

Economic Forecast

2012-13 GUAM-CNMI EDITION

Guam's Economy: Favorable and Improving

In many ways, 2012 has proved to be better than 2011 for Guam's economy. Some optimism has returned and, although it is not at the same level as it was in 2010, it probably is more in tune with reality. In other words, although not everything is rosy about Guam's economy, the overall picture is favorable and promising.

A summary:

- **Tourism:** Tourism rebounded remarkably, with Guam welcoming 13.16% more visitors between January and August 2012 than it did during the same period last year when the fallout from Japan's tsunami depressed visitor totals.
- **Military build-up:** Welcome developments include availability of new information on the military build-up plan for Guam and positive indications, including recent statements from Defense Secretary Leon Panetta that the build-up is back on track. Although additional details would be helpful, the level of uncertainty surrounding the military build-up in Guam is not nearly as high and uncomfortable as it was a year ago.
- **Inflation:** Guam continues to enjoy another year of low inflation with little threat of increase in the near future.
- **On the other hand:** Not-so-rosy developments in the Guam economy include local government's continued fiscal challenges, a mixed employment picture and a sluggish real estate market.

A year ago, the Guam economy faced uncertainty from two of its economic drivers: tourism and military.

Tourism started strong in early 2011 but slowed significantly following the March earthquake and tsunami in Japan. Thanks to growth in other tourist markets, the year ended with visitor arrivals down by only 3%.

Uncertainty was worse with regard to the military build-up plan, first introduced in 2006. Many in Guam viewed the build-up as an opportunity to increase economic activity, local jobs, incomes and tax revenues. The optimism turned into a guessing game, owing to the lack of clear information on details. By 2010, when the build-up was originally expected to commence, the economic environment had changed significantly; its costs had increased, challenging the tight budget situations of both the U.S. and Japan governments. At the same time, these governments' attention had shifted to addressing domestic issues which, for Japan, included rehabilitating the areas affected by the earthquake-tsunami. As a result, 2011 was the low point with regard to being able to forecast, understand and plan for the military build-up in Guam.

GUAM'S MACROECONOMIC ENVIRONMENT

Gross Island Product (GIP)

The latest available estimate of Guam's Gross Island Product (GIP) is for 2010; it was released by the U.S. Department of Commerce-Bureau of Economic Analysis (BEA) in September 2012. The BEA said Guam was a \$4.052 billion economy in 2010, measured in real terms using 2005 prices, translating to real annual income of \$25,420 per person. The same source shows that

per-capita income peaked at \$25,818 in 2005.

BEA estimates also show the different contributors to Guam's 2010 GIP: 60.74% personal consumption; 5.36% business fixed investment; 13.89% exports of goods and services; and 62.98% government expenditure and investment. The low figure for business fixed investment is suspicious and, with improved estimation, would probably account for 10-12% of GIP. The contribution of the government sector, nearly 63% of GIP, accounts for both Federal government spending in Guam (41%) and the Government of Guam (22%). That government sector is larger than personal consumption, which represents consumers and households, demonstrating the government's large presence in Guam's economy and the challenge of balancing the benefits and costs of such large presence.

The BEA estimates also highlighted Guam's import dependence, with imports making up 42.87% of GIP in 2010. This import dependence reduces the local spending multiplier (estimated at 1.30; Ruane, December 2011) and limits the impact on the local economy in terms of jobs, income and tax revenues of any additional spending that occurs on Guam. This concern has been around for years but has been

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Gross Island Product (continued from page 1)

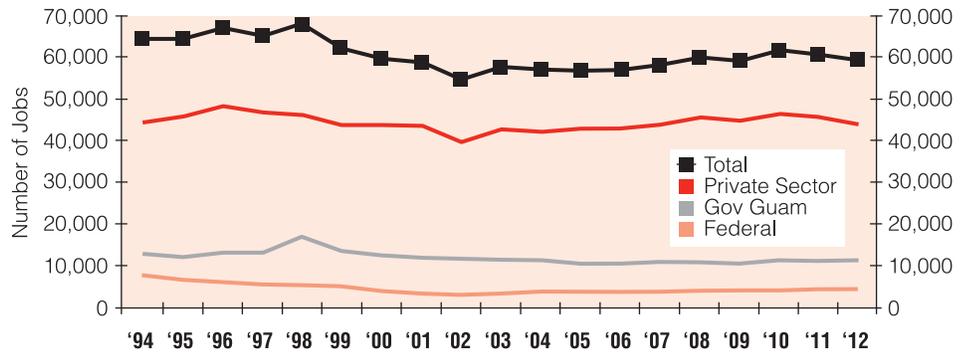
expressed more clearly with the “Guam Buy Local” campaign. (<http://www.guambuylocal.com>).

Like many governments around the world, the Government of Guam has had its own share of fiscal challenges, although comparatively less alarming than Greece’s and, to some extent, those faced by the U.S. federal government. The Calvo-Tenorio administration has been very clear in its message to give back money the government owes to its people. It had opportunities to pay overdue tax refunds through the issuance of two bonds, \$240 million issued in November 2011 and \$110 million in April 2012. On the positive note, both bonds were issued at relatively low interest rates, thanks to overall market conditions and the bonds’ favorable credit ratings (A-/A) from S&P and Fitch.

In addition, the \$198 million of tax refund checks issued in December 2011 and the \$60 million issued in early June 2012 put purchasing power in the hands of local consumers who spent most of their tax refunds, providing a boost to the economy, even if for only a short time. The downside is that the bonds put the island’s debt to its legal debt ceiling, necessitating the most skillful management of government finances and increasing the pressure to reduce budget deficits.

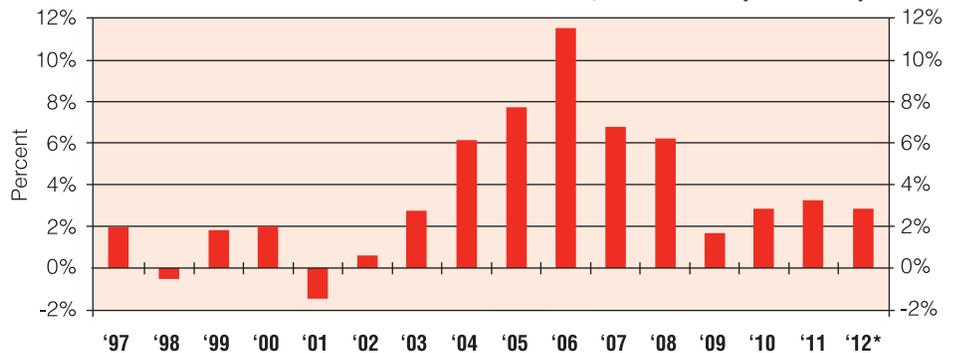
Unfortunately, there remain overdue tax refunds from 2011 and earlier years, compounded by insufficient funding to pay 2012 tax refunds. A pending class-action lawsuit might force the government to pay tax refunds within a set timeline (currently, within six months of when the tax return was filed). All of these have kept Governor Calvo’s fiscal team working on proposals that would allow the government to meet its obligations, including proposals to reduce payroll through retirement. The situation could get worse if the budget issues in Washington, D.C. are not resolved in time, leading to sequestration — across-the-board federal spending cuts by \$1.2 trillion over 10 years.

CHART 1 • GUAM JOB GROWTH, JUNE 1995-2011



Source: Guam Bureau of Labor Statistics

CHART 2 • GUAM INFLATION RATE, 1997-2012 (3RD QTR.)



*2012 - 3rd Quarter. Source: Bureau of Statistics and Plans-Cost of Living Section. Guam Consumer Price Index, 3rd Quarter 2012, Vol. XXXVIII, No. 3, Table C.

Guam Job Count Lower; Unemployment Down, Too

Employment on Guam (Chart 1) decreased 2.37% from June 2011 to June 2012, according to the Bureau of Labor Statistics’ Current Employment Reports. Despite a 2.12% growth in government jobs, this was not enough to offset the 3.86% decline in private sector jobs, which account for approximately 75% of employment in Guam.

United Airlines, one of Guam’s largest employers, recently announced that 90 employees on Guam will be affected by the closure of its contact center and cargo department, which will not help improve the employment situation (*Pacific Daily News*, September 20, 2012).

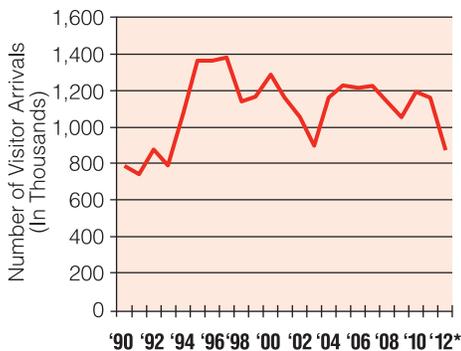
The latest unemployment rate estimate from the Guam Department of Labor was 11.8% in March 2012, which is lower than the 13.3% figure a year earlier. Despite the decline in the rate, the overall employment picture is mixed:

Although the number of unemployed decreased to around 8,000 compared to almost 10,000 a year earlier, the number of employed also decreased from almost 65,000 to a little above 60,000. Worse is that the number of people *not* in the labor force increased from 44,770 in March 2011 to 52,410 in March 2012. Of the latter figure, 10,450 were classified as “wanting a job during survey period but did not look for work”; the main reason for 5,200 of them is “school attendance” which increased from 2,600 in March 2011.

Inflation Remains Lower Than 2011’s Rate

Guam continues to enjoy relatively low inflation (Chart 2). The consumer price index (CPI)-based annual inflation rate for the third quarter of 2012 shows a 2.9% increase, compared to 3.3% in 2011 and 2.9% in 2010.

CHART 3 • GUAM VISITOR ARRIVALS, 1990-2012*



*2012-Total for January-August, up 13% vs. same period of 2011.
Source: Guam Visitors Bureau

Tourism Up, Strongly in Some Markets

Guam tourism did well in 2010, with arrivals growing 13.6% over 2009. 2011 was a challenging year because of the earthquake and tsunami in Japan, Guam's largest tourist market, but ended down in overall visitor arrivals by only 3% over 2010, thanks to the recovery of the Japanese tourist market by mid-year and fast-growing markets in China, Russia, Taiwan and Hong Kong.

So far, 2012 is promising to be a strong year. Through August, Guam welcomed 866,861 visitors, 13.16% more visitors than the same period last year (Chart 3) and only 5.5% below the same period during the last peak year in 2010, when almost 1.2 million visitors came to Guam.

As Chart 4 shows, Guam continues to rely heavily on the Japanese market (71.7% of total visitor arrivals this year vs. 70.49% in 2011). Some markets — Korea, Taiwan, China, and especially Russia — continue to gain market share while others, including U.S. mainland, Hawaii and neighboring islands, reduce their share of Guam's visitors market. Thanks to the Visa Waiver for Russian visitors, their share, although still small, increased significantly from 0.05% in 2011 to 0.27% in 2012. Visitors from China posted the second biggest gain in market share, from 0.59% in 2011 to 0.73% in 2012, thanks to an increase in charter flights from major Chinese cities, including flights during the Chinese

CHART 4 • SOURCES OF GUAM VISITOR ARRIVALS, 2011-2012

	Jan-Aug 2012	Jan-Aug 2011	Growth	Share in 2012
Japan	621,515	539,987	15.1%	71.7%
Korea	114,887	100,671	14.1%	13.3%
Taiwan	35,380	30,423	16.3%	4.1%
U.S. Mainland	34,681	33,528	3.4%	4.0%
CNMI	12,094	12,315	-1.8%	1.4%
Hawaii	7,723	7,477	3.3%	0.9%
FSM	6,911	7,015	-1.5%	0.8%
Philippines	6,497	6,537	-0.6%	0.7%
China P.R.C.	6,354	4,503	41.1%	0.7%
Hong Kong	5,221	5,634	-7.3%	0.6%
Australia	2,698	2,547	5.9%	0.3%
Palau	2,431	2,443	-0.5%	0.3%
Russia	2,374	372	538.2%	0.3%
Other/Unknown	5,623	5,477	2.7%	0.6%
Total Arrivals	866,861	766,028	13.2%	100.0%

Source: Guam Customs Declaration Forms, Customs and Quarantine Agency. Processed by the Guam Visitors Bureau.

New Year (*Marianas Business Journal*, July 16, 2012). Many hold out hope for the approval of a Visa Waiver for Chinese visitors by the U.S. Department of Homeland Security, which just recently added Taiwan to U.S. list of countries/territories eligible for a 90-day Visa Waiver effective Nov. 1, 2012. There is concern that visitors from Taiwan would go to the United States instead of Guam.

Increased flights and an additional budget airline (*Marianas Business Journal*, various issues) have increased accessibility and affordability of visits to Guam, increasing market shares of Taiwan, Korea and Japan:

- More charter flights have come from United Airlines (from China, Taiwan and Haneda, near downtown Tokyo), EVA Airlines (from Taipei and Tokyo) and Korean Air (from Narita and Busan).
- Additional weekly regular flights have come from Korean Air (from Seoul), EVA Air (from Taipei), Delta Airlines (Narita and Kansai) and United (from Sendai).
- New budget airline Jeju Air began flying from Incheon and Busan (Korea). (KUAM, September 27, 2012)

CHART 5 • GUAM HOTEL OCCUPANCY, ROOM RATES, 2000-2012

Year	Occupancy	Rate (\$ Per Night)
2000	63%	\$101
2001	58%	\$102
2002	57%	\$98
2003	54%	\$97
2004	58%	\$103
2005	63%	\$106
2006	60%	\$106
2007	68%	\$111
2008	64%	\$116
2009	60%	\$108
2010	71%	\$111
2011	72%	\$123
Jan-July '12	78%	\$119
Jan-Jul '11	69%	\$112

Source: Guam Hotel and Restaurant Association

Other measures of tourism show improved prospects. The weighted average of hotel occupancy rates (Chart 5) was 78% for January-July 2012, compared to 69% for the same period in 2011. The weighted average of nightly room rates was \$119 for January-July 2012 compared to \$112 during the same period in 2011. Hotel tax collections between January and July 2012 were estimated at \$21.2 million, 13.36% higher than the same period last year.

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CHART 6 • PERCENT ECONOMIC GROWTH IN GUAM'S TOURIST MARKETS

	U.S.	Japan	Korea	Taiwan	China	Hong Kong
2009	-3.5	-6.3	0.3	-1.8	9.2	-2.6
2010	3.0	4.0	6.2	10.7	10.4	7.0
2011	1.7	-0.7	3.6	4.0	9.2	5.0
2012*	1.9	2.2	3.4	3.4	8.2	3.0
2013*	2.2	1.5	4.0	4.6	8.5	4.5

Source: Asian Development Bank

Tourism Up (continued from page 3)

Compared to the same period last year, the U.S. dollar continues to be 1-3% weaker against tourist market currencies, which helps keep visits to Guam affordable.

The Asian Development Bank's latest forecasts of near-term economic growth in Guam's tourist markets (Chart 6) are favorable for Guam tourism. Japan's economy has resumed growth this year, estimated at 2.2% and forecast to grow at 1.5% in 2013. The economies of Korea, Taiwan and Hong Kong grew in the 3.6% to 5% range last year, and are forecast to grow at comparable rates this year and in 2013; China's economic growth was 9.2% last year and, although forecasts have been adjusted downward, continues to be in the 8% range. Prospects of tourism from Russia will be positive for some time.

Build-Up: New Plan Details Revealed by Washington

It has been a long and winding road since the Guam military build-up plan was outlined in the 2006 U.S.-Japan Agreement. At the time, the \$10.27-billion plan envisioned relocating 8,000 U.S. Marines plus their families from Okinawa to Guam from 2010-2014. But planning quickly stalled.

The Master Plan, which was expected in July 2011, was not released. Funding for Guam to make preparations

for the military build-up did not get support from the U.S. Senate and initiated debates over the merits, costs and alternatives. The very tight budget situations for both U.S. and Japan governments shifted their priorities to more pressing issues. Useful information or answers were scarce, even to the question of whether the military build-up in Guam would even take place.

Then, on April 26, 2012, the new U.S.-Japan Agreement was released, focusing more on realignment of U.S. forces in the Pacific. It also provided details that paint a picture of a smaller, perhaps more manageable plan: a lower cost of \$8.6 billion, with a smaller share of \$3.1 billion to be funded by Japan, and relocation of approximately 4,700 U.S. Marines from Okinawa to Guam. This new, smaller plan is expected to take place over a longer period. A new study of this plan was completed in June (*Pacific News Center*, June 20, 2012), reviewed by the Department of Defense and submitted to Congress in July (*Marianas Variety*, July 26, 2012). The statement by Defense Secretary Panetta that the U.S. and Japan "... agree on the need to rapidly implement the terms of the revised realignment plan... so that we can move forward on this key part of realigning U.S. forces' posture in the Asia-Pacific region" provided the most recent confirmation of the new plan (<http://www.defense.gov>, September 17, 2012).

Unfortunately, the military build-up, along with many other issues, could see reduced funding from the U.S. Congress through budget cuts to lower the federal deficit. These budget issues are likely to be unresolved until January, when the new presidential and congressional terms begin.

Meanwhile, the military presence in Guam, along with other federal spending, continues to contribute to the overall economy. 2011 saw federal spending of \$1.067B in Guam. Although this figure is 11% lower than it was in 2010, reflecting efforts to reduce federal spending, the amount going to military actually increased to \$659 million in 2011 to compared to \$639 million in 2010.

Between January and September of 2012, Guam received \$700 million of federal funding, with \$332 million in military spending. Just recently, the Naval Facilities Engineering Command (NAVFAC) Marianas awarded an \$11.7-million contract for the repair and modernization of Sierra Wharf at Naval Base Guam (*Marianas Business Journal*, September 24, 2012).

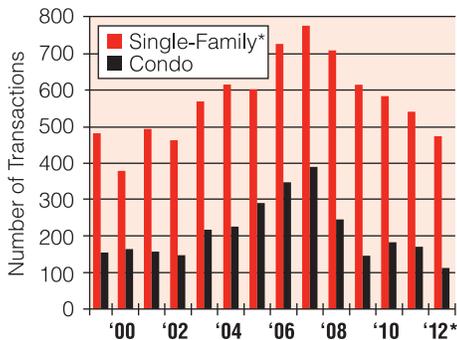
Real Estate: 2011 Flat, 2012 Sales Down

According to Siska S. Hutapea, President of Cornerstone Valuation Guam, Inc., the Guam real estate market peaked in 2007 after the military build-up news in 2006. Transaction volumes declined sharply from the peak of nearly \$700 million to the low \$300 million range in 2010 and 2011. Although military build-up plans continue to be on hold, various local market participants continue to take advantage of lower interest rates and availability of large construction companies to develop owner-occupant facilities. Various commercial acquisitions in early 2012 also involved local buyers taking advantage of reasonable prices and low interest rates.

Based on data provided by Hutapea, sales volume in 2011 was comparable to 2010 for the overall real estate market as well as for the residential market. The number of units sold (Chart 7) declined by 7.42%, but that was offset by a 7.54% increase in median prices (Chart 8) between 2010 and 2011. Compared to 2010, the sales of single-family dwelling and condominium units were 541 and 170, down 7.68% and 6.59%, respectively.

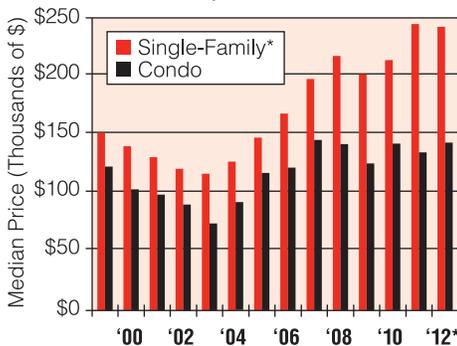
CNMI Economy: Positive Signs, Though Uncertainty Remains

CHART 7 • NUMBER OF REAL ESTATE TRANSACTIONS, 1999-2012*



*Single-family includes one-family to four-complex residential units. 2012 data includes January-June.
Sources: Captain Real Estate Group of Companies (1999-2008); Cornerstone Valuation Guam, Inc. (2009-June 2012).

CHART 8 • REAL ESTATE MEDIAN PRICES, 1999-2012*

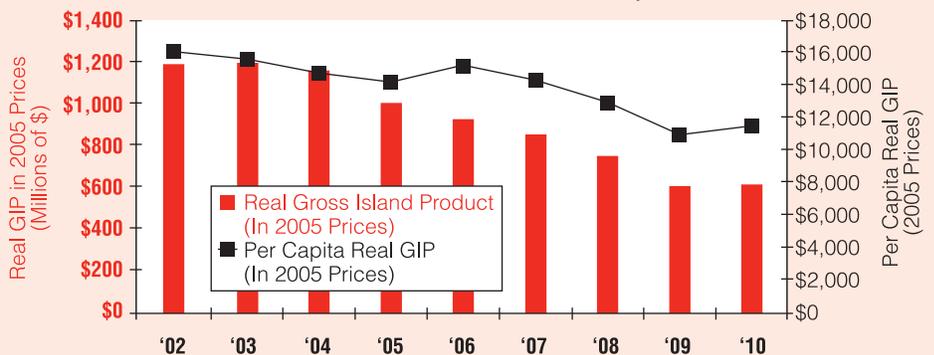


*Single-family includes one-family to four-complex residential units. 2012 data includes January-June.
Sources: Captain Real Estate Group of Companies (1999-2008); Cornerstone Valuation Guam, Inc. (2009-June 2012).

Whereas the median price for condominium units decreased by 5% to \$133,000 from \$140,000 a year earlier, the median price for single-family dwellings was up 15.57% at \$245,000.

Hutapea stated that, based on the overall number of transactions in the second quarter 2012 and not counting the sale of Ladera Tower, it is clear that market activity continues to slow. Sales volume of residential units reflected substantial decline, although it is expected to improve for the third quarter once summer sales activities are accounted for. It is widely perceived that price contraction is imminent, although supplies of new houses are decreasing based on the lower number of building permits.

CHART 1 • CNMI GROSS ISLAND PRODUCT, 2002-2010



Source: U.S. Department of Commerce-Bureau of Economic Analysis, released September 17, 2012

After several years of a slow economy and tough business environment, the Commonwealth of the Northern Mariana Islands (CNMI) is beginning to see positive developments. Some in the business community are of the opinion that the economy might have bottomed out. Maureen Maratita, publisher of Glimpses Publications, aptly described the CNMI economy as “battered, bruised, but not out for the count” (*Guam Business Magazine*, July-August 2012).

However, uncertainty remains, especially with regard to the effects of the Federalization Law on the CNMI.

Economic Growth, At Last

In September 2012, the U.S. Department of Commerce reported (Chart 1) that the CNMI economy (Gross Island Product) peaked in 2003, then declined every year through 2009 when it was less than half of 2003’s figure. In this context, the economy’s growth of 2.3% in 2010 is cause for optimism and possibly marks a turnaround.

The decline in population, which includes foreign workers, parallels the decline in GIP. CNMI population reached a peak of 78,900 in 2004 and declined to 53,900 in 2010. “Business executives speculate

that the population has dropped to around 45,000 today,” reflecting out-migration by foreign workers and residents, *Guam Business Magazine* reported in July-August 2012.

Combining the 2010 increase in GIP and the decline in population, CNMI’s per-capita income (also shown in Chart 1) stood at \$11,484 in 2010, a 5.35% increase from the previous year — but well below the 2002 figure of \$15,968.

Inflation Decreasing

Chart 2 shows that the CNMI inflation rate has been steadily decreasing since 2007, when it was 14.6%. Recent estimates from the CNMI Department of Commerce show CPI inflation for 2012 to be 2.7%.

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CHART 2 • CNMI INFLATION*, 2004-2010 (SAIPAN-BASED)

Year	CPI Inflation (%)
2004	1.0%
2005	0.7%
2006	2.4%
2007	14.6%
2008	10.9%
2009	-3.2%
2010	4.8%
2011	3.7%
2012	2.7%

*Annual CPI (using Second Quarter of every year) calculated for a basket of goods and services purchased by a typical consumer living in Saipan.
Source: CNMI Department of Commerce (August 2012)

Visitor Arrivals Growing

Tourism has been a strong contributor to this year's CNMI economy. In 2011, CNMI's visitor count (Chart 3) was 10% lower than in 2010. In 2012, however, arrivals between January and June were up 18.8% compared to the same period in 2011.

Unlike Guam, which continues to rely heavily on the Japan tourist market, CNMI's tourist markets are more diversified, as Chart 4 shows.

Just as noted in the Guam section of this report, access to CNMI's major islands is a major factor in increasing the number of visitors. Currently, CNMI is served by regular flights on Asiana Airlines (from Seoul and Busan); Sichuan Airlines (from Shanghai); Delta Airlines (Tokyo); United Airlines (from many tourist markets to Guam and via United Connection to Saipan); and Freedom Air (Guam, Saipan, Tinian and Rota routes).

"If there could be just one thing . . . that we could fix, (it) would be aircraft capacity," said Arthur Smith, president of Management Analysis, consultant to the Marianas Visitors Authority for NMI's 2012-2016 Tourism Master Plan (*Guam Business Magazine*, July-August 2012). Unfortunately, the launch of a new airline, Saipan Air, was postponed in July (*Marianas Business Journal*, July 2, 2012).

The Russian tourist market continues to be lucrative because Russian tourists stay longer and spend more. Charter flights from Russia planned by Aviacharter DV will offer access not only to Saipan but also to Tinian and Rota and family-oriented flight packages (*Marianas Business Journal*, September 24, 2012).

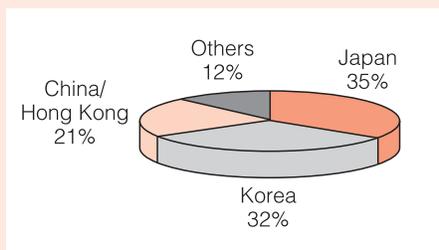
CHART 3 • SAIPAN VISITOR ARRIVALS, 2006-2012

Year	Arrivals	Percent Change
2006	352,350	
2007	389,345	10.5%
2008	397,274	2.0%
2009	353,956	-10.9%
2010	379,091	7.1%
2011	340,957	-10.1%
2012*	198,914	18.8%

*January-June 2012 total compared to Jan-June 2011 figure of 167,457.

Source: Marianas Visitors Authority, Saipan Visitors

CHART 4 • SOURCES OF SAIPAN VISITORS, JANUARY-JUNE 2012



Sources: Marianas Visitors Authority, Saipan Visitors

FEDERALIZATION LAW Minimum Wage Increased

As a precursor to the implementation of the Federalization Law in 2009, CNMI minimum wages have increased since 2007, when the hourly rate was \$3.05. The original plan was for an annual \$0.50 increase until the CNMI rate reached the prevailing U.S. Federal minimum wage rate. CNMI's hourly rate was at \$5.05 since September 2010. A law allowed CNMI and American Samoa to skip a \$0.50 increase in September 2011 but an increase became effective in September 2012, bringing the minimum to \$5.55.

A 2011 study by the U.S. General Accountability Office found the minimum wage increases having adverse effects on local employers, as expected, but also on employees, who indicated that they worry about losing their jobs or reducing their work hours.

In anticipation of this year's wage increase, employers began reducing work hours (*Saipan Tribune*, September 26, 2012). The minimum wage would also require an increase in pay of 30 government employees, affecting a government already challenged by limited budget resources.

Uncertainty on Foreign Labor

One source of uncertainty caused by the Federalization Law was the status of the "CW" visa category, used by many local businesses to recruit foreign workers. The law envisions no foreign workers in the CNMI by the end of 2014, although an extension is possible if recommended by the U.S. Department of Homeland Security and approved by the U.S. Department of Labor. In July 2012, the Saipan Chamber of Commerce submitted a formal request to the Department of Homeland Security to extend the transition period by five years (*Saipan Tribune*, July 21, 2012). Worker groups are opposed (*Saipan Tribune*, July 24, 2012).

In September 2012, the U.S. General Accountability Office (GAO) released a report (<http://www.gao.gov/products/GAO-12-975>) estimating that 12,311 foreign workers petitioned for a CW status as of September 25, 2012, with 7,128 (58%) already granted. The same report stated that the Department of Labor is not required to decide on extending the transition period until July 2014, just months before the end of the transition period (*Saipan Tribune*, September 29, 2012).

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