Surging Economy Generates Impressive Income Growth

by

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EXECUTIVE SUMMARY

Any signs of cooling evident in second quarter data disappeared in the third quarter. Tourism rebounded and personal income was revised upward. The residential construction sector continues to perform at an exceptionally high level. While we expect the economy to slow a little in the fourth quarter, we now forecast real income growth of 4.3% for 2005. The strong growth is expected to generate some additional inflation over the next two years.

- The spike in inflation associated with the hurricanes and tight global oil supplies, along with the associated near-term fall in consumer confidence, will contribute to some slowing of the U.S. economy in the fourth quarter and the first part of next year, resulting in only 3% growth in 2006. While there remains a risk that high energy prices could lead to broader slowing, the retreat of national gasoline prices ($2.20 per gallon ($2.73 in Hawai‘i) is encouraging.

- As expected, the Japanese economy has slowed from the buoyant pace of the first quarter, but appears to be continuing a moderate expansion. Japanese GDP has risen for four consecutive quarters, posting a 1.7% annualized increase in the third quarter. We expect overall growth of 2.2% for the year as a whole, slowing marginally to 1.9% in 2006.

- Because U.S. visitor arrivals for the third quarter came in somewhat stronger than anticipated, we have raised our forecast for overall 2005 arrivals slightly to 6.7% growth. However, the pace of Japanese market recovery, already tepid, has slowed further. We expect only 3.4% growth in Japanese arrivals for 2005.

- With statewide occupancy rates expected to average near 80% for the next several years, we expect a slowing of expansion for all visitor markets. U.S. arrivals growth will slow to 2.5% in 2006, the Japanese market to 2.7%.

- Labor market conditions remains extremely tight; if anything, there have been signs of strengthening labor demand, with marginal acceleration in both payroll jobs and household survey-based employment. We now expect 2.7% growth in payroll jobs for the year as a whole. We continue to expect gradual slowing of job growth to 1.8% in 2006.

- At the sectoral level, construction job growth is coming in even stronger than anticipated, and will end the year 10% higher than in 2004. Wholesale and retail trade will rise 3.2% for the year as a whole, and health care will post a 3.3% rise in jobs. Accommodations and food services will add 3% to their job base. The decline in government jobs will be a bit smaller than last forecast, falling just 0.2% from 2004 levels. With the exception of the public sector, we expect slower growth in every major sector next year.

- There have been repeated upward revisions to income figures for Hawai‘i, and we have now posted four consecutive quarters of 5% or better real income growth. As a result, we now expect real income to rise 4.3% for 2005 as a whole, up from our third-quarter forecast of 3.7%. It is unlikely that such robust income growth can be sustained much longer; we expect slowing to 2.7% in 2006.

- The large spike in energy prices led to an uptick in U.S. inflation in the third quarter, and it is likely that a similar boost occurred in Hawai‘i prices. (The Honolulu CPI is measured only twice each year, so second-half prices will not be available for some time.) While gas prices are now receding, home price inflation is still ongoing. We expect inflation of 3.7% for the year as a whole, peaking at 3.9% in 2006. Local inflation will remain above the national average for the foreseeable future.
Hawai‘i Economic Indicators, Year-Over-Year %Change

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<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
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<tr>
<td>Visitor Arrivals</td>
<td>1.4</td>
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<td>U.S. Visitor Arrivals</td>
<td>2.8</td>
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<tr>
<td>Japan Visitor Arrivals</td>
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<tr>
<td>Payroll Jobs</td>
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<td>1.9</td>
<td>2.6</td>
<td>2.7</td>
<td>1.8</td>
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<tr>
<td>Employment</td>
<td>-0.5</td>
<td>0.8</td>
<td>1.2</td>
<td>3.4</td>
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<tr>
<td>Unemployment Rate</td>
<td>4.1</td>
<td>3.9</td>
<td>3.3</td>
<td>2.7</td>
<td>2.7</td>
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<tr>
<td>Inflation Rate, Honolulu MSA (%)</td>
<td>1.0</td>
<td>2.3</td>
<td>3.3</td>
<td>3.7</td>
<td>3.9</td>
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<tr>
<td>Real Personal Income</td>
<td>2.5</td>
<td>2.4</td>
<td>4.5</td>
<td>4.3</td>
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Notes: Source is UHERO. Figures for 2005–2006 are forecasts.

Upcoming UHERO Forecast Reports

4th Quarter: The Global Outlook Report. Review of economic conditions in the world economy with particular focus on Asia. Includes forecasts for major countries and regions.


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