

U.S. Virgin Islands Economic Review

Bureau of Economic Research

April 2008

Economic Highlights

The pace of economic activity began to slow at the end of 2007, signaling that conditions in the US are beginning to impact the economy.

A second quarter decline in gross receipt—a good measure of spending by residents and visitors—signals a tightening in consumer spending.

Residents will receive tax rebate checks between \$600 and \$1,200. This will boost spending and increase business receipts in the second half of the year.

The strongest performing sectors will continue to be manufacturing, construction, tourism and business services.

The value of refined petroleum products is expected to exceed \$11 billion.

The civilian employment has averaged 49,346 for the first half of the year.

The Territory's unemployment rate is 5.9 percent. The rate for St. Thomas/ St. John is 4.9 percent and 7.2 percent for St. Croix.

A total of 1,275,957 visitors came to the Territory in the first five months of the fiscal year—298,064 air visitors and 1,275,597 cruise passengers.

Overview

The Virgin Islands economy has begun to experience the effects of the downturn in the US economy. Deterioration in the US housing markets and volatility in the equity markets along-side higher energy prices have triggered a slow-down in the pace of economic activity. Most notably, consumer and business spending has begun to tighten as evident by the recent drop in business receipts. Taxable business receipts—a broad measure of economic performance—fell during the second quarter of fiscal year 2008. The growth of consumer spending sustained by growth in income and borrowing, is being curtailed by increased cost of borrowing, persistently high oil prices and the rising cost of food, utilities and other consumer goods and services.

Although there is weakness in some sectors, the outlook in the near-term is for the economy to stay on course, though growth is expected to be marginal. There are reasons for optimism. The \$152 billion federal fiscal stimulus package which gives rebate checks to individuals and tax breaks to businesses should boost consumer and business spending in the second half of 2008. Beginning in May, more than 130 million US households and 40,000 US Virgin Islands residents will receive tax rebate checks of up to \$600 for individual taxpayers who earn up to \$75,000 and up to \$1,200 for couples who earn up to \$150,000, plus \$300 for dependent children under the age of 17 years. Seniors living on Social Security and veterans are also eligible to receive a minimum of \$300. The US Virgin Islands residents will receive a \$41.5 million federal fiscal stimulus package.

The impact of the stimulus package largely depends on how much of it consumers choose to spend, save or pay debts. Although the magnitude of the spending response is uncertain, previous experience suggests that a large percentage of households are sensitive to temporary cash flow and are likely to spend it. Tax rebates will boost expenditures; hence, a lift in consumer spending should lead to resumption in growth of business receipts. While there will be an immediate impact on consumer and business spending as a result of the fiscal stimulus package, the impact will be temporary and may not be sufficient to eke out more than modest Gross Territorial Product (GTP) growth in 2008. But the combination of federal, fiscal and monetary stimulus adjustments underway to

correct the housing and credit conditions should lead to an improvement in the economy and stronger growth in 2009.

Economic Outlook 2009

This sanguine outlook for 2009 rests on a number of initiatives designed to bolster the local economy. A number of major capital projects have started or are about to start that should generate economic activity. These projects include the \$54 million Pond Bay Club and the \$51 million Calabash Boom housing development on St. John; the \$50 million Raphune Vista, the \$70 million Cabrita Partners housing development and the \$60 million Dolphin Cove villas and condominium development on St. Thomas; and the \$50 million Stanford Business Center Holdings and the \$10 million South Grapetree Bay Hotel on St. Croix. The construction activity should receive solid support from both the private and public sector mainly from housing and hotel development, road and other infrastructure development. The construction sector, in addition to manufacture, tourism and business activity will continue as the major drivers of economic activity in 2009.

The manufacturing sector will continue to benefit from strong demand for oil and refined products, although industry experts report that prices of refined products have failed to keep pace with the sharp rise in oil prices, thereby narrowing refined products margins. This, notwithstanding, it is anticipated that output from this industry will be strong in 2009 with the value of exports of refined products well over \$11 billion. This sector will be further strengthened by strong output from the rum industry. In anticipation of increased production, Cruzan VIRIL, Ltd. is constructing space to house 40,000 additional barrels. Although its parent company, Vin & Sprit AB, a Swedish-based international wine and spirits company, recently signed an \$8.8 billion agreement with Pernod Ricard, Ltd. to purchase the company, no disruption in local

rum production is anticipated.

The tourism sector is expected to rebound in 2009 stemming from a strong marketing and promotional campaign by the Department of Tourism and the Tourism and Hotel Associations to bring more overnight visitors to the Territory. The tourism department is increasing its marketing efforts in Europe to take advantage of the depreciation of the US dollar as well as offer incentives to travelers to encourage them to visit the Territory. Additionally, there is expected to be resurgence in cruise passengers on St. Croix as some 50 cruise ship calls are scheduled for 2009. The combination of these factors foreshadows an increase in economic activity in the year ahead.

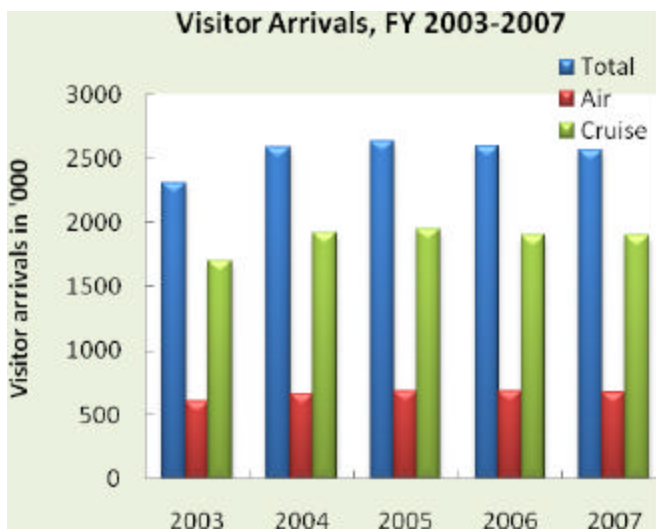
Sectoral Performance in 2008

Tourism

The number of visitors to the Territory increased 4.8 percent for the first five months of fiscal year 2008 to 1,275,957 from 1,217,276 for the corresponding period in fiscal year 2007. Air arrivals were up a solid 13.5 percent while cruise passenger arrivals were less robust at 2.4 percent. There were 298,064 air visitors during this period compared to 262,674 air visitors for fiscal year 2007. There were 977,893 cruise passengers compared to 954,602 the year before.

Air visitors have improved remarkably due to aggressive marketing and promotional efforts by the Department of Tourism such as the *Winter Escape* promotion which gave a \$200 gift card and a \$100 resort credit or a discount on the room for bookings made between February 3-16, 2008, and the St. Croix Air Credit program which gave a \$250 credit per person on stays of seven nights or more. Additionally, there are a number of planned initiatives to increase airlift. Efforts are being made to improve connections between key European markets to allow same-day

connections to the USVI, particularly with Iberia and British Airways. Similar efforts are being made to improve connections between several Caribbean islands and the Virgin Islands for passengers travelling on regional carriers to make connections. The government also executed a one-year contract with Danish marketing firm Atlantic Link Aps to grow the number of Danish visitors. A new campaign will also be launched for St. Croix which provides a distinct brand identity showcasing its culture and heritage. More importantly, discussions are underway with Spirit and American Airlines for service to St. Croix. Approximately 700,000 air visitors are projected to visit in 2008, up from 676,000 in fiscal year 2007.



The cruise passenger arrivals, though currently sluggish, should increase next year. Royal Caribbean Cruise Lines has committed two ships to visit St. Croix—the Serenade of the Seas and Adventure of the Seas which will visit year-round every other week. Disney Cruise lines will also be bringing two weekly trips to St. Croix starting in 2009.

Against this backdrop of stronger bookings to the region as well as an aggressive effort on the part of the new administration to bring cruise ship passengers back to St. Croix, cruise passenger arrivals to the Territory in 2008 are

projected to increase to 2 million in fiscal year 2009, up from 1.9 million in this fiscal year.

Manufacture

The manufacturing sector accounts for 12 percent of GTP and 5 percent of total nonagricultural wage and salary employment. The number of manufacturing jobs averaged 2,309 in the first six months of fiscal year 2008, practically the same as last year.

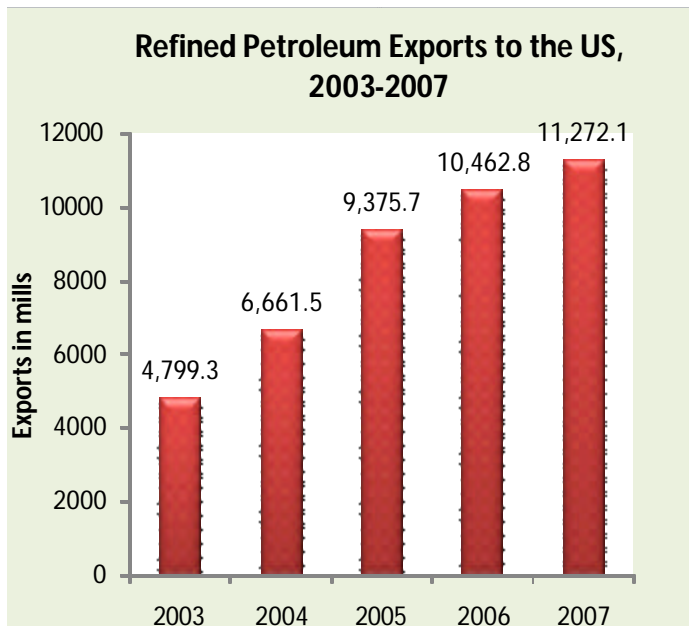
Refined petroleum products are the dominant commodities produced by this sector. Other major commodities include rum and watches. This sector continues to be a strong performer, with both the volume and value of its major export rising sharply.

Oil Industry

Hovensa, L.L.C., a limited liability company formed by a wholly owned subsidiary of Hess Corporation and a wholly owned subsidiary of Petróleos de Venezuela, S.A. (PDVSA) is the Territory's largest manufacturer and the industry's strongest performer. The refinery processes crude from all over the world, although the majority of crude is supplied from Venezuela. It has crude oil processing capacity of 495,000 barrels per day (BPD). The refinery also operates a Fluid Catalytic Cracking unit capable of producing 175,000 BPD of gasoline. About 2,000 people are employed at the refinery, including Hovensa and its subcontractors.

Roughly \$11.3 billion of refined petroleum products were exported to the US in 2007? a 12 percent jump over the previous year. The value of 2008 exports is expected to exceed that number. February 2008 year-to-date figures, the most recent available, show the value of refined petroleum products exported to the US was \$2.3 billion, up from \$1.5 billion for the same period in 2007.

The industry experts reported that record crude prices, reduced production and lower refining margins have dragged down refining earnings in the first quarter of 2008. A refining margin is the difference between what companies pay for crude and the selling price of gasoline and other products. The industry outlook, however, is for some improvement in refining market fundamentals in the spring and summer months and improved profitability in the latter half of 2008.



The price of crude oil rose to a record high of \$129 a barrel. The price hike followed declines in the value of the dollar, strong oil demand from China, and a prediction by experts that oil could rise to an average price of \$141 a barrel in the second half of this year.

Concerns over OPEC's consistent refusal to lift supplies to counter growing demand and worries about high prices are prompting the U.S. Energy Department to suspend purchases of oil for the U.S. strategic petroleum reserve. The action follows a congressional vote to stop filling the reserve until oil prices fall to \$75 dollars a barrel. The US government had been buying about 76,000 barrels of oil a day to fill the

reserve. The U.S. reserve can hold 727 million barrels of oil and it is now nearly full with more than 700 million barrels.

Rum Industry

A large percentage of manufacturing shipments come from rum production, the industry's next strongest performer. The rum industry consists of a single company, Cruzan VIRIL, Ltd., a wholly-owned subsidiary Vin & Sprit AB, a Swedish-based international wine and spirits company. In March 2008, Pernod Ricard, a French company signed an \$8.8 billion agreement with the Swedish government to buy the state-owned Vin & Sprit. The deal is expected to be finalized this summer. The governor announced that the new owners are committed to continue rum production on St. Croix and to build the market share of Cruzan Rum.

The company has about 60 employees and manufactures Cruzan and Old St. Croix brand rum as well as bulk shipments for other labels. Rum produced in the US Virgin Islands is exported to the US primarily in bulk, and sold to local and regional bottlers for sale under a variety of private label and regional brand names. Cruzan Rum is reported to be the fifth-leading premium brand in the United States according to statistics published by Impact Adams Liquor Handbook, a leading spirits industry publication.

The industry shipped 7.4 million proof gallons of rum to the US in 2007 for which the Territory received \$86.7 in excise taxes. Some 7.6 million proof gallons of rum is projected for export in 2008. The federal government imposes and collects federal excise taxes on rum produced in the Virgin Islands and exported to the United States. The current assessed excise tax rate is \$13.50 price per proof gallon and the Cover Over rate (the rate at which excise taxes are transferred back to the Virgin Islands) is \$13.25.

Rum Shipments to the United States, 2003-2007



The outlook for this industry is for continued growth. In anticipation for increased production, the company is currently constructing additional space to house 40,000 additional barrels. The company has in place a five-year marketing agreement with the government to promote and market the brand.

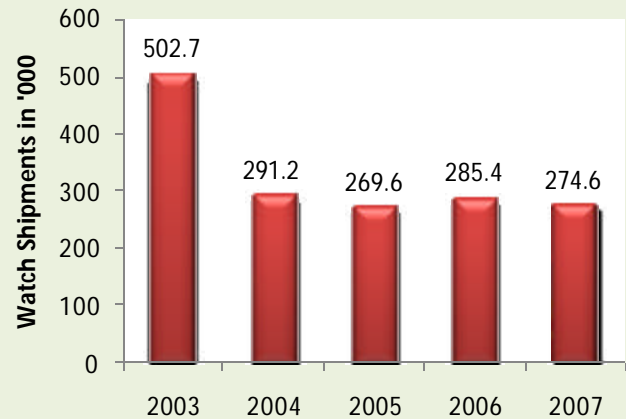
Watch industry

Output from the watch industry has declined significantly in recent years. The industry which is comprised of three companies? Belair Quartz, Hampden Watch, Co., and Tropex Watch Co., employs about 118 workers. Approximately 274,625 watches were exported in fiscal year 2007 down from 285,428 the previous year. February 2008 year-to-date figures show that 32,748 watches were exported, down from 39,511 for the same period in 2007. The watch industry continues to struggle from high unit costs and increased competition.

The US Department of Commerce ruling in May 2007 increased the cap on the values of watches imported duty-free from the US Insular Areas to the US mainland. The value of export watches increased from \$800 to \$3,000 per watch value

and watch movements from \$35 to \$300 per watch movement value. This change was due to the increase in the price of gold. It was anticipated that this change might help to increase output in the industry.

Watch Shipments, 2003-2007



Construction

The construction sector accounts for an estimated 5 percent of GTP and 7 percent of employment. Activity in the construction sector, as measured by the number and value of approved developments and the value of building permits, has softened, signaling the completion of major tourism-related development, housing and seaports, and the development of commercial and residential properties. The value of construction permits? an indicator of current and of future activity? declined by 37 percent in fiscal year 2007 from the previous year. Despite this drop, the new projects on the drawing board should strengthen the industry. Foremost among these projects are four on St. Croix: a \$47 million Gallows Bay Marina; a \$250 million Golden Resorts 400-room hotel, casino and convention center; the \$60 million William and Punch 300-room hotel and casino and 125 luxury home development; and Stanford Caribbean \$50 million aviation hangar and 900-sq. ft. office building.

On St. John, a \$5 million Coral Bay 116-slip marina and office building, the \$54 million Pond Bay Club luxury resort, the \$50.8 million Calabash Boom housing development and the \$50.8 million Sirenusa 47-private homes development are among the projects that will create activity. St. Thomas also has a number of projects which include the \$80 million 70-room boutique hotel at Yacht Haven Grande slated for 2008, the \$120 million Ritz Carlton luxury homes development, \$15 million East-End Plaza retail and commercial office space, \$60 million Dolphin Cove housing development, and the \$13 million Long Bay Road expansion phase 1.

The number of construction jobs averaged 3,144, in fiscal year 2007 nearly 200 jobs more than the previous fiscal year. Most of these jobs resulted from retrofitting and maintenance projects in the oil industry. There was an average 3,395 jobs in the industry in the first half of fiscal year 2008, down 6.6 percent from an average 3,634 jobs in 2007.

Leisure and Hospitality

The leisure and hospitality? which is comprised of hotels and other lodging places, restaurants and food services, and arts and entertainment? accounts for 7 percent of GTP and 16 percent of total employment. For the first six months of fiscal year 2008, the number of jobs averaged 7,527 and a year-on-year increase of 3.4 percent. The job growth driver was the arts, entertainment and recreation super-sector. Delving deeper, activity in amusement, gambling and recreational sub-sector is driving the growth. An expanding hotel and villas industry and new restaurants, such as Yacht Haven Grande Wikked, Grande Cru and Fat Turtle, added to the gains in the leisure and hospitality sector.

Trade, Transportation and Utilities

The trade, transportation and public utilities sector holds the second largest share of jobs in

the economy, averaging 8,754 jobs in 2008? up 1.6 percent over the last fiscal year.

Retail and Wholesale Trade

The trade sector contributes 12 percent to GTP. Retail trade accounts for 10 percent and wholesale just about 2 percent. Retail trade jobs averaged 6,336 this fiscal year and were up 2.3 percent, while wholesale trade jobs averaged 785, down by half a percent from last fiscal year. Trade jobs and retail jobs in particular are expected to remain stable.

Financial Services and Real Estate

The Financial services sector, which holds a 6 percent share of total employment, continues to show decline in jobs, albeit marginal. The number of jobs in this six-month period averaged 2,459, down from 2,519 for the same period in fiscal year 2007. Much of the loss in this sector has been attributed to changes in The American Job Creation Act 2004 which caused some companies to leave the Territory. There are about 100 beneficiaries of the EDC incentive program.

The American Job Creation Act 2004 changed the residency requirement for the Economic Development Commission (EDC) incentive program. In January 2006, Treasury issued final regulations establishing that bona fide residents must be present in the territory for at least 183 days per year. This requirement was amended in November 2006 allowing taxpayers to average the 183-day residency over a period of three years instead of requiring they spend 183 days each tax year in the Territory. Taxpayers are still required to spend at least 60 days in the Territory. The final ruling also confirmed that taxes on income connected to US sources should be paid to the US Revenue Service.

The final US Treasury Regulations may now ease concerns of current and potential beneficiaries and allow for the EDC program to rebound and

the financial service sector to grow. The University of the Virgin Islands Research and Technology Park (RTPark) holds strong growth potential for this sector. In January 2008, RTPark formed a strategic alliance with Baltimore Technology Park to provide “managed services” for the park’s businesses. These services include web hosting and naming; secured e-mail-service, and hosting web applications and database servers. The RT Park also formed a strategic alliance with Tropical Tower Inc., to manage the RTPark’s global telecommunications connectivity and network capacity inside the Global Crossing fiber hub on St. Croix.

Although there has been a decline in the operations of financial services, economic activities in other subsectors have increased. The combined total assets of commercial banks domiciled in the US Virgin Islands as the end of 2007 were \$2,652.9 billion. Total assets grew by \$53.6 million or a 2 percent increase over the previous year’s total assets of \$2,599.2 billion—mainly due to increase credit to businesses and industry and private household for the purchase of land, homes and consumer durables. Credit of \$1.7 billion accounted for 65 percent of total assets.

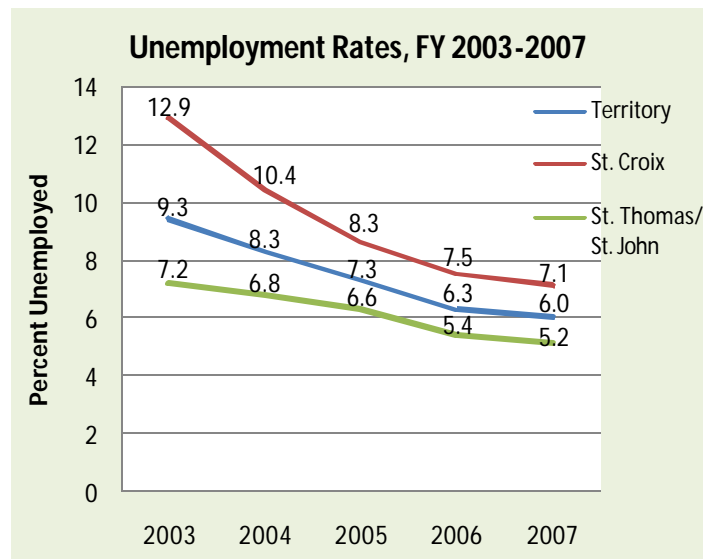
Bank deposits—which consist of savings demand accounts, demand deposits and time deposits—increased by 3 percent or by \$67 million to \$2,372.2 billion from \$2,304.4 billion in 2006. Overall deposits of private individuals, partnerships and corporation rose by \$20.4 million to just over \$1.7 billion in 2007 from \$1.68 billion in 2006.

Banks domiciled here do not engage in sub-prime lending; hence, the Territory is not experiencing the housing market crisis experienced on the mainland. The Territory is however experiencing secondary effects. Economic softness abroad, tighter credit and rising interest rates have slowed the demand for home sales. The number of homes sold in the

Territory declined by 2 percent in 2007; however, the average selling price of a home increased by 6 percent to \$525,000. The number of condominiums sold declined by 38 percent, but the average condominium sale price increased 31 percent to \$279,000 in 2007.

Employment

For the first half of this fiscal year, 49,346 persons were employed? 21,219 on St. Croix and 28,128 on St. Thomas and St. John. This is insignificantly higher than the 49,179 persons employed for the corresponding period last fiscal year.



The Territory’s unemployment rate has steadily declined since 2003 from a high of 12.9 percent to 6.0 percent as depicted above. The rate has remained steady at 5.9 percent for the first six months of the fiscal year. The rate for St. Croix is 7.2 percent, while the rate for St. Thomas and St. John is 4.9 percent.

Public-and private-sector employment

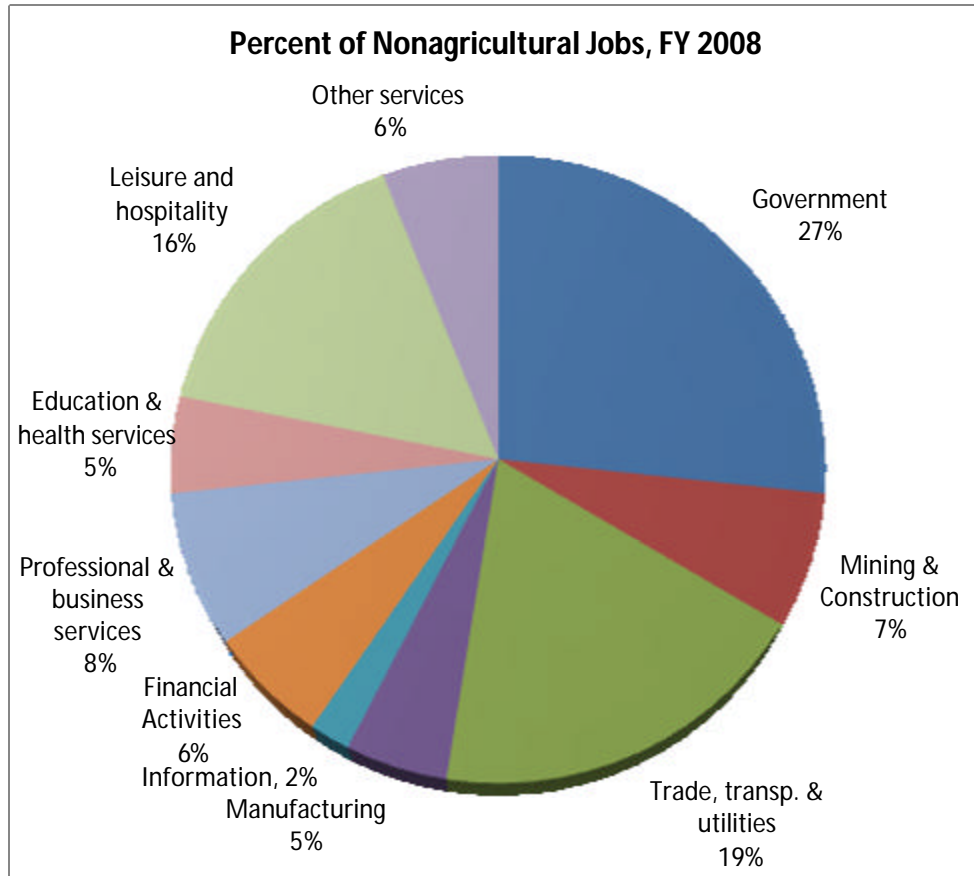
Wage and Salary Employment

During the first six months this year, 46,140 persons were employed compared to 45,655 last

year? about 1 percent more. Nine in ten jobs in the US Virgin Islands are in the service-producing industries and one in ten jobs in the goods producing industries.

Public sector jobs increased 1.9 percent. The increase occurred in both federal and local government jobs. Local government jobs averaged 11,777, up 1.9 percent over fiscal year 2007, while federal government jobs averaged

947 or a 1.9 percent increase from last fiscal year. The private sector is the largest employer in the Territory, employing 7 in every 10 persons. The private sector jobs have shown minimal growth in the past half-year, adding no more than 180 jobs. There were 33,417 private sector jobs compared to 33,236 last year. Improvement in jobs in this sector rests on the buoyancy of the tourism industry, capital investment and the general strength of the economy.



Government; trade, transportation and utilities; and leisure and hospitality are the industries with the largest number of jobs. These three sectors account for 62 percent of all jobs. Professional and business services, construction and financial activities account for 8 percent, 7 percent and 6 percent, respectively. Manufacturing and educational and health services account for 5 percent each, while other services and information account for the remainder of the jobs.

V.I. NONAGRICULTURAL WAGE AND SALARY EMPLOYMENT
Annual Average, Fiscal Years 2003-2008

INDUSTRY	FISCAL YEARS					
	2003	2004	2005	2006	2007	2008
TOTAL NONAGRICULTURAL	41,833	42,276	43,711	45,037	46,001	46,140
TOTAL PRIVATE SECTOR	29,207	29,821	31,391	32,656	33,367	33,417
CONSTRUCTION AND MINING	1,737	1,695	2,213	3,112	3,591	3,395
MANUFACTURING	2,023	2,062	2,210	2,306	2,321	2,309
TRANSPORTATION, WAREHOUSE, & PUB. UTILITIES	1,429	1,490	1,651	1,634	1,324	1,633
WHOLESALE TRADE & RETAIL TRADE	6,905	6,871	6,896	7,703	7,780	7,121
WHOLESALE TRADE	713	705	769	794	795	785
RETAIL TRADE	6,192	6,166	6,127	6,909	6,985	6,336
INFORMATION	877	876	891	845	809	785
FINANCIAL ACTIVITIES	2,304	2,483	2,569	2,599	2,486	2,459
PROFESSIONAL AND BUSINESS	3,103	3,277	3,391	3,452	2,376	3,574
EDUCATION AND HEALTH	2,168	2,182	2,204	2,323	2,376	2,378
LEISURE AND HOSPITALITY	6,811	7,119	7,101	7,132	7,374	7,527
OTHER SERVICES	1,839	1,845	2,357	2,378	2,310	2,236
GOVERNMENT	12,626	12,449	12,320	12,381	12,633	12,724
FEDERAL	906	875	853	904	938	947
TERRITORIAL	11,720	11,575	11,467	11,477	11,695	11,777

Note: data for 2008 is a 6-month average

SOURCE: V.I. Department of Labor, Bureau of Labor Statistics

Labor Force Data

U.S. Virgin Island: Fiscal Years 2003-2008

Year	Virgin Islands				St. Croix				St. Thomas & St. John			
	Labor Force	Civilian Employed	Unemployment	Unemployment Rates	Labor Force	Civilian Employed	Unemployment	Unemployment Rates	Labor Force	Civilian Employed	Unemployment	Unemployment Rates
2003	48,460	43,833	4,627	9.3	20,096	17,533	2,585	12.9	28,342	26,300	2,042	7.2
2004	49,536	45,694	4,092	8.3	20,275	18,178	2,097	10.4	29,261	27,266	1,995	6.8
2005	50,867	47,178	3,689	7.3	20,751	19,941	1,810	8.3	29,116	27,237	1,880	6.6
2006	51,565	48,312	3,253	6.3	22,462	20,774	1,687	7.5	29,103	27,538	1,565	5.4
2007	52,430	49,287	3,141	6.0	22,771	21,193	1,619	7.1	29,617	28,094	1,522	5.2
2008	52,442	49,346	3,096	5.9	22,860	21,219	1,641	7.2	29,582	28,182	1,455	4.9

Note: data for 2008 is a 6-month average.

Source: VI Department of Labor, Bureau of Labor Statistics