

Kaua'i Economic Outlook Summary:
Kaua'i Hit Hard by Global Recession

prepared for the County of Kaua'i by the

**University of Hawai'i
Economic Research Organization**

July 15, 2009



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University of Hawai‘i Economic Research Organization

2424 Maile Way, Room 540

Honolulu, Hawai‘i 96822

(808) 956-7605

uhero@hawaii.edu

Carl S. Bonham Ph.D., Executive Director (808) 956-7605

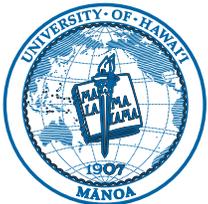
Byron Gangnes Ph.D., Director Hawai‘i Economy Project (808) 956-7285

Kimberly Burnett, Ph.D., Economist

Leroy Laney, Ph.D., Senior Contributing Economist

Andrew Kato, M.A., Data Analyst

Research assistance by Sean D’Evelyn, Heber Moulton, and Cheryl Geslani



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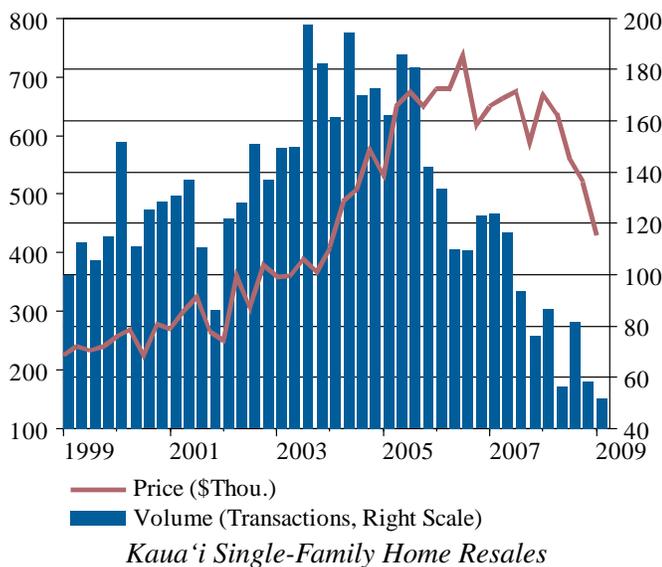
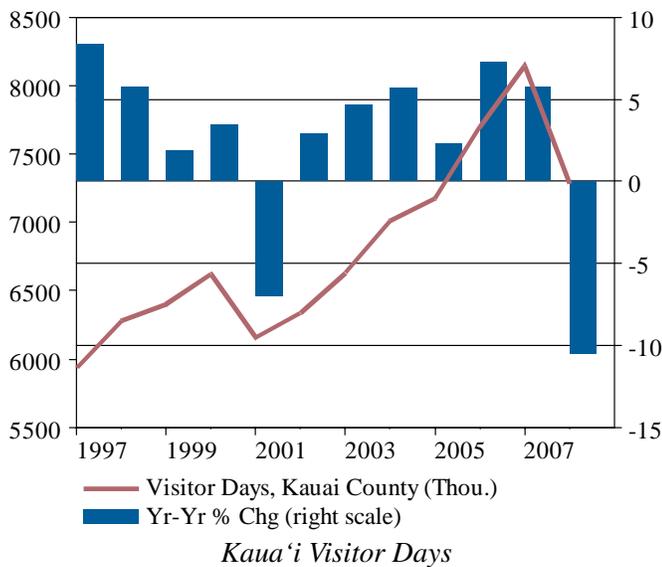
EXECUTIVE SUMMARY

Kaua‘i County faces a particularly challenging economic environment over the next two years. Because recovery of the U.S. and global economies will be anemic, visitor numbers will return very slowly. The construction cycle has only recently begun to turn down hard, and activity will continue to decline for the next several years. Government stimulus will help to support growth, but it will not be sufficient to avoid a long and painful contraction. The exploding State fiscal crisis has the potential to further delay recovery.

- 2008 was a miserable year for the Kaua‘i visitor industry, and arrivals continue to run about 14% lower than at the beginning of last year. We do not expect a return of inter-island cruise ships anytime soon, and recovery of the dominant U.S. market will take a number of years. Kaua‘i visitor arrivals will decline 7.5% this year, and then begin to recover at a 5.4% rate in 2010. Hotel occupancy will remain below 65% through 2010.
- Kaua‘i’s residential construction cycle peaked in October 2008 and has recently turned down hard. We expect construction jobs to decline about 13% this year and to drop another 4% in 2010. By the time construction jobs bottom out in 2011–2012, they will have fallen about 20% from their 2008 peak, based on annual data. This will represent a relatively mild construction sector downturn, compared with the other Neighbor Island economies.
- Last year’s visitor industry meltdown and the turning of the construction cycle mean that job losses will be widespread throughout the Kaua‘i economy over the next year. The overall non-farm payroll job count will drop 4.8% in 2009, by far the largest employment drop since the period following Hurricane Iniki. By 2010, the level of jobs will be about 7% lower than at the 2007 peak.
- UHERO estimates that county real (inflation-adjusted) personal income fell 2% last year. Income will fall by a larger 4.3% this year, with strong transfer payment growth offsetting only a fraction of the losses in labor income. We expect a small additional decline in aggregate real income in 2010, before recovery begins in 2011.
- The H1N1 Flu threat appears to have diminished, at least for now. The ballooning State budget deficit is of more immediate concern. While negotiations with public sector unions are ongoing, some combination of pay cuts, layoffs and/or tax increases is inevitable. These measures will restrain economic activity and could delay recovery in the Islands.

Recent Developments

Kaua‘i’s economy tumbled into recession in 2008. Shocks to visitor industry capacity, surging energy prices, and the erupting global financial crisis all combined to drag tourism and the economy downward as the year progressed. Kaua‘i’s construction boom, which lasted a bit longer than those of the state’s other counties, also came to an end last year. In recent months, the number of jobs on Kaua‘i has been running well behind levels seen in early 2008, and the county’s unemployment rate has spiked above 10%.



The following are key developments over the past year:¹

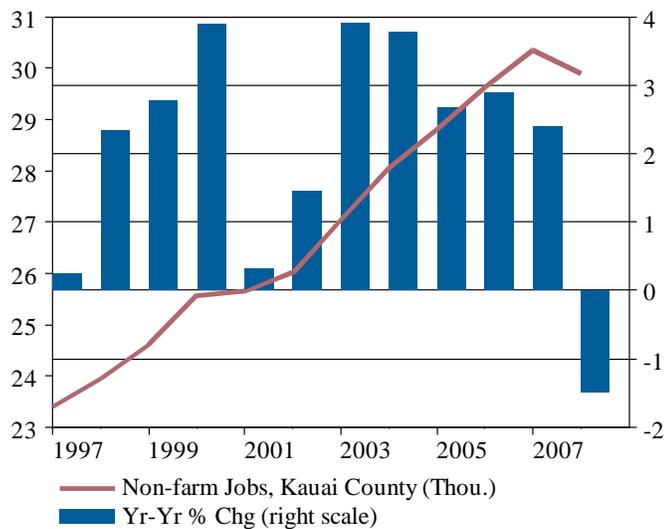
2008 was a miserable year for tourism. The departure of two of three Norwegian Cruise Lines (NCL) ships from the inter-island circuit led to a precipitous drop in cruise visitors, which had been a source of growth in recent years. A shock to the broader tourism industry came in late March and early April with the bankruptcies of Aloha Airgroup and ATA Airlines. The surge of energy prices to record levels in the summer further undermined travel plans. Finally, the eruption of the global credit crisis in September led to a sharp pullback in household spending on leisure travel.

The blow to Kaua‘i tourism was staggering. Visitor arrivals fell over 20% for the year as a whole, and they were down a larger 27% in the year’s second half. To some extent, these arrivals numbers overstate the adverse impact on the industry, because each cruise visitor typically stays a single day on the Garden Isle. Still, there was a substantial drop in visitor days, which takes into account length of stay. For 2008 as a whole, Kaua‘i visitor days were 10.5% lower than in 2007; they were running nearly 18% behind year-earlier levels in the fourth quarter.

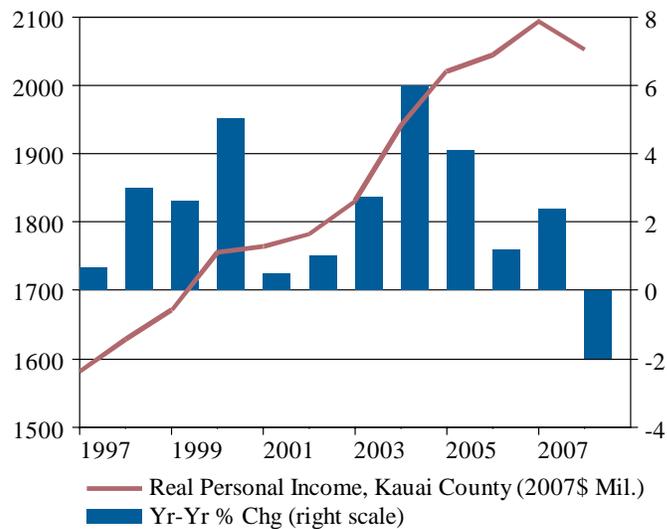
Tourism activity was weak across all markets. U.S. West, U.S. East and Japanese arrivals dropped 19%, 24% and 25%, respectively. Canadian arrivals have been strong in recent years, in part because of the strong Canadian dollar, but 2008 saw a decline of 23%.

Hotel occupancy fell from 76% in 2007 to an average of just over 70% in 2008. Kaua‘i’s hotel occupancy in December was down 15 percentage points from the year before to a meager 53%. In 2008, the daily room rate stayed steady at \$206, but the revenue per available room dropped from \$156 in 2007 to \$145. Vacation rentals have also been down.

¹This report is based in part on the *UHERO Annual County Forecast* report, June 12, 2009, which describes recent developments and prospects for Hawai‘i’s four counties, including industrially detailed multi-year forecasts for each county. Please contact UHERO for more information. The Kauai forecast has been updated to reflect recent developments.



Kaua'i Non-Farm Payroll Jobs



Kaua'i Real Personal Income Growth (2008 is UHERO estimate)

The loss of the two NCL cruise ships had a substantial negative impact on Kaua'i, particularly for areas and businesses that had only recently ramped up to cater to increased visitor numbers. This includes the Anchor Cove concentration of shops and restaurants near Nawiliwili Harbor, and tourist activities such as helicopter and boat tours, luaus, and so forth.

The market for Kaua'i residential real estate is affected both by developments in the mainland markets that drive offshore demand and by economic conditions facing domestic residents. Both sources of demand suffered in 2008. Kaua'i's real estate market was weak throughout the year, with total sales volume falling 31% for single family homes and 43% for condominiums. The decline in median prices was smaller, 7.4% for single family homes and 5.5% for condominiums.

For the first three months of 2009, Kaua'i single family residential transactions were down about 40% and condominium sales dropped 62%. Single family median prices fell 36%, and condo prices dropped a much higher 61% for the same period. Because the volume of real estate transactions is now very low, short-term movements in prices can be erratic, and it is too soon to tell whether these large price declines will be sustained.

The decline in real estate has ripple effects throughout the Kaua'i economy. Job losses in the sector have been substantial, and there has been a decline in jobs in finance as well. Lower home prices also restrain spending by Kaua'i households because of the loss of home equity.

Kaua'i's construction industry continued to expand much longer than in the other counties, and for 2008 as a whole the sector saw 7.3% job growth. However, by the fourth quarter growth dropped to only 0.8%, and construction jobs were down 8% in the first quarter of 2009. While a number of projects continue to move forward, last year's credit problems and worsening economic prospects have led to a reconsideration of some projects and to a slowdown at others.

Aside from construction, the only other major private sector to see net job gains last year was health care, which expanded by just over 1%. State and local government saw about a 3% increase in jobs. There were large job losses in the accommodation and food services sector, down 3.5%, and in transportation and utilities, which dropped about 10%. Finance, insurance and real estate fell 1.4%, and wholesale and retail trade lost 2% of its job base. Agricultural jobs declined by about 12%.

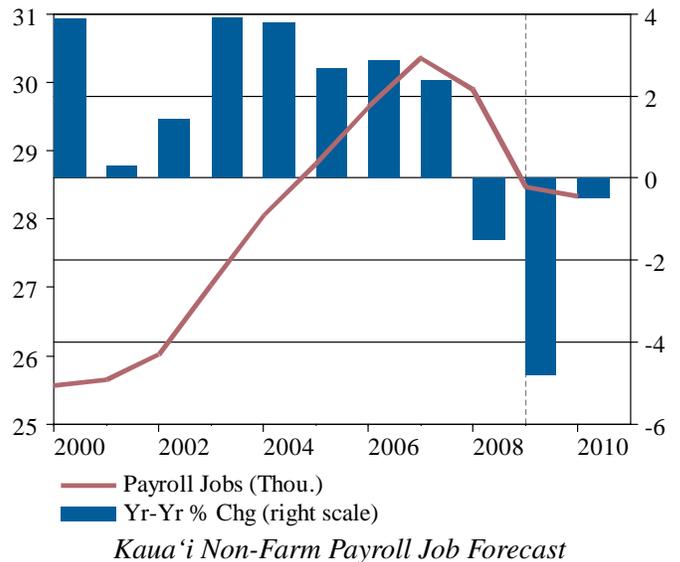
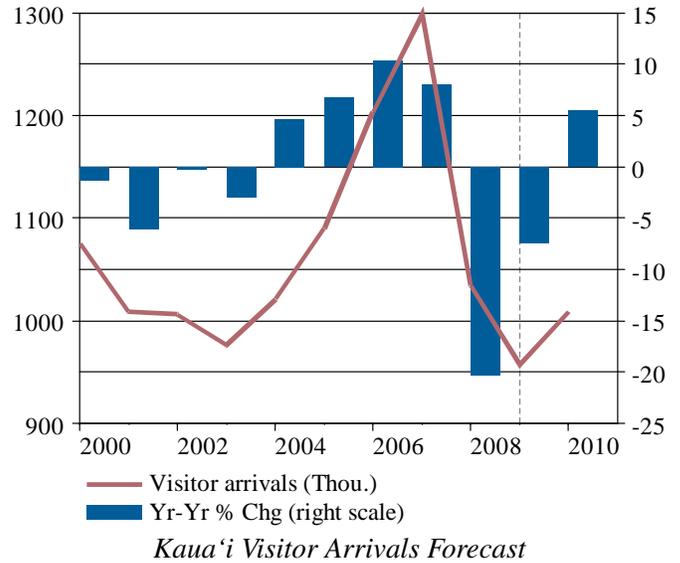
In most cases, job losses late in the year were much larger than suggested by these annual averages. This pattern of deterioration over the course of the year is also evident in aggregate statistics. For the year as a whole, the number of payroll jobs was down 1.5%, and the unemployment rate increased from 2.5% in 2007 to 4.4% in 2008. But by December, the payroll job count was running 5.4% behind 2008 levels, and the job situation has continued to worsen in recent months. The unemployment rate increased to 7.2% in December 2008 and to 10.5% in May 2009.

UHERO Kaua'i Forecast Summary

Kaua'i County faces a particularly challenging economic environment over the next two years. Because recovery of the U.S. and global economies will be anemic, visitor numbers will return very slowly. The construction cycle has only recently begun to turn down hard, and activity will continue to decline for the next several years. Government stimulus will help to support growth, but it will not be sufficient to avoid a long and painful contraction. The exploding State fiscal crisis has the potential to further delay recovery.

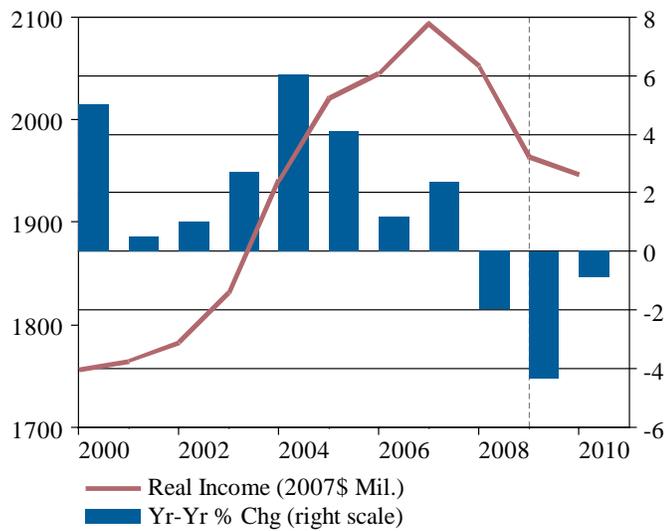
Last year, the county saw a 20.4% decline in arrivals. Visitor numbers appear to have stabilized in the first quarter of 2009, and in May they were down "only" 14% compared with the first months of 2008. However, we do not expect a return of inter-island cruise ships anytime soon, and recovery of the dominant U.S. market will take a number of years. Kaua'i visitor arrivals will decline 7.5% this year, and then begin to recover at a 5.4% rate in 2010.

The hotel occupancy rate on Kaua'i averaged a seasonally-adjusted 64.7% in the first quarter of 2009, more than twelve percentage points lower than in the first quarter of 2008. This was the lowest occupancy rate since the mid-1990s, illustrating the damage that the visitor downturn is inflicting on Kaua'i hoteliers. (Jobs in the sector were down more than 10% in the first quarter.) With weak demand and some expected



additions to the room stock, occupancy will drop a bit further over the next two years.

Kaua'i's residential construction cycle peaked in October 2008 and has recently turned down hard, with the April 2009 job count 14.7% lower than April of last year. We expect construction jobs to decline about 13% for the year as a whole and to drop another 4% in 2010. By the time construction jobs bottom out in 2011–2012, they will have fallen about 20% from their 2008 peak, based on annual data. This will represent a relatively mild construction sector downturn, compared with the other Neighbor Island economies.



Kaua'i Real Income Forecast

Last year's visitor industry meltdown and the turning of the construction cycle mean that job losses will be widespread throughout the Kaua'i economy over the next year. Tourism-related sectors experienced substantial job losses last year, and this will continue. The largest losses will occur in accommodation and food services and in the transportation and utilities sector, with a smaller decline in wholesale and retail trade jobs. A weak housing market and general industry retrenchment will lead to a significant drop in jobs for the finance, insurance and real estate sector. Following a statewide pattern, the only major private sector expected to add jobs in 2009 is health care; govern-

ment jobs will increase modestly, although state and local jobs will flatten out in 2010 under growing budget pressures. The agriculture sector will continue its trend decline.

Through May, Kauai's total non-farm payroll job count is running 5.8% behind year-earlier levels. We expect a decline of 4.8% for 2009 as a whole, by far the largest employment drop since the period following Hurricane Iniki. The lost jobs will be hard to recover in coming years, because of the construction downswing and the lack of any significant visitor industry rebound. By 2010, the level of jobs will be about 7% lower than at the 2007 peak.

County real personal income is reported with more than a one-year lag. Deflated by the Honolulu CPI, Kaua'i real income grew 2.4% in 2007. We estimate that real income fell 2% last year, because of job losses and poor business profitability. Real income will fall by a larger 4.3% this year, with strong transfer payment growth offsetting only a fraction of the losses in labor income. Patterns of sectoral real income growth will largely parallel that of jobs, with moderate gains in health care and social assistance and losses nearly everywhere else. (Note that for confidentiality reasons, income figures are not reported for some sectors on Kaua'i where there are a limited number of firms reporting.) We expect a small additional income loss in 2010, before recovery begins in 2011.

Kaua'i Economic Indicators, Year-Over-Year %Change

	2006	2007	2008	2009	2010
Visitor Arrivals	10.4	8.0	-20.4	-7.5	5.4
U.S. Visitor Arrivals	10.8	6.9	-21.1	-5.0	3.6
Japan Visitor Arrivals	-23.1	2.3	-22.4	-23.3	17.4
Other Visitor Arrivals	19.2	16.8	-14.9	-19.9	17.0
Payroll Jobs	2.9	2.4	-1.5	-4.8	-0.5
Inflation Rate, Honolulu MSA (%)	5.8	4.9	4.3	0.5	0.2
Real Personal Income	1.2	2.4	-2.0	-4.3	-0.9

Notes: Source is UHERO. Figures for 2009 – 2010 are forecasts. Income for 2008 is a UHERO estimate.

Two issues of concern have emerged in the past several months: the outbreak of A/H1N1 “Swine Flu,” and the growing State fiscal crisis. The Swine Flu threat appears to have diminished, at least for now. The virus has been less virulent than feared, and Japanese visitor arrivals, which fell sharply in May, have recovered relatively quickly. In any case, Kaua‘i is probably somewhat less exposed to the virus risk, because there is very little dependence on Asian markets, which saw the

majority of losses during the SARS epidemic. The ballooning State budget deficit is of more immediate concern. While negotiations with public sector unions are ongoing, some combination of pay cuts, layoffs and/or tax increases is inevitable. These measures will restrain economic activity and could delay economic recovery in the Islands. A quick resolution of the budget impasse would be helpful by providing households with clarity about their job and income prospects.

**TABLE 1: MAJOR ECONOMIC INDICATOR SUMMARY
KAUA'I COUNTY FORECAST**

	2006	2007	2008	2009	2010
Non-farm Jobs (Thou)	29.6	30.4	29.9	28.5	28.3
% Change	2.9	2.4	-1.5	-4.8	-0.5
Total Population (Thou)	62.0	62.8	63.7	63.9	64.0
% Change	0.6	1.3	1.5	0.3	0.1
Total Personal Income (Mil \$)	1,950.2	2,093.5	2,139.6	2,056.5	2,043.5
% Change	7.1	7.3	2.2	-3.9	-0.6
Inflation Rate, Honolulu MSA (%)	5.8	4.9	4.3	0.5	0.2
Real Personal Income (Mil 2008\$)	2,132.0	2,182.7	2,139.6	2,047.1	2,029.5
% Change	1.2	2.4	-2.0	-4.3	-0.9
Real Per Capita Income (Thou 2008\$)	34.4	34.8	33.6	32.0	31.7
% Change	0.6	1.1	-3.4	-4.6	-0.9
TOURISM SECTOR DETAIL					
Total Visitors (Thou)	1,203.3	1,299.0	1,034.3	956.7	1,008.7
% Change	10.4	8.0	-20.4	-7.5	5.4
U.S. Visitors	1,028.5	1,099.7	867.3	823.8	853.2
% Change	10.8	6.9	-21.1	-5.0	3.6
Japanese Visitors	33.6	34.4	26.7	20.5	24.0
% Change	-23.1	2.3	-22.4	-23.3	17.4
Other Visitors	141.1	164.9	140.4	112.4	131.5
% Change	19.2	16.8	-14.9	-19.9	17.0
Avg. Length of Stay (Days)	6.4	6.3	7.0	7.4	7.0
Visitor Days (Days)	7,693.0	8,141.1	7,290.1	7,037.7	7,107.5
% Change	7.3	5.8	-10.5	-3.5	1.0
Occupancy Rate (%)	74.8	75.8	70.5	63.9	63.1
Total Room Stock (Thou)	8.3	8.7	9.2	9.5	9.9
% Change	0.5	5.2	5.9	3.6	3.5

Note: Source is UHERO. Figures for 2009 – 2010 are forecasts. Figures for 2008 income are UHERO estimates.