Already weak, Hawaii's prospects look increasingly dicey

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

Economic growth in the Islands has slowed to a standstill. That's bad news, considering shocks on the horizon.

Hawaii has been slowing for several years. That slowing has deepened in 2019 and extends to most corners of the economy. Two years of population decline have undercut demand in many sectors. Tourism, while still generating impressive visitor numbers, has seen spending slip, and many international markets have fallen back sharply. Add to that the impending shock to Oahu from the crackdown on home vacation rentals, and prospects for further tourism growth look poor. Construction remains a relative bright spot, although even here further softening of the Hawaii, US, and global economies would undercut growth. All told, the outlook is for Hawaii to tread water over the next few years, vulnerable to waves that could well pull us under.

Our population is a drag

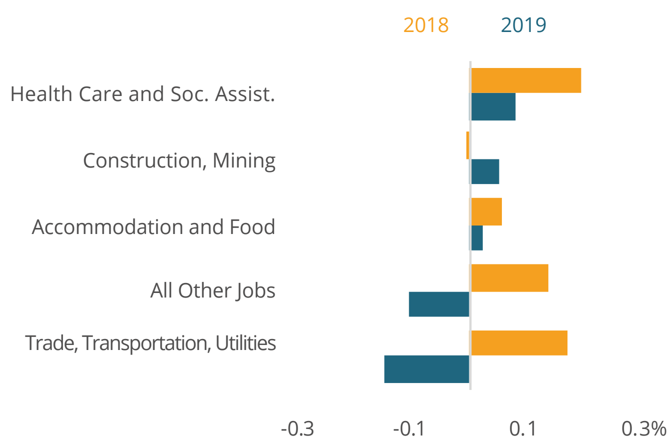
Demographic factors have played a key role in Hawaii's recent slowing. The state's population fell in both 2017 and 2018, the first back-to-back annual declines since the 1950s. Only a portion of this can be attributed to a drop in the number of active duty military and their dependents, with the rest involving outmigration of other residents, likely responding to better work opportunities and lower living costs on the US mainland.

The outflow of residents has undermined aggregate demand in the Islands, leading to broad weakness. Payrolls flatlined in the second half of 2018 and have declined since the beginning of this year. According to UHERO estimates, there are now two thousand fewer jobs statewide than at the end of last year. (Our figures for the recent period differ from published data, because we estimate forthcoming government benchmark data revisions.) The broad-based nature of this weakness is striking: of nine aggregate sectors that we forecast, five have seen outright job losses and the remaining four have grown by less than 1% this year.

While we expect Hawaii's population count to stabilize over the next few years, very restrained growth will continue to weigh on activity across much of the economy. We expect overall payroll numbers to be essentially flat for this year as a whole and to expand by less than a half-percent in 2020.

Contributions to payroll job growth

The labor market is seeing broad-based weakness.



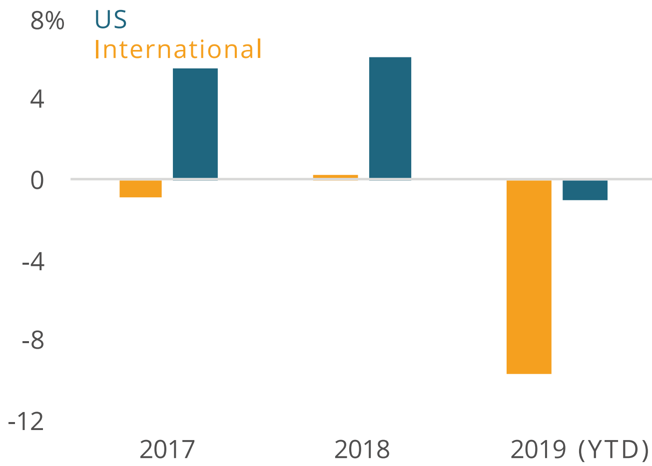
Despite job weakness, Hawaii's labor market still appears tight. The headline unemployment rate stood at 2.8% in July, up just a half-percent from its trough near the end of 2017. However, this is somewhat misleading. Population decline and the ongoing retirement of baby boomers have weighed on the labor force, which has declined by 3.5% since the beginning of 2017. This has offset in part the decline in employment over this time period. And the broadest measure of unemployment, which includes workers who have given up looking for jobs or are getting fewer hours than they would like, has risen by 1.4 percentage points over the past year. We expect the unemployment rate to continue to edge up, reaching 3.5% by 2021.

Fewer foreign visitors, and now fewer rooms

Conditions in the visitor industry are also weaker than they might at first appear. While arrivals numbers continue to set records, the number of visitors in Hawaii on a typical day has grown by just 1% this year. (The two can differ because of changes in the average length of visitor stay.) Most worrisome has been a sharp pullback in international markets, where the number of visitor days has declined across all major market segments. Because of a stronger

Change in inflation-adjusted visitor spending

There has been a sharp pullback in international markets.



dollar, international visitors are facing an increase in the price of Hawaii vacations, and the global economy has also slowed markedly. Trump's rhetoric adds insult to injury. Those visitors who do come tend to spend fewer dollars. Inflation-adjusted international visitor spending is down more than 9% this year; only spending by US visitors remains on par with the same period in 2018. Not surprising, then, that jobs in the accommodation and food service sector have been flat for the past two years. Jobs in the trade sector have fallen sharply.

Against this more vulnerable backdrop, Oahu tourism is set to take a significant hit from the recent crackdown on transient vacation rentals (TVRs). Honolulu Ordinance 19-89, which went into effect on August 1, prohibits advertising illegal TVRs. While we are only now getting the first data, the ordinance has already led to a sharp reduction in the number of TVRs advertised on online sites. Based in part on data from the AirBnB website, we estimate that about 10,000 units on Oahu were advertised on various vacation rental sites prior to the adoption of the ordinance, of which more than 6,000 units appear to have operated unlawfully outside resort or resort/mixed use zones. Since the ordinance went into effect, about 3,500 units have withdrawn their listings. This represents a greater-than-8% drop in Oahu's overall visitor plant inventory, which averaged a little more than 40,000 units in the first half of this year.

While some of these potential visitors will find alternative accommodations—in hotels, timeshares, condos, TVRs in resort areas, and on the Neighbor Islands—others will choose to forgo a Hawaii vacation. As a result, some of the rise in visitor numbers that had been fuelled by the proliferation of vacation rentals will now be reversed. The reduction in advertised units that we have seen so far is likely to reduce Oahu visitor days by more than 4% in 2020. Neighbor Island visitor numbers will be somewhat stronger. Statewide hotel occupancy will edge up above 81%. All told, Hawaii visitor days will contract by a half-percent in 2020, a marked decline from this year's 2.6% gain. Trend growth in visitor days will remain very limited thereafter, averaging less than 1% in the 2021-2023 period. Considering that a substantial number of illegal units appear to still be advertising online, the ultimate effects of the ordinance could yet be larger. We will of course be watching data closely in coming months and updating the outlook as appropriate.

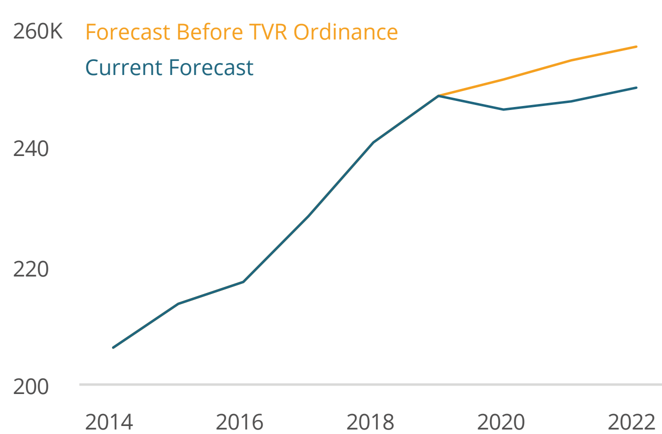
Construction remains a bright spot

The construction industry remains a focus of relative strength. Construction jobs have been inching up for nearly two years, climbing back to within 1,700 of their early-2016 peak. While the value of building permits has been very weak recently, anecdotal evidence from industry sources is much more upbeat, citing high capacity utilization and a large pipeline of work on the way. Our baseline outlook is for a continuing modest upward trend over the next several years, although we have yet to assess the potential impact on housing markets and residential construction of the TVR ordinance. We will have much more to say about this and other factors affecting prospects for the industry in our forthcoming UHERO Construction Forecast.

Local residents have seen little improvement in their purchasing power in recent years, and soft economic conditions will limit earnings growth even more going forwards. Per capita real income will grow at half-percent average annual rate over the forecast horizon, further constraining local spending. One silver lining of the weak economic environment is restrained inflation. Easing demand, low interest rates, relatively stable fuel prices,

Average Daily Visitor Census

The reduction in TVR units will affect visitor numbers.



and the strong dollar have combined to alleviate price pressures. Consumer prices grew at a 1.8% pace in the first half of the year and will trend at a sub-2% rate for the next several years.

We are poorly positioned for risks

Hawaii finds itself in an increasingly vulnerable position. With weakness in international markets, the tourism industry has become more reliant on domestic arrivals at a time when the US economy is cooling and risks are on the rise. While US consumer confidence remains relatively strong, tariffs and lackluster global demand have undercut manufacturing, and policy uncertainty is weighing on business investment. Despite low (and falling) interest rates, US construction spending has also been weak. It wouldn't take much to tip our only healthy visitor market into recession.

Oahu's restrictions on transient vacation rentals add a new risk, the extent of which is not yet fully known. Certainly it will lead to some pullback in visitor numbers, and therefore spending and related tax revenues. But it is important to note that this comes against a backdrop of tremendous visitor expansion over the past five years. It is also important to acknowledge that the decision to impose these limits is a complicated one that involves an array of considerations, including housing affordability and the footprint of vacation rentals within communities. A simple tallying of actual or potential visitor losses does not do justice to this complex issue.

If the economy were booming, these risks might be less of a concern. Unfortunately, population outflow and global weakness have already brought hiring to a halt. That makes Hawaii's prospects more dependent than ever on what happens next in the broader US economy.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2017	2018	2019	2020	2021	2022
Nonfarm Payrolls	1.1	0.6	-0.1	0.4	0.3	0.1
Unemployment Rate (%)	2.4	2.5	2.8	3.2	3.5	3.9
Visitor Arrivals	5.2	5.9	5.1	-1.2	-0.1	0.3
U.S. Visitor Arrivals	5.1	9.0	8.6	-1.9	-0.2	0.4
Japan Visitor Arrivals	6.7	-1.0	-0.3	0.8	0.1	-0.3
Other Visitor Arrivals	4.0	2.2	-2.0	-0.6	0.1	0.3
Inflation Rate, Honolulu MSA (%)	2.5	1.9	1.7	1.6	1.6	1.9
Real Personal Income	1.2	1.0	1.2	0.6	0.6	0.5
Real GDP	1.1	1.4	1.3	0.9	0.6	0.4

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

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