

ECONOMIC OUTLOOK



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Summary

Economic activity in FY2008 is expected to continue to exhibit moderate but increasing expansion driven primarily by substantial increases in construction activities. Over a billion dollars in construction projects have been permitted or contracted and construction will increase significantly. Many projects that have been in the planning and permitting stages have recently or will soon commence. Absent unforeseen major adverse events, the magnitude of the overall dollar value of the expansion in economic activity based on planned activities is expected to be greater than FY2006 which showed a 2% increase in total GRT and more likely towards that of FY2004 & FY2005 which had estimated gross receipts expansion of 8% in each year. This outlook for planned economic activity increases could be affected either upwards or downwards based on the handling of Government of Guam fiscal issues including expenditure changes or payments made for outstanding obligations.

Payment of Government of Guam's outstanding obligations has the potential to inject substantial amounts of funds into the economy during this period if proposed debt financing is realized. This includes resolution of the Earned Income Tax Credit (EITC) and Cost of Living Allowance (COLA) litigation as well as payment of other obligations including but not limited to prior years' income tax refunds. The debt limit issue on the bond litigation in the U.S. Supreme Court may be decided this summer and should determine if these plans can proceed. The plans to fund these obligations have the potential to inject hundreds of millions of dollars into the economy in late FY2007 or FY2008. The cumulative amount of cash disbursements from all of these proceeds combined could exceed the annual expenditures of the General Fund. Therefore, the outcome of each of these issues and the timing of any such disbursement of funds in FY2007 or FY2008 will similarly have significant impacts on economic activity and associated revenues in the years affected. In the absence of substantial disbursement of funds for these items, downward operational adjustments due to cash availability constraints may affect government expenditures as well as revenues. How and when these issues are resolved present substantial uncertainty to the economic and financial impact on the General Fund in FY2008.

Construction

Construction is likely to be the primary economic driver of increased economic activity on Guam in FY2008. Construction is expected to increase in the Federal Government, Government of Guam and the private sector. Employment, wages and tax revenue should correspondingly increase. Construction activities should positively impact income tax as well as business privilege tax revenue. A compilation of major construction projects which are very likely to occur as indicated by funding authorizations, contracts and building permits as well as in many cases work that has already commenced, indicate substantial construction in the next several years. The construction anticipated for this

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period does not include that which is planned for the relocation of the Marines from Okinawa to Guam as that work is expected to substantially commence after the FY2008 forecast period. Smaller scale planning, environmental impact studies and other preparatory work will be underway during this period. Similarly, closure of the Ordot dump and the opening of a new landfill may experience additional delays for the activities scheduled for 2007 and is not included in the construction numbers for this time period. Construction work anticipated for the forecast period includes major projects in both private industry and government. Private sector projects planned exceed \$475 million with hotel renovations, commercial and residential construction. Federal Government projects total over \$325 million and Government of Guam projects total over \$200 million. Delays in the commencement of a number of projects such as the new Government of Guam schools construction, originally planned for FY2006 will shift those activities and revenues to FY2007 and beyond. There is a long list of planned projects for the 2006 to 2025 time period, primarily federal defense related and Government of Guam water and power utilities improvements totaling over five billion dollars outlined in the P.L. Mangilao Energy LLC economic forecast. Only those contracted and scheduled within this time period are included in this FY2008 forecast.

The U.S. Air Force Global Strike Task Force (GSTF) proposed for Andersen Air Force Base (AFB) was scheduled to commence in 2007 with construction projects and be completed by 2016. According to an October 2005 Air Force notice, “establishing the GSFT would add as many as 3,000 military, civilian, and contractor personnel and dependents at Andersen AFB.” Despite the concerns of the U.S. Environmental Protection Agency with the U.S. Air Force’s preliminary environmental impact study, the Pentagon has decided in a Record of Decision dated January 12, 2007 to proceed with its plan to base permanent tankers on Guam to support the Air Strike mission at Anderson Air Force Base. According to a January 29, Marianas Variety story, “The Pentagon is planning to deploy 12KC-135 tanker aircraft and four Global Hawk unmanned aerial vehicles and personnel to Andersen Air Force Base on a permanent basis. As many as 40 fighter planes such as the F-22 and the F-15E and six bomber aircraft will be rotated from bases in the 50 states. The mission will be deployed in four phases over a period of 16 years. Air Force officials expect the Andersen population to increase by 3,000.” This analysis incorporates the associated construction projects awarded and scheduled for this period.

Building permits in calendar year 2006 ending December 31, totaled \$198,733,000, up from \$163,422,000 in 2005 and \$123,594,000 in 2004. Department of Defense construction projects of \$5 million and above contracted in 2006 totaled \$168,031,000, up from \$39,988,000 in 2005 and \$69,735,000 in 2004. The combination of these federal and local projects indicate a dollar value of construction projects permitted and contracted in 2006 of \$366 million, up 80 percent or \$163 million from 2005. The dollar value is somewhat above the figure of \$328,988,000 in 1996 when Guam had over 7,000 construction workers compared to a little over 4,000 through 2006. Statistical analysis indicates that building permits and contracts to be strong predictors of the level of construction activity in the subsequent year or two.

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Tourism

Tourist numbers and expenditures as indicated by Hotel Occupancy Taxes have been increasing only slightly over the last two years according to statistics released by the Guam Visitors Bureau. Visitor arrivals have increased from 1,156,199 in FY2004 to 1,210,147 in FY2005 to 1,217,111 in FY2006. Hotel Occupancy Tax Collections have increased from the FY 2004 total of \$17.6 million to \$19.0 million in FY2005 to \$19.6 million in FY 2006. Visitor prepaid and On-Island expenditures have varied somewhat in exit surveys in each survey period over the last several years, however the expenditure trend appears to be a one of generally modest increases. The tourist arrival and associated spending increases will not be sufficient to cause major economic expansion – however – they are expected to be slightly positive so as to be somewhat complementary to construction driven expansion.

As hotel occupancy on Guam has averaged a little over sixty percent in the latest year, there remains room as well as airline capacity for substantial increases in the number of visitors. The ownership changes of many hotel properties on Guam are resulting in substantial renovation and upgrade work. Substantial investment in construction of new hotels is not foreseen for the forecast period as substantial room capacity remains and the long lead time needed to plan and construct new hotels.

As Japan visitors account for approximately 80% of Guam's tourists, and visitor surveys indicate that the economy is often a consideration in travel planning. It is noteworthy that the Japan economy is improving, and could support stable or increased arrivals.

The Bank of Japan Regional Economic Report (Summary) (January 2007) notes:

- According to reports from each of the nine regions in Japan, the economy as a whole expanded moderately as all regions remained on an expansion or recovery trend, although there were regional differences.
- Specifically, the corporate sector became more buoyant as seen in the fact that business fixed investment was on an increasing trend in all regions and business sentiment improved in most regions.
- Most regions reported that production was “increasing” supported by growing domestic and external demand.
- Most regions reported that the employment and income situation was “improving”. However, there were still substantial regional differences in the assessments of labor market conditions.

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- Compared with the assessment in October 2006, at the time of the last branch managers' meeting, all regions maintained their assessments as either expanding or on a recovery trend.

Consumer Expenditures

Guam residents accounted for 38.8 percent of the 4.5 billion dollars in sales receipts for all industries and visiting tourists accounted for 27.5 percent according to the 2002 Guam Economic Census. Therefore in 2002, the expenditures of Guam consumers totaled over \$1.7 billion. Payment of outstanding government obligations to individuals could significantly affect consumer expenditures. Increasing real estate values may also increase consumer and business assets as well as expenditures. Increases in refinancing activities which allow borrowing against increased equity may also support higher consumer expenditures. The price of oil and related energy products and services remains a concern which could affect expenditures of both local residents and visitors.

Federal Expenditures

Federal expenditures on Guam ranged from \$809.7 million in 1995 to \$1.538 billion in FY2003. FY2004 expenditures were \$1.249 billion. Comprehensive figures for FY2005 and FY2006 are not yet available. FY2003 expenditures increased largely for typhoon assistance and recovery efforts. Volatile annual changes in federal expenditures of two or three hundred million dollars, up 23% in FY2002, up 38% in FY2003 and down 19% in FY2004 increases the difficulty of economic and revenue forecasting. It is assumed that due to increased defense related activities, the Procurement Contract component of federal expenditures will increase in FY2008 followed by increased payments for Salaries and Wages in subsequent years. Retirement/Disability Payments for Individuals have been increasing on a fairly steady path, more than doubling from \$108 million in FY 1994 to \$221 million in FY2004. In some periods, particularly following typhoons, increased federal expenditures have off-set reduced tourist expenditures. In FY2008, all three drivers of the economy, tourism, federal government and construction investment expenditures are expected to increase so the increases in each sector should complement rather than off-set each other.

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