Coronavirus presents danger To Hawaii tourism

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THE ECONOMIC RESEARCH ORGANIZATION AT THE UNIVERSITY OF HAWAI'I

Already in slow-growth mode, Hawaii's economy could be hit hard by coronavirus travel concerns.

Hawaii's economy has been on an expected slowing trend for the past several years. While visitor arrivals racked up another record year in 2019, real visitor spending fell last year as international spending languished. And now the coronavirus rears its ugly head. That represents a considerable—if as yet uncertain—risk to Hawaii's economy in the year to come.

Global Conditions

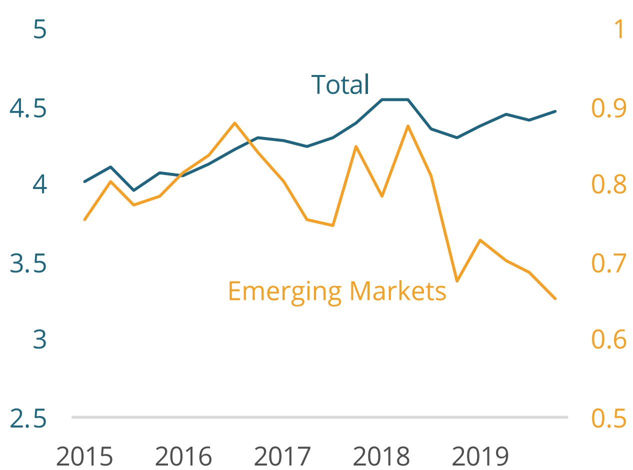
After a very weak 2019, Hawaii's external environment was posed for gradual improvement. In the US, manufacturing is in recession, and business fixed investment has fallen for three straight quarters. But a partial resolution of trade uncertainty should help to stabilize investment this year. With very healthy labor markets, there is every reason to believe that consumer spending will continue to extend what is now a record-long US economic expansion. Faced with last year's slowing, the Federal Reserve made three "insurance" interest rate cuts last fall and maintained these lower rates at their January meeting. This will help support the recent uptick in residential investment and the broader economy.

The global economy slowed broadly last year. At least pre-coronavirus, we have expected 2019 to be the low-water mark, with very gradual strengthening over the next several years. In Japan, employment has surprised to the upside, as supportive public policies have boosted women's labor market engagement. But last fall's tax hike has had a significant impact on growth. China's ongoing slowing, the trade war, Brexit, and industry-specific factors have depressed growth in many other countries. With some respite from these challenges, conditions were looking a bit brighter.

And then came the coronavirus. While some firming of global conditions remains the most likely outcome, the still-spreading disease poses a substantial risk. We will return to this below.

Real Visitor Expenditures (2018 $Bil.)

Emerging market spending declined sharply last year.



Tourism

Real visitor spending was weak throughout last year. While it picked up a bit in the fourth quarter, inflation-adjusted spending still finished the year 0.3% below the 2018 level. Real per-person daily spending declined across all markets except for Japan, which was up about 2%. For emerging visitor markets, the combination of declining visitor numbers and falling daily spending resulted in a sharp 15% decline in expenditures. The decline in per-person daily spending was due primarily to reduced shopping expenditures, reflecting the combined effects of a strong dollar and soft conditions in home country economies.

Visitor arrivals peaked in August, and have eased back since then, but they still posted a solid five-plus percent growth for the year as a whole. The average daily census, which reflects both the number of visitors and their length of stay, grew by less than half that, moving sideways for most of the year. The length of stay has been declining for a number of years, likely reflecting rising hotel and other travel costs as the long tourism expansion has continued. At the end of 2019, visitors spent on average about 8.5 days in Hawaii, almost a day less than in the period following the Great Recession, when room rates were 30% less in real terms. Competition from transient vacation rentals (TVR's) kept real hotel room prices and hotel occupancy rates flat last year.

Growth in visitor numbers continues to be supported by expanding accommodation and transportation capacity. While the stock of traditional hotel rooms changed little over the past year, the supply of TVRs grew more than 10% in the fourth quarter, according to Hawaii Tourism Authority data. (Our own analysis of AirBnB data shows a

Coronavirus: The Great Unknown

By mid-February, less than two months after the initial signs of the novel coronavirus (COVID-19) outbreak, the number of confirmed cases worldwide has surpassed 75,000, with 99% of these reported in China. Researchers are still trying to pin down the exact transmission and mortality rates, but the estimated 2,000 fatalities have already surpassed the number of deaths attributed to other coronaviruses, such as Severe Acute Respiratory Syndrome (SARS) and Middle East Respiratory Syndrome (MERS). To combat the spread of the virus, Chinese authorities imposed travel restrictions affecting about 35 million people around Wuhan, the epicenter of the outbreak, as well as quarantine requirements for those returning from the region to other cities. Other countries have imposed restrictions on visitors or flights arriving from China and on some cruise ships, as well domestic quarantine measures.

COVID-19 is on track to deliver a significant blow to China's economy, but the rest of the world will also feel at least a limited impact. As a comparison, the SARS outbreak—totaling just over 8,000 cases—was contained within eight months, but disruptions due to the epidemic subtracted up to one percent from China's economic growth in 2003. Since then, China has become an essential link in global supply chains, producing a wide range of products and driving demand for commodities. The country now also has a large consumer base purchasing imports from around the world. The shutdown of significant parts of the Chinese economy will affect imports, exports, and domestic consumption. The epidemic comes at a time when China is already struggling to keep its economic growth on target, and a delay in containment would require the government to prolong and expand strict quarantine measures, further snarling global supply chains. Already, some overseas producers, such as Korean auto-maker Hyundai, have had to halt or scale back production reliant on Chinese parts.

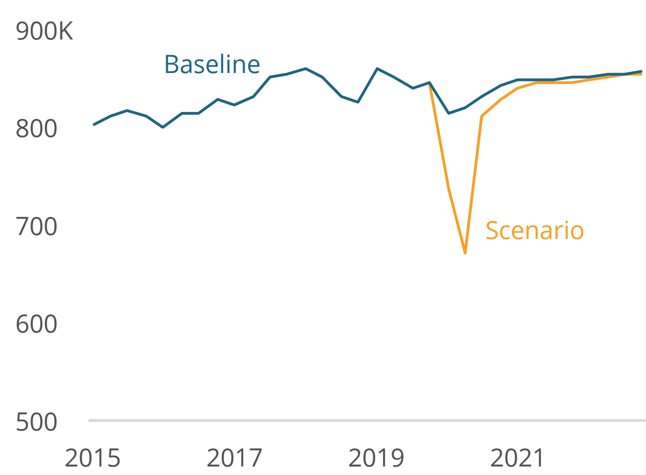
Service industries are also affected by epidemics, and tourism is among the most vulnerable. Travel restrictions that are intended to contain the spread of the virus have a direct impact. Indirect impacts are mostly due to the choices potential vacationers make. The wide coverage of the outbreak in traditional and social media raises awareness and lowers travel demand, as would-be airline (and cruise ship) passengers opt to avoid tight spaces shared with others or the risk of quarantines abroad. Hawaii has only a limited direct exposure to the Chinese tourist market, but experience from past epidemics originating in China indicates that we may also see a temporary decline in the number of visitors from other emerging markets and from Japan. It remains too early to assess these impacts, and as we note in the text, the decline to date has been limited. As of mid-February, seasonally adjusted passenger counts from Japan are down nearly 10% compared to a strong January. Passengers from other emerging markets are off 20% compared with January counts, while domestic passenger counts are flat. One recent incident of specific concern has been the identification of a Japanese national and his wife who tested positive upon their return to Japan from a Hawaii vacation. Operations are underway to track people who may have come in contact with the couple. Since the outbreak was only recognized gradually and the cancellation of booked flights is costly, the economic impact may ramp up over time.

A recent Travel Weekly survey found that about half of surveyed US travel agents have seen a decline in forward bookings due to COVID-19, although domestic destinations were perceived to be safer. Hawaii's experience with the 2003 SARS outbreak may provide an indication of the potential downside risk. During the SARS crisis, there was a temporary 25% decline in the number of visitors from non-primary markets, and a dramatic 40% drop in Japanese visitors, while US arrivals were rising steadily. The trough in international arrivals occurred in late spring, about six months after the first diagnosis, and visitor levels rebounded to normal by the end of the year. Our scenario for the impact of COVID-19 assumes a similar path forward. Arrivals from Japan bottom out in the second quarter, nearly 30% below year-earlier levels, but they fully recover by the first quarter in 2021. The number of visitors from non-traditional visitor markets—which includes China—take a 15% hit in the second quarter, and begin a gradual recovery thereafter. Arrivals from the US remain close to the baseline forecast, as any potential loss is offset by visitors choosing Hawaii over more exposed Asian destinations. The overall impact is to reduce total arrivals by about 230,000 visitors in the first half of the year, recovering fully by the third quarter.

Again, it is important to stress that the length of the epidemic, its reach, and duration are as yet unknown. It is encouraging that the falloff in passenger counts has been relatively limited so far. Hawaii will certainly feel the effects of the virus, but we can hope that the fallout will be less severe than in 2003. This is of course something we will be tracking closely in coming weeks.

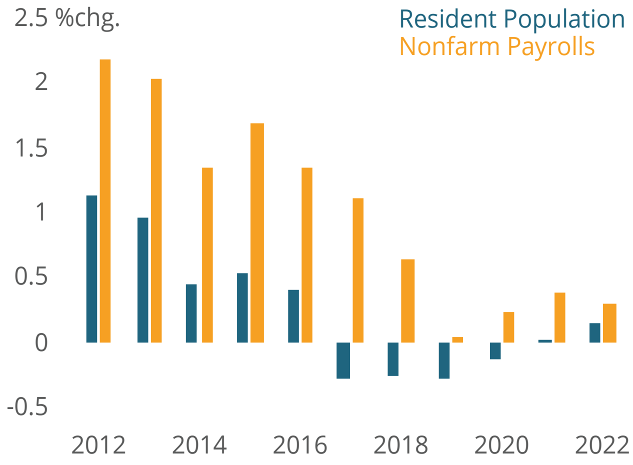
International Visitor Arrivals

Our COVID-19 scenario is influenced by Hawaii's SARS experience.



Resident Population and Nonfarm Payrolls

Population has declined and job growth slowed.



slight drop at year end due to declining listings on Oahu.) TVR occupancy rates were only a few percentage points below the occupancy of traditional hotels. Airline capacity also expanded last year, with strong growth on domestic routes more than offsetting some decline in international air seats. Airlines have remained optimistic about the near future, growing their capacity by nearly 7% for the first four months of the year.

The coronavirus presents the risk of substantial disruption to Hawaii travel, particularly from international markets. In the first half of February, international passenger counts from countries other than Japan have fallen 21% below year-earlier levels, and our forecast assumes no arrivals from China until the third quarter of this year. The more important unknown is whether virus concerns will also cause a sharp falloff in Japanese travelers. So far that is not evident, but past experience raises concerns. In the box, "Coronavirus: The Great Unknown," we discuss the virus impacts to date and describe what a SARS-like travel downturn would look like if it were to occur. Considering the strength of the domestic market, the anticipated Chinese visitor losses and limited effects in other Asian markets will not be enough to pull visitor growth much below 2% this year, under our baseline forecast. Overall arrivals will pick up a bit in 2021, but then remain muted compared with recent years, given tight capacity here.

Employment and income

As we have noted in past reports, the state's labor force and employment have been in decline for the past several years, accompanied by a marked slowing of population growth on the Neighbor Islands and outright decline on Oahu. Labor force and employment stabilized in the the fourth quarter. But with a smaller labor force and still-healthy economy, hiring conditions have remained tight. New claims for unemployment insurance remain at very low levels, and the unemployment rate, which had moved up beginning in 2018, has edged back downward.

The number of payroll jobs picked up a little in the second half of last year, but the annual average remained unchanged from its 2018 level, according to UHERO estimates of the forthcoming government benchmark revision. Categories that added a significant number of jobs last year include construction, health care, and accommodation and food services. Construction jobs grew by nearly 3%, rising to within 2% of their 2016 peak. Accommodation and food service jobs bounced back from a weak showing in 2018. Federal government jobs also expanded moderately. The trade sector continued to be very weak, reflecting at least in part the decline in real visitor spending. The US Bureau of Labor Statistics will release official benchmarked data for 2018 and 2019 in March.

The outlook is for some moderate firming of payroll employment over the next several years. Still, so late in the expansion, there is limited room for upside gains, and job growth will average just 0.3% per year over the next three years. Sectors tied to tourism—trade, transportation, and accommodations and food—will be weak, and of course face the greatest downside risk. Real personal income, which has been a welcome surprise to the upside, is expected to post another year of growth exceeding 1%, before decelerating. Real gross domestic product, the broadest measure of economic activity, will grow by a little more than 1% this year and next.

Conclusion

The top level indicators for this forecast are not significantly different from those in our December report: weak job growth and a bit better performance for income, another year of no growth in real visitor spending, and visitor arrivals decelerating from recent robust growth rates. What is different of course is the extent of downside risk. As we noted in the box, Hawaii's experience during the 2003 SARS epidemic suggests that much more significant visitor industry fallout could occur, depending on the spread of the virus, the pace of containment, and especially the reaction of travelers to virus concerns. It is simply too early to know the extent of these risks. The good news is that even during the SARS epidemic, visitor industry impacts were short-lived, and effects on jobs and income were hardly discernible. Needless to say, the potential effects of COVID-19 will likely command most of our attention as we track the performance of the economy in coming weeks.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2017	2018	2019	2020	2021	2022
Nonfarm Payrolls	1.1	0.6	0.0	0.2	0.4	0.3
Unemployment Rate (%)	2.4	2.5	2.7	2.8	3.1	3.3
Visitor Arrivals	5.2	5.2	5.3	1.8	1.9	0.8
U.S. Visitor Arrivals	6.3	8.1	7.7	4.0	1.6	0.8
Japan Visitor Arrivals	2.5	3.0	-1.6	1.8	1.4	0.3
Other Visitor Arrivals	3.7	-2.1	2.9	-6.1	3.8	1.3
Inflation Rate, Honolulu MSA (%)	2.5	1.9	1.6	1.7	1.9	2.0
Real Personal Income	1.3	2.1	1.3	1.3	1.0	0.8
Real GDP	1.6	3.0	1.6	1.1	1.2	0.8

Note: Source is UHERO. Nonfarm Payrolls for 2018 and 2019 are UHERO estimates of the benchmark revision. Figures for income and GDP for 2019 are UHERO estimates. Figures for 2020-2022 are forecasts.

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