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# Moody's Downgrades Hawaii GO Bonds

May 17, 2011



HAWAIIAN  
TAX-FREE TRUST

Credit rating agency, Moody's Investors Services, downgraded Hawaii's general-obligation bond rating to Aa2 (the previous rating was Aa1). The change was announced by the agency on May 17th.

## Moody's bond rating scale

The ratings assigned by Moody's are displayed here. The Aa2 rating is the third highest of 21 ratings in the Moody's scale, and applies to the mid-tier of their High Grade category. Investment grade bonds are those in the 10 highest rating categories, ranging from the highest, AAA, to the lowest investment grade rating which is Baa3.

## Budget issues

In issuing the revised rating, Moody's reported that Hawaii's state revenues have fallen over a period of several years and that the state is facing a budget shortfall of just under 10 percent of revenues, which is comparable to the challenge faced by other states. Also, like many states, Hawaii is faced with structural problems related to growing pension and health care benefits for public sector employees.

## The recession and tourism

In reporting the rating downgrade, Moody's analysts Nicole Johnson and Nicholas Samuels cited Hawaii's strained financial operations in the wake of the recession. Tourism is an important industry in Hawaii and the recession, along with higher airfares and energy costs, have reduced tourist visits to the state. Hawaii is a popular destination for Japanese tourists, and the earthquake and related nuclear problems have also contributed to a decline in tourism. The tourism industry is anticipated to recover, and data from the first quarter of 2011 indicate that visitor spending was up 16.9% compared to the same period a year ago. The Moody's report indicated that they have issued a "Stable Outlook" for Hawaii, recognizing the optimistic economic signs of improvement in construction and tourism.

## Market reaction

There was little immediate market reaction to the rating change, and many issues in the state actually traded higher on the day of the announcement. In addition, there has not been any material widening of yield spreads in the following market sessions. Given the decline in tourism, particularly since the earthquake in Japan, and the related impact on the state's budget, a change in the rating had been anticipated.

## Potential to motivate legislators

The rating downgrade has the potential to serve as an additional motivator to Hawaii state legislators in their efforts to resolve some of the difficult budgetary issues. A credit rating reduction to Aa2 from Aa1 usually adds about one-tenth to two-tenths of a percentage point to the yield on state bonds; an additional expense that politicians would prefer to avoid.

## Hawaiian Tax-Free Trust

In managing Hawaiian Tax-Free Trust, we continually monitor developments in the local economy and the impact those developments have on issuers of tax-exempt bonds in the State. We continue to pursue the objectives of the Trust; to provide as high a level of current income exempt from Hawaiian state and regular Federal income tax as is consistent with preservation of capital.

Moody's Long-Term Bond Ratings	
1	Aaa Prime
2	Aa1
3	Aa2 High Grade
4	Aa3
5	A1
6	A2 Upper Medium Grade
7	A3
8	Baa1
9	Baa2 Lower Medium Grade
10	Baa3
11	Ba1 Non-Investment Grade Speculative
12	Ba2
13	Ba3
14	B1
15	B2 Highly Speculative
16	B3
17	Caa1 Substantial Risks
18	Caa2 Extremely Speculative
19	Caa3 In Default with Little Prospect for Recovery
20	Ca
21	C In Default