

UHERO Quarterly Hawai'i Forecast Update
Cooling Economy Faces U.S. Headwinds

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EXECUTIVE SUMMARY

Key Changes in This Forecast.

Our 2008 forecast for visitor arrivals growth has been reduced from 0.5% to 0.3%, and visitor days from 0.7% to 0.2%, largely because of weakening U.S. economic conditions.

Because of the surge in oil prices since mid-year, we have raised our inflation forecast marginally, and we have reduced our estimate of 2007 real income growth from 1.9% to 1.6%. Real income growth will rebound to 1.9% by 2008.

The weakening U.S. economy and the persistence of high energy prices lead us to mark down a bit our Hawai'i growth estimates for the end of this year and 2008. However, we do not yet see an end to the current long economic expansion. Moderate job growth will continue next year, and real income will recover to nearly 2% growth. The visitor industry, which saw modest declines in arrivals and sluggish spending this year, will be essentially flat in 2008 before strengthening U.S. and Japanese economies begins to resuscitate travel in 2009. As we noted in our recent global outlook report, risks to the world economy have risen, and this leaves Hawai'i more exposed should a broad mainland downturn occur.

- This year's visitor numbers are coming in a little bit better than anticipated last quarter, but we still expect a 1.1% decline in arrivals and a 2% drop in visitor days for the year as a whole. We expect total arrivals to rise just three-tenths of a percent next year, and visitor days by a similar 0.2%. The switch to positive growth will come from markets other than the U.S. and Japan.
- Because of the struggling U.S. economy, we have lowered our U.S. visitor forecast for 2008 slightly to a two-tenths of a percent decline over this year's level. The Japanese market will also be anemic, with some modest improvement over this year.
- We expect nominal visitor expenditures to finish the year just 0.2% higher than in 2006. After 4.0% growth in 2006, this year's total visitor spending has been very weak, particularly if one takes into account the increases we have seen in hotel room rates (up 6.6% through the third quarter) and local consumer prices (up 5% in the year's first half). Nominal spending will pick up a bit to 2.8% growth in 2008, but this will still represent a decline in real terms.
- The labor market continues to be the strongest feature of the local economy. For 2007 as whole, non-farm payroll job growth will average 2.1%, slowing to 1.6% in 2008. The annual unemployment rate bottomed out at 2.4% last year and will ease to 2.8% in 2008.
- The general outlook for the local construction industry continues to be rather sanguine, despite the subprime concerns and related financial market problems. Real contracting receipts will turn negative next year as nominal receipts flatten out and construction costs continue to rise. Hotel renovation and industrial and commercial construction are serving as a stabilizing influence in the face of a steadily weakening residential sector, providing a much more optimistic outlook for Hawai'i's construction industry than for the U.S. as whole.
- The surge in oil prices since mid-year has caused us to raise just a bit our inflation forecast for 2007 as a whole and for the 2008–2009 period. We now expect the Honolulu CPI to rise by 5% this year (up from our 4.8% estimate in the third quarter), cooling to 3.8% in 2008. It will take several years for a return to

moderate inflation because home price appreciation of the 2000–2006 period continues to feed through into consumer prices.

- Nominal income barely kept pace with the inflation surge last year, and real (inflation-adjusted) income managed less than a 1% gain. In line with our somewhat higher inflation forecast, we have pulled down our estimate of 2007 real income growth from 1.9% to 1.6%. Real income growth will rebound to 1.9% by 2008.
- Hawai‘i’s exposure to the U.S. subprime mortgage mess is primarily through indirect effects on credit availability and U.S. economic health. Tight credit and higher risk premia could affect Hawai‘i businesses and financial institutions that need to tap national markets. Hawai‘i’s visitor industry is particularly vulnerable if U.S. consumer spending stalls.

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

	2004	2005	2006	2007	2008
Visitor Arrivals	8.3	7.3	0.6	-1.1	0.3
U.S. Visitor Arrivals	7.3	8.5	3.3	-0.8	-0.2
Japan Visitor Arrivals	10.6	2.4	-10.2	-3.4	-0.6
Payroll Jobs	2.8	3.1	2.5	2.1	1.6
Employment	1.4	2.9	2.3	0.9	0.4
Unemployment Rate	3.2	2.7	2.4	2.5	2.8
Inflation Rate, Honolulu MSA (%)	3.3	3.8	5.8	5.0	3.8
Real Personal Income	5.1	4.0	0.9	1.6	1.9

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

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1st Quarter: Hawaiʻi Construction Forecast Update. Review of construction industry conditions and multi-year forecasts.

2nd Quarter: County Economic Forecast. Review of economic conditions and detailed three-year forecasts for the four counties.