Outlook for the Hawai'i Economy

April 27, 2000

Carl Bonham and Byron Gangnes
University of Hawai'i Economic Research Organization
Summary

Economic conditions in Hawaii have improved measurably over the past year, with virtually all economic indicators signaling a moderate business cycle expansion. A healthy external environment and growing domestic strength will support somewhat stronger growth for Hawaii's economy in 2000. With continued strong westbound growth and at least an end to the declines in eastbound growth, total visitor arrivals should grow by 4% this year. Construction will rise by 5%. Payroll jobs are expected to rise, and real personal income will accelerate from the current 2% pace to 2.6% growth in 2000.

1999 Year in Review

Hawaii's economy clearly bottomed out in 1998 and entered a more robust growth phase during 1999. While eastbound visitor arrivals were down 5.9% for the year as a whole, their drag on the tourism market had all but ended by late in the year. Westbound growth continued to exceed expectations, expanding 6.1%. Overall visitors rose 1.6% for the year as a whole, with the average daily census up 2.1% because of increases in the length of stay. Visitor expenditures almost certainly strengthened in 1999, as a result of the strong yen and brisk US consumer spending.

There is finally convincing evidence that the construction cycle in Hawaii has bottomed out. Construction put in place continued to be rather weak in 1999, with the real tax base down 1.8% from the year before. But other indicators are much more upbeat. Home re-sales continue to rise strongly, aided by ongoing price declines. The median time on the market for single-family homes has declined from 81 days in March to 49 days in October, the fastest absorption rates since early 1990. And for the state as a whole, median resale prices rose 0.9% last year. The issuing of private building permits was up 33% in 1999, hinting at measurable growth in coming months.

Labor markets tend to lag general economic conditions, and nonagricultural payroll jobs continued to decline through the first quarter of 1999. Job creation strengthened as the year wore on, so that jobs
rose 0.5% for the year as a whole. In the first quarter of 2000 nonagricultural jobs rose nearly 2% above the previous year’s level. Other labor market indicators have also improved. The unemployment rate has fallen by more than one percentage point since last year, to 4.4% in December. Civilian employment, which includes self-employed persons, rose 0.6% over 1998 levels. The gradually improving labor market conditions should help to support consumer confidence in coming months.

The decline in consumer prices we saw in 1998 is a symptom of exceptionally weak demand. Consumer prices have started to firm, rising 1% above 1998 levels. This inflation occurred despite that fact that recent increases in home rental rates and the pronounced gasoline price spike have not yet shown up in the data. Once they do in the first part of 2000, we can expect further increases in measured inflation rates.

For the overall state economy, economic activity expanded moderately in 1999. For the first three quarters of the year, nominal personal income rose 2.9% over the same period in 1998. Strength in the second half of the year suggests that real (inflation adjusted) income should grow by near 2.2% for the year as a whole.

**External Conditions**

In February the U.S. economy set a record for the longest-running U.S. economic expansion. The economy has grown since April 1991, raising total real output by $2.4 trillion over the nine-year period. The U.S. economic expansion shows no signs of ending soon. The economy has posted 4%-plus growth rates for the past three years, and business and consumer spending remain buoyant. The expansion is broad-based, with strong growth in both consumption spending and business investment, and with most regions of the country participating.

Despite robust growth, inflation has been notably moderate. By late in the last expansion, inflation was running at a 5% annual rate; average consumer prices for 1999 were only 2.2% higher than a year earlier. The excellent inflation performance has been one factor cited by proponents of the "New Economy" school, who argue that high technology and increased global competition mean the U.S. can achieve faster trend rates of growth than in the past. Indeed, labor productivity has risen briskly in the recent years. Since 1996, productivity has risen more
than 2.6% per year on average, considerably faster than the 1.6% average gain of the post-1973 period. Whether this reflects a structural improvement in productivity performance or normal cyclical improvements remains to be seen.

The international sector is one of the few areas of chronic macroeconomic weakness still remaining for the U.S. economy. The U.S. expansion has outpaced recovery abroad, causing a strengthening dollar and boosting imports relative to exports. The U.S. current account balance has posted record deficits in recent months.

The U.S. economy will continue to grow at a healthy pace in 2000, perhaps a bit slower than in the past three years. High levels of private sector debt, higher borrowing costs and higher input costs should begin to restrain growth this year. We expect U.S. real GDP to grow by nearly 4% in 2000.

Prospects for the California economy are also excellent. The state’s strength in high technology and business services will continue to propel employment and income forward at rates that match or exceed the national performance.

Japan's economy continues to frustrate with its seesaw performance. In 1999, consumer spending was strong in the first part of the year, suggesting growing optimism, but it fell hard at the year’s end. After positive growth in the first half, both third and fourth quarter growth rates were negative, signaling another official recession. Overall, Japanese GDP rose just 0.3% in 1999. And government spending continued to prop up demand, representing fully 47% of economic growth last year! The 1999 performance was an improvement over the crushing contraction of the previous year, but an indication that recovery is still elusive.

Nevertheless, there were measurable improvements in business conditions, with rising profit rates and, finally, upward movement in stock prices. Business expectations continue to improve. Barring unforeseen negative shocks, we expect Japan’s economy to resume a moderate recovery in 2000, growing 1% this year, before gradually building strength over the next several years. While no dramatic bounce back is expected, slow and steady consolidation of economic gains will be good news for Japan and for Hawaii.

**Hawaii Outlook**

For the first time in several years virtually all of the key underpinnings of Hawaii growth are moving in a positive direction. Together with expected favorable external conditions, the developing strength in Hawaii’s domestic economy will support continued growth over the next several years.

The overall U.S. economy and California are expected to slow moderately in 2000, but should still support westbound arrivals growth of more than 5%. While the situation in Japan is more fluid, gradual economic recovery is expected, so that eastbound visitor arrivals should begin to show improvement. Following a 5.9% eastbound decline in 1999, we expect 1% growth this year. With expected strong westbound growth, even a limited eastbound recovery will produce overall state visitor growth near 4% in 2000.

Along with this moderately strong visitor industry outlook, improvements in the domestic Hawaii
The economy will also support growth.

We expect payroll job growth of 1.1% percent in 2000. We still expect overall employment growth to be somewhat stronger, with growth of nearly 1.5%. The overall labor market will remain relatively soft, but the limited job gains combined with improving profitability will lay the basis for increased wage and salary income growth.

The construction sector will begin to contribute positively to Hawaii’s economy in 2000. We expect the contracting tax base to increase by 5% in real terms.

Inflation will remain moderate, but can be expected to build gradually from its low point in 1998, converging toward the U.S. average. As mentioned above, the inflationary process appears already to be under way, and will accelerate with improved demand conditions and expected increases in shelter costs. We expect 1.8% inflation in 2000.

Strength in the external environment and in local conditions will support improving overall economic conditions here. We expect real aggregate personal income to grow 2.6% in 2000. Real gross state product will show similar growth.

Risks

This month's bear market in technology stocks reminds us that America's amazing economic expansion is not invincible. A substantial and sustained downturn in equity prices could undermine consumption spending and undercut investment by raising capital costs. A repeat of the inflation surprise that prompted the recent stock sell-off could cause substantial Federal Reserve tightening that would more dramatically slow growth. The Fed’s approach so far has been quite moderate; they are clearly keen to avoid excessive slowing. But that restraint would end with evidence of strong price pressures. At the same time, there are also upside risks on the U.S. side. Our growth forecast may well turn out to be too pessimistic if economic slowing takes longer than expected.
By now we know that forecasting Japan's economy is fraught with risks. Recent news about industrial orders and consumer spending are very heartening, but with Japan the proof will be in the pudding. Private spending must somehow receive the baton from fiscal stimulus and set a pace for sustainable expansion. As in the U.S. case, there is some upside risk. When Japan's economy does turn the corner, we expect a substantial recovery in Japanese tourism growth.

**Hawai'i Economic Indicators (Annual Growth Rates)**

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income (Current $)</td>
<td>2.4</td>
<td>3.2</td>
<td>4.4</td>
</tr>
<tr>
<td>Real Personal Income</td>
<td>2.7</td>
<td>2.2</td>
<td>2.6</td>
</tr>
<tr>
<td>Real Gross State Product</td>
<td>2.2</td>
<td>2.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Consumer Price Inflation</td>
<td>-0.3</td>
<td>1.0</td>
<td>1.8</td>
</tr>
<tr>
<td>Visitor Arrivals</td>
<td>-2.0</td>
<td>1.6</td>
<td>4.0</td>
</tr>
<tr>
<td>Eastbound</td>
<td>-10.9</td>
<td>-5.9</td>
<td>1.0</td>
</tr>
<tr>
<td>Westbound</td>
<td>4.1</td>
<td>6.1</td>
<td>5.5</td>
</tr>
<tr>
<td>Real Contracting</td>
<td>2.7</td>
<td>-1.8</td>
<td>5.0</td>
</tr>
<tr>
<td>Non-agricultural Jobs</td>
<td>-0.1</td>
<td>0.5</td>
<td>1.1</td>
</tr>
<tr>
<td>Employment</td>
<td>0.2</td>
<td>0.7</td>
<td>1.4</td>
</tr>
</tbody>
</table>

*1999 income and state product figures are estimates. All 2000 figures are forecast. Real values adjusted for inflation.

email: bonham@hawaii.edu, gangnes@hawaii.edu