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St. Cloud Area Quarterly Business Report, Vol. 9, No. 1

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Q ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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AREA ECONOMY STILL ON SLUGGISH PATH

Mixed data cloud outlook; firms weigh in on transportation options

EXECUTIVE SUMMARY

The St. Cloud-area economy slowed in the past three months as firms reported weakness across a variety of activities.

While seasonal patterns suggest slower activity is to be expected in winter, information from the latest reading of the St. Cloud Index of Leading Economic Indicators and results from the St. Cloud Area Business Outlook Survey indicate the current slowdown is considerably worse than is normally expected at this time of year.

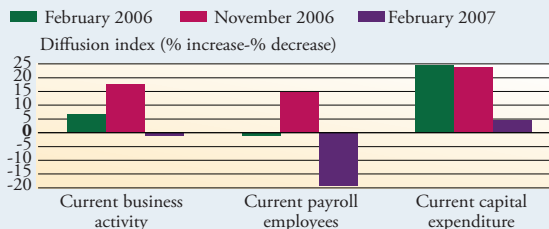
The leading indicators index rose 1.05 percent, but three of the four indicators were negative.

Increases in unemployment insurance claims have combined with weakness in manufacturing workweek length to produce a weaker local labor market than is normally expected at this time of year.

While employment grew at a healthy 2.4 percent pace in the year ending in January, further investigation suggests this is significantly related to benchmark employment revisions that artificially overstate current strength in the local labor market.

If taken at face value, these revised employment numbers indicate the relationship between the area economy and the Twin Cities and state economies has reversed course 180 degrees. All of a sudden the num-

KEY RESULTS OF SURVEY



bers suggest St. Cloud-area employment is growing more rapidly than its long-term trend while the Twin Cities and state labor markets plod along.

It's unlikely the area can continue to outperform the state given labor shortages and other indicators.

More firms report a decrease in economic activity in the past three months than report an increase. In addition, one-third of the 88 firms that returned this quarter's business survey indicate a reduction in employment in the past quarter.

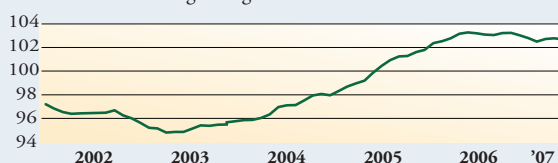
The local labor market was very weak over the winter quarter. At -19.4, the diffusion index on current employment is the lowest ever reported. The index on the length of the workweek also reached a historic low.

This weakness, however, was not confined to the labor market. Almost 20 percent of firms report a decrease in capital expenditures in the past three months. The diffusion index on this item is the lowest it has been since December 2001 — when the area economy was in recession.

While future conditions are expected to improve — a normal seasonal pattern — the magnitude of expected improvement is less than normal. Sixty percent of firms expect increased activity by August, but its 49.8 index is the lowest for this period since 2001.

INDEX OF LEADING ECONOMIC INDICATORS

Six-month moving average



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This quarter's special questions asked firms to consider various local transportation project options.

Firms are supportive of efforts to attract an additional airline to serve the area, although they are unsure whether two rival carriers can each offer a profitable service.

A majority of businesses expect neither a net gain nor a net loss from a proposed extension of the Northstar Corridor commuter rail service to St. Cloud and Rice.

Almost one-half of firms surveyed expect a net gain from the proposed expansion of Interstate Highway 94 to three lanes. Forty-seven percent identify the expansion as the most important transportation project to foster area economic development.

CURRENT WEAKNESS

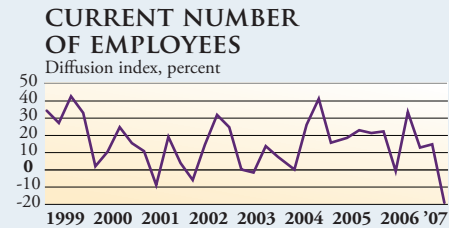
Tables 1 and 2 report the most recent results of the business outlook survey. Responses are from 88 area businesses that returned the survey. Participating firms represent a diverse collection, including retail, manufacturing, construction, financial, health services and government.

Responses are confidential. Written and oral comments have not been attributed.

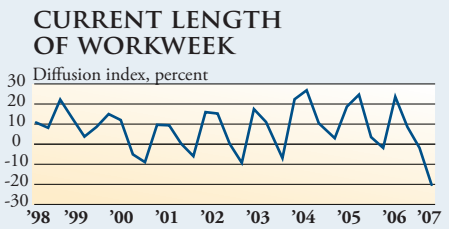
Survey responses suggest in the past three months, the St. Cloud area experienced its weakest quarter in several years. One has to go back to December 2001 — when the

area economy was in the fourth month of a two-year recession — to find a comparably weak period in which so many indicators are as weak as they were this quarter.

About the same number of firms experienced decreased activity as posted increases. But reported employment fell to an all-time low of -19.4. One-third of firms indicate decreased hiring in the past three months.



The length of the workweek index also reached an all-time low and hours worked by employees appear to have declined. This is a sign of a maturing expansion.

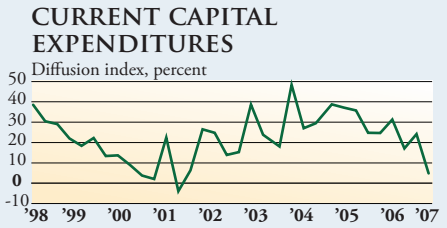


Capital purchases were equally weak as the index plummeted 20 points to 4.6. In a maturing expansion, capital investment

About the diffusion index

The diffusion index represents the percentage of survey respondents who indicated an increase minus the percentage indicating a decrease.

slows as firms acquire enough to equip their workers.



The index on national business activity turned negative for the first time in four years. Part of the area's economic weakness is associated with perceived national weakness. (All surveys were collected before the disquieting financial market activity in U.S. and world market exchanges in late February.)

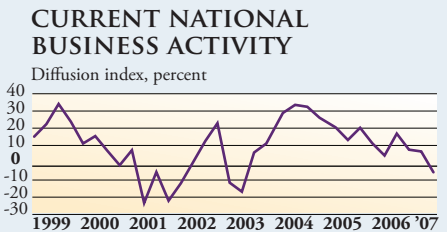


TABLE 1-CURRENT BUSINESS CONDITIONS

	February 2007 vs. Three months ago			Diffusion Index ³	November 2006 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)		
What is your evaluation of:					
Level of business activity for your company	38.6	23.9	37.5	-1.1	17.7
Number of employees on your company's payroll	33.0	53.4	13.6	-19.4	14.6
Length of the workweek for your employees	29.5	61.4	9.1	-20.4	-2.0
Capital expenditures (equipment, machinery, structures, etc.) by your company	19.3	56.8	23.9	4.6	23.9
Employee compensation (wages and benefits) by your company	4.5	64.8	30.7	26.2	32.3
Prices received for your company's products	10.2	63.6	25.1	14.8	6.2
National business activity	22.7	54.5	17.0	-5.7	6.3
Your company's difficulty attracting qualified workers	9.1	70.5	19.3	10.2	9.4

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

SLOWER FUTURE GROWTH?

Area firms do expect a brighter future in the next six months. But this is an ordinary seasonal occurrence.

A more interesting question is if the outlook is optimistic (or pessimistic) relative to normal winter readings.

The results are somewhat discouraging.

While 60 percent of firms expect increased business activity in the next six months, 10 percent expect a decrease. The diffusion index (49.8) is the lowest for the winter survey in five years.

The index on future employment and length of the workweek also is lower than is normally expected this time of year.

Future capital purchases are expected to rebound, but an index of 29.5 marks the lowest winter survey since 2002.

There are some brighter prospects for the future. The indexes on future national business activity and difficulty attracting qualified workers are more optimistic than other items in the survey. Although expected future prices received is substantially lower than a year ago, they are similar to recent quarters.

SPECIAL QUESTIONS

Future transportation options have been at the forefront of area discussions for years. Numerous factors drive these discus-

sions, including an increased number of commuters, economic development concerns, more rapid population growth and greater integration between the St. Cloud and Twin Cities economies.

This quarter's special questions surveyed area business leaders on a range of these potential transportation options.

ADDITIONAL AIRLINE

One proposal that has long been considered is the viability of attracting another air carrier to the St. Cloud Regional Airport. One of the key elements of any proposal is to attract a carrier that would serve destinations besides Minneapolis-St. Paul.

The only commercial air service offered locally is by Northwest Airlines, which connects to the Twin Cities through its regional air partner Mesaba.

Area business leaders expressed the extent to which their firms approve of local efforts to attract another airline. Seventy-four percent of firms are either strongly or mildly in favor of these efforts, and only one business is opposed.

Whether two competing carriers could profitably offer air service in St. Cloud is an interesting economic question.

One school of thought is that competition is always good, and it leads firms to efficiently allocate resources to their most

WHAT IS AFFECTING YOUR COMPANY?

■ "St. Cloud's a very conservative market. If overall the state gets busier, St. Cloud will follow."

■ "Intense competition for fewer deals."

■ "The local building slowdown has had a marked effect on our sales and profits. It is causing us to really 'tighten the ship' and will probably result in layoffs."

■ "We are engineering- and construction-based. Therefore we have some seasonal layoffs. However, in the engineering marketplace, work is slower due to the slowdown in residential growth."

■ "Biofuel expansion is spurring demand for specific types of (our company's product)."

■ "We are getting high numbers of applicants, but (they are) lacking on qualifications for open positions."

■ "The increase in ethanol from corn (has caused) corn prices to double."

■ "We are a fourth-quarter/holiday-driven business — retail. That is why we are decreasing from three months ago. Year-over-year business is up 50 percent."

■ "The uncertainty of gas prices."

■ "Increased high-deductible insurance plans and (health savings accounts) keep people from going to the doctor unless they absolutely have to."

TABLE 2-FUTURE BUSINESS CONDITIONS

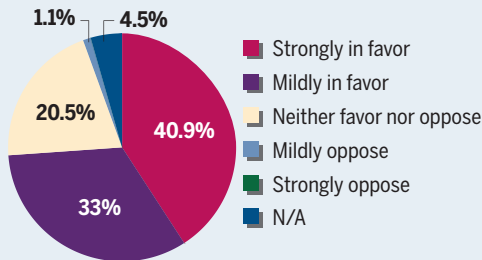
BUSINESS CONDITIONS	Six months from now vs. February 2007			Diffusion Index ³	November 2006 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)		
What is your evaluation of:					
Level of business activity for your company	10.2	26.1	60.0	49.8	32.3
Number of employees on your company's payroll	3.4	56.8	35.2	31.8	26.1
Length of the workweek for your employees	5.7	63.6	25.0	19.3	3.1
Capital expenditures (equipment, machinery, structures, etc.) by your company	5.7	51.1	35.2	29.5	32.3
Employee compensation (wages and benefits) by your company	0	48.9	45.5	45.5	50.0
Prices received for your company's products	3.4	56.8	33.0	29.6	29.2
National business activity	6.8	48.9	33.0	26.2	26.1
Your company's difficulty attracting qualified workers	2.3	64.8	26.1	23.8	17.7

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.

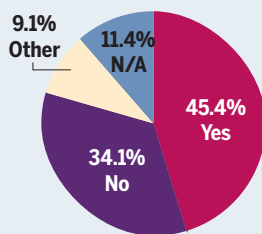
Source: SCSU Center for Economic Education, Social Science Research Institute and Department of Economics

QUESTIONS 1 and 2

To what extent does your company approve of local efforts to attract an additional airline to St. Cloud that would serve destinations besides Minneapolis-St. Paul?



Do you think two competing air carriers can profitably offer air service at the St. Cloud airport?



valued uses in search of profits.

But an alternative school of thought questions whether any air carrier could operate profitably out of the regional airport. After all, it appears profitability has been elusive to the existing carrier, and it is unclear how the addition of an airline would improve matters. Some express concern that more competition could yield two unsuccessful airlines competing away any economic returns and an area left with no airline service.

Forty-five percent of firms believe two carriers can profitably offer service, but 34 percent disagree. Twenty percent were unsure or offered other comments about potential profitability. Comments include:

- “I think competition is good, but probably not enough demand to support?”
- “More options than (there are now) would bring in more passengers.”
- “If the service was reliable and there were more destinations, more people would use the service.”
- “I don’t believe there will be enough travelers to support both.”
- “I think it would be tough at first until it catches on.”
- “I would worry about losing both if there wasn’t enough business.”
- “If this was perceived to be profitable, another airline would be here already.”
- “Direct flights to Chicago, Denver,

Phoenix, N.Y., Fla., would be a plus.”

- “They would have to offer different routes to be profitable.”

EXPANDING NORTHSTAR

Expanding the Northstar Corridor Commuter Rail Service from Big Lake to St. Cloud and Rice has long been a goal of community leaders.

Among other advantages, Northstar would make it easier for people to live in St. Cloud and work in the Twin Cities (and vice versa). It also would presumably help decongest roads.

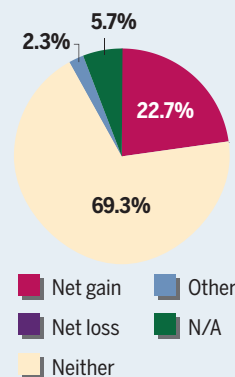
We asked firms if they would experience a net gain, net loss or neither from a northward expansion.

None said it would experience a net loss (which is interesting because it can easily be argued that higher area labor costs could result) and almost one-quarter expect a net gain.

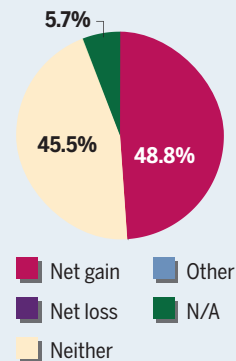
Most firms — 69 percent — expect no change. Comments include:

- “(It would) bring (our customers) to (us) easier.”
- “It would increase development of that corridor, which would lead to more business.”
- “More people could live further out from the metro, thereby increasing population base and demand for business services in St. Cloud.”
- “Hopefully would cut down on I-94 traffic, but my experience is these projects never pay for themselves.”
- “There won’t be enough ridership to make a difference.”
- “I don’t have a lot of belief on the usage of the rail system. It will just be another cost added on to taxes, like Metro Bus.”
- “St. Cloud becomes a more attractive place to live for highly skilled employees.”

QUESTION 3
Do you think your company would experience a net gain, net loss, or neither, from an expansion of the Northstar Corridor Commuter Rail Service from Big Lake to St. Cloud and Rice?



QUESTION 4
Gov. Pawlenty recently proposed expediting the expansion of I-94 to three lanes each way from Rogers to Clearwater. Assuming this proposal comes to fruition, do you think your company will experience a net gain, net loss, or neither upon completion of the project?



EXPANSION OF I-94

Another transportation option is to expand the number of lanes on I-94 between St. Cloud and the Twin Cities.

Gov. Pawlenty recently proposed expediting the expansion of I-94 to three lanes each way from Rogers to Clearwater.

Assuming this proposal comes to fruition, we asked firms if they would experience a net gain, a net loss or neither upon completion of the project.

Almost one-half of firms expect this expansion to yield a net gain, while 46 percent expect no change. Comments include:

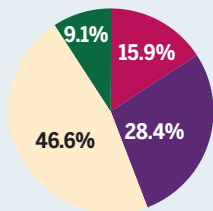
- “Will allow our personnel to spend less windshield time on metro-area projects.”
- “We depend on the trucking industry, and this will make it easier for them to get to our facility.”
- “Better commute for employees plus we may get some benefit from the increased level of construction.”
- “Easier access to us from metro — people will move out further.”
- “Reduce travel time (getting through the Twin Cities), especially for our trucks.”
- “More growth will follow expansion of roadways.”
- “We don’t do much business in the Twin Cities; this seems more of a convenience issue.”
- “Will add housing units in the corridor and beyond.”

RATING TRANSPORTATION

Last, we asked firms to identify which is the most important transportation project for St. Cloud’s long-term economic development. Only 16 percent of firms listed additional air service as most important, and 28 percent chose Northstar.

More lanes on I-94 is the preferred option for almost half of businesses, suggesting the governor's proposal should be well-received by the local business community.

QUESTION 5
Is additional air service, expansion of Northstar, or more lanes on I-94 the most important transportation project for long-term development?

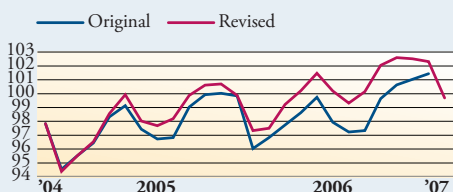


REVISED ECONOMIC DATA

It was reported early in 2007 that the Bureau of Labor Statistics calculated 752,000 more jobs were held in March 2006 than it had reported through the end of last year, a revision of 0.6 percent. This is about triple the usual revision.

ORIGINAL AND REVISED PAYROLL EMPLOYMENT

St. Cloud MSA 2005-06



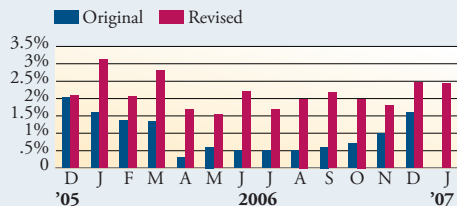
The new data reveal St. Cloud-area employment rose 2.1 percent in 2006. Growth for the 12 months up to December was 2.4 percent versus 1.6 percent previously reported, and held at that level in January. The size of the revision grew in 2006 versus 2005.

Looking at the graph below, the size of the revision completely changes the story of 2006 from growth rates below 1 percent to more than 2 percent, much more than the size of the national revision.

These revisions occur because each year the survey, which generates the monthly

12 MONTH CHANGE IN EMPLOYMENT

St. Cloud MSA 2005-06



WHO'S MINDING THE STORE?

We have spent time in QBR discussing where people who live in St. Cloud work. Data show 12 percent of residents drive to jobs in Hennepin and Ramsey counties. More probably work in the Twin Cities' other five counties.

About 105,000 workers live in the St. Cloud metropolitan area — composed of Benton and Stearns counties — while area businesses hire about 101,000 workers.

The number of local workers who drive to the Twin Cities are partly replaced by workers from other counties.

The St. Cloud MSA does not include Sherburne County, so a number travel from there to the other two counties, but not as many as you might think.

The map below has a circle that we centered on downtown St. Cloud. It extends five miles from there in every direction. There were 44,111 workers in that circle in 2003.

We used a U.S. Census household database to ask where people who were primarily employed at addresses in that circle lived. Each dot on the graph represents the home of a worker. Bigger dots represent multiple workers on that point.

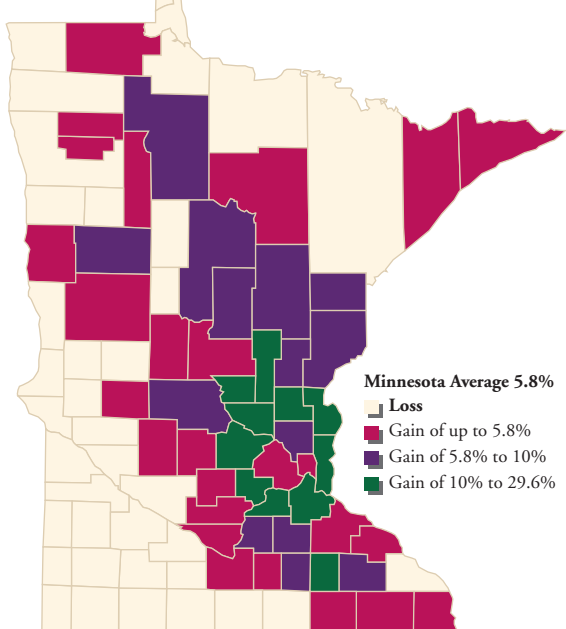
By county, we found 53 percent of workers in the ring live in Stearns. Those are all counted in the St. Cloud employment figures. But the county is 54 miles east to west and 36 miles north to south. The map shows many Stearns County workers — probably more than 5,000 — are coming across the county line to work in St. Cloud.

More than 10,000, or 23.1 percent, of workers in the circle had addresses outside the three counties that make up St. Cloud, including 1,176 workers from Morrison County and 1,635 from Hennepin County.

This pattern matters because the growth

RAPID GROWTH IN SUBURBAN COUNTIES

Population change, 2000 to 2005



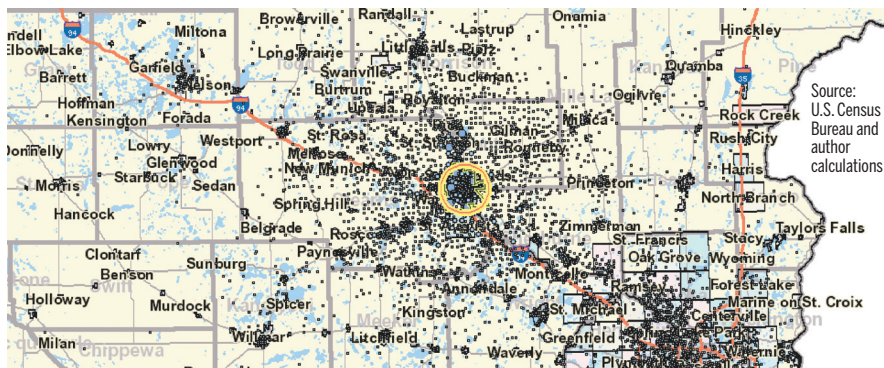
Source: State Demographic Center.

of population and, presumably, the work force in the state, is increasingly concentrated in the second ring of suburbs around the Twin Cities. If Minneapolis and St. Paul continue to pull workers from the St. Cloud area, St. Cloud must find workers from the west, north and south. And those areas are growing more slowly than in the past.

We believe this decline in work force growth in the St. Cloud area has and will continue to put downward pressure on employment growth for the medium term.

Another aspect of this demographic shift is an aging work force. The State Demographic Center projects 10 years from today there will be fewer workers younger than 35.

The area will see more international immigration and less inflow of workers from neighboring states. These will provide challenges for businesses that require skilled labor and opportunities for those who train such workers.



**TABLE 3-
EMPLOYMENT
TRENDS**

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend growth rate	Jan. '06-Jan. '07 growth rate	Jan. '07 employment share	15-year trend growth rate	Jan. '06-Jan. '07 growth rate	Jan. '07 employment share	15-year trend growth rate	Jan. '06-Jan. '07 growth rate	Jan. '07 employment share
Total nonagricultural	2.1%	2.4%	100%	1.7%	0.7%	100%	1.7%	0.7%	100%
Total private	2.3%	2.3%	84.9%	1.7%	0.7%	86.1%	1.8%	0.8%	84.7%
Goods producing	2.3%	2.4%	22.0%	0.6%	-1.4%	15.5%	0.9%	-1.0%	16.8%
Construction/natural resources	4.3%	-3.4%	4.4%	3.9%	-3.7%	4.1%	3.4%	-4.0%	4.3%
Manufacturing	1.9%	4.0%	17.6%	-0.3%	-0.5%	11.4%	0.2%	0.1%	12.5%
Service providing	2.0%	2.4%	78.0%	1.9%	1.1%	84.5%	1.8%	1.1%	83.2%
Trade/transportation/utilities	0.6%	2.8%	21.5%	1.2%	0.4%	19.3%	1.2%	1.0%	19.5%
Wholesale trade	1.9%	0	4.3%	1.7%	1.8%	4.9%	1.5%	-0.9%	4.8%
Retail trade	0.2%	3.1%	14.1%	1.4%	0.2%	10.6%	1.3%	2.0%	11.3%
Trans./warehouse/utilities	1.1%	5.8%	3.1%	0.3%	-0.5%	3.7%	0.7%	0.4%	3.5%
Information	1.3%	4.9%	1.3%	0.4%	-3.5%	2.3%	0.6%	-2.2%	2.1%
Financial activities	4.2%	2.5%	4.5%	2.1%	1.0%	8.1%	2.1%	1.2%	6.7%
Professional & business service	6.9%	9.7%	8.1%	2.3%	0.4%	14.4%	2.6%	0.7%	11.6%
Education & health	2.8%	0.9%	14.4%	3.2%	4.5%	13.6%	3.2%	3.3%	15.2%
Leisure & hospitality	2.5%	-3.9%	8.5%	2.1%	0.5%	8.8%	1.9%	0.3%	8.6%
Other services (excluding govt.)	1.8%	3.3%	4.6%	1.5%	1.1%	4.2%	1.5%	0.5%	4.3%
Government	1.1%	3.0%	15.1%	1.5%	0.9%	13.9%	1.0%	0.3%	15.3%
Federal government	0.3%	2.1%	1.7%	-0.2%	-0.6%	1.2%	-0.5%	-1.0%	1.2%
State government	0.7%	-2.2%	4.2%	1.8%	2.6%	4.1%	0.8%	-0.6%	3.5%
Local government	1.5%	5.7%	9.2%	1.7%	0.3%	8.6%	1.3%	0.7%	10.6%

Note: Long-term trend growth rate is the compounded average employment growth rate in the specified period.

Source: Minnesota Department of Employment and Economic Development and author calculations.

estimates the government publishes, is updated by a study of all payroll submissions from area businesses. New businesses are added, and others go out of existence.

There have been more births and fewer deaths of businesses than estimated, including in the St. Cloud area.

As seen in Table 3, growth was strong in trade and transportation (up 2.9 percent for 2006), financial activities (up 4.2 percent) and professional and business services (up 7 percent).

Growth was weaker in manufacturing (up 0.8 percent), and there was a decline of 1.7 percent in leisure and hospitality.

In a separate survey of the St. Cloud area, average weekly wages grew 4.2 percent over the year through the second quarter of 2006 and wages paid to all workers in the area rose 6.2 percent over the same period. When adjusted for inflation, real wages and real labor income in the area grew at a pace roughly consistent with national trends.

In January, the area posted its seasonal drop of 2,627 workers, slightly less than usual for January, but this may be because the usual extra surge of workers in November and December did not materialize. Retail employment in January still stood 300

**TABLE 4-OTHER
ECONOMIC INDICATORS**

	2007	2006	Percent Change
St. Cloud MSA labor force January (Minnesota Workforce Center)	105,996	104,261	1.7%
St. Cloud MSA civilian employment # January (Minnesota Workforce Center)	99,691	98,389	1.3%
St. Cloud MSA unemployment rate* January (Minnesota Workforce Center)	5.9%	5.6%	NA
Minnesota unemployment rate* January (Minnesota Workforce Center)	5.4%	5.1%	NA
Minneapolis-St. Paul unemployment rate* January (Minnesota Workforce Center)	4.7%	4.3%	NA
St. Cloud-area new unemployment insurance claims November-January average (Minnesota Workforce Center)	1,623.3	1,409.0	15.2%
St. Cloud Times help-wanted ad lineage November-January average, in inches	4,773.7	5,191.7	-8.1%
St. Cloud MSA residential building permit valuation In thousands, November-January average (U.S. Dept. of Commerce)	6,689.3	8,322.7	-19.6%
St. Cloud index of leading economic indicators January (St. Cloud State University)**	102.3	102.8	-0.4%

MSA = St. Cloud Metropolitan Statistical Area, composed of Stearns and Benton counties.

- The employment numbers here are based on household estimates, not the employer payroll estimate in Table 3.

* - Not seasonally adjusted

** - January-March 2001=100

NA - Not applicable

workers above its August levels, indicating strength in that sector.

Other local economic data are shown in Table 4. The state added 25,675 jobs a month on average in 2006 versus 2005. The state's (not seasonally adjusted) unemployment rate jumped to 5.4 percent

in January. St. Cloud and Minneapolis-St. Paul had similar experiences with unemployment.

New claims for unemployment insurance rose 15.2 percent last quarter from a year ago, indicating potential weakening in the labor market.

The valuation of building permits has been down; the number of permits for single-family homes dropped to the 800-unit range in the last quarter of 2006.

Help-wanted lineage declined mildly as well over the year, though it rebounded late last year to help move up the St. Cloud Leading Economic Indicators for the last quarter.

All other indicators are flat or down, as seen in Table 5, continuing the sideways movement we have had all year. Both direct measurements of employment activity — hours worked in manufacturing and new claims — moved strongly negative last quarter, while new business incorporations remain flat.

Were it not for the increased activity in help-wanted advertising, local LEI would be down for the last six months, which could have lead us to project a recession in the second half of 2007.

So how reliable is that indicator? Employment figures have held up relatively well. Employment growth has been remarkably steady at about 2 percent per year for some time, and that is consistent with the long-term average. On the other hand, if the story of increased reliance on outside labor is accepted, it also would make sense that area businesses are using print advertising more to find workers in rural Stearns County and counties to the north.

Nationally, except for former Federal Reserve Chairman Alan Greenspan's comments, forecasters have been forecasting a relatively slow economy in 2007 but no recession.

The Federal Reserve forecast, released in February, indicated growth in real GDP at 2.5 to 3 percent, with inflation holding at 2 to 2.25 percent and an uptick in unemployment to 4.75 percent.

This is in line with private forecasts. Only four of 59 forecasts in the National Association of Business Economists' forecast predicted GDP growth less than 2 percent. This amount of agreement is higher than usual.

The reduced uncertainty and upward revision in employment data make us somewhat more optimistic than previously reported. This may mean labor costs have risen locally more than we previously thought and squeezed profits. That would help explain the cooling reported by area businesses in the survey, but continued reporting of difficulties in hiring would indicate at least good demand for area products and services.

IN THE NEXT QBR Participating businesses can look for the next survey in May and the accompanying St. Cloud Area Quarterly Business Report in the July edition of ROI. Area businesses that wish to participate in the quarterly survey can call the St. Cloud State University Center for Economic Education at 320-308-2157.

TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

Changes from November 2006 to January 2007	Contribution to LEI
Help-wanted advertising in St. Cloud Times	2.64%
Hours worked	-1.12%
New business incorporations	-0.09%
New claims for unemployment insurance	-0.38%
Total	1.05%

*Numbers may not add up due to rounding.

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