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Economic Outlook for Guam Fiscal Year 2014

Summary

The economic outlook for Guam's short term future throughout the remainder of FY 2013 and continuing into FY 2014 is likely to be one of economic stability on a plateau relatively comparable to current levels, although modest growth appears possible. However, a number of potential adverse risks, if realized, could lead to a less favorable outlook.

In FY 2012, there were increases in tourist arrivals, construction, employment, and Government of Guam revenues. The economic rebound that Guam's economy experienced in FY 2012 was due in large part to continuing recovery in Japan's outbound tourism following the March 11, 2011 earthquake, tsunami and nuclear power plant incidents. Other factors contributing to the rebound in Guam's economy included an increase in construction and a substantial infusion of bond-financed payments for outstanding income tax refunds. Two bond funded disbursements occurred in FY 2012 totaling \$307.8 million. In December 2011, bond proceeds paid \$198 million in tax refunds and \$16.8 million in cost-of-living-allowance payments. In June 2012 refunds from the proceeds of a second bond were disbursed for income tax refunds in the amount of \$93 million. Payment of the refunds enabled the Government of Guam to obtain federal reimbursement of Additional Child Tax Credits paid. The timing of the receipt of federal reimbursement for tax credit payments was accelerated by the bond-financed payments and increased Government of Guam's FY 2012 receipts by \$24.5 million for the December 2011 refunds and an additional \$14.5 million for June 2012. Two U.S. federal stimulus measures, including a two percent reduction in payroll tax withholding and expenditure of previously awarded American Recovery and Reinvestment Act (ARRA) funds also contributed. Of the \$236.8 million in ARRA funds awarded, \$34.4 million remained as of September 30, 2011. In FY 2012 an additional \$20.5 million was expended or encumbered. ARRA funds did contribute to the economy somewhat in FY 2012 but most of the impact occurred in earlier fiscal years.

All of these measures which contributed to the recovery in FY2012 have been realized for the most part, or entirely, and will not contribute much to future growth, although the increase in tourist arrivals to current levels is anticipated to help support continuation of economic activity.

Economic stability in the near term for Guam is contingent on a projected modest increase in tourist arrivals as well as continued strong levels of construction activity. A resolution of the plans to sequester federal expenditures with more moderate federal expenditure cuts is also necessary to avoid a downturn.

Department of Defense construction projects, including projects which already have funding appropriated from the United States and Japan governments for realignment of Marine Corps forces from Okinawa, are on hold until additional plans, reports and a supplemental environmental impact statement are completed and other conditions are met. Due to the time it will take for completion of these requirements, followed by procurement processes to contract the projects, the commencement of construction for such projects is not expected within FY 2014. Other Department of Defense military construction projects not associated with the Marine Corps realignment are proceeding as

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planned. The delay and uncertainty regarding the realignment has contributed to a weakening in the real estate market. In some cases real estate investments were made to prepare for buildup activities which have not yet occurred.

For the quarter ending September 2012, total employment increased modestly, 550 jobs to 61,140 from the comparable figures of September 2011 while unemployment fell to 10.9 percent a decrease of .9 percentage points from March 2012 according to published reports from the Department of Labor's Bureau of Labor Statistics. The rate of employment growth has lagged behind sales and revenue growth in the economy.

Tourism

The total number of visitor arrivals to Guam in CY 2012 was 1,307,796, a 12.8 percent increase from the prior CY 2011 count and the highest since CY 2000. CY 2012 numbers were just 5.3 percent below the CY 1997 figure of 1,381,513 which is the highest number of arrivals during a calendar year.

Guam Visitors Bureau projections are for a 3.8 percent increase for FY 2013 and another 2.6 percent increase for FY 2014. The Guam Airport Authority's website notes that "Guam has been ranked 5th overall in the Top Ports in International Arrivals. In February 2012, Guam ranked right below Honolulu, and outranked San Francisco and Newark, New Jersey. Guam has been gaining in its reputation as a preferred destination, having moved up the ranks from 8th in November 2011, to 6th in January 2012, and to 5th overall in February" according to statistics released by the US Office of Travel and Tourism Industries.

There is sufficient capacity for increases in tourist arrivals as current levels remain below peak historical levels. However, at certain times of the year, hotel rooms are booked to capacity and have become a constraint on arrival increases during those periods. Recent increases in air service to Guam along with scheduled opening of new hotel rooms will expand the capacity to accommodate further growth in the industry. Guam Hotel and Restaurant Association's May 2012 weighted average occupancy rate was at 79 percent, up from 71 percent for the May 2011 year-to-date figures. Higher occupancy levels may lead to increased average room rates, hotel revenue and occupancy tax collections as higher demand may result in less discounting or higher room rates. While air service to Guam was reduced with the ending of United Airline's twice weekly flight from Okinawa in October 2012, additional capacity was added recently from Korea. On June 8, 2012, the U.S. Department of Transportation issued an order that allowed Jeju Air Co. Ltd, a Korean low-cost carrier, to conduct scheduled foreign air transportation to points in the United States and beyond. The application specifically proposed to commence services on the Pusan-Guam and Incheon-Guam routes in October 2012. The airline, encouraged by a strong start, added more flights to Guam; it now offers eleven flights a week.

The Verona Resort had a soft opening in October 2012, with plans to increase capabilities to be fully operational by May 2013. It was formerly the 12 story 340 room Sherwood Hotel which has been closed for 10 years. In October 2013, the Dusit Thani Hotel Resort plans to open its doors to guests. It is currently under construction and is adding a new tower and other facilities adjacent to the Outrigger Guam Resort. The hotel property will include a convention center, 417 rooms on 30 floors, private bungalows and world class restaurants. The hotel is expected to create between 150-200 new jobs. Increased arrivals to Guam will continue to be facilitated by visa waiver programs

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implemented in previous years as well as faster processing of mainland Chinese visas facilitated by increases in U.S. staffing in China. The U.S. State Department issued more than one million U.S. visas for Chinese applicants in FY 2011, up 34 percent from the previous year. The State Department has announced that it has already processed more than one million visas in China this year, a 43 percent increase over the first six months of FY 2011. The U.S. Department of Commerce forecast annual growth rates of visitors from China above 20 percent for CY 2013 – 2015. For a comparison of the two latest calendar years, CY 2011 – CY 2012, arrivals to Guam from China increased 26.5 percent, arrivals from Korea increased 22.6 percent and Japan 12.7 percent; visitors from Russia increased by 538.9 percent following the implementation of a visa waiver program.

Japan remains the point of origin for the largest share of Guam tourists although the share has been declining somewhat due to the successful expansion and diversification to other markets. In CY 2012, the share of Guam's tourists from Japan fell to 71.2 percent.

Japan's Economy

As the major source for Guam's visitors, the welfare of Japan's economy is of considerable interest. Japan recently abolished a spending limit imposed by the last government and removed a ceiling on government debt issuance in an effort to speed up reconstruction work in Japan's disaster zone. The new LDP Prime Minister, Shinzo Abe, has announced a 10.5 trillion yen stimulus package, and political pressure is being put on the Bank of Japan to make good on its commitment to further, aggressive monetary expansion. According to a January 11, 2013 report in The Asahi Shimbun, "The DPJ government decided to implement income tax increases of 10.5 trillion yen (U.S. \$115 billion). But that in itself was insufficient, so additionally it cut about 4 trillion yen (U.S. \$44 billion) from government spending—even shrinking civil-service salaries by an average of 7.8 percent over a two year period." Also, "the consumption tax rate will increase from the current 5 percent to 10 percent by October 2015." Another development is the recent and substantial depreciation of the Japanese Yen relative to the U.S. dollar. As of October 31, 2012 the exchange rate was 79.8 yen for a dollar. By December 31, 2012 it had increased to 86.7 and by January 25, 2013, had further increased to 90.9. From the Japanese tourist's perspective, a devalued yen will make the U.S. dollar and travel to and purchase of goods in Guam, more expensive. It will also make its exports cheaper and should strengthen its export sector while making Japanese goods in Guam less expensive. The first item is negative with respect to tourism but strengthening Japan's export sector and economy which would provide greater income to travel is a plus. Whether the Japan currency will continue to depreciate and what the net effect of these developments on Japan's economy will be and its subsequent effect on Japanese travel to Guam remains to be seen.

Construction

A short term leading indicator of future levels of construction activity is the value of building permits and construction contracts awarded. Following the issuance of building permits and construction contracts, construction activity follows. In periods with high dollar amounts of permits and contracts, high levels of construction will follow. Building permit information from the Department of Public Works (DPW) shows a recent trend of increasing permit dollar value totals. In CY 2010 the value of building permits issued was \$184.8 million; this increased to \$211.1 million in CY 2011 and further to \$364.5 million in CY 2012, the highest level since the early 1990's. Construction projects on U.S. military bases do not obtain building permits from DPW. For DOD projects, the dollar amount of construction contracts awarded is a leading indicator of

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construction work to follow. The trend in DOD construction contracts has been generally increasing over the last decade although with substantial deviations from the trend on a year to year basis. In CY 2010, DOD issued a record total of \$370.4 million in construction contracts, a record surpassed with \$424.3 million in CY 2011. In CY 2012 the number declined to \$152.1 million. The combined total of DPW permits and DOD construction contracts has been more stable with the total exceeding half a billion dollars in four of the last five fiscal years.

Chart 1

BUILDING PERMITS & CONSTRUCTION CONTRACTS (in thousands)

Calendar Year:	2007	2008	2009	2010	2011	2012
Building Permits	305,853	241,388	299,057	184,837	211,097	364,504
U. S. Military Construction Contracts	136,747	295,889	148,823	370,413	334,597	152,095
Japan Funded Military Contracts					<u>89,720¹</u>	
TOTAL:	442,600	537,277	447,880	555,250	635,414	516,599

Note: ¹ Budgeted amount. The full amount of MACC indefinite contracts is not recorded in the above figures, only task orders for specific projects.

Building permits and Construction contract data provide the most immediate indicator of construction to follow in the following year or two. For a somewhat longer period, appropriations and other funding information is an insightful indicator. Obtaining the funding for construction projects is an activity that occurs somewhat prior to a building permit issued or a construction contract being awarded. Prior to FY 2010, there was a close relationship with the level of military construction appropriations and the level of contract awards that followed generally within a year. Since FY 2010, the appropriations related to the Marine Corps relocation have not been contracted out for the most part. The appropriations for military construction from the U.S. Government and the Government of Japan increased steadily each year from FY 2007 through FY 2010 reaching a peak of just over \$1.2 billion. The totals have dropped off dramatically in FY 2012. While defense construction contracts increased in FY 2010 and FY 2011, the contracted amounts were well below the appropriated amounts leaving over \$1.3 billion of the \$2.3 billion appropriated from the U.S. and Japan during FY 2010 – FY 2013 still available for contracting subject to restrictions on the use of funds being resolved.

Chart 2

APPROPRIATIONS (in thousands)

Fiscal Year (FY):	2007	2008	2009	2010	2011	2012	2013
U.S. DOD Military Construction	192,246	345,000	180,000	737,654	176,030	83,600	101,904
Japan - Fiscal Year (JFY)			<u>336,000</u>	<u>500,000</u>	<u>582,000</u>	<u>93,000</u>	
Combined:	192,246	345,000	516,000	1,237,654	758,030	176,600	101,904

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A listing of major construction projects for which financing has already been obtained or is likely to be obtained from bond financing or other financing that could be underway sometime in FY 2014 indicates there are a sufficient number of projects in the pipeline to maintain stability in the construction industry through FY 2014 as existing projects are completed. As noted earlier, the Dusit Thani hotel is scheduled for opening in October 2013. While there are no announced specific plans to restart the Versace Oka Point Towers project, if construction were to resume it would add to the list of major ongoing construction projects. Without Marine Corps relocation projects, construction could remain near current levels based on the volume of existing permits and contracts awarded in recent years. There is potential for increases above current construction levels if a number of new projects get underway concurrently as well as the possibility that the industry could contract modestly if too many of the projects planned experience material delays. The two largest projects currently under construction on Guam, each in excess of \$100 million, are the new Navy Hospital in Agana Heights and the Guam Regional Medical City Hospital in Dededo followed by the \$60 million Dusit Thani Hotel project in Tumon. A \$50 million defense funded port modernization project will break ground January 30, 2013 following the groundbreaking last week on a Guam Housing and Urban Renewal Authority \$28.1 million, 70 unit affordable housing project in Tamuning.

Chart 3	
LIST OF PLANNED MAJOR CONSTRUCTION PROJECTS AND FUNDING	
Planned Projects –Bond/Loan Financing	Amount
Okkodo High School Expansion Project (DOE)	\$24,223,000
2030 Transportation Plan Financing (DPW)	75,000,000
Ironwood Lada Senior Village (Private Activity)	20,000,000
Guam Port Authority Wharves life extension	10,000,000
Planned Projects – Funds Available	
Hagatna Revitalization, Museum & Tumon Upgrades	56,000,000
Guam Power Authority Fadian Campus Building	35,000,000
DPW Road and Bridge Projects in Planning & Design	79,800,000
Tower 70 Affordable Housing (GHURA)	28,100,000
Port Modernization Project (Defense-funded)	50,000,000
FY 2013 (DOD) Military Construction Projects	101,904,000
TOTAL:	\$480,027,000

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Marine Corps Relocation to Guam

The National Defense Authorization Act for Fiscal Year 2013 includes two sections in *Subtitle D-Provisions Related to Asia-Pacific Military Realignment* that will further delay the realignment of forces and the construction activities to prepare for them which were originally scheduled to commence in FY2010.

The first item requires a certification as a condition to establish a live fire training range complex on Guam. The second places restrictions on the use of funds for the realignment until various conditions are met:

A Live Fire Training Range complex on Guam may not be established (including any construction or lease of lands related to such establishment) in coordination with the realignment of United States Armed Forces in the Pacific until the Secretary of Defense certifies to the congressional defense committees that there is a military training and readiness requirement for the Live Fire Training Range Complex.

Except as provided in subsection (c), none of the funds authorized to be appropriated under this Act, and none of the amounts provided by the Government of Japan for construction activities on land under the jurisdiction of the Department of Defense, may be obligated to implement the realignment of Marine Corps forces from Okinawa to Guam or Hawaii until each of the following occurs...

These requirements include an assessment of the strategic and logistical resources needed, master plans including detailed descriptions of costs and schedules, a plan detailing investment and schedules required to restore Marine Corps Air Station at Futenma and a plan detailing work, costs and a schedule on non-military utilities, facilities, and infrastructure affected by the realignment. Subsection (c) exempts studies required under the National Environmental Policy Act of 1969 and planning and design of construction projects at Andersen Air Force Base and Andersen South and authorizations provided in section 2204 as specified in the funding table in section 4601. This table includes all three items authorized for appropriation in the FY 2013 Defense Act. These include the North Ramp Parking (Andersen AFB) – Inc2, Upgrade of a Fuel Pipeline and the Army National Guard JFHQ Ph4 totaling \$101.9 million.

On April 27, 2012, a revised agreement between the United States and Japan regarding the Marine Corps realignment was reached. The 2006 plan to relocate Marines to Guam was revised to shift 9,000 Marines from Okinawa with 5,000 going to Guam and the rest to other locations including Australia and Hawaii. The agreement reduced the scope and funding for the Guam component, with Japan cash commitment of \$3.1 billion down from a previous total commitment of \$6.09 billion dollars with \$2.8 billion in cash and the balance in other financing arrangements. While the size of the eventual move was reduced, the resolution of the replacement site for the Futenma base which was previously a condition for the commencement of the move was delinked in the agreement. So this is no longer an impediment to proceeding, providing optimism that the relocation could proceed. However, other impediments remain.

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Deficit Reduction

The Joint Select Committee on Deficit Reduction, referred to as the Supercommittee, created by the Budget Control Act of 2011, came to the conclusion that it was not possible for them to make any bipartisan agreement of cutting the federal deficit, thus triggering the law's requirement of automatic federal budget cuts in FY 2013. On August 4, 2011, then-director of the Office of Management and Budget (White House Chief of Staff until January 2013) Jack Lew wrote that the sequester was not intended to be implemented: "Make no mistake: the sequester is not meant to be policy. Rather, it is meant to be an unpalatable option that all parties want to avoid." The President's FY 2013 budget calls on Congress to replace the sequester. The House, Senate and White House agreed to delay the effects of sequestration until March 2013 under the American Taxpayer Relief Act of 2012. The across-the-board cuts will mean about an 8.4 percent cut in most affected non-defense discretionary programs, a 7.5 percent cut in affected defense programs, an 8.0 percent cut in affected mandatory programs other than Medicare, and a 2.0 percent cut in Medicare provided payments. In 2014, there will be no across-the-board cuts but the Appropriations Committees will decide how to allocate funding within budget caps requiring similar levels of percentage cuts.

The federal debt ceiling increase needed to avoid a default has been delayed from February until mid-May, with Congress providing borrowing authority until then. Another deadline occurs on March 27, 2013 when the legislation funding the federal government will expire creating the risk of a federal government shut down for non-essential functions.

Deficit reduction issues similarly continue to be a concern for the Government of Guam operations as well. These concerns have become more pronounced in the context of a revenue stream that will grow more slowly than previously anticipated due to the delay and downsizing of the Marine Corps relocation activities. These concerns include constraints on further borrowing associated with the Organic Act debt ceiling as well as ongoing litigation regarding the prompt payment of income tax returns and outstanding unfunded liabilities of the Government of Guam.

Conclusion

The outlook for a stable economy for FY 2014 assumes that the three issues facing the federal government this year - sequestration, the debt limit and extension of budget authority for this fiscal year for federal operations - will be resolved without the federal expenditure cuts currently required by the sequester extending into FY 2014. Implementation and continuation of cuts at such a level would almost certainly ensure a modest economic contraction for Guam as the island is heavily dependent on federal funding for defense and nondefense operations as well as defense construction expenditures. It is also assumed that the budget deficit resolution will involve some level of federal expenditure cuts which will extend to Guam during the FY 2014 budget period reducing that source of income receipts. A Defense spending blueprint presented by U.S. Defense Secretary Leon Panetta January 5, 2012 provided a Statement on Defense Strategic Guidance which states that "we are also rebalancing our global posture and presence, emphasizing the Pacific and the Middle East." Depending on the relative importance of emerging budgetary and defense issues, it is possible that increases in defense expenditures for Guam could, in the aggregate, outweigh other budgetary considerations and reductions. Stability and growth also depend on further increases in tourism as well as continued high levels of construction. As a small economy, a given level of change will have a larger percentage effect than on a larger one. Often, the positive gains in one part of the

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economy are off-set by a loss in another resulting in little net change. Should a number of the major components concurrently move in either a positive or negative direction the cumulative effect of the change from the status quo could be significant.

While the performance of the economy is the most important component in the level of tax revenues collected in a fiscal year, a number of other variables can have a measurable impact. Price inflation remains low for the U.S. and Guam but even moderate inflation can increase tax collections for a constant level of activity for taxes assessed on the dollar value of sales. Government revenue receipts are not determined solely by economic activity but are affected by the timing of tax and other payments as well as accounting and tax policy issues.