Ready or not, Hawaii is set for more growth

UHERO STATE FORECAST UPDATE, PUBLIC EDITION

MAY 4, 2018

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

With tourism seemingly unstoppable, Hawaii's economy will continue to grow, and to push up against constraints.

Now in its ninth year, Hawaii's expansion shows no signs of letting up. Tourism has surged again in the first part of 2018, extending one of the longest periods of sustained visitor growth. Construction, while volatile month to month, also remains on a high plateau. The long run of strong demand has created very tight labor markets, and it has imposed burdens on infrastructure and some communities. These constraints will slow, but not stop, growth over the next few years.

Tourism going gangbusters. Again.

2018 tourism is off to an extraordinary start. In the first three months of the year, visitor arrivals surged more than 9%, and visitor days, which take into account length of stay, are up more than 7%. US visitors took advantage of double-digit growth in direct flights, raising the US arrivals count by 12%. Second quarter domestic airlift also looks to be very strong—planned seat counts are 13% higher than a year ago—and so we have raised our forecast for US arrivals growth to nearly 8% for the year as a whole. On the international side, new direct flights to Kona supported Japanese visitor growth to the Big Island of more than 25% in the first quarter. Statewide growth in Japanese arrivals has been less spirited, and the market will grow just 2% for the full year. Combined with 6% growth in emerging markets, overall visitor gains of more than 6% are expected this year.

Home vacation rentals (HVRs) have played a major role in absorbing the steadily rising number of visitors. At the same time, the limited expansion of the hotel and timeshare stock has pushed up occupancy in traditional visitor accommodations. In each county, occupancy rates averaged more than 80% in the first quarter, levels not seen since the mid-2000s. These buoyant conditions allowed hotels to raise room rates by double digits on the Neighbor Islands, although they remained flat on Oahu. (We will have much more to say about economic conditions in the four counties in our upcoming *UHERO County Forecast* report.) Rising lodging and other visitor costs and pressure on tourism capacity will increasingly act as brakes on further visitor expansion, slowing incremental arrivals growth gradually in coming years.

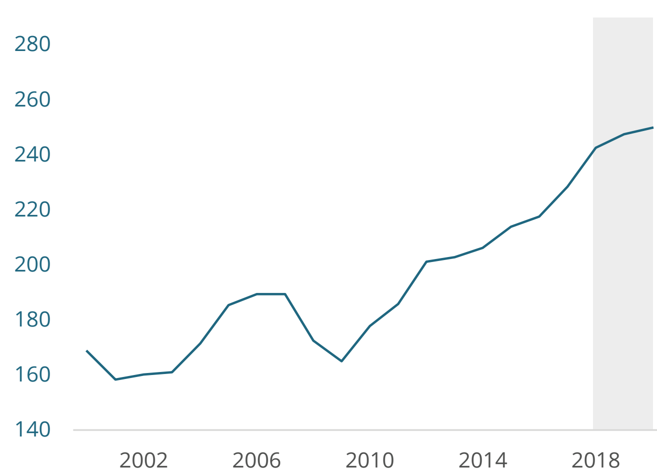
Hawaii continues to grapple with the impacts that burgeoning tourism numbers are having on airports, roads, parks, and the overall quality of life. The proliferation of unlicensed HVRs has become a nuisance to residents, and it is encroaching on the supply of homes for long-term rental. State and county governments are struggling to find solutions to regulate the rental properties and collect taxes. Partly in response to rising tourism burdens, the State legislature considered a bill that would have allocated a greater fraction of Transient Accommodation Taxes to the counties to help pay for tourism-related activities. The bill was also intended to compensate the Neighbor Islands for the recent TAT hike used to finance Honolulu Rail Transit construction. Ultimately, the bill failed to pass this year.

Help wanted. Now pay for it.

The state's labor market continues to run red hot. The seasonally-adjusted unemployment rate has held steady at 2.1% since October 2017 and has been below 3% since mid-2016. At this point, virtually everyone who wants a job has one, and businesses are having difficulty finding workers with—or even without—the skills they need. The tight labor market will begin to limit payroll job growth, but it should also generate wage gains for workers, which have been hard to come by in this expansion.

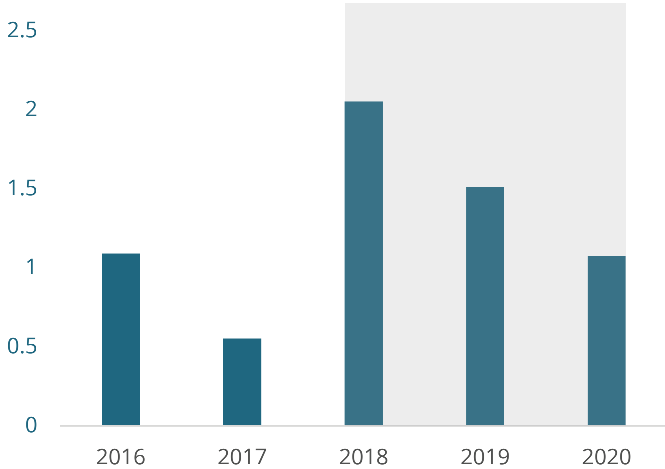
Average Daily Visitor Census (Thou)

Surging tourism is impacting infrastructure and quality of life.



Real Per Capita Income Growth (%)

Tight labor market will translate into meaningful wage gains.



Despite the abundance of job opportunities, last year actually saw net out-migration of residents to the US mainland, further exacerbating labor shortages. That tide may have turned back this year. Preliminary figures indicate that the labor force has begun to edge up again, expanding by about 1,500 people over the past four months. As always, some caution should be taken when interpreting these preliminary numbers. That being said, further expansion in the labor force would allow for a bit stronger job growth than would otherwise be the case.

And job growth has generally been on a slowing trend for several years. These days, the industries connected to tourism and the healthcare sector are doing the lion's share of hiring, while most other industries are seeing only limited employment gains. That is likely to continue. With visitor counts pushing ever higher, we expect jobs in the accommodation and food services industry to expand by 4% this year, the fastest rate of any industry. The transportation and utilities sector will see a healthy 2.6% gain in jobs, especially in areas linked to air travel. Employment in health care will expand by 3%. Our broad other services sector will see a half-percent growth, and the number of public sector jobs will also remain essentially unchanged.

Construction industry hiring has been volatile over the past eighteen months. After a year-long decline in jobs, firms began hiring again at a rapid clip late last year. But in recent months, preliminary figures suggest that payrolls have edged back down. Despite these ups and downs, there appears to be plenty of work in the pipeline, so that the industry workforce should remain near current levels through the end of the decade. We will take our annual in-depth look at the industry and its prospects in our third-quarter *UHERO Construction Forecast*.

Through the end of the decade, labor shortages will continue to weigh on overall job growth. This year, total nonfarm payroll employment will expand by 1.3%, but growth will slow to just over a half-percent annual pace by 2020. The good news for workers is that the tight labor market should finally translate into meaningful increases in real wages. This year we expect real (inflation-adjusted) per-capita income to expand by 2%, the fastest rate since 2015, with growth easing to 1% by the end of the decade.

Revenues rising rapidly.

Robust economic activity has been a boon for State coffers. Through the first nine months of the 2018 fiscal year, deposits into the General Fund are up 6.5% year-over-year, outpacing earlier projections. General Excise and Use tax receipts are running nearly 10% higher than a year ago. At its March meeting, the State Council on Revenues increased its revenue forecast for the current fiscal year to 5.3%, up from the previous forecast of 4.5%.

State lawmakers have approved a $14.4 billion operating budget for the 2019 fiscal year, a slight increase over funding levels for the current fiscal year. Notable additions to this year's budget include increased funding for homeless services and a $28 million subsidy for the Maui Health System. A separate appropriation will provide $125 million in disaster relief for Kauai communities devastated by recent flooding, as well as affected areas on Oahu. SB 2922 will ask voters in November whether the state constitution should be amended to permit an additional property tax surcharge on investment properties to fund public schools. As written, the bill does not specify the amount of the surcharge or the types of properties it would apply to.

Hawaii will see a boost in federal funding following the latest federal omnibus spending bill adopted in March. The state will receive increased funding for highway maintenance and construction, as well as additional support for public transit. There will be a sizable increase in military construction, including an additional $90 million in funding for the Army's command and control facility at Fort Shafter. Increased funding for Veterans Affairs will go towards construction of a 120-bed medical facility in Honolulu. Even before these increases, the total value of government contracts awarded has been running at significantly higher level this year than last.

Everything coming up roses?

The stars have aligned to produce a long and strong expansion in Hawaii. Buoyant US and foreign markets are sustaining tourism demand right when home vacation rentals are producing a boom in accommodations supply. Together with healthy conditions in other industries, these forces are driving ongoing job creation that has pushed unemployment to record lows. While wage growth has disappointed, the circumstance are right for significant income gains for at least the next few years. Good times in Hawaii.

But expansive growth is also expensive. The relentless rise of visitors is straining an already overburdened tourism infrastructure. The surge in HVRs is creating stress in communities and limiting long-term rentals. While an overdue benefit for workers, tight labor markets are making it harder for firms to meet current demand or take advantage of new opportunities. Dealing with growth stresses is not new to Hawaii, but the challenges have become more obvious over the past year or two.

Unfortunately, what has typically relieved growth pressures in the past is an economic downturn. Right now, there are no signs of that. Economic conditions are good across most of the globe. At the same time, there are risks that have emerged, ranging from geopolitics to increasing debt burdens to rising interest rates. Barring policy missteps, these look manageable for now, providing a generally positive outlook for the next few years.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2015	2016	2017	2018	2019	2020
Visitor Arrivals	4.5	3.0	4.9	6.5	1.2	0.5
U.S. Visitor Arrivals	6.9	4.6	5.1	7.8	1.2	0.5
Japan Visitor Arrivals	-1.9	0.4	5.4	2.1	0.7	0.0
Other Visitor Arrivals	3.1	0.4	3.9	6.1	1.6	1.0
Non-farm Payrolls	1.7	1.3	1.0	1.3	0.8	0.6
Employment	2.2	1.9	0.8	1.1	0.7	0.3
Unemployment Rate (%)	3.6	3.0	2.4	2.1	2.3	2.6
Inflation Rate, Honolulu MSA (%)	1.0	2.0	2.5	2.6	2.9	2.8
Real Personal Income	4.3	1.3	0.5	2.0	1.8	1.5
Real GDP	4.9	1.6	1.1	1.8	2.1	1.3

Note: Source is UHERO. Figures for GDP for 2017 are UHERO estimates. Figures for 2018-2020 are forecasts.

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