% in 2008 with the numbers unemployed averaging 118,000 next year.

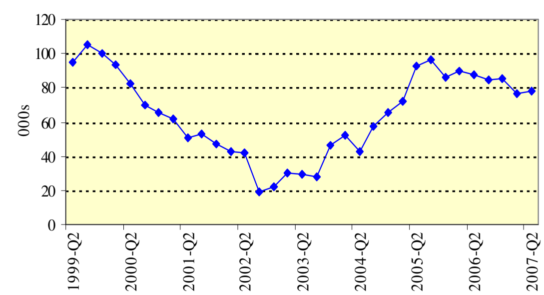
Macroeconomic Context

The strong growth rates of 6.5% (GNP) and 5.7% (GDP) registered last year are unlikely to be repeated in 2007. The indications are that most of the growth for 2007 has already taken place in the first half of this year. The latest figures from the national accounts show GNP and GDP growing by 5.7% and 6.7% respectively in the 12 months to the first half of 2007. However, when seasonally adjusted, both GDP and GNP fell quarter-on-quarter by -1.4% and -0.9% respectively in Q2 2007. Furthermore, the slowdown in the residential building sector will act as a drag on economic growth in the second half of year. Essentially, a shift from domestically driven growth to export led growth has begun to take place. The recent increase in our export volume has been primarily due to an expanding world market rather than an improvement in our international competitiveness. In fact, competitiveness is likely to have weakened this year due to the rise in the value of the euro vis-à-vis the dollar.

Employment Trends

Given the strong year-on-year economic growth recorded in the first half of the year, it is not surprising that job creation continues to be significant. Employment grew by 3.9% (+78,400) year-on-year in Q2 2007 to 2.095 million (Table 1). This was slightly faster than the growth rate of 3.8% recorded in Q1 but slower than the 4.6% growth registered in Q2 2006. More generally, employment growth peaked towards the end of 2005 and has been trending downwards since (Figure 1). Despite the recent deceleration, Ireland's rate of job creation continues to be extremely high when viewed from an EU perspective. In the year to Q2 2007 employment in the EU27 grew by 1.5% with Latvia the only Member State to have a growth rate (4.4%) faster than Ireland's[2].

Figure 1: Year-on-Year Employment Growth 1999-2007



Source: CSO

Table 1: Summary of Labour Force Statistics

Statistic (000s)	2006Q2	2007Q2	Change
Total Employment	2,017.0	2,095.4	*3.9%*
Female Employment	855.0	899.4	*5.2%*
Male Employment	1,162.0	1,195.9	*2.9%*
Full-time Employment	1,665.4	1,716.2	*3.1%*
Part-time Employment	351.6	379.1	*7.8%*
Agriculture	114.5	111.7	*-2.4%*
Manufacturing	288.5	291.5	*1.0%*
Construction	262.7	280.3	*6.7%*
Services	1351.2	1408.9	*4.3%*
Unemployment	91.4	98.8	*8.1%*
Labour Force	2108.3	2194.1	*4.1%*
Unemployment Rate	*4.3%*	*4.5%*	*0.2pp*
Employment Rate	*68.1%*	*68.9%*	*0.8pp*
Participation rate	*62.6%*	*63.4%*	*08pp*

Source: CSO

[2] However, Q2 figures were not available for some Member States, most notably Luxembourg and Bulgaria who both had employment growth rates in excess of 4% in Q1.

The Irish employment rate was 68.9%, an increase of 0.8 percentage points on the 68.1% recorded in Q2 2006. The female employment rate was 60.3% which exceeds the EU Lisbon target of 60% by 2010. A noticeable aspect of recent employment growth was the importance of part-time work which accounted for 35% of the total growth in the year to Q2 2007.

Sectoral Employment

The services sector continues to dominate employment growth. In Q2 2007, services employment grew by just under 58,000 (+4.3%) year-on-year, accounting for almost 75% of the increase in total employment over the period. The importance of the services sector is due in part to its sheer size (accounting for 2 out 3 jobs in Ireland) and in part to Ireland's continued evolution towards a services-based economy. Within the services sector the most rapid growth rates were recorded in the health sector (+5.9%), the hotels and restaurant sector (+6.9%) and, in particular, the financial and other business services sector (+7.6%) where employment grew by over 20,000. This sector has been at the forefront of the growth in service exports in recent years and the increase in employment partly reflects this.

Employment growth in the financial and other business services sector even outpaced the construction sector which has consistently recorded the fastest rate of jobs growth in recent years. Although year-on-year growth in the construction sector continued to be strong at 6.6% (+17,600), this represents a considerable deceleration from the 11.2% growth rate recorded in the previous quarter. In fact, on a quarter-on-quarter basis, the seasonally adjusted figure for construction employment actually fell from 285,000 in Q1 to 283,500 in Q2. This signals the end of a five year upward trend during which time an additional 100,000 net construction jobs were created, accounting for almost one third of the increase in total employment (Figure 2). The recent deceleration was inevitable given the fall off in residential housing activity in the first half of the year.

Figure 2: Seasonally Adjusted Q-on-Q Construction Employment Growth 2002-2007

Source: CSO, QNHS

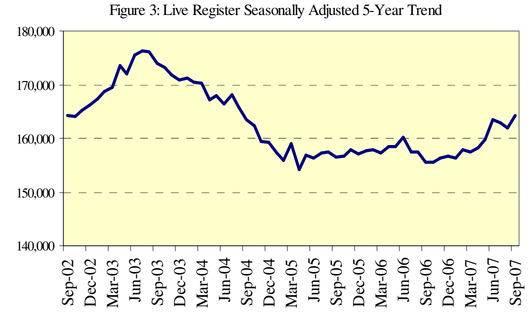
While the construction sector has been a mainstay of jobs growth since 2002, the manufacturing sector has lost 30,000 net jobs over roughly the same time period. Yet the current signs are that manufacturing employment is beginning to make a recovery (albeit a modest one). In Q2 2007, employment in the sector had increased by 1.1% (+3,200) year-on-year to 292,800. This is consistent with the increase in exports that occurred during this period. Agricultural employment remained virtually unchanged from a year previous.

Unemployment Trends

The number of unemployed persons rose by 7,400 year-on-year to 98,800 in the twelve months to Q2 2007, while the seasonally adjusted unemployment rate increased from 4.4% to 4.6% over the same period. All of the recent increase was accounted for by short-term unemployment (+8,600), while long-term unemployment fell by 1,200. Foreign nationals accounted for 14,900 of the total unemployed, an increase of 1,200.

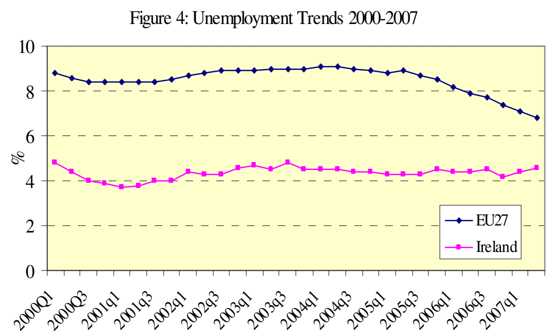
The Live Register, which provides a more up-to-date indicator of unemployment trends, points to a further loosening in the labour market in recent months. When seasonally adjusted, there were 164,200 persons signing on the Live Register in September of this year, an increase of 8,500 since the end of 2006 (Figure 3). In fact, the numbers signing on are currently at the highest they have been since September 2004. While some increase is to be expected, given the growth in the labour force over the intervening period, the pace of the rise over the last 12 months suggests that the labour market is not as tight as it was a year ago. This is reflected in the seasonally adjusted unemployment rate, which, when recalibrated to take account of the rise in the Live Register, is estimated to have risen to from 4.3% in September 2006 to 4.7% in September 2007. A further sign of a slight weakening in the labour market has been an 11% year-on-year increase in the number of redundancies for the first nine months of the year. The most noticeable increase occurred for the construction sector where redundancies have risen by 66% year-on-year.

Figure 3: Live Register Seasonally Adjusted 5-Year Trend



Source: CSO

Despite the recent increase in our unemployment rate, it continues to be one of the lowest rates in the EU. However, the gap between the Irish unemployment rate and the EU27 average has been narrowing since 2004 when the EU27 unemployment rate was twice the Irish average at 9% (Figure 4). In the most recent 12 month period the EU27 unemployment rate has fallen from 7.8% to 6.7%. The largest reduction has occurred in Poland where the unemployment rate fell by over 4 percentage points from 13.3% to 9.1% (Figure 5). The Netherlands and Denmark had the joint lowest unemployment rate in the EU at 3.3%.



Source:Eurostat

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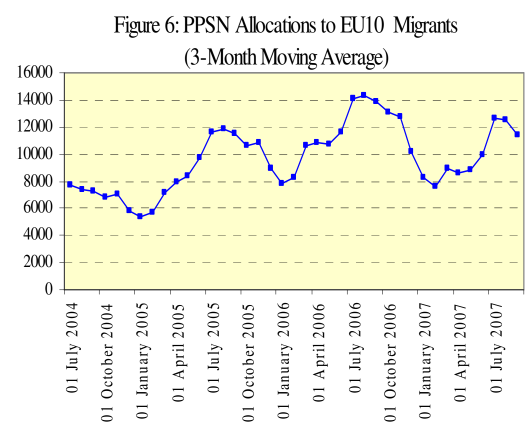
Labour Supply

There were 2.194 million persons in the labour force in Q2 2007, up 86,000 (+4.1%) on Q2 2006. Demographic factors (i.e. immigration and the natural increase) accounted for 75% of the increase, with increased participation accounting for the remainder. Notably, over half of the demographic component of the labour force increase was accounted for by the 25-34 age group. The labour force now accounts for 63.4% of all persons aged 15 or over.

The contribution of immigration alone is estimated to have accounted for 52% of the increase in the labour force with non-Irish nationals now making up approximately 13% of the total labour force. As has been pointed out in the previous *Quarterly* this estimate is sure to be revised upwards in light of the results from the 2006 Census.

Data on the issuing of Personal Public Service (PPS[3]) numbers provide a further source of information on migration (specifically from the new EU Member States). As of September, over 400,000 PPS numbers have been issued to EU10 migrants since January 2004, of which almost 300,000 have involved some form of employment. While the inflow of EU10 migrants continues to be strong, with over 90,000 being issued PPS numbers in the first nine months of this year, it has moderated slightly since 2006 (Figure 6).



Since EU enlargement, the rate at which work permits have been issued has halved. In the first nine months of 2007 there were 18,000 permits issued compared to 36,000 for the

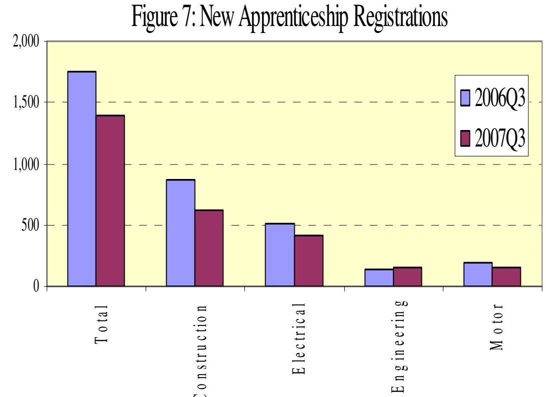
[3] PPS numbers are issued by the Department of Social and Family Affairs (DSFA) and are necessary to take up employment.

same period in 2003. The vast majority (89%) of new work permits issued so far this year were in the services sector, up from 78% in 2003. There has been a large increase in the number of work permits issued in the health sector, rising from 1,001 in 2003 to 2,309 in 2007. The 2007 figures include Green Cards issued under the new employment permits system introduced this year. So far, approximately one-third of the new work permits issued have been Green Cards.

Labour Demand

Almost 1,400 new apprentices were registered in Q3 2007. While this suggests that labour demand remains relatively strong, it does represent a fall of 21% compared to Q3 2006 (Figure 7) when construction starts were reflecting the strong growth in the construction sector. Not surprisingly, the recent moderation in apprenticeship registrations has primarily occurred in the construction-related trades although there has also been a slight decline in the motor trades.

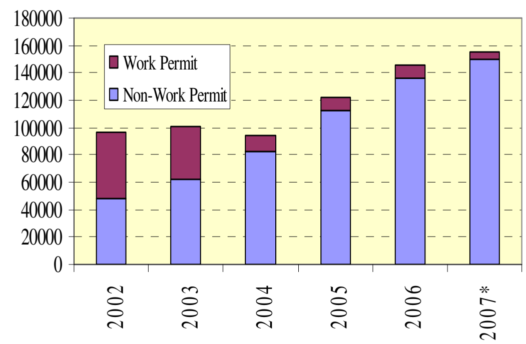
Figure 7: New Apprenticeship Registrations



Source: FÁS

The number of vacancies notified to FÁS continued to grow. In fact, the total number of vacancies in 2007 is expected to exceed 150,000 which would be the highest in the 20-year history of FÁS (Figure 8). The increase is being driven by the services sector which accounts for the vast majority of FÁS vacancies. However, the share of vacancy notifications that are associated with work permit applications continues to fall as the number of work permits being issued declines.

Figure 8: Vacancies Notified to FÁS 2002-2007



Source: FÁS

Other vacancy data from the *FÁS\ESRI Employment and Vacancies Survey* suggests that economy-wide the level of vacancies has fallen slightly. There was a 2 percentage point drop in the proportion of firms reporting vacancies from 17% to 15% in the twelve months to September[4] (Figure 9). The most notable falls were in the industry and construction sectors. In fact, the number of constructions firms reporting vacancies has almost halved since the start of the year, falling from 14% in January to just 8% in September.

[4] Based on a three-month moving average

This is the lowest incidence of vacancies in the construction sector since the survey began five years ago (Figure 10).

Although vacancy trends are a good proxy for trends in labour demand, the proportion of these vacancies that are 'difficult-to-fill' provides additional information on the extent of labour shortages. The percentage of firms with difficult-to-fill vacancies increased from 7% in September 2006 to 10% in September 2007 (Figure 11). The vacancies that employers found most difficult to fill in September were, by sector:

- *Construction: Quantity surveyors and managers*
- *Services: Managers and accountants*
- *Industry: Engineers, managers, sales personnel*
- *Retail: Sales staff and mechanics*

Overall, the available indicators point to continued strong demand for labour in the services sector but a significant weakening in demand for construction workers.

Figure 9: Firms in All Sectors With Vacancies

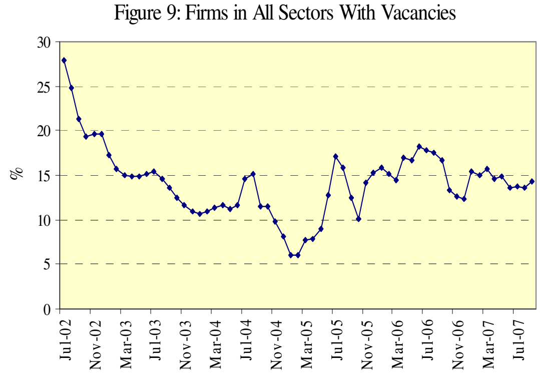


Figure 10: Consturction Firms with Vacances

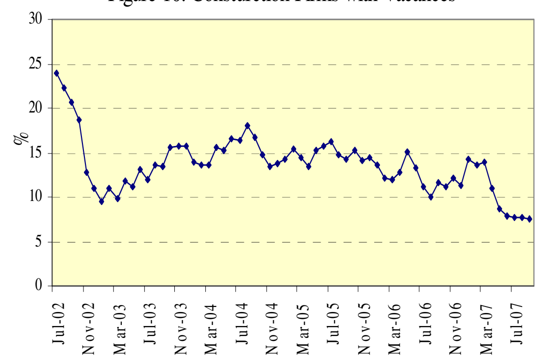
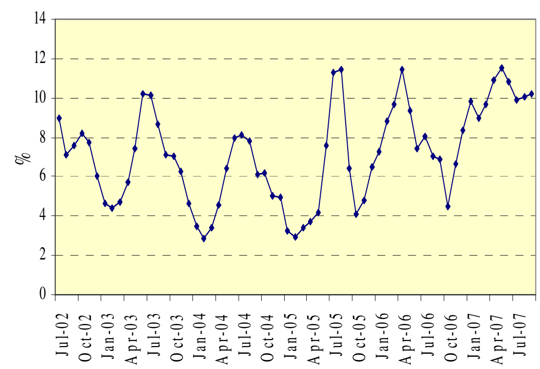


Figure 11: Firms with Difficult-to-Fill Vacancies



Source: FÁS\ESRI Employment and Vacancies Survey.

Earnings Trends

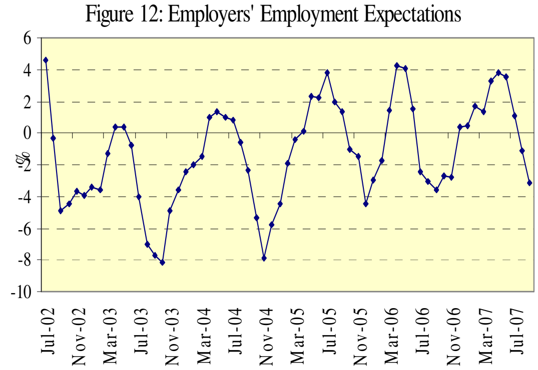
Annual earnings growth so far this year has been broadly in line with inflation averaging just over 5%. As a result, there has been very little growth in real earnings. The rate of growth has tended to be marginally higher than in 2006 when earnings growth averaged 4.5%. However, a noticeable acceleration has taken place in the construction sector where the annual earnings growth rate was 6.1% in Q2 2007 compared to 0% in Q2 2006.

Prospects and Conclusions

Since the last *Quarterly* was published, the short-term outlook for the economy has become less favourable for two main reasons; weaker than anticipated housing data and the recent credit crisis. As a result, most economic commentators have revised downwards their growth forecasts for both 2007 and, particularly, 2008. While there is no consensus among commentators as to the speed of the deceleration, growth forecasts for GNP and GDP are averaging in the region of 4.5% and 4.75% for 2007 respectively and 3% and 3.25% for 2008. The main sources of economic growth are expected to be consumer demand and exports as house completions fall significantly from their 2006 level. The risks to these average forecasts are on the downside given the continuing uncertainty in the financial markets and rising oil prices.

The less favourable economic environment will reduce the scope for employment expansion. The employment impact of the slowdown will be amplified by the fact it is being caused by a contraction in output in the labour-intensive construction sector. That said, we are actually raising our employment forecast for this year on the basis of stronger than anticipated jobs growth in Q2 2007. Specifically, our employment growth forecast is up from 3.0% (+60,000) to 3.4% (+70,000) for 2007. As a result, employment is expected to average 2,109,000 for the year. However, this strong growth rate masks the fact that job creation in the second half of this year is likely to be noticeably weaker than in the first half. The deceleration is expected to become more marked in 2008 with net employment growth expected to slow to just 1.0% (+21,000). Recent data from the FÁS\ESRI Vacancy Survey on employment expectations points to a decline in recruitment sentiment in recent months, although employers' expectations are usually more pessimistic in the second half of the year (Figure 12).

Figure 12: Employers' Employment Expectations



Source: FÁS\ESRI Employment and Vacancies Survey

The primary reason for the slowdown in employment growth is the downturn in the construction sector, and in particular, the decline in new house completions. While NDP infrastructural projects and home improvements will absorb some of the negative impact of the housing slowdown, net job losses seem inevitable given the likely scale of the output contraction. Employment in the sector probably peaked at 285,000 in Q1 of this year and there is every reason to believe that the trend will be downward over the forecast period, with a net loss of 25,000 jobs expected by the end of 2008. The Ulster Bank Construction PMI for September would seem to support this pessimistic prognosis, recording the sharpest fall in staffing levels since June 2003. That said, the *annual average* for construction employment is still expected to rise by 4.5% (+12,000) in 2007 compared to 2006, before falling by -6.2% (-17,000) in 2008.

The largest absolute increase in employment will continue to come from the services sector. In fact, over the forecast period, we expect employment growth in the services sector to exceed total jobs growth. In short, we are forecasting the number of service sector jobs to increase by 4.1% (+56,000) in 2007 and by a further 2.7% (+38,000) in 2008. This forecast assumes that there is lag period before the full impact of the construction slowdown spills over into the services sector. The risks to the 2008 forecast are probably on the downside, and much will depend on the impact of the forthcoming budget on employment in the public sector and on the credit crisis in the financial sector – two sectors that have been major contributors to recent jobs growth.

We expect the modest recovery in the manufacturing sector to continue for the remainder of this year and into 2008 as exports continue to benefit from an expanding global market. Indeed, the NCB PMI for September suggests that both employment and business activity in the sector has been increasing in recent months. However, the appreciation of the euro vis-à-vis the dollar is likely to put a limit on the scope for expansion. On balance, we are forecasting manufacturing employment to rise by 1.1% (+3,000) in 2007 with a more moderate increase of 0.6% (+2,000) anticipated for 2008.

The appreciation of the euro, combined with adverse weather conditions this summer, is likely to have a negative knock-on effect on the agricultural sector. A slight fall of -0.5% (-1,000) in the employment level in the sector is expected this year followed by a further decline of -1.8% (-2,000) in 2008.

The impact of the slowdown in employment on unemployment will partly be determined by the immigration response to fewer job opportunities. While the magnitude of any such immigration response is very hard to predict, some general observations can be made. Firstly, the improvement in Central European labour markets will increase the incentive for EU10 migrants to return home, and reduce their incentive to come here. Indeed, the latest PPS trends suggest that inward migration is beginning to slow, although inflows are still stronger than in 2004 and 2005. However, little is currently known about the outward flow of migrants. Nevertheless, it seems likely, given the transient nature of much of the recent migration, that migratory flows will be quite sensitive to an employment slowdown.

On balance, therefore, it is assumed that there will be a slight moderation in migration this year before a more noticeable deceleration in 2008. We are forecasting that net-inward migration will moderate from 74,000 in 2006 to 70,000 this year before halving to 35,000 in 2008.

The deceleration in immigration combined with a smaller contribution from both the participation effect and the natural increase should see labour force growth moderating from 3.7% (+80,000) in 2007 to 1.6% (+36,000) in 2008. Despite this deceleration, the labour force will be growing at a faster rate than employment and as a result, the unemployment rate will rise. Specifically, the annual average unemployment rate is forecast to increase from 4.4% in 2006 to 4.6% in 2007 before rising more rapidly to 5.3% in 2008. This equates to an average of 118,000 persons unemployed in 2008.

In summary, the outlook is for a marked deceleration in employment and a noticeable upturn in unemployment next year. This is in sharp contrast to the strong employment performance of recent years. While the slowdown in the construction sector is the main reason for this reversal, a spillover effect into the services sector can be expected in the latter part of 2008.

Table 2: Annual Averages (000s) 2006-2008

	2006	**2007**	**2008**
Agriculture	117	116	114
Construction	269	281	264
Manufacturing	291	294	296
Services	1,362	1,418	1,456
Total Employment	2,039	2,109	2,130
Unemployed	93	102	118
Labour Force	2,132	2,212	2,248
Net Immigration	74	70	35
Unemployment Rate	4.4%	4.6%	5.3%