

Economic Forecast

2011-12 GUAM-CNMI EDITION

Uncertain Times for Guam's Tourism, Military Build-Up

Fallout from the Japan earthquake and ongoing discussions in Tokyo and Washington over the scope and timing of Guam's pending military build-up have created uncertainty for Guam's economy in 2012.

A year ago, economic signals for Guam were upbeat, but subsequent developments have dampened some of that optimism regarding two of the island's main economic drivers, tourism and the military. Current and future developments will test the Guam economy and provide it with an opportunity to show its resilience.

In key sectors of the Guam economy:

- Tourism is down 4.8% between January and October 2011, owing to the March earthquake in Japan, the main source of Guam's visitors. Fortunately, there has been some rebound in tourist arrivals from Japan since June, other tourist markets show promise and the weakening of the U.S. dollar makes Guam vacations more affordable for many foreign visitors.
- The terms, size and timing of the long-planned relocation of troops from Japan to Guam have become the subject of increasing speculation due to fiscal problems in Japanese and U.S. governments and a delay in releasing the Master Plan for the Guam military build-up. The Navy Secretary says the plan will likely look "much different" than had been envisioned earlier.
- Employment on Guam is down 1.35% in 2011, with decreases in both private and local government jobs. Unemployment is at double-digit levels.

"We've confidently supported Guam's economy for four decades and First Hawaiian Bank looks forward to continuing to play a role in its future growth."

—Senior Vice President Laura Dacanay
First Hawaiian Bank Regional Manager,
Guam and CNMI

- The inflation rate has inched up from 2010 but continues to be low.
- The real estate market sent mixed signals, with strong sales volume and large median price declines

EXECUTIVE SUMMARY

2011 started off with a lot of promise. Guam welcomed a new governor and lieutenant governor (the Calvo-Tenorio administration) and five new senators in the Legislature. Tourism looked like it could repeat its strong performance of 2010 when almost 1.2 million tourists visited Guam. The military build-up was relatively on-track; the Record of Decision, signed in September 2010, signaled for many the start of large-scale construction projects and creation of thousands of new jobs.

It did not take long for challenges to emerge:

- The new administration soon faced a budget shortfall, a hospital struggling to pay for essential supplies, and several years and millions of dollars of tax overpayments and interest owed to local residents.
- The 2010 Record of Decision appeared to be more a formality than a "go signal" for the military build-up. Tension continued over use of Pagat, a historical and cultural site, as a

firing range and training site until the Programmatic Agreement was signed in March 2011.

- Then came the March 11, 2011, earthquake/tsunami in Japan, the primary source of visitors to Guam.

While the voice of activism (made visible by We are Guahan) was heard more loudly, those favoring the military build-up also became more visible, including efforts by Para Hita Todu (Making Guam Better . . . Together). Unfortunately, a lack of clear information on timing and details of the build-up created much uncertainty, fueled by increasing criticism and skepticism in Washington.

There were concerns that the cost of the military build-up is much higher than original estimates (around \$11 billion). There were questions about whether the U.S. should bear the cost of upgrading Guam's infrastructure (such as Sen. John McCain's comment regarding \$33 million for this purpose in the National Defense Authorization Act of 2012). Some asked if Asia-Pacific stability and national security could be achieved at a lower cost, such as reestablishing Subic Bay in the Philippines as a site for the U.S. military. U.S.-Japan relations were strained as information was leaked that the \$1 billion highway proposed to connect Andersen Air Force Base in the north

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ON THE INSIDE

5 Commonwealth of Northern Marianas Faces Continuing Struggles

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of Guam and Navy Base in the south was merely a tactic to artificially increase the U.S. share of the cost.

Some aspects of the military build-up remain uncertain, due largely to the delay in the availability of a Master Plan originally expected in July 2011. Also, the U.S. budget crisis could lead to reduction of Federal support of education, health, public assistance, and other Guam programs.

GUAM'S MACROECONOMIC ENVIRONMENT

Gross Island Product (GIP)

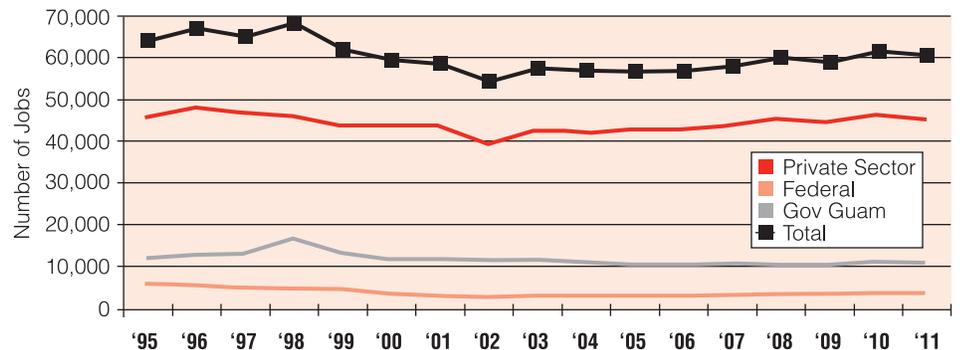
The latest estimate of Guam's Gross Island Product (GIP) is for 2009 and was released by the U.S. Department of Commerce-Bureau of Economic Analysis (BEA) in July 2011. The BEA said Guam was approximately a \$4 billion economy in 2009, measured in real terms using 2005 prices, translating to real annual income of \$22,293 per person. The same source shows that per-capita income peaked at \$23,743 in 2005.

The 2010 U.S. Census estimates Guam's population at 159,358, well below estimates at the time. This translates to a mere 2.9% growth in population from 2000-2010, compared to 16.3% growth between 1990 and 2000. Lower population could reduce Federal funds allocated to Guam, where local government relies heavily on such grants.

The Calvo-Tenorio administration has had to do some maneuvering to restore fiscal discipline. Recognizing the importance of tourism and the standard of living, the government successfully borrowed upwards of \$89 million to build a museum and finance "a host of cultural- and tourism-related infrastructure improvements." The bond, backed by hotel occupancy tax (HOT) revenues, received a rating of BBB+ from Standard and Poor's in March 2011 and a stable outlook.

After lengthy debate, the Government of Guam received approval from the Legislature to borrow \$244 million through bonds, after the release of an

CHART 1 • GUAM JOB GROWTH, 1995-2011



Source: Guam Bureau of Labor Statistics, Current Employment Statistics History, 1993-2011

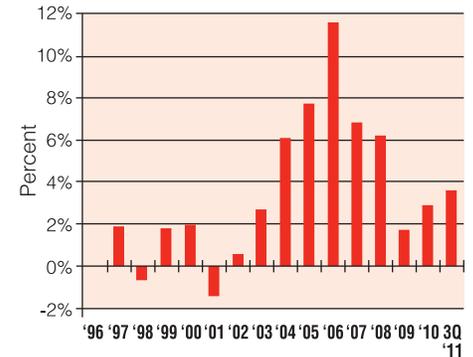
independent cost-benefit analysis by the University of Guam-Finance and Economics unit. Proceeds will be used to pay for \$198 million of tax refunds and interest owed to local residents, \$20 million court-mandated cost of living allowance (COLA) payments and \$26.4 million owed to the government retirement fund. (Pacific Daily News, September 24, 2011). This proposed bond, which will be secured by business taxes, recently received excellent ratings, A- and A, from Fitch and S&P, respectively. Preliminary reports from official sources confirm that the \$244 million bond was sold at 4.942% and was \$1 billion oversubscribed.

Job Count Lower, Unemployment Higher

Employment on Guam decreased 1.35% from June 2010 to June 2011, according to the Bureau of Labor Statistics' *Current Employment Reports*. Both private sector jobs (down 1.77%) and local government jobs (down 1.33%) contributed to the decline, the former reflecting the tourism slowdown following Japan's tsunami and the latter due to reorganization by the Guam administration. In the past 10 years, the private sector has provided approximately 75% of employment on Guam with 18%-20% provided by the local government and 5%-6.5% by the Federal government.

The latest unemployment data from the Guam Department of Labor show a rate of 13.3% in March 2011, well above U.S. (8.8%) and Hawaii (6.3%) rates at the time. Prior to this,

CHART 2 • GUAM INFLATION (CPI) RATE, 1996-2011



Source: Bureau of Statistics and Plans-Cost of Living Section, Guam Consumer Price Index, 1st Qtr. 2011, Vol. XXXVII, No. 1, Table C

the last unemployment estimate for Guam was 9.3% in September 2009. To make matters worse, the estimate was based on a survey conducted before the Japan disaster. Also, the estimate did not include "discouraged workers" (those who stopped looking for jobs) who, by definition, are not in the labor force. Any adjustment to the estimate for "discouraged workers" would likely be higher.

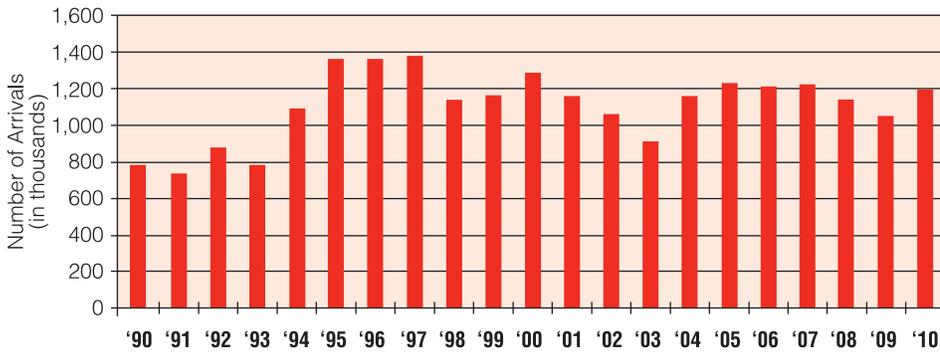
Inflation Continues Low

Guam continues to enjoy relatively low inflation (Chart 2). The consumer price index (CPI)-based annual inflation rate for the third quarter of 2011 shows a 3.6% increase, edging up from the rates of 2.9% in 2010 and 1.7% in 2009.

Tourism Down, But Some Markets Growing

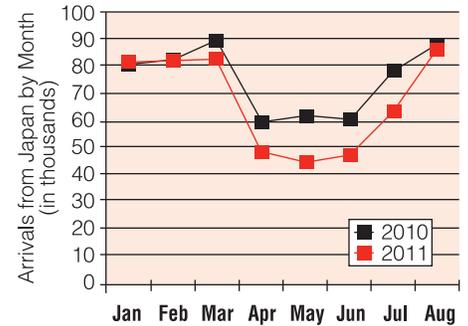
Guam tourism (Chart 3) did well in 2010, growing 13.6% over 2009. 2011 started off promising as well in

CHART 3 • GUAM VISITOR ARRIVALS, 1990-2010



Source: Guam Visitors Bureau, *Visitor Statistics*, December 2006-2010

CHART 4 • JAPAN ARRIVALS TO GUAM, 2011 VS. 2010



Source: Guam Visitors Bureau, *Visitor Statistics*, August 2011

January and February, but March arrivals were impacted by the Japan disaster. Fortunately, there was some rebound in tourist arrivals from Japan (Chart 4) beginning in June, resulting in a smaller decline of 4.8% in tourist arrivals from all markets from January through October.

As Chart 5 shows, the vast majority (70%) of visitors to Guam are from Japan. The fastest growing tourist markets are China, Russia, Taiwan and Hong Kong; about 35% more tourists from each of these markets visited Guam between January and August 2011 compared to the previous year. However, these countries still provide only a small fraction of the total.

Other measures of tourism on Guam have not shown the same level of decline. For example, the weighted average of hotel occupancy rates (Chart 6) is 72% for January-September 2011, compared to an average of 73% for the same period in 2010. The weighted average of room rates per night is \$116 for January-September 2011 compared to \$111 during the same period in 2010.

However, hotel tax collections between January and September 2011 were \$25.3 million, comprised of both gross receipts taxes (\$10.6 million) and room occupancy taxes (\$14.7 million). These figures were around 12% lower than those from 2010.

The U.S. dollar continues its weaker trend against tourist market currencies, which has helped attract visitors to Guam.

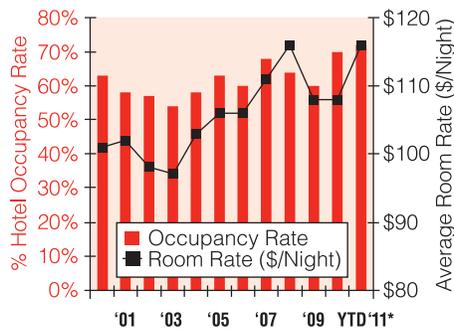
Forecasts of economic growth this year in Guam's tourist markets (Chart 7)

CHART 5 • SOURCE OF GUAM VISITORS, 2010-11

| | Jan-Dec 2010 | Share of 2010 | Jan-Oct 2011 | Share of Jan-Oct 2011 |
|-----------------------|--------------|---------------|--------------|-----------------------|
| Japan | 893,596 | 75% | 678,236 | 71% |
| Korea | 134,705 | 11% | 122,176 | 13% |
| Taiwan | 31,328 | 3% | 38,282 | 4% |
| Others | 136,580 | 11% | 117,859 | 12% |
| Total Civilian | 1,196,209 | 100% | 956,553 | 100% |

Source: Guam Visitors Bureau, *Visitor Statistics*, October 2011

CHART 6 • GUAM HOTEL OCCUPANCY, AVERAGE ROOM RATE, 2000-11



*YTD '11 includes January-September.
Source: Guam Visitors Bureau, *Visitor Statistics*, Dec 2006-10; Guam Hotel and Restaurant Association, *Summary Statistical Report September 2011*

have recently been adjusted downward by the Asian Development Bank. Japan's economy is forecast to decline by 0.5% in 2011 followed by 2.8% growth in 2012. Forecasts in the short term for other key markets are Korea (4.3%), Taiwan (4.7-4.8%) and Hong Kong (5.7-5.5%). China's forecast growth has also been downgraded but it is expected to still be above 9% this year and in 2012.

How tourism will fare going into 2012 depends on a combination of factors. The continued weakening of

CHART 7 • ECONOMIC GROWTH IN GUAM'S TOURIST MARKETS

| | U.S. | Japan | Korea | Taiwan | China | Hong Kong |
|------|-------|-------|-------|--------|-------|-----------|
| '08 | 0.4** | 1.2** | 2.3 | 0.7 | 9.6 | 2.1 |
| '09 | -3.5 | -6.3 | 0.2 | -1.9 | 8.7 | -2.7 |
| '10 | 3.0 | 4.0 | 6.2 | 10.9 | 10.3 | 7.0 |
| '11* | 1.6 | -0.5 | 4.3 | 4.8 | 9.3 | 5.5 |
| '12* | 2.2 | 2.8 | 4.3 | 4.7 | 9.1 | 5.7 |

*Forecasts.
Source: Asian Development Bank (September 2011), *Asian Development Update*. **World Bank.

the U.S. dollar encourages tourism. Forecasts of sluggish economic growth in Japan, Guam's main market, can have both favorable and unfavorable effects on travel to Guam. On the one hand, leisure travel is a non-essential expense when times are difficult. On the other hand, a visit to Guam is more affordable for many tourists and requires less travel time.

Forecasts of 4-5% growth in Korea, Taiwan and Hong Kong and 9% for China, along with stepped-up marketing to these tourist markets, can help make up for any decline or weak recovery of arrivals from Japan and the U.S.

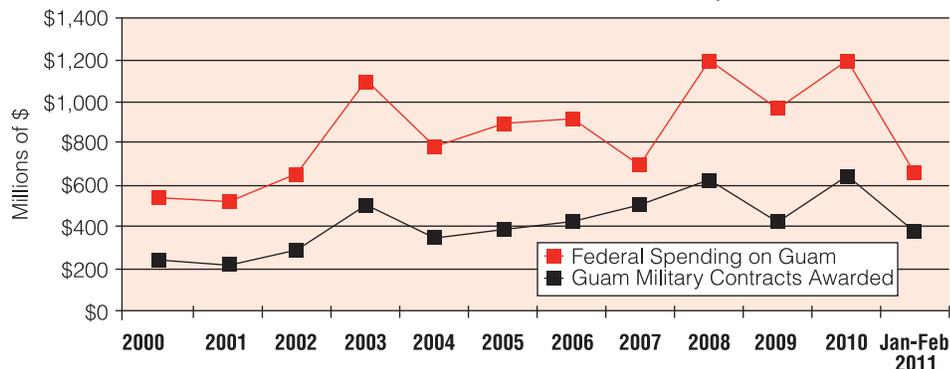
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Tourism Down (continued from page 3)

Several recent developments can have positive effects on tourism on Guam:

- In February 2011, Fly Guam began offering more affordable flights for tourists from China, Hong Kong, Palau, Philippines, Taipei and Saipan. (Pacific News Center, February 11, 2011). Some flights have since been suspended but they plan to expand service to include Japan and China by December, following the sale of 51% of its interest to Triyar Capital, a Los Angeles-based company. (Pacific News Center, November 15, 2011).
- The Calvo-Tenorio administration, with the continued support of Guam Congresswoman Madeleine Bordallo and the Guam Chamber of Commerce, is working to persuade the U.S. Department of Homeland Security to approve the China-Russia Visa Waiver Program (VWP) allowing tourists from China and Russia easier access to Guam.
- New express lanes at the Guam International Airport speed up processing of arriving visitors from Visa-Waiver countries who obtained entry visas electronically prior to arriving through the Electronic System for Travel Authorization (ESTA). The airport's goal is to have visitors from plane to hotel in about 30 minutes. (Marianas Variety, September 13, 2011).
- The merger of United and Continental Airlines will provide passengers to and from Guam access to a more extensive air route network and introduce new aircraft that will allow for an additional 100,000 customers per year. The Continental One Pass frequent flyer program will be merged into United's Mileage Plus program in 2012. Direct flights between Guam and Okinawa have been introduced. The two airlines continue to wrestle with growing pains associated with the merger. (Pacific Daily News, September 29, 2011).

CHART 8 • FEDERAL SPENDING ON GUAM, 2000-11



Source: <http://www.usaspending.gov>, retrieved on September 24, 2011

Military: Uncertainty About Build-Up

Since 2006, the proposed military build-up has been expected to have a major economic impact on the local economy. However, this process tends to be largely outside the control of local policymakers and leaves the local economy exposed to instability. Partly as a result of the earthquake/tsunami in Japan and developments in the U.S. Congress, the terms, size, and timing of the military build-up on Guam might deviate from those spelled out in the 2006 U.S.-Japan Agreement. Much depends on the fiscal health of both governments, which initially agreed to share the cost of the military build-up on about a 40-60 basis. (University of Guam-Pacific Center for Economic Initiatives, September 2011).

The delay in releasing a Master Plan, originally scheduled for July, leaves local residents uncertain. According to Secretary of the Navy Jackalyn Pfannenstiel “the fight over the level of the U.S. budget and alternative military strategies advanced by some members of Congress will likely produce a final build-up plan much different than that reflected by the 2010 Record of Decision.” (Pacific News Center, August 30, 2011). A recent article in a Japanese newspaper suggested that the U.S. “will move combat troops instead of headquarters staff to Guam,” which if true would significantly reduce the scale, timing and resulting economic benefits of the build-up (Yomiuri Shimbun, September 16, 2011).

On the other hand, contracts continue to be awarded (Chart 8), suggesting that the build-up is still on track. For example, a contract for almost \$90 million was awarded in August 2011 from the Japanese share of the build-up, a funding referred to as “mamizu.” This contract was for “phase one of utilities and site improvement work on Guam at Andersen Air Force Base in Yigo and Naval Base Guam at Apra Harbor.” (Marianas Business Journal, August 29, 2011). Military contracts totaled \$367 million between January and August 2011, more than half of Federal government spending on Guam.

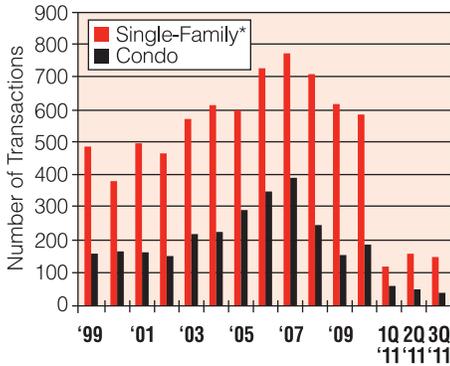
Real Estate: Still Short of 2007 Peak

The market update from Captain Real Estate Group of Companies for the third quarter of 2011 reports “mixed signals . . . in Guam’s real estate” — on the one hand, a 42% increase in sales volume compared to the previous period; on the other hand, median prices plummeting for both single-family dwellings (-25%) and condominium units (-84%). (Charts 9 and 10, next page.)

Real estate transactions on Guam peaked in 2007, with 774 single-family dwellings and 388 condominium units sold. Since then, the market has slowed, with 586 single-family dwellings and 183 condominium units sold in 2010. The latest market update from Captain Real Estate Group of Companies shows the downward trend

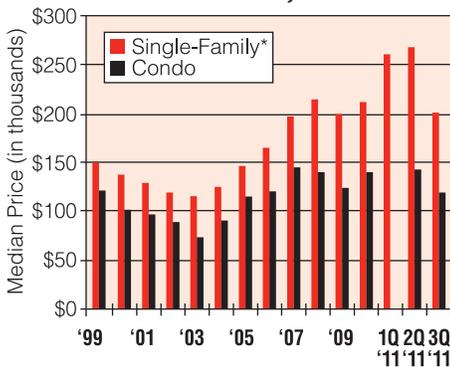
Commonwealth of Northern Marianas' Economy Continues to Struggle

CHART 9 • GUAM REAL ESTATE, NO. OF TRANSACTIONS, 1999-2011



*Includes one-family to four-plex residential units.
Source: Captain Real Estate Group of Companies

CHART 10 • GUAM REAL ESTATE MEDIAN PRICES, 1999-2011



*Includes one-family to four-plex residential units.
Source: Captain Real Estate Group of Companies

continuing, with 575 single-family dwellings expected to be sold in 2011.

Between January and September of 2011, 419 single-family dwellings were sold, with the median price being very sensitive to the mix of new and old homes sold during a given period, reaching a high of \$268,000 in the second quarter of 2011 and declining to around \$201,000 in the third quarter.

A total of 183 condominium units were sold in 2010 at a median price of \$140,000. Between January and September 2011, 138 condominium units were sold, with the median price fluctuation reflecting the product mix and going from \$158,000 in the first quarter to \$142,000 in the second quarter of 2011, and down to \$119,000 in the third quarter. ✱

The economy of the Commonwealth of the Northern Marianas Islands (CNMI) continues to struggle. Tourism, which has been on a decline for some time, took a turn for the worse as a result of the earthquake and tsunami in Japan, the main source of CNMI tourists. Local businesses face weak demand, a 66% rise in labor costs since 2007 and increased fuel and shipping costs.

CNMI ECONOMIC INDICATORS

Gross Island Product

In July 2011, the U.S. Department of Commerce-Bureau of Economic Analysis (BEA) released estimates showing CNMI's Gross Island Product (GIP) declined by almost 20% between 2008 and 2009, and by more than 9% on an annual basis from 2002-2009. (See Chart 1.) This translates to a more than 4% annual decrease in per-person real income between 2002 and 2009. (The per capita decrease was lower than the GIP decrease because of population loss.)

Population

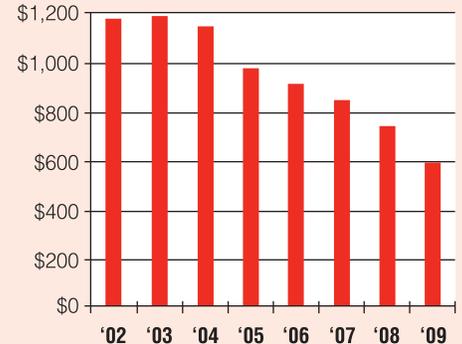
Based on preliminary U.S. Census estimates, CNMI's population in 2010 was 53,883, a loss of 22% since the 2000 estimate of 69,221.

Inflation

CPI inflation for 2010 was 6.4%. Overall, the rate has been increasing since 2007.

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CHART 1 • CNMI REAL GROSS ISLAND PRODUCT, 2002-2009



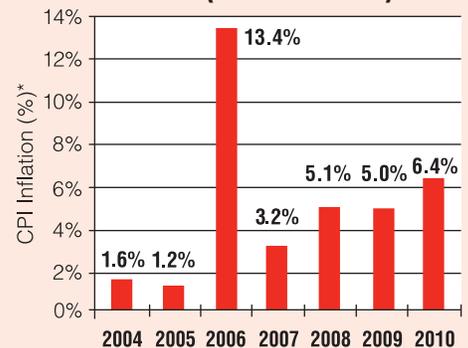
Source: U.S. Department of Commerce-Bureau of Economic Analysis, released July 2011. (Real GIP in 2005 dollars.)

Chart 2 • CNMI Population Estimates, 2010 vs. 2000

| | 2000 | 2010 | % Change |
|------------------|--------|--------|----------|
| CNMI | 69,221 | 53,883 | -22.16% |
| <i>By Island</i> | | | |
| Rota | 3,283 | 2,527 | -23.03% |
| Saipan | 62,392 | 48,220 | -22.71% |
| Tinian | 3,540 | 3,136 | -11.41% |

Source: 2010 U.S. Census

CHART 3 • CNMI INFLATION RATES, 2004-10 (SAIPAN-BASED)



*Calculated using CPI for a basket of goods and services purchased by a typical consumer living in Saipan.
Source: CNMI Department of Commerce (August 2011), Consumer Price Index of the Commonwealth of the Northern Marianas, Fourth Quarter of 2010

“First Hawaiian Bank has had a presence in CNMI since 1997 and is committed to supporting its long-term growth.”

—Senior Vice President Laura Dacanay
First Hawaiian Bank Regional Manager,
Guam and CNMI

Economic Indicators

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CNMI Tourism

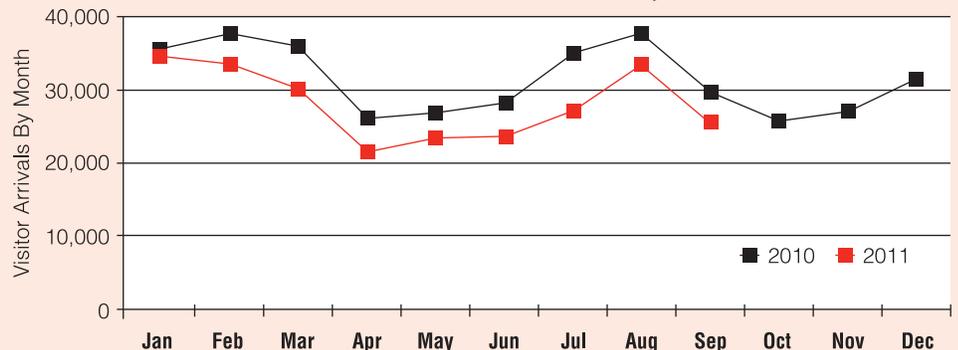
Unfortunately, tourism in the CNMI trended down for several years, declining 30% from 2005 to 2009 when 353,956 tourists visited CNMI. This number increased to 379,091 in 2010. Between January and September of 2011, tourism declined 15.07% compared to the same period in 2010; every month in 2011 reported fewer tourist arrivals than the same month in 2010. (Chart 4)

As on Guam, the largest factor affecting tourist arrivals to the CNMI in 2011 was the earthquake and tsunami in Japan in March. Reduced flights connecting CNMI to Japan in July 2011 also contributed to the decline in Japanese visitors (Marianas Visitors Authority Press Release, August 26, 2011). There were some hopes when Fly Guam introduced flights between Nagoya and Saipan on August 11 but the full effect was not seen due to a number of flight cancellations in August (Marianas Visitors Authority Press Release, September 22, 2011).

Similarly, reduced flights from Seoul and Busan resulted in 17% fewer tourists from Korea in July 2011, compared to July 2010. For the current fiscal year-to-date (October 2010-August 2011), tourist arrivals from Korea were at par with the 2010 estimates. Additional flights and upsizing of airplanes by Asiana Airlines in the coming months are expected to lead to a recovery in the number of Korean tourists visiting the CNMI during the balance of 2011 and into 2012. (Marianas Visitors Authority Press Release, September 22, 2011).

Arrivals from China and Russia have increased, lending support to the CNMI's push for continuation of the China-Russia Visa Waiver Program as it applies to the CNMI. In addition, arrivals from Hong Kong increased

CHART 4 • CNMI VISITOR ARRIVALS, 2011 VS. 2010



Source: Marianas Visitor Authority

tremendously as a result of the direct Hong Kong-Saipan flights by Fly Guam, which commenced in May 2011. (Marianas Visitors Authority Press Release, August 26, 2011).

Federalization Law: Minimum Wages

As a precursor to the implementation of the Federalization Law in 2009, CNMI minimum wages have increased significantly since 2007, from an hourly rate of \$3.05 to the current \$5.05. The original plan was to increase the minimum by \$0.50 every year until it reached the prevailing Federal level. At the current Federal minimum wage of \$7.25 per hour, it was originally expected that minimum wages in the CNMI would be \$7.25 by 2015.

The CNMI minimum wage had been scheduled to increase by another \$0.50 in September 2011, but President Obama signed a law allowing CNMI (and American Samoa) to skip this increase and to resume yearly increases in 2012. (Saipan Tribune, October 2, 2010). This development is good news to many local businesses, many which have struggled with the 66% wage increase since 2007 while facing weak product demand and low revenues.

Although the law affects only 2011, there is support for postponing future increases until the CNMI economy is able to accommodate such changes. U.S. Interior Assistant Secretary for

Insular Affairs Tony Babauta said on Sept. 23 that the “economic prospects for the CNMI and American Samoa (are) bleak for the foreseeable future.” (Saipan Tribune, September 26, 2011).

Concerns over the economic impact of the wage increase since 2007 are not trivial. A June 2011 study by the U.S. General Accountability Office found that:

- Employment in all sectors in the CNMI decreased by 13% from 2008-2009, while employment in tourism decreased by 8%.
- Earnings of all employed during 2008-2009 increased by 3% above and beyond the inflation rate for that year, while earnings by minimum-wage earners who kept their employment and work hours in 2008-2009 increased by 9%.
- 73% of those working in tourism had an increase in wages following the September 2010 minimum wage increase. The study shows this number will increase to 95% when the minimum reaches the current Federal rate of \$7.25.
- By early 2012, tourism employers representing 62% of workers have plans to lay off workers, although none indicated the action to be a result of minimum wage increases.
- CNMI workers surveyed indicated that they would like raises but worry about losing their jobs or reducing their work hours. ✖

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Ms. Laura Lynn Dacanay, *Senior Vice President, Guam-CNMI Region Manager at the First Hawaiian Bank*

Dr. Anita Borja Enriquez, *Director of the University of Guam-Pacific Center for Economic Initiatives*

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