

# Economic Outlook

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## Economic Outlook for Guam Fiscal Year 2015

### Summary

The state of the economy of Guam in FY 2015 is anticipated to be influenced positively by a continuation of the global economic expansion; America's rebalancing of its strategic focus and posture toward the Pacific; and increased investment and expansion related to resident and tourist facilities, public utilities and infrastructure. The cumulative effect of positive trends in the major drivers of Guam's economy, tourism, defense and construction point the economy in the direction of moderate expansion in FY 2015. Policy initiatives at the federal or local government level on the economy, health care, wages and an array of other issues could have additional effects on both revenues and expenditures.

### International Economic Environment

The World Bank, in its January 14, 2014 report entitled "Global Economic Prospects" notes that "the world economy is showing signs of bouncing back this year, pulled along by a recovery in high-income economies". It notes that growth prospects are "sensitive to the tapering of monetary stimulus in the United States, which began earlier this month, and to the structural shifts taking place in China's economy." It projects Gross Domestic Product growth for the world economy to grow at a 2.7 percent rate in 2014 and accelerating to 3.9 percent in 2015. Growth in the United States is projected at a 2.9 percent rate in 2014 and a 3.4 percent rate in 2015. Japan GDP is expected to decrease to a 1.5 percent growth rate in 2014 and a one percent growth rate in 2015.

The projected growth rate for China in 2014 is 8.2 percent and in 2015, 7.5 percent. The 2014 growth rate for South Korea according to its Ministry of Strategy and Finance is 3.9 percent and for 2015, 3.5 percent. This was projected by Trading Economics Forecasts, which also projected Taiwan's growth rate at under 2 percent in 2014 and 1.69 percent for 2015.

### Tourism

Expenditures of tourists visiting Guam along with spending for investment in support those activities accounts for a major source of flows of funds to the island along with federal expenditures for defense and non-defense activities and capital investments. Therefore, as one of the most significant markets for the economy, changes in both the number of tourists arriving as well as their expenditures will have a significant impact on the economy.

The number of tourist arrivals to Guam reached a historically high level in recent years of 1,337,665 for FY 2013. The aggregate numbers projected by the Guam Visitors Bureau are expected to grow about one percent in FY 2014 and six percent in FY 2015. The number of Japan visitors is not projected to increase in this timeframe, but projected growth from all other major markets including Korea, Taiwan, Hong Kong, Philippines, China and Russia may contribute to meeting this projection.

International travel to the United States based on the U.S. Department of Commerce National Travel and Tourism Office's 2013 *Fall Travel Forecast* is expected to experience strong growth through 2018. According to the current forecast, the United States would see 3.4 percent to 4.3

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percent annual growth rates in the 2013-2018 timeframe. The devaluation of the dollar against major currencies except the Yen promotes visiting U.S. destinations as they are relatively less expensive. Asia is projected to generate a visitor increase of 9 percent in 2014. The Asia-Pacific region is projected to have similarly large increases over the next few years for a 59 percent total increase from 2012 to 2018. Japan, the largest Asian market and the second-largest overseas market, is forecast to increase by 2 percent in 2014 and at a similar level through 2018. High growth rates and large growth volumes are expected for China (24%), India (8%) and South Korea (6%). Similarly, these three countries are expected to have among the largest total visitor volume growth of any country from 2012 to 2018.

The strong projected travel from Asian destinations to the United States provides the basis to support the Guam Visitors' Bureau projections for market expansion should Guam continue to capture a constant share of the Asian outbound travel growth.

The major factor currently adversely affecting Guam's tourist revenue is the effect of the weakening Yen on both the number of Japan arrivals and the expenditures of those who do visit. The U.S. Dollar as of October 7, 2012 would buy 78.28 Yen; by May 26, 2013 it was up to 102.03. From the Japanese perspective, the price of the U.S. dollar increased by 33% during that period. If compared to earlier time periods in recent years when the yen was stronger, the depreciation of the Yen is less dramatic. On April 6, 2009 the U.S. Dollar would buy 100.32 Yen. The trend in the exchange rates from 2009 to 2012 was one of an appreciating yen. That trend reversed in 2012 when the Yen began depreciating. The rise to 78.28 was closely associated with U.S. expansionary monetary policy since late 2008, just as the drop to 102.03 is associated with Japan's expansionary monetary policy since late 2012. The U.S. Dollar/Japanese Yen exchange rate has continued to fluctuate as expected but the dramatic rise appears to have stopped for now and has been relatively stable, increasing very little from 102.3 in May 26, 2013 to 105.02 as of January 5, 2014. Since the rate has stabilized over the last eight months, the effect on Japanese travel habits and expenditures at current exchange rates has already to a large extent been incorporated into Guam's recent economic and revenue statistics.

The weaker Yen affects Japan outbound costs not only to Guam but to other international travel destinations as well. Guam's proximity and travel market rates could be an advantage relative to other outbound destinations. The upside of the devalued Yen is that it promotes exports from Japan creating greater economic activity which will to an extent mitigate the higher cost of travel with higher personal and corporate income levels which promote travel. While the effect of the exchange rate appears to have had a dampening effect on Japanese arrivals and expenditures, the economy as a whole, nevertheless, expanded in the first quarter of FY 2014 compared to FY 2013 as measured by Business Privilege Taxes which increased by six percent and total revenues by 9.3 percent. The Japan Consumption Tax is scheduled to increase from 5 to eight percent in April 2014 which could become a further drag on the economy as well as reduce the amount of discretionary income for international travel.

The FY 2013 weighted average hotel occupancy rate provided by the Guam Hotel and Restaurant Association was 77 percent, nearing the annual high rate of 85 percent occupancy. High occupancy rates are associated with higher average room rates. Further increases in the number of tourists are likely to generate additional hotel revenues from both higher occupancy levels as well as higher rates as the demand exceeds the supply in some time periods. The higher occupancies are likely to constrain increasing arrivals in the short term but the increased profitability should encourage capacity expansion. Two properties plan to offer additional rooms in 2014. The Lotte Hotel Guam was previously operated as the Aurora Resort which was closed in August 2013 for a \$20 million

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dollar renovation and rebranding; the hotel currently has 242 rooms. The Dusit Thani Hotel 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.

Additional shopping space is under construction. The Grandview Shopping Mall formerly known as the Tumon Bay Shopping Center, an unfinished 179,000 square feet building, is under construction with plans to open in late 2014.

## **Federal Government Expenditures**

Federal expenditures comprise one of the major flows of funds to Guam along with tourism. Federal expenditures are comprised of defense and non-defense categories. The defense category is likely to increase due to the emphasis on expanding U.S. Armed Services capacities on Guam with substantial military construction projects and in preparation for relocation of Marines from Okinawa to Guam. The increase in military construction projects appropriations is shown in Chart 2. The relocation of Futenma which has been an obstacle to relocation of Marine Corps personnel was approved by Okinawa governor Hirokazu Nakaima on December 27, 2013, with a promise from Prime Minister Abe to allocate funds (US\$2.9 billion) for the promotion of Okinawa's economy each year until 2021. The National Defense Authorization Act for Fiscal Year 2014 makes significant progress on strategic military projects according to a press release from Congresswoman Bordallo: "In addition to the military construction projects contained in the FY 2014 appropriations, it also allows nearly \$114 million in Government of Japan contributions to be used for site improvements at North Ramp on Andersen Air Force Base in support of realignment efforts."

According to former United States Secretary of Defense Leon Panetta in December 2012, the rebalancing includes continuing to develop Guam as a strategic hub, but the vast majority of the rebalance comes in non-military areas like trade and efforts to deepen diplomatic ties and partnerships with and between nations in the region. It is important to note that the vast majority of the rebalance comes in non-military areas like trade and efforts to deepen diplomatic ties and partnerships with and between nations in the region. The non-defense budget category is likely to decline somewhat due to the limitations imposed by The Bipartisan Budget Act of 2013 which was signed into law December 26, 2013. This measure raises the sequestration caps for fiscal years 2014 and 2015, increasing federal spending for these two years but less in subsequent years. The Bipartisan Budget Act indicates that overall federal budget levels will be somewhat less than pre-sequester levels but less severe than when the sequester requirements were in place. The budget for FY 2015 is due the first Monday in February but is expected later. The FY 2014 Federal budget was submitted in April 2013. The FY 2015 Budget will provide a clearer idea on what projects and expenditures are planned for the nation as well as Guam.

The passage of the Bipartisan Budget act reduces budget uncertainty and eliminates the possibility of another Federal Government shutdown this year but uncertainty regarding the debt ceiling extension which Treasury Secretary Jack Lew indicated is necessary to avoid a U.S. default. After February 7, 2014 unless Congress extends the debt limit extension, the Treasury Department will have to deploy special accounting maneuvers to pay the country's bills on time.

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## 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, and to \$449.1 million in CY 2013, the highest level for CY permits in 19 years. 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 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 for projects of \$5 million and above, a record surpassed with \$424.3 million in CY 2011. In CY 2012 the number declined to \$152.1 million, in CY 2013 it declined to \$88.0 million. The combined total of DPW permits and DOD construction contracts has been far more stable with the total exceeding half a billion dollars in five of the last six fiscal years.

Calendar Year:	2008	2009	2010	2011	2012	2013
Building Permits	241,388	299,057	184,837	211,097	364,504	449,147
U. S. Military Construction Contracts	295,889	148,823	370,413	334,597	152,095	88,001
Japan Funded Military Contracts				<u>89,720<sup>1</sup></u>		
TOTAL:	537,277	447,880	555,250	635,414	516,599	537,148

Note: <sup>1</sup> 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 leading indicator of construction in the following year or two. For a somewhat longer period, leading information on upcoming projects which have not yet been permitted or contracted but are likely to proceed is provided in appropriations and other funding information. Obtaining the funding for construction projects is an activity that occurs somewhat prior to a building permit being 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, some appropriations related to the Marine Corps relocation have not been contracted for construction as they were restricted by law until additional plans and studies were submitted to the U.S. Congress. The appropriations for military construction from the U.S. Government and the Government of Japan increased steadily each year from FY 2008 through FY 2010 reaching a peak of just over \$1.2 billion. The totals have dropped off dramatically in FY 2011, FY 2012 and FY 2013; and have rebounded in FY 2014. While defense construction contracts increased in FY 2010 and FY 2011, the contracted amounts were well below the appropriated amounts leaving approximately \$1.3 billion of the \$2.3

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billion in appropriations from the U.S. and Japan between FY 2010 and FY 2013; much of which is still available subject to certain restrictions on the use of funds.

The National Defense Authorization Act for Fiscal Year 2014 specifically allows funds for construction that directly supports the realignment of Marines from Okinawa to Guam. It authorizes the expenditure of Government of Japan contributions for the realignment. It provides an extension of authorizations of certain FY 2011 projects for Defense Access Roads Improvements in the amount of \$66.7 million and increases the FY 2013 appropriation for construction of a hangar from \$58 to \$128 million.

The largest projects currently under construction on Guam excluding those on military bases include the new Navy Hospital in Agana Heights, the Guam Regional Medical City Hospital in Dededo, the \$60 million Dusit Thani Hotel project in Tumon, a \$50 million defense funded port modernization project and the Guam Housing and Urban Renewal Authority's \$28.1 million, 70 unit affordable housing project in Tamuning. The completion of these projects will create hundreds of new jobs in the hotel, medical services and retail trade industries in 2014 if openings proceed as scheduled.

The available funding for construction indicates that an increase in levels of construction activity on Guam is likely to occur beginning in late 2014 and 2015. Appropriations are a very strong indicator of future activity but actual construction may differ from the appropriated amounts as well as time schedules. An analysis of the FY 2010 defense appropriations for construction found the lag from the time of appropriations to contracting ranges from about five to eleven months with construction averaging about two years for most projects and three years for major projects. It also found that not all of the appropriations were contracted and some contracts were awarded below the appropriation amounts. The new funding made available for construction, with the combination of bond issuance, U.S. appropriations and released Japan appropriations is close to one billion dollars. The new projects will increase total the amount of construction on Guam but much of the new activity will be to replace the current major projects scheduled for completion in 2014 including the Navy Hospital, the Guam Regional Medical City and the Dusit Thani Hotel. The impact on the level of economic activity and revenues for FY 2015 will be highly dependent on the timing of the commencement of these projects, and projects started in 2015 will have a partial year economic impact. There is also the possibility that U.S. monetary policy action as well as increased bank regulation could increase interest rates and reduce mortgage availability constraining private development in the years ahead.

**Chart 2**

**APPROPRIATIONS (in thousands)**

Fiscal Year (FY):	2008	2009	2010	2011	2012	2013	2014
U.S. DOD Military Construction	345,000	180,000	737,654	176,030	83,600	101,904	494,607
DOD Civilian Guam Infrastructure							119,400
Japan - Fiscal Year (JFY)		<u>336,000</u>	<u>500,000</u>	<u>582,000</u>	<u>93,000</u>		
Combined:	345,000	516,000	1,237,654	758,030	176,600	101,904	614,007

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## Public Financing and Infrastructure

A leading indicator of Federal construction is contained in the appropriations. For the Government of Guam projects over a quarter of a billion dollars have been realized from the sale of revenue bonds in 2013 and additional projects are planned for future bond and loan financing. The extraordinary infusion of bond financed tax refund payments in 2012 which stimulated consumer expenditures and receipt of additional federal reimbursements for tax credits will be to an extent replaced by increased bond funded expenditures for infrastructure in FY 2015.

In 2013 Guam's credit ratings for its agencies were maintained or achieved improvements as follows:

- S & P Guam Hotel Occupancy Tax Revenue Bonds, Series 2011A was affirmed at BBB+
- S & P Guam Waterworks Authority series 2005 & series 2010 A- New Rating
- S & P Guam Limited Obligation (Section 30) bonds series 2009A BBB+/Stable Affirmed
- Moody's A.B. Won Pat International Airport Authority Series 2003 Baa2 Reaffirmed with stable outlook.
- S & P Guam Business Privilege Tax (BPT) bonds Series 2012B A, Stable

Chart 3 LIST OF PLANNED MAJOR CONSTRUCTION PROJECTS AND FUNDING SOURCES	
Planned Projects – Funds Available	Amount
Guam Waterworks Authority (GWA)	139,280,961
FY 2014 (DOD) Military Construction Projects	494,607,000
DOD Civilian Guam Infrastructure	119,400,000
Guam Int'l Airport Authority (GIAA) – Airport A	13,000,000
Guam Int'l Airport Authority (GIAA) – Airport B	96,710,000
<b>Subtotal</b>	<b>862,997,961</b>
Planned Projects –Bond/Loan Financing Proposed	
Guam Legislature Building	4,000,000
Port Authority of Guam (PAG)	10,000,000
Department of Land Management	15,750,000
University of Guam (UOG)	21,700,000
Guam Community College (GCC)	6,000,000
Guam Power Authority (GPA)	60,000,000
Guam Waterworks Authority (GWA)	258,000,000
Guam Public Infrastructure Projects (DOD requested)	400,000,000
<b>Subtotal</b>	<b>775,450,000</b>
<b>TOTAL:</b>	<b>\$1,638,447,961</b>

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## ECONOMIC INDICATORS

Guam's Gross Domestic Product (GDP) increased in nominal terms by 4.5 percent from CY 2011 to CY 2012 reaching \$4,761 billion. In real terms it increased by .5 percent after adjusting for inflation. Per capita real GDP, adjusting the GDP for inflation and population growth shows an increase of .3 percent to \$25,388. Total employment increased by 1 percent from March 2012 to 61, 630 in March 2013. Visitor arrivals increased by 5.3 percent from FY 2012 to FY 2013 reaching 1.34 million. A November 2013 draft report shows General fund gross receipts increased by 2 percent from FY 2012 to FY 2013 and general fund revenue increased by 6.0 percent (excluding provisions for refunds) in the comparison of latest two fiscal years.