UHERO
THE ECONOMIC RESEARCH ORGANIZATION AT THE UNIVERSITY OF HAWAI'I

UHERO STATE FORECAST UPDATE, PUBLIC SUMMARY

Hawaii on Steady Course for 2015

FEBRUARY 27, 2015

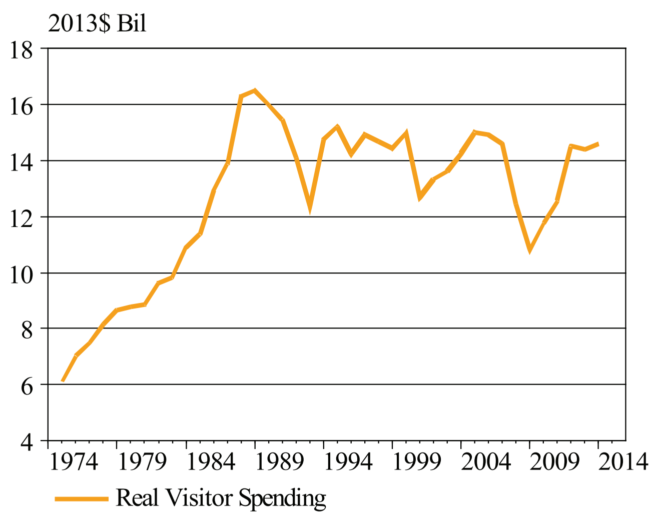
A little stronger here, a little weaker there. Overall, 2015 will see a continuation of last year's moderate expansion.

The Hawaii economy in 2015 will look a lot like last year's. Tourism will see only marginal gains, but steady labor market improvement will continue, and there will be moderate income growth. While not all damage from the past recession has been repaired, by many measures economic activity in the state is returning to normal.

The visitor industry posted another record year in 2014. After languishing early in the year, the industry had a strong fourth quarter, and visitor arrivals climbed above 8.1 million. The total number of visitor days, which takes into account length of stay, rose by 1%. Visitor spending also reached record levels, mostly due to continuing growth in lodging prices. However, after adjusting for inflation, real visitor spending remains below its 1989 peak. Continuing the pattern of recent years, the strongest contribution to last year's performance came from secondary markets around the Pacific Rim, that is, international markets other than Japan and Canada. At the same time, the momentum from these markets has slowed to mid-single-digit growth rates, in part because of the US dollar's strength and the rising cost of a vacation in Hawaii.

This year is expected to be a very rocky one for the Japanese economy, which is still struggling to recover from the effects of last April's consumption tax increase. Japanese visitor days fell by nearly 3% in 2014, which, coupled with the continuing depreciation of the yen, led to a similar decrease in visitor spending. Without any major improvements in the Japanese economy, we expect that Japanese visitor days for 2015 will fall by about 4%. The decline in Japanese visitor activity will be mostly offset by the increasing presence of other international visitors. Weak energy prices, while hurting commodity exporters such as Canada and Australia, will also put a lid on airfares. This will make the cost of a Hawaii vacation slightly more affordable and contribute to a 2.3% gain in arrivals from secondary markets in 2015.

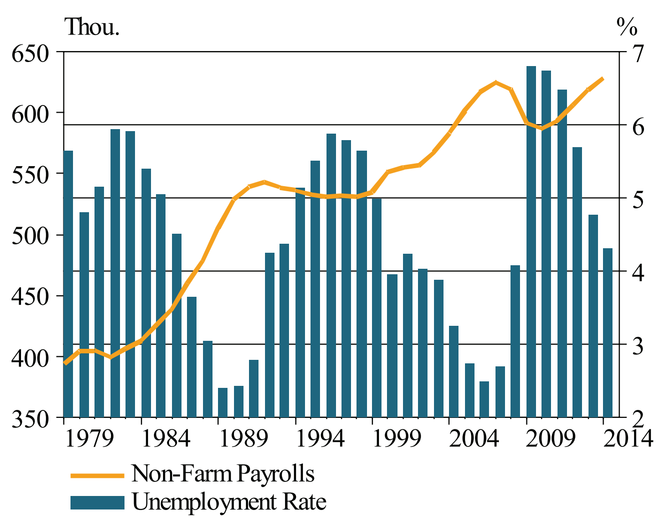
The tourism industry will get some much-needed support from US visitors this year. With new flights introduced from the Midwest to Honolulu, from the West Coast to the Big Island, and even new inter-island flights to Molokai, US visitors will have more opportunities to explore attractions across the state. The Ohana Waikiki West hotel is shutting down for renovations in March, so the room supply on Oahu will remain very tight, helping to maintain last year's pattern of relatively stronger growth on the Neighbor Islands. In fact,



DESPITE RECENT GAINS, VISITOR SPENDING IN REAL TERMS REMAINS BELOW LEVELS SEEN IN THE LATE 1980S with Oahu occupancy rates near historic highs and room prices having surged 50% since the depth of the recession, we expect most of the growth in the coming years will come from visitors traveling to the Neighbor Islands.

Conditions in the local construction industry remain decidedly mixed. In 2014 we saw a surge in non-residential permitting, particularly on retail and medical facilities, but there was a dramatic slowdown in permits for new residential building, particularly on Oahu. Partly due to the mix of building types—large scale projects can be built more efficiently than single family homes—job growth in the sector was anemic. Preliminary official figures actually point to a decline of nearly a half percent in the number of construction jobs. We expect upcoming revisions will indicate a bit stronger job growth above 1%, but still nothing to get excited about. Industry activity will firm over the next several years. We will have more information on the construction sector and a detailed outlook in our UHERO Construction Forecast in late March.

The top line indicators of local labor market conditions have now recovered all of their recession-induced losses, but the industry and household surveys paint somewhat



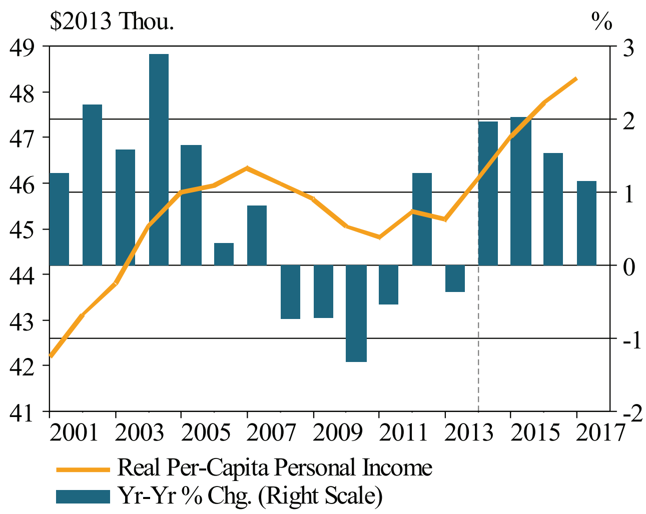
NON-FARM PAYROLLS HAVE NOW SURPASSED PRE-RECESSION LEVELS, AND THE UNEMPLOYMENT RATE CONTINUES TO DECLINE.

different pictures of the pace of recent improvements. The industry survey points to only a 1.2% increase in nonfarm jobs in 2014, the slowest rate of expansion since 2011. (We expect a slight upward correction to the 1.4-1.5% range in the upcoming mid-March revisions.) Despite weak growth, the number of jobs statewide has now finally surpassed pre-recession levels to set a new all-time high.

The household survey paints a more encouraging picture. In response to better job prospects, individuals are now returning to the labor force, which expanded by 2.3% last year. The number of people employed increased by 2.8%, the strongest growth in more than 20 years. As a result, the unemployment rate edged down to 4% by the end of 2014.

These employment gains raise hope that we will begin to see more headway on some particularly intractable labor market problems. The share of the population that is in the labor force still remains very low by historical standards. Some of the decline has been the result of population aging, but labor force participation also remains depressed in other age groups, including among prime aged workers. In addition, the number of part-time workers who want a full-time job but cannot find one (so called involuntary part-time workers), remains elevated, although considerably lower than a few years ago. These challenges represent a painful legacy of the Great Recession that is not yet fully behind us.

Aggregate income growth accelerated in 2014. With labor market conditions still far from tight, gains in total labor income largely reflected larger payrolls, as opposed to higher wages. The lion's share of income gains for state residents last year came from increases in property income and transfer payments, particularly expanded Medicaid coverage. While data for the fourth quarter is not yet available, we estimate that real (inflation-adjusted) personal income increased by nearly 3% statewide, the fastest pace since 2005.



MODERATE INCOME GROWTH WILL CONTINUE FOR THE NEXT SEVERAL YEARS.

Last year's income gains got a boost from the effect of falling oil prices on the local cost of living. The positive effects of low oil prices extend beyond keeping a lid on inflation, freeing up a substantial amount of purchasing power that would otherwise go to transportation and electricity costs. (See the UHERO blog for two recent posts on these issues.)

The pace of overall job growth in the Islands will ease from the current 1-1.5% range to about 1% by 2017. Improving conditions in the labor market will put upward pressure on wages, but rising consumer prices will offset most of this. The combination of cooling job growth and modest wage gains will result in slowing aggregate real labor income growth as well, easing below 1.5% by the end of the decade. These moderate rates of growth reflect an economy that is converging onto its long-run potential growth path, after a bruising half-decade of crash and recovery.

As we have noted, not all ills from the recession have been fully cured, and the economy remains vulnerable to outside shocks, whether from a global spillover of European malaise or some unforecastable natural or manmade disaster. Of particular concern is the possibility of a substantial cut in active duty military presence in Hawaii. The potential cuts are large enough that they would take a measurable chunk out of the overall economy, not to mention much larger adverse impacts on local communities. It is too soon to tell what the eventual outcome will be, but in any case risks of federal downsizing will likely remain with us for a number of years.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2012	2013	2014	2015	2016	2017
Visitor Arrivals	9.7	1.7	2.0	1.0	1.1	0.9
U.S. Visitor Arrivals	5.2	0.7	1.3	1.7	1.2	1.0
Japan Visitor Arrivals	18.0	3.6	-0.5	-2.7	-0.1	-0.4
Other Visitor Arrivals	17.6	3.2	6.4	2.3	1.8	1.6
Non-farm Payrolls	2.2	2.1	1.5	1.6	1.2	1.1
Unemployment Rate (%)	5.7	4.8	4.3	3.8	3.6	3.4
Inflation Rate, Honolulu MSA (%)	2.4	1.8	1.0	0.7	2.3	3.1
Real Personal Income	2.2	0.6	2.9	2.9	2.3	1.9
Real GDP	1.5	1.9	2.9	3.8	2.6	2.0

Note: Source is UHERO. Figures for income, inflation and GDP for 2014 are UHERO estimates. Figures for 2015-2017 are forecasts.
Non-farm Payrolls for 2013 and 2014 are UHERO estimates of the benchmark revision.

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