

US Virgin Islands Economic Review

March 2010

Bureau of Economic Research
1050 Norre Gade No. 5
Charlotte Amalie
St. Thomas, US Virgin Islands 00802

REPORT: ECONOMIC CONDITIONS

Economic Review

Following contraction in the major economic indicators in the latter part of 2008 and 2009, the first two quarters of fiscal year 2010 have shown indications that the US Virgin Islands economy may be at a turning point. Many of the Territory's economic indicators, although still negative, have improved from lows posted last year. The Territory's unemployment rate declined from 8.5 percent in the first quarter of fiscal year 2010 to 8.0 percent in the second quarter. Initial jobless claims have also been trending lower, which indicates the level of job loss is subsiding. The hiring of some 600 temporary workers for the decennial census positively impacted employment and was critical in the slowing of job losses. Nonetheless, unemployment and the level of claims remain elevated, evidence of a continuing weak labor market.

One sector that is steadily rebounding, however, is the visitor sector. Growth returned to tourism in the first quarter of fiscal year 2010 and continued in the second quarter, yielding robust results in key tourism indicators. Total visitor arrivals for the first six months of the fiscal year registered a solid 12.2 percent growth over last year as a result of a significant 4.6 percent upswing in arrivals in the first quarter and 18.4 percent in the second quarter. Hotel performance also improved noticeably, indicating that demand for overnight stay has grown. Occupancy rates improved 3.4 percentage points in the past six months, while hotel revenues grew 12 percent above last year's level.

Consumption activity appeared to be strengthening as demonstrated by business gross receipts which have been trending

upward as of February. Leading indicators in the housing and real estate market have improved, as the value of construction permit approval increased in recent months. Government revenues have also appreciated with each quarter as the economy continues to improve

Even so, economic activity remained subdued and weaknesses widespread, with many economic sectors reporting negative job growth. Construction, trade, financial services and tourist accommodation sectors continue to be the source of most of the job losses. Even the addition of a few jobs in the second quarter in professional and business services, other services, arts and entertainment and educational and health sectors lacked the strength to make a substantial improvement in the overall level of employment.

Even as the job market remained anemic, there were promising developments from the most recent labor market report which bodes well for the outlook of the economy. The number of jobs in the other services sector, which contains many small businesses, grew 6.2 percent in the second quarter, the first increase in the past five quarters. The professional and business sector also showed modest job growth of about 2 percent for the past two quarters, a reversal of trend. Even construction which has been the hardest-hit industry has started to see a pickup in activity and jobs primarily from private residential construction, government public works projects and the Diageo and Cruzan Rum distillery and wastewater treatment plant construction.

There remain, however, lingering impediments that threaten to derail the broader recovery, not the least of which is the

REPORT: ECONOMIC CONDITIONS

government's operating budget deficit. The government sector, which has served as a stabilizing factor in the economy during this slump, is facing a \$170 million operating budget deficit in the current fiscal year. To help cover the current operating budget gap and to avoid lay-offs, the government received

legislative authorization to issue up to \$250 million in bonds which will be backed by the rum cover-over. This federal program provides for the Territory to receive \$13.25 of the \$13.50 per proof gallon on rum produced locally and sold in the United States. The government is also bridging the budget shortfall through additional spending cuts, which include directive to departments and agencies to cut budget expenditures through attrition, hiring freeze, and the utilization of federal funds.

The fiscal challenges facing the government and the limited stop-gap fixes available to fill the operating deficits may necessitate additional spending cuts in the new fiscal year's budget. Otherwise, budget woes are expected to continue into fiscal year 2011. And unless the government takes remedial action to improve its financial standing, the government sector will be a net drag on the growth of the economy moving forward.

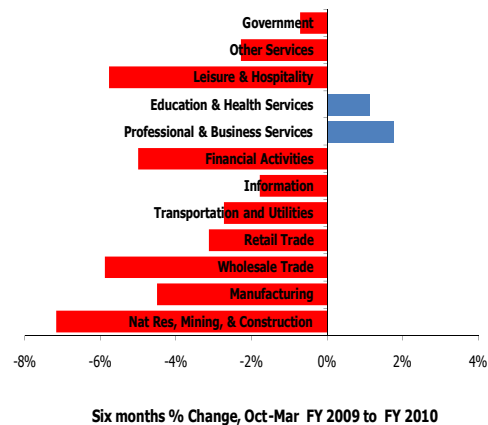
Economic Outlook

Overall, the underlying fundamentals of the local economy are expected to improve as the recovery in the US and global economies gains momentum. However, though growth in the economy is expected to return in 2011, the pace of recovery will be slow and tepid. The labor market will remain sluggish and aggregate demand will continue to lag amid relatively higher unemployment levels.

Consequently, the economy will experience below-trend growth next year.

Major Sector Performance

Recent data show that conditions as it relates to economic activity and employment have improved in some sectors, while others have experienced a moderation in the rate of decline. As the chart below indicates, the economic crisis has adversely impacted the job performance of most sectors of the economy, with only a couple experienced job growth in the first half of fiscal year 2010.

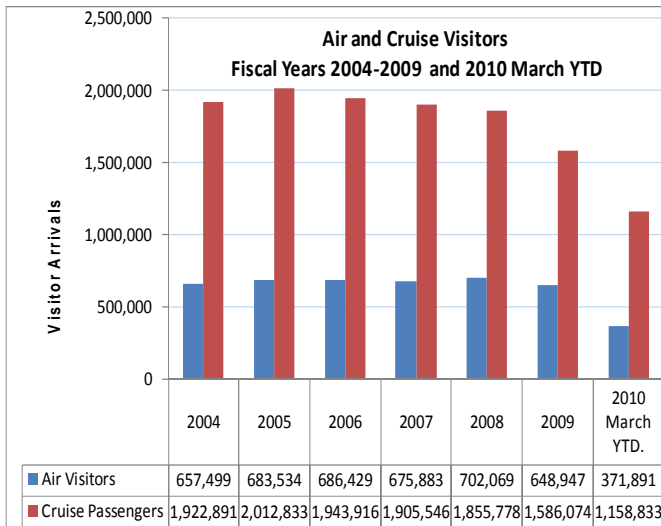


Tourism

The upturn in tourism indicators established last quarter was carried into the second quarter. Visitor arrivals increased a solid 18.4 percent in the second quarter above the 4.6 percent first quarter growth. Air arrivals increased 15.4 percent to reach 213,583 and cruise passenger arrivals increased a robust 19.4 percent to 656,125, bring total visitors to 869,708 from 734,551 in the second quarter of

REPORT: ECONOMIC CONDITIONS

fiscal year 2009. So far, visitor arrivals have reached 1,491,579 for the first six months, 12.2 percent over the corresponding period in fiscal year 2009.



The growth in visitor arrivals was supported by the VI Department of Tourism multi-media advertising and promotional campaign launched to attract more holiday-makers from the US, Europe and Puerto Rico. Targeting families' summer travel, the department's newest campaign *The Family fun package* offers a second room for children at half price for those who reserve a room for two people. It also offers \$200 in gift certificates and coupons for dining, shopping, golfing, spa visits and sailing. The package is available for booking through May 31, 2010 for travel between June 1 and August 1, 2010.

The Department has also unveiled a campaign "Dive in Five" aimed at the dive market. The promotion allows divers to save up to \$300 on dives for those who stay five nights or more. The package is available for booking through September 2010 for travel between June 1 and October 31, 2010.

The tourism department has also sponsored and teamed up with the 8th Annual St. John Blues Festival and the International Rolex Regatta both in March to bring music lovers and sailing enthusiast to Territory as part of the springtime recreational activities. These events augur well for the outlook for visitors and the tourism industry.

Leisure and Hospitality

Hotel industry indices were positive in the second quarter amid stronger tourist arrivals. The Territory's hotel occupancy rate improved slightly to 70.6 percent in the second quarter compared to 62.5 percent correspondingly last year. The total room nights occupied for the second quarter was 319,430, a 13.6 percent increase from 281,112 room nights occupied in the second quarter of fiscal year 2009.

The hotel occupancy rate for St. Thomas and St. John averaged 72.9 percent for the second quarter, up from 68.6 percent in 2009, while the rate for St. Croix improved substantially to 63.2 percent from 44.3 percent for the corresponding quarter in 2009.

Job growth in the leisure and hospitality sector has not begun to materialize; however, the pace of job losses has slowed with the second quarter demonstrating the smallest quarterly job loss in the past year. In the second quarter of fiscal year 2010, the net jobs averaged 6,898, a 4.2 percent year-on-year decrease from 7,196 in 2009. The accommodation subsector, which contains about 55 percent of the jobs, experienced a 6.4 percent decline in jobs and accounted for most of the job losses in the leisure and hospitality sector. Restaurants and food stores also showed a quarterly 2.9 percent

REPORT: ECONOMIC CONDITIONS

decline in jobs, while arts and entertainment showed a 1.9 percent increase.

Manufacture

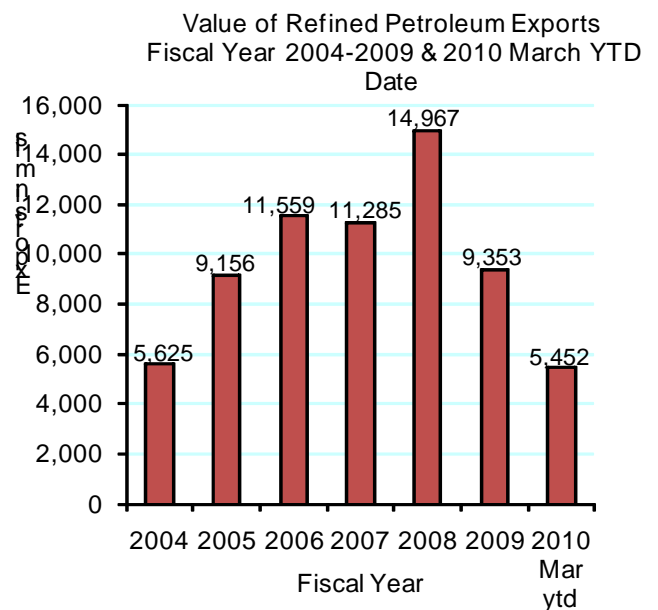
The manufacturing sector, the second largest sector in the economy, and comprised primarily of refined petroleum products, rum, dairy and jewelry, registered a decline in output and employment last year. Weakening global demand, high oil prices and lower refined petroleum margins added to the decline in Hovensa's export products last year, while competition from lower producing countries and weak demand caused the near collapse of the watch industry to the point where only one watch company remains.

Employment in the manufacturing sector fell 4.5 percent in the second quarter, averaging 2,166 or a decrease of about 110 jobs over the second quarter fiscal year 2009. The completion of Hovensa's turnaround project primarily accounted for the job losses+.

Oil Industry

The Hovensa oil refinery jointly produces a variety of refined products from crude oil imported from around the world, but primarily from Venezuela. The refinery is jointly owned by Hess Corporation and Petróleos de Venezuela, S.A. (PDVSA) and is located on St. Croix. It is one of the ten largest in the world with a crude oil distillation capacity of 495,000 barrels per day (BPD). Some of the products refined include gasoline, diesel, home heating oil, jet fuel, kerosene and residual fuel oil. Most of the industry's refined products output or 95 percent are exported to the United States.

The better second quarter performance of the manufacturing sector was attributed to the improved performance of oil product exports. The value of Hovensa's refined products increased a significant 61.0% to \$2,920.3 billion from \$1,813.9 the second quarter one year ago. This increase followed growth in refined petroleum exports in the first quarter, though a less pronounced 4.5 percent increase. Comparatively, the value of refined petroleum products were \$2.531.9 billion in the first quarter of fiscal year 2010 and \$2,410.2 billion in the first quarter of fiscal year 2009. As the table below shows, \$5,542.2 billion of refined products were exported for the first six months of the fiscal year.



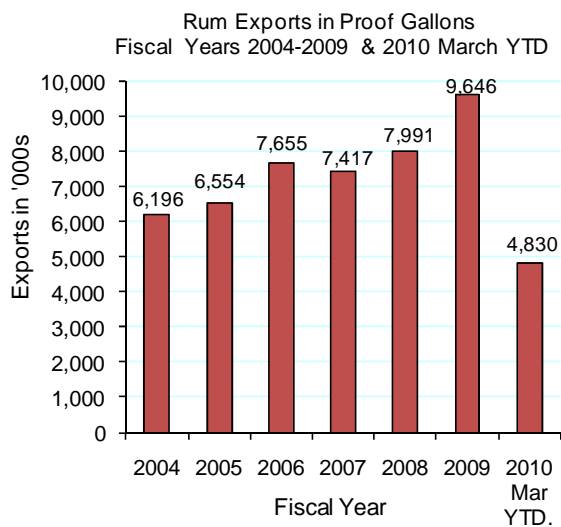
Rum Industry

Cruzan VIRIL Ltd., the single rum manufacturer which is based on St. Croix was acquired in October 2008 by Illinois-based Fortune Brands, the largest U.S. spirits company and the fourth largest premium spirits company in the world. Cruzan VIRIL, Ltd., manufactures Cruzan and Old St. Croix brand rum as well as bulk shipments for

REPORT: ECONOMIC CONDITIONS

other labels. Rum produced in the US Virgin Islands is exported in bulk to the US primarily, and is sold to local and regional bottlers for sale under a variety of private label and regional brand names.

Cruzan VIRIL Ltd., signed a 30-year public-private partnership agreement with the government that includes an expansion of the rum facility and the construction of a wastewater treatment plant to address the long-standing effluent disposal issues. Expansion of the facility will increase production capacity by about 50 percent. The expansion will not only grow the rum production capacity of the industry, but also provide a long-term stream of revenue for the government.



The rum industry has shown remarkable improvement and continued to perform well. Rum exports in the second quarter of fiscal year 2010 increased 23.9 percent to 2,654 proof gallons compared to 2,143 proof gallons in the second quarter of fiscal year 2009. Rum exports in the first six months of fiscal year 2010 totaled 4,830 proof gallons or 20.7 percent increase over last year as shown above.

The Territory received \$30.5 million or a 28.8 percent increase in the first quarter rum excise taxes revenues or cover-over program. In the second quarter, \$26.2 million were rebated to the Territory or a 20 percent increase year over year. Under the cover-over program, the federal government 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 collects \$13.50 in excise taxes, from which \$13.25 is rebated to the Territory. The Territory receives about \$90 million annually in excise rum tax rebates.

The government also signed a 30-year public-private partnership agreement with Britain's Diageo PLC, the world's leading spirits, wine and beer company for the construction and operation of a high-capacity distillery on St. Croix. The \$165 million new distillery which broke ground in May will have capacity to distill up to 20 million proof gallons of rum per year, thereby generating an estimated \$100 million a year in tax revenues. The distillery will begin production in 2011, and by 2012 will supply the rum used to make all Captain Morgan branded products for the United States. Captain Morgan is the sixth premium spirit and the second leading premium rum consumed worldwide. Its brands include Johnny Walker, Guinness, Red Stripe, Smirnoff, Cuero, Tanqueray, J & B, Crown Royal, Beaulieu Vineyard and Sterling Vineyard wines.

Watch Industry

After years of dwindling watch production and exports, the watch industry has virtually collapsed. The one remaining company shipped 13,830 watches in the first quarter

REPORT: ECONOMIC CONDITIONS

and 13,235 watches in the second quarter or about 64.6 percent decline in exports for the first six months of the fiscal year when compared to last year. The survivability of this industry is in doubt as it will continue to face challenges of demand and competition.

Construction

The construction sector remained an area of weakness in the economy, impacted by the housing collapse and ensuing problems that have plagued the industry. Nonetheless, there are signs that the construction sector may be girding for recovery based on the improvement in the number and value of issued building permits. The total value of building permits which measures future construction activity increased 8.4 percent in the first quarter to \$58 million from \$53 million in the same quarter of 2009. In the second quarter, permit values increased 12.6 percent year-on-year to \$47.5 million from \$42.2 million. A significant increase in the private residential construction accounted for the second quarter increase in construction permit value.

While the number of construction jobs remained below pre-recessionary levels, there has been gradual improvement aided by local and federal stimulus funding on road projects, Diageo rum distillery and storage facility, and Cruzan Rum distillery expansion and wastewater facility. The number of construction jobs averaged 2,159 in the second quarter compared to 2,269 for the corresponding period in fiscal year 2009, for a 4.8 percent quarter-on-quarter decline.

While construction activity is expected to improve from a number of projects on the drawing board, the rest of the year is

expected to be a down year for the construction labor market.

Trade, Transportation and Utilities

The trade, transportation, and utilities sector, dominated by retail trade activities, has experienced the effects of a fall-off in consumer spending, visitor travel and other transportation-related services. Retail trade jobs, which represent 90 percent of the jobs in the trade sector declined 3.8 percent in the second quarter and averaged 6,025 compared to 6,266 in the same quarter of fiscal year 2009. Wholesale trade jobs declined to 668 from 705 last year, for a decreased of 5.3 percent. Jobs in transportation, warehouse and utility were lowered by 2.8 percent to 1,602 from last year's second quarter average of 1,647 jobs.

Financial, Insurance and Real Estate

The financial services and real estate sector continued to experience a drop in activity relative to home sales and real estate development as observed from the most recent available 2009 annual numbers. Relative to home sales, the number of homes sold in the Territory declined 11 percent in 2009 to 298 from 335 in 2008. The average home price declined just 1.4 percent to \$456,295 from \$462,687 in 2008.

While home prices were lower on St. John and St. Croix, 13 percent and 7 percent respectively, St. Thomas experienced an 11 percent increase in the price of homes sold. The average sale price moved up to \$487,930. This compares to an average sale price of \$1,006,144 on St. John and \$356,9544 on St. Croix. The market for condominiums also declined. The average \$251,832 sale price of condominiums declined 8 percent

REPORT: ECONOMIC CONDITIONS

Territory-wide while the number sold declined 43 percent to 152 from 266 in 2008.

Numbers for 2009 and 2010 are not yet available for the banking industry. In 2008 economic activities in the banking sector also declined. The combined total assets of commercial banks domiciled in the US Virgin Islands at the end of 2008 declined imperceptibly to \$2,649.6 billion. Total assets fell by just \$3.3 million or a 0.1 percent decline over the previous year's total assets of \$2,653.9 billion—mainly due to a decrease in credit to businesses and industry and private household for construction and land development, purchase of homes and consumer durables.

Bank deposits—which consist of savings demand accounts, demand deposits and time deposits—increased by 2 percent or by \$67 million to \$2,322.6 billion from \$2,372.2 billion in 2007. Overall deposits of private individuals, partnerships and corporation fell \$15 million to about \$1,688.4 billion in 2008 from \$1,703.1 billion in 2007.

For the second quarter fiscal year 2010, the number of jobs in the financial, insurance and real estate sector declined 6.3 percent to an average 2,395 compared to 2,555 for the second quarter period in 2009.

Professional and Business Services

One of the few sectors to record positive job growth during this period was the business and professional services sector. This was a reversal of this sector's performance, perhaps signaling that business activity is rebounding as consumers spending improve. Overall, second quarter jobs improved to 3,421, up 2.0 percent year-on-year from 3,355 jobs in 2009.

The outlook for this sector is positive with renewed confidence in the economy

Labor Force Trends

Generally, employment losses were less severe in the second quarter of fiscal year 2010 than the first quarter. From January to March 2010, civilian employment fell 3.7 percent year-on-year, for a net loss of about 1,809 jobs. There were 46,906 persons employed in civilian jobs in the second quarter—20,170 on St. Croix and 26,737 on St. Thomas and St. John.

Non-Agriculture Wage and Salary Employment

An average 43,779 persons were employed in the nonagricultural wage and salary jobs in the second fiscal quarter, about 2.0 percent below last fiscal year second quarter average of 44,650. Goods producing employment fell by net average 211 jobs, with the construction sector accounting for more than two-thirds of those losses. Job losses in the service-producing industries netted about 660 and were spread across most sectors, with the exception of educational and health and the professional and business services, and arts and entertainment.

Public and Private Sector Jobs

The three-month average of private sector employment declined 2.4 percent to 31,008 compared to 31,787 last year. This second quarterly decline was the lowest of the past five quarters.

Public sector jobs declined by 0.7 percent in the second quarter. Federal government jobs declined 1.4 percent in the second quarter to

REPORT: ECONOMIC CONDITIONS

average 979 compared to 993 in the same quarter in fiscal year 2009. Local government jobs averaged 11,791, down slightly by 0.8 percent from second quarter fiscal year 2009 average of 11,870.

Unemployment

As of the second quarter, the Territory's unemployment rate averaged 7.9 percent, or 1.4 percentage points higher than a year ago. The rate for St. Croix increased to 8.5 percent from 7.8 percent in 2009, while the rate for St. Thomas and St. John increased year-over-year to 7.5 percent from 5.6 percent in 2009.

REPORT: ECONOMIC CONDITIONS

FISCAL YEAR ECONOMIC INDICATORS United States Virgin Islands

INDUSTRY	1st QUARTER			2nd QUARTER			YEAR-TO-DATE MARCH		
	2009	2010	% Annual Change	2009	2010	% Annual Change	2009	2010	% Annual Change
Labor Force	52,273	52,287	0.0	52,120	50,951	-2.2	52,197	51,619	-1.1
Civilian employed	49,163	48,038	-2.3	48,715	46,906	-3.7	48,939	47,472	-3.0
Civilian unemployed	3,110	4,249	36.6	3,405	4,045	18.8	3,258	4,147	27.3
Unemployment rate (%)	6.0	8.1	2.2	6.5	7.9	1.4	6.3	8.0	1.8
Total Nonfarm	44,814	43,310	-3.4	44,650	43,779	-2.0	44,732	43,544	-2.7
Total Private	31,825	30,415	-4.4	31,787	31,008	-2.4	31,806	30,712	-3.4
Production Sectors	4,635	4,311	-7.0	4,533	4,322	-4.7	4,584	4,317	-5.8
Natural Resources & Construction	2,363	2,141	-9.4	2,269	2,159	-4.8	2,316	2,150	-7.2
Manufacturing	2,272	2,170	-4.5	2,264	2,163	-4.5	2,268	2,166	-4.5
Trade, Transportation & Utilities	8,593	8,360	-2.7	8,638	8,304	-3.9	8,615	8,332	-3.3
Wholesale Trade	722	677	-6.3	705	668	-5.3	714	672	-5.8
Retail Trade	6,242	6,091	-2.4	6,266	6,025	-3.8	6,254	6,058	-3.1
Transp., Warehousing, Utilities	1,628	1,592	-2.2	1,667	1,611	-3.4	1,647	1,602	-2.8
Service Sectors	16,252	15,691	-3.4	16,304	15,926	-2.3	16,278	15,809	-2.9
Information	784	774	-1.2	790	771	-2.4	787	773	-1.8
Financial Activities	2,488	2,396	-3.7	2,555	2,395	-6.3	2,522	2,396	-5.0
Professional & Business Services	3,370	3,424	1.6	3,355	3,421	2.0	3,363	3,422	1.8
Education and Health	2,414	2,433	0.8	2,408	2,442	1.4	2,411	2,438	1.1
Leisure & Hospital	7,196	6,664	-7.4	7,196	6,898	-4.2	7,196	6,781	-5.8
Arts and Entertainment	888	880	-0.9	882	899	1.9	885	890	0.5
Accommodation & Food	6,307	5,784	-8.3	6,314	5,998	-5.0	6,311	5,891	-6.6
Accommodation	3,825	3,343	-12.6	3,796	3,553	-6.4	3,811	3,448	-9.5
Food Services & Drink	2,482	2,441	-1.7	2,518	2,445	-2.9	2,500	2,443	-2.3
Other Services	2,346	2,053	-12.5	2,311	2,456	6.2	2,329	2,254	-3.2
Government	12,989	12,895	-0.7	12,863	12,771	-0.7	12,926	12,833	-0.7
Federal	980	977	-0.3	993	979	-1.4	987	978	-0.8
Local	12,009	11,918	-0.8	11,870	11,791	-0.7	11,940	11,855	-0.7
General fund revenues (\$1,000)									
Individual	62,617	54,832	-12.4	78,142	82,656	5.8	140,759	137,489	-2.3
Corporate	10,260	8,880	-13.5	14,872	13,429	-9.7	25,133	22,308	-11.2
Real Property	11,260	3,831	-66.0	7,183	3,811	-46.9	18,443	7,642	-58.6
Trade and Excise	5,465	5,353	-2.1	5,157	5,686	10.3	10,622	11,039	3.9
Gross Receipts	28,456	27,198	-4.4	33,862	37,539	10.9	62,317	64,737	3.9
Visitor Arrivals									
Air	140,361	158,308	12.8	185,145	213,583	15.4	325,506	371,891	14.3
Cruise	454,156	463,563	2.1	549,406	656,125	19.4	1,003,562	1,119,688	11.6