

HAWAII'S GROWTH DOWN, BUT NOT OUT

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Natural disasters and sagging construction have taken a bite out of Hawaii growth.

Hawaii's economic expansion has slowed along several dimensions this year. On top of the painful human toll, volcanic activity and flooding have dealt a setback to tourism. The construction sector has continued to shed jobs, dropping back further from the peak reached in 2016. Total payroll employment growth has slowed to a near-stop. At the same time, the fundamentals underpinning the local economy look favorable. Global tourism continues to power forward, and there remains a healthy pipeline of construction work that should stabilize the industry near its current level. And even with the recent job weakness, Hawaii continues to enjoy its lowest unemployment in many years.

Tourism on top, but disasters hurt

Natural disasters have been the headline story for Hawaii tourism in 2018, but the year is still turning out to be another very strong one for the industry statewide. Year-to-date visitor arrivals are running 8% higher than a year ago, and inflation-adjusted expenditures are up 9%. Even Kauai and the Big Island, which have since been hammered by flood and fire, started the year off very strong, benefitting from a dramatic rise in direct airlift. For the state overall, this will be another record year when all is said and done.

April flooding on Kauai and volcanic eruption on the Big Island have destroyed properties and livelihoods, and they have had a measurable adverse impact on travel. The pace of arrivals growth to Kauai went from a more than 22% surge in March to a less than 8% year-on-year gain in July, which of course still represents a marked increase. On the Big Island, between April and July, the number of visitors fell 20%, and occupancy rates for hotels dropped from nearly 83% to less than 71%. Short-term visitor rentals have been affected by a ban in the Pahoia region since the eruption began, and businesses across the East Side have been reporting large drops in activity. The aftermath of Hurricane Lane flooding has added a new challenge for these islands, one that may weigh on the industry for some time. Following the natural disasters on Kauai and the Big Island, some visitor traffic has spilled over to Oahu and Maui. Demand for vacations in Honolulu remains strong,

with occupancy rates hovering in the 84%-86% range, and arrivals to Maui accelerated to a 12-13% year-on-year pace in June and July.

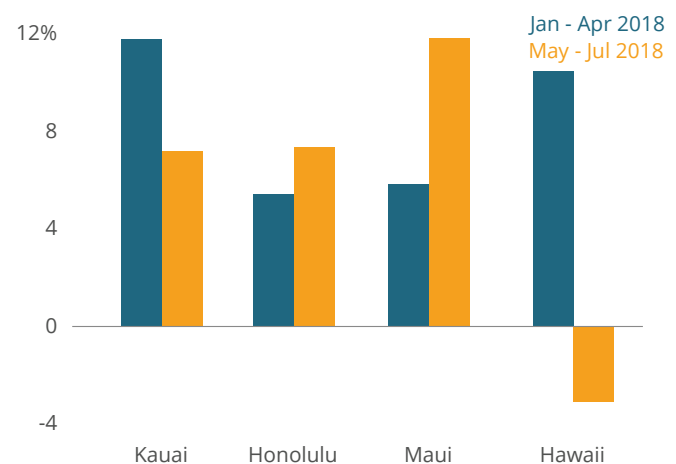
Despite the disruptions from natural disasters, statewide visitor arrivals will advance by more than 6% for this year as a whole. Growth will taper off thereafter. US markets have been the strongest and are expected to jump nearly 9% this year, but Japanese arrivals will grow by less than 1%, following a surge in 2017 associated with the resumption of direct flights. Statewide occupancy rates will remain near 83% throughout the forecast horizon, while room prices will continue to trend upward. This year, inflation adjusted total visitor spending will finally break above the previous peak set in the late 1980s. However, real daily spending by an average visitor remains less than 70% of the level of three decades ago.

Job picture not as pretty

Hawaii labor markets continue to be very healthy, but there are now signs of softening. Having settled at historically low levels, the statewide unemployment rate and initial claims for unemployment compensation have changed very little over the past year. In recent months, the labor force and employment have been trending up, but they

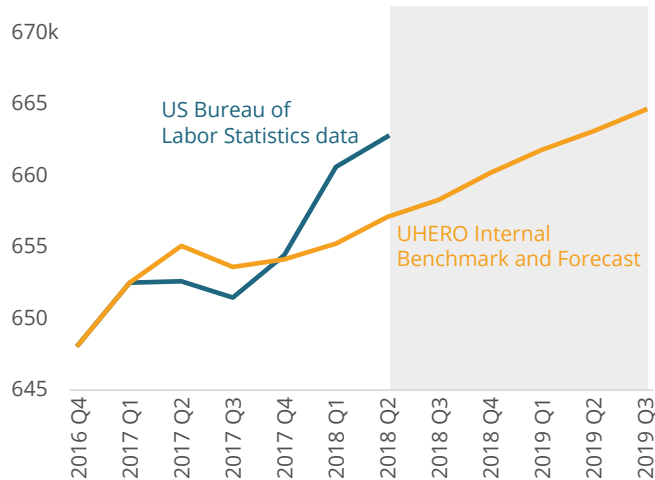
Year-Over-Year Change in Visitor Days

Natural disasters have redirected some visitors to Oahu and Maui.



Total Nonfarm Jobs

Job growth is much slower according to UHERO estimates.



are flat for the year to date. Based on our estimates of the official benchmark revisions, nonfarm payrolls are running just 0.4% higher than a year ago.¹ The natural disasters hitting the Big Island and Kauai have left a mark on labor market conditions, with both counties seeing an uptick in the unemployment rate. Over the next three years, statewide nonfarm payrolls will expand at a less than one percent annual average rate. As the expansion eases, the unemployment rate will edge upward toward a more sustainable 3% level early in the next decade.

The greatest contributor to statewide job growth has been the health-care sector, as the impact of the Maui state-run hospital system privatization continues to impact the year-over-year growth rates. Tourism areas are taking a short-term hit, although we expect this to continue to be an area of relative strength going forward. Combined wholesale and retail trade jobs have recovered their first-quarter losses but are little changed compared with a year ago. Recent data show an ongoing decline in construction employment, which has fallen to about 10% below the cyclical peak reached in the second quarter of 2016. We nevertheless expect a fairly stable level of construction employment for the next several years, given anticipated work and projects already in the pipeline. We will have much more to say about the construction industry in our upcoming *UHERO Construction Forecast*.

In recent months, finance and real estate jobs picked up strength and reversed last year's losses. Local and federal government job growth has been offset by state

¹ Each March the Bureau of Labor statistics issues benchmark revisions to the preliminary estimates of nonfarm payroll job counts. We prepare estimates of these forthcoming revisions. As a result, the payroll numbers we report here for 2017 and the first half of 2018 may differ from the official preliminary data reported by statistical agencies and on our data portal <https://data.uhero.hawaii.edu>.

government job losses, and overall public sector jobs are down nearly one percent for the year so far. Public sector hiring will remain restrained throughout the forecast horizon, hampered by budget pressures.

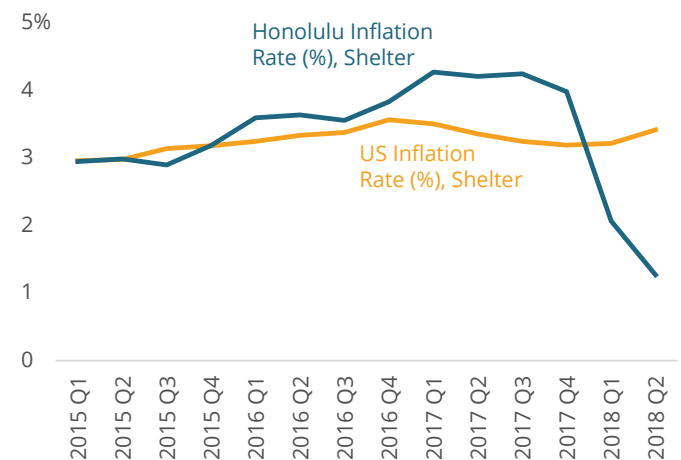
Enjoying income gains—for now

Income data for 2018 is only available for the first quarter. Real personal income and nonfarm labor earnings rose approximately one percent over year-earlier levels. The greatest gains were recorded in the finance, insurance, and real estate industry, which will slow from a mid-single-digit pace to below 2% by the end of the year. Healthy overall tourism activity supported solid income growth in arts, entertainment, and recreation, as well as the dominant accommodation and food services industry, which saw a greater-than-3% gain. Real income growth in the latter industry will hold up in the 2% range for the next year or so, supported by tight labor markets, before easing to 1% as the cycle slows. Health care, which generated income gains of nearly 3% in the first quarter, will trend toward a 1-2% pace over the forecast horizon. Hourly wages in the construction industry are up more than 6% year-to-date, reaching nearly \$43 in April. With construction employment settling on a plateau, real earnings in the industry will remain near their current level. Overall real labor earnings growth will decelerate from 1.3% this year to 0.9% by 2021, while total real income will grow slightly faster due in part to higher dividend, interest, and rental income.

In the first half of this year, Honolulu consumer price inflation was 1.6%, well below the 2.5% national average. One of the reasons for this discrepancy is the limited rise in local shelter costs, 1.3% in Honolulu versus a 3.4% national average rate in the second quarter. The growth of rents in Honolulu is restrained by demand, as the island's population has fallen nearly a half-percent since 2015. Since

Inflation Rate

A smaller rise in shelter costs is holding down local inflation.



the shelter component represents 40% of local household spending, this has been the key factor keeping a lid on inflation. Headline inflation will remain below 2% this year and next, and it will accelerate to 2.5% during the following two years as generally tight markets for goods and services push inflation toward the US average.

Rebuilding infrastructure and image

Volcanic activity around Kilauea appears to have quieted down, and the floodwaters on the Big Island and Kauai have receded. Recovery efforts are still just at their initial

stages, and as we go to press, much of the state is in the path of Olivia. The tourism industry, already bumping into capacity constraints, will now have to do without some of the facilities impacted by the disasters. And because media coverage tends to focus on the rare but graphic and dramatic events, industry representatives will also have to restore Hawaii's image as a safe destination for family vacations. Eventually rebuilding—whether financed from local resources or federal relief funds—will provide a bump in construction jobs. That may come as a welcome silver lining to what has been a difficult and painful year for a number of Hawaii communities.

HAWAII ECONOMIC INDICATORS YEAR-OVER-YEAR PERCENT CHANGE

	2016	2017	2018	2019	2020	2021
Visitor Arrivals	3.0	4.9	6.7	2.5	1.2	1.1
U.S. Visitor Arrivals	4.6	5.1	8.7	2.8	1.0	1.2
Japan Visitor Arrivals	0.4	5.4	0.8	1.4	0.4	0.3
Other Visitor Arrivals	0.4	3.9	5.3	2.5	2.3	1.6
Non-farm Payrolls	1.3	1.2	0.6	0.9	0.7	0.6
Employment	1.9	0.8	0.6	0.6	0.3	0.5
Unemployment Rate (%)	3.0	2.4	2.1	2.3	2.6	3.0
Inflation Rate, Honolulu MSA (%)	2.0	2.5	1.9	1.9	2.5	2.4
Real Personal Income	1.3	0.5	1.5	1.6	1.3	1.1
Real GDP	1.7	1.2	1.8	1.7	1.1	1.1

Note: Source is UHERO. Non-farm Payrolls for 2017 are UHERO estimates of the benchmark revision. Figures for 2018-2021 are forecasts.

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