Against a backdrop of local slowing and deteriorating conditions in the US and global economy, Hawaii will see only modest growth in 2012. The strongest part of the tourism recovery is now behind us, and further industry gains will be more incremental. Job growth will continue to occur in many areas of the economy, but not at a pace that will rapidly alleviate unemployment. Somewhat better, but still measured, growth will occur in 2013-2014. While we are not forecasting a US recession, American economic and political conditions represent a substantial downside risk for Hawaii.

Conditions have weakened across much of the developed world. The DC debt debacle and market gyrations have dealt a blow to confidence on top of the fundamental US challenges of a private debt overhang, a moribund construction industry, and a looming fiscal contraction. We anticipate very weak US growth in the near term with only moderate strengthening in 2012-2013. In Japan, the Great East Japan Earthquake inflicted considerable economic damage, including direct losses of output, disruptions to supply chains, and destruction of infrastructure. Largely on the strength of government reconstruction spending, we expect Japanese GDP growth to turn positive in the current quarter. The debt crisis in Europe has gone from bad to worse, contributing to a generally weaker global environment and posing systemic risks that could affect US financial institutions.

There has been a generalized slowing of local economic activity in recent months, paralleling to some extent developments in the US and global economies. After a strong increase in the second half of last year, visitor numbers have dropped back somewhat. While the Japanese quake explains part of this, US arrivals have also fallen. Economic slowing extends to the labor market, where statewide job counts drifted down from January to June and the unemployment rate has stagnated at 6.0-6.1%.

Despite the weakness of recent months, the visitor industry has made significant strides since the dark days of 2008-2009. Further gains will be constrained by global weakness. We expect less than 1% growth in the American market in 2012 and only modest additions thereafter. Japanese arrivals will bounce back more than 5% next year, but this reflects rebound from very low post-quake numbers. Visitors from countries other than the US and Japan will continue to be a bright spot, rising 16% this year and averaging roughly 5% annual growth over the next three years.

After a 1.7% rise this year, total arrivals will expand by just over 2% annually in each of the next three years. With some decline in the length of stay, the total number of visitor days in Hawaii will edge up just 0.8% in 2012. Nominal visitor spending growth will decelerate sharply from this year’s strong 10.2% pace to 4.4% growth in 2012. While global economic conditions will be a challenge, there are several promising developments for Hawaii tourism, including the opening of the Disney Aulani resort, the first regularly scheduled flights.
from China, and the APEC conference coming up in November.

Near-term prospects for construction remain limited. Permits for private residential and commercial development are weak, and budgetary pressures will hamper public works spending. We still expect a substantial boost from Oahu rail mass transit by 2012, although the likelihood of delays related to pending legal challenges is unknown. Overall construction activity in the Islands will begin to turn up this year and post an employment gain of about 5% in 2012. This reflects an upturn on Oahu, which has already begun to show year-on-year gains; Neighbor Island construction will continue to shed jobs well into next year.

As anticipated, the past year has brought some broadening out of employment gains from tourism to other sectors of the local economy. In 2012, low-to-moderate job growth of 1.1-1.7% will be seen in most sectors of the local economy. The government sector—federal, state and local—will be the biggest drag on local job growth. The aggregate job base will expand 1.5%, and the unemployment rate will average 5.5%.

Federal government programs have helped to stabilize local income during a period of declining or weak growth in labor income since 2008. This year, the payroll tax holiday will contribute to a projected 1.2% rise in real personal income. The expiration of this cut will cause sharply lower income growth of just 0.7% in 2012. Gradually strengthening job growth and moderating inflationary pressures will facilitate a gradual recovery of real income over the 2013-2014 period.

While we expect Hawaii’s recovery to continue in 2012, there is a significant risk that things will turn out much worse. Our view is that the US will avoid an outright recession, but clearly the risk has gone up substantially in just the past few months. Too bad that much of this is self-inflicted by a US congress that at best is placing principle over pragmatism, and at worst is interested only in short-term partisan gain regardless of the cost. In any event, the potential damage to an economy already saddled with 9%-plus unemployment is substantial. Given the recovery’s precarious state, Congress and the President may well hold the key to whether we tip into recession, both in whether they can prevent crippling near-term budget cuts and in how they go about the negotiations.

<table>
<thead>
<tr>
<th>Hawaii Economic Indicators</th>
<th>Year-Over-Year Percent Change</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2009</td>
</tr>
<tr>
<td>Visitor Arrivals</td>
<td>-4.4</td>
</tr>
<tr>
<td>U.S. Visitor Arrivals</td>
<td>-3.9</td>
</tr>
<tr>
<td>Japan Visitor Arrivals</td>
<td>-0.6</td>
</tr>
<tr>
<td>Other Visitor Arrivals</td>
<td>-10.5</td>
</tr>
<tr>
<td>Payroll Jobs</td>
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</tr>
<tr>
<td>Employment</td>
<td>-4.1</td>
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<tr>
<td>Unemployment Rate (%)</td>
<td>6.8</td>
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<tr>
<td>Inflation Rate, Honolulu MSA (%)</td>
<td>0.5</td>
</tr>
<tr>
<td>Real Personal Income</td>
<td>-0.7</td>
</tr>
<tr>
<td>Real GDP</td>
<td>-1.6</td>
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Note: Source is UHERO. Figures for 2011-2014 are forecasts.
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