Economy Strong, But Signs of Slowing Emerge

by

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EXECUTIVE SUMMARY

Key Changes in This Forecast.
The visitor arrivals forecast has been reduced somewhat, to 2.8% growth this year, from our February forecast of 3.4% growth.

Job growth continued to be strong in the first-quarter, leading us to raise our forecast for 2006 job growth from 2.1% to 2.5%.

Because of marked slowing in 2005, we have reduced marginally our forecast of real income growth to 3% growth this year (down from 3.2% in February).

Prospects for the Hawai‘i economy continue to look very good for 2006. A relatively weak first quarter and limited airline capacity through the summer lead us to lower our visitor forecast slightly. At the same time, 2005 job growth has been revised upward and that strength has carried over into 2006. As expected, there are now signs that slowing has begun to occur, particularly in neighbor island economies. In the face of a very tight labor market, further slowing is expected to continue over the next year.

- Conditions continue to look favorable in key external economies. U.S. GDP grew at an annual rate of 4.8% in the first quarter of 2006, rebounding from a slow fourth quarter. We have raised our forecast for this year marginally, to 3.2% growth. Japan’s economy finished the year with a flourish, posting growth at a 5.4% annual rate in the fourth quarter, but slowed to 1.9% in the first quarter. Still, forward-looking indicators are very positive, and lead us to raise our forecast for real GDP growth to 3%.

- We now expect somewhat weaker visitor arrivals growth for 2006 than we forecast in February. This reflects the weak first quarter and reduced expectations for airline capacity over the next several months. We have reduced our forecast for overall arrivals to 2.8% growth this year, down from our 3.4% forecast made in February. U.S. mainland arrivals are expected to grow by 3.1%, and Japanese arrivals will be essentially flat, rising 0.5% for the year as a whole. With some further decline in the length of stay, daily census will expand by about 1%.

- The local labor market has continued to tighten in recent months. Job growth remained strong in the first-quarter, leading us to raise our forecast for 2006 job growth to 2.5%. With the unemployment rate nearly as low as the 2.4% seen at the height of the Japanese bubble in 1989, labor constraints will necessarily act to slow growth over the next two years. Slower job growth is already evident on Maui and Kaua‘i. We expect job growth to decelerate to 1.3% in 2007. The statewide unemployment rate will remain low at 2.4% for the next two years.
• Residential resales volumes have begun to fall on all islands, and price increases appear to have slowed. Declining affordability and higher interest rates will lead to further cooling over the next several years. While the construction job growth trend is heading downward, the year has started off very strong, and we have marked up our 2005 job forecast for the sector from 5% to 7.7% growth. After that, construction job growth will remain above average in 2007, but drop down in 2008 as the cycle closes in on its peak.

• We have also made upward revisions to 2006 job growth forecasts for retail and wholesale trade, the “other services” category—which includes business, administrative, and professional services—and financial, insurance and real estate. With recent data revisions, we now expect a significant drop in agriculture this year, and further declines are expected next year, as the Del Monte layoffs occur.

• The marked slowing evident in aggregate Hawai‘i real personal income over the course of 2005 leads us to lower by just a bit our forecast for this year and the next. We now expect 3% growth in real income this year (down from 3.2% in February), slowing to 2.2% in 2007.

• Housing costs drove the acceleration in inflation that occurred in the second half of last year, and further feed-through of home price appreciation may yet occur. The spring surge in energy prices and the continuing labor market tightening reinforce inflation concerns. We do not yet see evidence to merit raising our inflation forecast, although this will bear careful watching in coming months. For now, we continue to forecast inflation of 3.8% this year, 3.2% in 2007.

• In our view there is now somewhat greater risk to the forecast from inflation and Federal Reserve policy reaction. U.S. inflationary pressure intensified in the first quarter. With the recent surge in oil prices and capacity utilization rates that are at their highest level since July 2000, there is now greater risk of continuing Fed interest rate increases, which could undermine spending.

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Notes: Source is UHERO. Figures for 2006 - 2007 are forecasts. Figures for 2005 income are UHERO estimates.
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