Hawaii Outlook: Too Early for Forecasts

September 24, 2001

Carl Bonham
Byron Gangnes
University of Hawai'i Economic Research Organization
The University of Hawaii Economic Research Org. provides regular semi-annual forecasts of the Hawaii economy. Our fall forecast was finished and being readied for release on September 10. And then came the unthinkable horror of September 11. Aside from their incalculable personal toll, the attacks on the World Trade Center and Pentagon are likely to have far-reaching adverse impacts on the US, World, and Hawaii economies. As a result, over the past two weeks we have seen an unprecedented demand for economic information on Hawaii’s prospects.

While there has been considerable media discussion of economic issues, it is our opinion that insufficient hard evidence is available at present upon which to base a reliable forecast. We are quite simply in uncharted territory. We will defer a quantitative forecast for at least several weeks. In the mean time, we will tell you what we do know. In the following we describe pre-crisis conditions in Hawaii, adverse effects to date, and our evaluation of the key areas of concern for the coming months. We hope you find this useful.

The Pre-Attack Economy

United States

The U.S. economy began to slow markedly in the middle of last year. After expanding at a better than 4% annual rate since 1997, the U.S. economy slowed to very near a standstill in the April-to-June quarter of 2001. Prior to the terrorist attacks, we were expecting negative growth for the third quarter with a gradual recovery beginning by the end of the year.

The slowdown in the U.S. had been centered in manufacturing, which saw industrial production fall 3.2% in July from the previous year’s level. Business investment, which had been the most buoyant sector during the late 1990s, fell sharply as a weakening profit outlook and the tech sector collapse forced firms to reassess capital needs. The deteriorating profit outlook depressed stock prices and national wealth.

Consumption and residential investment continued to be surprisingly strong, although consumer confidence had fallen to its lowest level in eight years. August retail sales were up 0.3%, following a 0.2% gain in July, according to the Commerce Dept. Since consumption represents 2/3 of output, the fairly upbeat consumer picture led to hope that the economy would resume growth without suffering an outright recession. At the same time, recent high-profile layoffs and a sharp jump in unemployment to 4.9% in August raised concerns that consumer spending might falter in coming months.

The Federal Reserve Board acted decisively to support economic recovery, reducing short-term interest rates seven times before September 11, and the fiscal stimulus check was in the mail
Japan

Even before the attacks, Japan's economic woes had been deepening. (See Japan in Downhill Slide.) The country's fragile recovery that began in 2000 had been struck broadside by the slumping global economy. With weak demand in its foreign markets and the tech sector collapse, Japanese exports have fallen by 12% over the past year. Industrial production has fallen steadily since the start of this year. Prices on the Japanese stock market are at their lowest levels in 17 years.

Japan’s dire straights were confirmed by preliminary estimates of second quarter gross domestic product released on September 7, which showed the economy contracting at a 3.2% annual rate in the April-June period.

These problems are compounded by the Japan’s inability to use policy measures successfully to restore growth. Repeated fiscal stimulus has failed to move the economy and monetary policy has been timid. Most promising from a long-run perspective is the Koizumi administration’s promise of bold reform to finally deal with the nation's banking problems. In the short run, however, more corporate layoffs and profit problems may accompany these restructuring efforts.

Hawaii

While the external environment deteriorated sharply during the first half of the year, continued strength in local economic activity resulted in limited slowing in Hawaii economic indicators. Visitor arrivals fell by 1.5% during the first six months of the year, yet an increase in length of stay held daily census near last year’s levels. In fact, with rising room prices and nearly stable occupancy rates, real (inflation adjusted) hotel revenues grew by over 1% compared with the first half of 2000.

Other indicators posting moderate growth include real personal income up almost 5% in the first quarter, real contracting up almost 4% relative to the first half of 2000, real general fund tax revenues up 4.4%, and jobs growing by 2% through July of 2001. In August 2001, there were
19,000 more jobs and 7,000 fewer unemployed persons when compared with August of 1999. Largely as a result of increased domestic demand fueled by a more stable job market, the Hawaii economy showed signs of strength at mid year. An optimistic assessment of the Global economy, based on expectations of a late year rebound in the US economy driven by falling interest rates, and fiscal stimulus, could have lead to a respectable if-not good year for Hawaii businesses and consumers.

Current Conditions: What We Know

As businesses and consumers attempt to deal with the economic implications of recent events, there is a strong desire to plan and prepare for the remainder of 2001 and beyond. Unfortunately there is precious little hard economic information on which to base these plans. Here’s what we know:

Travel Industry Woes

The airline industry and much of the transportation sector was at a near standstill during the second week of September. All major US, and some international carriers have announced cut backs in their schedules—most by near 20%. Both Hawaiian and Aloha have announced schedule cuts. Yet it appears that Hawaii has yet to see major reductions in lift, and cuts may be reduced if bookings resume near pre-attack levels. The HVCB reported late last week that domestic and international air service to and from Hawaii was near 100% of scheduled flights. JAL will operate all scheduled flights except one through the end of September.

Nevertheless, passenger counts are down significantly as visitors and residents alike cancel or postpone flights. On September 15, the first day International flights resumed, passenger counts on flights from Japan were off 78% from last year’s levels; by Wednesday the 19th counts were near 50% of year-ago levels. For Domestic flights, by Monday the 17th passenger counts were off “only” 30% from 2000 levels.

These immediate measures of travel may not be good indicators of activity in coming weeks. Passenger counts from last week were clearly depressed by the initial reaction to the terrorist attacks, but may also have been skewed by returning residents who were stranded during the three days all air traffic stopped. There have reportedly been a large number of trip cancellations, but many trips have also been rescheduled. The Japanese tour giant JTB says more than 12 percent of its 32,000 customers have canceled reserved package tours to U.S. destinations, including Hawaii and Guam, since September 11. According to the HVCB, Japanese tour
operators indicate 70% of trip cancellations are being rebooked. Three major tour agencies—JTB, Nippon Travel Agency and Kinki Nippon Tourist Co.—have resumed service to Hawaii, so we should get a better assessment of the Japan market over the next several weeks.

Since the terrorist attack on Sept. 11, the airline industry nationally has announced more than 100,000 layoffs. In Hawaii, those layoffs are just beginning in the airline industry, but started almost immediately in other areas of the tourism market.

President Bush signed a $15 billion airline industry aid package Saturday. The package includes $5 billion in immediate grants to compensate airlines for losses suffered from the government-ordered grounding of flights. It also provides for $10 billion in loan guarantees to airlines, and some measures designed to prevent small markets from losing air service. "We are here to put back on its feet an industry that represents 10% of our $7 trillion gross domestic product," said Rep. James Oberstar of Minnesota, senior Democrat on the House Transportation Committee, Friday.

**US Economic Reaction**

The U.S. economy will suffer a measurable drop in production from the direct impact of terror attacks. The halt in economic activity during the 2nd week of September alone could trim 0.5% to 1% from third quarter U.S. GDP growth. Manufacturing firms reported substantial reductions in output because of transportation bottlenecks, and firms throughout the economy effectively ceased operation as management and employees turned their attention to television coverage of the aftermath.

The reaction of financial markets was also severe. Equity trading resumed last Monday, and the Dow-Jones Industrial Average fell more than 1,360 points, or 14%, the largest weekly percentage loss in 70 years. The Nasdaq fell 16% for the week. Unless reversed, these losses of wealth will undermine consumer spending and raise capital costs for firms.

Nevertheless, there is little direct evidence of a sharp consumer retreat. According to a phone survey conducted by The Conference Board on Sept 18th and 19th, nearly half of all Americans believe the terrorist attacks on September 11 will push the U.S. into recession. Yet, 90% of consumers indicated that they do not intend to cut back on their purchasing plans, and nearly 70% said they would not postpone or cancel air travel plans.

The Federal Reserve has moved quickly to shore up economic conditions, making their eighth interest rate cut of the year before markets opened last Monday. The Fed cut interest rates to their lowest levels since the early 1990s, and engaged in other actions to provide extra liquidity. The Federal government has also weighed in with fiscal support, including the airline bailout but also money for rebuilding.
**Hawaii Hit Hard**

Hawaii’s dependence on air travel means we have been harder hit than most parts of the country. The state is now in the midst of a sharp downturn in tourism-related activities. A trip to Waikiki or Ala Moana Shopping Center provides a clear picture of the extent of the immediate downturn.

While centered in the tourism sector, layoffs are having negative impacts throughout the economy. A continuation of these dire conditions just through the end of the month would likely reduce third quarter visitor arrivals more than 15% below last year’s levels and reduce 2001 output in Hawaii by about 1%.

The business disruption has shown up in labor markets. New claims for unemployment insurance have risen sharply, more than doubling the weekly rate of 1,400 claims experienced prior to the attack.

The Governor’s planned response to these events will have only a limited impact on the situation. By extending the period of eligibility for unemployment compensation and health care access, some the state may provide some direct relief for displaced workers. The state may also provide additional funding for tourism marketing. The magnitude of the state’s resources is very limited, compared with those of the Federal government, so that the extent of economic stimulus it can provide is limited. In contrast, Hawaii may be well positioned to receive substantial Federal stimulus.

It is unclear to what extent this downturn will extend beyond the very immediate future, so that the medium-term impact cannot be clearly assessed at present. We take these issues up in the next section.
Looking Ahead

Hawaii’s links to the rest of the world are extensive. Spending by tourists accounts for about 25% of overall economic activity, including both direct and indirect effects. Air transportation is also an important lifeline for local businesses, which need to move personnel and some freight by air. Developments in international financial markets also affect spending in the local economy.

The nature of these links are well understood, so that we can identify key factors abroad that influence the course of our economy. For example, the number of Japanese visitors to Hawaii is driven primarily by real income and wealth in Japan, as well as by changes in the yen/dollar exchange rate. Similarly, U.S. income, wealth and prices drive Hawaii visitors from the mainland. U.S. interest rates affect borrowing costs here and so influence home and big-ticket consumer purchases. The price experience on the mainland ties down Hawaii consumer prices over the long run.

In normal times, we can predict tourism flows and other components of the local economy with reasonable precision by using statistical models that relate economic activity to key determinants in our major markets.

But these are not normal times. Historical experience can tell us how California visitors will decline if recent events lead to recession there, but it is little guide to gauging how heightened safety concerns might compound the problem. As we mentioned above, The Persian Gulf War experience may provide some insight, but it is not clear how apt the analogy is. President Bush has promised a protracted “war” on terrorism, which would unsettle consumers and visitors for an extended time period. And unlike the Gulf War, the direct attacks on civil aviation may undermine confidence and willingness to travel in a much more profound way. One wonders if we will ever get back to the low-cost, frequent travel pattern of the past.

The Gulf War and the 1991 Downturn

As a direct consequence of the Gulf War, Hawaii lost 12% of its visitors during the 1st quarter of 1991. While Westbound visitor growth turned negative almost immediately after the Iraqi invasion of Kuwait in August 1990, Eastbound arrivals growth remained strong until the start of the U.S. offensive in January 1991. The worst monthly decline came in February, when total arrivals were 22% lower than the previous year.
The end of hostilities brought a sharp rebound of Eastbound arrivals, which posted near 8% growth in May 1991. The failure of Westbound travel to recover fully owes less to the lingering effects of the war than the mainland recession that was then underway. California’s recession was particularly lengthy—real income growth did not reach pre-war levels until 1995. And Hurricane Iniki hit Westbound travel hard in the fall of 1992.

Another significant difference between the Gulf War shock to Hawaii’s economy and the current situation is the collapse of the Japanese Bubble Economy. In the late 80s, the Japanese Bubble powered not only visitors to Hawaii, but also a massive building spree in the islands. As a result, the 90s saw a loss of 38% of Hawaii’s contracting jobs. In contrast, our position near the start of a construction upswing should help to cushion the overall impact of the tourism downturn.

What We Will Watch

In the coming months, we will work to pin down a forecast for Hawaii as information becomes available. Here are some of the primary factors we will be watching:

**US Economy**

- Consumer behavior—not necessarily consumer confidence—as measured by retail sales, new and existing home sales, and especially indicators of travel demand.

- Monetary and Fiscal Policy. What further stimulus will we see in lower interest rates? Is there evidence that lower rates are buoying spending? How large a federal fiscal stimulus $180 billion dollar fiscal package? How will mortgage rates respond to the prospect of federal deficits?

**Japan**

- Can Japan stabilize industrial production and the labor market, or does further weakness begin to severely undermine consumer spending?

- Does the yen continue to gain some strength against the U.S. dollar, which would tend to support visitor spending here, or does the dollar rally?

- What progress is being made in addressing Japan’s financial sector problems, and, more importantly, does the business community see progress in this area?
Hawaii

- Airline capacity. Does airline “lift” recover to pre-attack levels or remain well below?

- Local sources of growth. How do local contributors to growth hold up, such as the construction and service sectors? Do additional tourism-industry layoffs undercut strength in these other areas?

- State government contributions to growth. The Governor has announced plans to use state resources to help weather the slowdown. Available tools are limited but could provide limited support.

The Great Unknown: War or Peace?

Certainly the most important determinant of a tourism recovery will be public perceptions of travel safety and overall security.

- What success is apparent in the U.S. campaign against terrorism? Do Americans and Japanese view the world as a safer place than at present?

- What progress is made in addressing concerns about the safety of the U.S. airline system?

The Urge to Say Something

Information is the most important commodity in the modern economy. In times of crisis, it becomes even more important, as businesses, governments and individuals scramble to assess their exposure to potential losses and line up resources that may be needed to meet adverse developments. Decision makers look to public providers of information and professional forecasters for reliable information. For the forecaster there is a strong temptation to say something—anything—to fill the information void. But doing so risks adding bad information that obscures rather than clarifies.

We have tried to describe the limits of information now available about the economic response to the September 11 terrorist attacks. We have indicated the factors we think must become clearer before a reliable forecast can be made. We hope that the situation stabilizes quickly and that we can come back to you soon with a much better picture of Hawaii prospects for the rest of 2001 and 2002.

email: bonham@hawaii.edu, gangnes@hawaii.edu
Copyright © 2001 Carl Bonham and Byron Gangnes. All Rights Reserved.