

Economic Forecast

OAHU EDITION 2012 - 2013

Hawaii's Tourism Industry Continues to be Robust; Other Economic Sectors Getting Brighter

For the past several years, our economic forecast for Hawaii has been roughly the same — and, as it has turned out, quite accurate: A gradual recovery following the steep dropoff in 2008 and 2009. Digging our way out of the trough from the Great Recession has been very slow, like everywhere else, but on a more optimistic note it has been fairly steady.

There are some bright spots besides robust tourism. Those bright spots — in a housing market that shows signs of turning, in retailing, in auto sales, and in some other areas — are cause for cautious optimism.

Hawaii's economy lives or dies by its main export industry, tourism. We can be very thankful for the visitor industry strength, because many regional economies haven't seen their economic mainstay recover so quickly and so strongly. But why has visitor industry strength not yet spread to other sectors of the economy?

Two thoughts:

- First, Hawaii, like practically everywhere else, has been buffeted by extraordinary headwinds that didn't exist in previous recoveries. There have been enormous reductions in personal wealth. The Federal Reserve found that the median net worth of American households — assets such as homes, cars, and financial assets minus any debt — fell by almost 40% from 2007 to 2010. Such a reduction put that median household back to 1992, two decades ago, and it takes time to recover from that. That, plus job uncertainties, have

FORECAST FOR 2013

	2012 (Estimate)	2013 (Forecast)
Visitor Arrivals	+9.0%	+3.5%
Job Growth	+1.1%	+2.0%
Unemployment Rate	6.2%	5.7%
Inflation	+2.8%	+2.5%
Real Personal Income Growth	+1.5%	+2.0%
Real Gross Domestic Product	+1.5%	+2.3%

Source: Dr. Leroy O. Laney

taken a toll on consumer and business confidence, especially smaller businesses. Residential building ground to a complete halt, and local government was forced to take draconian measures.

- Second, it could be a lot worse. Hawaii's unemployment rate has always been significantly lower than the national rate since the bottom dropped out. Of course, if you want to live in North Dakota, the unemployment rate is around 3%. But in California it's close to 11%; in Nevada just under 12%. So maybe "lucky you live Hawaii" does still have some meaning.

Laney's Forecasts:

- **VISITOR ARRIVALS — +3.5% in 2013:** Visitor arrivals growth could easily break a strong 9% in 2012. So far they have even been running slightly higher than that. But strong growth this year means it will be hard to sustain it next year. The visitor industry should remain strong, and added airlift will help.

But hotel occupancies, for example, have been running so high this year in many places that there doesn't remain much room for expansion close to what we have seen this year. Something in the 3% range would be quite respectable.

- **JOB GROWTH — +2.0% in 2013:** In 2012, job growth has been running about 1% over last year. But if you take out the visitor industry that growth is closer to zero. It could come in at just over 1.0% this year, and, as the recovery takes hold, could accelerate to 2.0% in 2013. Other than the visitor industry, the strongest categories will likely be services including

—continued on page 2

ON THE INSIDE

6 Neighbor Island Economies

11 The Recession's Lingering Grip

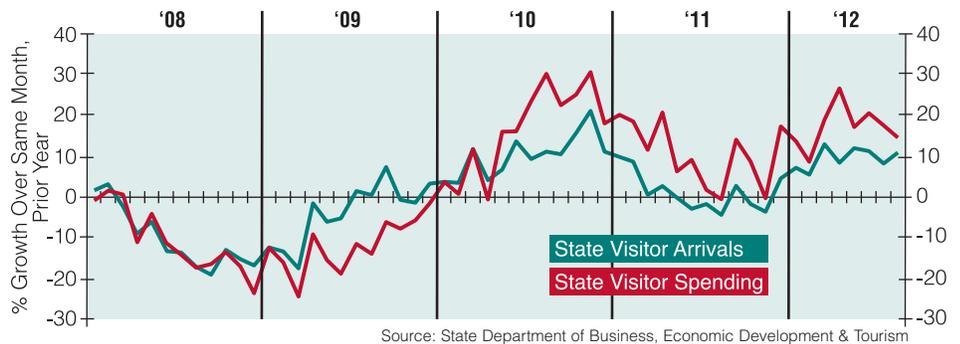
Tourism Continues to be Robust

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health care, wholesale and retail trade. Government job growth is likely to be one of the bigger drags on overall job creation.

- **UNEMPLOYMENT RATE — 5.7% in 2013:** Hawaii's jobless rate has been trending down over the last several years, but very slowly. The rate could end up in the mid-5% range for 2013, but it would take some unforeseen positive development to take it below 5%.
- **INFLATION — +2.5% in 2013:** Global economic conditions remain fragile, but that has a silver lining of keeping a lid on energy prices. That can be especially good for Hawaii because of the impact on airfares. Overall inflation should hover in the 2% range, maybe coming down if we're lucky. Even with a potential rebound in home prices, it will take a while for rises in the shelter component of the CPI to kick in.
- **REAL PERSONAL INCOME GROWTH — +2.0% in 2013:** Inflation-adjusted personal income growth has been fluctuating around 1% for the past two years, after dipping into negative territory in 2008 and 2009. In 2013, with any consolidation in the recovery and an end to state pay cuts, it could hit 2% — though probably not much above that.
- **REAL GDP — +2.3% in 2013:** Something in the mid-1% range this year and the mid-2% range in 2013 are plausible projections.

CHART 1 • VISITOR INDUSTRY GROWTH, 2008-2012



Tourism

The visitor industry is Hawaii's central locus of recovery, and Chart 1 shows how visitor arrivals and spending have held up recently. After the dark days of 2009, Hawaii's visitor industry snapped back with an alacrity that surprised some. It had something of a relapse in mid-2011, with Japan's tsunami, but has come back strongly again this year. Besides these two gauges of the industry, other measures — hotel occupancies, visitor days, length of stay, person-per-day spending and person-per-trip spending — are all performing solidly.

Added airlift has helped, from Alaska and Allegiant, for example, as well as added routes by Hawaiian Airlines. This bodes well for the future. Smaller cities on the Mainland are now being served with direct flights, and added international flights will bring more visitors from emerging markets. In the future, growth in both the local airline industry and in tourism itself will depend more on growth in those emerging markets rather than more mature sources of visitors.

Construction

The construction industry usually plays a larger role in the local economy than it does at the national level. Throughout this period of economic weakness, construction has been one of the biggest lagging sectors. Much of that has been due to the dearth of residential construction, but Chart 2 shows that some life is returning in the construction tax base.

CHART 2 • CONSTRUCTION TAX BASE, 2006-2012

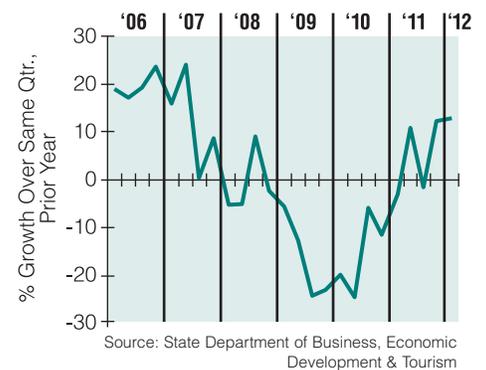
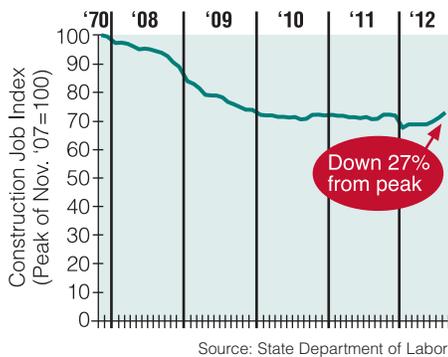


CHART 3 • STATEWIDE PRIVATE PERMITS, 2006-2012



Private building permits (Chart 3) lead to future building activity. The recent surge is mostly due to high-rise condos in Kaka'ako and non-residential activity in shopping center development and resort-related activity. There is not much sign of life yet in residential building, but the recent overall growth is encouraging. It's apparent from both Charts 2 and 3 that the construction sector's contribution has been slow to come back because it has had to

CHART 4 • STATE CONSTRUCTION JOB INDEX



emerge from a deep slump at the height of the recession.

Construction jobs (Chart 4) are still nearly 30% below the peak (indexed to 100 in November 2007). Two recently approved housing projects on the leeward side of Oahu will eventually be felt, but that may be slow in coming.

Retailing

Strength in the retail sector is also corroborated by growth in the retailing tax base (Chart 5), which in 2011 and early 2012 reached a rate of growth matching or sometimes exceeding the boom years of the mid-2000s.

Chart 6 is a good indicator of spending in the Hawaii economy by category, taken from same-store credit card spending among First Hawaiian Bank's merchant customers. Growth still seems concentrated in categories influenced by visitors, but there are signs that spending is spreading to other sectors — such as automotive, home improvement, supermarkets, and home furnishing.

Vehicle Sales

Another sign of an improving local economy is found in new car and truck sales (Chart 7). New vehicle registrations in Hawaii were up an impressive 20% in the first half of 2012, and the Hawaii Automobile Dealers Association projects a 16% increase for the entire year followed by another 9% growth in 2013, bringing the total to 47,000 vehicles. That's well below the peak of over 70,000 in 2005, but the direction is right. In 2009, the low was under 34,000.

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CHART 5 • STATEWIDE RETAILING TAX BASE, 2006-2012

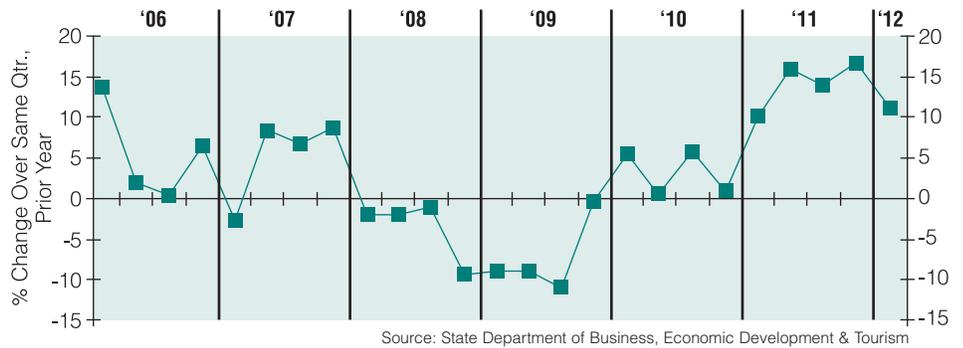


CHART 6 • FIRST HAWAIIAN BANK BUSINESS ACTIVITY REPORT, 2011 VS. 2012

January - August Sales			
Industry	2012	2011	% Change
Shipping	\$ 38,987,158	\$ 33,214,687	17.4%
Convenience Stores	\$ 44,011,860	\$ 38,546,189	14.2%
Other	\$ 197,058,078	\$ 173,500,339	13.6%
Hotels	\$ 431,899,735	\$ 381,495,491	13.2%
Utilities, Communications	\$ 141,770,488	\$ 126,082,681	12.4%
Travel Activities	\$ 99,449,351	\$ 89,226,675	11.5%
Restaurants	\$ 306,398,094	\$ 277,629,561	10.4%
Retail	\$ 238,930,445	\$ 217,589,920	9.8%
Automotive	\$ 97,605,041	\$ 90,071,206	8.4%
Supermarkets	\$ 27,334,854	\$ 25,232,242	8.3%
Medical Services	\$ 75,675,628	\$ 69,908,527	8.2%
Home Improvement	\$ 85,247,064	\$ 81,604,176	4.5%
Automotive Parts, Svcs. & Accessories	\$ 35,755,190	\$ 34,320,230	4.2%
Home Furnishing	\$ 66,074,119	\$ 64,057,032	3.1%
Insurance	\$ 26,885,793	\$ 26,319,834	2.2%
Travel Agencies	\$ 70,588,824	\$ 84,026,564	-16.0%
	\$ 1,983,671,722	\$ 1,812,825,355	9.4%

Source: First Hawaiian Bank

CHART 7 • HAWAII NEW VEHICLE SALES, 1989-2013



Tourism Continues to be Robust

—continued from page 3

Real Estate

More good news may be in the wings for Honolulu real estate, which has had its ups and downs in recent years. Record low mortgage rates have boosted affordability, but 2010's surge in sales (Chart 8) after five years of declines wasn't repeated in 2011, which saw a slight decline. This year so far there has been a mild increase, but in recent months the number of sales has been accelerating some.

As for median prices (Chart 9), 2009's drop of almost 8% was followed by rough stability — up 3% in 2010 and down 3% in 2011, a better picture than many Mainland markets. As we look ahead, the stage is being set for better performance. Honolulu median price growth tends to move in steps, a price boom followed by several years of much milder decline, then another boom.

We may be on the verge of the next upswing. So far this year, median prices have risen about 9%, the best performance since 2005. By 2013, it's quite possible the old record high for median prices will be broken, thanks to low inventory, the famine of new residential construction, and low interest rates. Once an upswing starts, it usually gains momentum. That's all the better news for the overall economy, because real estate upswings usually coincide with better economic performance generally.

CHART 8 • OAHU SINGLE-FAMILY HOME SALES GROWTH, 1986-2012

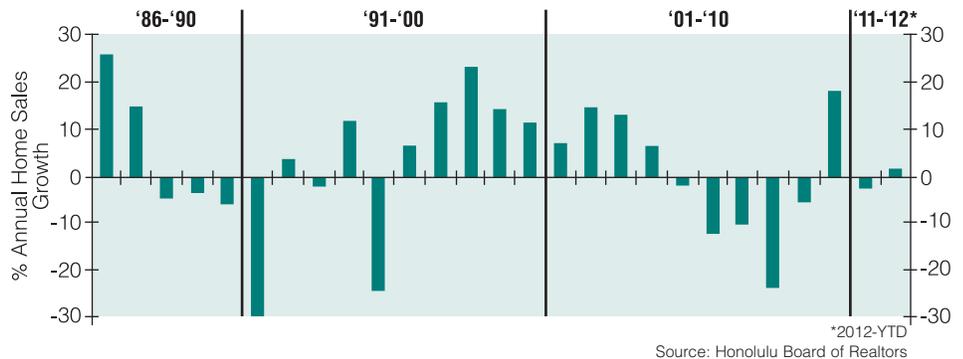


CHART 9 • OAHU SINGLE-FAMILY MEDIAN PRICE GROWTH, 1986-2012

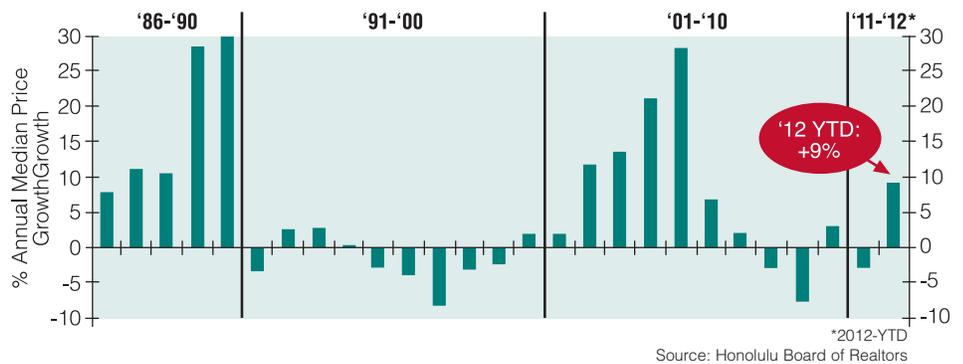
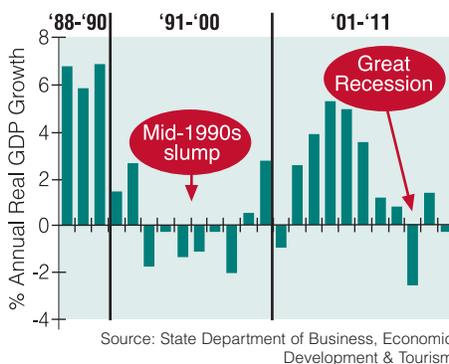


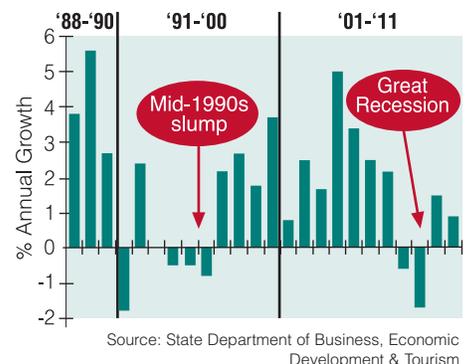
CHART 10 • HAWAII REAL GDP GROWTH, 1988-2011



Real Gross Domestic Product

Real (or inflation-adjusted) Gross Domestic Product (Chart 10) shows the broadest measure of a state economy. After a disastrous 2009, Hawaii came back to positive growth fairly quickly in 2010 — nothing to compare with earlier boom years, but not as bad as some might have thought. The Great Recession was deeper than the 1990s' slump, but didn't last as long. A recent fairly large revision to

CHART 11 • REAL PERSONAL INCOME, 1988-2011



Real GDP put the 2011 growth number back into negative territory.

Real Personal Income

Real Personal Income Growth (Chart 11) reveals a similar picture— a recession followed by modest growth, but not the prolonged malaise of the mid-1990s.

A Look at Hawaii's Jobs Picture

By Dr. Leroy O. Laney

Most people don't look at some of the broader statistical measures of the economy, but perceive the job creation scene to be a better and more direct gauge of their overall welfare. And Chart A presents a more somber picture. The lines in the chart are indexes of jobs set equal to 100 at the peak of three recessions: the long slump Hawaii experienced in the 1990s, the recent Hawaii downturn, and the current national job creation picture.

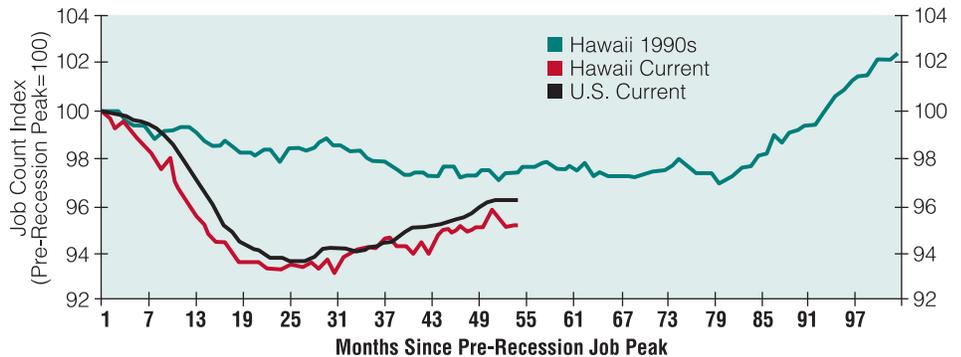
Hawaii's 1990s' downturn (the teal line) was unexpected by many, and it took the Hawaii economy almost eight years to get back to the same level of jobs that existed when recession hit.

But while it was drawn out, that slump was not nearly as deep as the more recent situation. Both the nation as a whole (black line) and the local economy (red line) felt the initial impact on jobs acutely. Both have been slow to recover. Overall, Hawaii jobs now hover about 5% below their peak. Until that previous peak is reached, we are technically still in a "recovery," not an "expansion."

Chart B, which compares jobs added or lost by major sector from mid-2011 to mid-2012, shows job growth spread unevenly across sectors. Job creation in the visitor industry has dwarfed all other sectors, which added together are a mixed bag. After visitor jobs, trade, transportation and utilities came in second. Much of that was retail job creation, but recall that a significant portion of Hawaii retailing is also tourism-related. Another source of strength in this sector comes from national retail chains making increasing incursions into the local market.

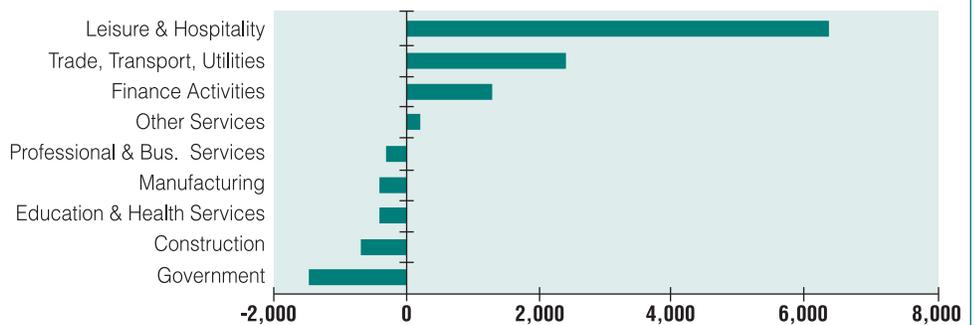
The unevenness of Hawaii's economic recovery also has a geographic dimension. Chart C, an index of jobs by county, with the peak year of 2007 set equal to 100, shows Neighbor Island counties lagging Honolulu's more diversified economy. A little more strength this year can be found in Maui than on either Hawaii Island or Kauai.

CHART A • COMPARING JOB IMPACT OF RECESSIONS



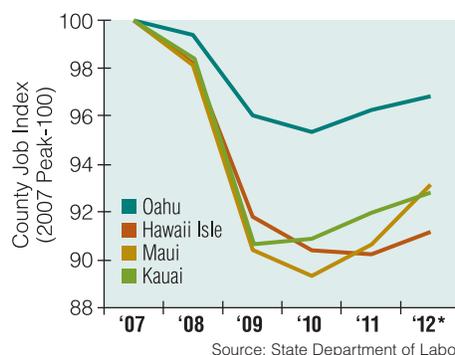
Source for the original data: State Department of Labor, U.S. Department of Labor

CHART B • JOBS ADDED, LOST BY SECTOR, 2011-2012



Source: State Department of Labor

CHART C • JOB INDEX BY COUNTY, 2007-2012

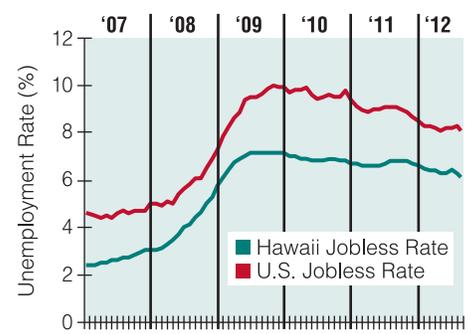


Source: State Department of Labor

The Neighbor Isles usually lag in their recoveries, but this time that lag might surprise some in that tourism is the center of economic strength and their economies generally are more dependent on tourism. It's just that tourism's strength has not spread to other sectors very well anywhere in the state.

Hawaii's unemployment rate (Chart D) shot up from record low levels as the Great Recession hit, and has been very slow to come down.

CHART D • UNEMPLOYMENT RATE 2007-2012



Source: State Department of Labor, U.S. Department of Labor

Hawaii's jobless rate has consistently been about two points below the national rate, but consider the fact that Hawaii's service economy has an unusually high number of multiple job holders, and if you lose one of your several jobs you are still employed. In addition, the unemployment rate can fall when discouraged workers just give up looking for another job, which means they are no longer counted as unemployed.

Maui No Ka Oi Among Neighbor Island Economies

Thanks to stronger job creation, a continued robust visitor industry and growing strength in construction, Maui is doing considerably better economically than the other Neighbor Islands.

For the past couple of years, one of the biggest underlying messages about the state economy has been the contrast between the recovering tourism sector and lagging construction. In 2012, for Maui at least, that message is changing. Maui is the only Neighbor Island that exhibits much in the way of current or near-term growth prospects in the construction sector.

CHART 1 • MAUI CONSTRUCTION JOBS, 2007-2012

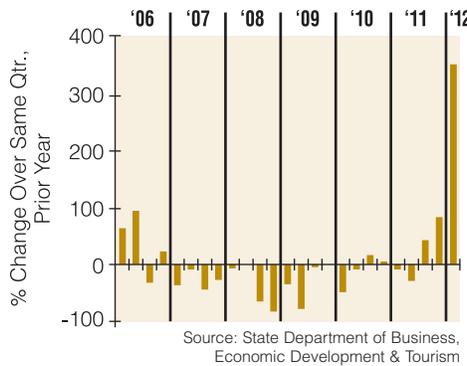


Maui construction jobs (Chart 1) have shown an uptick recently, the only one of the four counties to see that kind of increase. This is one of the reasons for overall Maui job gains. Most of the construction is commercial, not residential, so it's mainly bigger contractors that are doing well, with some continued shakeout among smaller ones.

Chart 2 shows a striking 350% increase in private construction permits on Maui for the first quarter of 2012 compared to the same quarter of 2011. Any time one sees that kind of surge, it's probably due to a few major projects. These ventures are under way or in the pipeline:

- Courtyard by Marriott, an Alexander & Baldwin hotel, had its grand opening in July. This \$16.5-million, 138-room hotel is minutes from Kahului Airport and well suited for several markets: interisland business

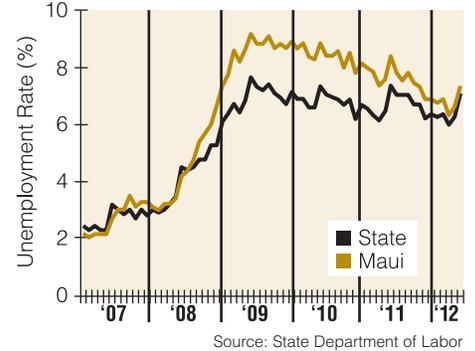
CHART 2 • MAUI PRIVATE CONSTRUCTION PERMIT GROWTH



travelers, state residents in sporting events, flight crews, and visitors who miss or have delayed flights. The property should do well.

- A&B's 179-acre Maui Business Park Phase II, zoned for light industrial use close to Kahului and near the harbor. Lot closings are anticipated for late 2012.
- The Andaz Wailea hotel project, renovation of the shuttered Renaissance hotel as a boutique accommodation (part of the Hyatt family). It's due for an early 2013 opening.
- Maui Lani Village Center. Adding to existing tenants like Paradise Beverage, Oceanic Time Warner, and the Mormon Church are others in the building process — like Walgreens and Ace Hardware.
- Kaheawa Wind Farm Phase II added 14 more wind towers to the existing 20 on the ridge above Ma'alaea. And Ulupalakua Auwahi wind farm has broken ground for eight more turbines on the slopes of Haleakala.
- The master-planned Honua'ula project in Wailea received environmental approval in July. It envisions up to 1,150 housing units above Wailea Resort, a golf course, clubhouse, and retail/commercial components, plus 250 affordable housing units off-site.
- Also being planned is a Consolidated Car Rental Facility at the airport.

CHART 3 • UNEMPLOYMENT: MAUI VS. STATEWIDE, 2007-2012



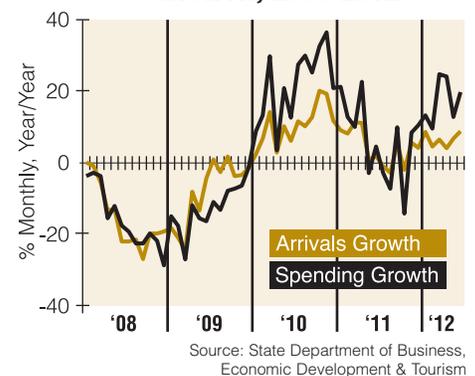
A Look at Sectors of the Maui Economy

Jobs: Jobs in each of Hawaii's four counties peaked in December 2007, the same month the national economy entered recession, and the job count has been climbing out of the post-recession hole ever since. At the deepest part of the Great Recession, Maui was bringing up the rear in job creation relative to other counties. Yet it has made the greatest strides since then. Its level of jobs is now only 6% below the 2007 peak. The gap between Maui's jobless rate and the state rate (Chart 3) has been narrowing steadily, the only Neighbor Island for which that is the case.

Tourism: The Maui visitor industry (Chart 4) continues to perform very well. The island's 2012 growth in visitor arrivals and spending doesn't look quite as spectacular as it did in the immediate snapback from recession. Maui got its airlift back more quickly

—continued on page 7

CHART 4 • MAUI TOURISM GROWTH, 2008-2012



Maui County (continued from page 6)

than Hawaii Island and Kauai, so the fact that those islands are only now regaining their airlift makes their growth numbers now look stronger by comparison. Still, in every measured category — arrivals, visitor days, length of stay, total spending, person per day and person per trip spending — Maui continues to be up from 2011.

There has been increasing airlift to Maui from Oakland, San Jose, Seattle, Sacramento, Bellingham, Monterey and Canada.

Maui's comparative advantage among Hawaii tourism destinations, as well as tropical destinations elsewhere, still resides in its upscale image and in the choice it offers — in accommodations, activities, cuisine, and other components of a quality vacation. So Maui can look forward to continued support from its main industry, even if other sectors falter due to external cyclical conditions in the future.

CHART 5 • RESIDENTIAL REAL ESTATE

Maui Real Estate Sales (% Change)		
	Single-Family	Condo
2011	+10%	+1%
2012 (YTD June)	-1%	+3%

Maui Real Estate Median Prices (% Change)		
	Single-Family	Condo
2011	-6%	-18%
2012 (YTD June)	+1%	+8%

Source: Realtors Association of Maui

Residential real estate (Chart 5): Maui real estate sales have picked up, as falling prices and lower mortgage rates increase affordability. It may be a buyer's market, but buyers who wait too long may lose the property. Inventories have declined almost 20% over the past year for both single-family and condo units. Short sales and foreclosures are being absorbed as the market returns to normal.

The decline in median prices for both single-family homes and condos seems to be reversing, or at least leveling off. Well-priced homes attract multiple offers, and sellers are being advised by Realtors to get pre-approval so they can shop with greater confidence.

Sugar: HC&S, the state's lone remaining sugar plantation, has survived mainly because of its size — 35,000 acres. Its future is looking up some. HC&S sugar production has been rising in recent years. While production is still below its target of 200,000 tons a year, it seems to be getting there. The plantation has achieved this mostly by bringing more acres back into production. Water availability is still a problem, and HC&S has suffered under what has turned into a 12-year drought. HC&S management emphasizes that the future there is biomass energy creation, not food sugar. The plantation provides 5-6% of Maui Electric's power, and it used to provide more than that.

HAWAII COUNTY

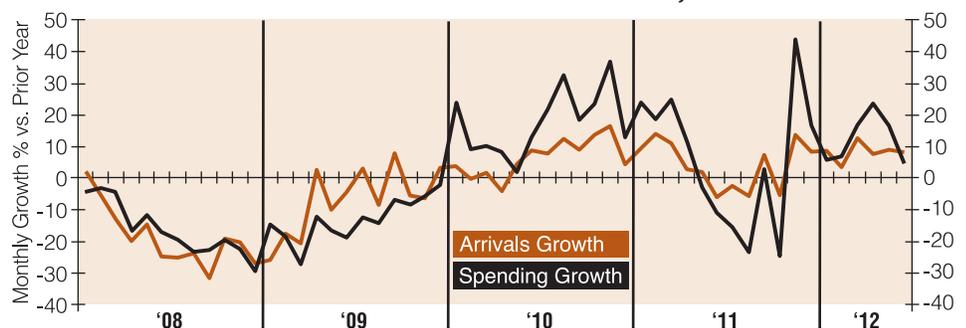
Hawaii Island Making Continued Progress

The good news is that the Hawaii Island economy is making progress. The bad news? Improvement is still slow. That's been our main message for three years now, and it will likely continue for a while.

We can be thankful in Hawaii that our main industry of tourism recovered as quickly as it did. For some local economies elsewhere, their mainstay of economic growth still hasn't recovered, leaving them in a far worse position than ours.

The Hawaii Island visitor industry performance (Chart 1) slumped some in 2011 with a post-tsunami blow to Japanese tourism and discontinuation of the direct JAL flight into Kona. But that strengthens 2012's growth. In fact, Hawaii Island could lead all

CHART 1 • HAWAII ISLAND TOURISM GROWTH, 2008-2012



Source: State Department of Business, Economic Development & Tourism

of the state's counties in visitor growth in 2012.

Hawaii Island's visitor experience differs from other Neighbor Islands in one important regard: you can't just check into your accommodations and comfortably see the entire island on a visit. This is a "chicken vs. egg"

problem. Full flights are needed to make new accommodations pay off, but those flights won't be full unless an upgraded Hilo visitor plant attracts passengers.

Average occupancy rates at Kohala Coast hotels are running somewhat

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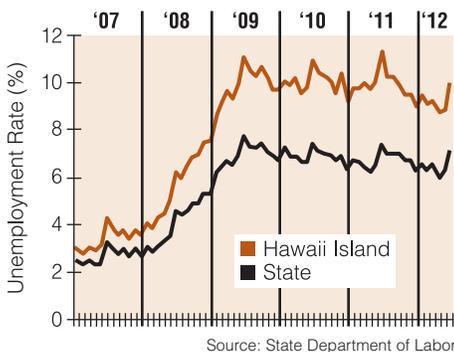
Hawaii County (continued from page 7)

higher in 2012 than the last two years, hovering just over 60%. Kona Village, wiped out by the Japanese tsunami in 2011, plans to start redeveloping soon. And Hilo Harbor notes that cruise passengers are up.

A review of segments of the Hawaii Island economy:

Jobs: Since jobs in each of Hawaii's counties peaked in December 2007, job creation on all Neighbor Islands has lagged Oahu. Hawaii Island, still 10% below its peak, marginally lags the other counties and its jobless rate (Chart 2) remains the highest in the state. An often cited reason that Hawaii Island unemployment is higher concerns the separation of population on the east side from jobs on the west side, but that should improve as Saddle Road extensions make it easier to commute.

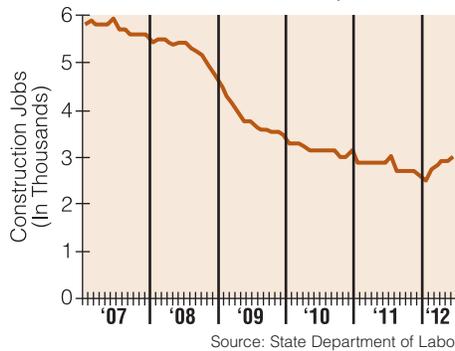
CHART 2 • UNEMPLOYMENT, HAWAII ISLAND VS. STATEWIDE



Construction: There's not much good news this year on the Hawaii Island construction front. The level of construction jobs (Chart 3) is still about 50% below the 2007 peak. There has been a significant fallout of contractors since the slump began. Nor does County private permit growth hold out much hope for the near future.

Still, several public sector and commercial projects will be underway soon, including West Hawaii Community Health Center's planned medical center at Kealakehe in North Kona, Kaiser Permanente's proposed health center at Honokohau and the

CHART 3 • HAWAII ISLAND CONSTRUCTION JOBS, 2007-12



long anticipated Pier 4 at Hilo Harbor, which should significantly expand harbor capacity. Also, the University of Hawaii received \$9.7 million from the Palamanui partnership to build the first phase of the planned Hawaii Community College Palamanui campus in West Hawaii.

Real Estate: Residential sales (Chart 4) seem to be leveling off after recovering some in the past few years. Though appraisers are cautious about saying Hawaii Island housing prices (Chart 5) are bottoming out, there are some signs of that now, after a drop of over 40% in single-family median prices from the 2006 peak. Until foreclosures work their way through the system, the added supply will continue to weigh on the market. But at least the significant drops in sales and prices appear to be behind us.

In the commercial and industrial real estate market, vacancies continue to be high and rising. Appraisers indicate asking rents are too high to stimulate demand.

Natural Energy Lab: The Natural Energy Lab at Keahole Point continues to play an important role in the economy. A recent study by the University of Hawaii Economic Research Organization concluded that the direct and indirect economic impact of the Natural Energy Lab was \$88 million statewide in 2010, much higher than previously believed. NELHA now has 32 tenants and accounts for almost 600 jobs. Tenants there are the main producer of one of the state's major exports — desalinated

CHART 4 • HAWAII ISLAND REAL ESTATE SALES 2004-12

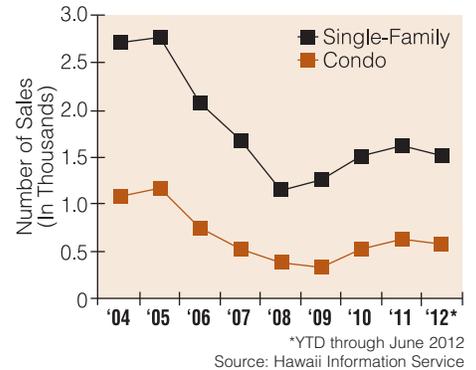
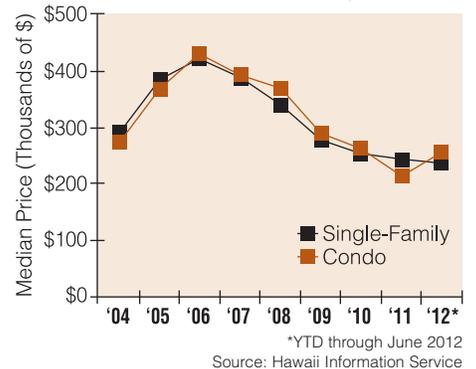


CHART 5 • HAWAII ISLAND MEDIAN HOUSING PRICES, 2004-12



bottled water — and it also accounts for 70% of the state's aquaculture production.

Astronomy: The Thirty Meter Telescope (TMT) project at the Mauna Kea summit is in its final approval stages. TMT has gotten more support from the community than some previous projects proposed for the summit, and a favorable decision is more critical than ever. First, this is the first of a new generation of much larger scopes that would mean a lot to Hawaii's astronomy industry. Losing it to another location like Chile could mean other large scopes would gravitate there. Second, Mauna Kea will likely be losing two existing telescopes at the summit — the UK Infrared Telescope (UKIRT) and James Clerk Maxwell Telescope (JCMT). Both are funded largely by the UK, which is discontinuing its support, leaving the scopes in search of other funding. TMT, a privately funded project, would like to start construction in 2014.

—continued on page 9

Hawaii County *(continued from page 8)*

Agriculture: The agriculture sector plays a more important role in the Hawaii Island economy than perhaps any other county. The picture this year is mostly upbeat:

- Forecasted macadamia nut production is expected to be up by about 15% for the coming season in West Hawaii due to favorable weather. In East Hawaii, the crop will remain about the same as last year. Overall, prices are expected to remain strong, at last year's levels or possibly better.

Strong tourism numbers definitely contribute to the stronger demand.

- In South Kona, coffee production is expected to increase over last season, also due to good weather. North Kona yields are forecasted to be slightly less because of drier conditions during flowering. But overall, production is expected to be up about 10%. The wild card is how much damage the coffee berry borer inflicts on the crop. The market remains strong for quality coffee, and prices should remain relatively stable. Ka'u coffee is garnering

honors in mainland competitions. Ka'u also has the coffee berry borer, but to a lesser extent.

- Beef supply remains short, so ranchers in Hawaii are receiving \$1.12 per pound live weight for 400-pound wean-offs to be finished on the mainland — a good price. Beef prices are expected to remain strong in the near future. Demand for local grass-fed beef is strong, though prices are relatively low at \$1.25 per pound carcass weight. So ranchers are choosing to ship their wean-offs to the mainland.

KAUAI COUNTY

Tourism Boom Leading Kauai Back from Recession

If all parts of the Kauai economy were doing as well as tourism, the entire island would be booming. Visitor arrivals, spending and direct flights to Kauai are all growing; hotel occupancies are strong; and the tourism plant is in solid shape, thanks to recent renovations of several hotel properties.

In other sectors of the Garden Island economy:

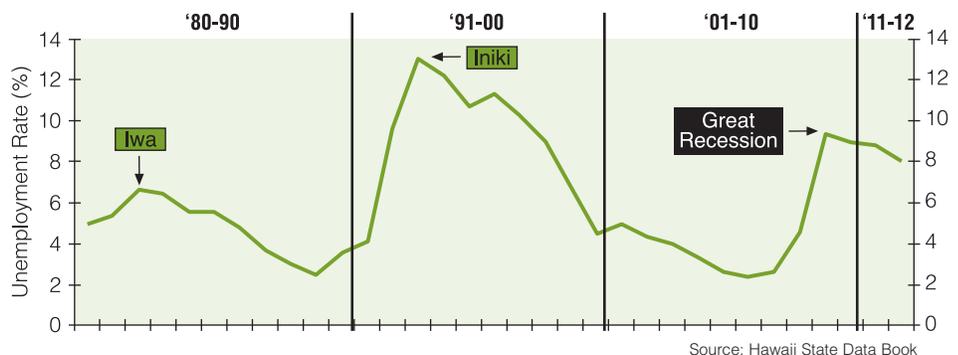
- Real estate sales are climbing, and
- The seed corn industry continues to expand. With the exit of Monsanto, there are now four companies on Kauai: BASF, Syngenta, Pioneer, and Dow Agrosciences.

On the down side, Kauai's construction industry continues in the doldrums, residential real estate prices are still dropping and the job count still has a way to go to recoup losses from the recent recession.

First Hawaiian Bank has been studying the Kauai economy for 38 years now, through good times and bad. As for the bad times, this is the 20th anniversary of Hurricane Iniki and the 30th anniversary of Hurricane Iwa.

The impacts of those natural disasters are reflected clearly in Chart 1, a three-decade picture of the Kauai

CHART 1 • KAUAI UNEMPLOYMENT RATE, 1980-2012



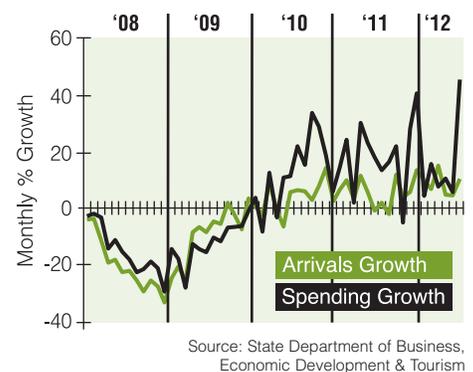
unemployment rate. Today, the island is struggling to recover from another blow, this time an economic one. But a lesson to be gleaned from longer-term history is that, as bad as those circumstances seemed at the time (with unemployment topping 12%, well above today's level), the Garden Island did overcome them and return to healthy, balanced growth — even if that process was drawn out.

Tourism: Both visitor arrivals and spending on Kauai (Chart 2) continue to perform well. Year-over-year growth numbers are erratic from month to month, which is often the case for a small economy like Kauai's, but a smoothed trend would clearly show

healthy growth for both arrivals and spending.

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CHART 2 • KAUAI TOURISM GROWTH, 2008-2012



Kauai County *(continued from page 9)*

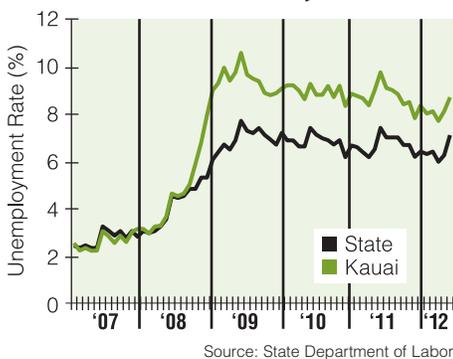
Kauai can look forward to an added Alaska Airlines flight in November, direct from Portland four times a week. Kauai continues to enjoy a reputation as one of the world's top island destinations, a priceless asset.

Hotel occupancies are very strong. Occupancy rates at the St. Regis Princeville were well into the 90% range over the summer, as they were at major time-share destinations like the Westin and the Wyndham. Kauai's hotels are all in great shape now, having used the down period for renovations, which means more choice for visitors and more competition.

ABC Stores just bought Coconut Marketplace on the East Shore. This is the first such venture for ABC, and much needed improvements should be in the future there.

Jobs: The job count on Kauai is still 8% below the peak hit in December, before the Great Recession, and the unemployment rate (Chart 3) is still well above the statewide figure. Like everywhere else, the Kauai jobless rate shot up dramatically with the onset of recession. It has been slowly moving down, but not fast enough for people to notice much difference.

CHART 3 • UNEMPLOYMENT: KAUAI VS. STATEWIDE, 2007-2012



Movie industry: A hit movie like *The Descendants*, shot on Kauai and also set in part on the island, has also been a big positive. The Kauai Visitors Bureau reports a surge in visitors asking about the locations where the movie was filmed. An ATV tour now operates to

CHART 4 • KAUAI CONSTRUCTION JOBS, 2007-2012



scenes from the movie and the film put a place like *Tahiti Nui* in Hanalei on the map. Movies are a big thing for Kauai, and several others are in the pipeline for the future.

Construction: The construction sector, including home building, remains mostly in the doldrums. Island construction jobs (Chart 4) are still about 35 percent below the late 2007 peak. But projects that may sooner or later provide an impetus include:

- Kilauea Lighthouse Village, a 47,000-square-foot shopping mall planned across from Kong Lung Center on the lighthouse road in Kilauea.
- A couple of sizeable photovoltaic facilities in the works, one at Port Allen on Alexander & Baldwin land and another in Koloa sponsored by Grove Farm partnering with Solar City.
- Safeway's planned shopping center at Hokulei Village.
- Grove Farm is still pushing forward on its Lihue-Hanamaulu Master Plan project and would like to start its 50-unit Waihohonu Project in Koloa soon.

But overall, recent data on Kauai private construction permits don't show much activity, with declines in the quarterly numbers over 2011.

Real estate: Residential real estate sales (Chart 5) have been picking up in recent years. Record low mortgage rates and falling prices have helped affordability, though some of the sales are still foreclosures. Activity in

CHART 5 • KAUAI REAL ESTATE SALES, 2004-2012

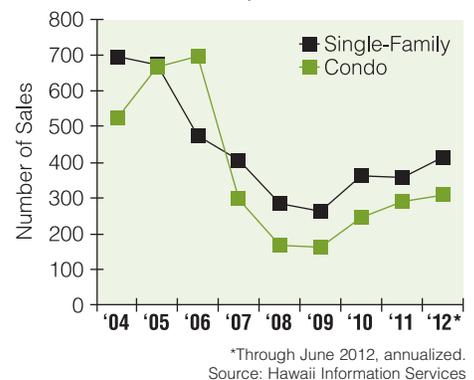
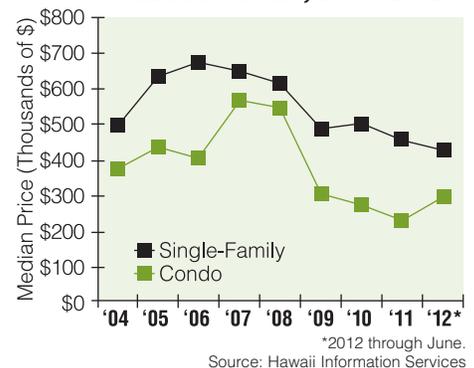


CHART 6 • KAUAI REAL ESTATE MEDIAN PRICES, 2004-2012



commercial real estate has been picking up. Median single-family home prices on Kauai (Chart 6) continue to fall, though at a somewhat decreasing rate.

Missile Range: The U.S. Navy's Missile Range at Barking Sands has about 900 employees with a \$50 million annual payroll, and that doesn't include spending by visitors coming for tests.

In the past, much of the Missile Range's testing has involved ship-based Aegis missiles and the Terminal High Altitude Air Defense (THAAD) missile system. Those programs have wound down.

The new program getting the most attention is a land-based component, Aegis Ashore, which will be tested at the Range and then deployed throughout the world. Work on the infrastructure for this system is imminent, with component parts being shipped in for assembly at the Range. This alone will likely be a big boost for construction on Kauai.

The Recession's LingerinG Grip

By Dr. Mark Zandi, Chief Economist and Dr. Steve Cochrane, Managing Director, Moody Analytics

The U.S. Economy

The economy cannot seem to break free from the grip of the Great Recession. The recovery, which began just over three years ago, remains lackluster. Real GDP growth is stuck near 2%, too slow to meaningfully bring the unemployment rate below 8%. By most measures, this recovery is among the weakest in the past 50 years (see Chart 1).

It is not that the economy has gone nowhere; progress has been made. Businesses are in excellent financial health; their costs are down and they have become highly competitive and profitable. Banks have never been as well-capitalized or as liquid. Households have aggressively worked down their debt burdens and are meeting their obligations more diligently. Yet despite the gains, growth has been tepid and sporadic.

More QE

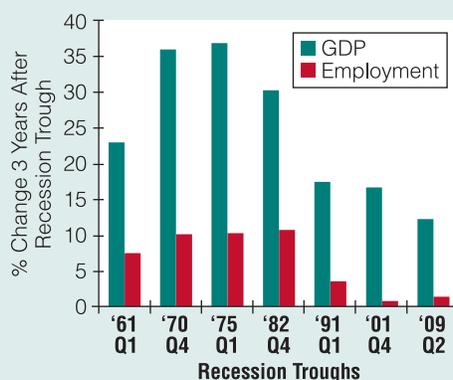
Federal Reserve officials are ready to try again to strengthen the recovery. With short-term interest rates near zero, policymakers are focused on reducing long-term rates. Their efforts so far have helped. The Fed has pumped cash into the system via Operation Twist and quantitative easing. Without the Fed's actions, 10-year Treasury yields would be above 3%, almost double the current level (see Chart 2).

The Fed's actions have given the stock market a big lift. Rock-bottom rates are a strong incentive for return-hungry investors to buy stocks, despite their greater perceived risk. Higher stock prices support more spending by wealthier households; they may also allay business executives' fears about expanding operations.

Record-low mortgage rates are also fueling the housing market's upturn and a refinancing boom. Since there are few new homes for sale, this leads quickly into more homebuilding.

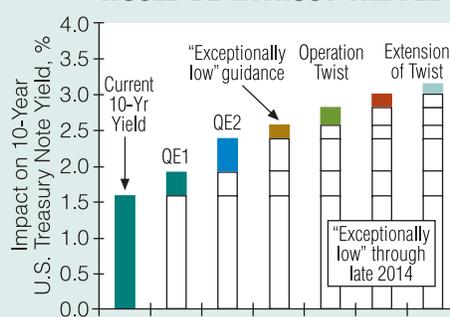
With fixed mortgage rates near 3.5%, and more than half of all homeowners holding mortgages with coupon rates above 5%, refinancing activity has

CHART 1 • U.S. ECONOMY LAGS PAST RECOVERIES



Sources: BEA, BLS, Moody's Analytics

CHART 2 • WHERE THE 10-YEAR WOULD BE WITHOUT THE FED



Sources: Federal Reserve, Moody's Analytics

soared. Lower monthly payments make it easier for stressed homeowners to remain current while freeing cash for other purposes. The Obama administration's revitalized Home Affordable Refinance Program is having an effect.

Taken together, the Fed's efforts to lower long-term rates have increased real GDP by an estimated 1.2% as of the second quarter of 2012. This is significant and suggests that policymakers, rightly scared that unemployment could remain stuck at 8%, will do more. Policymakers will surely extend their projection for holding interest rates near zero from late 2014 into mid-2015, but they could be even more aggressive. They could signal that they will not raise rates until unemployment has fallen below a specific threshold.

The Fed is likely to buy more bonds eventually in a new round of quantitative easing. The central bank will probably concentrate on purchasing mortgage

securities to lower mortgage rates further. A new QE program could stipulate that they will buy bonds until the unemployment rate is definitively falling or until nominal GDP reaches a specified target.

European Bank steps up

Understanding the economic havoc if the euro zone fractures, the European Central Bank is determined to preserve the currency union. The ECB recently adopted an open-ended bond buying program to reduce borrowing costs for troubled euro zone member governments. The ECB will buy an unlimited amount of sovereign debt of up to three years' duration. As a condition for receiving this help, euro zone governments must formally request assistance from Europe's bailout funds; this means accepting strict fiscal oversight and committing to major structural reforms.

The ECB action raises the odds that the euro zone will remain intact for the foreseeable future. It breaks the negative cycle of higher interest rates increasing fiscal pressures that push interest rates still higher (see Chart 3, next page). Moreover, the ECB is effectively mutualizing European sovereign debt. Since every euro zone member nation has a financial stake in the ECB, all will feel the pain if one of them defaults. The central bank is buying time for European fiscal policymakers to erect the necessary institutional and fiscal framework, and making the task easier by getting troubled sovereigns to cede fiscal authority.

To be sure, many things could go wrong. Germans charge that the ECB is letting troubled governments avoid making hard decisions. Greeks and Spaniards worry that fiscal austerity is plunging their economies into depression. The costs of keeping the euro zone whole are great, but the costs of a breakup are much greater.

—continued on page 12

The Recession's Lingering Grip

(continued from page 11)

Fiscal uncertainty

The U.S. economy can shake the Great Recession's grip only if the president and Congress tackle the nation's fiscal problems. Worries about how lawmakers will deal with the coming fiscal cliff — more than \$700 billion in tax increases and spending cuts are set to start in 2013 — and whether the Treasury debt ceiling will lead to another round of debilitating political brinksmanship are weighing on businesses' hiring and investment decisions today.

The unusually wide discrepancy between hiring and job openings is telling. Indeed, while hiring rates remain very low by historical standards, opening rates have nearly fully rebounded from the recession (see Chart 4).

This is partly due to a mismatch between jobs and skills, particularly in a shortage of engineers and technicians qualified for today's manufacturing and technology jobs. The gap may also reflect employers' increased pickiness. Uncertain about what conditions will be like in a year or two, managers are reluctant to hire someone who could take that long to master a job.

Higher gear

It is encouraging that job openings are on the rise. It suggests that once major uncertainties are resolved, hiring and the broader economy will quickly pick up. The U.S. is expected to muddle along until next summer, likely weakening as the fiscal policy debate heats up after the election.

But by this time next year, we expect lawmakers to have bridged their differences and scaled back the fiscal cliff, raised the Treasury debt ceiling, and agreed to longer-term tax and spending policies that will put the nation on a path to fiscal sustainability. Combined with the Fed's aggressive actions and a more stable Europe, this will ease businesses' fears. The economy will finally break free of the Great

CHART 3 • ECB IS FULLY COMMITTED TO THE EURO ZONE

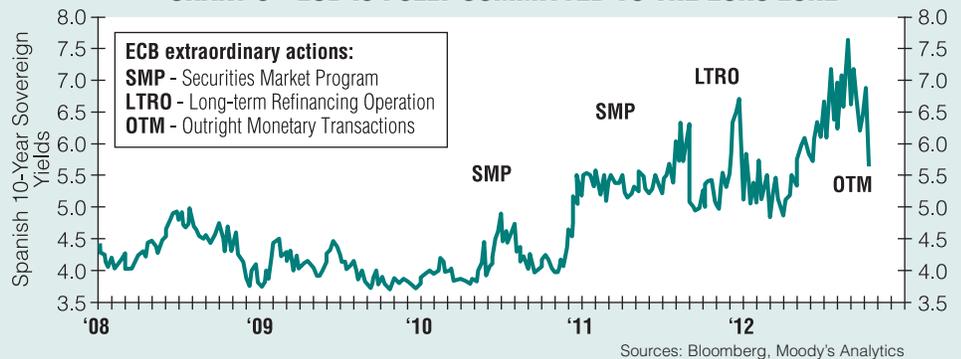


CHART 4 • MORE OPENINGS, NOT MUCH HIRING



Recession's grip, growth will accelerate, and unemployment will fall in earnest.

Housing

As housing markets recover, home sales improve and new construction accelerates. The industry will make its mark through the jobs it creates, the added demand for construction supplies, and the demand it creates for durable goods and for services that range from decorating to lawn care to mortgage finance.

Currently, the West is benefiting the most from the resurgence in housing demand, but nearly all states that were hit hardest in the housing downturn are at least beginning to see the end of house price declines and an emergence of pent-up demand from both investors and owner occupiers.

Outlook

Uncertainties regarding the federal fiscal cliff and the European recession will slow the pace of growth everywhere through early next year.

But by the second quarter of 2013, the West should once again accelerate and lead the nation in growth. Parts of the South will not be far behind.

Risks

The risks are great from the impending fiscal cliff. Most immediate would be the risks to the District of Columbia, Maryland, and Virginia economies if currently legislated spending cuts are enabled. Alaska, Hawaii and New Mexico are also at risk with high shares of federal employees in the workforce. Other states that depend on federal payments to manage urban or rural poverty — Louisiana, Mississippi, Montana, New York, Vermont and Wyoming — could also be hit by cutbacks in federal spending.

If taxes are allowed to rise only for higher-income households, Connecticut, the District of Columbia, Maryland, Massachusetts, New Jersey, and New York — which rank highest in per capita income — would experience some diminution of disposable income, although the impact on spending would not be great.

The greater impact on consumer spending would arise from a loss of consumer confidence, which would affect spending trends more broadly. This would likely be felt by durable goods producers, including automakers, in the industrial Midwest and Southeast. It also likely would delay housing market recoveries across the country.