

Spring 2004

# St. Cloud Area Quarterly Business Report, Vol. 6, No. 2

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# St. Cloud Area Quarterly Business Report

Spring 2004

## Inside This Issue:

Executive Summary	page 1
Outlook Survey	page 2
Special Questions	page 2
Data Analysis	page 4

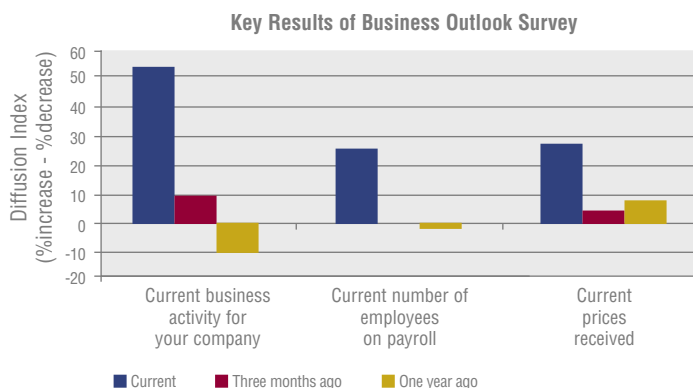
Volume 6, Number 2

## Area Businesses Report Strong Growth

Business Leaders Divided on Extending Sales Surtax

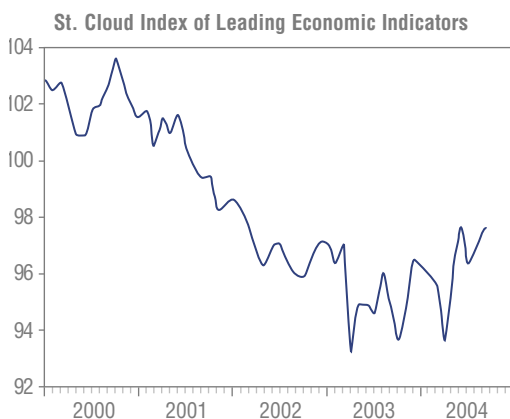
### Executive Summary

Sustained economic growth has finally returned to the St. Cloud area. Favorable predictions of the revamped St. Cloud Index of Leading Economic Indicators, combined with highly improved business conditions at surveyed firms, indicate the area economy has begun to converge to a normal growth path. Recent improvements in such key measures as manufacturing hours worked, new area business incorporations, St. Cloud Times help-wanted lineage, local claims for unemployment insurance, overall area employment growth, and a favorable national economy have all contributed to the strength of the current economic outlook.



Area business leaders responding to the most recent St. Cloud Area Business Outlook Survey report unprecedented strong performance at their companies over the past quarter. They also remain reasonably optimistic going forward six months. Strong improvement in overall business activity, renewed strength in the regional labor market, and improved pricing power all indicate an improved area business climate.

Forty-three percent of area businesses surveyed indicated either mild or strong support for extending the sales surtax to pay for local projects while 34% were either mildly or strongly opposed to the extension. In a separate special question, 52% of businesses reveal that rising energy prices are having either a “moderate” or “major” adverse effect on profit margins.



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## The St. Cloud Area Business Outlook Survey

The tables on the adjacent page report the most recent results of the business outlook survey. Responses are from 55 area businesses that returned the recent mailing. Participating firms are representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, financial, and government enterprises of sizes ranging from small to large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

For the quarter ending April 2004, area businesses experienced the strongest overall business conditions since June 1999. The diffusion index (representing the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given category) on current business activity was 53.7 in April. This was up from 8.9 in January and much larger than the -9.4 reading recorded last spring. Sixty-seven percent of surveyed businesses indicated an increase in the current level of business activity. Note that only 28% of businesses surveyed one year ago reported improved business conditions. One-third of surveyed businesses added to payrolls over the past quarter and almost half increased capital expenditures—the largest reported increase in capital expenditures ever recorded in the St. Cloud Area Business Outlook Survey! The diffusion index on prices received rose to its highest level of the last four years as businesses regained some of the pricing power lost during recent area economic weakness. Of course, some of the reported price increases are firms' efforts to retain margins in the wake of accelerating costs (particularly energy and health care costs). Some of this pricing inertia may also be due to a recent easing of highly competitive pricing pressures from imported goods. Finally, area businesses experienced a net increase in difficulty attracting qualified workers for the first time since December 2000—a sure sign of a rebound in the area labor market and in the general economy.

Looking forward six months, area businesses remain upbeat. A diffusion index of 59 on future business activity is very much in line with normal spring numbers. Only one business expects activity to be weaker six months from now while 61% expect improved conditions. A diffusion index of 33 for number of employees on company payrolls essentially matches what was reported one year ago (when the economy was first expected to rebound) and is improved over Spring 2002 numbers. Despite strong current capital expenditures numbers, one-third

of surveyed businesses expect to further increase spending on machinery, equipment, and structures over the next six months. The diffusion index on this item is the highest spring number recorded since 1999. Finally, 17% of surveyed firms expect increased difficulty attracting qualified workers by October (only two firms expect less difficulty). This is the second straight quarter in which this index has been positive—yet another sign of area economic rebound.

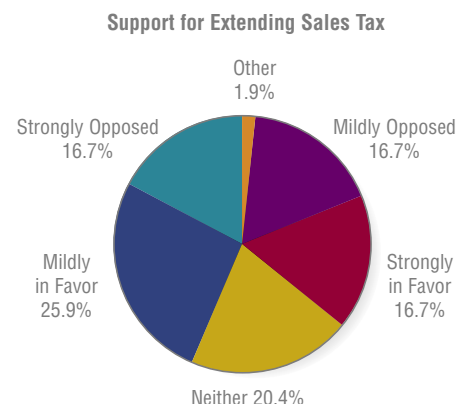
Written comments on factors influencing businesses include:

- ❖ “Rising mortgage rates have the potential to slow volume.”
- ❖ “Medical offices in town have become busier again, however, there are still a lot (of) people without health insurance.”
- ❖ “Steel prices continue to increase causing our building prices to increase and therefore some projects just are not being built because of additional cost.”
- ❖ “Our business is very cyclical (Dec – April 15).”
- ❖ “Spring has always been a busy time for (our business). We are especially busy because of our last promotion. It was a huge success.”

### Special Question #1

Area businesses were asked the following question:

It appears that St. Cloud voters will be asked to approve a ballot referendum in the November election that would (with legislative approval) give St. Cloud the authority to continue charging a 1/2¢ local tax to pay for local building and road projects. The referendum might also allow St. Cloud to increase its taxes on food, liquor, and lodging. To what extent does your business support the proposed tax increases? (Cont. on p. 4)



**Table 1--Current Business Conditions\***

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary April 2004 What is your evaluation of:	April 2004 vs. Three Months Ago				January 2004
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index <sup>3</sup>	Diffusion Index <sup>3</sup>
Level of business activity for your company	13.0	20.4	66.7	53.7	8.9
Number of employees on your company's payroll	7.4	57.4	33.3	25.9	0
Length of workweek for your employees	5.6	66.7	27.8	22.2	-7.1
Capital expenditures (equipment, machinery, structures, etc.) by your company	0	51.9	48.2	48.2	17.9
Employee compensation (wages and benefits) by your company	1.9	57.4	40.4	38.8	28.6
Prices received for your company's products	5.6	55.6	33.3	27.7	3.6
National business activity	5.6	42.6	38.9	33.3	28.6
Your company's difficulty attracting qualified workers	9.3	75.9	14.8	5.5	-7.1

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 April 2004 What is your evaluation of:	Six Months from Now vs. April 2004				January 2004
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index <sup>3</sup>	Diffusion Index <sup>3</sup>
Level of business activity for your company	1.9	25.9	61.1	59.2	75.0
Number of employees on your company's payroll	3.7	50.0	37.0	33.3	42.9
Length of workweek for your employees	7.4	70.4	14.8	7.4	21.4
Capital expenditures (equipment, machinery, structures, etc.) by your company	3.7	57.4	33.3	29.6	44.6
Employee compensation (wages and benefits) by your company	1.9	44.4	46.3	44.4	62.5
Prices received for your company's products	3.7	50.0	33.3	29.6	23.2
National business activity	5.6	46.3	31.5	25.9	46.4
Your company's difficulty attracting qualified workers	3.7	70.4	16.7	13.0	17.8

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.  
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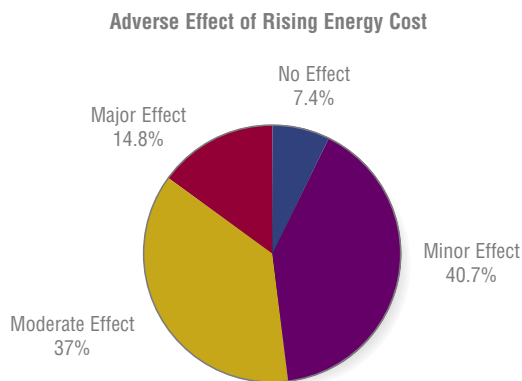
Responses to the question illustrate how remarkably divided area business leaders are over this issue. At this point in time, there clearly is no consensus in the area business community about the extension of the surtax. While 43% of surveyed businesses are either “mildly in favor” or “strongly in favor” of the extension, an almost equally offsetting 34% are mildly or strongly opposed to the initiative. This will be a most interesting issue as the November election approaches.

### Comments include:

- ❖ “Public development is needed and great for the community and business.”
- ❖ “We are a company that derives a portion of its sales from discretionary consumer revenues. Both the tax and energy prices impact our end users and therefore us as well.”
- ❖ “I’m OK with food, liquor, and lodging tax increase.”
- ❖ “In favor because the tax is coming from outsiders visiting our community in large part. Not in favor because of the decision-making process with local buildings, i.e. Civic Center and library.”

### Special Question #2

Area businesses were asked to indicate the extent to which rising energy prices are adversely eroding profit margins. Responses reveal that the bottom line for many area firms is being compromised by the recent surge in energy prices. While some firms are easily able to pass off higher costs in the form of increased prices, other firms (such as those using fixed menus and other scheduled pricing schemes as well as those who have contractual pricing arrangements) find margins squeezed during a period of unanticipated price increases. Fifteen percent of surveyed firms indicated rising energy prices are having a major effect on the bottom line. Another 37% reported a moderate effect. Only 7% of firms indicated rising energy prices are having no effect on profit margins.



### Comments include:

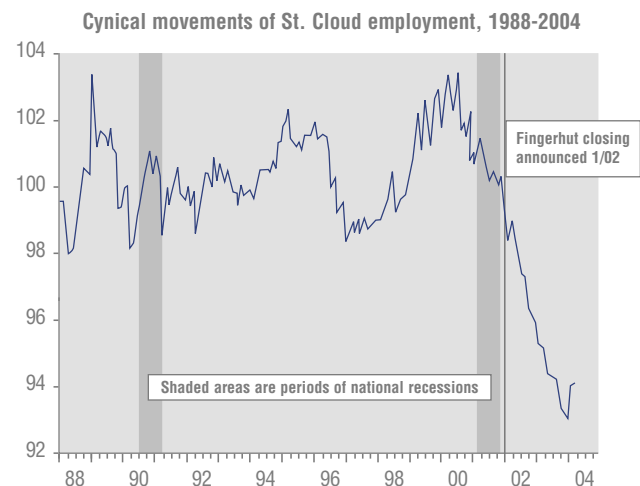
- ❖ “We run 9 trucks, our cost of material has also increased—aluminum, steel, plastic, etc. (we plan to increase prices 13% in the future).”
- ❖ “Energy costs are a very small part of our budget.”
- ❖ “Increases in (energy prices) are causing our smaller customers to postpone major purchases. Larger customers are able to operate their businesses with a better vision for the future.”
- ❖ “If energy prices continue to increase in the next year, it will have a major impact on our budget.”

### Looking at the Data:

#### There and Halfway Back Again

One of the first things we teach to students of forecasting is to be careful when “forecasting data outside a model’s experience”. A forecasting method or model is after all a numerical way of saying “tomorrow will be like the past”. When you have pretty good evidence that today is nothing like any yesterday, it’s rather foolish to assert that tomorrow will be like the day before yesterday.

As we began to consider possible revision to the leading indicators series we publish, we first wanted to review how the data we have on current economic conditions in St. Cloud were behaving. The only comprehensive economic data we have available within a month is local area employment. Our leading indicators are meant to help show what will happen to employment four to six months into the future. And when we looked at employment, we got a funny picture that made us think tomorrow will not necessarily be like the past.

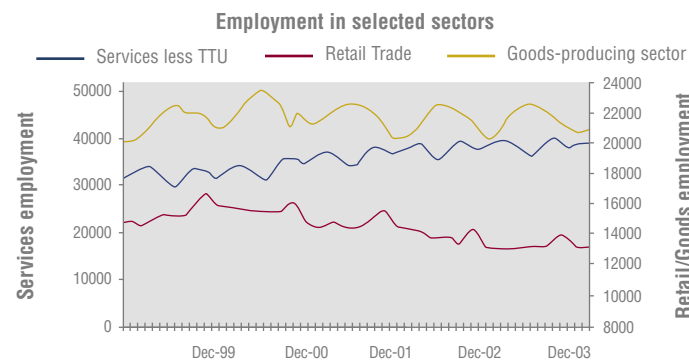


This graph is the result of what forecasters call a “classical decomposition” of St. Cloud area employment. We removed the seasonal pattern that exists in employment – we tend to add jobs in the last quarter of the year, as

well as as in May when students are out for the summer – and we removed the trend growth rate of employment in the area, which is about 2.5% per year. This does two things: It puts the series on a horizontal plane on a graph rather than sloping upward, and it removes some of the seasonal fluctuations that might obscure larger trends in the data. What remains is a representation of the state of the business cycle in St. Cloud. The horizontal plane centers on 100, so that when the graph moves above 100 it means employment is in expansion and when it is below then employment is in recession. A reading of 100 indicates that the level of employment that month was exactly consistent with the long-term trend level of employment, adjusted for normal monthly fluctuations.

This picture tells us a very cautionary tale: the recession we have been through is unlike anything we've experienced in the last twenty years. The movement to new lower levels of growth has mostly come after the last national recession ended in November 2001. It should surprise no one that the Fingerhut closing announcement in January 2002, coming at the end of the national recession, compounded the local decline. Removing 2700 jobs from Fingerhut also meant a decline in other economic activity in the St. Cloud area, as those former employees lived on less income and bought fewer items. Retail employment, not surprisingly, has also declined over the last few years.

The effects are felt to this day. Not only is employment still running six percent (about 5900 jobs as of March) below the trend level of employment, but also this is well outside St. Cloud's experience with employment. The models one would use to forecast would naturally lead you to assume that the economy will move back towards the norm (towards 100 in the graph.) The question really is: Will St. Cloud revert to that normal experience, or has the norm changed?



The survey results this quarter suggest that rapid growth is already here. On a seasonally adjusted basis<sup>1</sup> 1600 jobs have already been added this year. Trends in the leading indicator series would indicate future growth is likely, and 37% of respondents to the survey indicated they will

increase the number of employees on their payroll, while only one in six firms indicated an increase in the difficulty of attracting qualified workers.

Private employment is picking up rapidly, as indicated in Table 3. Growth has been strong across the board except for public employees and professional and business services. It has been, in fact, faster than growth in the state or the Twin Cities metro area. Retail trade employment continues to be below trend, though picking up lately. Indeed, as the graph in the previous column shows, service employment in wholesale and retail trade and related utilities and transportation industries (TTU) has been in steady decline for the last few years. Growth has been strongest overall in financial and professional services, and in the education and health professions. This can be seen in Table 3 to be part of a statewide trend, as we discussed last quarter.

Another interesting trend in St. Cloud is that growth in employment is occurring in occupations with fairly good wages. As we noted in the previous edition of the St. Cloud Area Quarterly Business Report, the growing sectors in St. Cloud have been construction, leisure and hospitality. Health and education employment, strong elsewhere in the state, has been relatively weak here. Construction wages in St. Cloud are roughly in line with those elsewhere in the state outside of the Twin Cities. Food preparation and office workers (including those in the leisure businesses) are paid below those in Minneapolis/St. Paul and Rochester, but in line with other cities of similar size to St. Cloud. Healthcare support wages have been relatively low, and that turns out to be an area where employment growth has been slower than elsewhere. Likewise, while manufacturing employment is down, wages there are below state averages. All this implies that income may be growing more rapidly than employment growth as employment rotates into areas with wages expanding more rapidly. (Unfortunately we do not have personal income data for St. Cloud later than 2001.)

## Developing a New St. Cloud Index of Leading Economic Indicators

We are beginning the process of revising the St. Cloud Index of Leading Economic Indicators. Part of this is due to data availability, and part of this is in response to the changing economic circumstances that we discussed at the beginning of this section. Thus while we are presenting a different economic indicator series this month, readers should expect that we will make one more change either in the next issue or the one after that.

<sup>1</sup>The government does not provide seasonally adjusted data to us; we have chosen to remove seasonality by an additive moving average technique. We note that the seasonal adjustment makes the decline in the data reported by the government into an increase, but on average employment declines 3000 between December and January. Please write to King Banaian for details if interested.

### *Salary Survey, First Quarter 2004*

Median Wages in Dollars per	Minneapolis		Rochester	Duluth Superior	Fargo Moorhead	St. Cloud
	Minnesota	St. Paul				
All Occupations	\$14.96	\$16.29	\$16.54	\$13.00	\$12.65	\$12.98
Management Occupations	\$38.32	\$41.17	\$38.17	\$29.88	\$28.95	\$30.90
Business & Financial Operations	\$20.43	\$24.86	\$23.12	\$21.04	\$20.53	\$23.89
Education, Training and Library	\$18.68	\$18.68	\$18.14	\$20.22	\$17.21	\$19.61
Health Practitioners and Technicians	\$23.48	\$24.70	\$25.66	\$20.40	\$20.07	\$22.76
Healthcare Support	\$11.46	\$12.38	\$12.99	\$11.04	\$9.62	\$10.77
Food Preparation and Serving	\$7.78	\$8.10	\$8.11	\$6.92	\$7.10	\$7.42
Sales and Related Occupations	\$11.11	\$12.68	\$10.20	\$9.01	\$9.60	\$9.39
Office and Administrative Support	\$13.69	\$14.47	\$14.35	\$11.68	\$11.60	\$11.96
Construction	\$21.54	\$24.14	\$19.14	\$20.12	\$15.39	\$19.03
Goods Production	\$13.83	\$14.96	\$13.07	\$14.13	\$11.00	\$11.82
Note: Per capita income, 2001	\$33,059	\$38,131	\$35,110	\$26,873	\$28,372	\$24,802

Source: Minnesota Workforce Center except per capita income, from U.S. Bureau of Economic Analysis

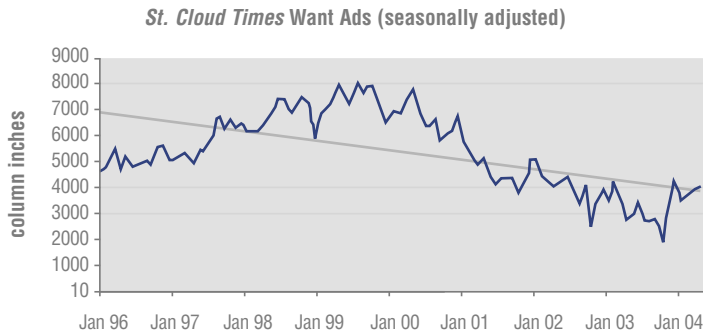
### *Table 3--Employment Trends*

	St. Cloud Employment Trends in Percent			Minnesota Employment Trends in Percent			Twin Cities Employment Trends in Percent		
	1990-2004 Long Term Trend Growth Rate	March 03-04 Growth Rate	March 04 Employment Rate	1990-2004 Long Term Trend Growth Rate	March 03-04 Growth Rate	March 04 Employment Rate	1990-2004 Long Term Trend Growth Rate	March 03-04 Growth Rate	March 04 Employment Rate
Total Nonagricultural	2.4%	1.5%	100.0%	1.6%	0.7%	100.0%	1.6%	0.6%	100.0%
Total Private	2.6%	1.7%	100.0%	1.7%	1.1%	100.0%	1.6%	1.3%	100.0%
<b>GOODS PRODUCING</b>	3.0%	1.9%	22.1%	0.8%	0.9%	17.4%	0.5%	1.5%	16.3%
Construction/Nat. Res.	4.5%	7.4%	4.5%	3.3%	3.5%	4.3%	3.9%	5.0%	4.3%
Manufacturing	2.6%	0.5%	17.6%	0.1%	0.1%	13.1%	-0.4%	0.3%	12.0%
<b>SERVICE PRODUCING</b>	2.3%	1.4%	77.9%	1.8%	0.6%	82.6%	1.8%	0.4%	83.7%
Trade/Transportation/Utilities	1.2%	2.3%	22.1%	1.2%	0.9%	19.7%	0.9%	-0.7%	19.2%
Wholesale Trade	3.3%	3.0%	4.8%	1.6%	2.7%	5.0%	1.4%	1.7%	5.0%
Retail Trade	0.4%	1.8%	14.0%	1.2%	0.7%	11.2%	0.9%	2.0%	10.4%
Trans./Ware/Util	2.1%	3.6%	3.2%	0.6%	-0.8%	3.5%	0.3%	0.3%	3.8%
Information	2.5%	1.9%	1.5%	1.0%	-0.7%	2.4%	0.9%	4.2%	2.5%
Financial Activities	4.1%	1.0%	4.3%	2.4%	2.6%	6.8%	2.4%	2.2%	8.2%
Prof. & Business Service	4.4%	-0.8%	7.2%	2.2%	-0.4%	11.0%	1.9%	-1.6%	13.7%
Educational & Health	3.5%	2.3%	14.8%	3.2%	1.8%	14.3%	3.4%	5.3%	13.0%
Leisure & Hospitality	2.6%	0.9%	8.5%	2.0%	3.9%	8.6%	2.1%	5.2%	8.8%
Other Services (Excl. Gvt)	2.4%	1.4%	4.7%	1.8%	-1.9%	4.4%	1.8%	2.0%	4.4%
Government	1.6%	0.7%	15.0%	1.2%	-1.7%	15.5%	1.4%	-3.7%	13.8%
Federal Government	-0.2%	1.9%	1.6%	-0.3%	-2.6%	1.3%	0.0%	-4.0%	1.3%
State Government	0.9%	5.7%	4.5%	0.7%	2.8%	3.5%	1.8%	5.5%	4.1%
Local Government	0.5%	-1.9%	8.9%	1.6%	-2.9%	10.6%	1.9%	-7.6%	8.4%

Note: Long term trend growth rate is the compounded average employment growth rate in the specified period. St. Cloud and Twin Cities represent the St. Cloud and Minneapolis-St. Paul MSAs, respectively.

SOURCE: MN Workforce Center

Because the index is based on predicting movements in labor markets, the first place for us to seek indicators has been labor market data. Of the four leading indicators selected, three are labor market indicators: the length of



the work week for manufacturing employees; the level of initial unemployment insurance claims; and the amount of help-wanted advertising in the St. Cloud Times. The first two mimic the national leading indicator series; longer work weeks and lessening initial claims for unemployment insurance are considered signals of improving future economic activity. At one time, help-wanted advertising was considered a leading indicator. Recently

firms have relied less on newspaper advertising to find employees, but they continue to use newspapers as a tool when seeking to expand their payrolls. We found through an analysis of detrended series that increases in help wanted advertising tended to indicate increases in payroll employment six months later.

We continue to use a series for new business incorporations, since firms will tend to take corporate status as they begin to grow. Assumed business names were not used in this revision of the index, as it appears not to be correlated with employment growth. The U.S. leading economic indicators series was also dropped from this iteration because the local series were found to have stronger correlation. In our research we found that incorporations and claims were longer-range predictors, meaning that they typically moved about ten to twelve months before movements in employment. Help-wanted advertising and length of the workweek were shorter-range predictors, moving approximately six months before employment moves.

All four indicators are moving in a positive direction for the St. Cloud economy. By March, help-wanted advertising and length of the workweek had returned to normal levels. A surge in business incorporations in March suggests that

we should see greater strength in employment in the second half of 2004. Recently, unemployment insurance claims have moved below trend levels, which again suggests that employment gains should pick up smartly in the second half of the year. Altogether, leading indicators suggest that about half of the distance between current level of employment and its trend level will be covered in the next four-to-six months. And given the movement in the longer-range predictors, even more may be found by early 2005.

Every forecast has its risks. It is now evident that interest rates have bottomed out, at least for the immediate future. Financial markets are forecasting that the Federal Reserve will start tightening monetary policy at its August meeting; we would not be surprised if the Fed acted sooner. Inflation

**Table 4--Other Economic Indicators**

	<b>2004</b>	<b>2003</b>	<b>Percent Change</b>
St. Cloud MSA Labor Force March (MN Workforce Center)	108,316	106,149	2.0%
St. Cloud MSA Civilian Employment # March (MN Workforce Center)	101,859	99,584	2.3%
St. Cloud MSA Unemployment Rate* March (MN Workforce Center)	6.0%	6.2%	NA
Minnesota Unemployment Rate* March (MN Workforce Center)	5.3%	5.4%	NA
Mpls-St. Paul/MSA Unemployment Rate* March (MN Workforce Center)	4.7%	4.9%	NA
St. Cloud Area New Unemployment Insurance Claims Jan. - March Average (MN Workforce Center)	613.3	682.3	-10.1%
St. Cloud Times Help-Wanted Ad Linage Jan. - March Average	3263.3	3225.7	1.2%
St. Cloud MSA Residential Building Permit Valuation (\$1,000) Jan. - March Average (U.S. Dept. of Commerce)	7458.7	5482.7	36.0%
St. Cloud Index of Leading Economic Indicators March (SCSU)	97.6	95.0	2.7%

# - The employment numbers here are based on resident estimates, not the employer payroll estimate in Table 3.  
\* - Not Seasonally Adjusted  
NA - Not Applicable



concerns are present; the Blue Chip Economic Indicators newsletter for May indicates a recent 1/4 point increase in inflation forecasts for 2004; they anticipate a 50 basis point rise in the federal funds rate by year-end. Conversations with one Minneapolis mortgage banker suggested that applications had already begun to slow. Building permits are holding firm, while many firms locally are reporting that they intend to increase capital expenditures. A quick back-up of interest rates, however, may dampen those plans.

International concerns will be present too. Import prices for consumer goods have begun to increase, perhaps a source of the pricing power that our survey respondents were feeling. Even removing petroleum products – where an increase is more likely to cause cost pressures than pricing power – import prices for consumer goods for March 2003 to March 2004 are up 1%. This is likely one reason why central banks, particularly in Asia, are beginning to intercede in foreign exchange markets to prevent further depreciation of the dollar. There is a risk, of course, that at some point dollar support from Asia will stop and the exchange rate will turn south again. That is more likely to affect costs than prices in the short run. But actions in

China to slow down their economic expansion are likely to ameliorate some of the pricing pressure on raw materials like steel.

Reasons for optimism abound. The National Association of Business Economists' Industry Survey from early April indicated similar figures to this St. Cloud Area Business Outlook Survey: 53% of respondents thought they would increase capital spending; demand is strong in all areas except transportation, utilities and communications (TUC); and 22% of firms reported a shortage of skilled labor and 5% shortages of raw materials inputs, meaning both prices and costs were rising. A diffusion index of 15 was found for firms' expectations for profits. While inflationary concerns are present, the core producer and consumer price indices rose less than 3% for the first quarter of 2004 (on an annual basis) and can be expected to remain at that level. In an environment of strengthening demand, favorable interest rates and a relaxation of pricing pressures from overseas, the national climate is ripe for the St. Cloud economy to surge forward in the second half of 2004.

Participating businesses can look for the next survey at the beginning of July and the accompanying **St. Cloud Area Quarterly Business Report** (including the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey**) in late August. Area businesses who wish to participate in the quarterly survey can call the SCSU Center for Economic Education at 320-308-2157. All survey participants will receive a free copy of the **St. Cloud Area Quarterly Business Report** on a preferred basis.