

U.S. Virgin Islands Economic Review

Bureau of Economic Research

May 2012

Economic Highlights

The Virgin Islands economic performance was mixed for the first half of 2012.

The manufacturing sector is expected to continue a decline in job employment.

The strongest performing sectors were trade, utilities, tourism, food and business services.

The value of refined petroleum products for 1st half of fiscal year 2012 was \$5.7 billion.

Civilian employment has averaged 46,119 for the first half of the year.

The Territory's unemployment rate is 8.9 percent. The rate for St. Thomas/St. John is 8.2 percent and 9.8 percent for St. Croix.

A total of 1,690,756 visitors came to the Territory in the first six months of the fiscal year—389,840 air visitors and 1,300,916 cruise passengers.

General Fund gross revenues were \$382 million. Individual income tax was \$142 million, gross receipts \$73million, corporate income tax \$22 million, trade and excise tax \$11 million and real property tax \$39 million.

Overview

The Virgin Islands economic performance, as tracked by employment indicators, was mixed for first half of fiscal year 2012 compared to the same period a year earlier. Industries including tourism, trade, utilities, professional and business, food and services, and information showed growth over the past six months. Other sectors of the economy namely construction, manufacturing, arts and entertainment, and government waned.

The manufacturing sector is expected to continue hemorrhaging jobs due to the January 2012 announcement by HOVENSA, L.L.C. to cease refinery operations by mid-February 2012. The refinery officially closed on February 21, 2012 and HOVENSA proposes to turn the facility into a storage terminal that will employ approximately 100 workers. HOVENSA, L.L.C. has agreed to allow the V.I. Water and Power Authority and St. Croix gasoline retailers to continue purchasing fuel supplies at a discounted rate through the end of 2012. Construction has remained flat with only the public sector engaged in infrastructure projects. These projects include the \$10 million University of the Virgin Islands St. Thomas Residence Halls, the \$20 million Whispering Hills housing development, the \$5 million Main Street Enhancement Project, the \$5.4 million Rothschild Francis Square Revitalization, the \$13 million UVI Research & Technology Park Campus Building and the first phase \$20 million Louis Brown Villas housing development both on St. Croix.

Additionally, the Government of the Virgin Islands' budget shortfall is placing pressure on public spending. The Territory faces a projected budget shortfall of an estimated \$67 million in fiscal year 2012. To close the gap, a number of proposed deficit-reduction and revenue-enhancement measures were implemented to ensure that the Territory overcomes its fiscal challenges and position the economy along a growth path. These measures included a 5 percent increase in gross receipts, collection of delinquent taxes owed, limited hiring, leveraging federal funds for hiring, and the termination of government workers. The dismissals or lay-offs of public sector workers has been an ongoing occurrence on the U.S. mainland and in areas of Europe since the recession began in December 2007. Dismissals of the Territory's public work force began late in first

quarter of 2012. Hence, the dismissals contributed to an 8 percent loss of public sector workers in the first six months of fiscal year 2012 compared to same period one year earlier. Government revenues, likewise, were mixed this period. During the first half of fiscal year 2012, individual and corporate income taxes were down 6 percent and 8 percent, respectfully. Trade and excise taxes improved by 1 percent.

Economic Outlook 2012

The closure of the HOVENSA refinery will affect overall value of exports. The refinery accounted for 21 percent of Gross Territorial Product and 95 percent of the refined petroleum products exported to the U.S. Overall, the manufacturing sector will continue to see a loss of jobs within this sector.

On the other hand, the rum industry is expected to strengthen with the production of Diageo rum that started in November 2011 and beginning in 2012, will produce Captain Morgan branded rum. Diageo has the capacity to produce 20 million proof gallons of rum annually. It is projected to return a gross of \$100 million annually.

In April 2012, the Governor submitted and the VI Legislature approved changes to the 2009 agreement with Cruzan VIRIL, Ltd subsidiary of Beam Inc. Under the amended agreement, the level of support decreases from 31.5 percent to 25 percent, effective on the first day of this month, rather than the 18 percent under the 2009 agreement. The transition rate will remain in effect through 2018. The amendments to the 2009 agreement with Cruzan VIRIL, Ltd were necessary because of significant changes in the U.S. bulk rum market, including competition from new producers, as well as new incentives that the Government of Puerto Rico has recently provided its own rum producers.

The tourism sector is expected to see a reduction of cruise passenger arrivals in the upcoming 2012 summer months. Cruise ship calls to St. Croix are not expected until October 2012 and the St.

Thomas/St. John district will experience four-to-five cruise ship calls per week that are scheduled for the upcoming summer months.

Economic activity, as tracked by employment, will continue to be mixed in the ensuing months. Additionally, anticipated losses in the construction and manufacturing sector will keep the unemployment rate hovering above 9 percent. Overall, improvement in the Territory's economy will hinge on the fragile recovery of the U.S. and global economies.

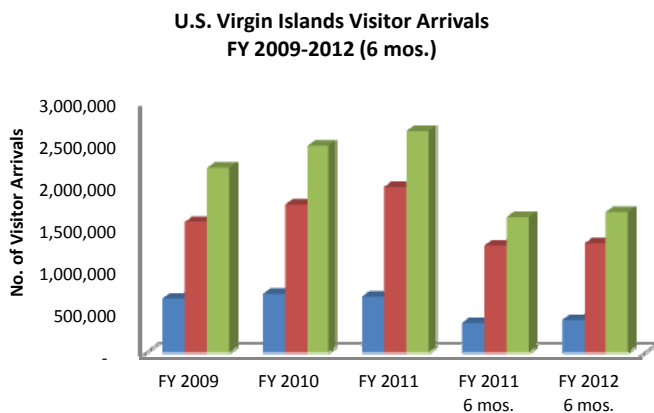
Sectoral Performance in 2012

Tourism

The number of visitors to the Territory increased 3.6 percent for the first six months of fiscal year 2012 to 1,690,756 from 1,631,900 for the corresponding period in fiscal year 2011. Air arrivals were up a solid 9.7 percent while cruise passenger arrivals were less robust at 1.9 percent. There were 389,840 air visitors during this period compared to 355,476 air visitors for fiscal year 2011. There were 1,300,916 cruise passengers for six months of the present fiscal year compared to 1,276,424 the same period year before.

Air visitors have improved remarkably since October 2011. This was partly due to aggressive marketing and promotional efforts by the Virgin Islands Department of Tourism. Such promotions included the *Winter Escape* promotion that offered air visitors various instant credits, discount shopping and dinner certificates. Another promotion was the Air Fantastic Flight Promotion Credit program that offered a \$350 instant credit per person on stays of seven nights or more.

Additionally, the Department of Tourism recently announced new air service from Air Canada and JetBlue Airways. Air Canada began offering one, weekly non-stop flight from Toronto to St. Thomas in December 2011. JetBlue also began service in December with a daily flight between San Juan and St. Croix and two daily flights between San Juan and St. Thomas. Additionally, JetBlue has made it easier for New Englanders to visit the Territory by offering five weekly departures from Boston Logan International Airport to Cyril E. King Airport. The government, in partnership with Bravo Tours, announced the launch of a new, weekly charter service to St. Croix beginning October 2011. The introduction of this charter flight has increased the number of Danish visitors as evident by 15,393 Danish guests staying in visitor establishments in 2011.



Cruise ship passenger arrivals, though slightly up, is expected to decrease during the summer months. The announcement of St. Croix cruise ship calls not returning until October 2012 will adversely affect overall cruise ship passenger numbers.

Manufacture

The manufacturing sector accounts for 5 percent of total nonagricultural wage and salary employment. The number of manufacturing jobs

averaged 2,091 in the first six months of fiscal year 2012, practically the same as last year.

Refined petroleum products were the dominant commodities produced by this sector. Other major commodities include rum and watches.

Oil Industry

Citing \$1.3 billion in losses during the last three years and dismal market projections for the refining industry due to global economic conditions, HOVENSA, L.L.C., a limited liability company formed by Hess Corporation and Petr leos de Venezuela, S.A. (PDVSA) announced the closure of its oil refinery with a current processing capacity of 350,000 barrels per day in January 2012. Shutdown of the refinery occurred on February 21, 2012, and HOVENSA is proposing an oil storage terminal with approximately 100 employees remaining.

A combination of high crude oil prices and weak demand for petroleum products dragged down HOVENSA's refining earnings since the first quarter of 2008. Additionally, competition from emerging markets that have less environmental constraints and its competitive disadvantage with U.S.-based refineries fueled by low-priced natural gas were other responsible factors that contributed to closure of the refinery.

This is not a unique event as these factors have led to several refineries within the US to closes. Valero Energy Corporation a manufacturer and marketer of petrochemical products closed its Delaware City refinery operations in late 2009 and furloughed 550 workers citing monetary losses of more than \$1.7 billion. Philadelphia based Sunoco Inc. sold its Ohio refinery plant and shutdown its Philadelphia oil refineries citing company had lost some \$800 million on refining operations since 2009.

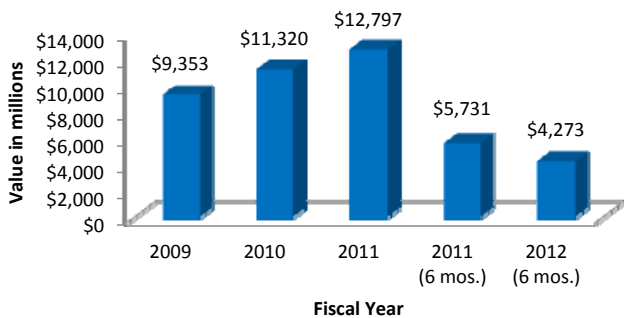
The HOVENSA refinery processed crude from global sources, although the majority of crude

was supplied from Venezuela. The closure of the refinery marks the dismissal of about 2,000 employees at the refinery, including HOVENSA workers and their subcontractors.

In March 2012, the Governor announced that an interim agreement with HOVENSA guaranteed that the V.I. Water and Power Authority would obtain fuel supplies at a discounted rate through the end of 2012. The interim agreement provides the Government and HOVENSA time to negotiate a long-term agreement and develop alternative forms of energy.

Roughly \$13.0 billion of refined petroleum products were exported in fiscal year 2011—a 12 percent jump over the previous year. Fiscal year March 2012 year-to-date figures, the most recent available, show the total value of refined petroleum products exported was \$4.3 billion, down \$1.5 billion for the same period in 2011.

**Value of Refined Petroleum Exports
FY 2009-2012 (6 mos.)**



Rum Industry

A large percentage of manufacturing shipments come from rum production, the industry's next strongest performer. The rum industry consists of two companies: Cruzan VIRIL, Ltd. and Diageo plc.

Cruzan VIRIL is a wholly-owned subsidiary of Beam Inc., a U.S.-based international wine and spirits company. The company has about 60 employees and manufactures Cruzan and Old St. Croix brand rum as well as bulk shipments for

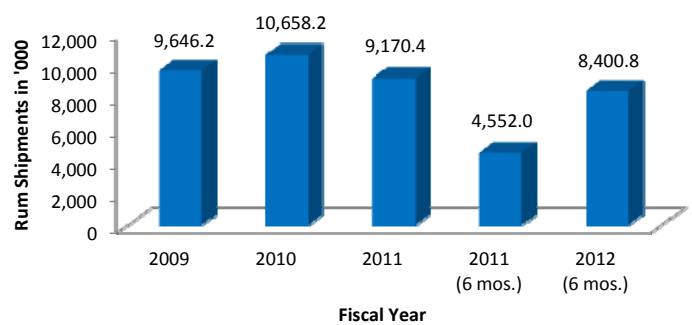
other labels.

Diageo plc, the world's leading spirits, wine and beer company, initiated plans for the construction and operation of a high-capacity distillery on St. Croix. The distillery began production in 2011, and beginning in 2012 will supply the rum used to make all Captain Morgan branded products for the United States.

Rum produced in the U.S. Virgin Islands is primarily exported to the U.S. 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 4.5 million proof gallons of rum to the U.S. in first half of fiscal year 2011 for which the Territory received \$72.7 million in excise taxes. Some 8.4 million proof gallons of rum has already been shipped for same period in fiscal year 2012 including Diageo produced rum. The Territory has, thus far, received \$70.1 million in excise taxes. In March 2012, the cover over rate reverted back to \$10.50 from the \$13.25 price per proof gallon. The U.S. federal government imposes and collects federal excise taxes on rum produced in the Virgin Islands and exported to the United States. The U.S. Congress normally reverts the Cover Over rate back to \$13.25 every two years.

**Rum Shipments to the United States
FY 2009-2012 (6 mos.)**

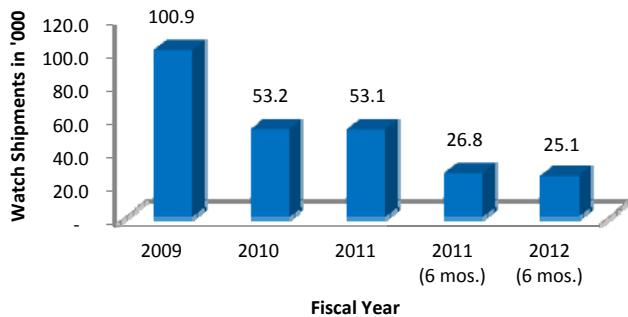


The outlook for this industry is for continued growth. Moreover, the agreements made with the government for marketing and promotion will assist the Territory in being competitive in this industry.

Watch industry

The one remaining company in the watch industry employs about 25 workers. Approximately 25,113 watches were exported for the first half of fiscal year 2012, down from 26,868 the previous year. The watch industry continues to struggle from high unit costs and increased competition.

**Watch Shipments
FY 2009-2012 (6 mos.)**



Construction

The construction sector accounts for an estimated 6 percent of employment. The value of construction permits—an indicator of current and of future activity—declined by 11.6 percent for the first six months of fiscal year 2012 compared to the previous period in fiscal year 2011. While the value of private residential construction increased by 1 percent, public construction permits value declined by 53.2 percent. Similarly, private nonresidential construction permits value declined by 10.4 percent during the same period.

There was an average 2,002 jobs in the construction industry in the first half of fiscal

year 2012, down 2 percent from an average 2,042 jobs in 2011.

Leisure and Hospitality

The leisure and hospitality sector—which is comprised of hotels and other lodging places, restaurants and food services, and arts and entertainment—accounts for 17 percent of total employment. For the first six months of fiscal year 2012, the number of jobs averaged 7,447 and a year-on-year increase of 1.6 percent.

An upturn in the tourism and hospitality industry within the past several months, specifically in the hotel accommodation, has improved this sector’s performance. However, this sector is expected to decline in the latter part of fiscal year 2012 as the sector’s seasonal jobs are lost due to annual temporary closing of hotels and other accommodation establishments.

Trade, Transportation and Utilities

The trade, transportation and public utilities sector holds the second largest share of jobs in the economy, averaging 8,564 jobs in 2012—up 4.5 percent over the last fiscal year.

Retail and Wholesale Trade

Retail trade accounts for 10 percent and wholesale, just about 2 percent of the overall trade sector. Retail trade jobs averaged 6,980 this fiscal year and were up 4.4 percent while wholesale trade jobs averaged 673, up by 4.5 percent from last fiscal year.

Financial Services and Real Estate

The Financial Services sector holds a 6 percent share of total employment. The number of jobs in this six-month period averaged 2,379, up from 2,358 for the same period in fiscal year 2011.

In regards to real estate sales, the number of homes sold in the Territory declined 2.2 percent

in calendar year 2011 to 272 from 278 in 2010. Conversely, the average home price rose 12.5 percent to \$533,862 from \$474,728 in 2010.

The average price of a home in St. Thomas grew a modest 1 percent from \$424,237 to \$427,482. St. John also experienced a 40 percent increase in average home prices from \$1,181,053 to \$1,649,172. In comparison, St. Croix average home prices declined by 2.4 percent from \$388,536 to \$379,024. Territory-wide, condominium sales rose by 36.0 percent from 162 to 253 in 2011. The average price of a condominium unit has fallen from \$227,708 to \$202,852.

Employment

For the first half of this fiscal year, 46,119 persons were employed—20,371 on St. Croix and 25,748 on St. Thomas and St. John. This is 1.8 percent lower than the 46,941 persons employed for the corresponding period last fiscal year.

months of the fiscal year. The rate for St. Croix is 9.8 percent, while the rate for St. Thomas and St. John is 8.2 percent.

Public and private-sector employment

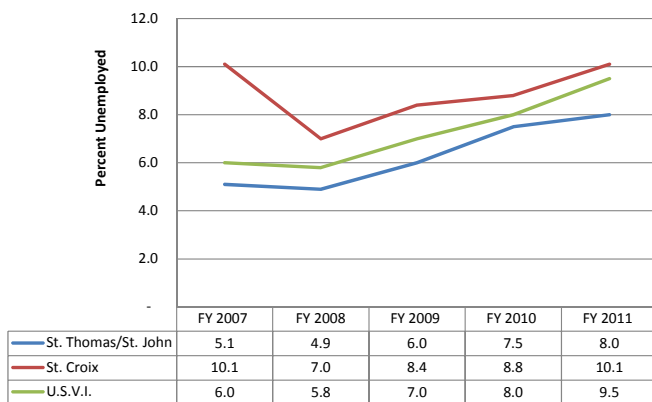
Wage and Salary Employment

During the first six months this year, 43,119 persons were employed compared to 43,859 last year—about 1.7 percent less or 740 fewer jobs. Nine in ten jobs in the U.S. Virgin Islands are in the service-producing industries and one in ten jobs in the goods-producing industries.

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 240 jobs. There were 31,249 private sector jobs compared to 31,035 last year. Improvement in private sector jobs rests on the buoyancy of the tourism industry, capital investment and the general strength of the Virgin Islands economy.

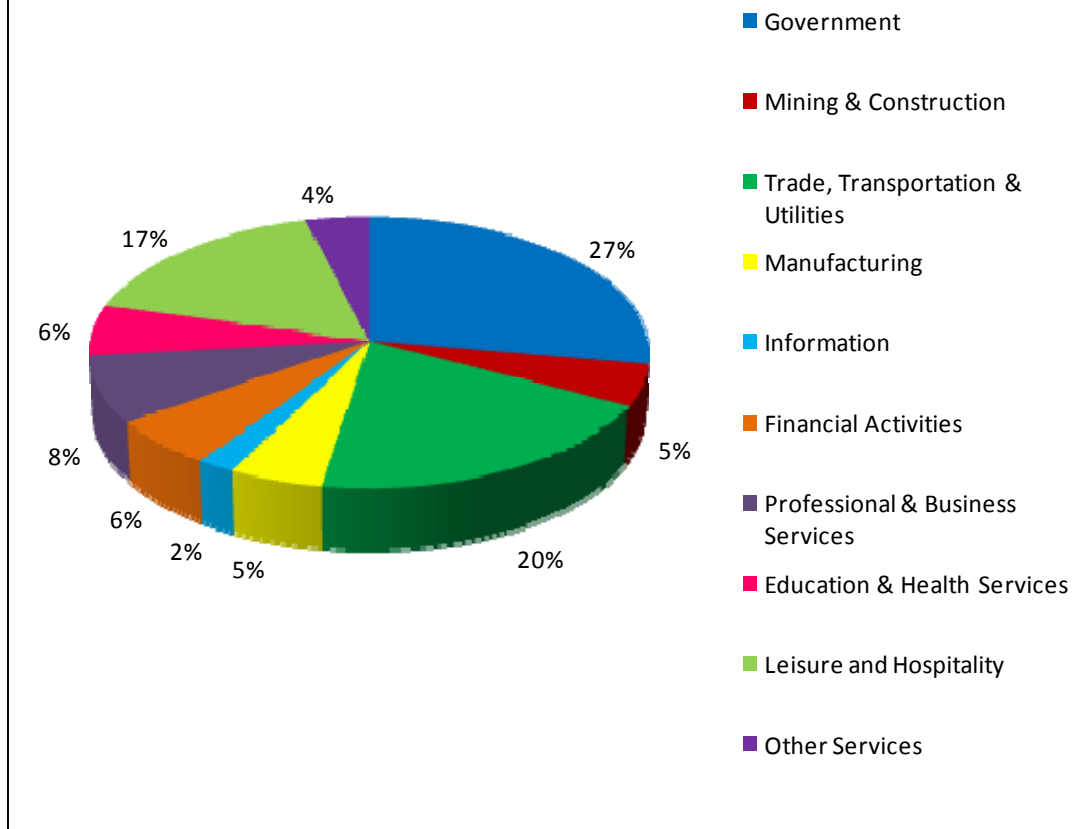
Public sector jobs decreased 7.4 percent. The decrease occurred in local government jobs. Local government jobs averaged 10,906, down 8.1 percent over fiscal year 2011. Federal government jobs remained at the same level—averaging about 965.

Unemployment Rates, FY 2007-2011



The Territory's unemployment rate has steadily increased since 2009 from a high of 7.0 percent to 9.5 percent as depicted above. The rate has remained steady at 8.9 percent for the first six

Percent of Nonagricultural Jobs First 6 mos. of 2012



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, 5 percent and 6 percent, respectively. Manufacturing and educational and health services account for 5 percent and 6 percent each, while other services and information account for the remainder of the jobs.

FISCAL YEAR ECONOMIC INDICATORS

United States Virgin Islands

2011 & 2012: 1st/2nd Quarter and Half-Year Percent Annual Change

Series	1st QTR			2nd QTR			6 MONTHS		
	2011	2012	% Annual Change	2011	2012	% Annual Change	2011	2012	% Annual Change
Labor Force	51,386	50,339	-2.0	51,185	46,775	-8.6	51,286	50,620	-1.3
Civilian employed	47,108	45,824	-2.7	46,775	46,415	-0.8	46,941	46,119	-1.8
Civilian unemployed	4,278	4,515	5.5	4,411	4,487	1.7	4,344	4,501	3.6
Unemployment rate (%)	8.3	9.0	0.7	8.6	8.8	0.2	8.5	8.9	0.4
Total Nonfarm	43,923	42,841	-2.5	43,795	43,396	-0.9	43,859	43,119	-1.7
Total Private	30,898	30,844	-0.2	31,171	31,653	1.5	31,035	31,249	0.7
Production Sectors	4,150	4,054	-2.3	4,148	4,132	-0.4	4,149	4,093	-1.4
Natural Resources & Construction	2,034	2,003	-1.5	2,050	2,000	-2.4	2,042	2,002	-2.0
Manufacturing	2,116	2,051	-3.1	2,098	2,131	1.6	2,107	2,091	-0.8
Service Sectors	39,772	38,787	-2.5	39,647	39,264	-1.0	39,710	39,026	-1.7
Trade, Transportation & Utilities	8,194	8,455	3.2	8,200	8,672	5.8	8,197	8,564	4.5
Wholesale Trade	651	667	2.5	651	680	4.4	651	673	3.4
Retail Trade	6,033	6,255	3.7	6,037	6,358	5.3	6,035	6,307	4.5
Transp., Warehousing, Utilities	1,510	1,533	1.5	1,512	1,635	8.1	1,511	1,584	4.8
Information	780	811	3.9	792	809	2.2	786	810	3.1
Financial Activities	2,352	2,377	1.0	2,364	2,381	0.7	2,358	2,379	0.9
Professional & Business Services	3,444	3,482	1.1	3,446	3,639	5.6	3,445	3,560	3.3
Education and Health	2,474	2,485	0.4	2,475	2,565	3.6	2,475	2,525	2.0
Leisure & Hospitality	7,234	7,320	1.2	7,433	7,574	1.9	7,333	7,447	1.6
Arts and Entertainment	912	868	-4.8	919	800	-13.0	915	834	-8.9
Accommodation & Food	6,322	6,452	2.1	6,514	6,774	4.0	6,418	6,613	3.0
Accommodation	3,534	3,603	2.0	3,718	3,804	2.3	3,626	3,704	2.1
Food Services & Drink	2,788	2,849	2.2	2,796	2,970	6.2	2,792	2,910	4.2
Other Services	2,270	1,860	-18.1	2,313	1,881	-18.7	2,292	1,871	-18.4
Government	13,024	11,997	-7.9	12,624	11,743	-7.0	12,824	11,870	-7.4
Federal	962	962	0.0	966	967	0.1	964	965	0.1
Local	12,062	11,034	-8.5	11,659	10,777	-7.6	11,860	10,906	-8.1
General fund revenues (\$1,000)	136,032	135,143	-0.7	151,511	155,309	2.5	286,877	290,449	1.2
Individual	78,923	73,085	-7.4	73,007	69,573	-4.7	152,158	142,657	-6.2
Corporate	7,289	10,796	48.1	18,447	11,864	-35.7	24,747	22,660	-8.4
Real Property	14,648	12,927	-11.7	16,755	26,878	60.4	31,485	39,805	26.4
Trade and Excise	5,624	5,871	4.4	6,147	5,998	-2.4	11,781	11,869	0.7
Gross Receipts	29,549	32,463	9.9	37,155	40,996	10.3	66,706	73,458	10.1
Hotel Room	16,448	15,762	-4.2	73,007	69,572	-4.7	7,300	8,066	10.5
Visitor Arrivals	691,844	724,353	4.7	940,056	966,403	2.8	1,631,900	1,690,756	3.6
Air	149,762	163,558	9.2	205,714	226,282	10.0	355,476	389,840	9.7
Cruise	542,082	560,795	3.5	734,342	740,121	0.8	1,276,424	1,300,916	1.9