

# Economic Forecast

MAUI EDITION 2011 - 2012

## Mixed Bag for Maui: Tourism Robust, Construction Lags

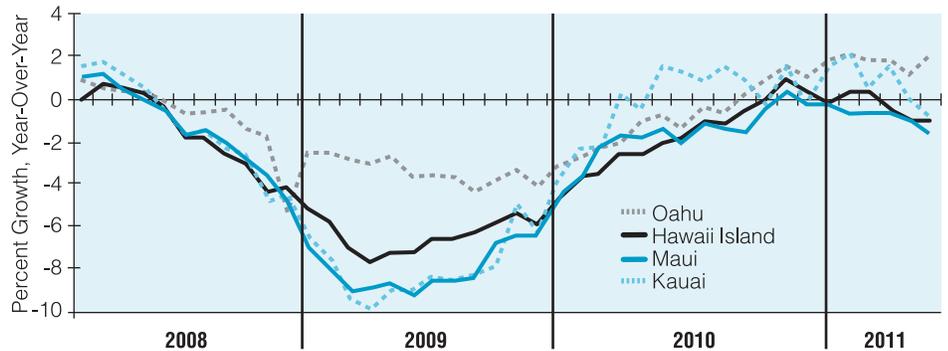
**M**au'i's economy this year is a mixed bag. The visitor industry is doing extremely well, thanks to its resilient upscale image (with resulting higher room rates) and a welcome growth in airlift, including flights from secondary Mainland cities. However, even the crucial tourism sector cannot be relied upon completely to bring Maui back to better times, and the job total continues to struggle to return to pre-recession levels.

Unfortunately, other sectors of Maui's economy — especially the construction industry — continue to lag significantly. Residential construction is down practically everywhere now, but any progress to resuscitate overall construction — public or private — would result in a more balanced and sustained recovery for Maui. Efforts to diversify the local economy are ongoing and admirable, but the smaller a local economy is, the more elusive the diversification goal becomes.

Depending on how economic activity is measured, practically all economies nowadays are still below their pre-recession peaks hit in 2007. At mid-year 2011, for example, Maui was 11% below its pre-recession peak for non-farm jobs. Compare that to a 10% shortfall for Hawaii Island and 9% for Kauai. (Oahu was only 3% below the peak.) It doesn't take much to change these rankings, but that should be Maui's first order of economic business.

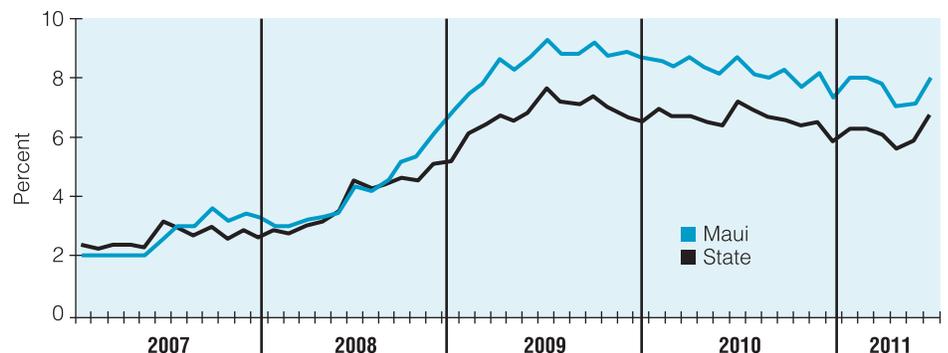
Chart 1 shows how job losses and subsequent growth have been distributed across Hawaii's four counties. Obviously most of the jobs created have occurred in Oahu's much more diversified and larger economy, not

CHART 1 • JOB GROWTH, BY COUNTY, 2008-11



Source: State Department of Labor

CHART 2 • UNEMPLOYMENT: STATE VS. MAUI



Source: State Department of Labor

just in absolute numbers but also in percentage growth terms.

Maui continues to lose jobs, the only county in the state for which that's consistently the case — even though the official end to the recession occurred some time ago. Although the visitor industry is doing quite well, weakness in other sectors of Maui's economy simply overwhelms that strength.

The Maui jobless rate has been creeping downward, as has been the case nationally and elsewhere in the state. Those slow declines will likely continue in the future. But there remains a stark

contrast between the current Maui jobless rate and the 2% number that prevailed in the peak year of 2007. And remember that this number doesn't measure discouraged workers who have dropped out of the labor force or job losses for multiple job holders.

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### ON THE INSIDE

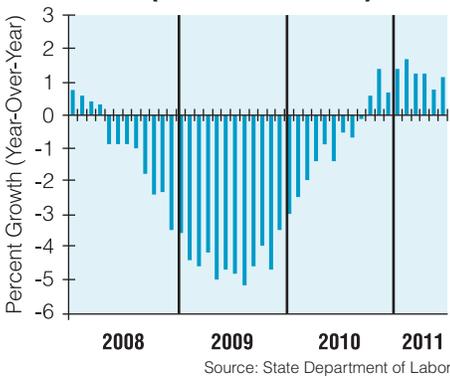
**5** U.S. & Global Economic Outlook: Great Debt Debate

# Sluggish Recovery Throughout the State

For the last couple of years our position has been that we could look forward to only a slow recovery from the serious recession. That has certainly proven to be the case — at the global, national, state, and individual county level here in Hawaii.

**Job growth:** One of the best concurrent indicators of the local economy is job growth; it is also what matters most to the great majority of people. Chart A shows that the State of Hawaii broke into positive territory in late 2010 after declines that began in 2008 and worsened in 2009. Those job gains have improved as 2011 has progressed. Barring unforeseen setbacks, this growth should improve as the recovery takes hold more. So far, state jobs are still about 5% below the pre-recession year of 2007. These overall job figures also mask some unevenness across various sectors of the economy.

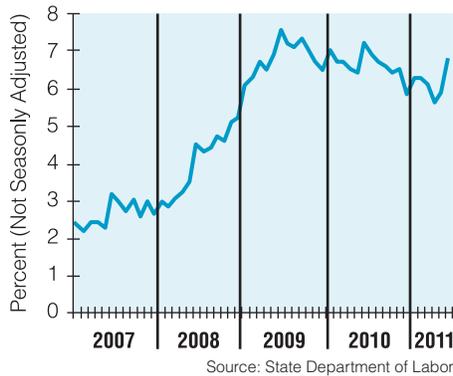
**CHART A • STATE JOB GROWTH (YEAR-OVER-YEAR)**



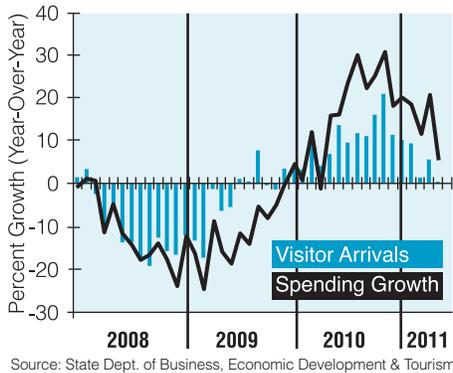
**Unemployment:** The statewide unemployment rate (Chart B) is well below the national number though still higher than average for Hawaii. Part of this lower unemployment rate is likely due to discouraged workers who dropped out of the labor force during the recent recession.

**Tourism:** The leading edge of the recovery has been the visitor industry; Chart C shows how it snapped back more strongly than many expected when the recession hit. State visitor arrivals have shown spectacular growth after the declines of 2009, and visitor spending growth has been even more stunning. Unfortunately, tourism's strength has

**CHART B • STATE UNEMPLOYMENT RATE, 2007-11**



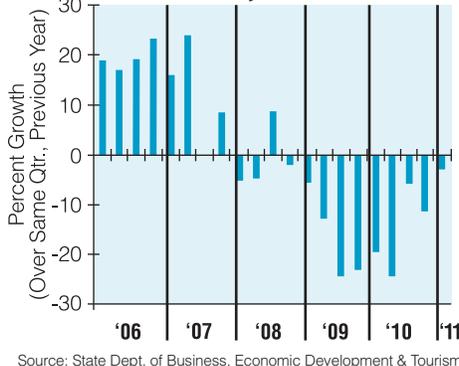
**CHART C • STATE VISITOR INDUSTRY GROWTH, 2008-11**



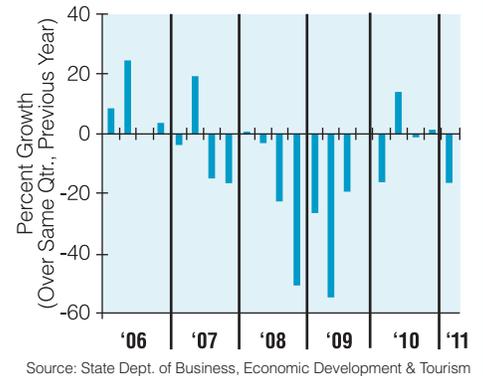
not yet spread to some other important sectors of the state economy.

**Construction:** One of those lagging sectors is construction. That continued weakness is shown in these figures on construction completed (Chart D), lower building permits (Chart E) and losses in the industry's job total (Chart F). As rail transit ramps up, there will be a big boost for the construction industry on Oahu, but that won't help Neighbor Island construction numbers.

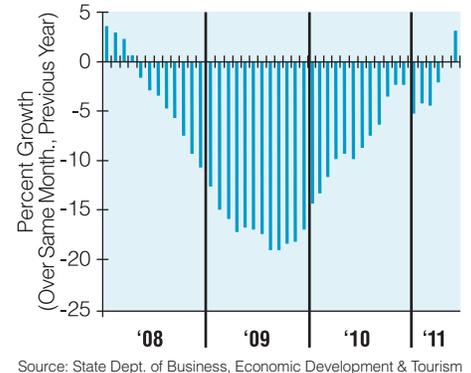
**CHART D • STATEWIDE CONSTRUCTION COMPLETED, 2006-11**



**CHART E • GROWTH IN PRIVATE PERMITS STATEWIDE, 2006-11**

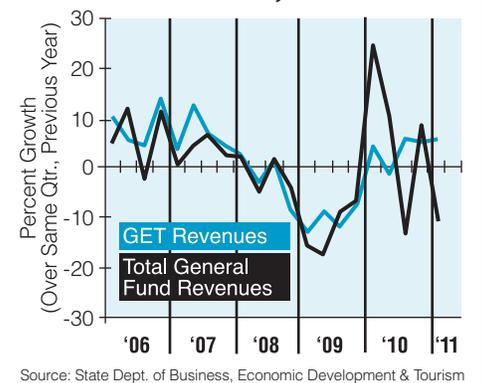


**CHART F • CONSTRUCTION INDUSTRY JOB GROWTH, 2008-11**



**Tax revenues:** The weaker economy has brought subpar growth in state tax revenues (Chart G), forcing unpopular budget cuts at just the wrong time. The general excise tax growth in recent quarters reflects some improvement in the economy, but the overall General Fund has not done as well.

**CHART G • STATE TAX REVENUE GROWTH, 2006-11**



**Maui County** (continued from page 1)

**Upscale Image, More Airlift Help Maui Tourism Thrive**

The Maui visitor industry is doing extremely well, as Chart 3 demonstrates, especially considering the lingering effects of recession in the major markets that supply the bulk of the island's visitors. Part of the reason lies in the fact that Maui continues to hang on to its reputation as a very upscale place for a tropical vacation. That's an asset that is extremely valuable, especially as more competition enters among such locales.

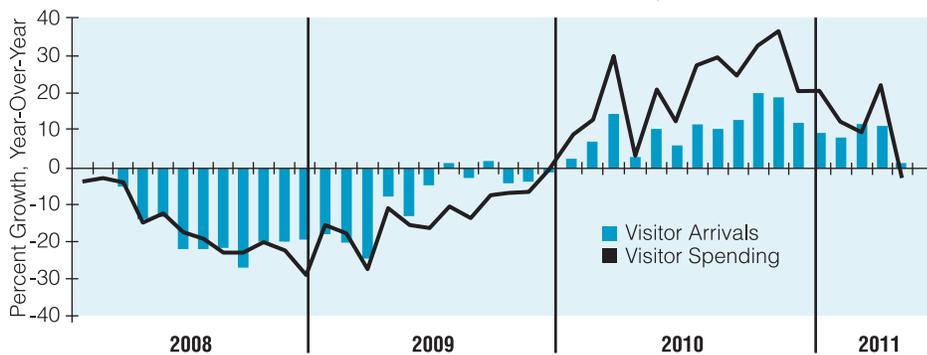
The downside is that the upscale image keeps some larger families and others away because of the overall expense of a Maui vacation, but the image is not one that Maui would rationally give up. And on Maui, more than a lot of similar destinations, there seems to be greater recognition on the part of local residents that tourism is critically important to the economy.

A major underlying reason for Maui's better performance has to do with increased airlift. Total airline seats for Maui have increased dramatically so far in 2011, with far stronger growth than elsewhere in the state. Honolulu has been up about 3%, and Kona's loss in 2010 of the direct Japan Airlines flight resulted in a 6% decline there. Kauai has shown healthy increases in airlift this year of about 6%. But these numbers are dwarfed by Kahului's surge of over 11% in seats in 2011.

A big reason is the fact that Maui has been picking up direct flights by Hawaiian and Alaska Airlines from secondary cities in the U.S. and Canada. That, combined with aggressive marketing in those cities, has paid off. Canadian business also has been helped by the strong exchange rate for the Canadian dollar. Also on the airlift side, the state Airports Division reports that conversations have been underway with several other carriers to enter the direct Maui route.

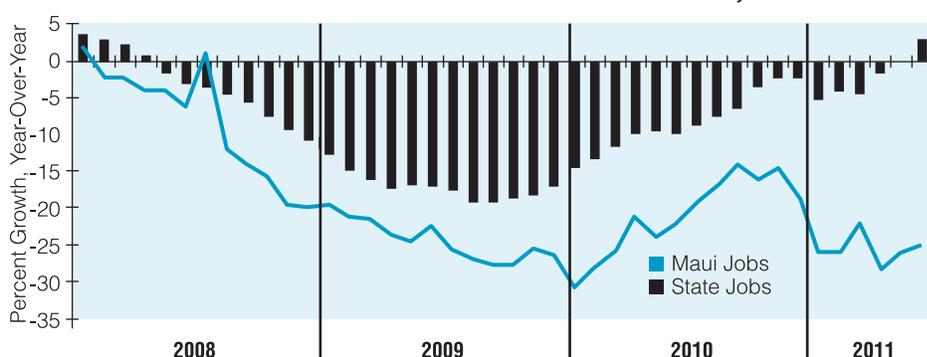
The strong visitor industry has enabled Maui hotels to raise their room rates. Now, Maui once again has the highest average daily room rate in the state. So reputation does pay off.

**CHART 3 • MAUI TOURISM GROWTH, 2008-11**



Source: State Department of Business, Economic Development & Tourism

**CHART 4 • CONSTRUCTION JOBS: STATE VS. MAUI, 2008-11**



Source: State Department of Labor

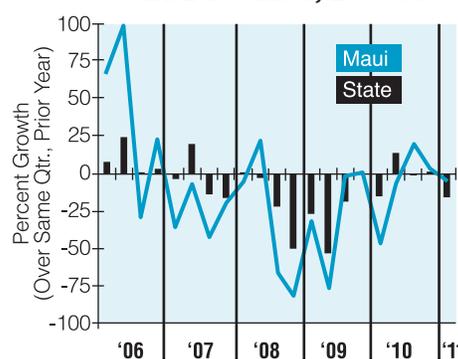
Another comparative advantage, even within the state: Maui has most things a larger city has to offer, but continues to retain its rural environment. Add to that the very wide range of activities available to Maui visitors, and you have a combination that's hard to top.

The visitor spending growth shown in Chart 3 is impressive, but it shouldn't be taken to mean that the good old days of unrestrained spending growth will return soon. While there is pent-up demand, there has been a shift toward shopping for value that wasn't there before the recession and wealth losses of recent years.

**Construction Jobs Still Weak, But Pipeline Offers Hope**

One major reason that Maui lags in job creation is the weakness of its construction sector (Chart 4), which is showing continued job losses. Residential construction is weak just about everywhere nowadays. With short sales and foreclosures causing continued downward pressure on home prices, it is simply cheaper to buy an existing home than a new one, or perhaps just rent

**CHART 5 • PRIVATE PERMITS: STATE VS. MAUI, 2006-11**



Source: State Dept. of Business, Economic Development & Tourism

until prices fall further. So developers just aren't building.

Maui does have some things that are added hurdles: the 50% affordable housing component requirement and the "show me the water" ordinance have been mentioned in previous editions of this report.

But help may be on the way for Maui's beleaguered construction industry. The County administration is pushing for more public sector construction and an expediting of the

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**Maui County** (continued from page 3)

permit process. So maybe next year Chart 5 on Maui construction permits will bring greater optimism.

Some signs that Maui construction numbers will turn up in the future:

- Hyatt is planning a time-share tower in West Maui.
- Alexander & Baldwin's Maui Business Park Phase II, 179 acres of light industrial development, is ramping up in Kahului.
- Ground has been broken for a 138-room Courtyard by Marriott hotel in Kahului, an area near the airport that has long needed a newer business-oriented hotel that can also serve travelers on cancelled or missed flights.
- Also ready to go, but waiting on the market, is A&B's MF-7 project in Wailea, a 75-unit fee simple resort residential condo development.

**Maui Real Estate Showing Declines for Sales, Prices**

Maui real estate is subject to some of the same trends just mentioned for construction. In 2011, sales for both single-family and condos have leveled off, after strong increases in 2010. And median prices have continued to fall.

Until the downward pressure on prices abates, there cannot be a sustained recovery in the real estate market. And that has to do with the inventory of short sales and foreclosures that constitute an overhang on the market.

Nonetheless, the usual caveats apply on reading too much into price

**CHART 6 • MAUI REAL ESTATE**  
(% GROWTH OVER PRIOR YEAR)

Sales	2010	YTD 2011
Single-Family	+17%	<b>+4%</b>
Condominiums	+39%	<b>-3%</b>
Median Price	2010	YTD 2011
Single-Family	-8%	<b>-5%</b>
Condominiums	-16%	<b>-24%</b>

Source: Realtors Association of Maui  
YTD 2011 through June

trends on Maui. The small sample can cause distortions in the total number, and recall that it is a mix of disparate transactions in dissimilar neighborhoods.

In commercial real estate, recent sales have tended to be very strong because prices have fallen far enough to bring buyers into the market. Some of this activity reportedly is for investment over the longer term.

**Visitor-Oriented Retail Market Doing Well Thanks to Rebound**

Again this year on Maui, there are differences in the retail sector between the local side and the visitor side. Visitor-oriented retail is doing quite well, in line with the robust recovery in the tourism industry. Proximity of time-share units is a plus, because occupancies are always higher in those units. The local side of retailing — even though it is recovering — continues to reflect some of the uncertainty about the overall economy.

**Rapid Enrollment Growth at Renamed UH Maui College**

One growth area in the Maui economy, which also helps to diversify it, is the recently renamed UH Maui College — replacing the old Maui Community College label. That name change reflects the addition of four-year degrees to its curriculum, the first UH community college to grant such degrees. At the same time, its accreditation moved from the Western Association of Schools and Colleges junior commission to the WASC senior commission.

Student enrollment growth has been quite rapid. UH Maui now has almost 4,400 students, up 33% over the past two years. The campus is also the top grant recipient among present (or former) two-year colleges in the UH system. The new \$25 million Science Building is ready for occupancy in the fall of 2011.

**Economic Development Board Aided by Supercomputer**

Activities of the Maui Economic Development Board in Kihei are enhanced by the supercomputer located there, and other tenants have proven to be fairly resilient in the recent recession. The board continues to focus on renewable energy projects, educating educators, and its Women In Technology program. One newer development is the Joint Technology Information Center program, which involves a \$36 million grant to develop and test medical technologies for military applications.

**Things Looking Up at State's Last Sugar Plantation**

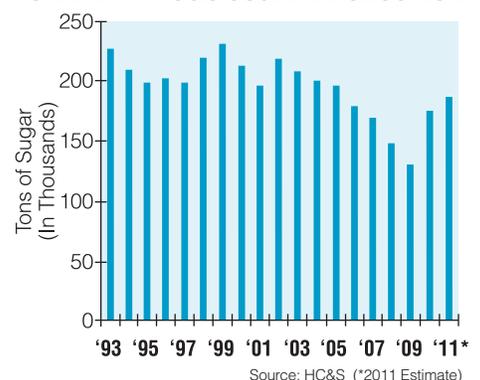
Agriculture on Maui is always dominated by HC&S, Hawaii's sole remaining sugar plantation. There, things have been looking up recently, with annual production back in a profitable range after two years — 2008 and 2009 — of very low total production and yields per acre.

Better age on the crop and slightly better rainfall are the main reasons for the recovery. HC&S estimates that 2011 production should be about 185,000 tons.

HC&S is important to the Maui economy for several reasons:

- It's a large employer.
- It keeps the central valley green.
- It provides enough power to Maui's grid that it is actually a net energy producer. Thus, when energy prices rise, HC&S actually benefits.

**CHART 7 • HC&S SUGAR PRODUCTION**



# U.S. & Global Outlook for 2012: The Great Debt Debate

By Dr. Jack P. Snyderhoud, Professor of Business Economics, Shidler College of Business, University of Hawaii at Manoa

In the wake of the Great Recession of 2007-09 both politicians and economists have been absorbed in a contentious debate about debt. The debt is the result of consumer borrowing as well as public sector deficits. The former was a contributing factor to the Great Recession while the latter has been a long-term problem exacerbated by the recession.

Economists can be placed into two camps regarding debt. In the first camp we have debt and deficit “hawks” who believe that debt is a drag on economic activity and, the sooner it is dealt with in a credible fashion, the faster the economy will return to adequate growth. In the other corner are the debt and deficit “doves” who recognize that something has to be done about debt but believe now is a bad time to do it because of the weak U.S. economy, European debt uncertainties, the effects of the Japan earthquake, unrest in the Arab world, and high commodity prices.

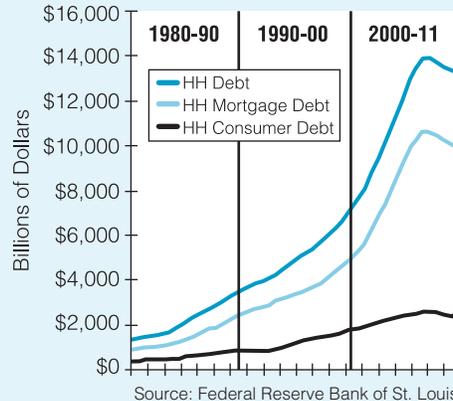
## The Accumulation of Debt

Households, businesses, and government all face a fundamental choice: How much do we consume now and how do we save and invest for the future? In the United States, as Chart 1 shows, for the last 30 years we have opted to consume more and borrow more, mostly in the form of mortgages. (However, other forms of household debt also increased, for example by 65% between 2000 and 2008.) Chart 2 shows how household debt (black line) grew while mortgage interest rates (blue line) fell to historic lows.

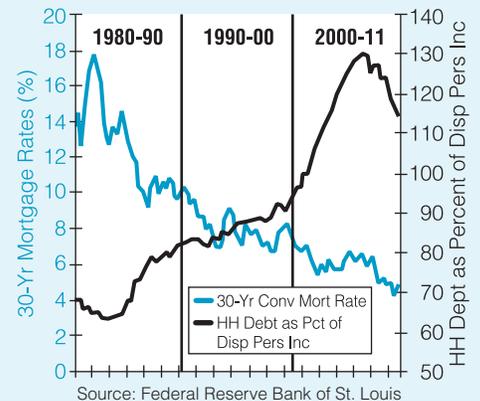
Households have actually reduced their debt levels since the start of the Great Recession, in part by walking away from some mortgage debt and in part by saving more and consuming less. But this decline in consumption contributed to the recession.

Deficit spending to fight the recession causes government debt to explode and has pushed debt levels to uncomfortable levels (Chart 3). If we add to this the “hidden” debt of Social

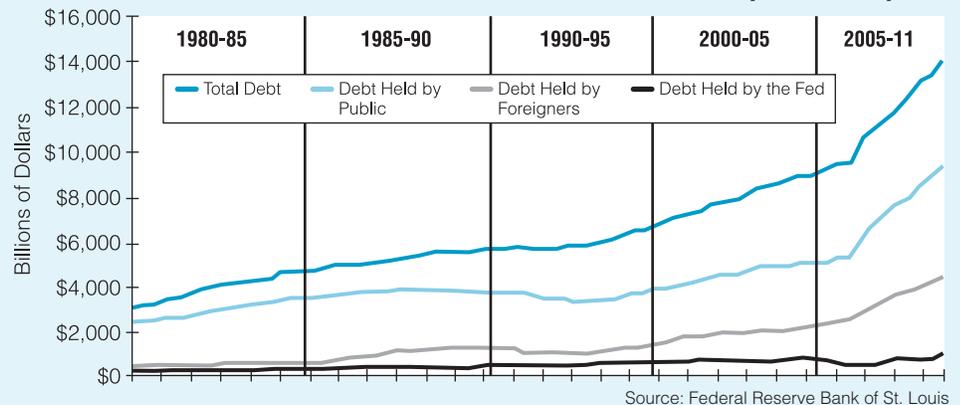
**CHART 1 • U.S. HOUSEHOLD DEBT (1980-2011)**



**CHART 2 • HOUSEHOLD DEBT, MORTGAGE RATES (1980-2011)**



**CHART 3 • U.S. FEDERAL GOVERNMENT DEBT (1990-2011)**



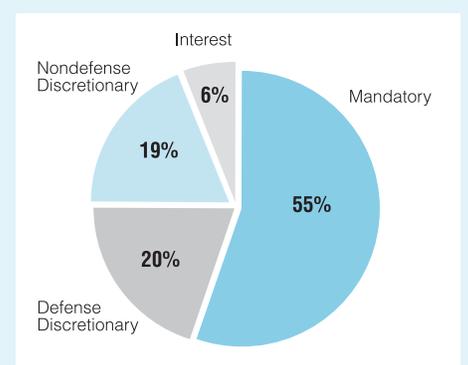
Security and state-local pension underfunding we can understand why ratings agencies have begun to express doubt about our future course.

## Ways to Reduce Public Debt

There are several ways to reduce public debt. The most scary is default. However, defaulting on U.S. government debt would shake the foundations of the global financial system and would cause great pain both in the financial sector and the real economy. Less painful would be inflation, which reduces the real cost of debt, but risks other economic consequences.

Debt and deficit hawks have pushed for austerity — raising taxes and/or reducing spending. The hawks, especially the political versions of the hawks, have pushed for spending reductions. Since our deficits are so

**CHART 4 • U.S. FEDERAL SPENDING 2010**



high (10% of GDP) and the Federal budget is so constrained by “mandatory” spending (Chart 4), debt reduction through spending cuts will be painful.

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## U.S. & Global Outlook for 2012

(continued from page 5)

The least painful solution is to increase the growth of the economy. If the economy grows faster than debt, the debt will become a smaller relative burden. But this still requires either increasing growth or reducing deficits.

### 2011: The Soft Patch

Meanwhile, the economy muddles along. 2011 has not been as strong as 2010 and has turned even softer than expected. The dreaded phrase “double dip” has been heard more often.

Job growth has finally returned, but it has been anemic and not sufficient to bring the national unemployment rate down significantly. The housing sector has remained in a state of depression. As a result, while consumer spending has rebounded, consumer confidence remains low.

At the same time, the fiscal stimulus that created the huge public debt increases has run its course. In fact, if austerity measures are implemented, fiscal policy may be a short-term drag on the economy. This leaves the Fed as the only potential stimulus through yet another round of quantitative easing.

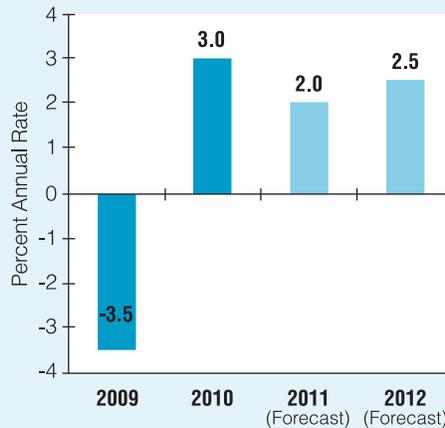
The only really good news is that our weak dollar and good economic growth in foreign markets has resulted in a strong rebound in U.S. exports.

### The Outlook

The outlook for the rest of 2011 and 2012 will depend in part on the extent of fiscal austerity the politicians agree to and on external forces such as commodity prices. I am assuming that until the 2012 elections little progress will be made on resolving the U.S. structural deficit issues. Likewise, I assume European economies will continue to struggle with their debt issues. These uncertainties will be a drag on the economy.

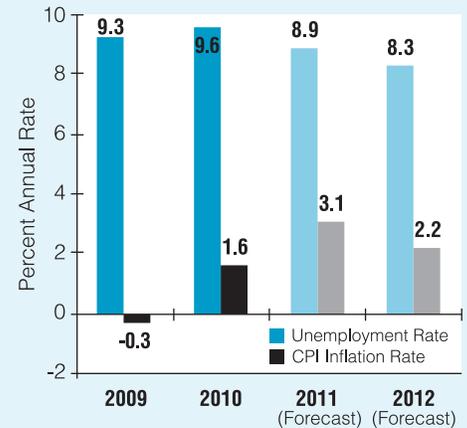
I am also assuming that oil prices will remain in the \$100-\$110 per barrel range through 2012. This sounds good, but remember oil averaged \$80 in 2010. Overall, energy prices will have a neutral impact on the economy for this outlook period.

**CHART 5 • U.S. REAL GDP GROWTH FORECAST**



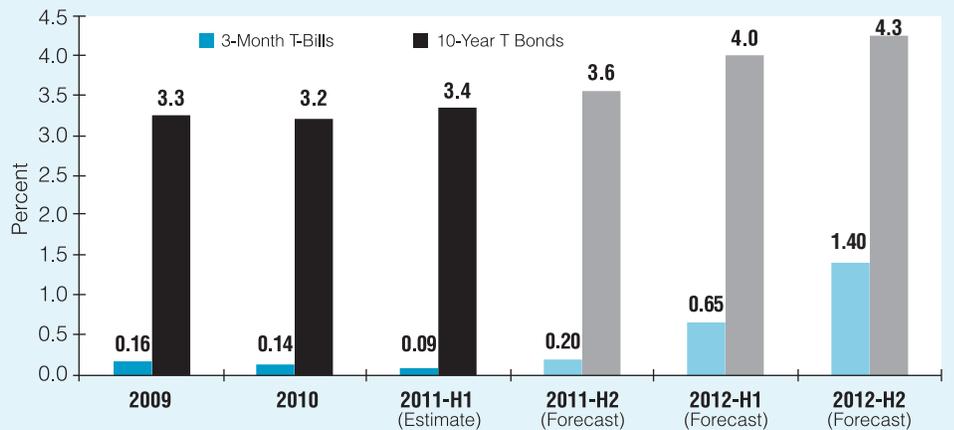
Source: Federal Reserve Bank of St. Louis

**CHART 6 • FORECAST U.S. UNEMPLOYMENT, INFLATION**



Source: Federal Reserve Bank of St. Louis

**CHART 7 • FORECAST U.S. INTEREST RATES**



Source: Federal Reserve Bank of St. Louis

**Developed Economies:** Growth returned to most developed economies in 2010 and '11. Only Japan is expected to have negative growth in 2011 due to the earthquake, tsunami, and nuclear problems. European growth is not expected to be robust (i.e., not above 3%).

**Asian Economies:** The picture looks much better in the Asia-Pacific region. China, Korea, India and Australia will all have growth rates above the global average. Starting in 2010 the central banks in these countries began to raise interest rates to try to avoid inflation and cool off torrid growth.

**U.S. Forecast and Risks:** In the first half of 2011 U.S. GDP growth was less than 2%. However, I expect it to pick up marginally in the second half of 2011 so that overall GDP growth will be about 2% this year (Chart 5). 2012 will also have positive growth, but

below the desired 3% rate that brings down unemployment significantly. As a result, the unemployment rate will remain near 9% through 2011 and only slightly better in 2012 (Chart 6). Inflation will see a bit of a bump in 2011, but remain in check through 2012.

The combination of slow growth and the absence of significant inflation will keep interest rates low (Chart 7). Both short-term Treasury bill rates and long-term 10-year Treasury yields will increase somewhat through 2012 but remain very low by historical standards.

Again, these forecasts assume relatively stable energy markets, short-term deficit fixes but no real progress in U.S. structural debt reduction. If things go awry in these scenarios, a loss of consumer confidence could push the economy into a second dip.