

**UHERO Quarterly Hawai'i Forecast Update**

# **Mainland Woes Pose Risks for Visitor Sector**

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## EXECUTIVE SUMMARY

### Key Changes in This Forecast.

Our 2007 forecast for visitor arrivals growth has been reduced from -0.2% growth to -1.4% growth. In part this reflects DBEDT's recent revisions to 2006 figures, but also results from a softening of conditions in the U.S. market.

The Federal government revised upward Hawai'i nominal personal income from 6.8% to 7.9% in 2005, and from 6.1% to 6.8% in 2006. We now expect real (inflation-adjusted) income growth of 1.9% for 2007, up from 1.4% in the June forecast.

Moderate economic expansion is expected to continue in Hawai'i for the remainder of the year, with further slowing into 2008 and 2009. The visitor industry will continue to be challenged by a weak American mainland economy. Despite recent financial market turmoil, Hawai'i's construction industry continues to settle toward a soft landing. Fallout from mainland housing and mortgage markets poses a risk, primarily to the visitor industry.

- The struggling U.S. economy is expected to take a toll on visitor arrivals. For 2007 as a whole we now expect U.S. arrivals to fall about 1% shy of last year's level. U.S. visitor arrivals will be flat next year.
- The Japanese market is expected to stabilize. We estimate a 2.5% decline in Japanese arrivals this year. The decline will slow to 0.9% next year. The number of Japanese arrivals will remain near recent low levels for the near future.
- Overall visitor arrivals for 2007 are now projected to decline by 1.4%. Next year will see flat arrivals growth. Visitor days will drop 2.3% this year, their first annual decline since the period following the September 11, 2001 terror attacks. Visitor days will grow less than 1% next year.
- This quarter marks our first forecast of visitor expenditures. After 4.0% growth in 2006, we expect flat nominal visitor spending this year due to weak arrivals. With both consumer price inflation and room rate increases running in the mid-single digits, this implies a significant decline in real (inflation-adjusted) spending. Real spending will be flat next year.
- Ongoing gradual deceleration in the broader economy will result in about one-half percent weaker non-farm payroll job growth this year (2%) than last (2.5%). Further slowing to 1.7% annual growth is expected to occur next year. The annual unemployment rate bottomed out at 2.4% last year and will ease to 2.8% in 2008.
- The construction job count is expected to peak in 2008 and decline only slightly in 2009. While real construction spending will turn downward, the nominal tax base will continue to rise as construction costs push up nominal values. While there are currently no signs of a significant and prolonged downturn in Hawai'i's construction sector, any further worsening in the availability or cost of credit will adversely impact this forecast.
- It will take several more years before Honolulu inflation recedes to moderate levels. Home price appreciation of the 2000–2006 period continues to feed through into consumer prices, and the recent move by oil prices above the \$80 per barrel threshold could mean another surge in electricity prices as well. We expect the Honolulu CPI to rise by 4.8% this year, gradually cooling to 3.7% in 2008.

- Even with an upward revision, nominal income barely kept pace with the inflation surge last year, and real (inflation-adjusted) income managed less than a 1% gain. Real income growth appears to be on a recovery path now, and we expect nearly 2% growth for 2007 as a whole. Income growth will expand 2.2% in 2008.
- The greatest downside risks are to visitor industry performance. Severe disruptions in financial markets and downturns in many regional housing markets could undermine visitor demand. Of particular concern to Hawai'i is the prospect of further weakening in California home values and the overall performance of the California economy, which could undermine visitor spending for this important market.

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Hawai'i Economic Indicators, Year-Over-Year %Change

	2004	2005	2006	2007	2008
Visitor Arrivals	8.3	7.3	0.6	-1.4	0.5
U.S. Visitor Arrivals	7.3	8.5	3.3	-0.9	0.1
Japan Visitor Arrivals	10.6	2.4	-10.2	-2.5	-0.9
Payroll Jobs	2.8	3.1	2.5	2.0	1.7
Employment	1.4	2.9	2.3	1.7	1.6
Unemployment Rate	3.2	2.7	2.4	2.5	2.8
Inflation Rate, Honolulu MSA (%)	3.3	3.8	5.8	4.8	3.7
Real Personal Income	5.1	4.0	0.9	1.9	2.2

Notes: Source is UHERO. Figures for 2007 – 2008 are forecasts.

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