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# St. Cloud Area Quarterly Business Report, Vol. 01, No. 02

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***Executive Summary***

Continued strength of the St. Cloud area economy should endure throughout Summer 1999 according to the most recent projections of the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey**. Both instruments are designed to forecast economic conditions in the St. Cloud area over the next four to six months. The Leading Indicators Index has increased in each of the past three months and remains well above its year-earlier level. It has been boosted by the strong performance of the U.S. index of leading economic indicators, solid recent growth in new local business names and incorporations, and a modest rise in residential electric hookups. A decline in manufacturing average weekly work hours is the only variable that has adversely impacted the index in recent months. Almost 77 percent of area businesses participating in the Business Outlook Survey expect an increase in the level of business activity for their company over the next six months. This compares to only 8 percent who expect conditions to worsen. Approximately 2 out of every 3 area businesses expect to add employees over the next six months. Seventy-seven percent of survey respondents expect employee compensation to rise in the next half-year. Shortages of qualified workers continue to be a primary factor tempering local economic growth. Sixty-five percent of area businesses believe it will become more difficult to attract qualified workers over the next six months. This trend is a continuation of conditions observed in the January 1999 **St. Cloud Area Quarterly Business Report**.

***St. Cloud Index of Leading Economic Indicators***

The February 1999 **St. Cloud Index of Leading Economic Indicators** suggests continued economic expansion over the next four to six months. Consecutive increases in the index in December, January, and February have followed a slight dip last fall. Of the underlying determinants, the healthy increase in new local business startups suggests favorable sentiments regarding the future. 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 February 1999 index also remains well above its level one year earlier.

St. Cloud area nonfarm employment grew 1.7 percent over the twelve month period ending February 1999. This compares to a 2.2% increase in both U.S. and Minnesota nonfarm employment over this same period. This is a continuation of a trend of the latter 1990s, one in which the performance of the St. Cloud economy lags that of the state and nation. It is also a reversal of the pattern observed in the first half of the 1990s.

Even though overall local employment growth is the same as last quarter, there have been changes in the overall health of some key sectors. Foremost, after more than three years of lagging the local economy, St. Cloud retail employment is finally growing faster than the overall employment growth rate. Between February 1998 and February 1999, St. Cloud retail employment expanded by 1.8% (compared to 2.9% in Minnesota). In the early 1990s, retail was a key sector that lifted local economic growth above the Minnesota average. The possible return of retail as a lead sector in St. Cloud is important because about one-fourth of the local labor force is employed in retail (well over the state average).

Unlike retail, elements of the local manufacturing sector appear to be struggling. Since early 1998, U.S. manufacturing has been hit by the global economic crisis and a strong U.S. dollar. St. Cloud manufacturing initially bucked this trend, but in recent months, local manufacturing has followed the nation. In the year ending February 1999, St. Cloud manufacturing employment is down 0.8% (this is still better than the U.S. decline of 1.8%). Local manufacturing weakness is further reflected by recent softness in production worker wages. Likewise, the average manufacturing workweek has declined by almost two hours in the last year.

Strong employment gains in the St. Cloud area over the past year have been observed in construction & mining (10.1%), transportation and public utilities (5.3%), wholesale trade (5.1%), finance, insurance, and real estate (6.3%), health services (5.3%), and educational services (8.1%). Government employment declined by 3.6 percent over the one-year period ending February 1999. This decline was heavily concentrated within state government (a 13.1% decline), specifically employment in state government education, which declined by 14.2%. Of some concern is a recent slowing in new housing permits. This could lead to a more moderate

home building season this year. Finally, there are growing signs of a late 1990s farm crisis, which also hurts local business activity. At least in terms of local businesses, it is fortunate that agriculture is a smaller share of the local economy than during the severe farm crisis of the mid 1980s. Yet, the **St. Cloud Area Business Outlook Survey** indicated that some local businesses are concerned about a growing farm problem.

Manufacturing and government employment represents about one-third of all jobs in the St. Cloud area. While employment declines have been observed in the past twelve months in these two sectors, the remainder of employers appear to be experiencing significant labor shortages. Participants in the **St. Cloud Area Business Outlook Survey** continue to show concern about a persistent shortage of qualified workers and February's unemployment rate in the area was 3.4% (compared with 4.3% one year earlier) showing that the available pool of workers is getting smaller. Increasing demand for new workers is further reflected in the strong year-over-year increase in help-wanted lineage in the *St. Cloud Times*, reversing a more moderate trend in late 1998.

Other signs do point to a moderation of the labor shortage. For instance, manufacturing hourly earnings increased 3.9 percent over the twelve month period ending in February 1999, but are actually lower than they were in March, September, and November of last year. In addition, average hourly earnings in the nondurable goods manufacturing sector in nine of the past twelve months were higher than reported in February 1999. To be sure, manufacturing only represents eighteen percent of St. Cloud area employment. Still, at some point, a labor shortage should lead to a more convincing rise in employee compensation. Survey results do indicate that 7 in 10 area businesses have increased employee compensation over the past three months (and an even larger fraction expect to further increase compensation over the next six months), yet this is not necessarily showing up in the regional labor market data. One encouraging sign is that a growing number of area businesses have experienced (and expect to experience) an increase in the prices they receive for their products in recent months. Should this continue, profit margins will improve and wage gains will likely follow.

Nonfarm employment growth in other metropolitan areas of Minnesota outpaced the St. Cloud area over the past 12 months. Minneapolis-St. Paul, Rochester, and Duluth experienced employment gains of 3.6%, 2.7%, and 2.2%, respectively. In addition, manufacturing employment *grew* in these areas by 1.8%, 2.2%, and 1.5%, respectively. Overall, manufacturing employment gains of 0.4% were observed in Minnesota from February 1998 to February 1999. To be sure, the Twin Cities and Rochester may be suffering from a severe shortage of workers with eye-popping low unemployment rates of 2.0% and 1.8%.

The **St. Cloud Index of Leading Economic Indicators** has been lifted in recent months by a rising U.S. index of leading economic indicators and growth in new local business names and incorporations. While the number of residential electric hookups has been flat over the past few months, they are still above their levels of one year ago. The index was negatively impacted by the decline in average manufacturing weekly work hours discussed above.

### ***St. Cloud Area Business Outlook Survey***

The **St. Cloud Area Business Outlook Survey** is a survey of current business conditions and area firms' future outlook. It is 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 sixty-four area business firms who returned the recent mailing of the Business Outlook Survey. Participating firms are representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, financial, 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.

Area businesses remain extremely optimistic about future business conditions. While the diffusion index for current business conditions in March 1999 is about the same as it was three months earlier, the index for the future business outlook has improved from 46.9 to 69.3 in the most recent survey. The diffusion index is measured as the percentage of respondents expecting an increase minus the percentage expecting a decrease. Thus a widening of this number is a very encouraging sign. Note that these results have not been seasonally adjusted. Many businesses (for example, those in construction, realty, etc.) indicate that business activity is expected to improve for seasonal reasons. On the other hand, at least one business is expecting a seasonal slowdown.

One area business indicated future uncertainty due to changing government regulations and another firm continues to be surprised by the backlog for its equipment orders. A financial employer surmises that it has benefited from consolidation in the banking industry, while another reports that the increased knowledge of financial investors has stimulated its education-related activities. Low interest rates continue to improve the fortunes of another local firm.

Area firms expect to meet increased future output demand by hiring additional workers and acquiring more capital. Most firms do not expect the length of the workweek to expand over the next six months. Almost 43 percent of surveyed firms expanded company payroll employment over the past three months, and fifty-eight percent expect to expand this further in the next six months. The extent to which this objective is consistent with the reported expectation of an increase in the difficulty attracting qualified workers remains to be seen. Sixty-five percent of surveyed firms think it will be more difficult attracting qualified workers in the next six months. These findings are very similar to the December 1998 survey. In written comments, area employers continue to express concern about local labor shortages. Statements such as "difficulty in attracting semi-skilled and skilled labor", "finding qualified workers has slowed growth", and "difficulty of maintaining a qualified staff grows every day with a lack of quality people to hire from" are common.

In this tight labor market, firms may find capital to be a useful substitute for additional hiring. 54.8% of responding firms plan to increase capital expenditures in the next six months. One firm notes its continued investment in computer hardware and software as well as phone systems.

Area employers continue to feel the pressure to increase employee compensation in the presence

**TABLE 1--CURRENT BUSINESS CONDITIONS\***

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary March 1999	March 1999 vs. Three Months Ago				December 1998 Diffusion Index <sup>3</sup>
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index <sup>3</sup>	
What is your evaluation of:					
level of business activity for your company	14.5	25.8	59.7	45.2	44.8
number of employees on your company's payroll	15.9	41.3	42.9	27.0	34.1
length of the workweek for your employees	6.3	79.4	14.3	8.0	10.6
capital expenditures (equipment, machinery, structures, etc.) by your company	7.9	54.0	38.1	30.2	38.3
employee compensation (wages and benefits) by your company	3.2	27.4	69.4	66.2	51.1
prices received for your company's products	13.1	55.7	31.1	18.0	4.3
national business activity	9.3	59.3	31.5	22.2	14.9
your company's difficulty attracting qualified workers	4.9	44.3	50.8	45.9	59.6
SPECIAL QUESTION 1: Your company's concerns regarding poor conditions in the agricultural sector	0	75.6	24.4	24.4	NA
SPECIAL QUESTION 2: Your company's concerns about "Y2K" effects	8.8	71.9	19.3	10.5	NA
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 CONDITIONS\***

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary March 1999	Six Months from Now vs. March 1999				December 1998 Diffusion Index <sup>3</sup>
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index <sup>3</sup>	
What is your evaluation of:					
level of business activity for your company	8.1	14.5	77.4	69.3	46.9
number of employees on your company's payroll	6.5	29.0	64.5	58.0	57.5
length of the workweek for your employees	3.2	75.8	21.0	17.8	17.0
capital expenditures (equipment, machinery, structures, etc.) by your company	4.8	40.3	54.8	50.0	36.2
employee compensation (wages and benefits) by your company	1.6	21.3	77.0	75.4	72.3
prices received for your company's products	8.3	61.7	30.0	21.7	14.9
national business activity	9.3	55.6	35.2	25.9	14.9
your company's difficulty attracting qualified workers	3.3	31.7	65.0	61.7	55.3
SPECIAL QUESTION 1: Your company's concerns regarding poor conditions in the agricultural sector	2.2	71.1	26.7	24.5	NA
SPECIAL QUESTION 2: Your company's concerns about "Y2K" effects	13.8	63.8	22.4	8.6	NA
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

of worker shortages. While manufacturing hourly wages reported above have varied greatly from month to month, a large majority of surveyed firms report that they have increased wages and benefits over the past three months. The diffusion index for current employee compensation compared to three months earlier is 66.2, a large increase from its 51.1 value in December 1998. Seventy-seven percent of area firms expect to increase wages over the next six months. One area employer remarks that it is "increasing wages to retain employees".

St. Cloud area firms are experiencing improvements in prices received for their company's products by a much wider margin than in December 1998. The diffusion index of 18.0 compares to the slight 4.3 margin in the earlier period. This trend is expected to widen over the next six months. Any increase in profit margins will be welcomed by area firms who feel squeezed by the local labor shortage.

National business activity is perceived to be improved from its level three months ago. A diffusion index of 22.2 compares to a 14.9 value in December 1998. The future national outlook is even brighter according to our survey respondents. This seems increasingly vital to St. Cloud area firms who have remarked on the importance of retaining strong national economic growth. Indeed one firm indicates that it has become more dependent on national economic conditions than at any time in the past. But another firm notes concerns about a "recession tendency" as well as "rising debt".

Special Question 1 asked responding firms to evaluate concerns regarding poor conditions in the agricultural sector. While a clear majority of companies reported "no change" in concerns about the effect of conditions in this sector on the present and future outlook for their business, there is a clear bias toward increased concerns. While this does not appear to be a major issue for most St. Cloud area firms, it is nevertheless still a concern for some of the respondents.

Responses to Special Question 2 suggest a wide variation of concerns about and preparation for "Y2K" effects. Most firms had "no change" in their attitudes about these effects either in the present or the future. Some firms expected matters to worsen over the next six months while others believe that their firm has (or will have) taken all necessary steps to assure "Y2K" compliance. In general, area firms appear to be quite confident that any adverse "Y2K" effects will be temporary and minor. Most firms that submitted written comments regarding "Y2K" effects believe they are compliant. Many also indicated that their vendors and customers were compliant as well. Despite this, the following responses confirm the uncertainty that is present:

"...(we are) watching closely at the corporate and world-wide level"

"Will IRS and Post Office be ready?"

"Just hoping everyone else is compliant"

"Not knowing about other companies' compliances"

"Concerns about health care equipment as well as computers"

"I expect a few bumps!"

"We provide Y2K consulting--rush of last minute clients"

"Supplier problems"

"Feel comfortable that our customers and vendors are prepared. More worried about the

world economy"

"Ability to receive payments from our clients and shipment of materials to our projects"

"Our customers perception of the problems that might happen--can't get money....,"

"A detailed and comprehensive plan to assess all key aspects of our operation...Key areas addressed: Information Systems, Facility Systems, Clerical Equipment, Suppliers, and Contingency Planning"

"Negative media stories which could scare people into taking funds out of financial services industry"

"Y2K concerns are primarily an overreaction caused by the media. Cars will run, airplanes will fly, and a few computers will be down"

Survey participants seem to agree that life will go on after January 1, 2000.