



UHERO

THE ECONOMIC RESEARCH ORGANIZATION
AT THE UNIVERSITY OF HAWAII

ANNUAL HAWAII ECONOMIC FORECAST
HAWAII RECOVERY
TAKES HOLD

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UHERO Annual Hawai'i Forecast

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This executive summary is presented as a public service through the support of Bank of Hawaii. The complete report provides comprehensive analysis of recent economic developments and prospects, including industrially detailed multi-year forecasts. The *UHERO Forecast Project* is a research program of the University of Hawai'i at Mānoa and depends on financial support from report subscribers and program sponsors. For more information, visit our *UHERO Forecast Project* information page at http://www.uhero.hawaii.edu/eis/eisdetails_sub.html.

EXECUTIVE SUMMARY

Hawai'i's economic recovery has begun. Employment is stabilizing, and many sectors will begin to add modest numbers of jobs as the year progresses. Visitor arrivals and spending will continue to firm along with economic conditions in our major tourism markets. Private construction is bottoming out, and the sector will begin to see more benefit from Federal and State spending programs. While growth is resuming, the pace of recovery will be slow, constrained by tepid U.S. consumer spending and the drag from the State and local fiscal conditions. As a result, unemployment will recede only gradually from current high levels.

- While the visitor industry remains in a deep slump, arrivals numbers edged up slightly over the course of 2009 and visitor spending stabilized by year end. With a mild recovery underway across the globe and more airlift planned, we expect a 2.9% gain in arrivals this year. International markets will be relatively stronger than the domestic market. We continue to expect a very attenuated recovery over the next several years. Discounting will continue to be the norm, continuing to exert downward pressure on profits.
- Quarterly UHERO forecast reports now include forecast figures for major construction industry indicators. The sector contracted sharply in 2009, but the pace of job losses had slowed by year end and building permits flattened out. Stirrings of private sector recovery and the short-term impulse from government contracts will lead to net hiring in coming months. Overall construction spending will be 17% lower this year than in 2009, but will rise more than 4% in 2011.
- Job losses last year were severe. The stabilization of recent months sets the stage for a resumption of modest job growth in 2010. Some sectors have already seen an uptick in jobs in the final quarter of 2009; most others will begin to add jobs during the first or second quarter of this year. Because of low job counts at the end of 2009, annual figures for 2010 will still show a net decline, masking these early gains.
- The private sector job turnaround does not mean a quick rebound from the steep losses incurred over the past two years. And additional public sector job losses are likely. The aggregate non-farm job count will show a small 0.7% net loss for 2010 as a whole, and we see only a 0.9% gain in 2011. This pace of job creation will leave the unemployment rate high for an extended time period. We expect statewide unemployment to average 6.9% this year, edging down to 6.4% in 2011.
- As we had anticipated last March, Honolulu inflation decelerated to just half a percent last year, with lower oil prices and moderating shelter costs causing a sharp cooling compared with 2008. Because there will be considerable slack in the local economy for the next several years, we expect relatively low inflation to be the norm in the Islands in coming years. After energy costs cause inflation to tick up to 1.9% this year, the Honolulu CPI will show just 1.1% inflation in 2011.
- Real personal income has not seen the same sharp drop as jobs, partly because of the surge in unemployment compensation but also because labor and proprietor income did not fall dramatically. We expect income to be flat in 2010. These are very restrained rates of income growth compared with the roughly 4% average during the 2004–2005 period.
- This report marks the first time we are releasing UHERO forecasts for Hawai'i real Gross Domestic Product (GDP). UHERO's approach to measuring real GDP differs from the Federal government's practice, as we describe in the box, *What is Hawai'i's real real GDP growth?* According to our estimates, Hawai'i real

GDP was down 0.4% in 2009 after contracting 1.3% in 2008. Real GDP will fall a slight 0.2% in 2010, before expanding by roughly 0.5% in 2011.

- While the past year has brought the anticipated business cycle turning point, there have been no developments that would warrant a substantially stronger forecast path. World growth appears sufficiently strong to support only a slow pace of Hawai'i recovery for now, and there is a downside risk that premature fiscal contraction in the U.S. and Europe could further weaken global economic conditions. The biggest downside risk for Hawai'i is the State budget crisis, where we are only now feeling the full impact of job losses and furloughs/pay cuts. Luckily, the revenue picture already appears healthier than what is reflected in the Council on Revenues projections, and so the drag from State and local government will ease as the recovery progresses.

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

	2007	2008	2009	2010	2011
Visitor Arrivals	-0.4	-10.5	-4.4	2.9	3.1
U.S. Visitor Arrivals	-0.5	-13.5	-3.9	1.0	3.2
Japan Visitor Arrivals	-4.9	-9.4	-4.9	8.1	0.9
Other Visitor Arrivals	6.3	3.0	-5.9	5.5	5.0
Payroll Jobs	1.3	-0.9	-4.4	-0.8	0.9
Employment	0.1	-0.5	-4.1	-0.6	0.8
Unemployment Rate	2.6	4.1	6.8	6.9	6.4
Inflation Rate, Honolulu MSA (%)	4.9	4.3	0.5	1.9	1.1
Real Personal Income	1.5	-0.6	0.2	-0.1	1.0
Real GDP	0.0	-1.3	-0.4	-0.2	0.5

Notes: Source is UHERO. Figures for 2010 – 2011 are forecasts. Figures for 2009 income are UHERO estimates.

Announcing New Forecast Release Schedule

Beginning with this report, we will release a single forecast report during each quarter focused on one of four themes:

1st Quarter: Hawai'i State Forecast Report

2nd Quarter: County Forecast Report, including 2nd-quarter State forecast update

3rd Quarter: Hawai'i Construction Forecast Report, including 3rd-quarter State forecast update

4th Quarter: Global Forecast Report, including 4th-quarter State forecast update

Along with the thematic coverage, reports for the 2nd through 4th quarters will include our update for the overall state outlook. In addition, we will now be including in each quarterly report our detailed numerical forecasts for the construction sector; in the past construction forecasts were reported just twice each year.

What is Hawai'i's real Real GDP growth?

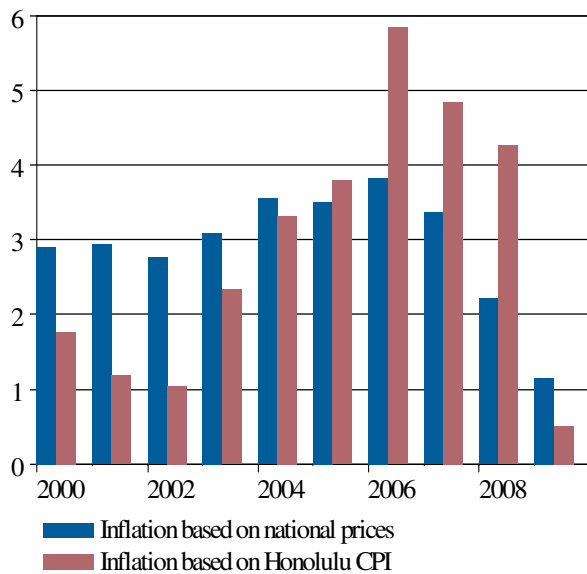
Many decision makers use estimates of real gross domestic product (GDP) as a measure of overall state economic activity. (Because of their higher frequency and shorter reporting lags, we usually focus instead on job counts and personal income data.) Beginning with this report, we will include forecasts for Hawai'i GDP in addition to other major economic indicators. Our UHERO approach to calculating real GDP differs from that adopted by the Federal government and reported by DBEDT.

Hawai'i's GDP measures the value of the state's total output of goods and services. Measured *nominal* GDP can increase either because output rises or because prices rise. Real, or *inflation adjusted*, GDP is void of the impact of price changes, and is therefore a more accurate gauge of output.

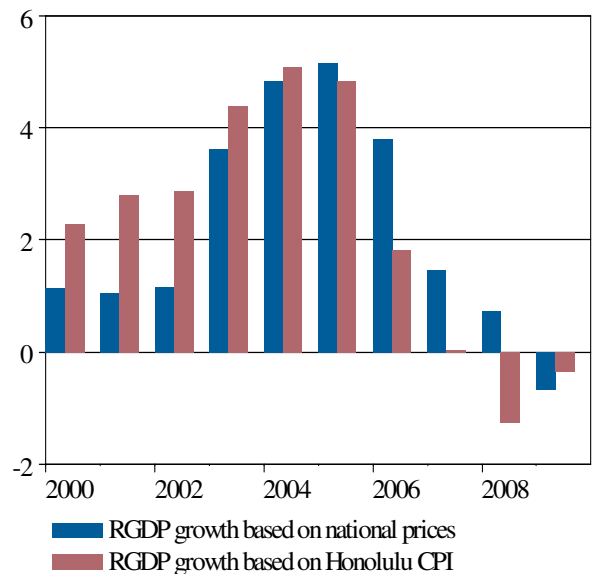
The Bureau of Economic Analysis (BEA) adjusts the state's nominal GDP for inflation using the *national* prices of the goods and services produced in Hawai'i. This would be an accurate measure of Hawai'i's real GDP if all local products were sold nationally, or if prices in Hawai'i behaved similarly to the national average. However, most of the local output, such as services to visitors, is consumed locally, and local prices can move in very different ways than those on the mainland.

To avoid this pitfall, UHERO uses a measure of local prices, the Honolulu consumer price index (CPI), to deflate nominal GDP. The figure on the left illustrates the more rapid rise in prices experienced in Hawai'i in recent years, caused by disproportionately large local impacts of increasing oil and home prices. In turn, the figure on the right shows how real GDP growth estimates differ depending on the choice of inflation measure. On the one hand, GDP deflated by national prices indicates that Hawai'i's economy was still expanding at a rate of 0.7% in 2008; on the other hand, GDP deflated by the Honolulu CPI indicates that the local economy was contracting at a rate of 1.3% in that year. Certainly the latter is more consistent with other indicators of local economic activity.

The CPI is not an ideal price measure for calculating real GDP, because it measures prices faced by consumers, not the prices of all goods and services produced here. However, it is the only macro level measure of local prices, and it permits us to avoid the clear bias associated with using national level prices.



Inflation based on national prices (GDP deflator) and the Honolulu CPI.



Real GDP growth based on two inflation measures.

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Kulia I Ka Nu‘u (literally “Strive for the summit”) is the value of achievement, those who pursue personal excellence. This was the motto of Hawai‘i’s Queen Kapi‘olani. Sponsors help UHERO to continually reach for excellence as the premier organization dedicated to economic research relevant to Hawaii and the Asia Pacific region.

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