

UHERO Annual Hawai'i Forecast

Tourism Pause Means Further Slowing Ahead

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EXECUTIVE SUMMARY

There was a pause in Hawai'i tourism growth last year, held back by capacity constraints and relatively soft visitor demand. It will be several years before additions to the accommodation inventory permit a resumption of moderate growth in arrivals and expenditure. Together with the residential construction slowdown, the weak near-term visitor outlook means that two pillars of Hawai'i's economic expansion have been sidelined, at least for now.

At the same time, there are no warning signs on the horizon of an outright end to Hawai'i's economic expansion. Job and income growth will slow further, but not cease, and the unemployment rate will gradually ease upward from recent record-low levels. As home price appreciation continues to feed through to shelter costs, we will have to contend with higher-than-normal inflation for the next several years.

- The local economy decelerated last year, after several years of buoyant growth. The housing market cooled markedly, and visitor industry growth came to a virtual standstill. In the broader economy, increasingly low unemployment rates began to enforce a more moderate pace of job creation. The other notable development was the return of high inflation. Driven largely by home prices (and to a smaller extent by energy costs), inflation spiked to almost 6% last year, the highest annual inflation in fifteen years.
- The external environment softened somewhat during the middle of 2006, but expansion in major markets strengthened at year's end. For the U.S., the housing sector will continue to be a drag through at least 2007, but a strong fourth-quarter consumption rebound and improving net exports promise respectable performance. This year, real gross domestic product will average about 2.7% growth, strengthening to 3% by 2009.
- Japan's economy has been in a growth phase since the beginning of 2005. There was slowing in the second and third quarters of last year, but the economy bounced back in the fourth quarter. We expect growth of 2.0% in 2007, and 1.7% in 2008. By 2009, trend slowing will begin as the population and labor force begin to shrink.
- Visitor industry expansion paused last year, with essentially flat arrivals and a declining real spending. In part this reflected weaker demand for Hawai'i vacations—the Japanese market had an abysmal year—but it also reflects supply constraints. The hotel occupancy rate averaged 81% in Hawai'i hotels, the highest rate since 1987. After two years of 7–8% growth, visitor days were down slightly last year.
- Only marginal visitor industry growth will occur for the next several years. Overall visitor arrivals will grow by just 0.8% in 2007 and 1.4–1.8% in 2008 and 2009. Beyond that, growth conditions will improve as a large number of new visitor accommodations enter the market. About 5,000 units will be added to the room stock statewide by 2010, according to ongoing and planned construction, the biggest net gain in accommodations since the 1980s.
- With the housing market peak now behind us, residential construction will no longer be an important contributor to job and income growth. Housing prices on O'ahu are now essentially flat, and a small decline is expected this year. After a rise of 7.6% in 2006, we expect less than 1% growth in construction jobs this year, followed by roughly 1.8% decline in 2008–2009. At this point, the correction in the statewide construction sector still looks to be a moderate one.

- Job creation has begun to slow very gradually in the face of tight conditions and perhaps somewhat weaker demand. The unemployment rate is now quite low, and firms now cite considerable difficulty finding workers. We expect that non-farm payroll job growth will slow from 2.7% in 2006 to 1.6% this year. Further slowing toward 1% annual growth will occur by 2009. The unemployment rate will bottom out at 2.6% this year, edging up to about 3% by 2009 as the economy cools.
- Over the next few years, the strongest job growth will be seen in the “other services” category, which includes business, administrative, and professional services. Job growth for wholesale and retail trade and for the accommodations and food service sectors will be limited, as both tourism and construction plateau. Finance, insurance and real estate will also slow. The health care sector will continue to see growth that is sub-par compared with recent years. State government jobs jumped at the end of last year, and this will drive an unusually-large 2.5% year-on-year increase in 2007. Agriculture, which shed 8% of its job base in 2006, will see a similar decline this year, most of this attributable to the closing of Del Monte’s operations on O‘ahu.
- Relatively high inflation will be with us for the next few years. Although home prices have peaked, inflation in the shelter cost component of the CPI actually accelerated in the second half of 2006, leading us to forecast only a gradual slowing of local inflation. Inflation this year is expected to be 4.8%, easing toward 3.4% by 2009.
- Nominal incomes did not keep pace with the inflation jump last year, so measured real (inflation-adjusted) income suffered. After rising 2.9% in 2005, aggregate real personal income probably managed just 0.2% growth last year. (Fourth-quarter income data will become available in late March.) As inflation is absorbed into worker and firm plans, real income growth is expected to recover to just above 2% by 2008.
- There are forecast uncertainties on both the upside and the downside. Downside risks include a sharper-than-expected housing market correction nationally or in Hawai‘i and the perennial security concerns. Upside risks include sustained lower oil prices that would stimulate travel and alleviate Federal Reserve inflation worries, and the possibility of yen appreciation.

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

	2004	2005	2006	2007	2008	2009
Visitor Arrivals	8.3	7.3	0.0	0.8	1.4	1.8
U.S. Visitor Arrivals	7.3	8.5	2.3	1.3	1.2	1.5
Japan Visitor Arrivals	10.6	2.4	-9.3	-3.0	1.3	1.8
Payroll Jobs	2.8	3.2	2.7	1.6	1.2	1.0
Employment	1.4	3.0	2.9	2.1	1.3	1.0
Unemployment Rate (%)	3.3	2.8	2.6	2.6	2.8	3.1
Inflation Rate, Honolulu MSA (%)	3.3	3.8	5.8	4.8	3.8	3.4
Real Personal Income	5.4	2.9	0.2	1.8	2.2	2.1

Notes: Source is UHERO. Figures for 2007 – 2009 are forecasts. Figures for 2006 income are UHERO estimates. See Tables 1-4 for additional macro and industry detail.

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