

Where We've Been Where We Are Where We're Going



presented to the

AGA Guam Professional
Development Conference

September 12, 2016

A Global Economic Overview

- The global economy has grown, but only modestly
 - Europe was disrupted by refugees and terrorism
 - The Middle East was disrupted by war, terrorism and extremely low oil prices
 - Africa, Australia and South America were disrupted by falling commodity prices and falling exports
 - Asia's exporting economies were disrupted by weak international economic conditions
 - The United States was disrupted by unbalanced sectoral growth (and decline), misguided fiscal policies and . . . the distractions of a *highly* unusual presidential campaign



A Global Economic Overview

- Europe doesn't affect us much, except indirectly
- The Middle East affects us a lot because OPEC actively chose to allow oil prices to plummet
- Africa, Australia and South America are on another planet from our economic perspective
- Asia is another story altogether
 - Japan and South Korea affect us through tourism
 - China affects us through regional military tensions
- U.S. housing and financial markets are booming (sound familiar?) while the real economy continues to lag

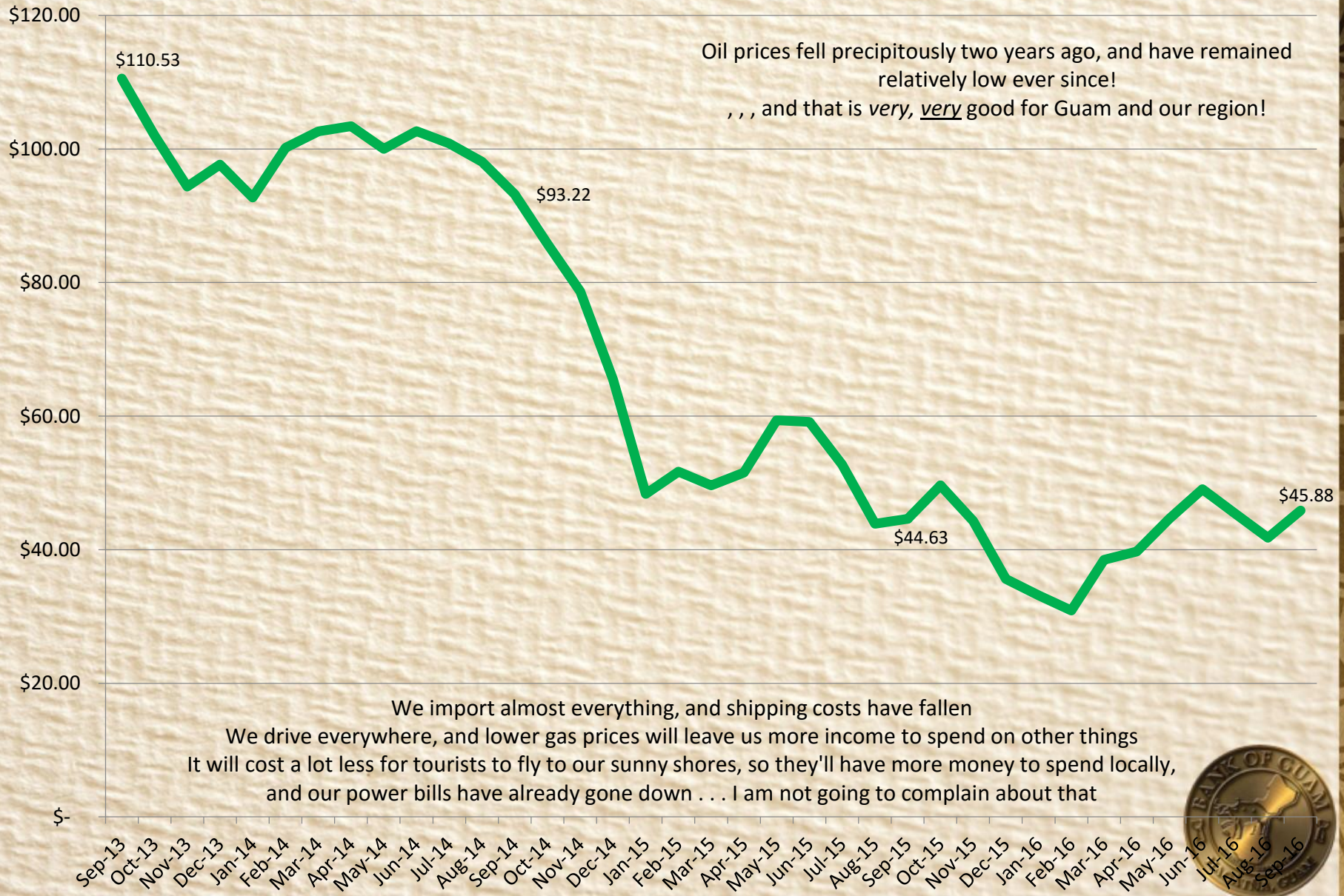


Oil Prices (and Energy Costs)

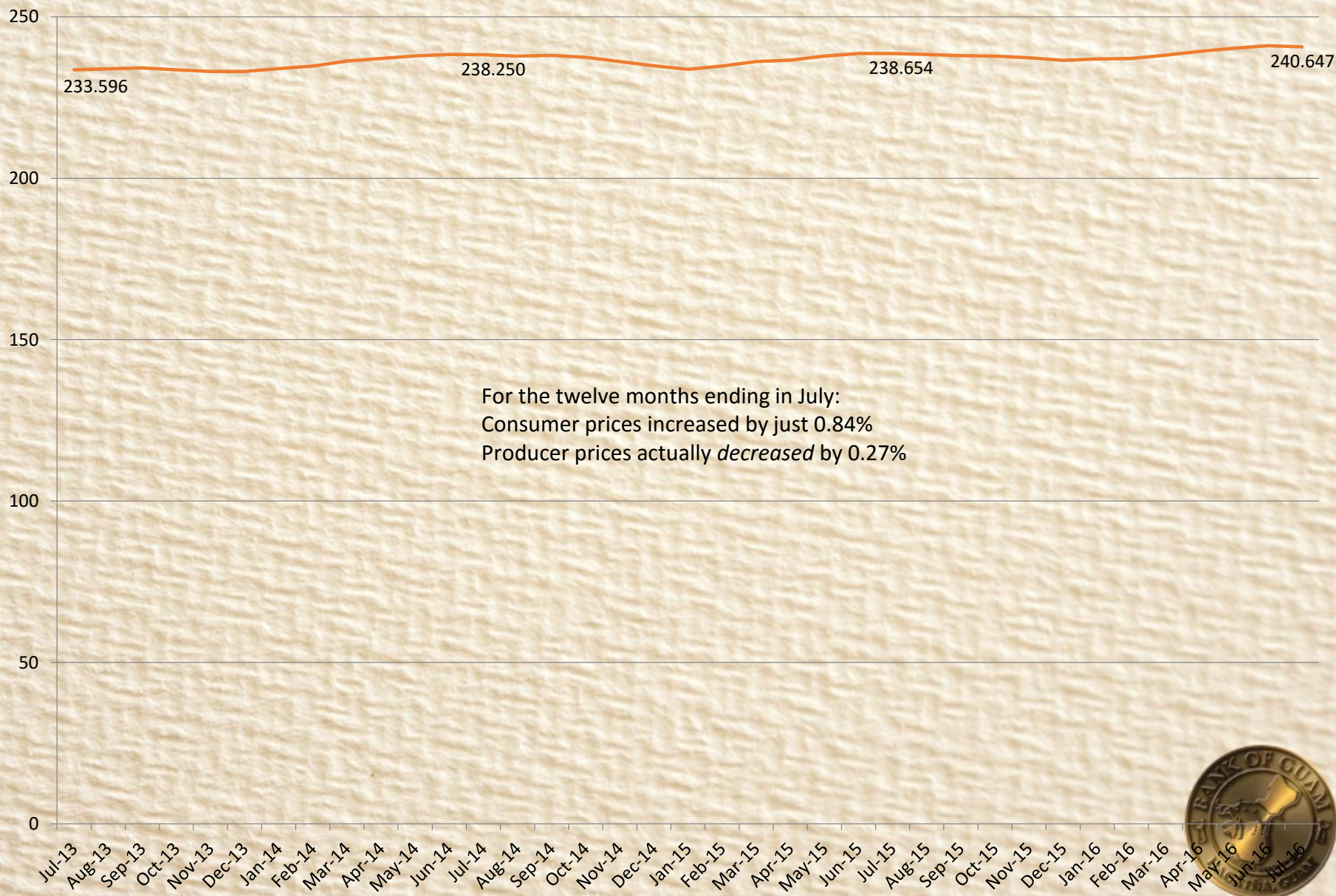
- Oil prices have fallen by more than half from two years ago
 - Because of price competition and the concurrent increases in production of other fossil sources, all energy prices have ridden the same road downward
- Low energy prices have helped us in many ways
 - We have been saving a *lot* at the gas pump
 - Electric power costs have fallen sharply
 - Shipping costs and airfare have fallen or stabilized
 - Even the goods we buy are produced at lower cost
- The effect on consumer prices tells the tale



West Texas Intermediate Crude Oil (\$/bbl)



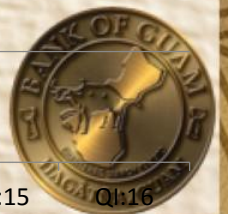
Consumer Price Index - U.S.



Consumer Price Index - Guam

(QIV 2007 base = 100)

The massive increase in consumer prices during the first quarter of this year was due to several fee increases at Guam Memorial Hospital for services that just happen to be part of the surveyed "market basket" of a representative household's consumer goods.



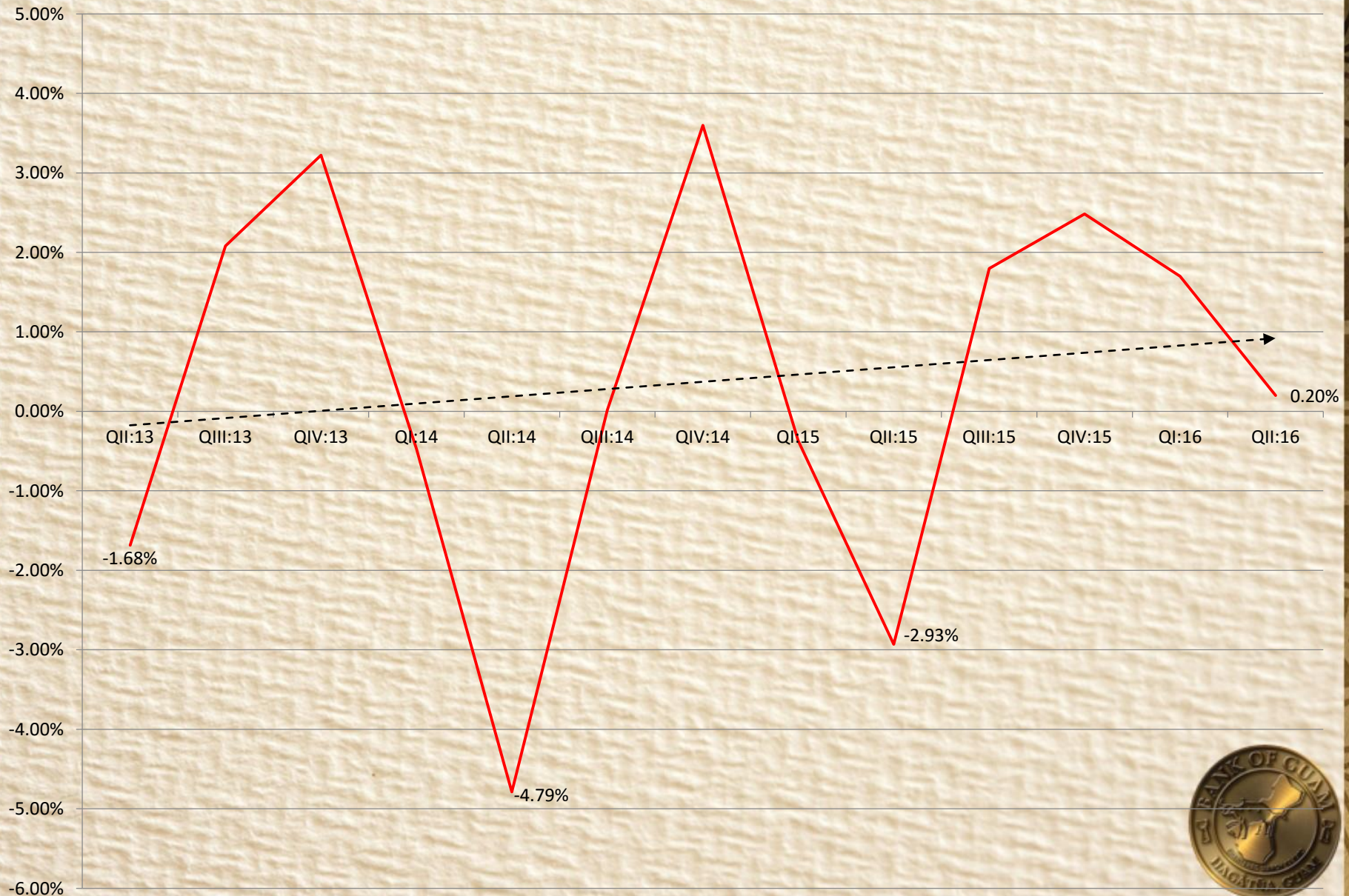
International

- Japan

- Second quarter gross domestic product grew by 0.2%
- Production is still below 2005 levels (a weak year)
- Employment is finally growing, but slowly
- Despite the massive devaluation of the ¥en (that didn't stick) . . . prices are still flat-to-falling
 - Devaluation did not spur exports as much as intended
 - Deflation has been Japan's biggest problem for 25 years
- The Nikkei was rising until China's market problems
- The interest rate on six-month government debt has been *negative* since the beginning of last year, and 10-year yields have been negative for seven months

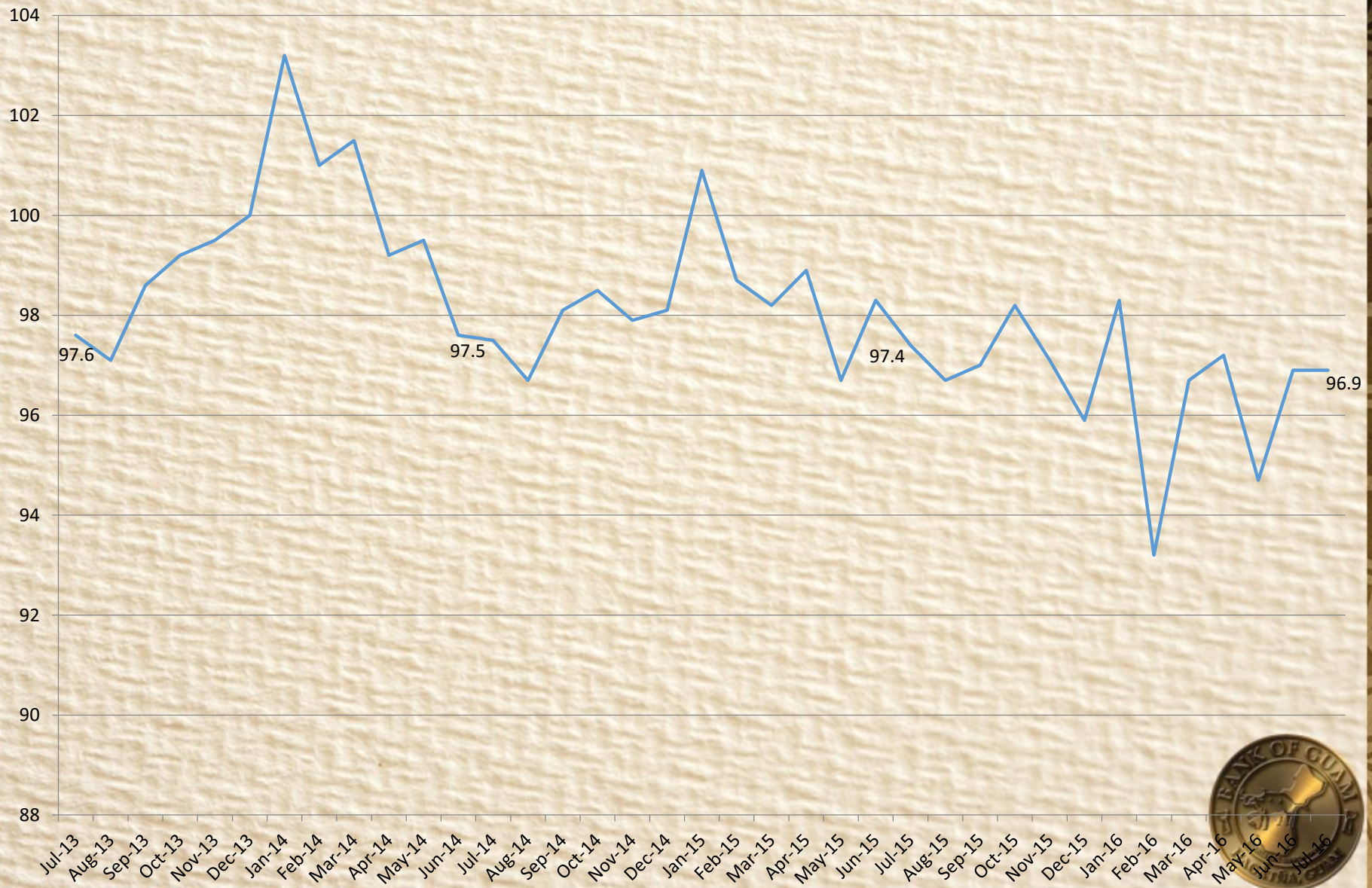


Trend in Japan's Real GDP Growth

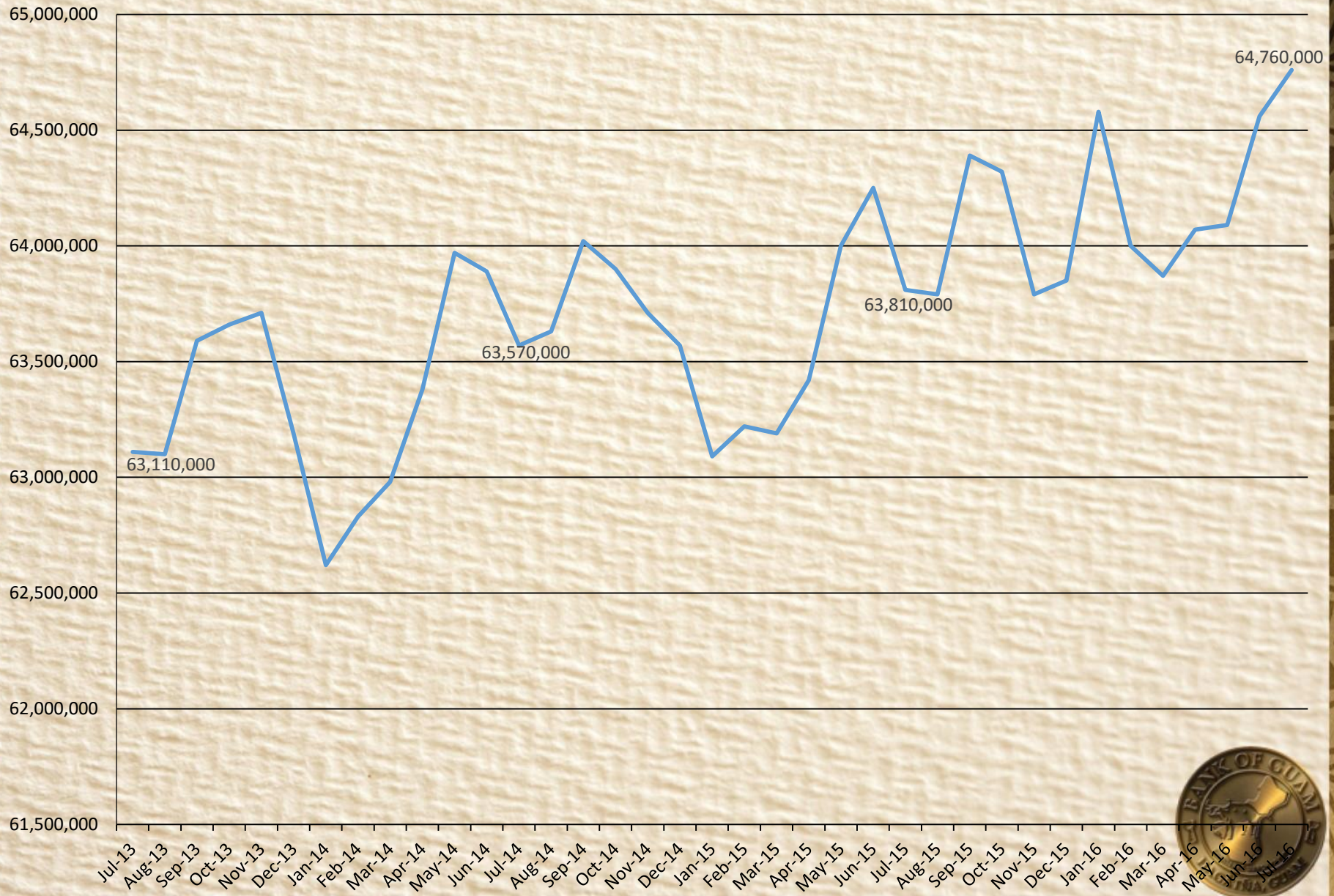


Industrial Production Index - Japan

2005 base = 100

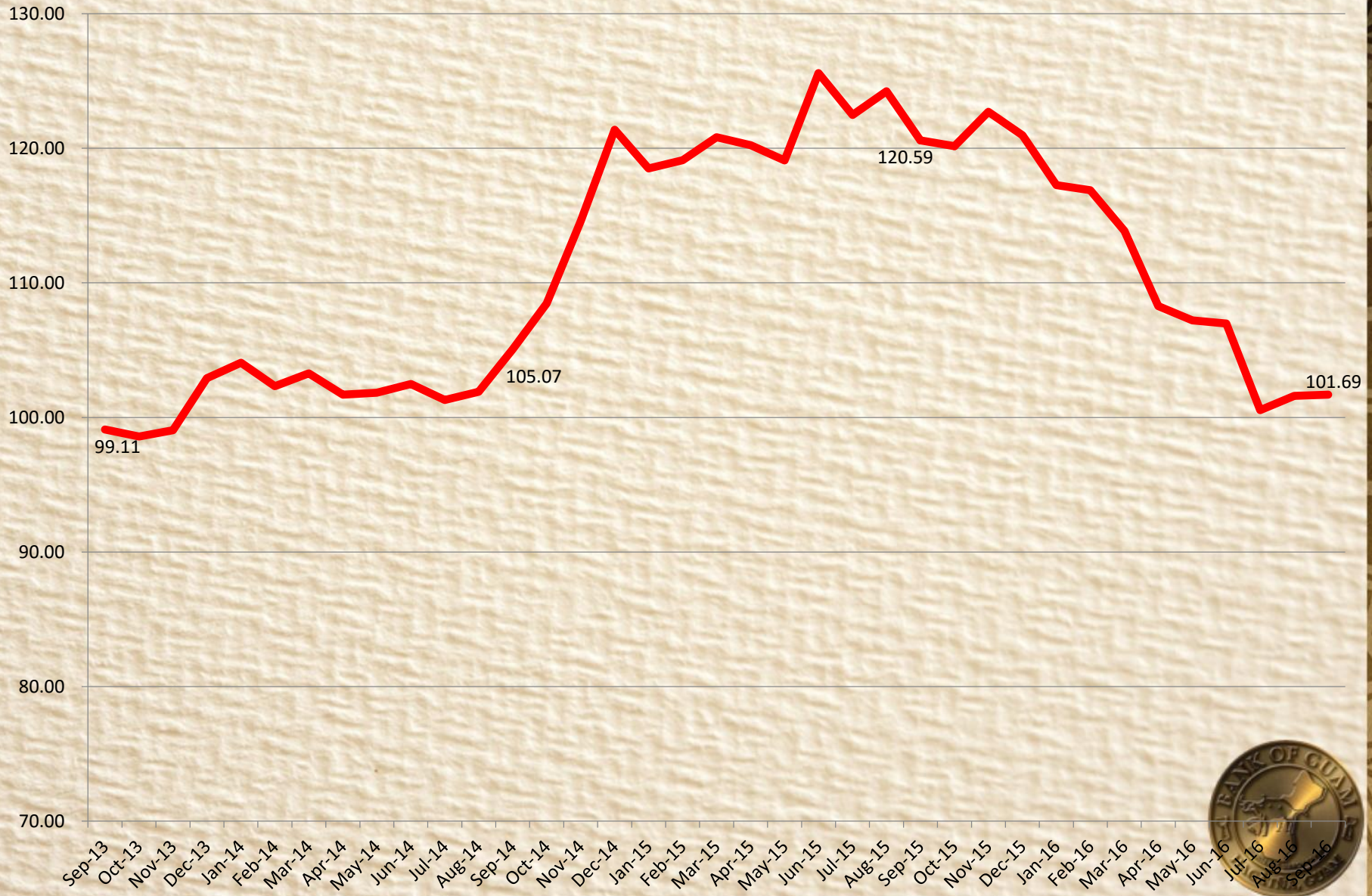


Japan Payroll Employment

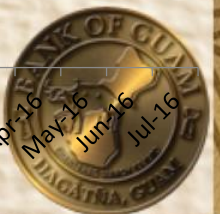
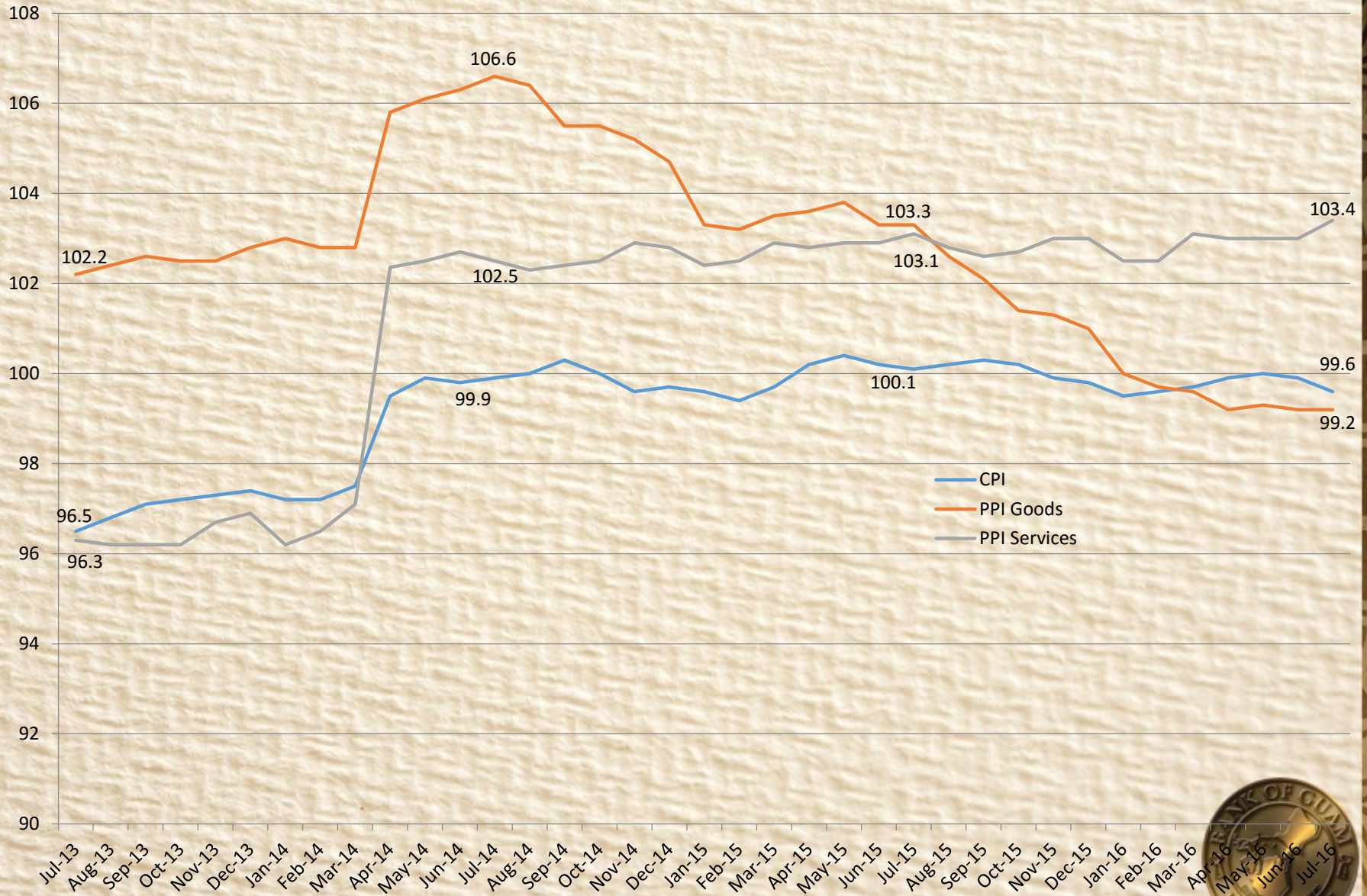


¥en per Dollar

As of Close - Friday before the Second Monday of the Month



Price Indices - Japan

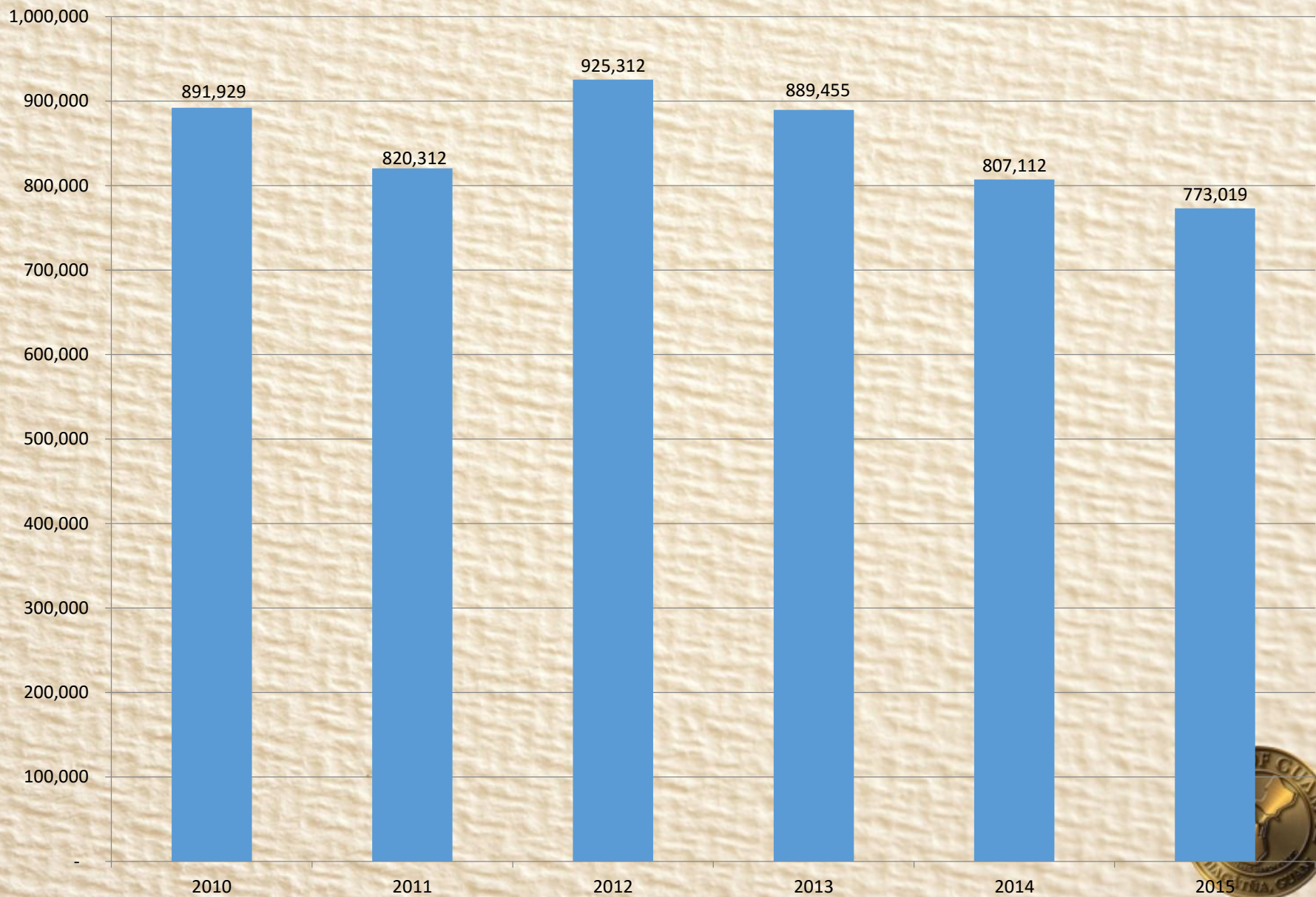


Japan's Impact in Guam Has Been Fading

- For 40 years, Guam tourism catered to Japan
 - For decades, Japan *was* our market: 80%-*plus*
 - Investment died with the collapse of Japan's real estate and financial markets in 1990 and '91
 - Visitor arrivals went flat, then dived in 2011
 - After a brief recovery in 2012, they have fallen more
- Finally, a change in policy focus devalued the ¥en to boost exports two years ago, just as the global economy started to contract again
 - Most signs now point negative for Japan's economy
 - Travel to Guam has become *extremely* expensive from the Japanese perspective (but is easing)



Japanese Visitor Arrivals



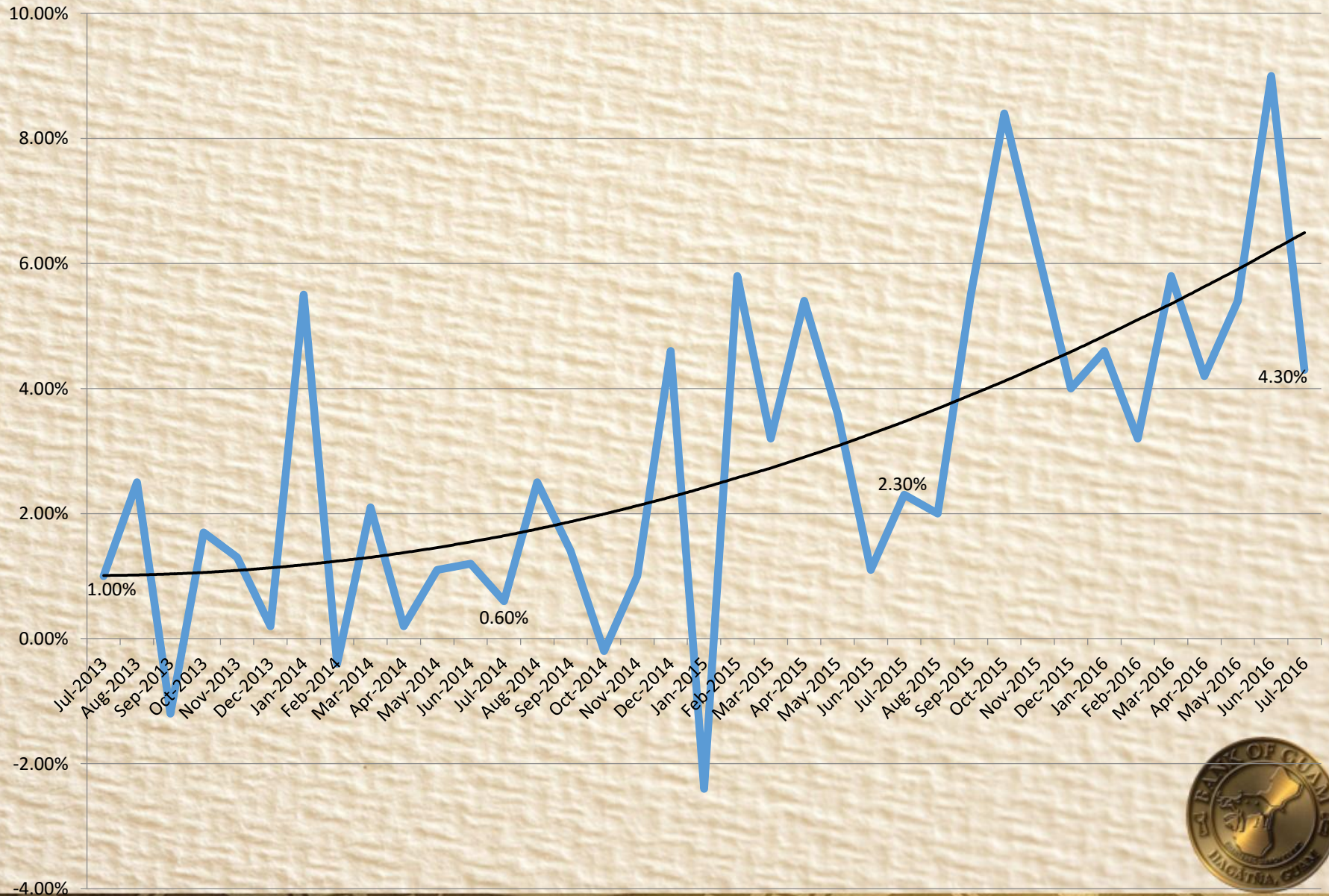
International

- South Korea

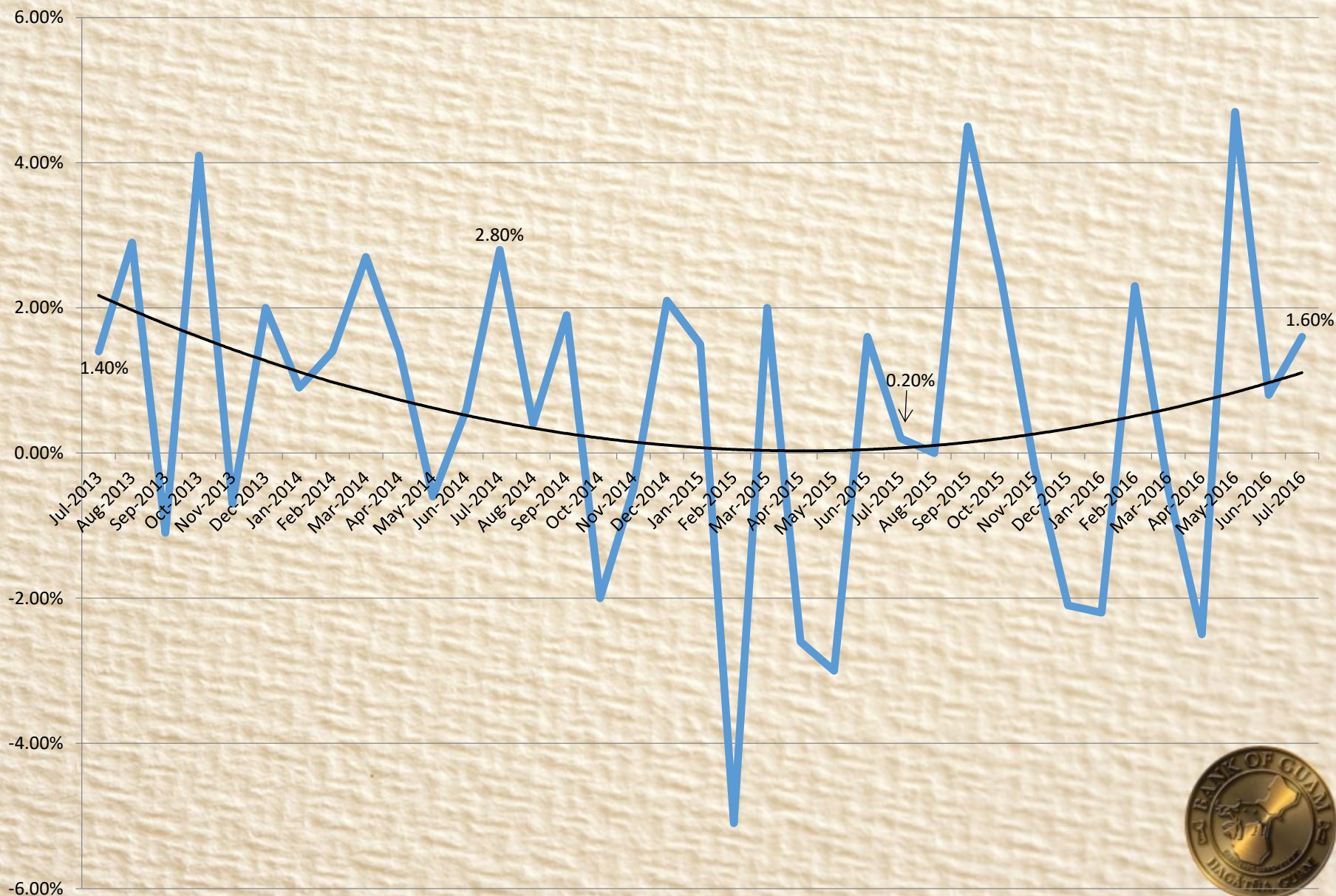
- Retail sales growth is improving
- Industrial production growth is erratic, but trending upward
 - Leading to slow growth in production capacity . . .
 - . . . because of a capacity utilization rate that is already quite low
- Producers' inventories are growing too fast . . .
- . . . but have started to recede again, stimulating output
- The unemployment rate is low, at 3.5%
- Inflation is mild, at 1.6%
- The KOSPI stock index stays between 1,900 and 2,100
- *AND:*
 - Koreans are coming to Guam in growing numbers, with opportunities for optional tours . . . and investment?



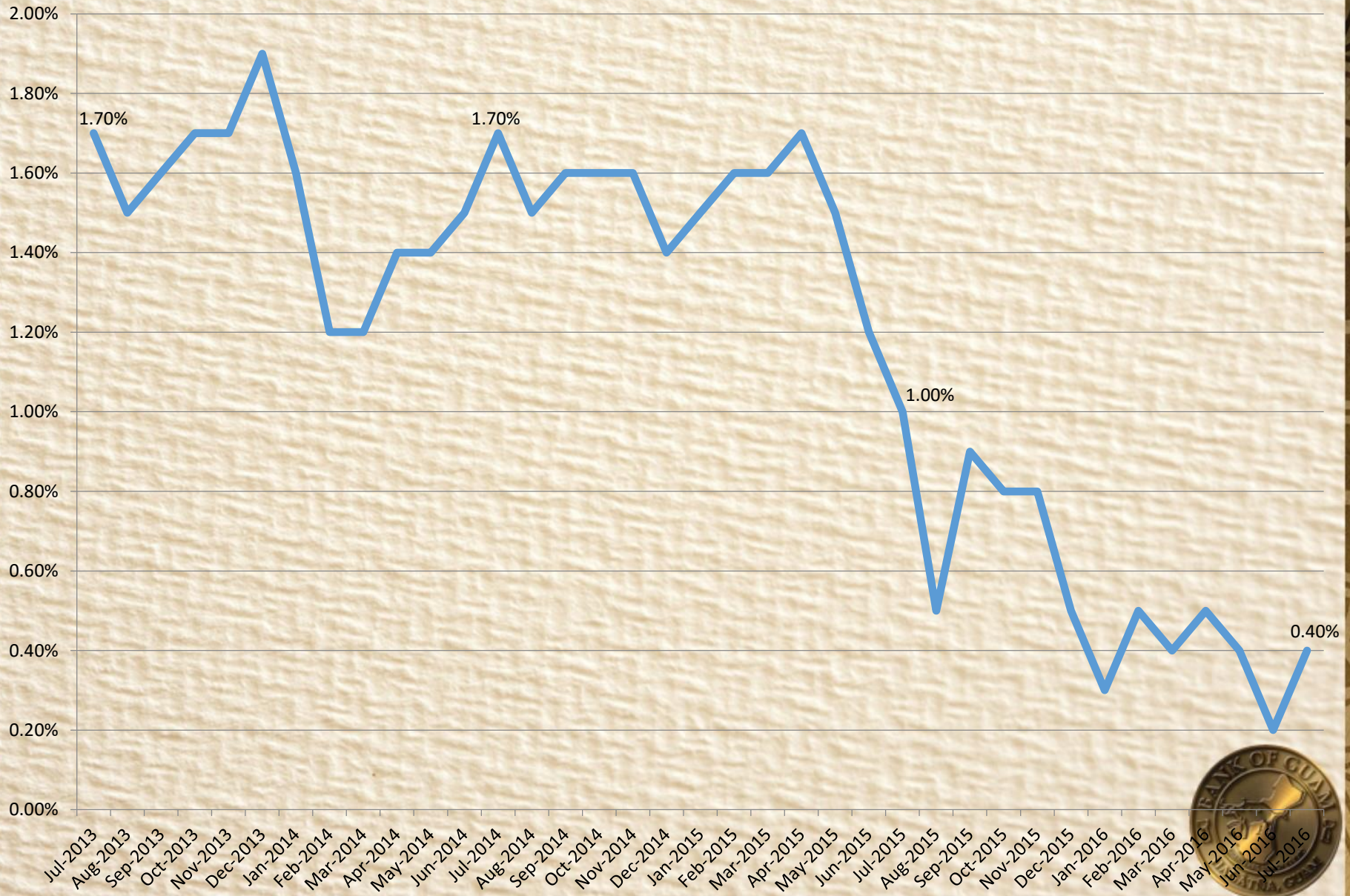
Year-over-Year Change in Retail Sales - Korea



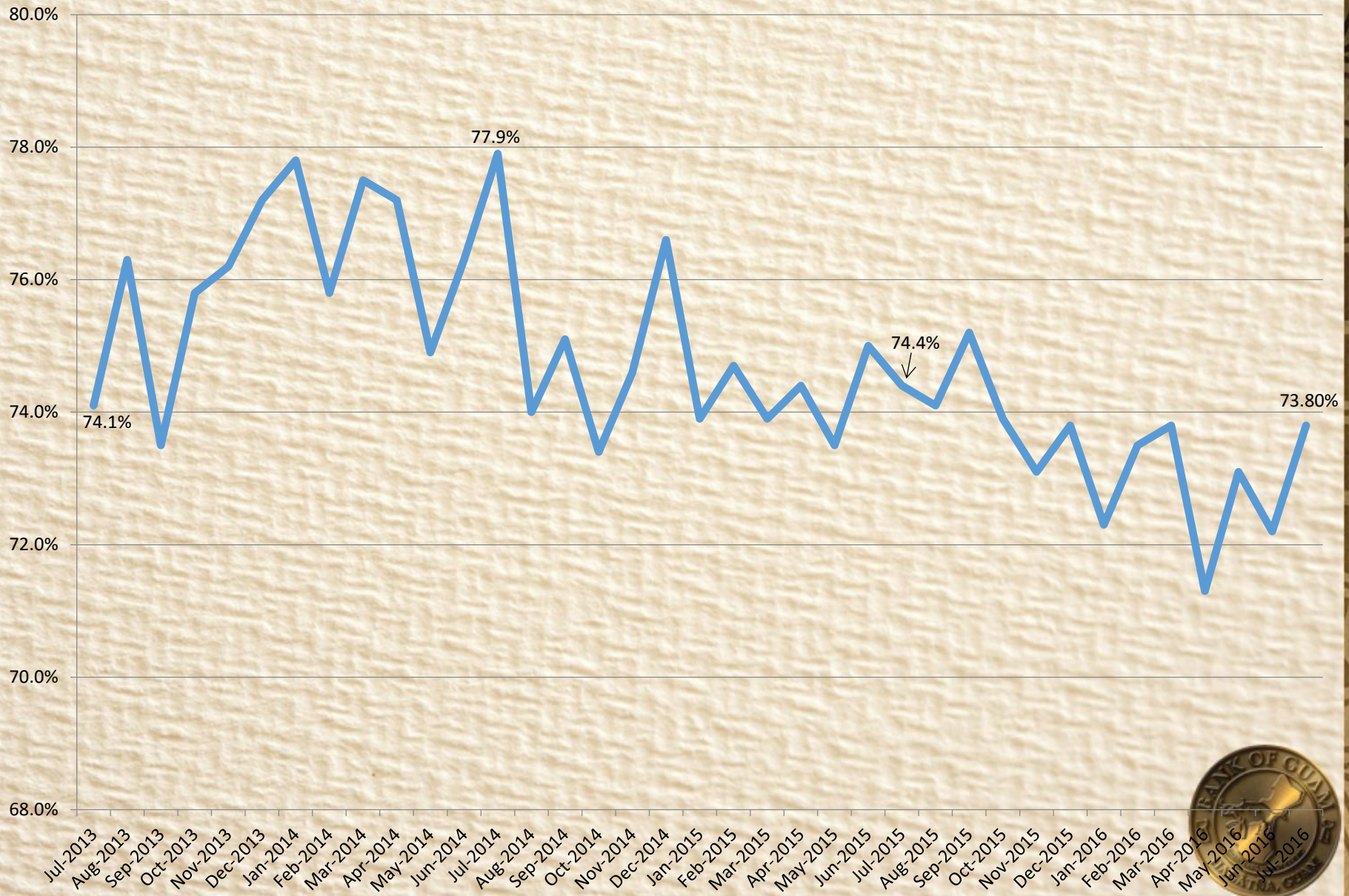
Year-over-Year Change in Industrial Production - Korea



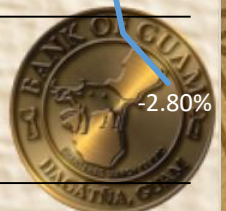
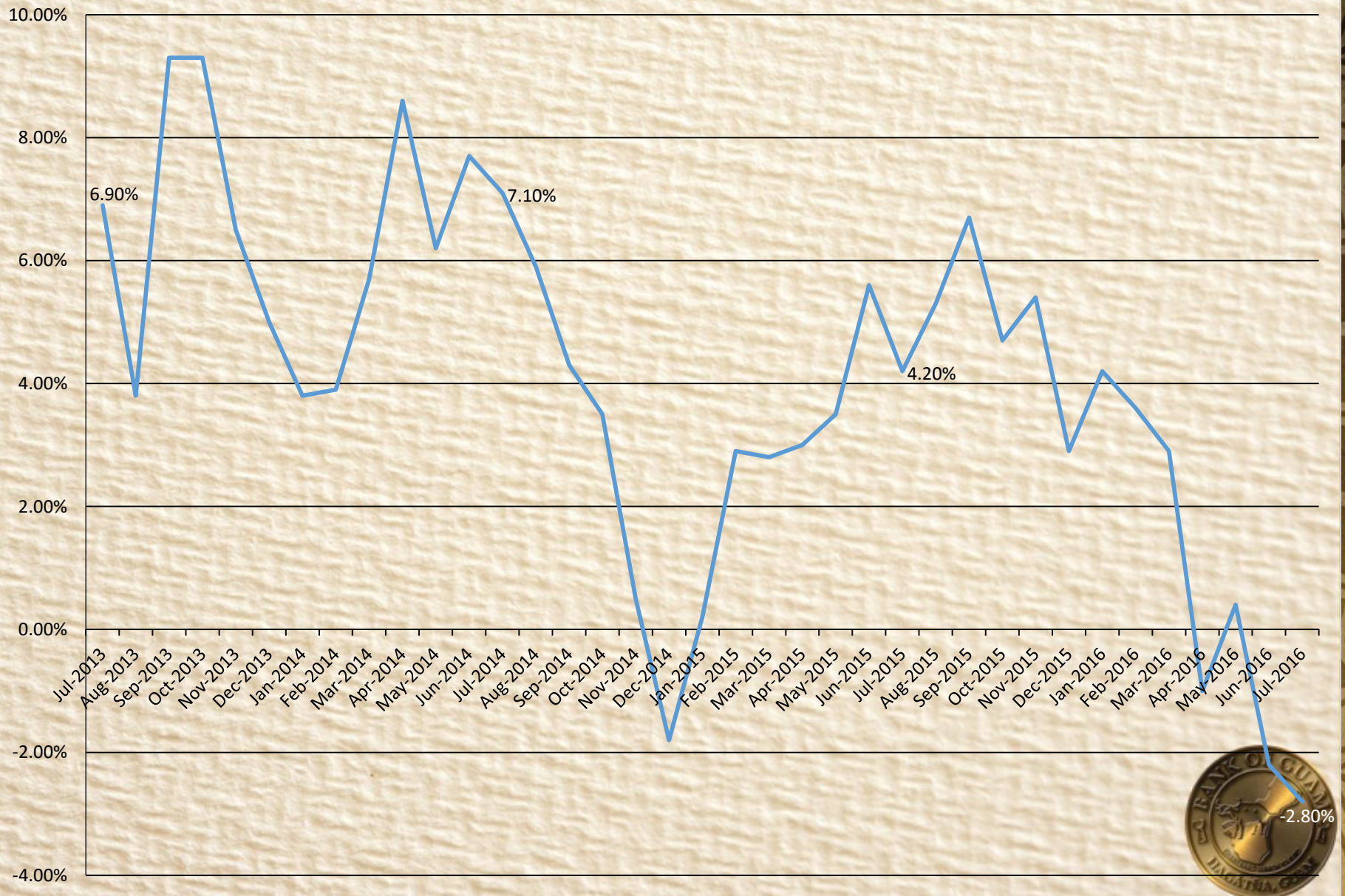
Year-over-Year Change in Production Capacity - Korea



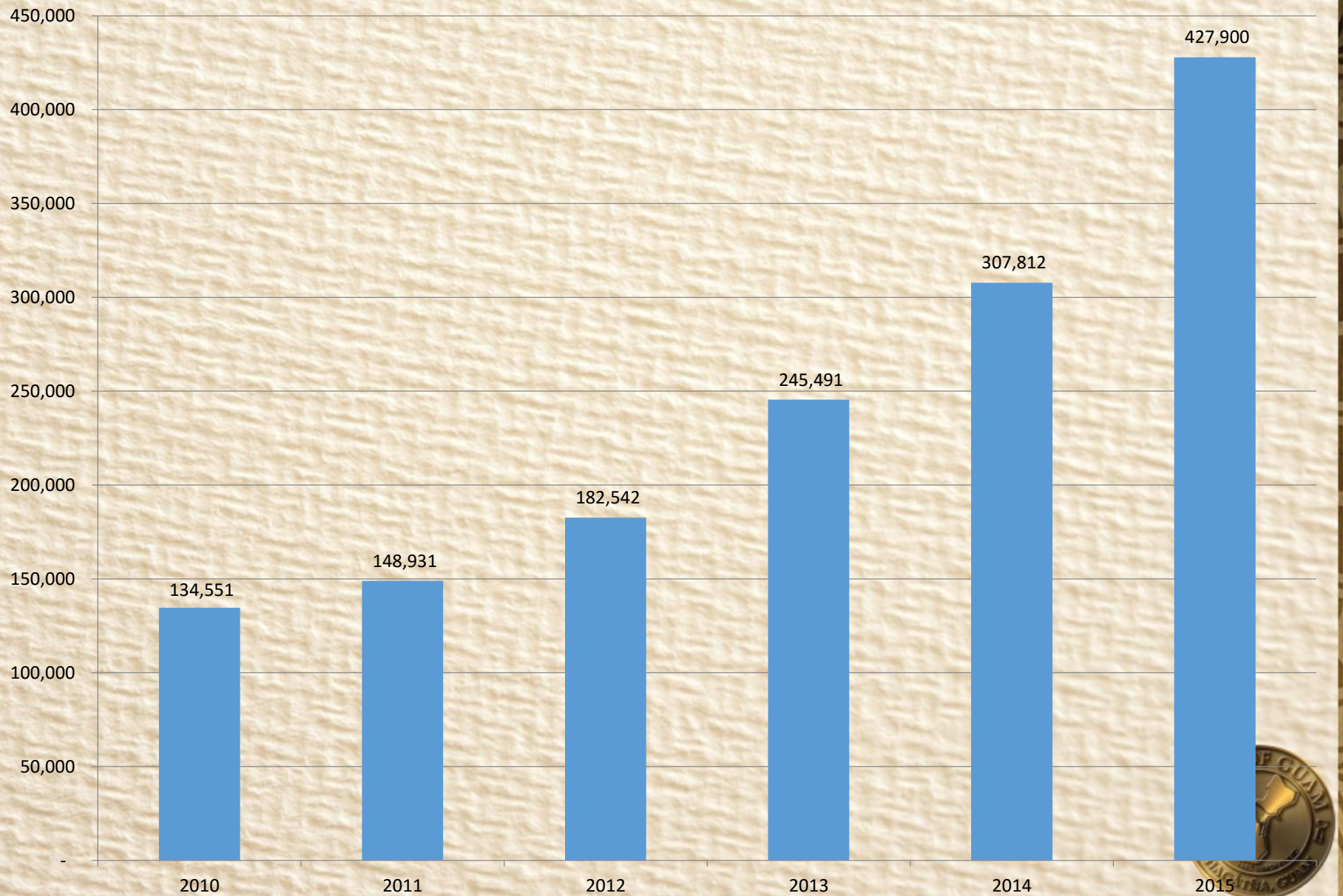
Capacity Utilization - Korea



Year-over-Year Changes in Producers' Inventory - Korea



Korean Visitor Arrivals



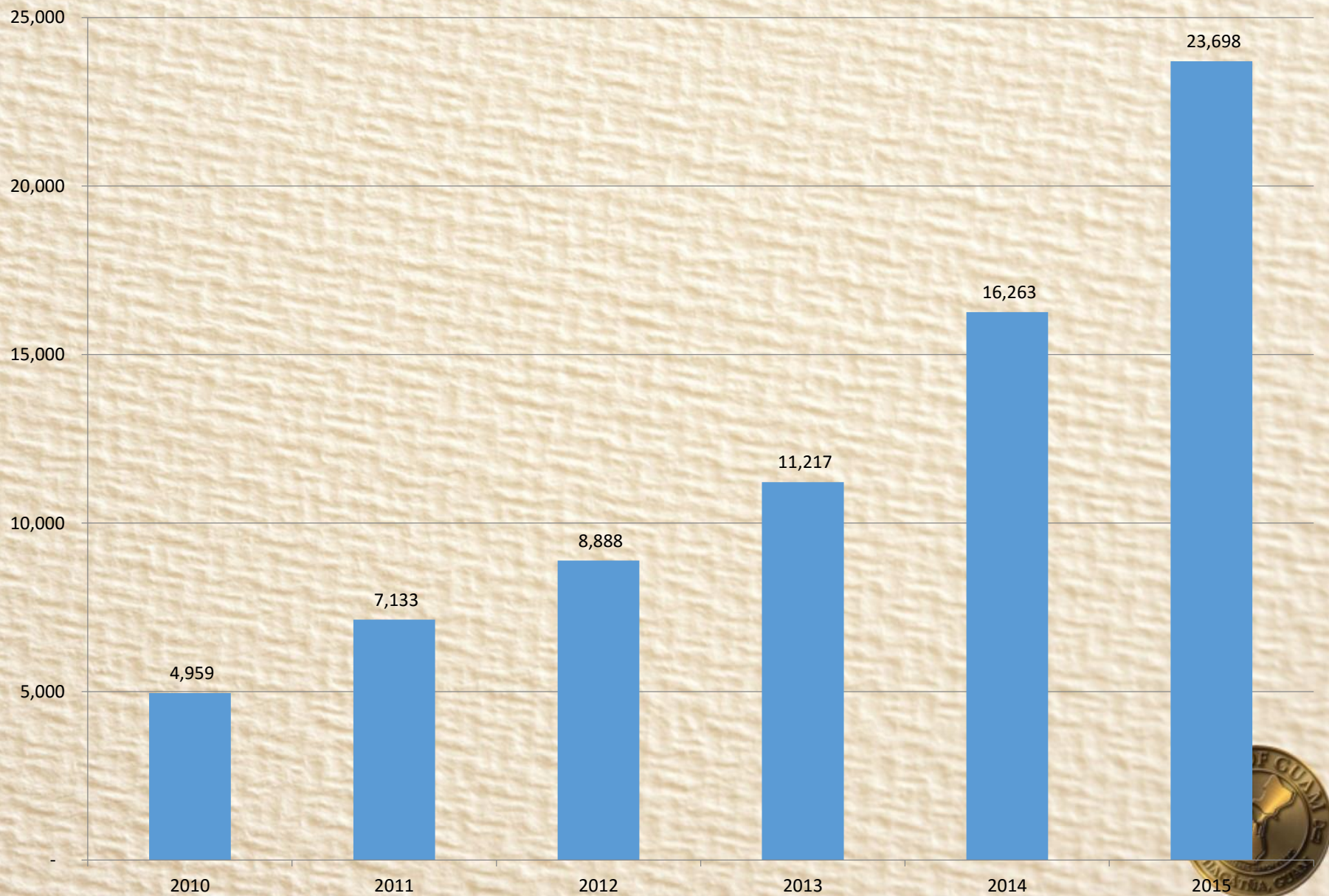
International

- China

- From the very beginning, my bet on the Chinese visa waiver has been . . . it's not going to happen
- China's impact on our tourism industry is very weak
 - Growing, but the numbers are still very small
- The impact of China in Guam is mostly through our other industry . . . military defense
 - The main reason for the “pivot” from Europe to Asia
 - Chinese activities in the South China Sea signal the prospect of expansionism in the region
 - Both political and economic interests ensure that the U.S. military presence will increase

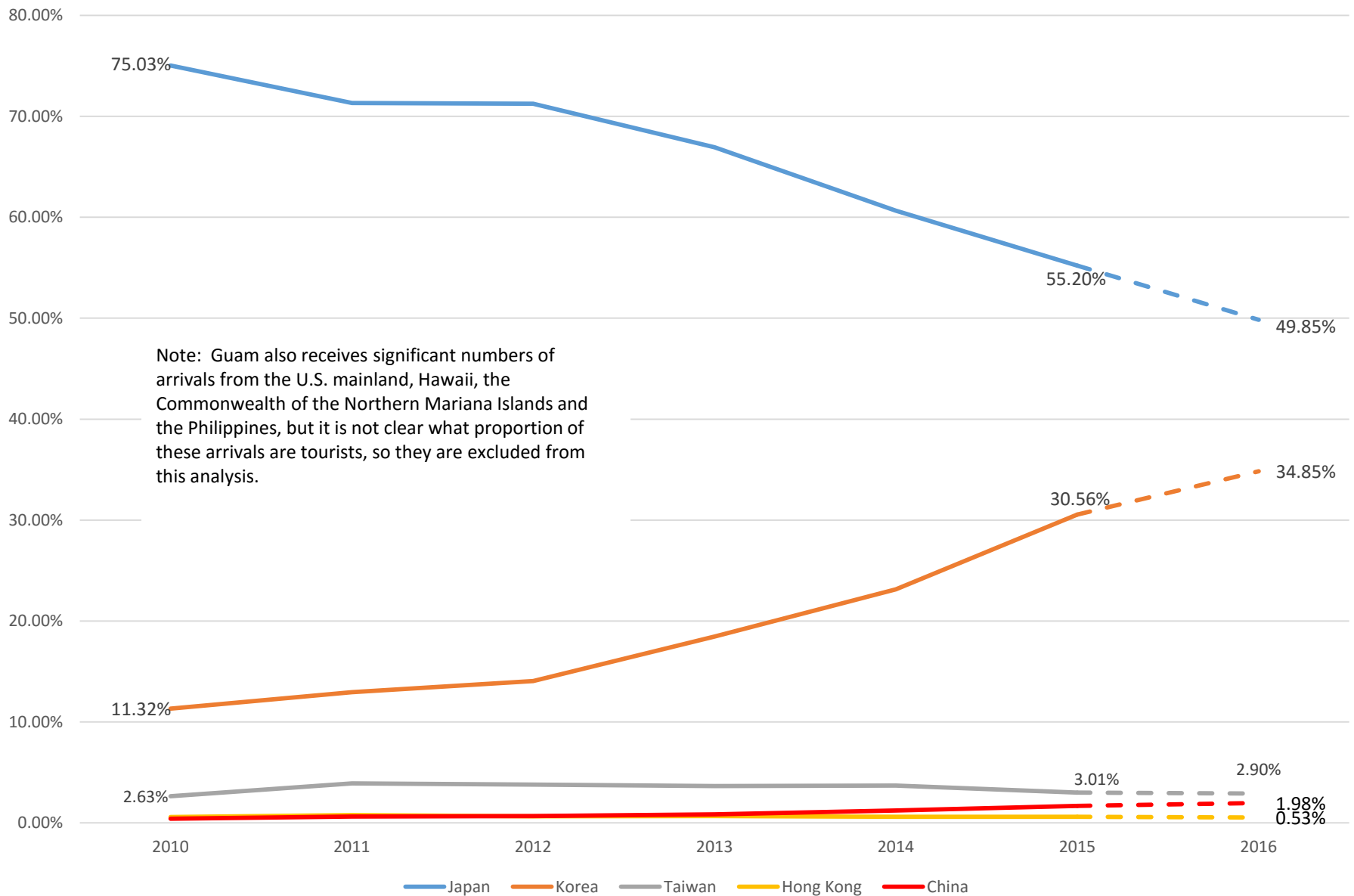


Chinese Visitor Arrivals



Major Markets' Shares of Total Arrivals in Guam

(Annual, except Year-to-Date August 2016)



National

- There is a lot of talk about “recovery,” but the activity is mostly in housing and finance
 - Housing prices are rising too fast – another bubble?
 - Financial asset prices seem somewhat elevated, too
- Retail sales growth is modest, at best
 - Business and wholesale inventories continue to grow
 - Inventory-to-sales ratios are still elevated
- Industrial production growth and capacity utilization ratios are both still low



U.S. Retail Sales - Rate of Change



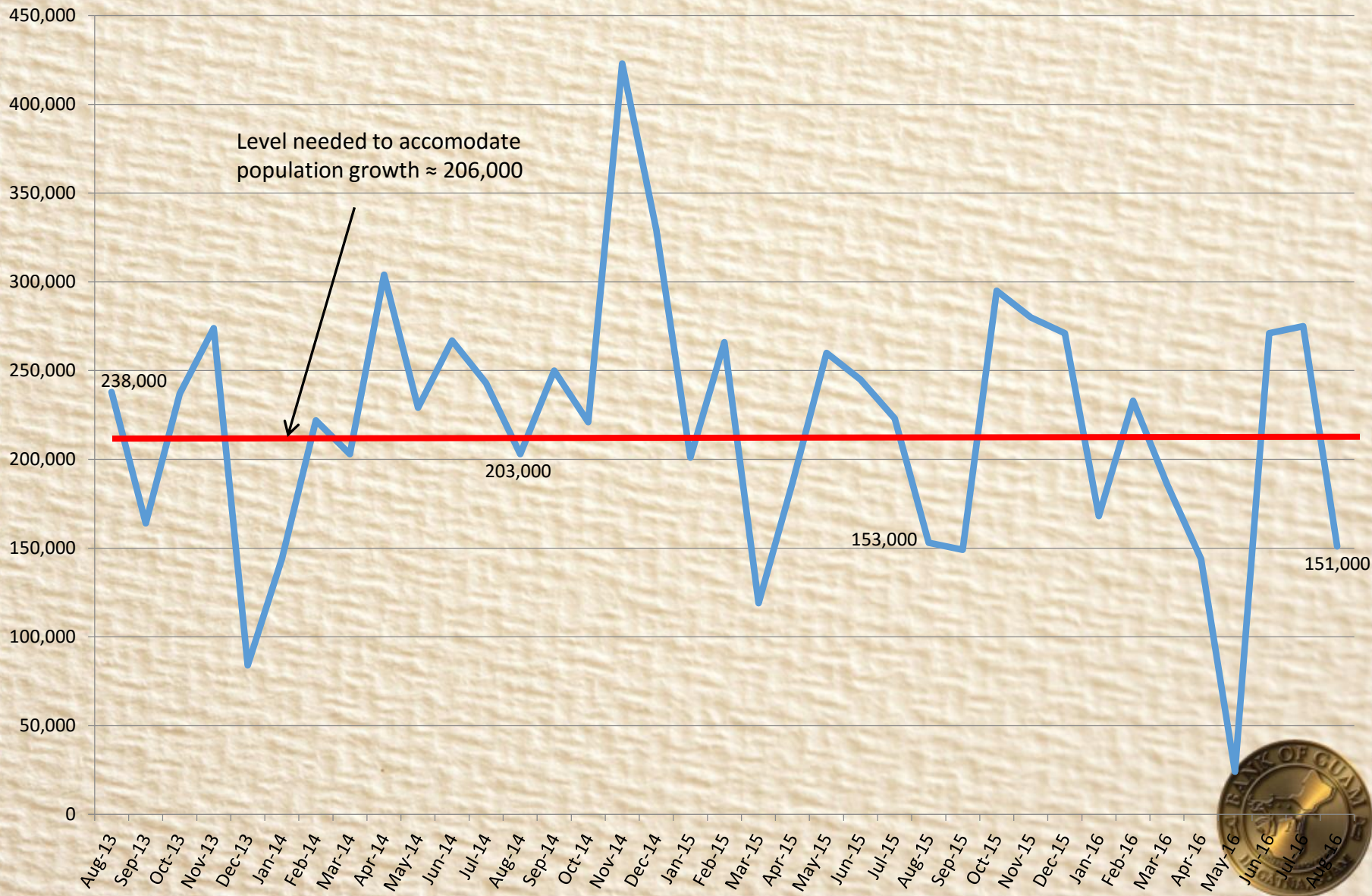
National

- Growth in durable goods orders and in factory orders was weak to negative until July
- Payroll employment growth, though, is *finally* gaining some tentative traction, with 2.4 million new jobs filled in the past year
- The unemployment rate appears to have stalled
 - The good news is that the long-term unemployed are slowly re-entering the labor force
 - The bad news is that it is mostly lower-paying service jobs that are being filled
- Consumer and producer price inflation is still tame . . .
 - . . . as is core personal consumption inflation

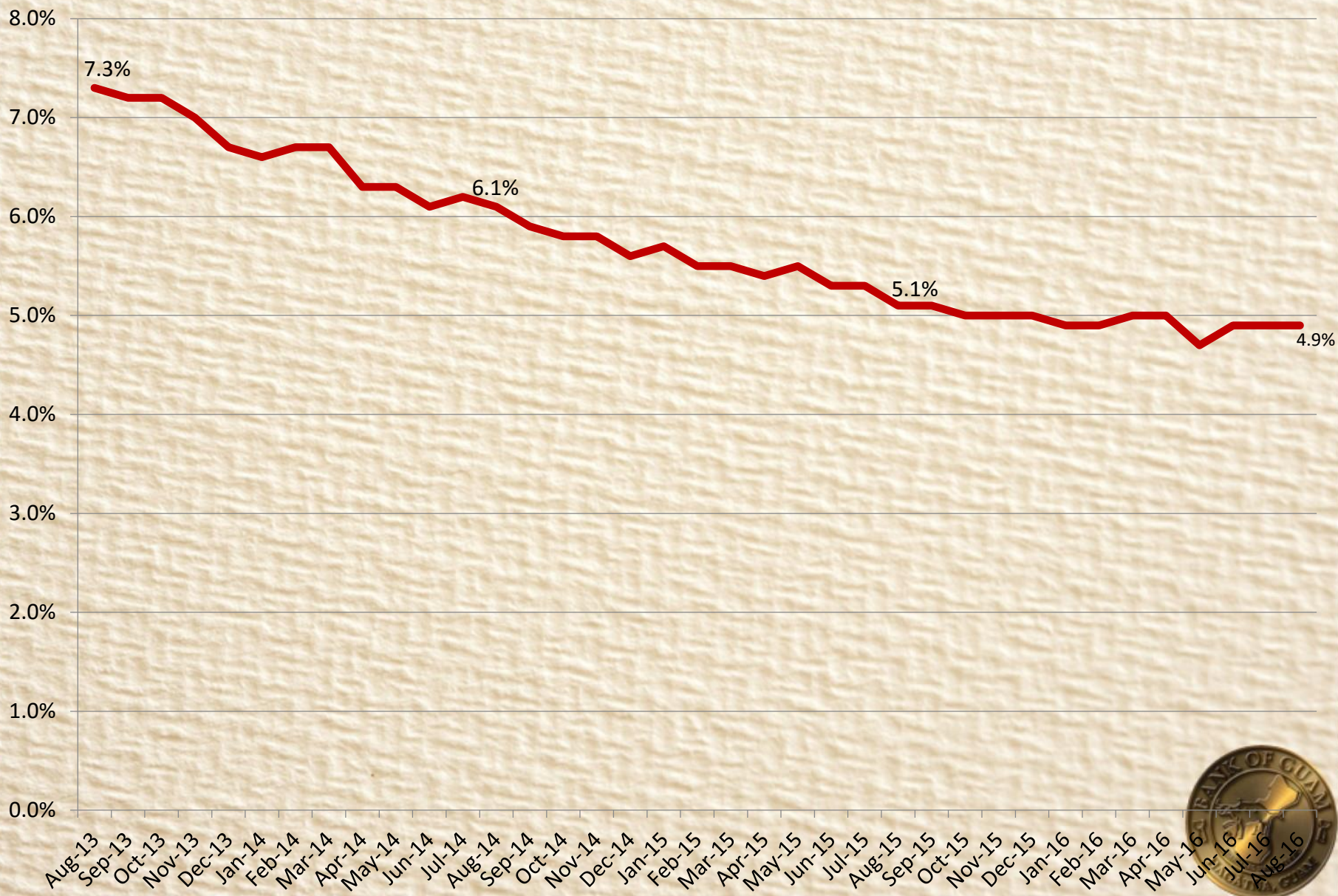


U.S. Payroll Employment

(monthly changes)

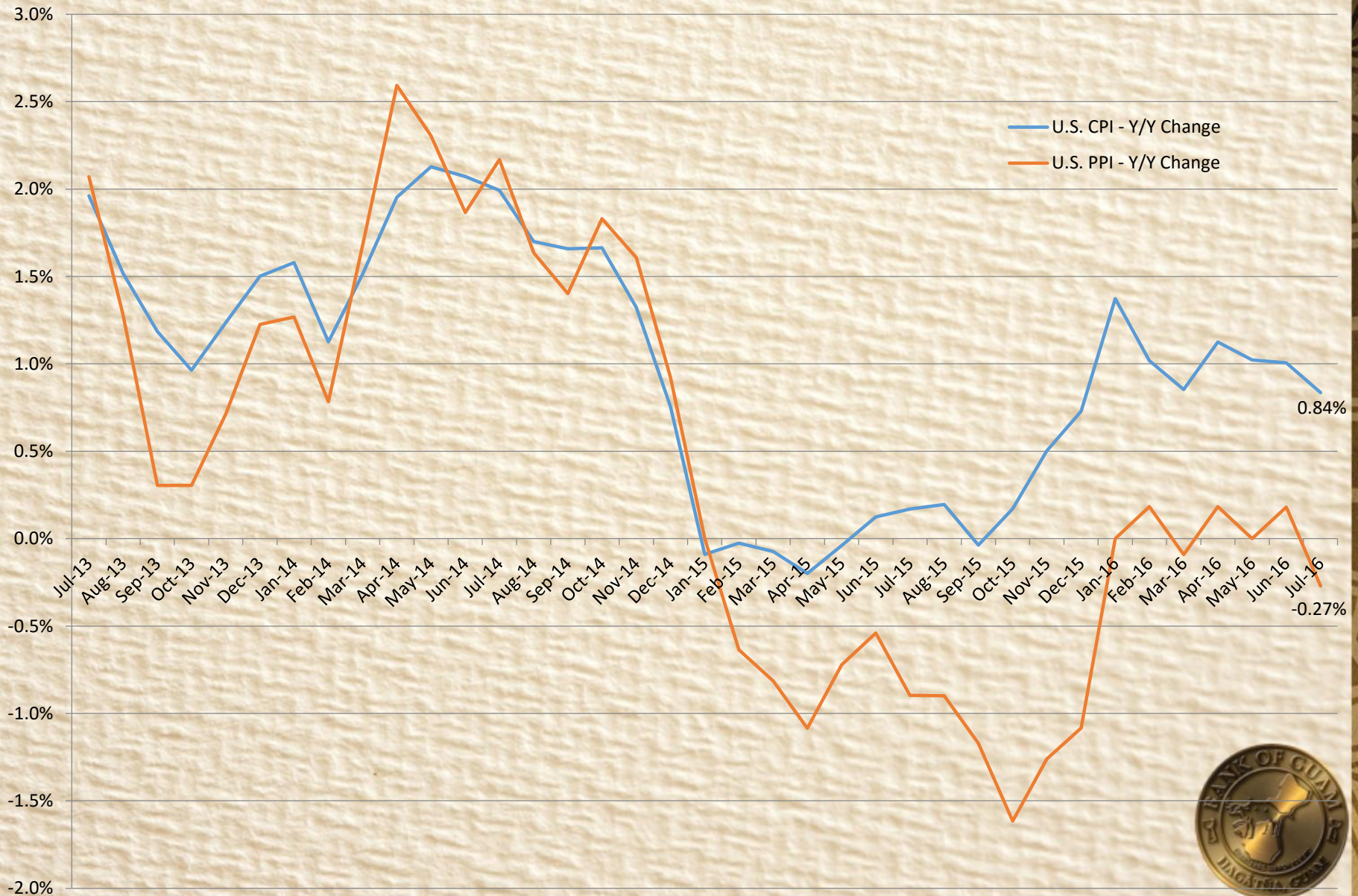


Unemployment Rate - U.S.



U.S. Consumer & Producer Price Inflation

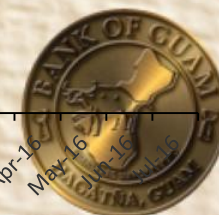
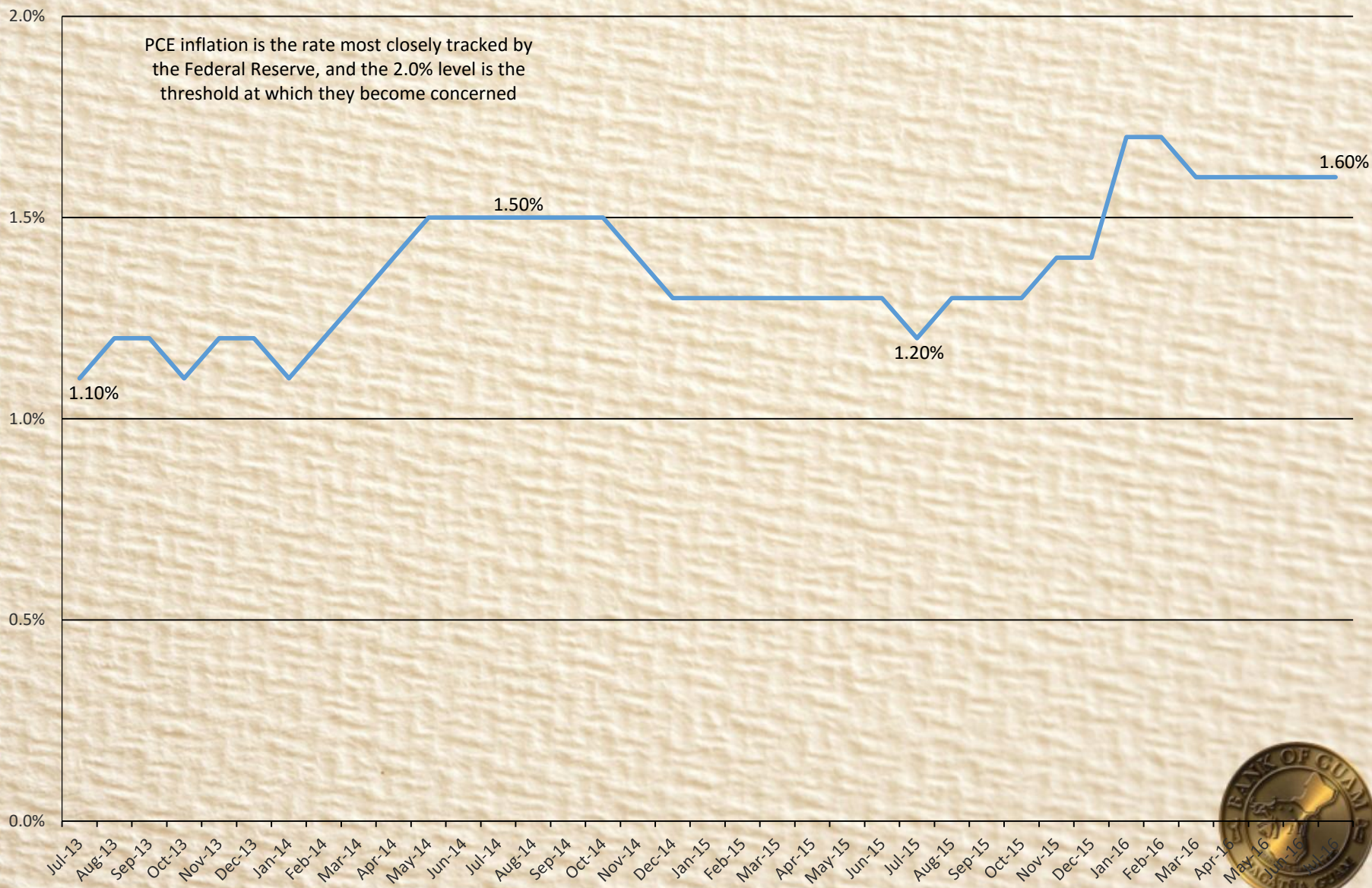
(Year-Over-Year)



Core Personal Consumption Expenditure Price Index

(Year-Over-Year)

PCE inflation is the rate most closely tracked by the Federal Reserve, and the 2.0% level is the threshold at which they become concerned



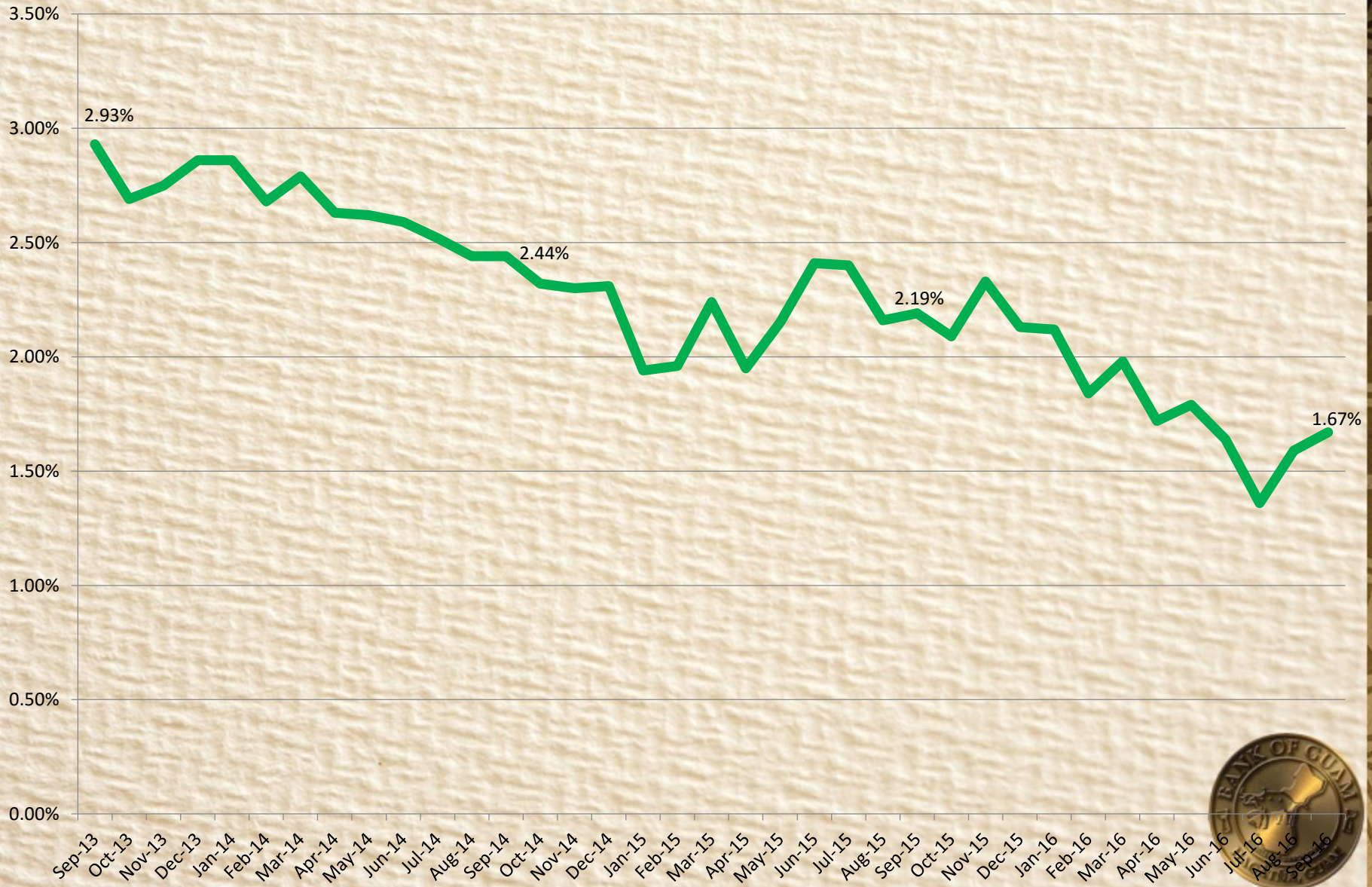
National

- Personal income has been rising more quickly
 - Unfortunately, a lot of the increase has been in unearned income rather than wages and salaries
- Consumption is rising, too, but is being fueled partially by consumer debt (again)
- The Dollar has strengthened against the ¥en and the €uro, inhibiting U.S. export prospects
- Interest rates remain historically (unnaturally?) low
 - Ten-year Treasury yields are hovering around 1.60%
- Inflation is low, unemployment is sticky, and global events again threaten weak growth



10-Year Treasury Yield

Friday Close Before the Second Monday of the Month



Regional

- The CNMI

- The economy *appears* to be doing well
 - Visitor arrivals are rising at about a 2.2% rate
 - Not too many rusty cars on the road and lots of new paint
 - A lot of storefronts that were empty a few years ago are now occupied by businesses
- Chinese investment and tourism are the driving forces

- Palau

- The Chinese influence is even more pronounced
 - There is a *lot* of new Chinese signage on storefronts
- There is a serious concern that the Chinese are displacing local firms in the tourism industry
- Drought was a problem earlier this year

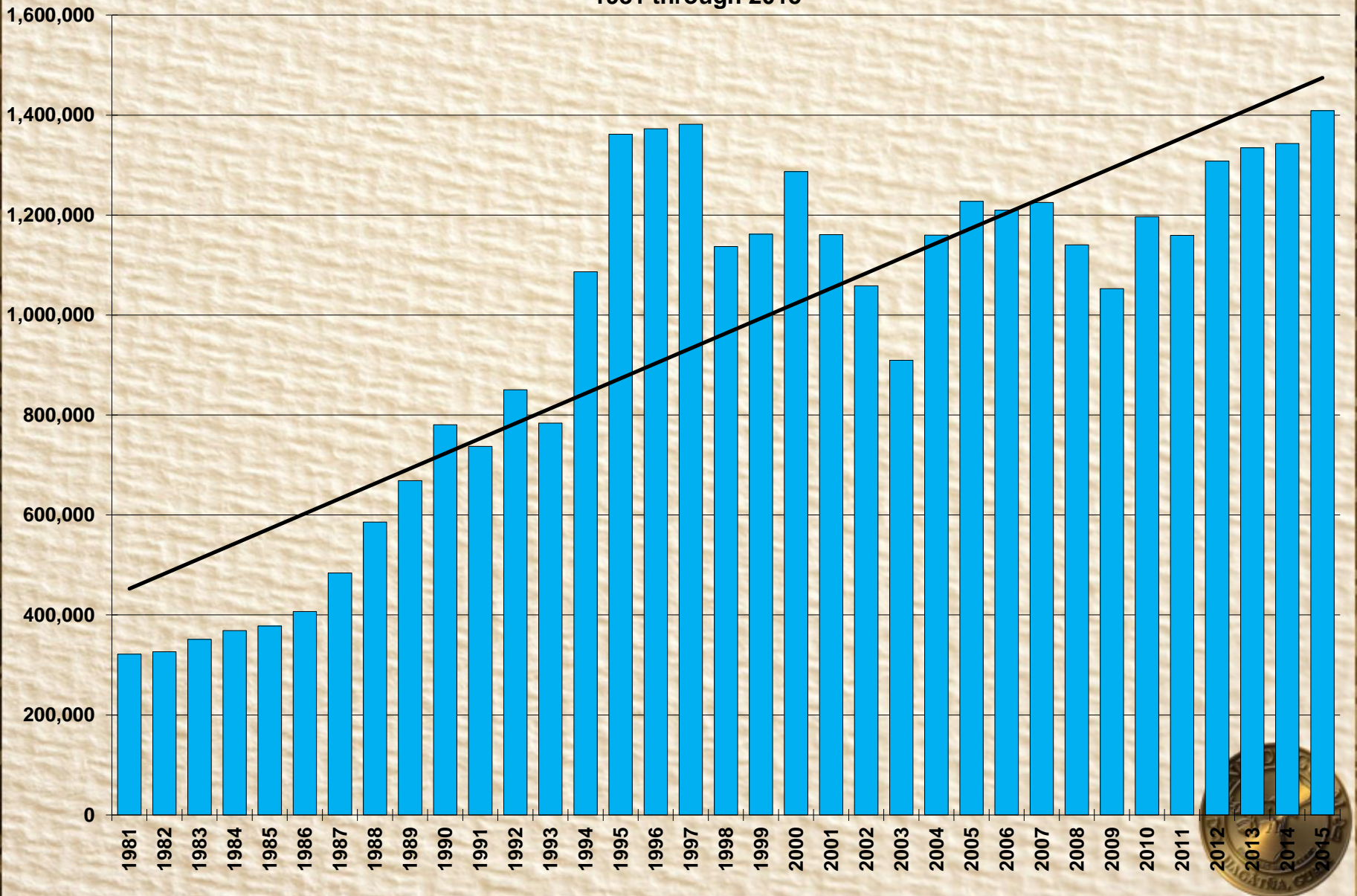


Guam

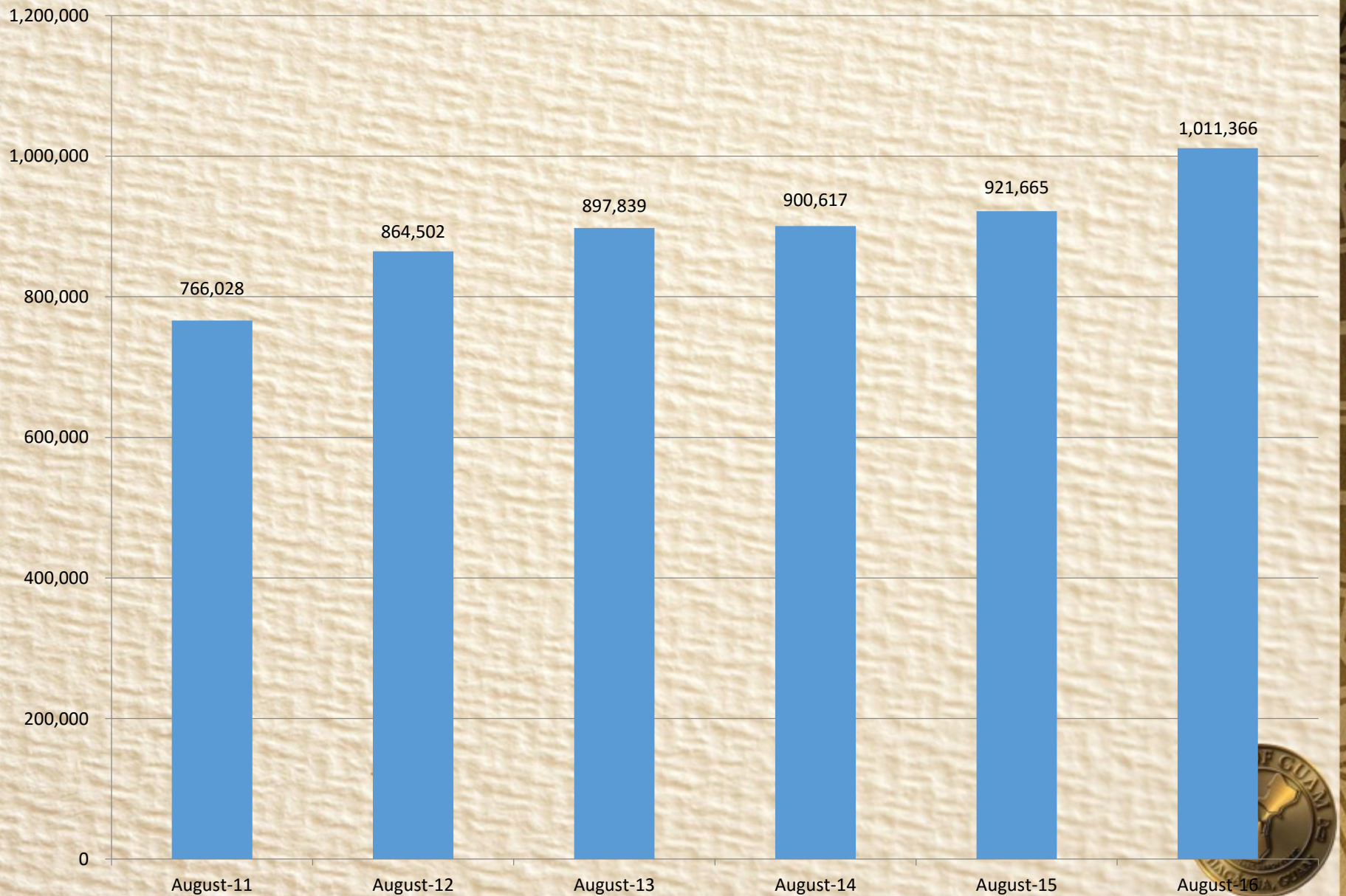
- Visitor arrivals in 2015 set a new, all-time record!!!
 - 1,409,033 arrivals *finally* beat the 1,381,513 in **1997**
 - So far, 2016 is shaping up to be an even better year
 - If my seasonal adjustments are close, *much* better (7.7%!)
 - A new hotel helped accommodate more visitors
 - Another has broken ground, with at least one more on the way
 - With the shift in our source market away from Japan and toward South Korea, opportunities abound
 - Koreans are looking for a “different” tourist experience than the Japanese, so we need new (or modified) optional tours
 - We may also experience a new round of hotel investment, this time from Korea, and possibly in locations outside of Tumon



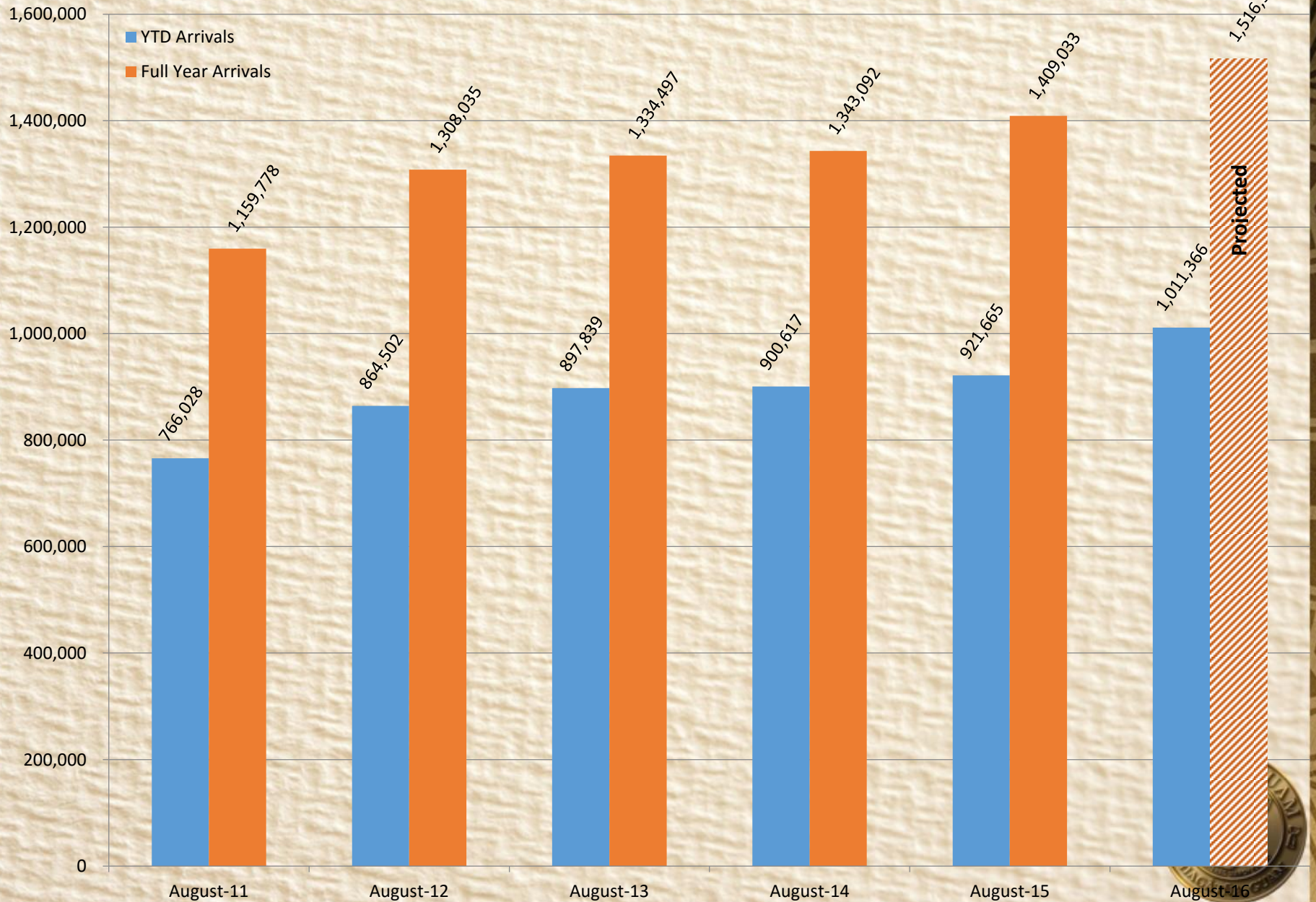
Actual Visitor Arrivals vs. Trend
1981 through 2015



Guam's Year-to-Date Visitor Arrivals



Guam Visitor Arrivals

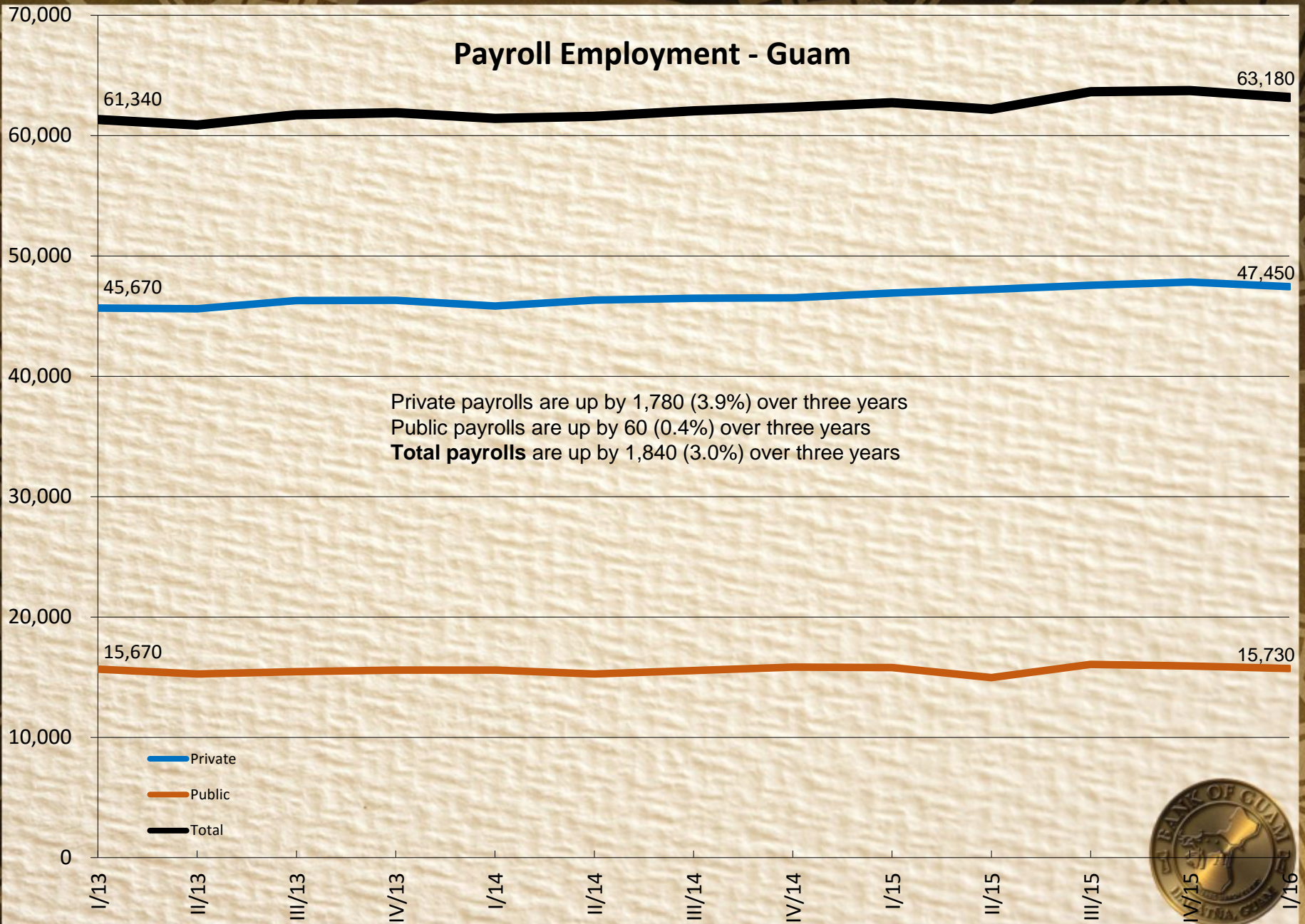


Guam

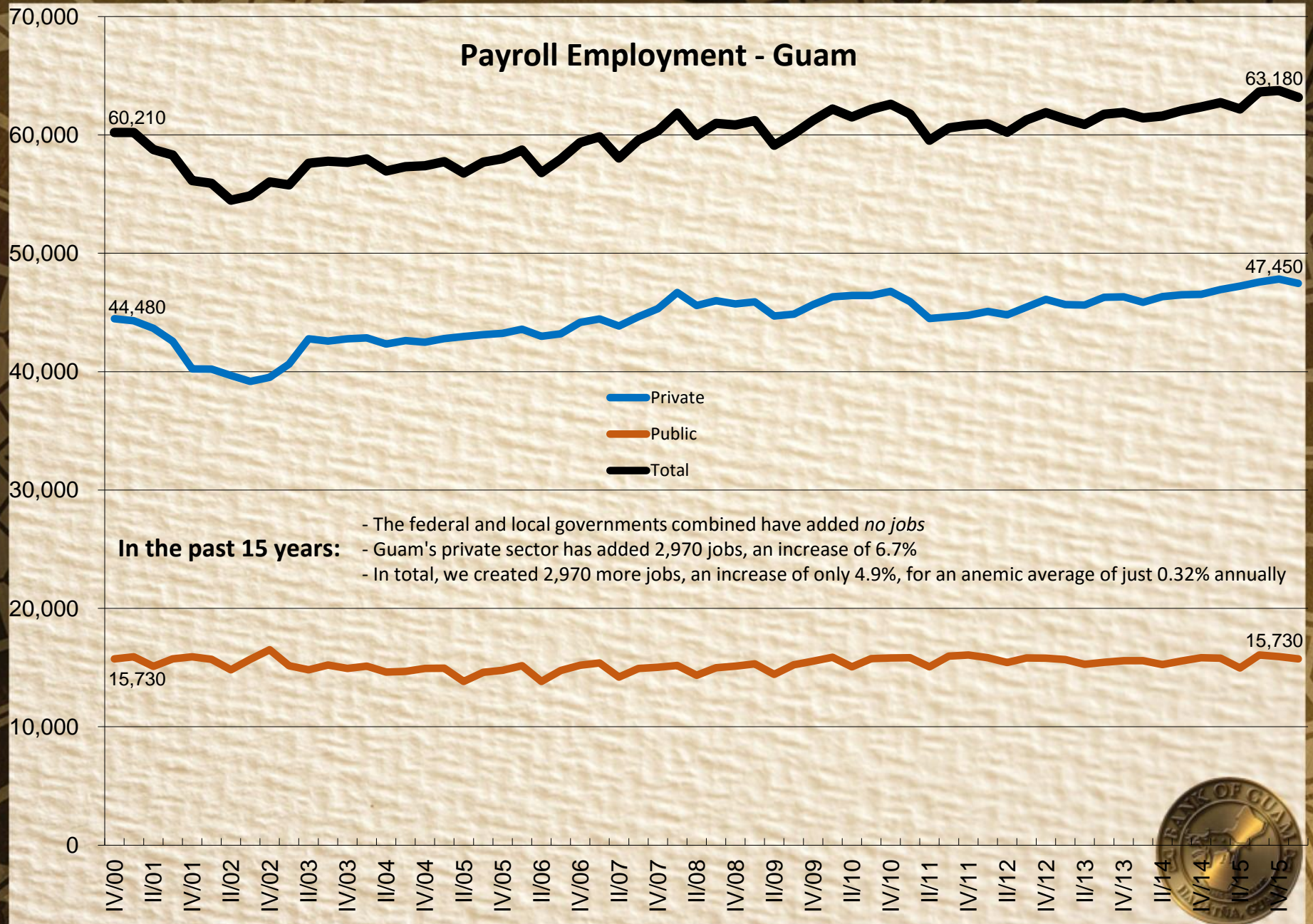
- Payroll employment has improved more in the past three years than in the twelve years before
 - But nearly two-thirds of the new jobs are in the lower-paying service industry . . . and construction continues to drive our business cycle
- The most recent unemployment statistics are still for March 2015 (an unemployment rate of 6.9%)
- That brings us back to prices
 - Consumer prices in Guam have been relatively flat for the past four years, primarily because of low oil prices
 - They surged in the first quarter of 2016, largely because of a jump in medical care costs

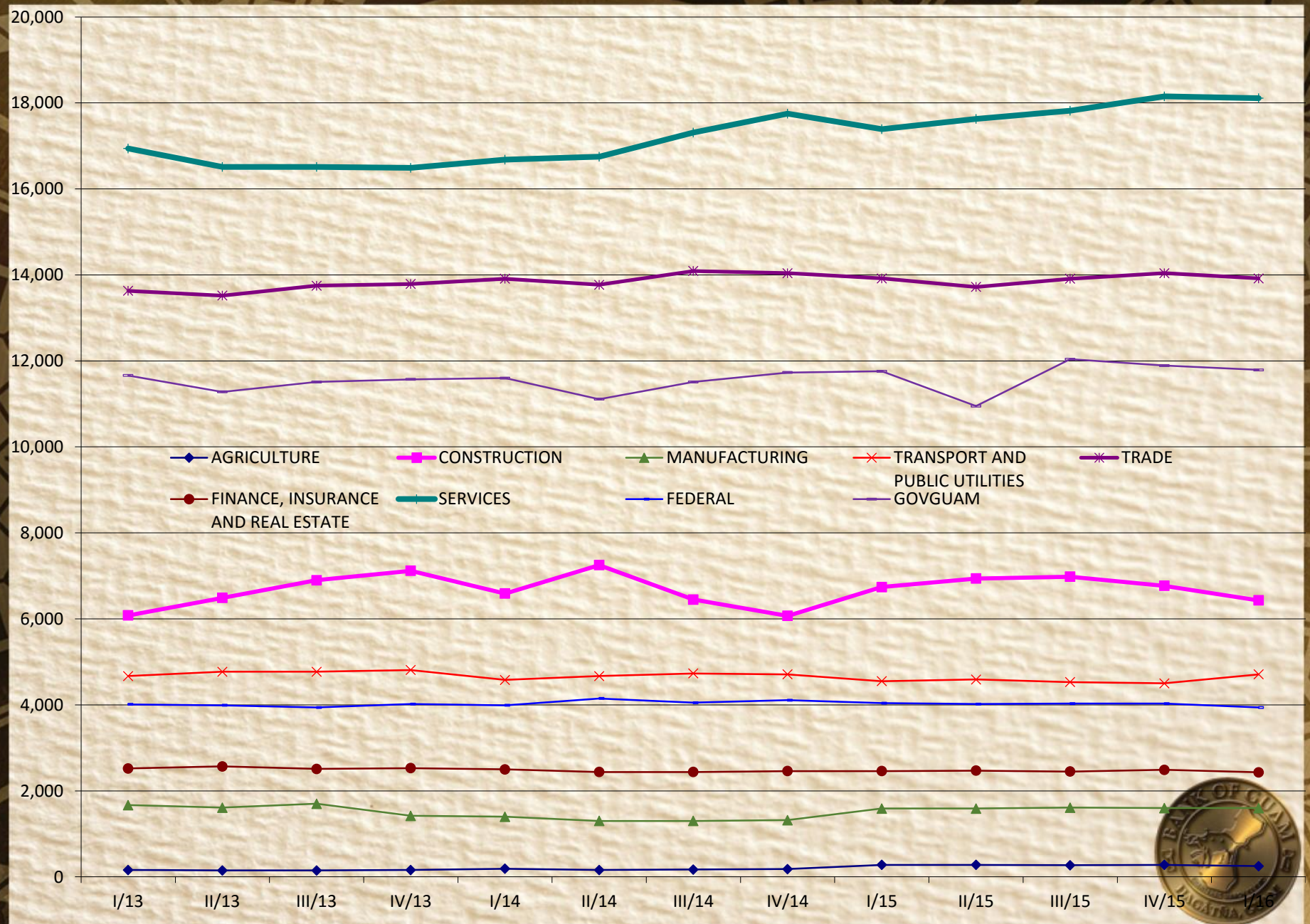


Payroll Employment - Guam



Payroll Employment - Guam





Consumer Price Index - Guam

(QIV 2007 base = 100)



Guam

- Consumer prices in Guam increased by 5.1% in the first quarter of this year and 4.6% from a year ago
- The increase was driven almost entirely by six items surveyed for typical outpatient services, lab work and X-Rays at Guam Memorial Hospital
 - Those items had an average 55.8% increase, pushing the medical care component of the CPI up by 28.2%
 - Medical care makes up 20.4% of the overall expenditures of the representative household in Guam
- Lower energy costs are still helping to hold prices down, which is beneficial to our entire community, and will be for some time to come



Guam

- Then there's our *other* industry, defense services
 - Congress has *finally* started to release funding for the relocation of Marines from Okinawa to Guam
 - This year's appropriation is just a little more than in the typical year, but they also released access to some of Japan's contributions to the process
 - The Navy and the Air Force have been quietly building up non-Marines capacity for the past several years
 - A few months ago, the Commander at Anderson Air Force Base announced an additional \$1 billion in projects that will take place over the next few years
- Remember: Construction drives our business cycle, and we're going to see a lot more of that



Guam

- However, we have a few problems that could inhibit our economic activity:
 - Our construction industry relies heavily on H-2B visa workers, who are now severely limited in number
 - It could halt hotel and military construction in its tracks
 - Our inability to create more jobs and income is causing increasing crime and social unrest
 - Our population is growing faster than job availability
 - Our government revenues don't seem to be able to keep up with ballooning government expenditures
 - Our inadequate income and jobs growth raises unrecoverable social welfare and criminal justice costs, as well as EITC tax expenditures



Summary

- The global economy is still very fragile
 - There were a lot of disruptions in the past year, and it is likely that destabilizing events will continue
- Energy prices have been a saving grace, but they undermine aggressively addressing climate change
- Japan is still weak, South Korea is stable and growing; the main risk in our region is China
- The U.S. economy looks good on the surface, but there are persistent underlying problems
- Guam's tourism and military industries are both showing remarkable strength



Conclusion

- Thank you for your time and attention
- I hope that my presentation this afternoon has been both informative and useful
- I will be happy to answer any questions that I can
- Again, thank you

