

UHERO Annual Hawai'i Forecast
Economy Grinds to a Halt

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EXECUTIVE SUMMARY

Key Changes in This Forecast.

We have downgraded our forecast for 2008 U.S. real GDP growth by a full percentage point to 1.2%. The U.S. economy is now in recession.

Our 2008 forecast for visitor arrivals growth has been reduced from 0.3% to -1.9%, because of weaker U.S. economic conditions and the exit of the Pride of Aloha. Visitor arrivals recovery will not begin until 2010.

We have reduced our forecast for 2008 real income growth from 1.9% to 0.3%. We now expect zero growth for payroll jobs this year and a 0.4% contraction in employment.

The Hawai'i economy that powered its way through much of this decade slowed to a standstill in 2007. The drag from a weakening visitor industry and an unwinding construction cycle spread to the broader economy. A U.S. recession is now underway. The mainland slump, national credit market problems, and soft local fundamentals mean there will be little growth in Hawai'i for the next two years. Some sectors will see net job losses. Moderate growth is not expected to resume until 2010.

- The U.S. economy has slowed dramatically since the middle of last year and is now in recession. Output growth will be negative for the first part of the year before a modest recovery begins. Real GDP will expand by only 1.2% in 2008, before strengthening to 2.6% in 2009. Employment growth will be flat this year, with very limited growth in 2009; this will cause the unemployment rate to rise to 5.5% by next year. This forecast implies a relatively mild recession by historical standards, but with a similarly restrained pace of economic recovery.
- Japan's economy has struggled to regain strength since passing through a very slow period mid-year. We expect a continuation of growth for the Japanese economy, but at unspectacular rates. Real GDP will expand by 1.9% in 2008 and 2009. Because of projected declines in the labor force as population aging intensifies, output growth will decelerate thereafter. The U.S. recession represents a downside risk for Japan.
- The Hawai'i tourism industry turned down in 2007, with losses in both U.S. and Japanese markets. We expect an even weaker year in 2008. The departure of two of three NCL cruise ships by May 2008 will cause a noticeable drop in visitor arrivals. Extremely weak conditions in the U.S., particularly in California, will contribute to further visitor losses. We do not expect a return to positive visitor arrivals until 2010. Visitor arrivals by air will fall 1.9% this year, visitor days by a similar 2.1%. Arrivals are expected to be flat in 2009 and return to moderate growth in 2010.
- Overall visitor spending was flat in nominal terms last year and down significantly in real (inflation-adjusted) terms. Expenditure weakness will continue, in part because of the decline in visitor days but also because of high fuel costs, stagnant mainland jobs and income and reduced household wealth. Expenditures are expected to expand by 0.2% in nominal terms this year, or -3.9% in constant dollars.
- The Hawai'i labor market softened considerably last year. Because of continuing construction slowing and very weak external conditions, we expect job and employment growth to remain very anemic for the next several years. Non-farm payroll job growth will be flat this year and expand by 0.7% next year, before recovering to the roughly 1% level consistent with normal growth. Employment, which has already contracted over the past year, will decline in 2008 and will not see any significant growth until 2010. The annual unemployment rate will rise to 3.5% this year and 3.9% in 2009.

- Coming off the recent period of broad-based growth, some sectors will see small net job losses over the next few years and most will see much slower growth than in recent history. Trade, transportation & utilities, finance, insurance & real estate, and the accommodations & food service sectors will all lose jobs in 2008. The only areas for which we expect moderate job growth over the next three years are health care & social assistance and the broad “other services” category.
- Compared with the national cycle, construction in Hawai‘i has remained relatively healthy and is likely to experience a fairly soft landing over the next several years. We expect construction jobs to top out this year and experience only modest job losses over the next few years.
- The gradual retreat of Honolulu inflation from 5.8% in 2006 to 4.9% last year will continue. We expect 4.3% inflation in 2008 slowing to 2.5% in 2009. The housing cost component will decline in importance during this time period, allowing the rate of inflation to fall toward trend. This year, inflation will continue to be relatively high because of the recent sharp spike in oil prices and high food prices which will take some time to recede.
- The recent inflation surge and the gradual slowing of nominal income growth created an abrupt slowing of real (inflation-adjusted) income. Real income managed less than 1% growth in 2006, and we estimate that real income growth for 2007 was 1.3%. Because of labor market weakness, we expect only a minimal 0.3% expansion of real income this year. The federal tax rebates due to arrive in May will help keep 2008 real income above the water line and support a modest recovery of growth in 2009.
- Heading into challenging economic times, Hawai‘i can take comfort in a healthier construction sector than the U.S. as a whole, the stabilizing influence of a large military, and limited direct exposure to the sub-prime mortgage crisis. On the down side, the visitor industry is extremely vulnerable to surging energy prices and the possibility of a sharper drop in American travel spending, depending on the length and depth of the mainland recession and credit crunch.

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

	2005	2006	2007	2008	2009
Visitor Arrivals	7.3	0.6	-1.3	-1.9	-0.1
U.S. Visitor Arrivals	8.5	3.3	-1.1	-2.2	-1.2
Japan Visitor Arrivals	2.4	-10.2	-3.5	-3.3	0.9
Payroll Jobs	3.1	2.6	1.1	0.1	0.7
Employment	2.6	2.2	0.0	-0.4	0.2
Unemployment Rate	2.7	2.5	2.7	3.5	3.9
Inflation Rate, Honolulu MSA (%)	3.8	5.8	4.9	4.3	2.5
Real Personal Income	4.0	0.9	1.3	0.3	0.9

Notes: Source is UHERO. Figures for 2008 – 2009 are forecasts. Figures for 2007 income are UHERO estimates.

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2nd Quarter: Next Hawai‘i Forecast Update.