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

UHERO STATE FORECAST UPDATE, PUBLIC SUMMARY

Visitor Industry Still Leading Recovery

MAY 11, 2012

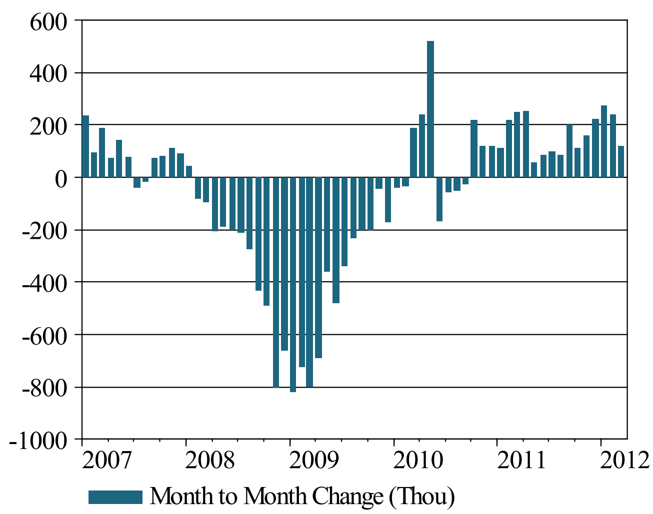
Tourism continues to be the primary engine of Hawaii's recovery. A number of other sectors have turned the corner, and we expect gradually improving performance this year and the next.

The first part of 2012 is looking a lot like 2011. The visitor industry continues to be the center of strength, and gains outside tourism-related sectors remain harder to come by. The drag from construction and government will end this year, setting the stage for broader growth.

The external economic environment has been a mixed bag in recent months. The US economy is making progress in a number of areas. More than 650,000 jobs have been added since the start of the year, and the unemployment rate has edged down to 8.2% in March. Consumer confidence has been on the rise, and spending strengthened in the first quarter. News for the rest of the world is more sobering. After the initial post-quake bounce, the Japanese economy is moving sideways. Gross domestic product declined in the fourth quarter, and industrial production is negative year on year. On the positive side, the Bank of Japan has announced new monetary easing. The yen has receded a bit as a result, which will benefit exporters. The worst news is (surprise, surprise) in Europe. European Central Bank lending programs and a successful Greek debt write-down helped to reduce sovereign borrowing rates earlier this year, but yields have crept up since. The austerity measures implemented across the continent have pushed the EU back into recession—and toppled at least one government. Absent a meltdown in Europe, US conditions should continue their gradual improvement, and we expect output to expand by 2.3% in 2012. Japan's economy will manage just 1.3% growth.

After a slowdown in the middle of last year, the Hawaii visitor industry is now expanding again at a healthy clip. In the first quarter, the total number of visitors to the state surged 8.5% above previous-year levels. Taking into account length of stay, the number of visitor days rose more than 9%. Strong visitor performance is occurring across the state, although Neighbor Island markets are not yet back to their pre-recession levels. (Recent developments and prospects for each of the county economies are discussed in the UHERO County Forecast, to be released later this month.) Visitor spending is also growing strongly, with a first quarter gain of more than 14%.

The mix of visitors by country of origin has been quite similar to previous years, with the biggest percentage gains in markets other than the US and Japan. Canadian visitor arrivals were up 8.3% in the first quarter, and overall arrivals from markets other than the US and Japan up more than 20%. For the year as a whole, we expect arrivals from non-Japan international markets to rise 14.6%. Accommodating these increases will be additional flights from Vancouver,



CHANGE IN US MONTHLY TOTAL NON-FARM PAYROLLS (THOUSANDS OF JOBS)

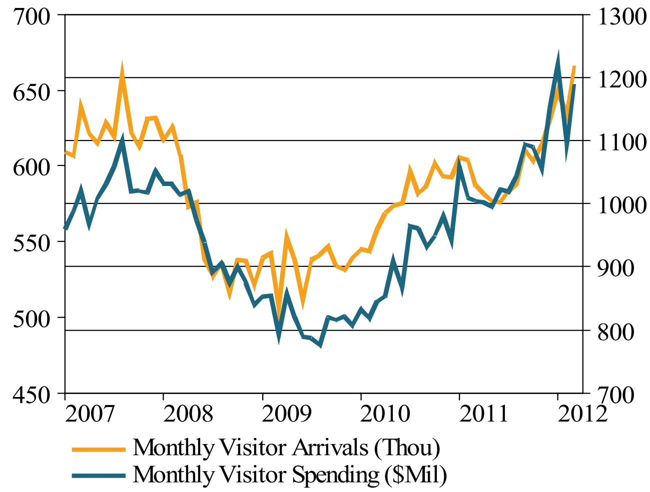
BC to Kona and Lihue, and additional flights from Seoul, Shanghai, and Sydney to Honolulu.

By early this year, Japanese arrivals had surpassed their pre-earthquake level. In the first quarter, there were roughly 334,000 Japanese visitors to the islands, the highest number since the third quarter of 2007 and a nearly 11% increase over 2011. New flights from Fukuoka and Osaka to Honolulu will contribute to the market's strength this year, as will the historically strong yen, which not only affects the purchasing power of Japanese travelers but has also led to downward adjustment of fuel surcharges. For the year as a whole, we expect Japanese arrivals to rise 6.7% from their 2011 total.

Visitors from the US mainland were up a healthy 4.7% in the first quarter. That kind of strength is unlikely to continue, in part because of the planned cancellation of nonstop flights from Minneapolis, as well as a significant decrease in the number of flights from Chicago, Houston, and Orange County. The drop in the first half of 2012 is likely to be offset by the launch of more nonstop flights from New York and Washington, D.C. in June as well as the resumption of American Airlines' Chicago flights during the peak summer travel season. Economic conditions in the US continue to be relatively weak, which will restrain US market growth. Overall, we expect US arrivals to Hawaii to rise 2% in 2012.

For all markets, higher oil prices will continue to restrain growth this year. To be sure, there has been a bit of relief recently, with crude oil falling from more than $128 per barrel in mid-March to $118/bbl in recent days (Brent crude). Still, oil remains in roughly the same territory as a year ago, considerably higher than it was back in 2010. Not all news on the energy front has been bad: plummeting natural gas prices are bringing down electricity costs on the mainland, offsetting at least some of the damage to household spending power.

Total visitor arrivals will rise 5.2% this year. This is a bit stronger growth than we had forecast in our first quarter report, reflecting performance in the year to date.



VISITOR ARRIVALS AND SPENDING

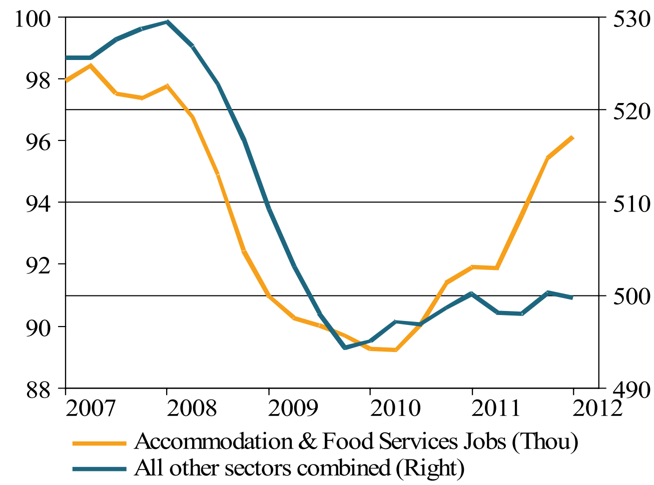
Despite some differences across Islands, the market for residential real estate remains frail. Except on Oahu, home prices continue to fall, and sales volumes are down in three of the four counties. On Oahu, median single-family resale prices rose more than 10% in the first quarter of 2012, and sales volume was down 2%. Sales fell 15% on Kauai, with prices edging down very slightly. A similar drop in sales volume occurred on the Big Island, and prices there were down a more substantial 6%. On Maui, an increase in sales volumes of about 3% was accompanied by a similar-sized drop in prices.

The number of jobs in the construction industry dropped 2% in 2011, according to recently revised data. There was a mini uptick in the past three months, but the number of jobs remains below year-earlier levels. Industry conditions are poorest on the Big Island and Kauai, with more positive signs on Maui and Oahu. Maui actually saw a small net gain in construction jobs in first-quarter data, although these data are sometimes subject to significant later revision. Forward-looking data on permits shows encouraging signs of stabilization, with statewide private permits up more than 15% in the fourth quarter, but again this is centered on Oahu and in Maui County. We expect a turn to slight positive statewide construction job growth this year, strengthening to more than 9% growth in 2013.

Early this year the Bureau of Labor Statistics released its annual benchmark revision of employment estimates. These involved some significant changes to earlier estimates of a number of labor market indicators. In particular, what had appeared to be a worsening unemployment situation during the second half of 2011 disappeared in the revised statistics. Unfortunately, the reason is that estimates for the earlier period were revised upward substantially. The December figure of 6.6% confirms our earlier observation that last year was a disappointing one for the local labor market. There have been a few positive developments recently. The seasonally adjusted unemployment rate has edged down a bit further, to 6.4% in March. And despite a significant spike in the number of initial unemployment insurance claims (which partly reflects the recent layoffs at Hawaii Medical Center), total claims were down nearly 5% in the first quarter. We expect unemployment to average 6.1% this year, dropping to 5.4% in 2013.

According to the revised figures, the number of non-farm jobs grew by less than 1% in 2011; they have edged up just slightly since the start of the year. For the first quarter, the payroll job count was 0.6% higher than during the first quarter of 2011. Growth in this range is slower than we had anticipated, and it has led us to reduce just a bit our forecast for the year as a whole to 1.5% growth, strengthening to 2.2% in 2013. Year-to-date growth has been highest on Maui and Kauai and slowest on Oahu.

Not surprisingly, accommodation and food service jobs have seen the strongest growth so far this year. Jobs in the sector were up 4.6% in the first quarter, with strength in both the lodging and restaurant components. The other sectors linked most directly to tourism have seen much smaller gains; retail trade and transportation and warehousing were up just 0.7% and 0.8%, respectively. The growth leader in 2011, administration and waste management, has continued to

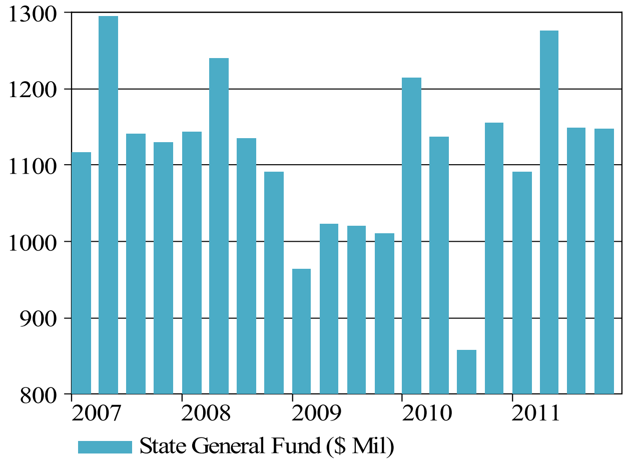


JOBS IN ACCOMMODATION AND FOOD SERVICES VS ALL OTHER SECTORS

do well this year, with first quarter jobs up 6.1%. Finance, insurance and real estate turned the corner in the second half of last year, and jobs were up 2.6% in the first quarter. As a reflection of HMC layoffs, in January health care lost roughly 1,400 jobs, but the job base rebounded in March; for the first quarter, the sector was essentially unchanged from a year earlier. Federal, state and local government continued to lose jobs in the first quarter, although we expect the public sector to stabilize over the course of this year. It is important to emphasize that employment figures have been revised substantially in recent years, so it would be unwise to put too much stock in these very recent figures.

Taking a broad view, it is interesting to note that the two sectors that have roughly recovered to their previous peak levels are accommodation and food services, and administration and waste management. The former reflects the tourism rebound; the latter includes, among other things, temporary employees, where demand has been strong during the past several years of challenging economic conditions. The health care sector never lost a significant number of jobs during the downturn, although the pace of growth has dropped toward zero over the past year or so. All other aggregate sectors remain well below their pre-recession levels.

UHERO emphasizes personal income data as an important overall indicator of economic health in the Islands.



STATE GENERAL FUND REVENUES

Since the time of our last report, the US Bureau of Economic Analysis has released income figures for the fourth quarter of 2011. Income measured in current dollars slowed a bit in the second half of last year and rose 4.5% for the year as a whole. Because of the energy price driven spike in consumer prices last year, inflation-adjusted real income was up just 0.7%. Real income will rise 1.5% this year, firming to 2.7% in 2013.

The state legislature finalized an $11.2 billion budget for fiscal 2013 after a deadline extension and a flurry of last minute activity. Lawmakers agreed to add about $430 million in new bond financing for capital improvement projects, bringing the total value of government sponsored construction projects to $3 billion in fiscal 2013. However, the expedited permitting process that would have exempted new projects from environmental review did not pass. Because this is the first year since 2009 that the State's budget deficit is not in the billions, room has also been found to restore some of the government services that have been cut in recent years. The budget was based on the assessment by the Council on Revenues that the general fund tax collections will grow by 14.5 percent in fiscal year 2012 and 6.5 percent in fiscal year 2013. According to preliminary data for March, total general fund tax collections were up 14.7% for the first nine months of fiscal year 2012.

Recovery progress has been predictably uneven, both from quarter to quarter and across sectors. Tourism continues to be the primary engine of that recovery, and this will continue to be a source of growth, supported by the recent resurgence of non-traditional markets. As the two millstones around Hawaii's neck—construction and government—lighten this year, employment gains will strengthen and touch more sectors of the local economy.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2009	2010	2011	2012	2013	2014
Visitor Arrivals	-4.4	7.7	3.5	5.2	2.5	1.7
U.S. Visitor Arrivals	-3.9	5.9	2.3	2.0	1.8	1.8
Japan Visitor Arrivals	-0.6	6.1	-5.1	6.7	2.0	-0.1
Other Visitor Arrivals	-10.5	17.6	17.8	14.6	4.8	2.8
Payroll Jobs	-4.5	-0.8	0.9	1.5	2.2	2.2
Employment	-3.9	1.8	2.0	1.0	2.2	1.6
Unemployment Rate (%)	6.9	6.9	6.7	6.1	5.4	4.9
Inflation Rate, Honolulu MSA (%)	0.5	2.1	3.7	3.2	2.5	2.6
Real Personal Income	-1.7	1.5	0.7	1.5	2.7	2.9
Real GDP	-1.6	-0.1	1.3	2.2	3.1	3.6

Note: Source is UHERO. Figures for 2012-2014 are forecasts.

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