UHERO
THE ECONOMIC RESEARCH ORGANIZATION AT THE UNIVERSITY OF HAWAI'I

UHERO STATE FORECAST UPDATE, PUBLIC SUMMARY

Some Improvement, After Disappointing 2011

FEBRUARY 10, 2012

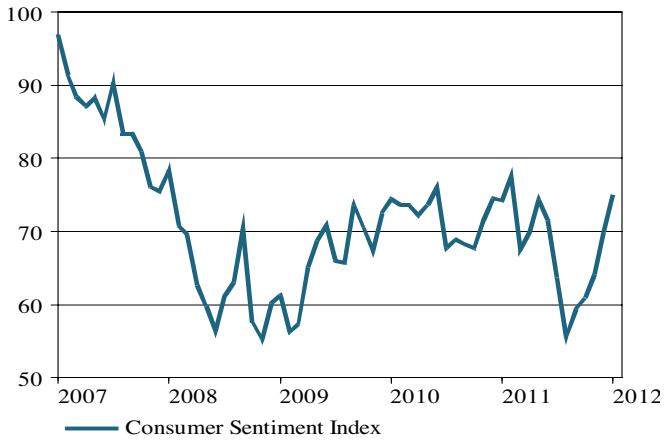
Hawaii's stop-start recovery continued in the fourth quarter. We are a bit more optimistic about prospects for 2012.

The fourth quarter in Hawaii ended with the same mixed results that typified 2011. Visitor arrivals and spending surged at the end of the year. But in the broader economy, job growth remained anemic and the unemployment rate worsened. With signs of life in the US economy overall, Hawaii's fitful recovery will gain a bit more ground in 2012.

The external economic environment has improved somewhat in recent months, although large risks remain. The US economy flirted with recession for much of the year, but there were a number of encouraging developments in the final quarter. Manufacturing orders edged upward, after hovering for several months at the line between expansion and contraction. Unemployment moved down to 8.5% from 9.1% in August. Consumer sentiment has risen for five consecutive months. News from Japan has been less encouraging. After a bounce back from earthquake-related disruptions, economic recovery seems to have stalled. The strong yen and weak overseas demand have hammered exports and production. At the same time, Europe's debt woes have continued, with no real progress in solving the fundamental problems. The continent's economy is slipping back into recession as contractionary fiscal policy accomplishes exactly what one would expect—unless you are an EU policy maker! Absent a meltdown in Europe, US conditions should continue their gradual improvement, and we expect output to expand by 2.0% in 2012. Japan's economy will manage just 1.5% growth.

The Hawaii visitor industry staged a recovery late in 2011, after a disappointing performance midyear. The industry had struggled under the weight of the Japanese earthquake, high oil prices, and weak US consumer confidence. There was a sharp pickup in September, with arrivals surging 4.1% above previous-year levels. Disney's Aulani Resort magic contributed to this, although Neighbor Island markets also rebounded. Year-over-year growth rates remained in positive territory thereafter, and with a very strong December, the year as a whole saw 3.5% arrivals growth, and more importantly a 15.6% increase in nominal visitor spending. Spending figures were buoyed by nearly 9% higher average daily room rates.

APEC was the fall's big news story, and the gathering did have measurable effects on the visitor industry. November arrivals were up 3.3% from their level in 2010. And the conference was a boon for Waikiki hoteliers: room rates were as much as 41% higher than the same week in 2010, according to data from Hospitality Advisors. Hotel occupancy peaked at more than 97% on Friday of that week. There were also some interesting adverse impacts. In particular, Japanese arrivals during the APEC week were off sharply, presumably reflecting crowding out in their preferred Waikiki destinations.

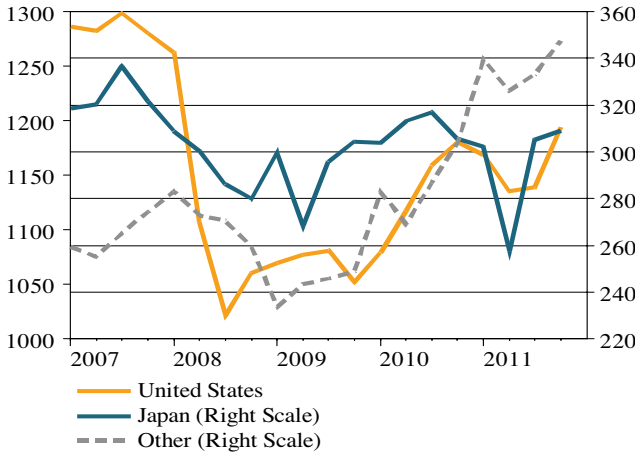


UNIVERSITY OF MICHIGAN CONSUMER SENTIMENT INDEX

A fourth quarter pickup reversed the downward trend in mainland arrivals that we experienced during the first half of the year. US arrivals at year end were 3.5% higher than at the start of the year. The planned cancellation of nonstop flights from Chicago and Minneapolis, as well as a significant decrease in the number of flights from Chicago, Houston, and Orange County, will drag down domestic arrivals in the first quarter of 2012. These changes may affect Oahu arrivals the most; airline lift to the Neighbor islands will rise somewhat in coming months. Overall, we expect only a 1.1% gain in US arrivals in 2012.

As we noted in our last report, by September Japanese arrivals had largely reclaimed their pre-earthquake level. Newly scheduled flights from Fukuoka and Osaka and the historically strong yen will be positives this year, while a poor economic environment will present challenges. Overall, we expect Japanese arrivals to rise more than 7% in 2012, reflecting in part the rebound that has already occurred. Arrivals from other markets continue to impress, with Canadian visitors up 18% in 2011, and overall arrivals for markets other than the US and Japan up more than 17%. This is also where we see the brightest prospects. Near-term scheduled air seats are way up over 2011 levels. For example, lift from Canada is nearly 30% higher (mostly to Neighbor Islands); seats from Sydney and Seoul to Honolulu are up about 40% each. The Obama administration's plans for increased visa-issuing capacity in Brazil and China and the proposal for a Taiwan visa waiver agreement provide hopes for further growth. We expect arrivals from markets other than the US and Japan to rise a robust 12% this year, before slowing in 2013.

A cautionary note for all markets is the potential adverse effect of higher oil prices. Oil has been trading near $100 per barrel, a significant increase from September's $86/bbl, if below the April level of $110/bbl. Pricey oil will restrain visitor growth. On the positive side of the ledger is Hawaiian Airline's expansion, including the creation of a hub in Maui.



VISITOR ARRIVALS FROM US, JAPAN, AND OTHER MARKETS (THOUSANDS)

We anticipate a 4.1% rise in total arrivals this year, backing off to roughly 2% growth by 2013.

In the construction sector, it is necessary to talk separately about conditions on Oahu and on the Neighbor Islands. On Oahu, employment bottomed out in mid-2010, and there has been a net gain of about 1,500 jobs since then. Neighbor Island construction continues to slide, with no sign of a slackening in the pace of contraction. In December, Neighbor Island construction employment was nearly 13% lower than a year earlier, with the greatest weakness on Maui. The more forward-looking data on permits shows encouraging signs of stabilization, with statewide private permits down less than 3% in the third quarter. We will have much more to say about conditions and prospects for the industry in our forthcoming "Hawaii Construction Forecast."

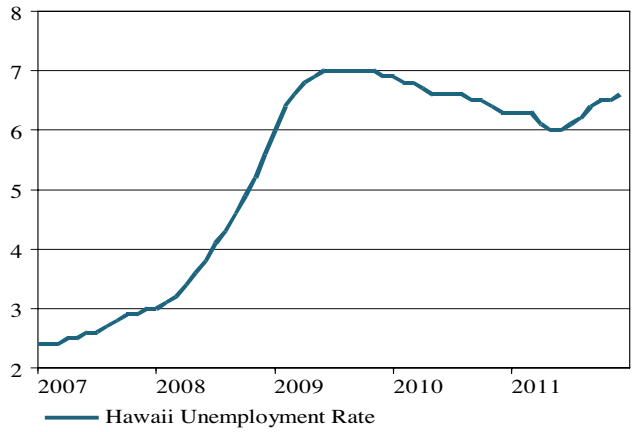
We are getting absolutely nothing so far from public sector construction. For the first three quarters of the year, government contracts awarded were off a staggering 67%. The future of the Honolulu Rail Transit project remains somewhat murky. In December the City received approval from the Federal Transit Administration (FTA) to enter the final design phase. However, the FTA was cautious in committing support from federal New Starts funding prior to the city developing contingency plans to deal with any funding shortfalls or cost overruns. The City expects that the Full Funding Grant Agreement will be reached by October. At

the same time the Ninth Circuit Court has rejected for now a city challenge on the standing to sue of several plaintiffs in an ongoing legal challenge. A resolution to the case may not occur until late this year.

The market for residential real estate in the Islands has yet to stabilize. On Oahu, median single-family resale prices last year gave up the modest gains they had made in 2010, and sales volume was also lower. On Maui, median prices were down nearly 5%, but with volume more than 10% higher. With 11 months of data available, prices were down 5% on the Big Island and 9% on Kauai. While sales were up by more than 7% on the Big Island, they were flat on Kauai. Home prices are expected to remain soft for the next year or so, until economic conditions improve and the foreclosure overhang is worked through. Once that begins to happen, the dearth of new building will set the stage for resumed price appreciation. The Honolulu median single-family home price will be essentially flat next year before accelerating to more than 10% growth by 2014.

Labor market data for recent months confirms earlier fears that Hawaii's job recovery has retreated. In December, the seasonally adjusted unemployment rate rose to 6.6%. The number of unemployed workers increased to 41,900, not including the Hawaii Medical Center layoffs that occurred at the end of the month. Total unemployment claims continued to decrease in 2011 and overall are 17% lower than in 2010, although they ticked back up recently. The federal program of extended unemployment benefits has been continued through at least March 6, 2012. Both the program extension and the layoffs at HMC will add to the initial as well as total unemployment insurance claims in the first quarter of 2012.

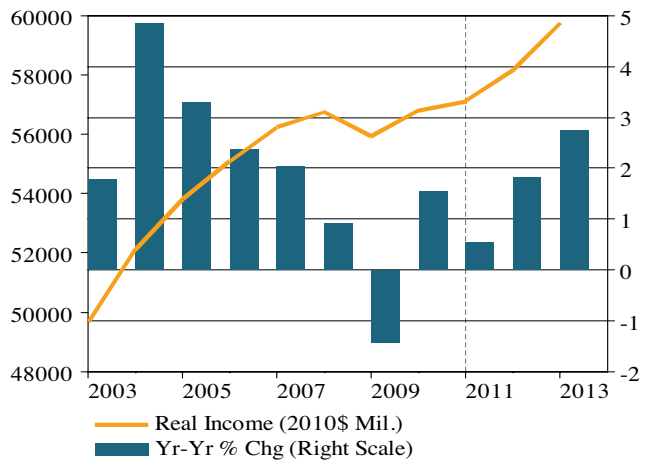
Payroll job counts, which come from a separate survey of businesses, ended the year with a modest 1.2% gain, in line with our previous forecasts. As with visitor arrivals, the year-over-year growth masked weakness during the summer and the lack of any significant gains over the course of the



HAWAII UNEMPLOYMENT RATE (PERCENT)

year. We expect payroll jobs to expand by 1.8% this year, firming to 2.3% in 2013. Because of the recent backsliding of employment, we have raised fairly substantially our unemployment forecast since our last report. We now expect statewide unemployment to average 6.2% this year and 5.5% in 2013.

At the sectoral level, the largest job gains last year were in accommodation and food services and the large "other services" sector, which includes an array of services from management to entertainment. Jobs in transportation and utilities dropped 2.9%, although we expect this to turn positive in 2012, in part because of recent and planned Hawaiian Airlines expansion. Finance, insurance and real estate turned the corner and will post 3.6% growth in 2012. Construction job gains will begin in earnest this year, assuming that rail gets on track, expanding by more than 4% and then nearly 10% in 2013. With the drag from construction easing, the combined wholesale and retail trade sector will expand by 1.5%. Health care will be hit hard by the 1,000 HMC layoffs, showing no net job gains this year. Public sector job losses have eased, but they will make no significant net contribution to growth for the foreseeable future. Looking to the longer term, recently announced cuts in military spending and base closures present the possibility of adverse impacts here, although it appears that Hawaii will be spared—or even see incremental gains—as the military



HAWAII REAL PERSONAL INCOME FORECAST

pulls back from some overseas locations.

UHERO emphasizes personal income data as an important overall indicator of economic health in the Islands. Income performance was disappointing in the first three quarters of last year, with growth falling off somewhat since the end of 2010. Taking into account increases in the cost of living, we estimate that real (inflation-adjusted) income rose just 0.5% last year. We now project a better income performance for 2012 than in previous reports, since it appears likely that payroll tax cuts and extended unemployment benefits will be continued through the end of this election year. Higher pay for federal workers will also help. The eventual end of payroll tax cuts will drag on income in 2013, but by then we expect stronger labor income to more than offset this negative impact.

The year 2011 brought a few positives in the form of Oahu construction stabilization and a late-year rebound of visitors from earlier lows. But it would be hard to sugarcoat what was a bitter year overall. Hawaii's labor market deterioration was particularly disheartening, considering the incremental gains that have been seen in the US as a whole. Conditions abroad are a mixed bag: strong recent overseas arrivals provide hope, while the European crisis looms dangerously. All in all, we are cautiously optimistic that 2012 will be a better year in the Islands as we begin to transition to a more satisfactory growth path.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2009	2010	2011	2012	2013	2014
Visitor Arrivals	-4.4	7.7	3.5	4.1	2.4	1.9
U.S. Visitor Arrivals	-3.9	5.9	2.3	1.1	1.7	1.5
Japan Visitor Arrivals	-0.6	6.1	-5.3	7.3	2.2	1.8
Other Visitor Arrivals	-10.5	17.6	17.8	11.9	4.8	3.2
Payroll Jobs	-4.5	-0.8	1.2	1.8	2.3	2.1
Employment	-4.1	-0.2	1.1	1.5	2.4	1.9
Unemployment Rate (%)	6.8	6.6	6.3	6.2	5.5	4.9
Inflation Rate, Honolulu MSA (%)	0.5	2.1	3.5	1.9	1.8	1.3
Real Personal Income	-1.4	1.6	0.5	1.8	2.8	3.0
Real GDP	-1.6	-0.1	1.2	2.3	3.3	3.7

Note: Source is UHERO. Figures for 2012-2014 are forecasts. Except for visitor and labor market data, figures for 2011 are UHERO estimates.

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