Nationwide Housing Slowdown Poses Risk for Hawai‘i Growth

by

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EXECUTIVE SUMMARY

Key Changes in This Forecast.

Employment growth has been revised upward by half a percent this year and by four tenths of a percent for 2007. Payroll job growth for 2007 has been raised by a similar amount.

The real personal income growth forecast has been reduced by two tenths of a percent for 2007 and 2008.

Visitor arrivals have been marked down to 0.4% growth this year (compared with our 1.5% forecast from September) primarily because of DBEDT revisions to 2005 data. The 2007 forecast has been reduced to 2% because of poorer U.S. and Japanese market prospects.

Hawai‘i’s general cooling trend continues to deepen. Job growth next year is expected to be more than a percentage point weaker than in 2006. The visitor arrivals forecast for 2007 has been reduced somewhat, partly because of now-familiar Japanese market weakness. A new factor is the marked slowing that has occurred in the mainland U.S. economy, and the possibility of a deeper U.S. slowdown represents an emerging downside risk. With housing turning down, the construction sector will no longer be a contributor to growth in the Islands.

- Conditions in the U.S. economy have softened in recent months, and relative weakness will continue into the first half of 2007. After real GDP growth of 3.2% this year, U.S. growth will be only 2.4% in 2007. The rapid retreat of mainland residential investment is now a considerable drag on the U.S. economy, and it significantly raises risks of a broader slowdown. Japan has done a bit better than expected this year, but is expected to cool from 2.7% growth this year to just under 2% for the next two years.

- Our inflation forecast was raised in September following news of the nearly 6% Honolulu CPI surge in the first half of the year. Housing cost pressures are the primary driver, but energy prices have also been important. Because of lags between home price increases and measured inflation in shelter costs, we expected inflation to remain high for the next two years. Overall Honolulu inflation will top 5% this year, exceed 4% in 2007, before slowing to 3.4% in 2008.

- Nominal incomes will not keep pace with inflation in the near term, so measured real (inflation-adjusted) income will suffer this year and next. After rising 2.8% last year, real personal income will manage just a 1.1% gain this year, strengthening somewhat to 1.8% in 2007. Actual purchasing power of Hawai‘i residents will probably not slow to the degree these figures suggest, since many homeowners do not face the full housing cost increases estimated by government statisticians.

- Upward data revision for 2005 have lowered our forecast for 2006 visitor arrivals, and we now expect just 0.4% growth for the year as a whole. Hotel revenues are putting up very healthy numbers. Arrivals next year will rise 2%, held back by a very soft Japanese market, which has been hurt by large fuel surcharges and the rise in Hawai‘i hotel room rates.

- The labor market continues to slow in the face of extremely tight conditions and somewhat weaker demand. The slowing trend is now well-established, and we expect further deceleration over the coming year. For this year as a whole, we expect 2.6% growth, down from 3.2% in 2005. Aggregate job gain will slow to 1.5% next year and 1.2% in 2008. Unemployment, which set a record low in October at 2.1%, will begin to edge upward in a slowing economy, averaging 2.9% in 2007.

- With the deepening slowdown of the housing market, residential construction will slow further in coming months. Housing prices are now essentially flat, and there will likely be a low single-digit decline in 2007.
We now expect flat construction jobs in 2007 and a small decline in 2008. The plateauing of construction jobs, after the run up of the past several years, will remove an important contributor to job growth, but construction sector adjustment in Hawai‘i is not expected to be as severe as on the mainland.

- 2007 job forecasts have been raised slightly in this forecast for most other sectors of the Hawai‘i economy, although growth will remain tepid by recent standards. Wholesale and retail trade and the accommodations and food service sector continue to slow as housing and visitors peak. Finance, insurance and real estate will slow in 2007 after relatively strong gains this year. Transportation and utilities and the “other services” category— which includes business, administrative, and professional services—will see above-average growth next year.

- Agricultural job losses in 2007 will be much larger than expected because of the acceleration of Del Monte layoffs. Health care and social assistance jobs have been exceptionally weak this year, and only modest growth is seen in 2007. The public sector job outlook continues to be weak, although state and local jobs are looking more favorable than Federal jobs.

- Over the next two years, a number of factors will weigh on the Hawai‘i economy, including high inflation, the end of the construction impetus to growth, and tepid visitor arrivals. While hotel rates are likely to remain healthy, the potential for a broad slowdown in the U.S. economy and the persistence of high energy prices both pose risks for the visitor industry. At present, we remain on the slowing trend that began a year or more ago, with positive overall growth at a more modest rate anticipated.

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Hawai‘i Economic Indicators, Year-Over-Year %Change

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<th>2003</th>
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<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
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<tr>
<td>Visitor Arrivals</td>
<td>-0.1</td>
<td>8.3</td>
<td>7.3</td>
<td>0.4</td>
<td>2.0</td>
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<tr>
<td>U.S. Visitor Arrivals</td>
<td>4.8</td>
<td>7.3</td>
<td>8.5</td>
<td>2.4</td>
<td>1.3</td>
<td>1.0</td>
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<tr>
<td>Japan Visitor Arrivals</td>
<td>-9.6</td>
<td>10.6</td>
<td>2.4</td>
<td>-8.6</td>
<td>0.2</td>
<td>2.6</td>
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<tr>
<td>Payroll Jobs</td>
<td>1.9</td>
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<td>3.2</td>
<td>2.6</td>
<td>1.5</td>
<td>1.2</td>
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<tr>
<td>Employment</td>
<td>0.9</td>
<td>1.4</td>
<td>3.0</td>
<td>2.6</td>
<td>1.5</td>
<td>1.1</td>
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<tr>
<td>Unemployment Rate (%)</td>
<td>3.9</td>
<td>3.3</td>
<td>2.8</td>
<td>2.7</td>
<td>2.9</td>
<td>3.1</td>
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<tr>
<td>Inflation Rate, Honolulu MSA (%)</td>
<td>2.3</td>
<td>3.3</td>
<td>3.8</td>
<td>5.1</td>
<td>4.4</td>
<td>3.4</td>
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<tr>
<td>Real Personal Income</td>
<td>1.6</td>
<td>5.4</td>
<td>2.8</td>
<td>1.1</td>
<td>1.8</td>
<td>1.8</td>
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Notes: Source is UHERO. Figures for 2006 - 2008 are forecasts.
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