

# Economic Forecast

KAUAI EDITION 2011 - 2012

## Strong Tourism Gains Fuel Upbeat Economic Trend for Kauai County

**K**auai's economy, led by strong tourism gains, is demonstrating a somewhat more upbeat trend than other Neighbor Island counties. Its spirit of measured optimism prevails despite the very slow pace of recovery nowadays in Hawaii and practically everywhere else.

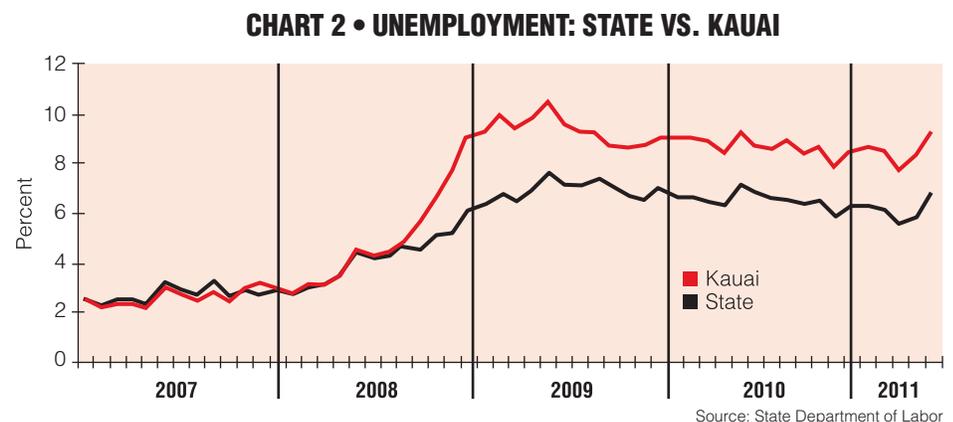
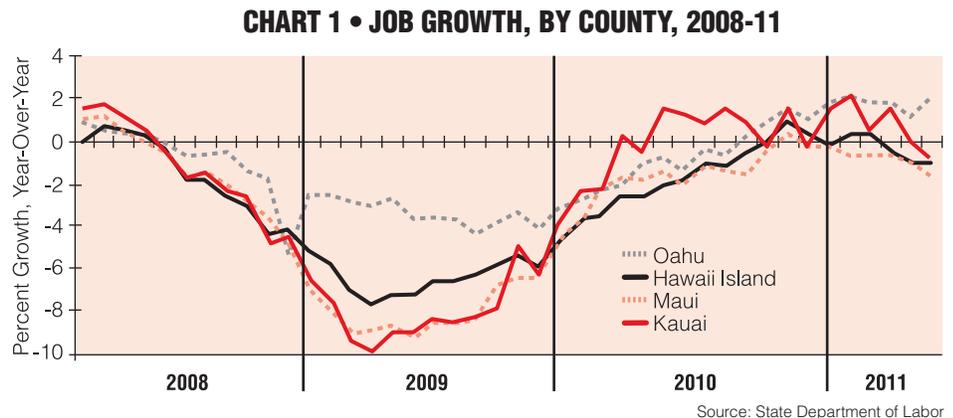
In addition to tourism, the island benefits from the strong, stable presence of the Pacific Missile Range Facility, one of Kauai's largest employers, and the diversification of its agriculture sector into seed corn and coffee.

Kauai and all the rest of Hawaii's counties are still below their pre-recession year 2007 peaks for most economic variables, however. And given the slowness of the recovery, it may be a year or two before those pre-recession levels are finally attained. But Kauai has traveled a little further toward reaching those pre-recession peaks than other Neighbor Islands.

At mid-year 2011, for example, Kauai was about 9% below its pre-recession peak for nonfarm jobs. Compare that to 10% for Hawaii Island and 11% for Maui. (Oahu was only 3% below its peak.) So even though Kauai took bigger hits than its two Neighbor Isle counterparts during the recession, it has made up for that in its better recovery.

As Chart 1 shows, job losses were less and jobs created were greater in Oahu's much more diversified and larger economy. Among the Neighbor Islands, Kauai shows the strongest growth, but also had lost the most — percentage wise.

The Kauai jobless rate (Chart 2) has been creeping downward with a few



recent reversals, as has been the case nationally and elsewhere in the state. Those slow improvements will likely continue in the future.

### Kauai's Tourism Rebound Has Been Strong

The snapback in Kauai tourism recently has been strong (See Chart 3, page 3). Arrivals have been growing robustly, and visitor spending growth is even stronger, helped by the additional \$1 million in marketing funds provided

by the Mayor and County Council. In some recent months, growth in Kauai visitor numbers has easily topped the other islands and the state as a whole.

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### ON THE INSIDE

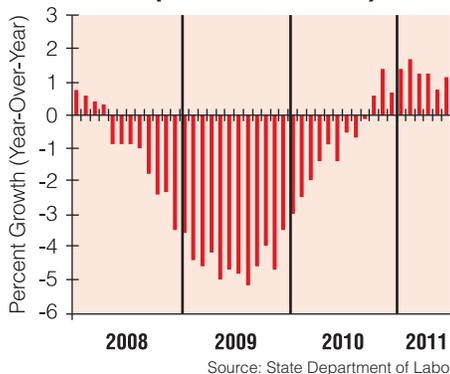
**5 U.S. & Global Economic Outlook: Great Debt Debate**

# Sluggish Recovery Throughout the State

**F**or 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.

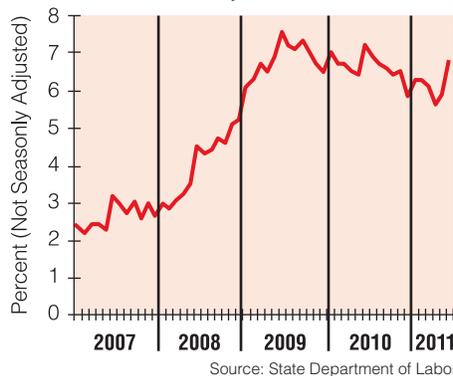
**CHART A • STATE JOB GROWTH (YEAR-OVER-YEAR)**



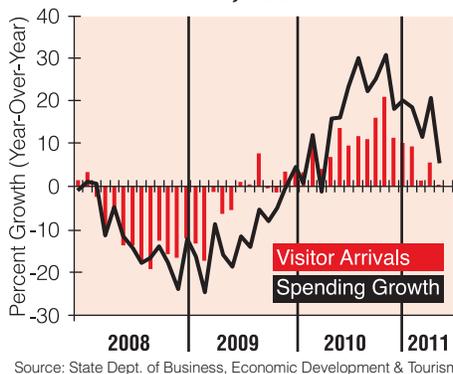
**Unemployment:** The statewide unemployment rate (Chart B) is well below the national number though still higher than average for Hawaii. Part of this lower unemployment rate is likely due to discouraged workers who dropped out of the labor force during the recent recession.

**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**



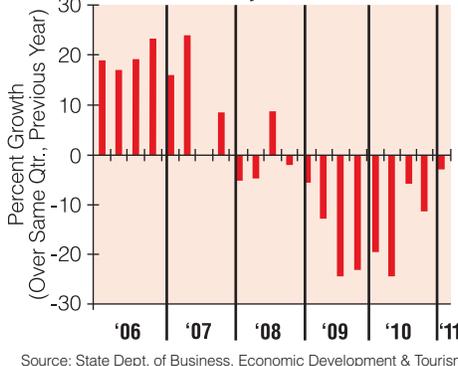
**CHART C • STATE VISITOR INDUSTRY GROWTH, 2008-11**



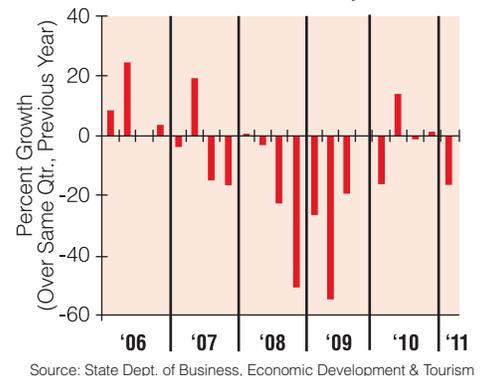
not yet spread to some other important sectors of the state economy.

**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.

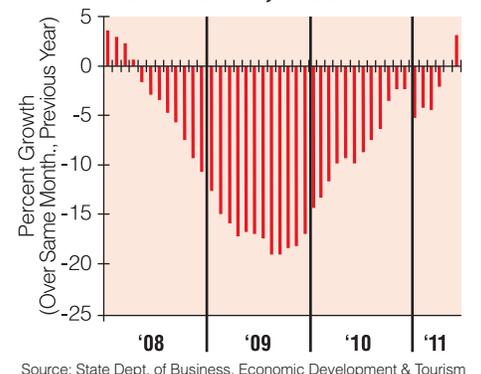
**CHART D • STATEWIDE CONSTRUCTION COMPLETED, 2006-11**



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

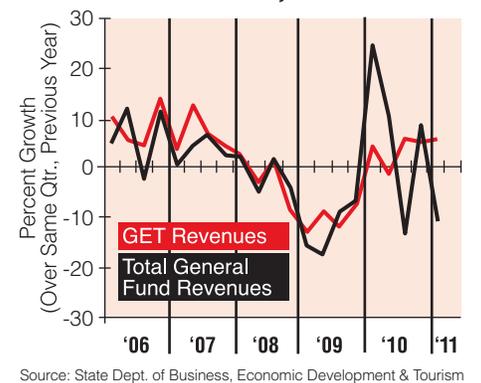


**CHART F • CONSTRUCTION INDUSTRY JOB GROWTH, 2008-11**

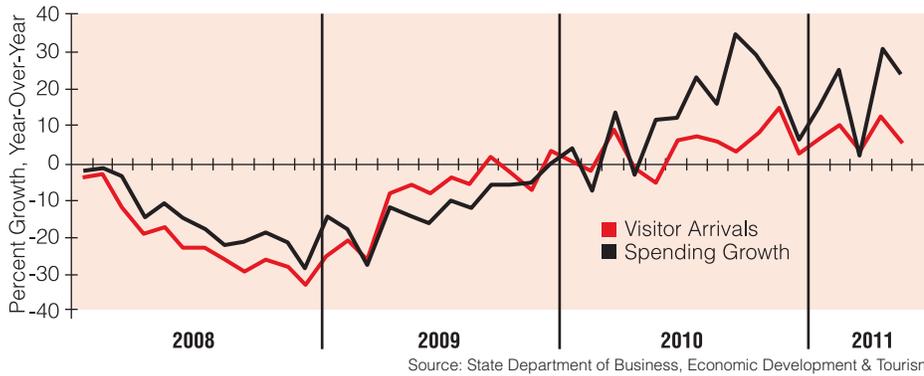


**Tax revenues:** The weaker economy has brought subpar growth in state tax revenues (Chart G), forcing unpopular budget cuts at just the wrong time. The general excise tax growth in recent quarters reflects some improvement in the economy, but the overall General Fund has not done as well.

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

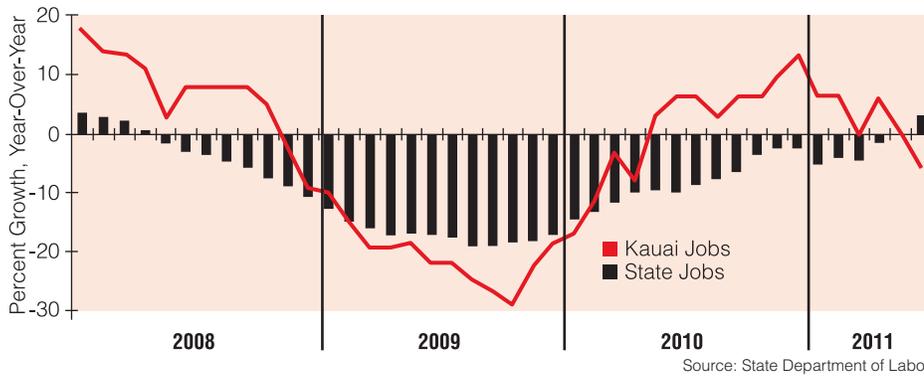


**CHART 3 • KAUAI TOURISM GROWTH, 2008-11**



Source: State Department of Business, Economic Development & Tourism

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



Source: State Department of Labor

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

Kauai can also thank its strong brand image and stable time-share segment. Here are some recent developments:

- Kauai's stellar reputation as a visitor destination truly can't be beat. In 2009 and 2010, *Travel + Leisure* magazine named Kauai the best Hawaiian island, and in 2010 the magazine named it #2 in the world after the Galapagos. In 2011 Kauai fell to #8 on the magazine's world list, but that's still quite good.
- Alaska Airlines added more direct flights to Lihue from San Jose and Oakland, while West Jet continues its seasonal direct flights from Vancouver.
- Another strong growth area is the conventions, meetings and incentives market.
- Grand Hyatt Resort and Spa and Courtyard by Marriott at Coconut Beach used the recession lull to reinvest in their properties. Also, the Sheraton Poipu is undergoing a \$19 million renovation with a

planned expansion of time-share. Kauai Lagoons opened its renovated golf course.

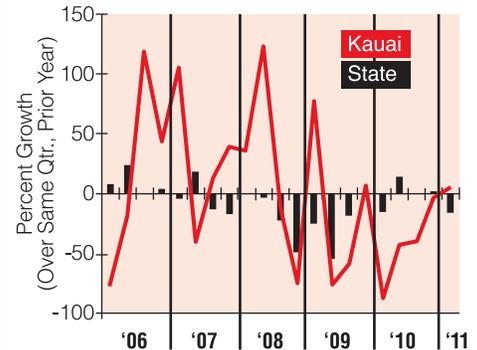
- In tourism retailing, Kukui'ula Shopping Village has been an increasing magnet for visitors and locals alike.

**Kauai's Continues to Be Prime Location for Films**

Kauai, a prime location for movies and TV films, had a very good year in 2010, with four feature films on-island — Sony Pictures' *Soul Surfer* (about island native Bethany Hamilton) and *Just Go With It*, Disney's *Pirates of the Caribbean: On Stranger Tides*, and Fox-Searchlight's *The Descendants* (to be released shortly).

A future prospect is *The River*, a TV series approved for the state, and Johnny Depp recently signed on for a fifth *Pirates*. Kauai is such a great location because it doubles well for other places in the world, but it gets a special publicity boost when the movie is actually set on Kauai, as has been the case with couple of recent productions.

**CHART 5 • CONSTRUCTION PERMIT GROWTH: STATE VS. KAUAI, 2006-11**



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

**Kauai's Construction Industry Aided by Public Projects**

One of the reasons Kauai job growth has been stronger recently than other Neighbor Islands is greater strength in its construction sector, thanks in part to public projects such as the continued widening of Kaunali'i Highway in Lihue and the just completed Bryan Baptiste Memorial Bridge in Wailua.

There is a smattering of private residential construction, such as a few units in Grove Farm's Pikake Subdivision, Poipu Beach Estates, an ag subdivision on the North Shore, and a smaller number in A & B's Kukui'ula on the South Shore. Kukui'ula also has just completed its golf course and clubhouse.

A future construction boost will come when Hokulei Village goes in with its super-Safeway store anchor. Permits for that project are now in process, and actual construction will be timed to coincide with road widening nearby. With the Lihue Big Save going out, that Safeway will fill a void in the market that was unforeseen earlier.

It should be noted that some sources that I interviewed this year see a lull coming in Kauai construction, an expectation borne out by weaker recent data on Kauai private construction permit growth (Chart 5, above). So the industry may rely more in the future on state projects in the works such as another \$46 million for Kaunali'i Highway, Port Allen harbor repair, Kapa'a School library, and airport improvements.

—continued on page 4

## Kauai County (continued from page 3)

One significant development regarding future Kauai construction is the sale to the State by Grove Farm of 78 acres of Ahukini Makai land adjacent to Lihue Airport. When that transaction is complete, the land will be used for airport expansion and a centralized rental car facility. It could trigger a total of \$75 million in construction, though this project itself is further down the pipe.

### Kauai's Real Estate Picture Mixed in 2011

Data for 2011 from the Hawaii Information Service show sales for single-family units are leveling off, but still rising for condos. Median prices for single-family units remain about flat, but for condos they are now falling faster. It is impossible to read much into these numbers, however, due to the transactions mix and small sample size.

But one thing Kauai shares with other locations on the Mainland and throughout the state is that a significant proportion of transactions is foreclosures and short sales, putting downward pressure on prices. Real estate prices cannot show a significant upswing until that inventory is worked down. As another indicator, Kauai Association of Realtors reports that the number of Realtors on the island has dropped almost 40% from the peak.

#### CHART 6 • KAUAI REAL ESTATE (% GROWTH OVER PRIOR YEAR)

Sales	2010	YTD 2011
Single-Family	+38%	-3%
Condominiums	+48%	+25%

Median Price	2010	YTD 2011
Single-Family	+3%	-1%
Condominiums	-12%	-28%

Source: Hawaii Information Service  
YTD 2011 through June

### Pacific Missile Range One of Largest Employers

The Navy's Pacific Missile Range Facility (PMRF) on the West Side is one of the island's largest employers with a payroll of about \$50 million and an employee base exceeding 900 — including civilian, civil service and military personnel. And many of the jobs are higher income ones. PMRF itself estimates a total \$125 million annual impact on the Kauai economy, plus an estimated \$11 million more associated with visitors in test events.

The site is the testing ground for the missile defense systems on U.S. Aegis cruisers, and the Terminal High Altitude Air Defense (THAAD) missile system. Congress also recently passed a \$68 million bill authorizing construction of an Aegis Ashore Test Facility, which will further solidify the site as the country's premier test and training range, while strengthening its role in Kauai's economy.

### High-Tech Industry Has Niches on Kauai

PMRF has spawned further development of the high-technology industry on Kauai. With funding assistance from the U.S. Department of Commerce, the West Kauai Technology and Visitor Center phases I and II have been built by the Kauai Economic Development Board in partnership with the County and State of Hawaii. This encourages high-technology industries to establish or relocate themselves on Kauai.

Forty employees, representing seven companies, currently work out of the facilities, adding economic diversification on an island where it is sorely needed. Other examples of a growing industry include two Tech Center alumni who moved to larger spaces in Lihue:

- Trex Hawaii Advanced Materials Group, manufacturer of a patented high purity silicon carbide ceramic material, and
- Oceanit Laboratories, a locally owned IT company specializing in missile defense, sniper fire detection and software development.

### Seed Corn, Coffee Help to Diversify Kauai Agriculture

Kauai is an ideal research laboratory for the seed corn industry because at least three crops per year can be grown, compared to Mainland operations that can produce only one to two. As a result, Kauai's seed corn industry continues to expand its crop base and infrastructure. The seed industry is predicted to remain stable during tough economic times because of the steady demand from farmers on the Mainland and around the world.

There are currently five parent seed corn operations on the island: Pioneer Hi-Bred International, Inc., Syngenta, Dow, Monsanto, and BASF. Dow Agrosociences recently leased 3,400 acres of former sugar land from Gay & Robinson, which exited the sugar business.

Kauai continues to produce the largest share of the state's coffee. Kauai Coffee Company, largest coffee plantation in the United States, was recently purchased by Massimo Zannetti, USA, a \$2 billion per year roasting company with American brands including Chock Full 'O Nuts, Hills Brothers, Chase and Sanborn, and MJB.

On another front, the County has funded improvement of Kauai's slaughterhouses to expand production of primarily grass-fed beef for local consumption. The goal is to keep some of the 6,000 head shipped to the Mainland for finishing and the income associated with the final product on Kauai by providing a quality grass fed product. This project could take time, but it may pay off.

Also, the State Land Use Commission recently approved an application by Maha'u-lepu Farm to dedicate over 1500 acres on the South Shore as Important Agricultural Land, virtually assuring use of the land for agriculture in perpetuity. Crops could include taro, fruits and vegetables.

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

By Dr. Jack P. Suyderhoud, 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.

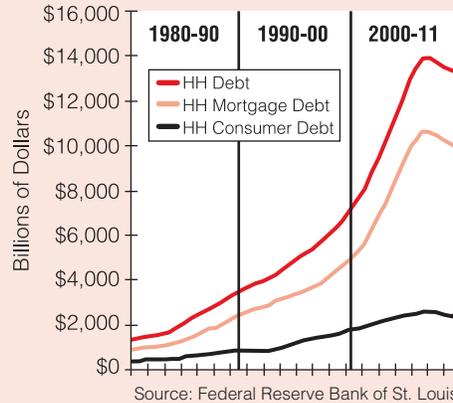
## The Accumulation of Debt

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 (red line) fell to historic lows.

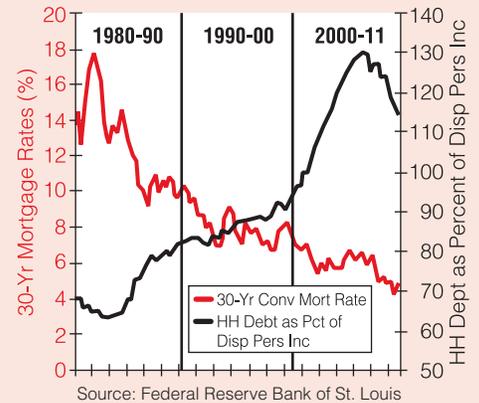
Households have actually reduced their debt levels since the start of the Great Recession, in part by walking away from some mortgage debt and in part by saving more and consuming less. But this decline in consumption contributed to the recession.

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

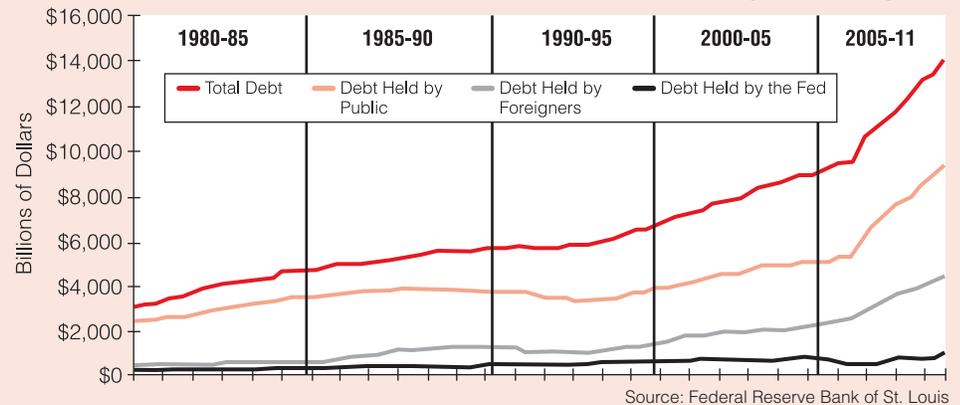
**CHART 1 • U.S. HOUSEHOLD DEBT (1980-2011)**



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



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



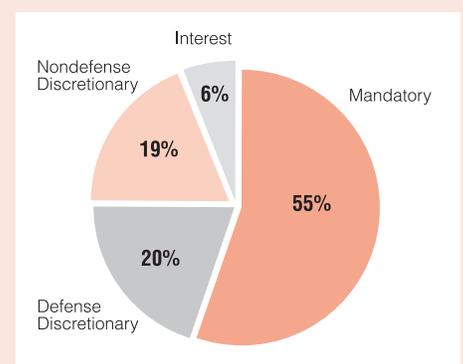
Security and state-local pension underfunding we can understand why ratings agencies have begun to express doubt about our future course.

## 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.

—continued on page 6

## 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.

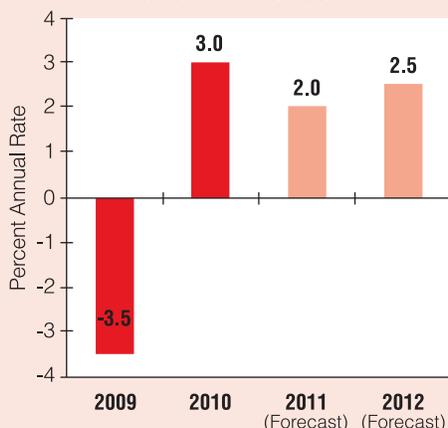
The only really good news is that our weak dollar and good economic growth in foreign markets has resulted in a strong rebound in U.S. exports.

### 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.

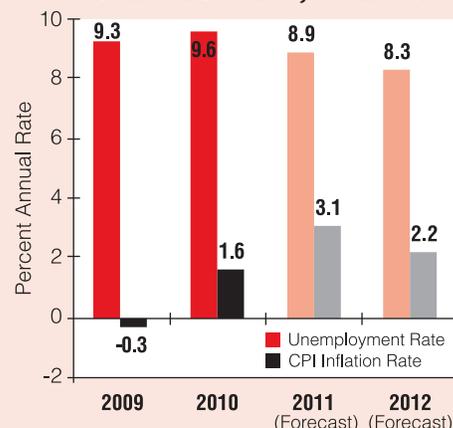
I am also assuming that oil prices will remain in the \$100-\$110 per barrel range through 2012. This sounds good, but remember oil averaged \$80 in 2010. Overall, energy prices will have a neutral impact on the economy for this outlook period.

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



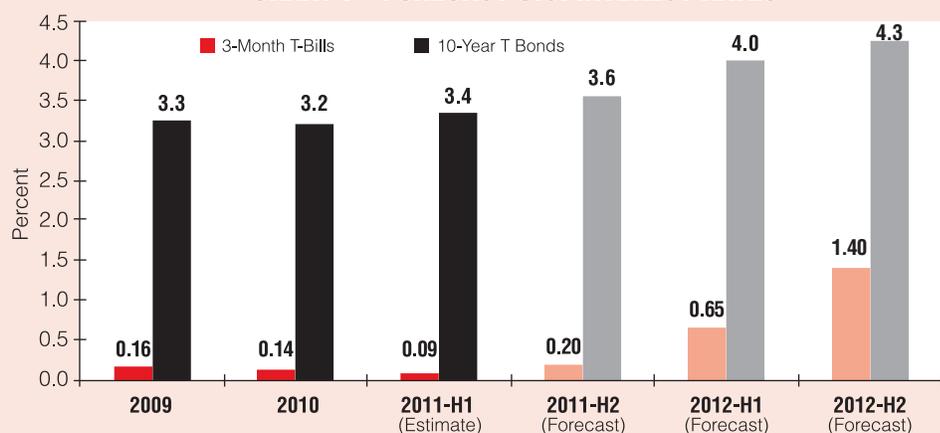
Source: Federal Reserve Bank of St. Louis

**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.