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ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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Executive Summary

St. Cloud's economy should maintain its robust economic expansion into Spring 1999. This prediction follows from the latest **St. Cloud Index of Leading Economic Indicators** and the debut of the **St. Cloud Area Business Outlook Survey**, both of which are designed to forecast economic conditions in the St. Cloud area for the next four to six months. The **Leading Indicator Index** is well above the levels of Spring 1998, although it has fallen slightly in recent months. The **Business Outlook Survey** suggests that area businesses are very optimistic about future St. Cloud economic conditions. Sixty-four percent of surveyed firms expect their company's business activity to increase in the next six months, compared to 19% who expect conditions to worsen. It appears that the primary factor tempering local economic growth is the persistent shortage of qualified workers at existing wages. Almost 60% of surveyed businesses indicate that qualified workers are harder to attract than three months ago and 57% believe that it will be harder yet to obtain workers six months from now. Virtually no area businesses expect this trend to be reversed in the near future. Area firms are experiencing increased wage pressures due to this excess labor demand. Fifty-one percent of surveyed firms have recently increased employee compensation, while a staggering 72% of local firms expect to increase employee compensation over the next six months. No companies expect employee compensation to decrease in the near future.

The St. Cloud Area Business Outlook Survey

This month marks the debut of the **St. Cloud Area Business Outlook Survey**, a survey of current business conditions and area firms' future outlook. It will be administered quarterly with the cooperation of the St. Cloud Area Chamber of Commerce. Survey results reported in Tables 1 and 2 reflect the responses of forty-seven area business firms who returned the initial mailing of the **Business Outlook Survey**. Participating firms appear to be representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, government, and educational enterprises of sizes ranging from small to large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Current and future business prospects for area firms look to be very bright indeed. 63.9% of surveyed firms reported increased business activity for their companies in December 1998 versus three months earlier. The same percentage of firms anticipate improved conditions six months from now. Only 19.1% of firms report that business conditions have worsened over the last three months,

while 17% feel that they will experience declines over the next six months. While one company reported that the "overall outlook is good" and another reported on a 12-month backlog on equipment orders, there were some items of concern for area firms. Two companies noted that business consolidation in their industries has hurt business. Another noted that unseasonably warm weather in November and early December had adversely impacted the sales of winter items. Another company reported flat earnings despite a large increase in sales revenues. Recent data also indicate a decline in new local business names and incorporations.

Surveyed firms are experiencing increases in the number of employees on their payrolls by a wide margin. 44.7% of firms noted an increase in the number of employees in December versus three months earlier, while 10.6% reported layoffs. A still healthier 63.9% anticipate a further increase in payrolls over the next six months, while only 6.4% see a decline in workers. One puzzling trend, however, is a decline in the growth of help-wanted lineage in the *St. Cloud Times* in late 1998.

Most companies report no actual or expected change in the length of the workweek for their employees, although 23.4% of firms do expect the workweek to lengthen in the next six months. 46.8% of surveyed firms report an increase in capital expenditures by their company over the past three months and 44.7% expect further increases over the next six months. These latter percentages are suggestive of strong business confidence and may be indicative of firms' desires to substitute capital for labor in the presence of continued labor shortages. It should also be noted that these sturdy capital investment numbers bode well for improvements in the productivity of area workers.

One unmistakable trend is a current and expected increase in employee compensation. No responding firms have recently experienced (or expect to experience) a decrease in wages and benefits paid employees. 51.1% of surveyed firms report that employee compensation was higher in December than three months earlier and 72.3% expect further pay hikes in the next six months. This could relieve some of the pressure of excess labor demands should this trend continue in the future.

By a slight margin, firms are experiencing increases in the prices they receive for their products, although most firms (57.4%) report no change in current prices received. 34 percent of surveyed firms do report that they expect an increase in prices received over the next six months while 19.1% are actually anticipating a decrease in prices received. It is a clear sign of the times that almost one in five area firms anticipate future price declines. This would have seemed unimaginable twenty years ago. One company noted that housing prices continue to rise. Another noted that interest rates have been dropping (and are expected to drop even further in the future).

Almost half (46.8%) of surveyed firms saw no change in national business activity in December 1998 versus three months earlier. It is interesting that a similar percentage of firms (48.9%) expect no change in U.S. growth over the next six months. Concerns about a slowing pace of manufacturing activity that have surfaced in other regions of the U.S. do not appear to be dampening business optimism in the St. Cloud area. One company was concerned that area firms are unprepared for "Y2K" problems. A special question addressing company concerns about the impact of global economic conditions on firm sales yielded similar results. More than half of surveyed firms reported no change in current and future effects of global conditions on their businesses. In general, it appears that area firms have little fear that a global economic slowdown will have a marked effect on firm sales. One firm did note that Asia's problems are likely to be long-term. This has forced the company to redirect their attention toward domestic markets.

Anecdotal claims of labor shortages by area firms appear to be validated by the survey. 59.6% of surveyed businesses report an increased difficulty in attracting qualified workers in December versus three months earlier. No firms reported that it was easier to find qualified workers in December. 57.4% of firms expect these conditions to continue over the next six months, while only 2.1% expect

some moderation of the labor shortage over this same period. One firm noted its difficulty in "finding quality employees at affordable prices in order to stay competitive in this area". Another reported a concern about the quality and work ethic of new entrants to the work force. One respondent simply noted "tight labor market".

TABLE 1--CURRENT BUSINESS CONDITIONS*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary December 1998	December 1998 vs. Three Months Ago			
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³
What is your evaluation of:				
level of business activity for your company	19.1	14.9	63.9	44.8
number of employees on your company's payroll	10.6	42.6	44.7	34.1
length of the workweek for your employees	8.5	70.2	19.1	10.6
capital expenditures (equipment, machinery, structures, etc.) by your company	8.5	42.6	46.8	38.3
employee compensation (wages and benefits) by your company	0	46.8	51.1	51.1
prices received for your company's products	17.0	57.4	21.3	4.3
national business activity	10.6	46.8	25.5	14.9
your company's difficulty attracting qualified workers	0	38.3	59.6	59.6
SPECIAL QUESTION: The impact of global economic conditions on your company's sales	4.3	53.2	14.9	10.6
Notes:				
(1) reported numbers are percentages of businesses surveyed.				
(2) rows may not sum to 100 because of "not applicable" and omitted responses.				
(3) diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.				

* Source: SCSU Center for Economic Education, Social Science Research Institute, and Department of Economics.

TABLE 2--FUTURE BUSINESS OUTLOOK*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary December 1998	Six Months from Now vs. December 1998			
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³
What is your evaluation of:				
level of business activity for your company	17.0	17.0	63.9	46.9
number of employees on your company's payroll	6.4	27.7	63.9	57.5
length of the workweek for your employees	6.4	68.1	23.4	17.0
capital expenditures (equipment, machinery, structures, etc.) by your company	8.5	42.6	44.7	36.2
employee compensation (wages and benefits) by your company	0	23.4	72.3	72.3
prices received for your company's products	19.1	40.4	34.0	14.9
national business activity	10.6	48.9	25.5	14.9
your company's difficulty attracting qualified workers	2.1	34.0	57.4	55.3
SPECIAL QUESTION: The impact of global economic conditions on your company's sales	6.4	51.1	14.9	8.5
Notes:				
(1) reported numbers are percentages of businesses surveyed.				
(2) rows may not sum to 100 because of "not applicable" and omitted responses.				
(3) diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.				

* Source: SCSU Center for Economic Education, Social Science Research Institute, and Department of Economics

St. Cloud Index of Leading Economic Indicators

The November 1998 **St. Cloud Index of Leading Economic Indicators** suggests that economic conditions will expand for the next four to six months. The index is well above Spring 1998 levels, although it has fallen slightly in the last couple of months. As a rule of thumb, three consecutive positive changes suggest an expanding economy, while three consecutive decreases indicate a

contracting economy and/or a slowing of economic growth.

The primary factor tempering local economic growth is a shortage of qualified workers at existing wages. The **St. Cloud Area Business Outlook Survey** confirms this finding. The labor shortage may partially explain why nonfarm employment in the St. Cloud metropolitan area has expanded less rapidly than in the nation and Minnesota. For the twelve month period ending in November 1998, St. Cloud nonfarm employment grew a robust 1.7%, while U.S. and Minnesota employment grew 2.3% and 2.2%, respectively. Over this same period, St. Cloud retail employment increased a scant 0.1%, compared to a 1.5% increase in state retail employment. This indicates that either the St. Cloud retail sector remains saturated or that it is particularly difficult for local retailers to attract workers to this relatively low compensation sector.

Rising manufacturing wages, which increased 4.5% from late 1997 to late 1998, are another indicator of a tight labor market. This compares to a 3.3% increase for the twelve month period beginning in early 1997. Likewise, the St. Cloud metropolitan area unemployment rate declined from 2.8% in November 1997 to 2.1% one year later. Labor market tightness appears to be even more severe in the Twin Cities and Rochester where the respective unemployment rates are an amazingly low 1.5% and 1.2%. Potential signs that the labor shortage could be moderating in St. Cloud include i) late 1998 unemployment insurance claims are above the corresponding levels of late 1997 and ii) the annual growth rate in help-wanted lineage in the *St. Cloud Times* dramatically declined in late 1998. Despite this, it appears that the labor shortage will persist well into the future. Area businesses and governmental authorities will likely find 1999 to be a crucial year to address solutions to this continuing problem.

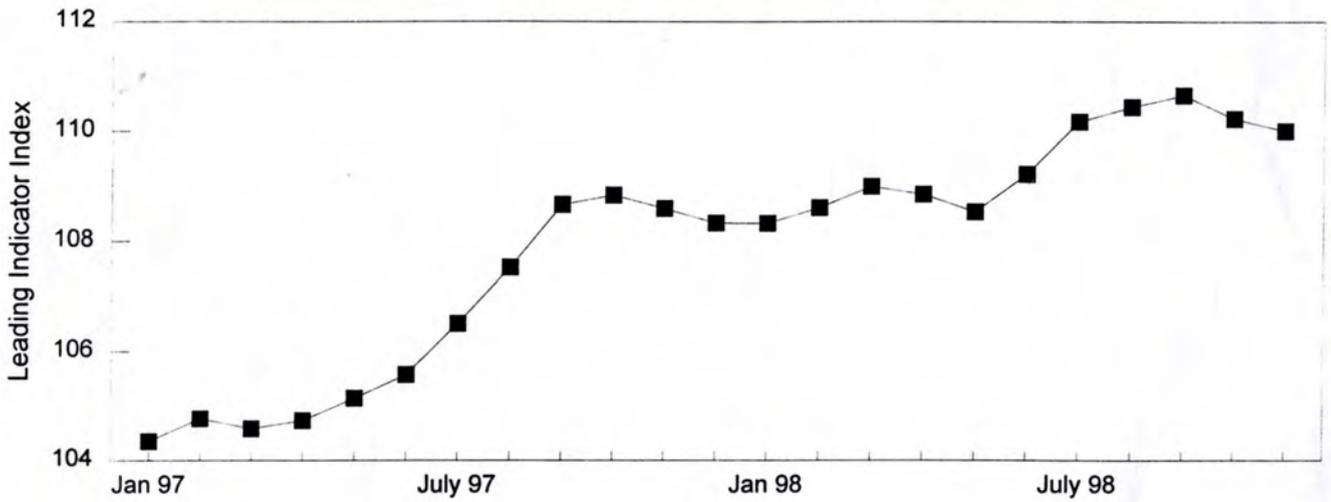
St. Cloud economic growth is concentrated in a few key sectors. Construction appears to be lifting local growth. In November 1998, construction employment was fully 7.8% above its year earlier level. Strength in this sector is broad based, with solid gains in residential, commercial, and public contracts. Other sectors of the economy that are faring especially well include wholesale trade; finance, insurance, and real estate; and health services. Annual employment growth is above 5% in each of these sectors.

Some sectors of the St. Cloud economy are not faring as well. State and federal government employment declined over the past twelve months and, as noted above, retail trade employment is up only 0.1% over the same period (and remains below 1995 levels). Retail represents an especially important element of St. Cloud commerce with approximately one in four area workers employed in this sector. By comparison, only one in six workers is employed in retail in Minnesota as a whole. Though agricultural employment figures are not reported in a timely fashion, there are indications that the farm sector is also suffering locally. Note that if St. Cloud was experiencing unbalanced growth with several lagging sectors, this would be a good indication that overall economic activity in our area would soon follow. At this point, such concerns do not appear warranted.

The **St. Cloud Index of Leading Economic Indicators** has been lifted in recent months by a rising U.S. index of leading economic indicators, increased new residential electric hookups in the St. Cloud area, and rising manufacturing average weekly work hours. The index was negatively impacted by a decline in new local business names and incorporations.

Four to Six Month Leading Indicator Index

St. Cloud, MN (1994=100) Nov 1998



Source: SCSU Center for Economic Education, Social Science Research Inst., R.MacDonald, M.Partridge