

UHERO Quarterly Hawai'i Forecast Update

Oil Surge Fuels Inflation, Threatens Deeper Downturn

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EXECUTIVE SUMMARY

Key Changes in This Forecast.

Our 2008 forecast for visitor arrivals growth has been reduced from -1.9% to -4.6% because of the failures of ATA and Aloha Airlines and the surge in oil prices.

We have reduced our forecast for 2008 real income growth by nearly half a percent, from 0.3% to -0.1%. We now expect a slight 0.2% contraction in payroll jobs both this year and next. Employment will fall by about half a percent this year and next.

Higher food and especially energy costs will keep inflation at 5% this year, before significant cooling in 2009.

Prospects for the Hawai'i economy have worsened significantly since our March *Annual Hawai'i Forecast*. The failures of ATA and Aloha airlines, the loss of a second NCL cruise ship, and the dramatic surge in oil prices will damage a local economy that was already feeling the effects of the national downturn. We now expect small net declines in both real income and jobs this year, and higher 5% inflation. A significant recovery of the local economy will not begin until 2010, making this a relatively shallow but lengthy Hawai'i economic contraction. A deeper slowdown could occur if oil prices remain at their current record levels or if the national housing slump worsens more than expected.

- Despite a fairly good first quarter, U.S. economic prospects remain poor. Recovery from the current downturn is not expected to begin until late in the year, and real GDP growth will be limited to 1.1% in 2008. Growth will be only 2.4% in 2009 with further strengthening as the year progresses. Employment will be flat this year, and expand by just 0.7% in 2009.
- We continue to expect a somewhat better performance for the Japanese economy, but with noticeable slowing compared with recent years. Real GDP growth will be 1.4% this year, down from 2% in 2007. Slightly stronger growth is expected in 2009. By 2010, projected declines in the labor force as population aging increases will begin to cause trend slowing in real GDP growth.
- Visitor numbers have taken a tumble since the failures of ATA and Aloha Airlines. Some of the lost air capacity will be replaced in coming months, but high oil prices, the weak U.S. economy and airline industry woes will restrain U.S. market recovery. We now expect U.S. arrivals to decline by more than 7% this year. Despite the strong yen, the outlook for the Japanese market is even worse. Because of macroeconomic slowing and heavy fuel surcharges, we expect an 8% decline in Japanese arrivals this year and no significant recovery for the next several years.
- Based on recent performance and the easing of restrictions on travel from Korea and China, we expect the number of visitors from Canada, non-Japan Asia and other markets to post a strong 12.5% gain this year. Overall visitor arrivals by air to Hawai'i will fall 4.6% this year to 7.03 million visitors. Visitor days will decline by more than 4%. Visitors to Hawai'i will remain relatively soft in 2009, and will remain well below 2007 levels in 2010.
- We now expect that most sectors of the local economy will see net job losses over the next two years. The airline industry will have by far the largest losses, and tourism weakness will also lead to job losses in accommodation & food services and wholesale & retail trade. Among sectors not directly linked to tourism, there will be net job losses in finance, insurance & real estate, and the civilian federal government sector, as

well as in the small and perennially shrinking agriculture and manufacturing sectors. Health care & social assistance, state & local government and the broad “other services” sectors are expected to see moderate job gains.

- Construction, which expanded by nearly 7% last year, will slow to just 1.4% job growth this year and begin to shed jobs in 2009. The construction adjustment is still expected to remain mild by national standards, with a net job decline of less than 5% in the 2009–2010 period.
- Total non-farm jobs in Hawai‘i will contract at a modest rate for the next two years, before returning to expansion in 2010. The first-quarter pick-up in job growth will be short-lived, as tourism and construction slowing begin to bite. Employment, from the household survey, will shrink by about half a percent in 2008 and 2009 before recovery begins in 2010. The annual unemployment rate will peak at 4.2% in the 4th quarter of 2009 before beginning to subside.
- Hawai‘i’s inflation picture has deteriorated since our last forecast, because of the sharp rise in oil prices. We have raised our Honolulu inflation forecast by six tenths of a percentage point, to 5% inflation for 2008, roughly the same inflation experienced last year. A partial retreat of oil prices from recent highs and continuing softening of the housing component will bring about a rapid deceleration to 2.2% in 2009.
- There is a fairly long list of factors that could further undermine economic prospects here. If oil prices remain at current record levels for long, there could be a profound negative impact on travel plans and the visitor industry. The solvency of several airlines is precarious, with the risk of additional drastic reductions in airline capacity if a new round of bankruptcies occurs. Further deterioration of the U.S. housing and financial markets is also possible. On the plus side, the U.S. downturn could turn out to be more limited than currently expected. There is considerable uncertainty about the future path of oil prices, with the possibility that oil could retreat rapidly below the \$100 per barrel mark.

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

	2005	2006	2007	2008	2009
Visitor Arrivals	7.3	0.6	-1.3	-4.6	1.3
U.S. Visitor Arrivals	8.5	3.3	-1.1	-7.1	0.7
Japan Visitor Arrivals	2.4	-10.2	-3.5	-8.0	-0.2
Payroll Jobs	3.1	2.6	1.1	-0.2	-0.2
Employment	2.6	2.2	0.0	-0.6	-0.5
Unemployment Rate	2.7	2.5	2.7	3.7	4.2
Inflation Rate, Honolulu MSA (%)	3.8	5.8	4.9	5.0	2.2
Real Personal Income	4.0	1.0	1.5	-0.1	0.4

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

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