

Economic Forecast

2011 - 2012 EDITION

Hopes for a Faster Hawaii Recovery Are Dampened by Worldwide Economic Woes

Hawaii's outlook for 2012 is likely to be somewhat more downbeat than was envisioned just a few months ago. The events affecting this include European debt problems and our own debt debate in Washington, a national story with implications here in Hawaii and everywhere else.

The impotence of national policy is increasingly sinking in. Monetary policy has done about all it can. Fiscal policy has shown a similar ineffectiveness, with a recent schizophrenia between balancing the budget and additional fiscal stimulus.

Even under the best of circumstances, the recovery will continue to be much slower than usual. The best scenario is a slight acceleration for 2012. If the external picture does take a turn for the worse, bear in mind that Hawaii tourism came back in the last recession rather quickly.

Despite talk about a "double-dip" recession, I'm not predicting one for Hawaii. Nonetheless, practically all forecasters — local, national, and global — have been revising down their forecasts recently.

Our Forecast for 2012

■ **JOB GROWTH: +1.2% in 2012.**

Partly in light of the fragile U.S. national recovery and lower confidence levels, which will undoubtedly have at least some impact on the local economic scene, the outlook is for only muted job growth (1.3%) for 2011 as a whole, with only a minor variation in 2012. Most of Hawaii's job growth

FORECAST FOR 2012

	2011 (Estimate)	2012 (Forecast)
Job Growth	+1.3%	+1.2%
Unemployment Rate	6.2%	5.5%
Inflation	+3.0%	+1.5%
Visitor Arrivals	+3.0%	+2.6%
Real Personal Income Growth	+1.0%	+0.9%

Source: Dr. Leroy O. Laney

will occur in the private sector, with the public sector remaining a drag. The problem with faster job growth in 2012 is mainly that much of the job growth that has taken place so far in our recovery can't continue at the same pace as earlier, and the growing sectors have not shown much propensity to spread to other weaker sectors.

- **UNEMPLOYMENT: 5.5% in 2012.** The unemployment rate is almost always a lagging indicator, especially so this time. Hawaii's jobless rate has been hovering just above 6% recently, and the average for 2011 may come in about that. If the local economy strengthens some and manages to avoid setbacks from external sources, a marginal improvement is possible in 2012.
- **INFLATION: 1.5% in 2012.** Local inflation was 3.5% in the first half of 2011, but if we manage to avoid things like oil price shocks it can be considerably lower in 2012. Inflation is *not* the primary economic concern nowadays —

economic recovery still is. Hawaii might even welcome a higher inflation rate if it would bring with it a stronger economy and a recovery in home prices.

- **VISITOR ARRIVALS: +2.6% in 2012.** Tourism will likely remain Hawaii's main economic driver in the near future. But a sure consequence of stronger growth in the recent past is slower acceleration in the future. And we are reminded once again that we do sell a luxury good to the rest of the world; a trip to Hawaii can be cut back in tougher times. Growth in visitor arrivals may come in at 3% in 2011, but that could mean slightly slower growth next year.

—continued on page 2

ON THE INSIDE

6 Neighbor Island Economies

11 U.S. & Global Outlook

Hopes for a Faster Hawaii Recovery

(continued from page 1)

■ REAL PERSONAL INCOME GROWTH: +0.9% in 2012.

Inflation-adjusted personal income growth, the broadest measure we forecast, usually corresponds closely to state Gross Domestic Product. Economic conditions have weakened across the globe as 2011 has progressed, and there are enough threats that forecasters only hope to avoid the all too real possible setbacks — including potential double-dip U.S. recession and magnified fallout from Europe. Avoiding another recession is still quite possible, especially for a tourism-driven service economy that has demonstrated relative resilience so far. But we shouldn't look for much above the 1% range for real personal income growth in the near future. And remember, any inflation-adjusted number can come in lower if inflation does pick up more than expected.

Job Growth Positive, But Remains Uneven

The recent recession hit Hawaii hard. As you can see in Chart 1, which shows monthly job growth on a year-over-year basis, job losses that began in 2008 accelerated in 2009 and continued well into 2010. It was late 2010 before the state started to show positive job growth compared to the previous year, but those gains have continued into 2011.

Recent job growth has been concentrated in the private sector — with visitor-related jobs, professional and business services, educational and health services, and information and technology leading the way. Leisure and hospitality job gains have slowed after earlier resurgence, however, and actual losses have occurred in trade, transportation, and utilities positions. But by far the biggest job reductions have happened in the public sector, with all three levels of government (federal, state and local) losing jobs.

CHART 1 • STATE JOB GROWTH

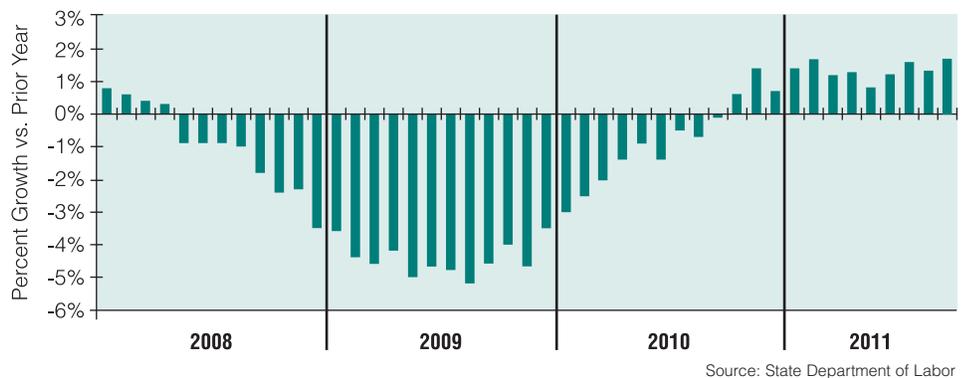


CHART 2 • STATE UNEMPLOYMENT

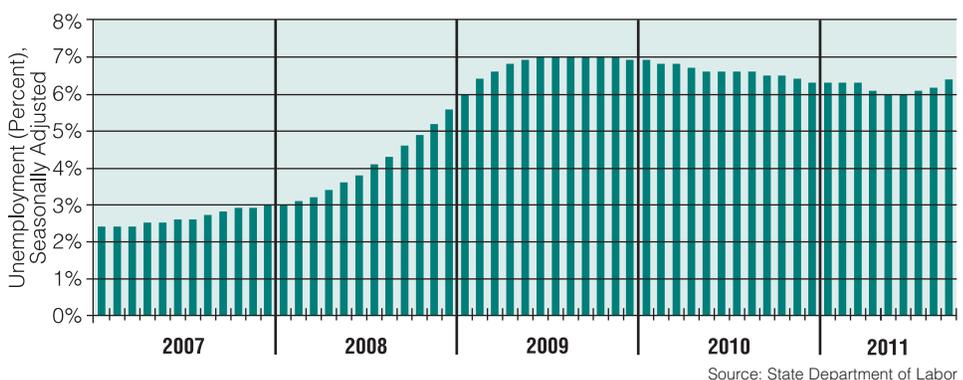
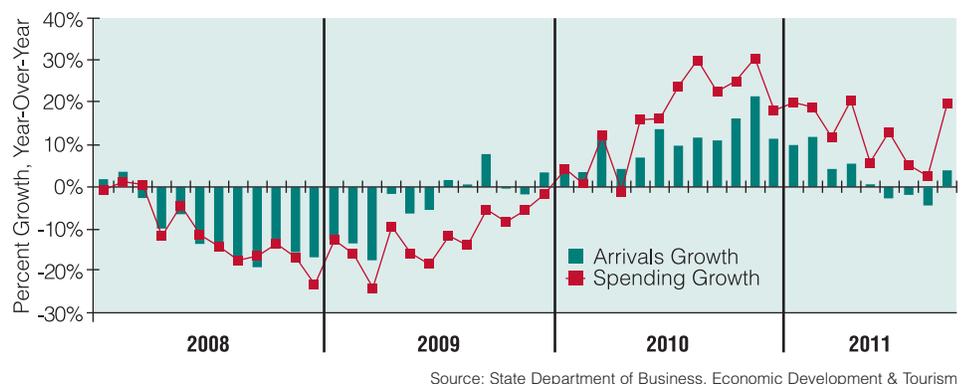


CHART 3 • STATE TOURISM GROWTH



It's also noteworthy here that what's true about uneven job creation across sectors of the economy is also true geographically. The Neighbor Islands have shown a good bit weaker job growth than Oahu. The state as a whole is now about 5% below the peak year of 2007 in the level of jobs. But while Oahu is only about 3% below its peak that year, all of the three Neighbor Islands are closer to 10% below that level. (See page 6)

Unemployment Dropping Slowly, Remains Well Below U.S. Rate

With overall job growth still weak, the state's unemployment rate (Chart 2) has been coming down only slowly. Hovering now at about 6%, it is running about 3 points below the national rate. But note also that this number doesn't include discouraged workers who have just dropped out of the work force, or some job losses by multiple job holders who are still technically employed but

earning significantly less. The labor market almost always lags the overall cycle, but the lags this time have been especially evident. And in recent months, Hawaii's jobless rate has ceased even that slow fall.

Tourism Has Remained Leading Edge of Island Recovery

The leading edge of our recovery has been in our main industry, tourism. The visitor industry sprang back quicker than many thought as the recession hit us. But at the current juncture, the main surge of that snapback is waning, as you can see in the monthly growth numbers for visitor arrivals and spending in Chart 3 (previous page) despite strong spending growth in September. Near-term future growth in this industry won't be as spectacular, even if it remains healthy.

During 2011, domestic arrivals have been increasing at a lower rate, and international arrivals were impacted earlier in the year by Japan's tsunami. The U.S. West market continues to be the mainstay of strength, and some increases in airlift have helped.

Construction Jobs Growing But Permits Continue to Lag

Unfortunately, the revival in the visitor industry hasn't spread to other sectors of the economy very well. Chart 4 shows construction job growth. Construction is always an important component of economic growth, but — as elsewhere — it lags considerably in Hawaii. The monthly job growth numbers for this industry have recently edged back into positive territory. All of this is attributable to Oahu; the Neighbor Islands continue to lose construction jobs. But other indicators in this industry don't show cause for great optimism.

CHART 4 • CONSTRUCTION JOB GROWTH

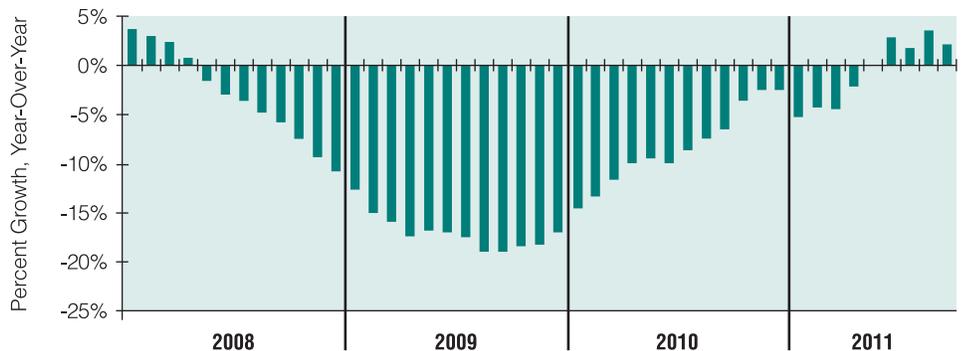
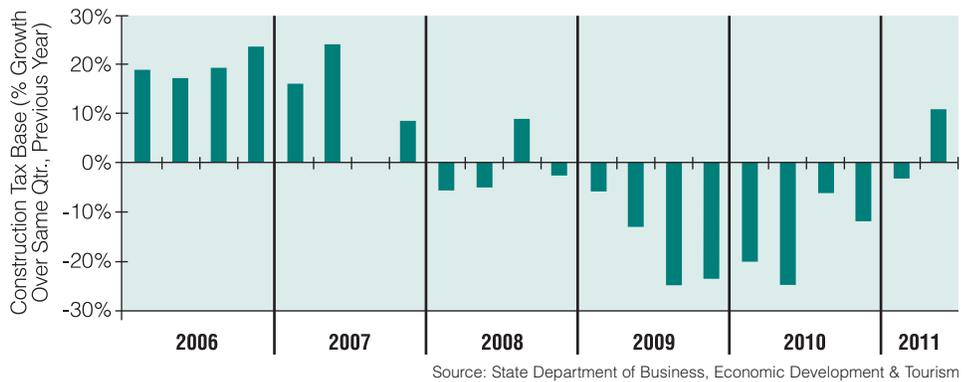


CHART 5 • CONSTRUCTION TAX BASE



Hopes for a Faster Hawaii Recovery

(continued from page 3)

General Excise Tax Growth Paints More Upbeat Picture

A more upbeat picture is seen in General Excise Tax growth (Chart 7), usually a good indicator of the economy because all transactions are subject to it. But remember most of this growth is a snapback from previous recessionary weakness.

New Vehicle Sales Trends Track Overall Economy

Big-ticket items like homes and cars are worth tracking because they tend to be good underlying indicators of any economy. Chart 8 on new vehicle registrations follows the overall economy well. Sales have been in general decline since a record of over 70,000 was achieved in 2005. The 2011 sales projection by the Hawaii Automobile Dealers Association was recently lowered to 33,500, a decline of 1.5%. Part of this is due to earthquake-related supply disruptions from Japan, which could lead to a 2012 rebound driven by pent-up demand.

Real Estate Market Stalls After Encouraging 2010

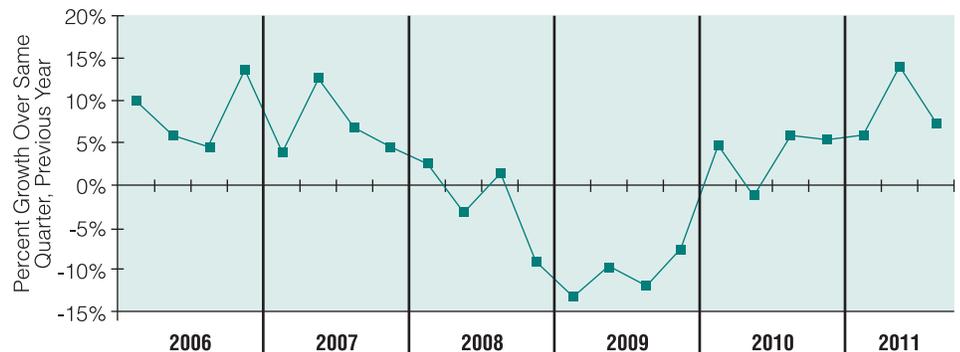
Residential real estate is even more important. In 2010, substantial increases in sales after several years of contraction, and a turnaround in median prices after a couple of years of decline, were encouraging. In 2011 so far, both sales and prices (Chart 9) have been falling some.

With rates at record lows, this weakness is certainly not an interest rate story. But overall confidence could be playing a larger role. The changes in this chart for single-family homes are mirrored by condos. The downward pressure on prices is coming at least partly from the continued overhang of short sales and foreclosures that I mentioned above with respect to construction.

Credit Card Spending Is Good Economic Indicator

Another good indicator of the local economy is First Hawaiian Bank's own

CHART 7 • GENERAL EXCISE TAX GROWTH



Source: State Department of Business, Economic Development & Tourism

CHART 8 • HAWAII NEW CAR, TRUCK SALES



*2011 - HADA Projection. Source: Hawaii Automobile Dealers Association

CHART 9 • OAHU SINGLE-FAMILY REAL ESTATE MARKET

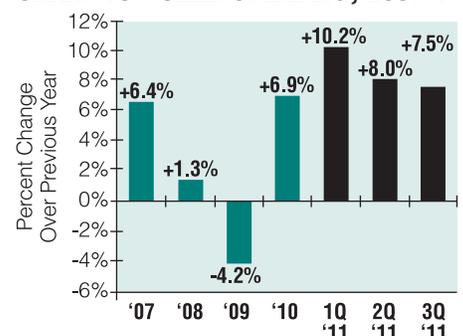


* YTD 2011 through September. Source: Honolulu Board of Realtors

internal data on credit card spending at the bank's top merchant customers (Chart 10). The recent recession is reflected in these numbers also. After flat growth in 2008 and a contraction in 2009, there was a rebound in 2010 and so far this year.

The recovery is attributable to the tourism rebound rather than local spending. But reflecting the recent tourism slowdown, the rate of card spending increase also slowed as 2011 progressed. ❄

CHART 10 • CARD SPENDING, 2007-11



Source: First Hawaiian Bank. Only includes card sales by the same company, year-over-year.

Local and National Recessions Vary In Length and Depth

By Dr. Leroy O. Laney

Chart 11 shows the last six U.S. national recessions, with U.S. employment indexed to 100 at their onset. Some lasted longer than others, but you can see examples of U-shaped, V-shaped, and saucer-shaped downturns.

This One Truly Has Been An L-Shaped Recession

For the last several years, I've been characterizing the most recent recession as L-shaped — a rapid decline followed by a very slow recovery. That's certainly proven to be the case, and now we know what an L-shaped recession looks like in the flesh. In recent months, fears have arisen that we would have a W-shaped recession, with a relapse even in that very slow recovery. And you can indeed see the recent dip in the yellow line that traces the most recent national downtick.

Hawaii's Economic Cycle Doesn't Always Mimic U.S.

But these are all national recessions, and some of them never reached Hawaii at all.

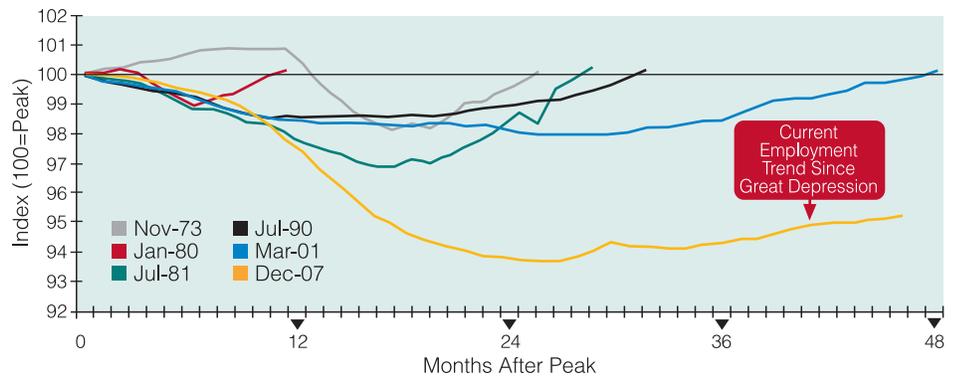
Using annual Hawaii inflation-adjusted personal income growth (Chart 12) to track the local economic cycle, there was a brief dip here in the early 1980s, but no subsequent recession until the mild but longer than average slump of the mid-1990s. That episode corresponded to a record national expansion, proof that the Hawaii cycle doesn't always mimic the national one.

Finally you see the most recent downturn, which almost the entire world has experienced.

Hawaii's Recent Job Losses Greater than in 1990s' Slump

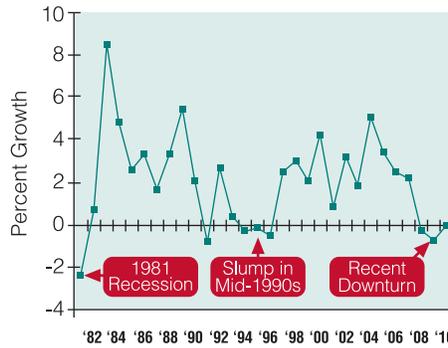
To put Hawaii's present downturn in perspective, Chart 13 shows a comparison of our shallow but long 1990s slump in the Islands to what's been going on over the last three years, with employment again indexed to 100 at the onset of both recessions.

CHART 11 • U.S. EMPLOYMENT DURING RECESSIONS AND RECOVERIES



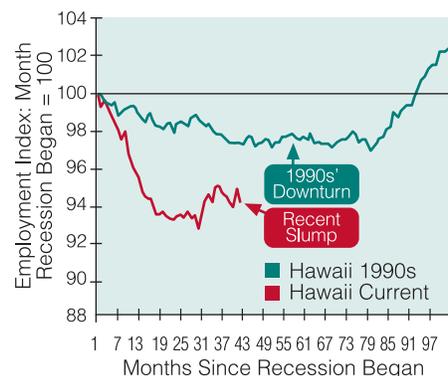
Source: U.S. Labor Department & Dr. Jack Suyderhoud, University of Hawaii

CHART 12 • HAWAII REAL PERSONAL INCOME GROWTH



Source: State Department of Business, Economic Development & Tourism

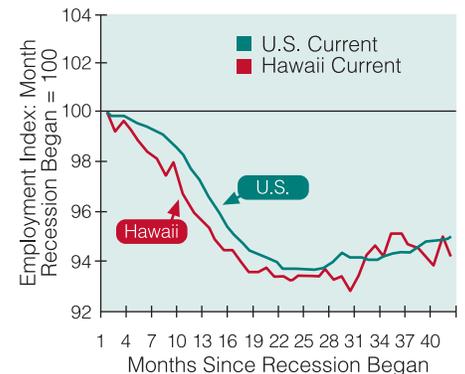
CHART 13 • COMPARING HAWAII'S 1990s' DOWNTURN TO OUR RECENT SLUMP



Source: U.S. Labor Department & State Department of Business, Economic Development and Tourism

In the 1990s, it took over seven and half years for Hawaii employment to return to its peak level, a stretch from mid-1992 to early 2000. But that employment level was never over 3% below the peak.

CHART 14 • COMPARING RECENT RECESSIONS IN HAWAII, U.S.



Source: U.S. Labor Department & State Department of Business, Economic Development & Tourism

This time, the trough was about 7% below the peak. As you saw in the earlier slide on year-over-year job growth, there have been recent gains, but a local relapse as 2011 has progressed is also apparent.

Hawaii Job Trends Mirror National Slump

How does Hawaii's recent downturn compare to the national one? As a comparison of the two lines in Chart 14 illustrates, the drop and recovery in jobs are roughly the same — though this year's national downtick seems to have occurred slightly before the local one.

So a bottom line from all this is that progress on a year-over-year basis shown in the earlier slides is good, but we still have a long way to go — at both the local and the national level — before the previous peak is approached. ✨

Neighbor Islands' Economic Recovery Led by Tourism Sector Strength

The overall forecast for the Neighbor Islands remains similar to a year ago — slow recovery, led by tourism, but held back by a mixed picture in other sectors and a downbeat construction industry.

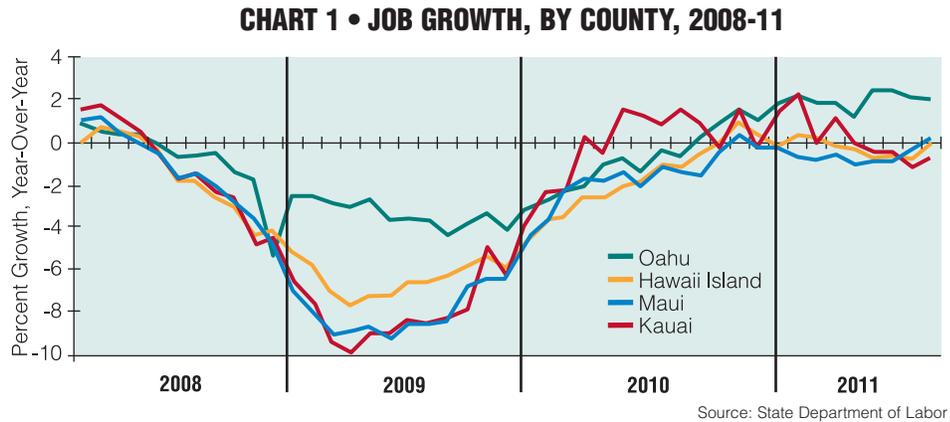
The economies of the three Neighbor Island counties are more like each other than the more diversified Oahu. Each of Hawaii's counties shares some similarities in its recovery from the recent recession, because they have all been impacted by many of the same underlying causes. Nonetheless, there are some differences even across the Neighbor Island economies.

- What distinguishes Hawaii County from its two Neighbor Island counterparts, in good times and bad, is its greater diversity. Astronomy and UH-Hilo contribute to that, and Hawaii Island has been able to hang on to a healthier and more diversified agricultural sector than any other county.
- In 2011, one thing that sets the Kauai economy apart is a somewhat more upbeat trend than the other Neighbor Island economies.
- Maui, with the exception of tourism, continues to lag both Oahu and the other Neighbor Islands in its recovery.

Chart 1 shows how job growth during our recession and recovery has been distributed across counties. Obviously most of the jobs created have occurred in Oahu's much more diversified and larger economy, not just in absolute numbers but also in percentage growth terms. That's not surprising.

While job growth on each of the Neighbor Islands has been lower than Oahu, there are some differences across the three.

- Kauai has shown the strongest growth until recently, but also had lost the most — percentage wise — during the recession.
- Hawaii County threatens to break back into positive territory, though only in some sectors.
- But Maui continues to lose jobs, the only county in the state for which



that's almost consistently the case; its visitor industry is healthy, but weakness in other sectors overwhelms that strength. Practically all economies nowadays are still below their pre-recession peaks hit in 2007. At mid-year 2011, for example, Maui was 11% below its pre-recession peak for non-farm jobs; Hawaii Island was still off 10% and Kauai still down 9% for Kauai.

Here's a look at the Neighbor Island economies, one by one:

HAWAII ISLAND:

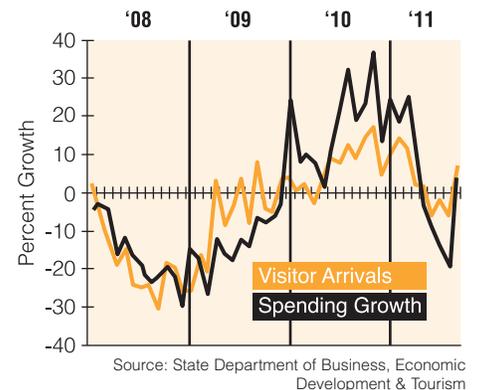
Visitor Industry Paces Slow Island Recovery

Visitor arrivals to Hawaii Island (Chart 2) have usually been registering welcome percentage gains; visitor spending growth usually surpasses even those high arrival numbers. However, Hawaii County's jobless rate remains highest in the state, something often true because of the separation of jobs in West Hawaii from the higher population in East Hawaii.

A significant development is a re-branding of the island in terms of marketing. The Hawaii Island Visitors Bureau considers the new identity for Hawaii County as "Hawaii Island" to be an important change in image.

Loss of the direct Japan Airlines flight into Kona in 2010 prompted a search for replacement airlift. Continental/United has begun direct daily 737-800 service from Los Angeles

CHART 2 • HAWAII ISLAND TOURISM GROWTH, 2008-11



into Hilo. A similar weekly flight comes from San Francisco. The last direct flight from the U.S. Mainland to Hilo was in 1983. The hope is that visitors will spend more time and money on the East side than just a rushed day trip from West Hawaii to see the volcano.

There remains a longstanding need for more updated visitor accommodations in Hilo. Since the state leasehold problems with Banyan Drive hotels make renovations there unprofitable, any addition would likely be located elsewhere.

Japan's tsunami in March 2011 did more damage to West Hawaii than elsewhere in the state, although its impact was spotty and the visitor industry did a remarkable job of getting back into operation. Four Seasons Hualalai now shows no sign of damage, with a price tag of about \$15 million. And management says it intends to get Kona Village back into operation.

Analysis by Dr. Leroy O. Laney

Construction

In 2010, a slight uptick in building permits gave rise to optimism that the island's construction cycle was turning around. But that was unsustainable; Chart 3 shows a different story for 2011. West Hawaii saw a big drop in permit values in the first quarter, breaking a positive trend, and East and North Hawaii continued to gradually decrease.

Thus, local residential construction trends mirror what is happening elsewhere. Prices of existing homes have fallen so far that one can get a better deal on a resale than a new home, so developers aren't building new product. Foreclosures and short sales continue to put downward pressure on prices.

Real Estate

Hawaii County real estate sales are still rising and prices are falling, according to 2011 data from the Hawaii Information Service. As Chart 4 shows, the rate of price decline for single-family units is about the same. The usual caveat on Neighbor Island real estate data applies here — small sample sizes can be distorted by the specific mix of transactions that occur in any given period.

Keahole Natural Energy Lab

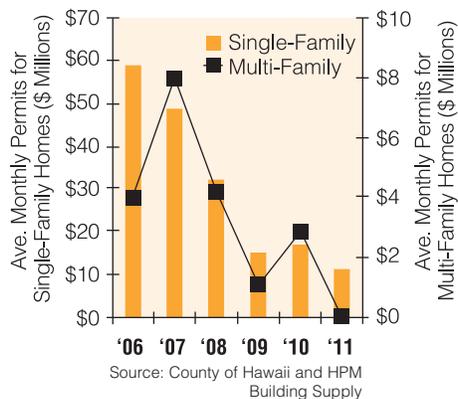
The Natural Energy Lab at Keahole Point survived the recession without losing any of its 41 tenants; its economic contribution is important. There are about 400 employees, and combined tenant revenues total about \$50 million. Around half comes from five bottled water operations (mainly selling to Japan), and the other half from aquaculture.

Thirty Meter Telescope

Development of the Thirty Meter Telescope (TMT) telescope atop Mauna Kea remains on track. The permit application was approved in February 2011 by the Board of Land and Natural Resources.

It is hard to overestimate the importance of this project for jobs, the construction industry, UH-Hilo base facilities and the image of the island

CHART 3 • HAWAII COUNTY BUILDING PERMIT VALUES



generally. A payroll of 140 permanent employees, not including contractors, and an estimated annual budget of \$26 million are only the beginning. Because TMT is the first of an entirely new generation of telescopes, its Hawaii location ensures the primary role of the state and county in astronomy's future. Based on requirements of current observatories and the creation of new positions with the TMT, it has been estimated that nearly 500 new observatory jobs will open up through 2023.

TMT will be the world's largest and most advanced optical/infrared observatory. Construction will extend over most of a decade, with the first scientific applications scheduled for 2018.

UH-Hilo

The growing presence of UH-Hilo puts Hilo on the road to becoming a "university town." One development in 2011 is graduation of the first class at the new Hilo College of Pharmacology. Also, the Western Association of Schools and Colleges recently approved a Doctor of Pharmacy program.

Additions to the campus in recent years have been several, and more are in the pipeline, including a new Office of Student Services Building and new student housing, which is critical for expansion. With an enrollment of 4,000 students, UH-Hilo now has only 600 beds on campus and estimates that it loses 350 admitted students each fall for lack of housing.

CHART 4 • HAWAII COUNTY REAL ESTATE SALES AND PRICES (% GROWTH OVER PRIOR YEAR)

Sales	2010	YTD 2011
Single-Family	+21%	+8%
Condominiums	+58%	+19%
Median Price		
Single-Family	-7%	-7%
Condominiums	-10%	-17%

Source: Hawaii Information Service
YTD 2011 through September

Diversified Agriculture

The Big Island's agriculture sector brings valued diversification, even though trends are often mixed:

- Cattle prices have rebounded from 2010 lows, but drought has affected herd size and conception rates.
- The number of growers of potted dracaena has shrunk due to low demand and strict quarantine issues in California.
- The 2010-11 macadamia nut crop was depressed due to effects of prior drought. Another downward pressure on supply has been the exodus of many independent farmers due to low return on investment. Prices have been holding at 2010 levels due to the shortages.
- The Kona coffee crop is expected to be significantly larger in 2011, closer to normal annual production. The coffee borer is expected to have some impact on the industry, however. Prices are expected to remain about the same as 2010. ✨

MAUI COUNTY:

Economy is a Mixed Bag — Tourism Robust, Construction Lags

Maui's economy this year is a mixed bag. The visitor industry is doing extremely well, thanks to its resilient upscale image (with resulting higher room rates) and a welcome growth in airlift, including flights from secondary Mainland cities. However, even the

—continued on page 8

Maui County (continued from page 7)

crucial tourism sector cannot be relied upon completely to bring Maui back to better times, and the job total continues to struggle to return to pre-recession levels.

Unfortunately, other sectors of Maui's economy — especially the construction industry — continue to lag significantly. Efforts to diversify the local economy are ongoing and admirable, but the smaller a local economy is, the more elusive the diversification goal becomes. There remains a stark contrast between the current Maui jobless rate and the 2% number that prevailed in the peak year of 2007.

Maui Tourism

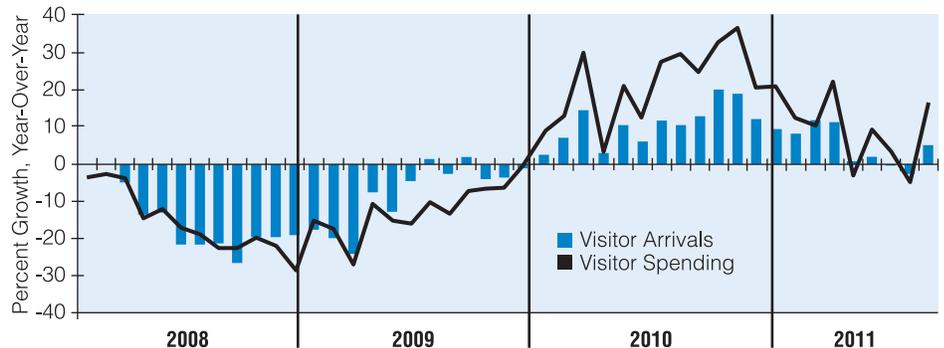
The Maui visitor industry is doing extremely well, as Chart 5 shows, especially considering the lingering effects of recession in the major markets that supply the bulk of the island's visitors. Part of the reason lies in the fact that Maui continues to hang on to its valuable reputation as a very upscale place for a tropical vacation. And on Maui, more than a lot of similar destinations, there seems to be greater recognition on the part of local residents that tourism is critically important to the economy.

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

Maui has been picking up direct flights by Hawaiian and Alaska Airlines from secondary cities in the U.S. and Canada. Canadian business also has been helped by the strong exchange rate for the Canadian dollar.

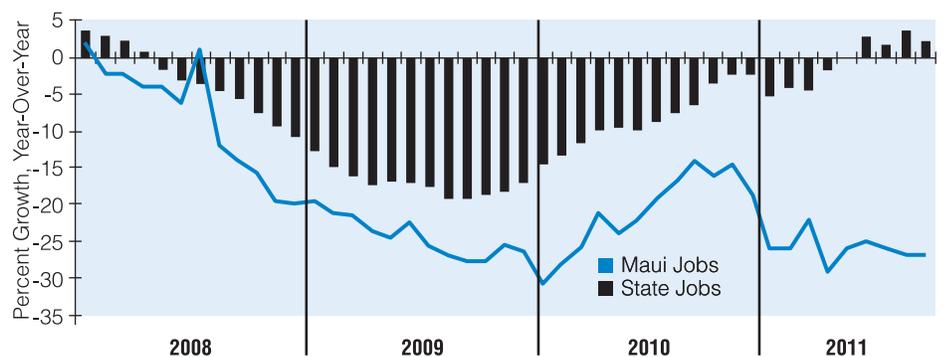
The strong visitor industry has enabled Maui hotels to raise their room

CHART 5 • MAUI TOURISM GROWTH, 2008-11



Source: State Department of Business, Economic Development & Tourism

CHART 6 • CONSTRUCTION JOBS: STATE VS. MAUI, 2008-11



Source: State Department of Labor

rates. Now, Maui once again has the highest average daily room rate in the state. So reputation does pay off.

Construction

One major reason that Maui lags in job creation is the weakness of its construction sector (Chart 6), which is showing continued job losses. Residential construction is weak just about everywhere nowadays, but Maui does have some added hurdles: the 50% affordable housing component requirement and the "show me the water" ordinance mentioned in previous editions of this report.

But help may be on the way. The County administration is pushing for more public sector construction and an expediting of the permit process and there are these other positive signs for the industry:

- Hyatt is planning a time-share tower in West Maui.
- Alexander & Baldwin's Maui Business Park Phase II, 179 acres of

CHART 7 • MAUI REAL ESTATE (% GROWTH OVER PRIOR YEAR)

Sales	2010	YTD 2011
Single-Family	+17%	+8%
Condominiums	+39%	-1%
Median Price	2010	YTD 2011
Single-Family	-8%	-6%
Condominiums	-16%	-20%

Source: Realtors Association of Maui YTD 2011 through September

light industrial development, is ramping up in Kahului.

- Ground has been broken for a long-needed 138-room Courtyard by Marriott hotel in Kahului near the airport.

Real Estate

Maui real estate is subject to some of the same trends as construction. In 2011, sales for both single-family and condos (Chart 7) have leveled off, after strong increases in 2010. And median prices have continued to fall.

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

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

UH Maui College

One growth area in the Maui economy, which also helps to diversify it, is the recently renamed UH Maui College. Replacing the old Maui Community College label reflects the addition of four-year degrees to its curriculum, the first UH community college to grant such degrees.

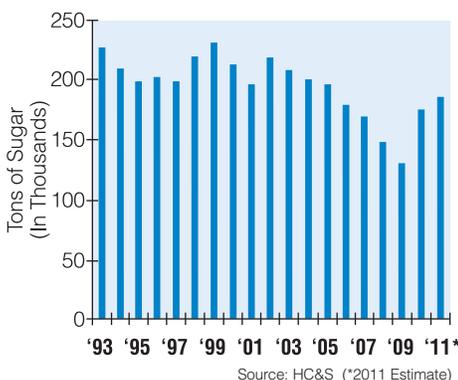
Student enrollment at UH Maui is now almost 4,400, up 33% over the past two years. Its new \$25 million Science Building is now being used.

HC&S Sugar Plantation

Agriculture on Maui is always dominated by HC&S, Hawaii's sole remaining sugar plantation. There, things have been looking up recently, with annual production back in a profitable range after two years of very low total production and yields per acre. (Chart 8)

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

CHART 8 • HC&S SUGAR PRODUCTION



HC&S is important to the Maui economy because:

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

KAUAI COUNTY:

Strong Tourism Gains Fuel Upbeat Economic Trend

Kauai'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 practically everywhere nowadays.

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.

Tourism

The snapback in Kauai tourism (Chart 9) has been strong. In some recent months, growth in Kauai visitor numbers has easily topped the other islands and the state as a whole. Kauai can also thank its strong brand image and stable time-share segment.

- 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.
- 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.

Film Industry

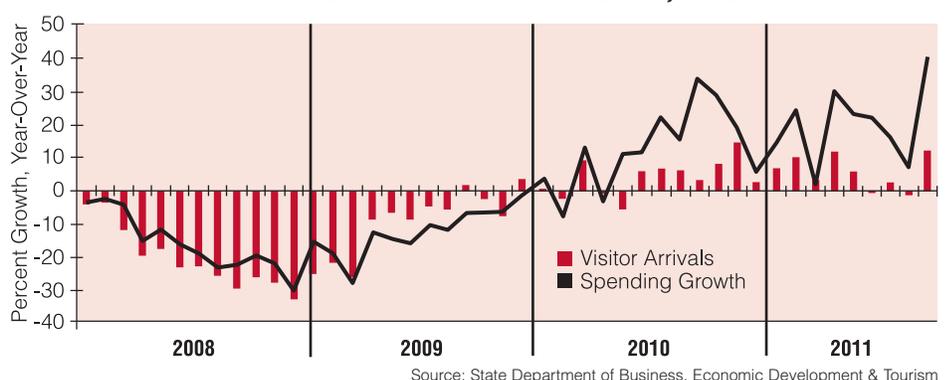
Kauai, a prime location for movies and TV films, had a very good year in 2010, with four feature films on-island — Sony Pictures' *Soul Surfer* (about island native Bethany Hamilton) and *Just Go With It*, Disney's *Pirates of the Caribbean: On Stranger Tides*, and Fox-Searchlight's *The Descendants*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

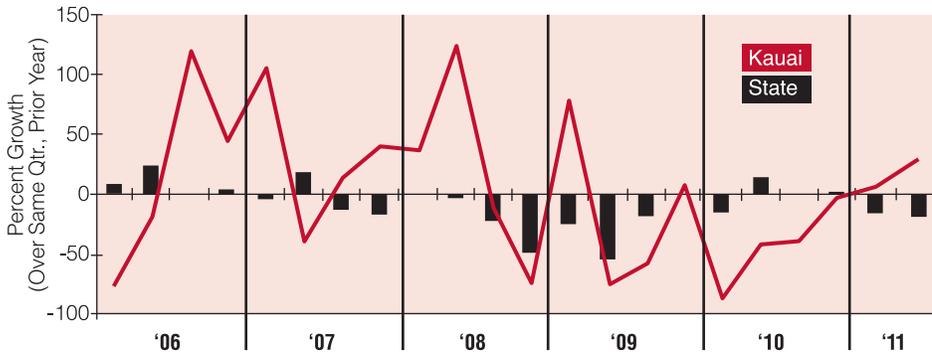
Construction

One of the reasons Kauai job growth has been stronger than other Neighbor Islands is greater strength in
—continued on page 10

CHART 9 • KAUAI TOURISM GROWTH, 2008-11



**CHART 10 • CONSTRUCTION PERMIT GROWTH:
STATE VS. KAUAI, 2006-11**



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

Kauai County (continued from page 9)

its construction sector, thanks in part to public projects such as the continued widening of Kaunualii 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. With the Lihue Big Save going out, that Safeway will fill a void in the market that was unforeseen earlier.

However, some sources see a lull coming in Kauai construction, despite a slight uptick in Kauai private construction permit growth in the first half of 2011 (Chart 10). So the industry may rely more in the future on state projects in the works such as another \$46 million for Kaunualii Highway, Port Allen harbor repair, Kapa'a School library, and airport improvements.

Real Estate

Data for 2011 from the Hawaii Information Service (Chart 11) show sales for single-family units are leveling off. Median prices for single-family units have been rising faster thus far in 2011,

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 a significant proportion of transactions are foreclosures and short sales, putting downward pressure on prices. As another indicator, Kauai Association of Realtors reports that the number of Realtors on the island has dropped almost 40% from the peak.

Pacific Missile Range

The Navy's Pacific Missile Range Facility (PMRF) 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.

The range has spawned further

**CHART 11 • KAUAI REAL ESTATE
(% GROWTH OVER PRIOR YEAR)**

Sales	2010	YTD 2011
Single-Family	+38%	+7%
Condominiums	+48%	-9%

Median Price	2010	YTD 2011
Single-Family	+3%	+20%
Condominiums	-12%	-26%

Source: Hawaii Information Service
YTD 2011 through September

development of the high-technology industry on Kauai. Forty employees, representing seven companies, currently work out of West Kauai Technology and Visitor Center facilities, adding economic diversification, and two Tech Center alumni have 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

Kauai's seed corn industry continues to expand its crop base and infrastructure. The island is an ideal research laboratory for the industry because at least three crops per year can be grown, compared to one or two on the Mainland. 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. ❄

U.S. & Global Outlook for 2012: Teetering on the Edge

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

The Great Debt Debate

In the wake of the Great Recession policymakers in the U.S. and Europe have been absorbed in contentious debates about debt. The debt was the result of low interest rates and liquidity that fueled careless lending and consumer borrowing in the early 2000's. The collapse of the U.S. housing bubble caused financial failures both here and abroad followed by significant declines in real economic activity.

Governments around the world pursued expansionary monetary and fiscal policies to fight the recession, but this worsened the pre-existing long-term (structural) deficit and debt problems. Now, two years into a fitful and tepid recovery, politicians and central bankers find themselves in a tough place: how to continue to provide necessary short-run stimulus while dealing with the structural imbalances and deficits that dampen future economic prospects. The inability to deal with this conundrum on either side of the Atlantic has cast a pall over the near-term economic prospects.

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 20 years we have opted to consume more and borrow more, mostly in the form of mortgages. Chart 2 shows how household debt grew while mortgage interest rates 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 caused 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

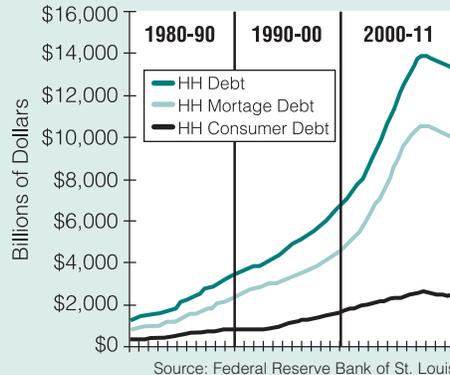


CHART 2 • U.S. HOUSEHOLD DEBT & MORTGAGE INTEREST RATES, 1980-2011

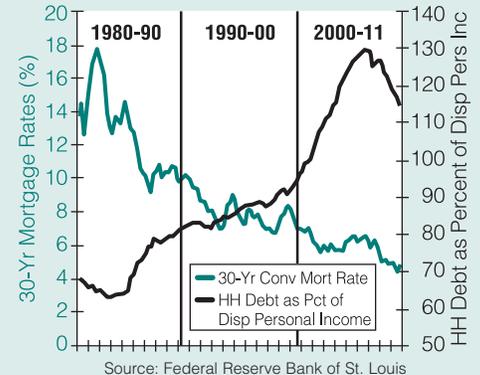
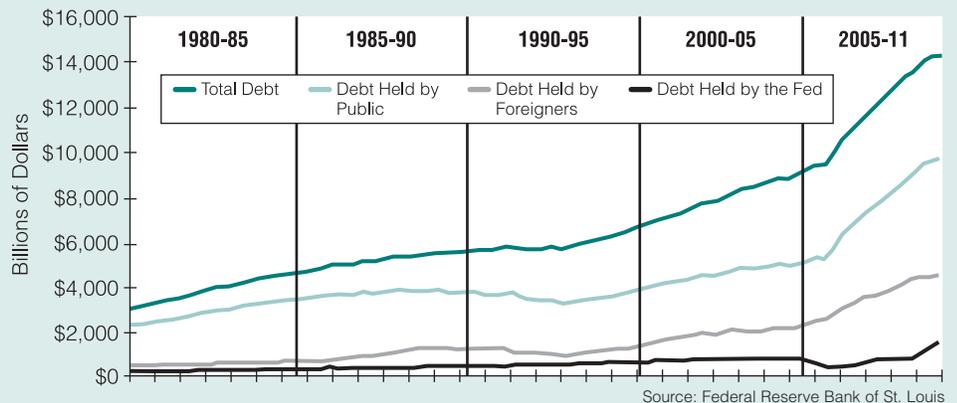


CHART 3 • U.S. FEDERAL GOVERNMENT DEBT, 1990-2011



Security and state-local pension underfunding we can understand why ratings agencies have begun to express doubt about U.S. fiscal prospects.

Ways to Reduce Public Debt

There are several ways of reducing public debt. The most troubling is default. 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 austerity — raising taxes and/or reducing spending. Since our deficits are so high (about 9% of GDP for FY 2011) and the Federal budget is so constrained by "mandatory" spending, debt reduction through spending cuts will be painful.

Likewise, getting agreement on revenue increases seems politically impossible.

The least painful way to deal with debt is through increased growth of the economy. If the economy grows faster than debt, the debt will become a smaller relative burden.

2011: The Soft Patch

But adequate, self-sustaining growth has yet to materialize. 2011 has not been as strong as 2010 and has turned even softer than expected. The potential for a "double dip" has increased as forecasters adjust their expectations downward.

Job growth has finally returned, but it has not been sufficient to bring the national unemployment rate down significantly (Chart 4, on page 12). The housing sector has remained in a state of depression. As a result, while

—continued on page 12

U.S. & Global Outlook

(continued from page 11)

consumer spending has rebounded, consumer confidence remains low.

At the same time, the fiscal stimulus packages of 2009-10 have run their course. In fact, austerity at the state-local government level and the lack of agreement (to date) on yet another federal stimulus package means that fiscal policy is now a short-term drag on the economy. This leaves the Fed as the only potential stimulus through yet another round of quantitative easing, and it seems prepared to do so.

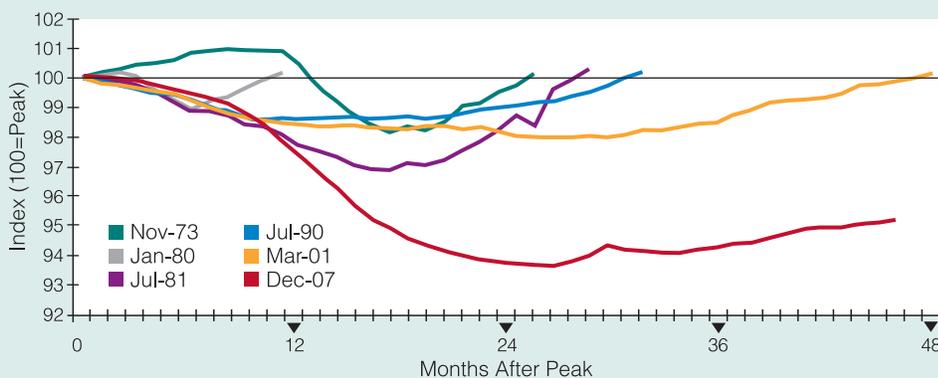
The Outlook

The outlook for the rest of 2011 and 2012 depends largely on political decisions in Washington and Europe. I am hopeful that the Europeans will agree to a credible plan to manage their sovereign debt crises. If not, Europe will fall into recession, and that will damage U.S. growth. I am not optimistic that the U.S. politicians can agree to a plan to deal with structural debt issues until after the 2012 elections. The uncertainties here and in Europe will be a drag on the economy.

Developed Economies: Modest growth returned to developed economies in 2010-11, including Europe. However, even if they manage their debt crises, European growth is expected to slow in 2012. Of the major economies, only Japan is expected to have negative growth in 2011, due to the effects of the earthquake, tsunami, and nuclear problems. However, 2012 will be better due to reconstruction.

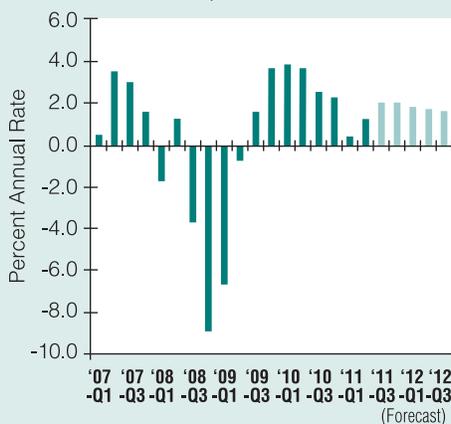
Asian Economies: The picture looks much better in the Asia-Pacific region. China, Korea, India and Australia will all have growth rates above the global average. Starting in 2010 the central banks in these countries began to raise interest rates to try to avoid inflation and cool off torrid growth. In fact, the possibility of China's property bubble bursting has raised concerns that China's economy may experience a "hard landing" as it slows its growth.

CHART 4 • U.S. EMPLOYMENT DURING RECESSIONS AND RECOVERIES



Source: Federal Reserve Bank of St. Louis

CHART 5 • U.S. REAL GDP GROWTH, 2007-2011-Q2 AND FORECASTS



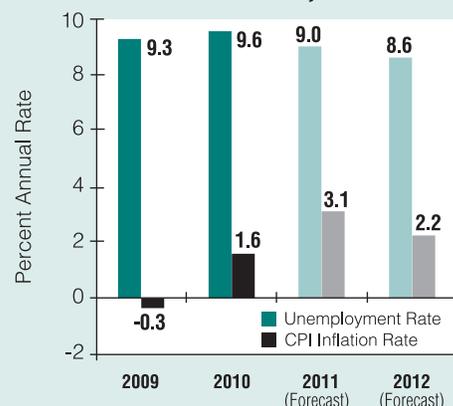
Source: Federal Reserve Bank of St. Louis

U.S. Forecast and Risks: In the first half of 2011 U.S. GDP growth was disappointing: less than 2%. Because of the political uncertainties at home and abroad, I don't expect GDP growth (Chart 5) to pick up significantly in the second-half of 2011. 2012 will be similarly burdened by the lack of political clarity and fiscal austerity measures so that growth will remain well below the 3% needed to reduce unemployment. As a result, the unemployment rate (Chart 6) will remain near 9% through 2011 and 2012. Inflation will see a bit of a bump in 2011, but remain in check through 2012.

The combination of slow growth, the absence of significant inflation, and the Fed's commitment to accommodative monetary policy will keep interest rates (Chart 7) at historically low levels.

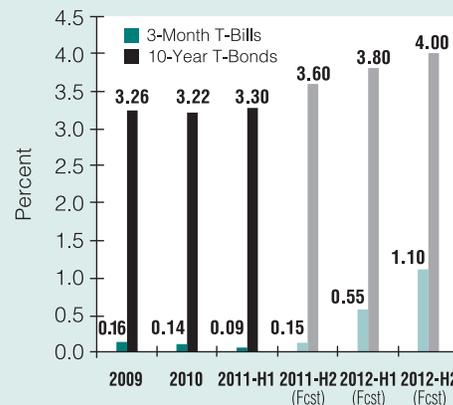
Unfortunately, the risks to this

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

forecast are on the downside. If the Europeans fail to address their debt issues, if U.S. politicians get it wrong, if China has a hard landing, another recession will occur in 2012 or 2013. ✨