Economy slows markedly. Is more in store?

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UHERO
THE ECONOMIC RESEARCH ORGANIZATION
AT THE UNIVERSITY OF HAWAIʻI

Economic conditions weakened over the course of the past year, posing risks to Hawaii's long expansion.

Hawaii's economy ended 2018 on a poorer footing than 2017. Across a number of dimensions, the year saw a flattening out or outright decline in activity. Tourism challenges were not limited to the aftermath of flood and fire, but also reflected weakening in some key markets and a falloff in spending. At home, population growth has been negative for the past two years, weighing on demand. Deceleration is now well established in the Islands, posing significant downside risks to our forecast of continuing modest growth.

The US and World slide lower

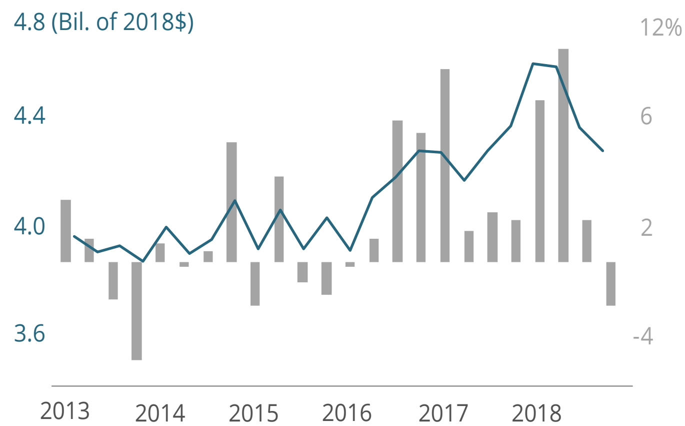
Since our fourth quarter report, external conditions facing Hawaii have worsened measurably. China's economy has slowed faster than expected, both from the trade war with the US and struggles with industrial restructuring. Germany narrowly escaped recession in the fourth quarter, but its rapid slowing — and Brexit uncertainty in the UK — raise the prospect of a European-wide recession. Buffeted by global headwinds, stuttering confidence, and market volatility, the most recent US data have come in much weaker than expected. Retail sales contracted sharply in December and inventories bumped up, yanking down model-driven estimates of fourth-quarter GDP growth. (Shutdown-delayed GDP estimates will be released February 28.) Reflecting a softening outlook, the Federal reserve has rapidly switched gears, with a rate cut now viewed at least as likely as a rate increase in 2019.

And tourism turns

With some month-to-month fluctuations, the number of visitor arrivals to Hawaii has been essentially flat since April, on a seasonally adjusted basis. As a result, year-on-year growth figures receded as the year progressed. The average daily census has shown a fairly steady downward drift since the second quarter. At year end, the strongest market was the US, which had recovered from some of its mid-year decline. Japanese and Canadian arrivals ended the year at roughly the same level as the year before. Arrivals from other international markets have fallen off sharply from a solid position at the start of last year. Korea and China have posted the weakest performance, with arrivals from these markets falling at double-digit rates in 2018.

Visitor Expenditure

Visitor spending declined in the second half of the year.



If arrivals statistics were relatively flat, visitor spending showed a marked decline in the second half of the year. Because of a nice bump in the first quarter, annual visitor spending for 2018 rose 4.3% after adjusting for inflation, but by the fourth quarter, spending was 2% lower than its level at the end of 2017. Average daily spending fell off in a number of markets, despite continuing upward movement in room rates. Accommodations occupancy has now eased off its recent highs to slightly below 80%, which may limit room price appreciation going forward.

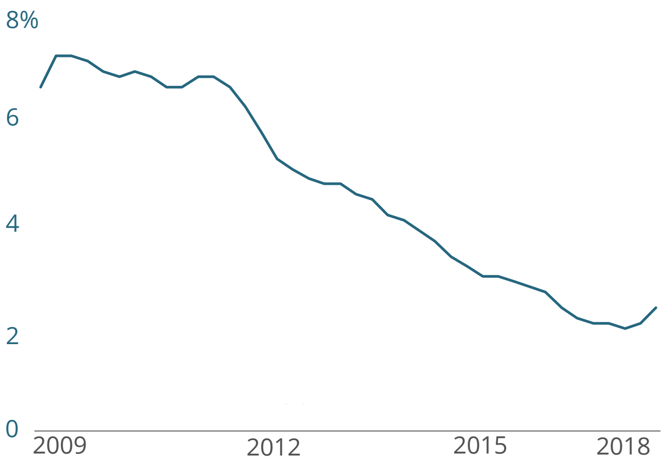
So while the annual number of visitors reached a new record in 2018, the health of the industry has become more tenuous. Given US and global conditions, we expect only modest growth in 2019 and slowing thereafter. Arrivals will expand by just 1-2% for the next two years, easing to sub-1% rates by 2021. With demand soft, real visitor spending growth will edge up only marginally. An upside risk is a potential boost to US travel with the planned entry of Southwest Airlines to the Hawaii market. Downside risks are clearer, centered on the possibility of further deterioration in the US and global economies.

The labor market cools a bit

Labor market conditions remain healthy, but have cooled somewhat over the past six months. After touching 2% in May, a record low, the unemployment rate edged up to

Hawaii Unemployment

The unemployment rate has edged up from its record low.



2.5% in December as employment receded a bit from mid-year on. The number of payroll jobs, based on a separate survey, has shown a little more strength. Still, for the year overall, the number of payroll jobs rose just 0.6%, about half the average rate of expansion over the previous three years. (Payroll job figures cited here are UHERO estimates of the upcoming government benchmark revision and are considerably weaker than official published numbers. See the UHERO blog post, *Benchmarking for a clearer employment picture.*

A flattening out of payroll employment can be seen across much of the economy. Tourism-related hiring had already fallen back by the beginning of 2018, and the gradual softening in the industry over the course of the year resulted in less than a half-percent job growth in accommodation and food services. Some recovery from this recent weakness, together with restrained room rates and stronger airlift, will support slightly stronger growth for the next couple of years, if still subdued compared with past years. Job growth had ceased in the transportation and utilities sector by year end, but a modest pickup is expected here as well. The broad "other services" sector, which accounts for roughly a quarter of all employment in the islands, will continue to add jobs at a moderate pace

A drag on employment growth has come from recent declines in the state's population. The shift into negative territory reflects in part a reduction in the number of military dependents associated with troop withdrawals in 2017. But non-military out-migration has also played a role, and there has been a trend decline in birth rates. While we expect net population growth to resume, it will be much weaker than in past decades.

Construction holds together

As we had anticipated, construction employment stabilized last year, after edging downward in 2016-2017. With some ups and downs over the course of the year, the industry has returned to a level of about 36,000 employees, roughly on par with the 2017 average. Given the healthy stream of residential, commercial, and resort projects in the pipeline, we expect building industry job counts and income to edge up slightly over the next two years.

Despite the growing popularity of online shopping, brick-and-mortar stores have absorbed retail space that has been added to inventory over the past couple of years, according to data from Colliers International. While falling retail vacancy rates and rising rents paint an upbeat picture, trade jobs have grown only marginally, and real income in the sector was flat last year. We expect industry expansion to continue at roughly half-percent rates for the next few years.

Private healthcare expansion slowed over the course of the past year, but we expect recovery to a trend above 1% by 2020. Rising demand for health care will support growth above that of most other sectors in coming years.

The thirty-five day partial federal government shutdown directly affected about 2,700 government employees in the Islands. There may also have been knock-on effects to tourism or local spending decisions due to the disruption of government services and the hit to confidence. With a second shutdown now avoided, things will rapidly return to normal, and some spending that was delayed in January will be moved to February and the next few months. In any event, the current tight federal budget conditions suggest that hiring in the public sector will remain limited in coming years.

Not so steady on?

Our fourth-quarter Annual Hawaii Forecast looked ahead to a gradual moderation of the business cycle expansion. This report takes a more downbeat view of economic prospects. Our more pessimistic outlook reflects both a clearer view of slowing in Hawaii as additional data has come in, as well as emerging negative indicators of conditions in the US and abroad. Our numerical forecasts are only marginally weaker than in our fourth-quarter outlook, reflecting our view that some recovery is likely in areas where we saw particular weakness in the second half of last year. But the configuration of risks is now tilted decidedly downward. Fasten your seatbelts please.

HAWAII ECONOMIC INDICATORS

YEAR-OVER-YEAR PERCENT CHANGE

	2016	2017	2018	2019	2020	2021
Visitor Arrivals	3.0	5.2	5.9	1.7	1.5	0.9
U.S. Visitor Arrivals	4.6	5.1	9.0	1.8	1.7	0.6
Japan Visitor Arrivals	0.4	6.7	-1.0	2.3	0.2	0.1
Other Visitor Arrivals	0.4	4.0	2.2	0.9	1.8	2.2
Non-farm Payrolls	1.3	1.3	0.6	0.6	0.6	0.5
Unemployment Rate (%)	3.0	2.4	2.3	2.5	2.8	3.2
Inflation Rate, Honolulu MSA (%)	2.0	2.5	1.8	2.0	2.1	2.0
Real Personal Income	1.3	1.2	0.9	1.1	1.0	1.0
Real GDP	1.5	0.7	1.2	1.0	1.0	1.2

Note: Source is UHERO. Non-farm Payrolls for 2017 and 2018 are UHERO estimates of the benchmark revision. Figures for income and GDP for 2018 are UHERO estimates. Figures for 2019-2021 are forecasts.

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