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# St. Cloud Area Quarterly Business Report, Vol. 9, No. 2

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# Q ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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## LOCAL ECONOMY SHOWS MODEST GROWTH

### Employment increases steadily as economic uncertainty abounds

#### EXECUTIVE SUMMARY

Employment growth in the St. Cloud area was steady in the past three months despite evidence of above-normal economic uncertainty among area firms.

While many key local sectors are experiencing relatively strong growth, others appear to be going through well-documented economic weakness felt elsewhere statewide and nationwide.

Information from the most recent reading of the St. Cloud Index of Leading Economic Indicators, as well as results from the St. Cloud Area Business Outlook Survey, indicates current activity is somewhat weaker than might be expected at this time of year.

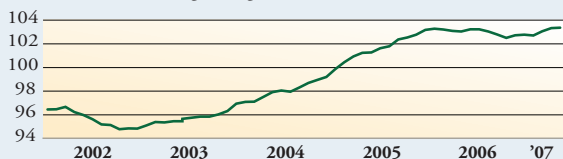
But economic uncertainty looms large. Results from the most recent survey of area business leaders, along with quantitative analysis of feasible future growth paths, suggest caution is in order.

The leading indicators index fell 2.09 percent over the quarter. Increases in unemployment insurance claims accelerated in recent months, and new incorporations have slowed. Only an increase in help-wanted advertising relative to normal season and trend prevented a more negative reading.

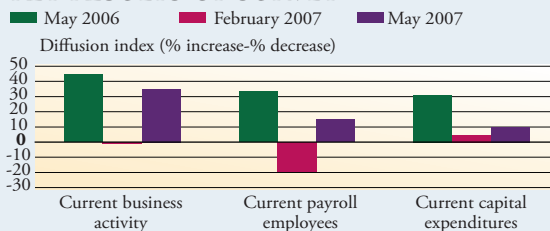
Job growth for the 12 months to April was 2.1 percent. Manufacturing employment has picked up, as have retail trade and professional and business services.

#### INDEX OF LEADING ECONOMIC INDICATORS

Six-month moving average



#### KEY RESULTS OF SURVEY



St. Cloud continues to experience faster employment growth than the Twin Cities and the state. But all three areas are growing at below-trend rates.

Fifty-one percent of the 80 responding firms report a rise in economic activity, while only 16 percent report a decrease. In addition, more than half expect improved economic activity six months from now.

The seasonal pattern of business activity for surveyed firms is typically strongest during the spring quarter, so these results are not surprising. Compared with the same period last year, current activity and the future outlook are about the same as expected.

However, certain survey results are somewhat disquieting and worthy of closer inspection. For example, only one-quarter of companies expect to increase capital expenditures six months from now, and 8 percent expect to decrease these expenditures. This is much weaker than is normally expected for this time of year and is one of the weakest numbers recorded in the nine years of our survey.

Part of this can be explained by looking at this quarter's special questions that asked businesses to evaluate overall local economic conditions (instead of reporting conditions at their company). Firms report the current performance of the local economy

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is weaker than is expected at this time of year. Fifty percent of surveyed firms also report there is more uncertainty regarding the performance of the area economy than is normally the case. Only 10 percent of companies say there is less uncertainty.

This uncertainty, combined with continued weakness in some key sectors here and elsewhere, suggests the area economy, while still undergoing expansion, is vulnerable to changing economic conditions.

## CURRENT ACTIVITY

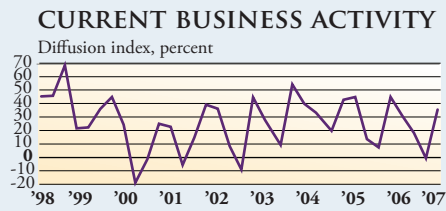
Tables 1 and 2 report the most recent results of the business outlook survey. Responses are from 80 area businesses that returned the recent mailing in time to be included in the report. Participating firms represent a diverse collection of businesses in the St. Cloud area. Survey responses are confidential. Written and oral comments have not been attributed.

Survey responses suggest in the past three months, the St. Cloud area experienced economic conditions that are somewhat weaker than normal this time of year. The current activity diffusion index is 35 in this quarter's survey, lower than 45 reported one year ago and 42 reported in Spring 2005.

This has improved from last quarter's report of -1.1, but that can be at least partly explained by normal seasonal patterns.

## About the diffusion index

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



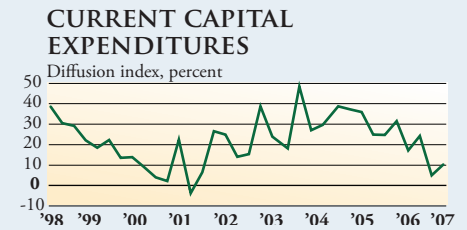
Both the employment and length of workweek diffusion indices were also lower than normally observed in May. Combined with less reported difficulty attracting qualified workers, these survey results paint a picture of a local labor market that is not quite achieving its full potential.



The survey response that is of greatest concern is current capital expenditures.

With a diffusion index of 10, this item remains very weak. But it is slightly improved from last quarter's reading of 4.6.

The local slowdown in capital purchases is quite consistent with national reports (discussed later in this report) of a slower pattern of capital purchases. Those reports have caused economic forecasters to revise national output forecasts to be weaker than originally projected.



Pricing pressures appear to have continued to moderate in the past three months. The local tendency toward increased prices observed in 2004-06 seems to have slowed since the fourth quarter of 2006.

Perhaps the widely reported soft landing that the Federal Reserve has attempted to engineer in the past couple of years has proved successful locally. Local perceptions of national business activity, while improved from three months ago, are still historically weak for this time of year.

**TABLE 1-CURRENT BUSINESS CONDITIONS**

	May 2007 vs. Three months ago			Diffusion Index <sup>3</sup>	February 2007 Diffusion Index <sup>3</sup>
	Decrease (%)	No Change (%)	Increase (%)		
What is your evaluation of:					
Level of business activity for your company	16.3	32.5	51.3	35.0	-1.1
Number of employees on your company's payroll	17.5	50.0	32.5	15.0	-19.4
Length of the workweek for your employees	11.3	71.3	17.5	6.2	-20.4
Capital expenditures (equipment, machinery, structures, etc.) by your company	13.8	62.5	23.8	10.0	4.6
Employee compensation (wages and benefits) by your company	0	63.8	35.0	35.0	26.2
Prices received for your company's products	10.0	60.0	27.5	17.5	14.8
National business activity	16.3	50.0	23.8	7.5	-5.7
Your company's difficulty attracting qualified workers	3.8	75.0	21.3	17.5	10.2

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

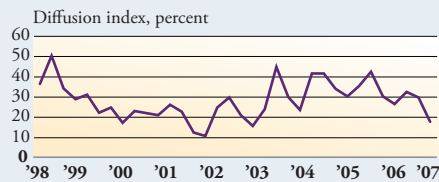
## FUTURE OUTLOOK

The future outlook of area business leaders is largely unchanged from one year ago, with a couple of exceptions.

The May diffusion index on expected future business activity is 43.7, down slightly from 44.3 a year ago. Similar index values are also found for the number of employees, length of workweek, national business activity and expected difficulty attracting qualified workers. These values all have some element of seasonal variation, so this would appear to indicate a very normal pattern of expected activity in the next few months.

The May survey results for future outlook are weaker than reported last quarter, although this is a normal seasonal effect.

### FUTURE CAPITAL EXPENDITURES



Expected future prices received are lower than a year ago, and the future capital expenditures index is substantially lower than in May 2006.

## WHAT IS AFFECTING YOUR COMPANY?

■ “Home building being down significantly affects the demand for (our company’s product) used in housing.”

■ “Travel impacts (our) industry and things don’t look good with fuel costs right now.”

■ “Lots of changes in health care. Payers are cutting reimbursements and scrutinizing care. More HSAs means higher percentage out of pocket and higher write-offs. Tough times for physicians and clinics.”

■ “There’s increasing pessimism on the residential home-building scene. Many had expected a turnaround by now but are projecting a tepid pace into 2008.”

■ “Difficulty doing business downtown – city seems not to care.”

■ “Increasing cost of feed due to ethanol demand will need to be passed onto consumers.”

■ “Residential appraisal activity is down, but commercial and agricultural is up slightly.”

■ “Residential subcontractors are bidding

(and procuring) more jobs in the commercial market. As a result we are bidding with lower margins and also bidding on larger commercial projects that we normally wouldn’t look at.”

■ “Gas prices will impact people’s willingness to travel and to come to St. Cloud (to use our services).”

■ “We are in a real estate industry. New construction starts are downright depressed in this area. Existing home sales are off 35-50% in places. Foreclosures are way up and more to surely come. The housing prices have fallen this first quarter in the local area.”

■ “Our company’s (industry) is residential construction. Our industry and related business are lower than average in business activity. We are seeing a greater than normal uncertainty with the public.”

■ “Private commercial building is slowing, we typically follow the housing market by 12-16 months.”

If there are dark clouds on the horizon, some of them are certainly associated with current and future weakness in capital expenditures.

## SPECIAL QUESTIONS

For several months, there have been mixed readings on the performance of the local and national economies. While

some sectors appear to be struggling, others seem to be experiencing strong growth.

Survey questions typically ask area business leaders about conditions at their own company and the national economy. But this quarter, we look into firms’ perceptions of the current and future performance of the local economy.

**TABLE 2-FUTURE BUSINESS CONDITIONS**

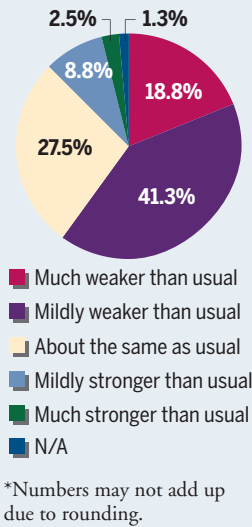
	Six months from now vs. May 2007			Diffusion Index <sup>3</sup>	February 2007 Diffusion Index <sup>3</sup>
	Decrease (%)	No Change (%)	Increase (%)		
What is your evaluation of:					
Level of business activity for your company	8.8	36.3	52.5	43.7	49.8
Number of employees on your company’s payroll	7.5	58.8	32.5	25.0	31.8
Length of the workweek for your employees	5.0	81.3	12.5	7.5	19.3
Capital expenditures (equipment, machinery, structures, etc.) by your company	7.5	65.0	25.0	17.5	29.5
Employee compensation (wages and benefits) by your company	0	60.0	37.5	37.5	45.5
Prices received for your company’s products	6.3	53.8	35.0	28.7	29.6
National business activity	6.3	55.0	27.5	21.2	26.2
Your company’s difficulty attracting qualified workers	1.3	67.5	28.8	27.5	23.8

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.

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



**QUESTION 1**  
**Compared to normal economic conditions for this time of year, which of the following is your company's perception of current local conditions?**



This special question yielded interesting results. Almost 19 percent of firms indicate the local economy is “much weaker” than normal and 41 percent suggest it is “mildly weaker.”

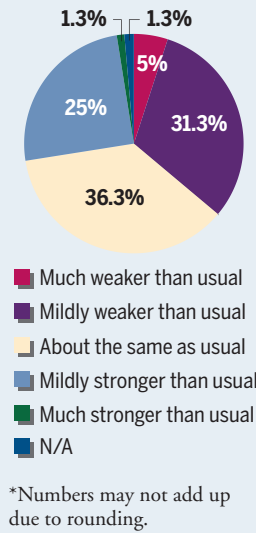
Almost 28 percent think it is about the same as usual, while 9 percent think it is “mildly stronger” than normal. Only two firms think it is “much stronger” than is usually found at this time of year.

More than one-half of surveyed firms think the area economy is currently weaker than normal. This helps explain reported weakness in such survey measures as capital expenditures and payroll employment.

**QUESTION 2**  
**Compared to normal economic conditions expected six months from now, which of the following is your company's perception of expected future local conditions six months from now?**

We also asked area companies to look at expected future local economic conditions six months from now and compare this to what would be normally expected. Firms were more optimistic about expected future local conditions relative to what is normally anticipated. The median survey response to this item was “about the same as normal,” which was given by 36 percent of survey respondents.

But there was some variation around this result, indicating a notable spread of what is anticipated for the economy by the end of 2007.



Five percent of firms expect the local economy to be “much weaker” than normal six months from now, and 31 percent say it will be “mildly weaker” than normal.

This is offset by one-quarter of firms who think it will be “mildly stronger” and one firm that thinks it will be much stronger.

We suspect this range of perceptions about the performance of the local economy underlies much of the uncertainty from recent forecasts found in the St. Cloud Area Quarterly Business Report.

In many respects, the most interesting result from this quarter's survey relates to area firms' sense of local economic uncertainty. Uncertainty is, of course, a factor in business decisions to undertake capital spending, hire new workers, price products, etc. While this is not something that can be measured easily, surveys can address the extent to which firms feel economic uncertainty exists.

**QUESTION 3**  
**In general, does your company feel there is currently more, less or about the same uncertainty as usually occurs regarding the performance of the local economy?**

While we have no benchmark to compare the result of this special question, it is

**TABLE 3-**  
**EMPLOYMENT**  
**TRENDS**

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend growth rate	April '06-April '07 growth rate	April '07 employment share	15-year trend growth rate	April '06-April '07 growth rate	April '07 employment share	15-year trend growth rate	April '06-April '07 growth rate	April '07 employment share
Total nonagricultural	2.2%	2.1%	100%	1.7%	1.3%	100%	1.6%	1.3%	100%
Total private	2.4%	2.1%	84.7%	1.7%	1.4%	86.2%	1.8%	1.6%	84.7%
<b>Goods producing</b>	2.2%	1.7%	21.8%	0.6%	-1.9%	15.4%	0.8%	-0.5%	16.8%
Construction/natural resources	4.1%	-0.1%	4.7%	3.7%	-2.0%	4.3%	3.3%	-0.5%	4.5%
Manufacturing	1.8%	2.2%	17.2%	-0.4%	-1.9%	11.1%	0.1%	-0.5%	12.3%
<b>Service providing</b>	2.2%	2.2%	78.2%	1.9%	1.9%	84.6%	1.8%	1.7%	83.2%
Trade/transportation/utilities	0.8%	3.4%	20.9%	1.3%	2.1%	19.0%	1.2%	2.1%	19.2%
Wholesale trade	2.1%	-1.5%	4.3%	1.7%	1.4%	4.9%	1.5%	0.2%	4.8%
Retail trade	0.3%	4.2%	13.5%	1.4%	2.2%	10.4%	1.3%	2.3%	11.0%
Trans./warehouse/utilities	1.6%	7.1%	3.1%	0.3%	3.1%	3.7%	0.7%	4.1%	3.5%
Information	1.4%	8.0%	1.3%	0.1%	-5.0%	2.2%	0.2%	-2.9%	2.0%
Financial activities	4.4%	2.9%	4.5%	2.0%	2.6%	8.1%	2.1%	2.5%	6.6%
Professional & business service	6.4%	3.2%	8.1%	2.3%	2.6%	14.6%	2.6%	2.9%	11.8%
Education & health	3.0%	0.1%	14.8%	3.2%	3.8%	13.7%	3.2%	3.1%	15.2%
Leisure & hospitality	2.5%	0.6%	8.6%	2.1%	0.3%	8.9%	1.9%	1.2%	8.8%
Other services (excluding govt.)	1.9%	3.4%	4.6%	1.9%	1.9%	4.3%	1.5%	0.2%	4.3%
Government	1.4%	2.2%	15.3%	1.3%	1.0%	13.8%	0.8%	0.1%	15.3%
Federal government	0.3%	2.5%	1.6%	-0.2%	0.3%	1.2%	-0.4%	-0.2%	1.2%
State government	1.6%	-0.2%	4.6%	1.6%	1.6%	4.1%	0.9%	-0.8%	3.5%
Local government	1.5%	3.3%	9.1%	1.4%	0.9%	8.5%	1.0%	0.5%	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 other calculations.

# BUSINESS BIRTHS

The last issue of the Quarterly Business Report noted that a data revision in the employment data made a significant difference in our view of the area's economic performance in 2006. Employment growth was much faster than had been reported up to February.

One area of growth the monthly employment data had not captured was growth of new firms in the St. Cloud area. These data are obtained through a quarterly census, which then is used to correct the monthly data each March.

Data show that after substantial growth of firms in the first half of 2005, new firm growth has virtually stopped. It has been mostly existing firms that have grown in the last five quarters that data were available. Wage income for workers in these firms has grown less than 3 percent through the third quarter of 2006.

Examining the net change in firms by sector, we see how strong 2005 was in retrospect, and the slowing that occurred in 2006. The number of firms in the city of St. Cloud fell by 19 in the year through September 2006, compared with a growth of 85 firms in the same period the previous year.

The number of workers in the area continued to grow despite the decline in the number of firms, indicating local employment growth is the result of existing firms' expansion.

The strongest growth of firms in 2006 was the health sector. Most of these appear to be small concerns, as employment only rose by 194 workers while the number of health industry firms rose by 26.

There was also some growth in the restaurant and hotel industry.

## QUARTERLY CENSUS OF EMPLOYMENT AND WAGES

St. Cloud (largely Stearns County)

Quarter	Private firms	Workers	Wages (in millions)
2005: I	2,005	42,836	\$323.03
II	2,072	43,741	\$337.01
III	2,086	44,356	\$368.46
IV	2,084	45,104	\$379.39
2006: I	2,099	43,683	\$369.96
II	2,087	44,377	\$355.30
III	2,064	45,285	\$379.11

Source: Minnesota Department of Employment and Economic Development

## NET BUSINESS BIRTHS

Through the third quarter	St. Cloud		Stearns/Benton counties	
	2006	2005	2006	2005
Manufacturing	-7	-2	-22	34
Wholesale trade	-2	-5	1	11
Retail trade	-10	11	-10	23
Information	-2	1	-1	10
Finance and insurance	-1	12	5	28
Real estate	-11	13	-1	14
Professional, technical services	-1	6	N/A	N/A
Educational services	0	0	N/A	N/A
<b>Health services and social assistance</b>	<b>26</b>	<b>17</b>	<b>N/A</b>	<b>N/A</b>
Arts, recreation and entertainment	-3	1	-8	4
Accommodation and food services	5	6	-3	24
Other services	-7	6	-15	21
Unclassified	-6	19	N/C	N/C
<b>TOTAL</b>	<b>-19</b>	<b>85</b>	<b>-29</b>	<b>303</b>

n/a = data not available for Benton County  
n/c = not comparable

Source: Minnesota Department of Employment and Economic Development

A similar story appears for the Stearns-Benton area. There were 303 firms added in 2005, but a reduction of 29 firms in 2006. Data from those counties (not shown) indicate 53 net new firms in the construction sector in 2005 but 19 fewer in 2006.

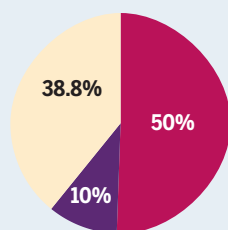
There is still growth in finance and insurance firms. While the number of firms in the manufacturing sector has fluctuated, the number of workers in that sector has declined in both years.

Our St. Cloud Leading Economic Indicators index, which includes new business incorporations, indicates employment grows about nine to 12 months after new businesses incorporate. Thus, the growth of new firms in 2005 could have been expected to stimulate economic growth in the area in 2006.

The slowdown of new business formation last year then would be expected to be a drag on employment growth in 2007.

It will be up to existing firms to continue expanding their production by adding workers if 2007 is to have as robust employment growth as 2006 turned out to have.

striking that one-half of surveyed firms think there is "more uncertainty" than normal, while only 10 percent believe there is "less uncertainty" than normal.



- More uncertainty than normal
- Less uncertainty than normal
- About the same uncertainty as normal

\*Numbers may not add up due to rounding.

This survey result helps explain the relatively weak survey results reported in Table 1 and further highlights concerns discussed elsewhere in this report.

## A LOOK AT CURRENT DATA

St. Cloud-area employment grew 2.1 percent in the 12 months up to April. Growth was broad-based, with substantial increases in information services, retail trade, transportation and warehousing, and professional and business services.

Table 3 (on previous page) shows that St. Cloud has done this despite the slowing of the Twin Cities economy, particularly in the goods-producing sectors.

The slowdown in construction employment in St. Cloud has come to a stop, but it continues in the rest of the state and in Minneapolis-St. Paul.

Service employment growth appears to be growing proportionately statewide.

The local labor force grew 1.8 percent in the past year. This is substantially faster than employment has grown, leading to a slight increase in the unemployment rate to 5 percent in April. There appears to be a slowing of hiring by employers and an increase in new claims for unemployment insurance.

Residential building permit valuations declined almost 20 percent in the past year through April. The number of permits issued now is less than 60 percent of the peak volume of 2004.

Some of these data may also be explained by the local economy growing more rapidly in this period than in Minneapolis-St. Paul. The most recent Federal Reserve Beige Book stated that housing permits in

**TABLE 4-OTHER ECONOMIC INDICATORS**

	2007	2006	Percent Change
St. Cloud MSA labor force April (Minnesota Workforce Center)	107,172	105,302	1.8%
St. Cloud MSA civilian employment # April (Minnesota Workforce Center)	101,814	100,928	0.9%
St. Cloud MSA unemployment rate* April (Minnesota Workforce Center)	5.0%	4.2%	NA
Minnesota unemployment rate* April (Minnesota Workforce Center)	4.6%	4.0%	NA
Minneapolis-St. Paul unemployment rate* April (Minnesota Workforce Center)	4.2%	3.6%	NA
St. Cloud-area new unemployment insurance claims February-April average (Minnesota Workforce Center)	937.7	838.7	11.8%
St. Cloud Times help-wanted ad linage February-April average, in inches	5,589	6,195	-9.8%
St. Cloud MSA residential building permit valuation In thousands, February-April average (U.S. Dept. of Commerce)	6,689.3	8,322.7	-19.6%
St. Cloud index of leading economic indicators April (St. Cloud State University)**	101.4	103.0	-1.6%

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

the Twin Cities were down 54 percent versus a year ago. St. Cloud commercial construction levels were up significantly in the first two months of 2007 compared with the same period in 2006. Growth in Minnesota in the first quarter 2006 was below the regional average.

Table 5 shows three of the four indicators of the St. Cloud LEI were down in the past three months. The only indicator that was up was the level of help-wanted advertising from several months ago, and as seen in Table 4, that number will decline for the next reading of LEI.

**TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI**

Changes from February to April 2007	Contribution to LEI
Help-wanted advertising in St. Cloud Times	1.55%
Hours worked	-0.04%
New business incorporations	-0.34%
New claims for unemployment insurance	-3.26%
<b>Total</b>	<b>-2.09%</b>

\*Numbers may not add up due to rounding.

The national economy has shown weakness as well this year. The latest outlook of the National Association of Business Economists revised its 2007 forecast for GDP growth downward to 2.3 percent from 2.8 percent, largely from deceleration of business investments.

Inflation should remain relatively unchanged despite below-average levels of productivity growth. This should mute any significant changes in monetary policy or interest rates generally.

More than half of the association's survey respondents thought the probability of a national recession within the next year was greater than 25 percent, but only three of 48 respondents thought the likelihood was greater than 50 percent.

In contrast, the Economic Cycle Research Institute's weekly index set record highs in May, fueled by increases in new orders for durable goods in five of the past six months. Consumption expenditures appear to be holding up.

At the base of the debate is the decline in the housing market. The National Association of Realtors reported there were 8.4 months of inventory of existing housing available on the market, up 37.7 percent over last year. The local real estate market appears to be affordable, with median home prices in the St. Cloud area of \$146,876 in April.

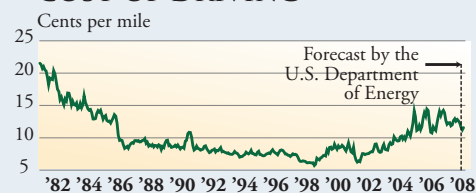
A majority of respondents to the NABE survey expect existing housing prices to decline nationally by less than 3 percent. Less than one in five expects prices to rise.

Rising gasoline prices also have hurt the local economy. While the increase is normal for this time of year, the degree of the rise has been a concern.

National reports have appeared on higher gasoline prices leading to less spending on recreation, restaurants and retail. We doubt this has led directly to the closing of two local restaurants (as of the time the report was written), but it is a concern when Wal-Mart announces higher gasoline prices led to its worst sales decline in April.

As shown in the graph below, the cost of driving is lower than the aftermath of the OPEC crisis of the late 1970s, but at 14 cents per mile for the average family driving the average car, it is four cents more than that family paid two years ago.

**COST OF DRIVING**



The combination of these factors — declines in LEI, survey results, national trends in housing and gasoline and the notable slowing of the regional and national economies — lead us to believe the risks of recession in the St. Cloud area have increased.

We suspect the probability of local recession is in line with the NABE survey of 25-50 percent. While we still would say it is less than a 50-50 proposition, business owners and managers would be wise to prepare for the possibility.

**LOOK FOR A NEW MODEL**

We are testing a newer model that would provide an additional measure of the probability of recession, based on the LEI series. Several models are being explored and all show a substantial increase in the probability of recession in the second half of 2007. We hope to have these results ready to report in the next QBR.

**IN THE NEXT QBR** Participating businesses can look for the next survey in August and the accompanying St. Cloud Area Quarterly Business Report in the October-December edition of ROI Central Minnesota. Area businesses that wish to participate in the survey can call the St. Cloud State University Center for Economic Education at (320) 308-2157.