

U.S. Virgin Islands Economic Review

Bureau of Economic Research

July 2008

Economic Highlights

The flagging US economy and higher energy prices have dampened consumer and business spending. Gross business receipts—a good marker of spending in the economy—fell two quarters in a row. The third quarter decline was 2 percent.

The impact of the tax rebates is muted by the persistent rise in the cost of utility, gasoline and food.

The value of refined petroleum exports reached a record \$12.5 billion for the first three fiscal quarters.

Employment growth moderated during the third quarter as payroll expanded just 0.2 percent.

The civilian employment averaged 49,549 for the first three-quarters 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 2,147,444 visitors came to the Territory in the first nine months of the fiscal year—561,168 air visitors and 1,586,276 cruise passengers.

Current Economic Conditions

Economic fundamentals have weakened under the weight from the weak US economy, high energy prices weigh noticeably on the consumers and businesses. Consumer spending is being squeezed as evident from the drop in gross business receipts for the past two consecutive quarters. The economic stimulus rebate checks were expected to boost consumer spending; however, the impact is being muted by the unrelenting increase in the cost of utility, gasoline, food and other basic necessities. The drop in consumer outlays, accompanied by a contraction in construction activity and private capital investment spending, aided in slowing economic activity in the third quarter.

Employment growth moderated during the third quarter as payrolls expanded just 0.2 percent over the third quarter last year. Job gains were limited due to further declines in construction and other services employment. A softening in residential real estate activity and private development projects corresponded with tighter credit conditions and a winding down of tourism-related developments. Businesses, feeling the economic pinch, appear to be retrenching.

Although there is a notable slowing in the economy, in a comparative context, the job market is still in fair shape. Employment levels expanded 0.6 percent for the first nine months of the fiscal year. Marginal jobs gains were centered in the service industries and in government, but job losses in construction, information and financial and other services constrained overall growth. The Territory's nine-month average unemployment rate held steady at 5.8 percent, the same rate as a year ago. The number of non-farm jobs averaged 46,204 for this period, about 275 over last year.

With nine months of the fiscal year behind us, there are concerns about the durability of government revenues in light of a stalling economy. So far, revenues are down for every major tax category, except corporate income tax when compared to last year. The loss in revenue, however, has been cushioned by strong corporate income tax receipts resulting from a run-up in profits from the oil industry. Total tax revenues for the first three fiscal quarters were 2 percent above last year, while aggregate revenues showed a mere 0.1 percent

year-on-year increase. There are also growing concerns that businesses struggling under the weight of persistently higher utility costs and the general economic malaise may cut jobs or at worse close down. Economic conditions are not expected to deteriorate sufficiently to create more than an incremental downshift in employment in the short-term. However, if the US economic and financial conditions worsen, the risks increase for contraction in business activity and employment dislocation.

Although the pace of growth is likely to further ease in the final quarter, economic activity is expected to pick up gradually towards the end of 2009, supported by public and private sector capital investment projects, tourism activity, manufacture and construction.

Summary of the 2009 Outlook

The spillovers on the local economy from the US economic crisis are likely to linger well into 2009, and it will take well-timed and executed policies and initiatives to keep the economy on course. A concentration on private and public-sector development projects, strong tourism marketing and promotional campaign along with strong manufacturing exports should provide support for the economy in 2009 and beyond.

Turning to policies and initiatives, the government entered into a 30-year agreement with international alcoholic beverage company Diageo PLC, to build a new Captain Morgan rum distillery on St. Croix. The agreement entered into brings the production of the second-largest rum brand to the Virgin Islands, which is projected to return \$100 million a year or \$3 billion in new revenue over the thirty years. Diageo will construct a \$165 million state-of-the-art facility with a capacity to produce 20 million proof gallons of rum annually. The distillery should begin to produce Captain Morgan branded products for the United States in 2011.

There are other development projects that will drive construction activity next year. These include the \$13 million St. Thomas Regional Library and Record Center, the \$300 million Thatch Cay villa development, 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; the \$54 million Pond Bay Club and the \$51 million Calabash Boom housing development on St. John; and the \$40 million Island Crossing shopping center and office complex, \$50 million Stanford Business Center Holdings and the \$10 million South Grapetree Bay Hotel on St. Croix.

A rebound of the tourism sector is anticipated for 2009, stemming from a step-up marketing and promotional campaign. The Virgin Islands Tourism Department is increasing its marketing efforts in Europe to take advantage of the depreciation of the US dollar, as well as offering incentives to travelers to encourage them to visit the Territory. Additionally, cruise ship passengers are returning to St. Croix beginning in November 2008. Some 51 cruise ship calls are scheduled for St. Croix in 2009, bringing 121,700 passengers and 44,000 crew members.

The manufacturing sector is also expected to continue to support the economy in the year ahead. Increased global demand for and the rise in prices of oil and refined petroleum commodities proved to be an advantage for the manufacturing sector in terms of stronger output and the profits generated. Although the price of a barrel of oil is expected to retreat, prices are likely to remain elevated relative to historical context. Furthermore, although refined petroleum profit margins have narrowed because of the difference in price between a barrel of refined product and a barrel of crude oil – the so-called crack spread – profit margins will likely improve, even as prices for refined fuels remain low relative to oil costs.

The manufacturing sector will be further strengthened by solid output from the rum industry. Cruzan VIRIL, Ltd., produces nearly 8 million proof gallons of rum per year and has expanded its Cruzan brand by introducing new flavors and rum concepts to capitalize on the growth trend in dark and aged rums, and to accommodate shifts in consumer tastes. Rum exports are projected to increase in order to satisfy the growing demand for bulk rum and spirits.

Sector Activity and Labor Market Conditions

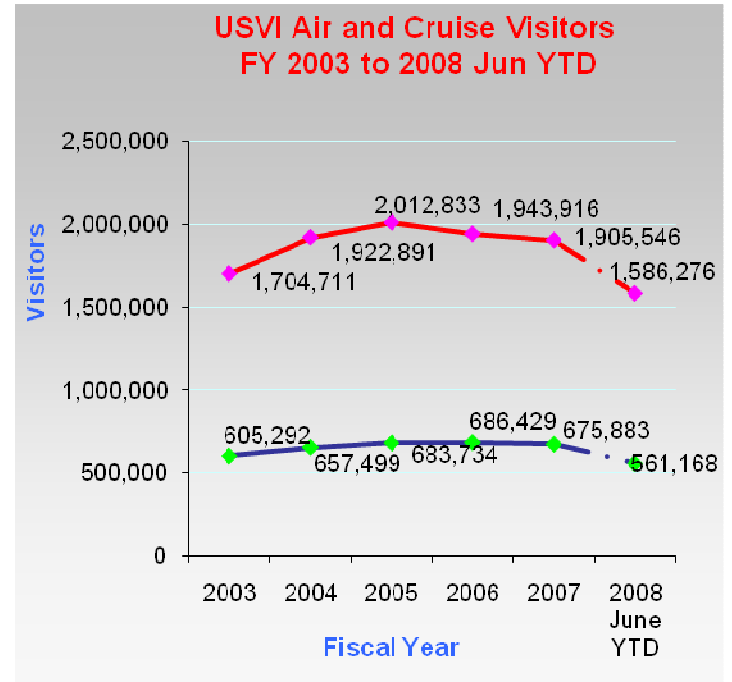
Tourism

The number of visitors to the Territory increased 3.3 percent for the first nine months of fiscal year 2008 to 2,147,444 from 2,079,250 for the same nine-month period in fiscal year 2007. Air arrivals grew a strong 6.6 percent, while cruise passenger arrivals were less robust at 3.3 percent. There were 561,168 air visitors during this period compared to 526,534 air visitors for fiscal year 2007. There were 1,586,276 cruise passengers compared to 1,552,716 the year before.

Air visitor arrivals improved as a consequence of new and creative marketing and promotional efforts by the Department of Tourism. The *Winter Escape* promotion and *Escape St. Croix* were successful in bringing visitors to the Territory. Up and coming promotional initiatives and events should continue to draw visitors. These include *Romance in the Virgin Islands* initiative which highlights romantic options for couples, honeymooners and newly weds; *Cultural St. Croix/Blue Bay Jazz Festival* in November which highlights the island's unique history and culture; and *Tempo and Paradise Jam* music and sport events also in November.

Additionally, there are a number of planned initiatives and incentives to increase airlift, particularly to St. Croix. *St. Croix Fantastic Flight*,

for example, offers a \$300 air credit per seven night booking on US Air. A Blue ribbon Airline Committee was also newly created to attract airlift to St. Croix. To also encourage travel to St. Croix, a number of ads were developed around a new brand, *St. Croix Your Port of Solace*.



The cruise industry is poised to take-off and set new records in the coming year. Over 2 million passengers are scheduled to visit in 2009. More than 700 cruise ships calls will be to St. Thomas and St. John, including some first time stops. Royal Caribbean Cruise Lines, the *Independence of the Seas*, will join *Freedom of the Seas* to visit year-round every other week. *Carnival Splendor* will arrive weekly. The highlight of the 2009 and 2010 season will be the 6,000 passenger ship *Oasis of the Seas*, which will visit every Tuesday beginning in December 2009. The *Carnival Dream* will also begin visit in December. Disney Cruise lines will bring two weekly trips to St. Croix. Celebrity, Holland America, and Azamara Cruiselines will also be making stops on St. Croix.

Manufacture

The manufacturing sector continues to register

strong performance on account of increased output of refined petroleum products and rum. Both industries are performing well as both the volume and value of exports have risen sharply.

The manufacturing sector contributes about 11 percent of GDP. While this share is not large relative to the tourism sector, for example, the manufacturing sector’s strong growth of exports in recent years translates into a huge contribution to the Territory’s economic growth. Exports from this sector, especially refined petroleum products, account for 95 percent of total exports.

The manufacturing sectors accounts for 5 percent of jobs. There was an average 2,314 manufacturing jobs in the first nine months of fiscal year 2008, practically the same as last year.

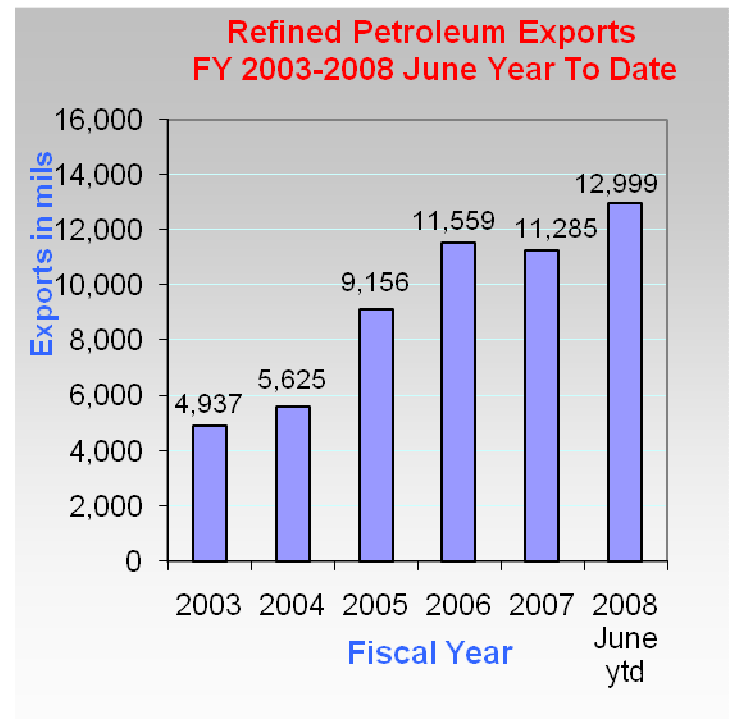
Oil Industry

Oil refining dominates the manufacturing sector. HOVENSA, a joint venture between a subsidiary of Hess Corporation and a subsidiary of Petroleos de Venezuela, S.A. (PDVSA) operates a world-class refinery on St Croix. The refinery processes crude from all over the world, although the majority of its crude is supplied from Venezuela. The facility is one of the most modern refineries in the United States and, with crude oil processing capacity of 495,000 barrels per day (BPD), it is one of the largest in the world. The refinery also operates a Fluid Catalytic Cracking (FCC) unit capable of producing 175,000 BPD of gasoline. In addition to the FCC, HOVENSA operates a delayed coking unit. The Coker allows for the manufacture of gasoline and heating oil to use lower cost heavy crudes.

Record shipments of refined petroleum products were shipped to the United States and other countries last year. These products include gasoline, kerosene, jet fuel, distillate fuel oils, residual fuels and lubricants. Roughly \$10.7 billion of refined petroleum products were

shipped to the US alone in 2007—a 43 percent jump over the previous year. The value of 2008 exports is trending upward matching growing demand for refined petroleum products. June 2008 fiscal year-to-date figures, the most recent available, show the value of refined petroleum exports reached a record \$13 billion, up from \$7.5 billion for the same period in 2007.

The price of crude oil rose to a high of \$143 a barrel at the end of June. The recent price hike was mostly due to financial developments – such as declines in the dollar, a drop in the equities markets, and a flight to the safety of commodities. A drop in demand is predicted to force the oil prices downwards, although prices will remain high relative to historic levels. In the meantime, heavy global demand for diesel fuel and gasoline from developing countries and from China and Russia is keeping world oil prices high.

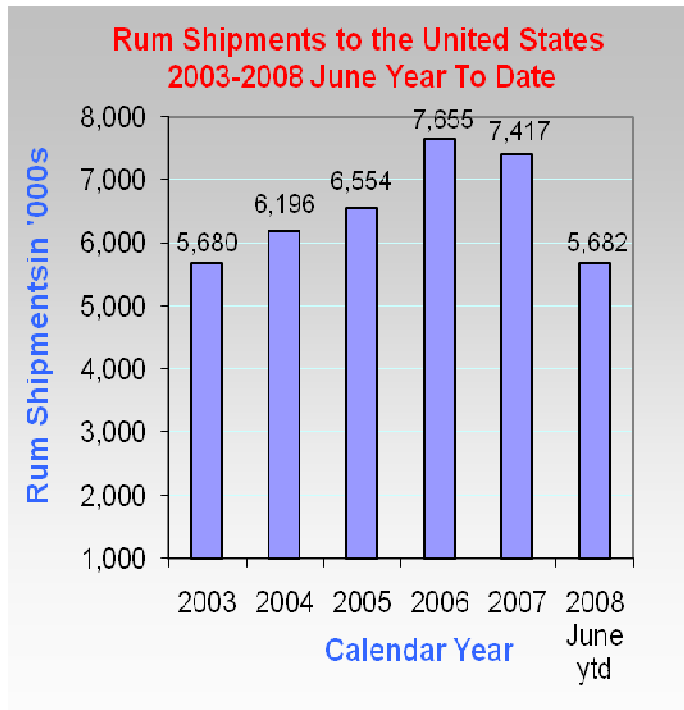


Rum Industry

Cruzan VIRIL, Ltd., a wholly-owned subsidiary Vin & Sprit AB, a Swedish-based international wine and spirits company, 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 the fifth-leading premium brand in the United States.

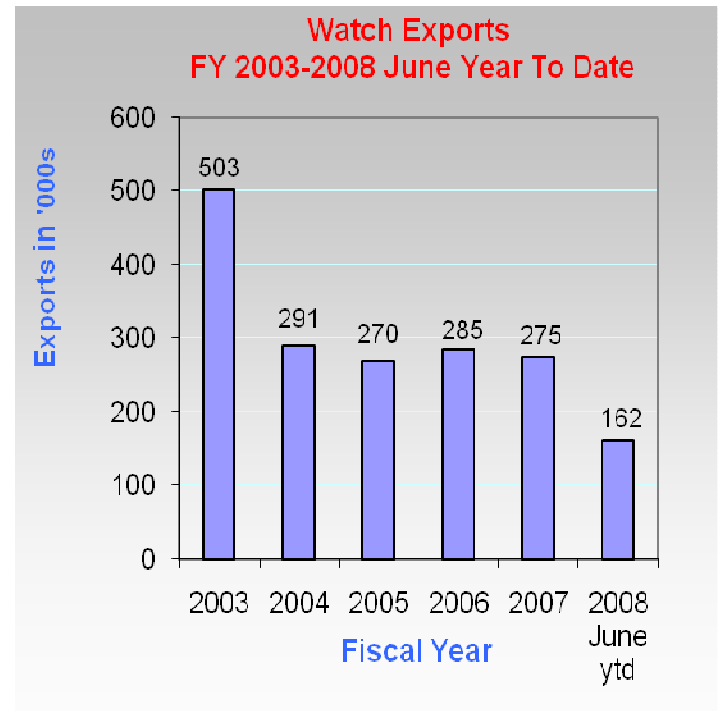
The rum industry has exhibited robust growth. The industry shipped 7.4 million proof gallons of rum to the US in 2007. Shipments for the first nine months of fiscal year 2008 total 5,681,887 proof gallons compared to 5,392,459 proof gallons for the same period in 2007. VIRIL is projecting rum shipments of approximately 7.6 million proof gallons of rum in 2008. As a result of the increased production, the government has seen an increase in matching fund revenues. Last year, the government received \$86.7 million in excise taxes from the federal government, which imposes and collects federal excise taxes on rum produced in the Virgin Islands and exported to the United States. For each proof gallon of rum produced in the Virgin Islands, the federal government pays \$13.50 in excise taxes, from which \$13.25 is rebated to the Territory.



The outlook for the rum industry looks even brighter with the snagging of the Diageo deal and the production of Captain Morgan branded products. Beginning in 2012, the distillery will supply all bulk rum used to make Captain Morgan branded products for the United States. Captain Morgan is the second leading rum consumed world-wide. Diageo is the world's leading premium drink business whose brands include Johnny Walker, Guinness, Red Stripe, Smirnoff, Cuero, Tanqueray, J & B, Crown Royal, Beaulieu Vineyard and Sterling Vineyard wines.

Watch industry

Output from the watch industry has declined significantly in recent years. The watch industry continues to struggle from high unit costs and increased competition. The industry is now comprised of two companies—Belair Quartz and Tropex Watch Co. In June, Hampden Watch Co., began to phase out its operation on St. Croix, citing poor economic conditions and revenue losses for the closing of the company.



Approximately 274,625 watches were exported in fiscal year 2007 down from 285,428 the previous

year. June 2008 year-to-date figures show that 162,428 watches were exported, down from 192,461 for the same period in 2007.

Construction

Jobs in the construction sector remained weak and declined further during this quarter. Construction jobs declined 5.3 percent in the third quarter and by 6.1 percent for the three-quarters of fiscal year 2008. The number of construction jobs averaged 3,419 for the first nine months of fiscal year 2008 compared to 3,643 for the corresponding period in fiscal year 2007.

Both residential and nonresidential real estate remained a soft spot as the number of building permits issued in recent months fell short of year-earlier level. Construction activity declined in part from a winding down of tourism-related development, housing and seaports, and the development of commercial and residential properties. The fall in residential construction is attributed to the tighter lending conditions and secondary effects of the sub-prime mortgage market collapse on the mainland. Many sub-prime borrowers—those with low credit scores and/or whose income may not qualify for a prime loan—agreed to adjustable mortgage rates which allowed for their monthly payments to remain low in the early years of the loan. Unfortunately, many homeowners saw their rates rise, resulting in higher monthly payments eventually pushed them into foreclosure. Although the Virgin Islands does not engaged in sub-prime lending, the decline in housing prices nationwide has led to a decline in housing construction, especially of second homes.

Construction activity is projected to increase from private construction activities in hotel development, road construction, seaport expansion, public and private-sector housing development and retail and commercial office space. The Diageo \$165 million rum distillery and storage facility is expected to break ground

in the second quarter of 2009. Other hotel projects, affordable housing and a commercial shopping center will provide anchor for the construction sector.

Leisure and Hospitality

The leisure and hospitality sector is one of the sectors that showed modest growth this fiscal year. For the first three-fourths of fiscal year 2008, the number of jobs averaged 7,532, a year-on-year increase of 2.4 percent. The job growth driver was the arts, entertainment and recreation sub-sector which grew by 8.1 percent. Activity in amusement, gambling and recreational sub-sector is driving growth. The expanding gaming industry, in particular video lottery terminals which are cropping up in bars, restaurants and hotel have added to the gains in employment 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 8,743 jobs in 2008—up 1.3 percent over the last fiscal year.

The trade sector plays a significant role in the Virgin Islands' economy, contributing over \$1.5 billion in sales or about 40 percent of sales annually and 19 percent of jobs in the economy. Retail trade, particularly, supports the trade sector. Retail activity accounts for 10 percent and wholesale, just about 2 percent of GTP.

The effects of the slowing economy has moved into the once-brisk trade, transportation, and utilities sector as consumers rein in spending and cut back on travel and other transportation-related services. Nonetheless, jobs remained relatively stable in retail, but wholesale and transportation and warehouse have shown some decline. Retail trade jobs, which represent 90 percent of the trade sector's total employment, increased 1.7 percent for the first three fiscal

quarters, averaging 6,993. Wholesale trade jobs averaged 776, down by 2.1 percent from last fiscal year. Jobs in transportations, warehouse and utility fell marginally by 0.3 percent to a nine-month average of 1,633 jobs.

Financial Activities, Professional and Business Services

The Financial Services sector, which holds a 6 percent share of total employment, continues to show a decline in jobs due directly to the real estate sub-sector and a drop-off in companies participating in the Economic Development Commission (EDC) incentive program brought about by the American Job Creation Act 2004. The number of jobs in this sector averaged 2,470 for the nine-month period down from 2,493 for the corresponding period in fiscal year 2007.

The Act changed the residency requirement for the Economic Development Commission (EDC) incentive program, establishing that bona fide residents must be present in the Territory for at least 183 days over a period of three years. The final ruling also confirmed that taxes on income connected to US sources should be paid to the US Revenue Service. The residency and source income requirements ostensibly caused a number of companies to leave the Territory. Prior to the ruling, there were about 121 EDC beneficiary companies; currently, there 98 companies.

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.

Final numbers are not yet available for 2008; however, financial activity is expected to be on par with 2007.

Falling profitability and sagging confidence have spread from the consumer sector to the business and professional services sector. This sector has seen a turn in business conditions over the past year which has resulted in lower volumes and profitability. Firms in this industry are experiencing not only the effects from the slowing economy and the credit crunch, but also the effects from the loss of EDC companies and the requisite services that were provided to them. Expectations for business expansion in the next 12 months are negative given the flagging state of the economy.

So far, jobs in the business and professional services sector are slightly above last year. For the first three fiscal quarters, the number of jobs averaged 3,581 up 3.4 percent over the corresponding period in 2007.

Employment Trends

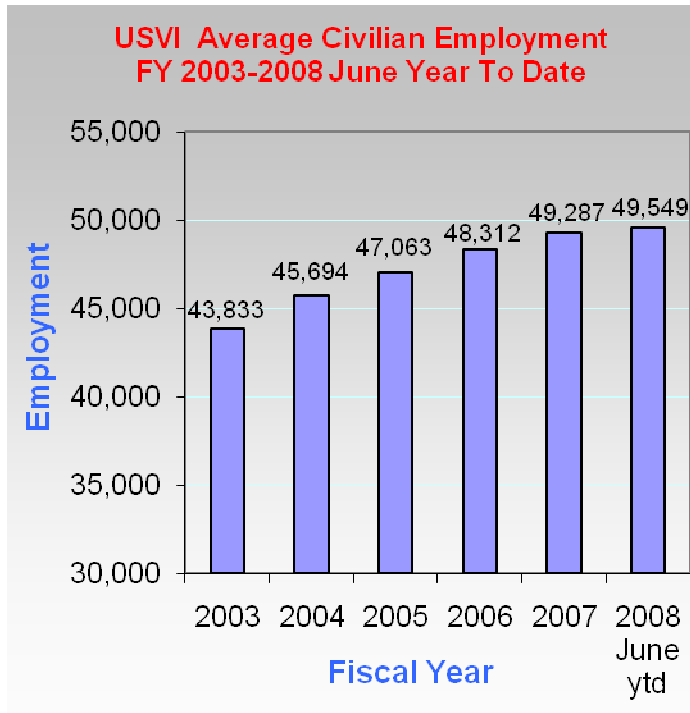
There were 49,549 persons employed in civilian jobs during the nine-month period— 21,306 on St. Croix and 28,243 on St. Thomas and St. John. This is merely 0.3 percent over the 49,418 persons employed for the corresponding period in fiscal year 2007.

Public-and private-sector employment

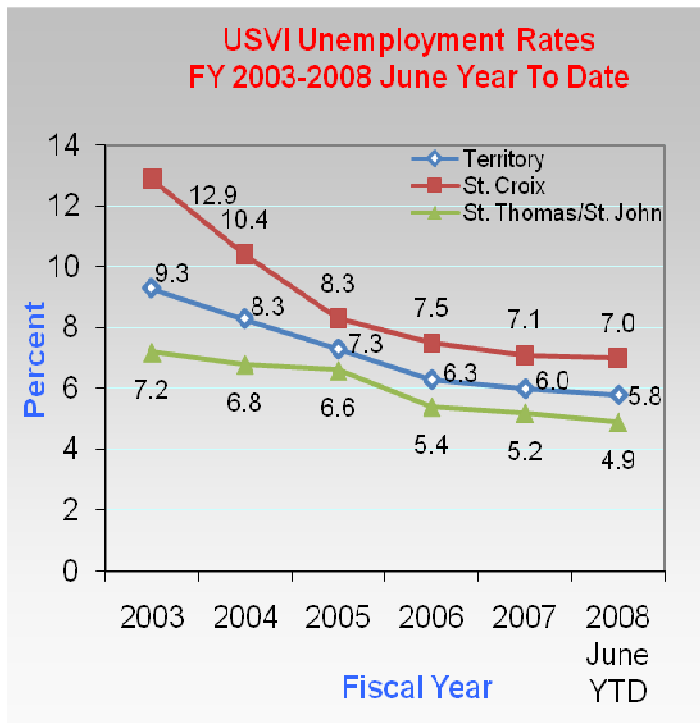
Wage and Salary Employment

An average 46,243 persons were employed in nonagricultural wage and salary jobs compared to 45,929 last year— about 0.7 percent more.

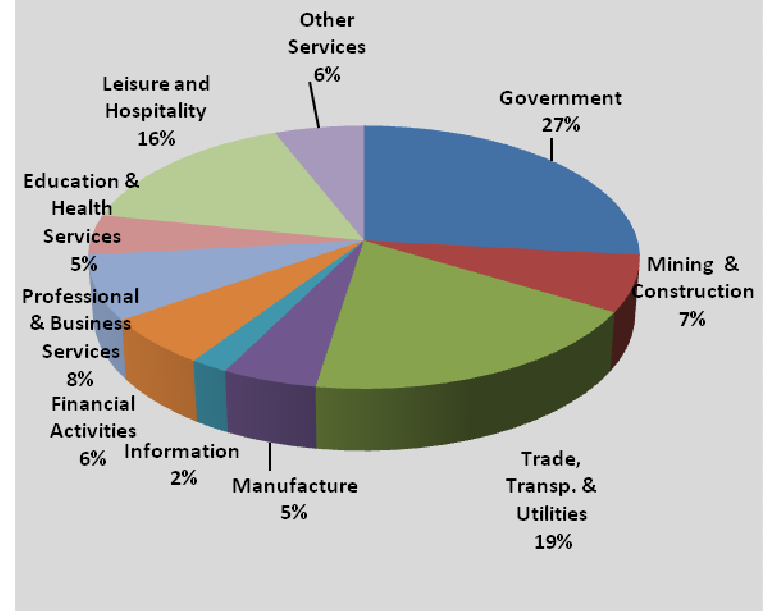
Nine in ten of these jobs are in the service-producing industries and one in ten jobs is in the goods producing industries. Government; trade, transportation and utilities; and leisure and hospitality are the industries with the largest number of jobs. These three sectors account for 62 percent of all 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.



The Territory's unemployment rate has steadily declined since 2003 from a high of 9.3 percent to 5.8 percent this fiscal year. The rate for St. Croix was steady at 7.0 percent for the past nine months, while the rate for St. Thomas and St. John declined one-tenth of a percentage point to 4.9 percent.



Percent of Nonagricultural Jobs, FY 2008



Public and Private Sector Jobs

Public sector jobs which comprise 27 percent of total nonagricultural jobs increased 2.6 percent in the third quarter. The increase for the quarter

occurred for territorial government jobs only. Public sector jobs grew 1.5 percent for the nine-month period to 12,776 from 12,587 for the same period last fiscal year. Local government jobs averaged 11,829, up 2.3 percent over fiscal year 2007, while federal government jobs averaged 947 or a 1.2 percent increase from last fiscal year.

Private sector jobs account for 73 percent of wage and salary jobs. Job growth has been flat and there are hints that weaknesses in the economy

are beginning to manifest in the private sector job market. The number of jobs declined in the third quarter—albeit a small 0.7 percent—when compared to the third quarter of fiscal year 2007. The private sector has added no significant number of jobs in the past nine months. There were 33,446 private sector jobs compared to 33,432 last year.

U.S. Virgin Islands Tourism Statistics, Fiscal Years 2003-2008

Year	Total Visitors		Air Visitors		Cruise Visitors		Tourist Rooms					
	Number (000s)	Percent Annual Change	Number (000s)	Percent Annual Change	Number (000s)	Percent Annual Change	Room Nights Available (000s)	Room Nights Occupied (000s)	Average Stay (Nights)	Occupancy Rate (%)	Total Rooms	Number Hotels
2003	2,309.9	-1.1	605.2	1.2	1,704.7	-2.0	1,848.9	1,042.7	4.4	56.4	5,061	47
2004	2,580.2	11.7	657.4	8.6	1,922.8	12.8	1,583.9	1,069.5	4.2	59.7	4,984	46
2005	2,696.3	4.5	683.5	4.0	2,012.8	4.7	1,727.4	1,112.1	4.5	64.9	4,795	47
2006	2,630.3	-2.4	686.4	0.4	1,943.9	-3.4	1,741.7	1,068.3	4.2	61.7	4,775	47
2007	2,581.3	-1.9	675.8	-1.5	1,905.5	-2.0	1,741.8	1,092.0	4.4	63.0	4,784	46
2008	2,147.3	-	561.1	-	1,586.2	-	1,310.1	862.0	4.4	63.6	4,796	47

Note: data for 2008 is a 9-month average

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	46,243
TOTAL PRIVATE SECTOR	29,207	29,821	31,391	32,656	33,367	33,467
CONSTRUCTION AND MINING	1,737	1,695	2,213	3,112	3,591	3,419
MANUFACTURING	2,023	2,062	2,210	2,306	2,321	2,310
TRANSPORTATION, WAREHOUSE, & PUB. UTILITIES	1,429	1,490	1,651	1,634	1,624	1,633
WHOLESALE TRADE & RETAIL TRADE	6,905	6,871	6,896	7,703	7,780	7,109
WHOLESALE TRADE	713	705	769	794	795	776
RETAIL TRADE	6,192	6,166	6,127	6,909	6,985	6,333
INFORMATION	877	876	891	845	809	786
FINANCIAL ACTIVITIES	2,304	2,483	2,569	2,599	2,486	2,470
PROFESSIONAL AND BUSINESS	3,103	3,277	3,391	3,452	3,492	3,581
EDUCATION AND HEALTH	2,168	2,182	2,204	2,323	2,376	2,376
LEISURE AND HOSPITALITY	6,811	7,119	7,101	7,132	7,374	7,532
OTHER SERVICES	1,839	1,845	2,357	2,378	2,310	2,250
GOVERNMENT	12,626	12,450	12,320	12,381	12,633	12,776
FEDERAL	906	875	853	904	938	947
TERRITORIAL	11,720	11,575	11,467	11,477	11,695	11,829

Note: data for 2008 is a 9-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	Unem- ployment Monthly	Unem- ployment Rates	Labor Force	Civilian Employed	Unem- ployment Monthly	Unem- ployment Rates	Labor Force	Civilian Employed	Unem- ployment Monthly	Unem- ployment Rates
2003	48,460	43,833	4,627	9.5	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	18,175	2,097	10.4	29,261	27,266	1,995	6.8
2005	50,085	47,063	3,689	7.3	20,990	19,180	1,810	8.6	29,762	27,882	1,881	6.3
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	52,623	49,549	3,074	5.8	22,920	21,306	1,614	7.0	29,703	28,243	1,460	4.9

Note: data for 2008 is a 9-month average

Source: VI Department of Labor, Bureau of Labor Statistics