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King Banaian
St. Cloud State University, kbanaian@stcloudstate.edu

Richard A. MacDonald
St. Cloud State University, macdonald@stcloudstate.edu

ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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AREA ECONOMIC SLOWDOWN CONTINUES

Weakening labor market, national business conditions raise flags

EXECUTIVE SUMMARY

Concerns about national business conditions, along with ongoing weakness in key sectors of the area economy, continue to cloud the economic outlook in the St. Cloud area. Employment growth remains slow, and firms appear hesitant to make a measurable commitment to adding to payrolls in the first half of 2008. Year-over-year growth in area employment increased by a modest 0.6 percent in the month ending October 2007, well below the employment growth trend and much lower than three months ago. Indicators suggest local economic sluggishness will endure for several months. Indeed, readings from the most recent survey of area business leaders continue to be very weak, and several pieces of local data point to a flat path of economic activity into 2008.

The St. Cloud Index of Leading Economic Indicators has remained flat in the past year, falling by 1.5 percent in the past three months. The probability-of-recession indicator rose to more than 50 percent in August before retreating to 39 percent in October.

Survey responses suggest the area had one of the weakest fall quarters on record. Thirty-seven percent of firms report an increase in economic activity in the past three months, while 29 percent report a decrease. Only 13 percent of firms added employees, while 21 percent decreased payroll employment. Reported current national business conditions are not encouraging, with only 12 percent of the 84 firms that returned the survey reporting an increase in national activity and 24 percent reporting a decrease. Prices received were also weak in the fall quarter.

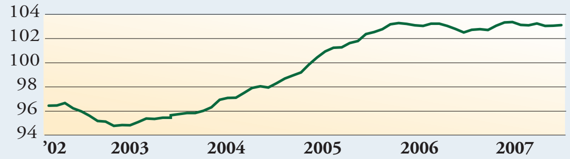
Of continuing concern is anticipated weakness six months from now. Results of expected future business conditions remain weak for this time of year. The fall survey of the future outlook is usually much stronger. Indexes on future national business conditions and expected future employment are the lowest recorded in the fall survey, and the index for firms' evaluation of future business activity hit its lowest fall value since the fall 2002 survey — when the area was in a recession.

In one special question, 68 percent of firms are opposed to parking fees being charged at St. Cloud Regional Airport. If parking fees are to be charged, two-thirds of firms think an average daily parking rate of $3 or $5 would be appropriate. In a second special question, 28 percent of firms report that the declining value of the dollar is having an unfavorable effect on their company; 10 percent see it as a favorable impact.

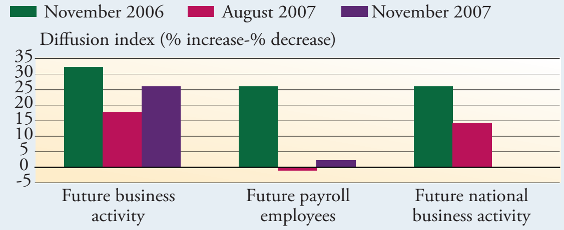
Finally, 86 percent of firms express at least some concern that higher fuel prices will cause a reduction in nonfuel-related household consumption expenditures. Indeed, 31 percent say this is a large concern.

INDEX OF LEADING ECONOMIC INDICATORS

Six-month moving average



KEY RESULTS OF SURVEY



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President: Tom Moore
320-656-3815

ABOUT THE AUTHORS

KING BANAIAN
Chairman
Economics Department,
St. Cloud State University
320-308-4797

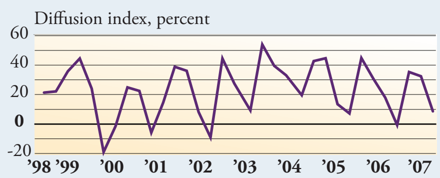
RICH MACDONALD
Assistant professor,
St. Cloud State University
Economics Department
320-308-4781

CURRENT ACTIVITY

Tables 1 and 2 report the most recent results of the business outlook survey. Responses are from 84 area businesses that returned the mailing in time to be included in the report. Participating firms are representative of the diverse collection of businesses in the St. Cloud area. They include retail, manufacturing, construction, financial, health services and government enterprises of sizes ranging from small to large. Survey responses are strictly confidential.

Current economic activity in the St. Cloud area continued to slow in the past three months. The current business activity diffusion index (representing the percentage of respondents indicating an increase minus the percentage indicating a decrease) is eight in this quarter's survey, the lowest reading recorded in the fall survey.

CURRENT BUSINESS ACTIVITY



The employment diffusion index was negative, with 13 percent of firms reporting increased hiring and 21 percent reducing payrolls. Area firms also report a shorter workweek for their employees. The -13.1 diffusion index for the length of workweek item in Table 1 is the second-lowest value recorded in the current business conditions survey. Combine these numbers with the lowest-ever fall survey index on employee compensation, and one can see the weakness in the area job market that is a concern of many area officials.

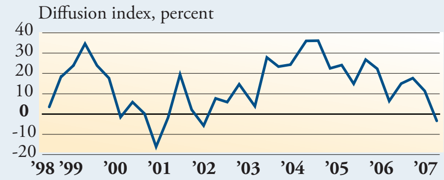
> **About the diffusion index**
> The diffusion index represents the percentage of survey respondents who indicated an increase minus the percentage indicating a decrease.

Capital expenditures remain sluggishly weak, and the prices-received item in Table 1 would seem to indicate either less pricing power for area firms and/or a lessening of inflationary pressures.

Indeed, the -3.6 diffusion index on current prices received is the lowest observed in the fall survey since 2001 (when recessionary and deflationary pressures were a concern). One can see in the accompanying chart that the pattern of movement of the current prices-received index seems to have taken on the form of that which was observed during the recession six years ago.

Finally, area firms still experience some difficulty attracting qualified workers. The index on Item 8 in Table 1 is an indication that the weakness in the area labor market is somewhat different from what was found in the recessionary years of 2001-03. In those years, area firms consistently reported less difficulty attracting qualified workers, which is not currently the case.

CURRENT PRICES RECEIVED



OUTLOOK

Not since 2002 have the fall readings from the future business outlook portion of the survey looked so bleak. While the index on expected future business activity (see the first item in Table 2) is higher than three months ago, this is a normal seasonal pattern. Indeed, the 26.1 value of this index is the lowest fall recording since the last recession hit the St. Cloud area. Only 44 percent of firms expect increased business activity six months from now. In contrast, two years ago — in the fall 2005 survey

TABLE 1-CURRENT BUSINESS CONDITIONS

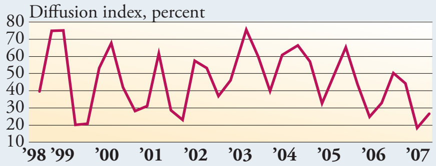
	November 2007 vs. Three months ago				August 2007
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	28.6	34.5	36.9	8.3	32.2
Number of employees on your company's payroll	21.4	65.5	13.1	-8.3	10.0
Length of the workweek for your employees	23.8	64.3	10.7	-13.1	10.0
Capital expenditures (equipment, machinery, structures, etc.) by your company	11.9	60.7	27.4	15.5	18.9
Employee compensation (wages and benefits) by your company	2.4	69.0	27.4	25.0	26.7
Prices received for your company's products	17.9	64.3	14.3	-3.6	11.1
National business activity	23.8	51.2	11.9	-11.9	8.9
Your company's difficulty attracting qualified workers	6.0	71.4	20.2	14.2	13.4

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

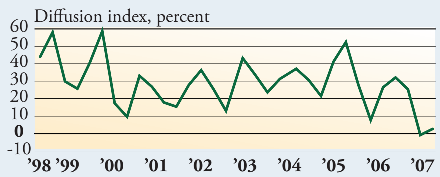
— 60 percent of firms were expecting increased business activity, and the diffusion index stood at 48.3, almost double its current value.

FUTURE BUSINESS ACTIVITY



Signs of anticipated weakness are found throughout Table 2, where the 2.3 value of the diffusion index on survey Item 2 is the second-lowest recorded and the weakest fall future employment outlook (see accompanying chart). The capital expenditures diffusion index is also the lowest recorded in the fall survey. Only 24 percent of firms expect to increase capital purchases in the next six months, and 5 percent expect these expenditures to decline.

FUTURE PAYROLL EMPLOYMENT



WHAT IS AFFECTING YOUR COMPANY?

Firms were asked to report factors affecting their business. Comments include:

- "Natural gas prices will increase moderately this winter, but (liquid propane) gas and fuel oil will be at record levels. This will affect budgets of rural residents and older homes with fuel oil heat."
- "We are seasonal, with construction peaking in December and hitting our low point in April/May."
- "Farmers continue to buy farmland because of increased corn and soybean prices caused in part by biodiesel and ethanol fuel usage. Food prices are being driven upward. The U.S. government has failed to provide an energy policy for the country."
- "In various degrees though less in Central Minnesota, the subprime mortgage implosion is felt everywhere."
- "The credit market will be and has been a factor in a slowdown in our business, even though we focus on commercial work. It has had a major spillover effect on our work."
- "Mortgage lenders are becoming more conservative; more equity required on new construction projects."
- "If we go into a recession, organizations will cut back on (using our services). We experienced this cutback right after 9/11."
- "The unstable economy has currently slowed our growth a bit."

Pricing pressures are expected to remain in the general range that has been observed in the past several quarters. The diffusion index on expected future prices is 27.4, with 39 percent of firms anticipating higher future prices and 12 percent expecting lower prices. Since the spring 2006 survey, the index on expected future prices has fluctuated in a fairly narrow band — between 18.8 and 34.5 — suggesting somewhat moderate pricing pressures going forward. These numbers remain around their historical average, but are well below the peak of 44 found in the fall 2005 survey.

In many ways, the most informative observation in this quarter's survey is the 0 diffusion index on expected future national business activity. As many local firms expect a decrease in future national business activity as expect an increase, and a majority of firms (54 percent) expect no change. This item seems to capture the uncertainty economic forecasters are experiencing nationwide. There is a diversity of opinions as to

FUTURE NATIONAL BUSINESS ACTIVITY

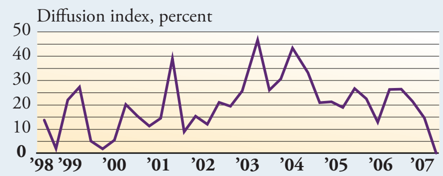


TABLE 2-FUTURE BUSINESS CONDITIONS

	Six months from now vs. November 2007				
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	August 2007 Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	17.9	36.9	44.0	26.1	17.8
Number of employees on your company's payroll	17.9	60.7	20.2	2.3	-1.1
Length of the workweek for your employees	11.9	69.0	16.7	4.8	-10.0
Capital expenditures (equipment, machinery, structures, etc.) by your company	4.8	69.0	23.8	19.0	10.0
Employee compensation (wages and benefits) by your company	0	48.8	48.8	48.8	40.0
Prices received for your company's products	11.9	42.9	39.3	27.4	18.8
National business activity	16.7	53.6	16.7	0	14.4
Your company's difficulty attracting qualified workers	3.6	75.0	16.7	13.1	11.1

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 the outlook and, while almost everyone agrees the economy will slow from its third-quarter pace, there is disagreement whether this will prove recessionary. Once again, area firms' responses to the St. Cloud Area Business Outlook Survey seem to be a snapshot of what is found elsewhere in the country.

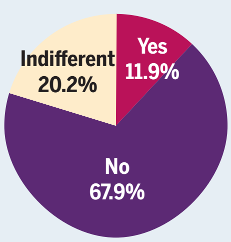
SPECIAL QUESTIONS

One of the unique features of St. Cloud Regional Airport is that it has had free parking since Northwest Airlines entered the market more than a decade ago. Now airport and city officials are considering charging those using airport parking lots. We thought it would be interesting to see what area business leaders think about the prospect of parking fees at the airport.

To be sure, one has to be careful in interpreting questions that ask whether a fee should be charged for a service that was previously free (especially given that parking seems to be in plentiful supply, even at a zero price). In such circumstances, survey respondents will naturally prefer lower (or no) prices. Of course, the resources used to provide the parking do have an alternative use and, therefore, this service does have a cost associated with it. Who bears the cost of this service would seem to be an important issue. With this in mind, we asked the following question:

QUESTION 1

Should parking fees be charged at St. Cloud Regional Airport?



As seen in the accompanying pie chart, more than two-thirds of respondents oppose a charge for airport parking, and only slightly more than one in 10 would favor this. A large percentage (20.2 percent) are indifferent.

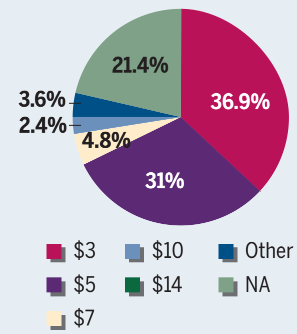
Written comments include:

- "It is the only reason I use this airport."
- "Aren't we already taxed in some way to pay for the airport?"
- "Unless air service becomes more reliable, this won't be a problem. Anyway, get over it … this isn't Hooterville any more."
- "We rarely use the airport."
- "A parking fee would eliminate one of the reasons to use St. Cloud."
- "This is a competitive advantage — people in St. Cloud strongly dislike paying for parking."
- "No — but yes if they are not cash-flowing."
- "This is one advantage of using the airport. Don't charge at least until another airline comes in or fix the one that is there."
- "Need more incentive to use the airport."
- "A reasonable fee would be appropriate."
- "Free parking is a great attraction."
- "I think that is something that attracts people to the airport."
- "I need to know if the airport can afford to waive the fees. Can they cash flow without the fees? If the answer is no, then they need to charge an appropriate fee."
- "This is a distinct advantage of using St. Cloud. If we pay for parking, there will be losses. St. Cloud residents can be dropped off and picked up easily."
- "Property is cheap by comparison to other cities. If the cost is similar to flying out of the cities, I would drive to save commuter times."
- "People starting to use airport and parking is a factor."
- "Less dollars to pay to fly out vs. drive to Minneapolis and park."
- "The lack of a parking fee is the major factor for me flying out of this airport."
- "Parking fees should not be charged until number of flights and reliability of flight schedules are increased."
- "It's what makes me use the airport vs. Cities — offsets the timing of flights issue."
- "Additional expense for business."
- "It is one of St. Cloud's benefits. Find another way! It separates STC from MSP."
- "Free parking is a supplement to the airport users."
- "It would be a shame but probably is inevitable."
- "An increase will have a negative impact on airport usage."
- "There is a way to have both — premium for close or metered and free for distance."
- "One of the pluses that overrides somewhat sporadic service."

QUESTION 2

Given that charging for airport parking in St. Cloud may be inevitable, we asked area business leaders what they thought an appropriate average daily rate would be. In identifying the options of $3, $5, $7, $10 and $14, we were simply trying to produce a range of potentially acceptable options. Of course, there may be other ways to charge for parking that allow for, say, frequent or long-term parkers, to pay a different rate. It should be noted that the lowest discounted daily maximum charge for covered parking in the Lindbergh terminal at the Minneapolis-St. Paul International Airport is $16. Other off-airport options are less costly — for example, one charges $11 per day to self-park.

Assuming parking fees are charged at St. Cloud Regional Airport, what would be an appropriate average daily rate?



*Numbers may not add up due to rounding.

More than two-thirds of respondents thought the daily average rate should be either $3 or $5, and no respondent thought it should be more than $10.

Written comments include:

- "As low as possible — $2 would be better."
- "Other — $8."
- "Can't answer without financial information."

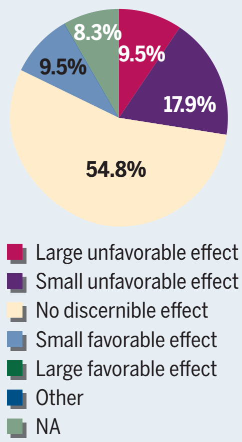
QUESTION 3

The international exchange value of the U.S. dollar against several key currencies has plummeted in recent months. For example, the U.S.-Canadian dollar exchange rate was at parity (one for one exchange) when this report was written, and the dollar was worth only 0.68 euros and 0.49 British pounds. Concerns about the declining value of the U.S. dollar are found in a number of areas — exporters' products are more competitive, importers might find it more expensive to buy foreign-produced goods and services, the Federal Reserve is likely

CONCERNS ABOUT THE DECLINING VALUE OF THE U.S. DOLLAR ARE FOUND in a number of areas — exporters' products are more competitive, importers might find it more expensive to buy foreign-produced goods and services, the Federal Reserve is likely worried the continuing dollar depreciation might restrict its ability to lower interest rate targets, oil products (in dollars) are more costly, etc.

worried the continuing dollar depreciation might restrict its ability to lower interest rate targets, oil products (priced in dollars) are more costly, etc. With the understanding that many area firms do not perceive that they are directly or indirectly impacted by a currency variation, we decided to ask the following question:

To what extent does the ongoing decline in the international exchange value of the U.S. dollar affect your business?



Most surveyed firms respond that this is having "no discernible effect" on their company, but more than one-fourth of respondents indicate it is having either a small or large unfavorable effect. Ten percent of firms say it is having a small favorable effect, and no companies believe any favorable effect is large.

Written comments include:

• "Our business does not cross national borders."

• "Our Canadian customers like the impact."

• "Our business is not directly affected, but our clients are. Higher prices for imported goods and an increased market for exporters."

• "Impacts cost of our (programs) and initiatives."

• "Some of our product comes from Canada."

• "Do not do international business."

• "Some of our products are imported, but we don't sell anything internationally."

• "We are selling some product to Canada."

• "We are a regional-based business."

• "We sell within the state of Minnesota."

• "Some clients export a significant amount of product."

• "Makes prices more competitive for U.S. products."

• "Cost of (our materials) has risen dramatically."

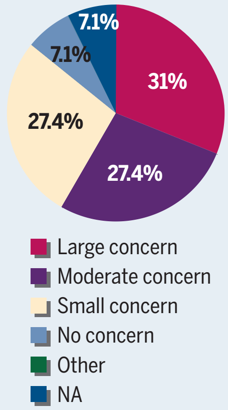
• "Price increase for products."

• "More Canadians crossing over the border to purchase American goods."

QUESTION 4

There have been many recent comments in the media suggesting that increased fuel prices might cause a reduction in nonfuel household spending. As oil prices approach $100 per barrel and consumers have a limited willingness and ability to tap savings and credit instruments to buy gas and other fuel products, a natural question people are asking is "what are we going to give up"? Of course, one long-run response is to cut back on fuel-related purchases, but that seems unlikely in the near term. Instead, it is quite likely that consumers will cut back on other discretionary spending. With this in mind, we asked the following question:

To what extent is your business concerned that increases in fuel prices will cause a reduction in nonfuel-related household consumption expenditures?



More than 30 percent of firms expressed a large concern and 27 percent were moderately concerned that consumers will cut back spending. Twenty-seven percent said this is a small concern and only 14 percent were either not concerned or didn't answer.

As is well known, households account for 70 percent of overall spending in the U.S. and anything that causes a cut in consumption spending will be worth a closer look. Increased fuel costs (from the consumers' perspective) are likely to have little overall aggregate effects — because the same number of dollars will still be flowing out of households (albeit to different recipients), but it can have a localized impact. Of course, the adverse macroeconomic effects of higher oil prices are largely felt on the supply side of the economy where higher costs of production cause a variety of overall economic dislocations.

Written comments include:

• "More money for fuel — less for (our services)."

• "Less (discretionary) income to buy our products."

• "My employees need to be able to pay for gas to get to work. This is a tough time."

• "Adjust prices."

• "We are more concerned with nonfuel-related business consumption expenditures."

• "This is or should be a major concern for everyone. All businesses and consumers will be affected by an increase in fuel."

• "It really eats up the spendable income for many. Only alternative is to cut many things out."

• "Less expendable income not good for housing sales."

• "We rely on capital expenditure. If the economy weakens, the business capital will be reduced and we will not get as many orders."

• "Need more high fuel economy vehicles ..."

• "The cost of fuel will impact all areas of the economy."

TABLE 3- EMPLOYMENT TRENDS

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend growth rate	Oct. '06-Oct '07 growth rate	Oct. '07 employment share	15-year trend growth rate	Oct. '06-Oct.'07 growth rate	Oct. '07 employment share	15-year trend growth rate	Oct. '06-Oct. '07 growth rate	Oct. '07 employment share
Total nonagricultural	1.9%	0.6%	100%	1.5%	0.4%	100%	1.5%	0.1%	100%
Total private	2.1%	0.9%	85.3%	1.6%	0.5%	86.3%	1.6%	-0.1%	84.9%
Goods producing	2.0%	0%	22.4%	0.4%	-3.1%	15.7%	0.5%	-3.7%	17.1%
Construction/natural resources	2.9%	-0.6%	5.3%	3.1%	-3.2%	4.7%	2.6%	-4.7%	4.9%
Manufacturing	1.8%	0.2%	17.1%	-0.5%	-3.0%	11.0%	-0.2%	-3.3%	12.2%
Service providing	1.9%	0.8%	77.6%	1.8%	1.1%	84.3%	1.7%	0.9%	82.9%
Trade/transportation/utilities	0.5%	1.0%	21.0%	1.1%	0.4%	19.0%	1.0%	-0.3%	19.1%
Wholesale trade	1.9%	1.3%	4.2%	1.6%	0.6%	4.9%	1.5%	1.7%	4.8%
Retail trade	-0.1%	0.3%	13.6%	1.0%	-1.4%	10.2%	1.0%	-0.8%	10.9%
Trans./warehouse/utilities	1.6%	3.8%	3.2%	0.6%	5.4%	3.9%	0.4%	-1.8%	3.4%
Information	1.2%	-0.1%	1.3%	0.2%	-3.2%	2.1%	0.2%	-2.3%	2.0%
Financial activities	4.2%	1.9%	4.5%	1.8%	0.8%	8.0%	1.9%	0.2%	6.5%
Professional & business service	5.6%	0.4%	8.3%	2.1%	1.2%	14.7%	2.3%	0%	11.8%
Education & health	2.8%	0.9%	14.6%	3.2%	4.0%	13.7%	3.2%	3.9%	15.3%
Leisure & hospitality	2.6%	2.1%	8.7%	2.1%	1.2%	9.0%	1.9%	2.0%	8.9%
Other services (excluding govt.)	1.7%	2.9%	4.6%	1.8%	0.1%	4.2%	1.3%	-0.9%	4.2%
Government	1.1%	-0.8%	14.7%	1.3%	0.4%	13.7%	0.8%	0.8%	15.1%
Federal government	0.3%	1.3%	1.6%	-0.1%	-1.0%	1.2%	-0.3%	-1.0%	1.2%
State government	0.5%	-5.9%	4.1%	1.7%	0.3%	4.0%	0.8%	0.8%	3.5%
Local government	1.5%	1.3%	9.0%	1.4%	0.6%	8.5%	1.0%	1.0%	10.4%

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.

• "Probably won't trade up in housing — can't afford to."

• "The reduction in household consumption will not affect us. It will cause an economic slowdown that will affect all of us."

• "We are especially concerned about the ability for people to build/buy a new home."

• "Though people don't think of it this way, it's reality — an increase in the cost of any good or service used by a very large percentage of the public is the same as a tax increase. Health care and fuel costs are good examples."

• "For us there will be an offset because this (can help improve our business)."

TABLE 4-OTHER ECONOMIC INDICATORS

	2007	2006	Percent change
St. Cloud MSA labor force October (Minnesota Workforce Center)	106,997	106,263	0.7%
St. Cloud MSA civilian employment # October (Minnesota Workforce Center)	102,931	102,977	0
St. Cloud MSA unemployment rate* October (Minnesota Workforce Center)	3.8%	3.1%	NA
Minnesota unemployment rate* October (Minnesota Workforce Center)	4.1%	3.4%	NA
Minneapolis-St. Paul unemployment rate* October (Minnesota Workforce Center)	4.0%	3.3%	NA
St. Cloud-area new unemployment insurance claims August-October average (Minnesota Workforce Center)	687.0	683.3	0.5%
St. Cloud Times help-wanted ad linage August-October average, in inches	5,753	5,647	1.9%
St. Cloud MSA residential building permit valuation In thousands, August-October average (U.S. Dept. of Commerce)	7,936.7	11,843	-33.0%
St. Cloud index of leading economic indicators October (St. Cloud State University)**	101.7	101.3	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
**- October 2001=100
NA - Not applicable

PAUSE? SLOWDOWN? DECLINE?

The local economy continues to move sideways through 2007. As seen in Table 3, the rate of growth of employment in the state economy has been practically nil, and while the local employment growth rate has been better, it is still less than half its long-term trend.

The growth that did happen occurred in leisure and hospitality and other service sectors. For all the discussion of troubles in the housing sector, construction employment was not a large drag directly on area employment.

For much of the past two years we have explained that the growth rate of employment in the area will naturally be lower than the averages we have in Table 3 that go back to 1992. It may be that rather than a recession, what we will experience is simply a pause, a period in which employment does not grow and output growth is very slow. Or it may be that the slowing down is a precursor to a period of employment decline.

Jobs held by St. Cloud residents, as shown in Table 4, fell by 46 in the 12 months up to October 2007. The unemployment rate, normally at its lowest point in the fall of a typical year, stood at 3.8 percent. Unemployment

A NEW LOOK AT ST. CLOUD'S GROSS DOMESTIC PRODUCT

GROSS DOMESTIC PRODUCT, ST. CLOUD MSA, SELECTED YEARS (MILLIONS 2001 DOLLARS)

INDUSTRY	2001 IN MILLIONS	2004 IN MILLIONS	2005 IN MILLIONS	4-YEAR AVERAGE ANNUAL GROWTH	SHARE OF TOTAL	EMPLOYMENT SHARE, 2005
Total Gross Domestic Product	5105	6115	6161	4.8%	100%	100%
Private industries	4473	5484	5509	5.3%	89.4%	85.3%
Construction	338	347	329	-0.7%	5.3%	5.1%
Manufacturing	1087	1336	1332	5.2%	21.6%	17.6%
Durable goods	620	733	712	3.5%	11.6%	----
Nondurable goods	466	604	620	7.4%	10.1%	----
Wholesale trade	345	375	340	-0.4%	5.5%	4.4%
Retail trade	558	546	543	-0.7%	8.8%	13.6%
Transportation and warehousing	NA	169	170	NA	2.8%	2.9%
Information	142	273	302	20.8%	4.9%	1.4%
Finance and insurance	288	308	328	3.3%	5.3%	4.4%
Real estate and rental and leasing	285	637	667	23.7%	10.8%	NA
Administrative and waste services	112	137	135	4.8%	2.2%	NA
Educational services	NA	NA	86	NA	1.4%	14.5%
Health care and social assistance	NA	NA	592	NA	9.6%	
Arts, entertainment, and recreation	22	26	27	5.3%	0.4%	9.1%
Accommodation and food services	125	132	135	1.9%	2.2%	
Other services, except government	157	157	154	-0.5%	2.5%	4.6%
Government	632	637	656	0.9%	10.6%	14.7%

Sources: U.S. Bureau of Economic Analysis, Minnesota Department of Employment and Economic Development for employment data, and our calculations

ONE DRAWBACK OF LOCAL AREA ECONOMIC STATISTICS is that the only variable available in a frequent, timely fashion is employment. For the national economy, we can use a variety of series on production, income and sales to tell us the current state of economic activity. Data on local area sales are difficult to come by — sales tax receipts can help, but with the exclusion of food and clothes, they are an imperfect indicator — and local area income comes only with a lag of almost two years.

Regional economists got another tool in September with the release of local area gross domestic product (GDP). We now have annual data over a period from 2001-05. While it still will not help us much with local economic forecasting, the GDP data do allow us to say something about our area economy's structure.

Production in the St. Cloud MSA economy was $6.8 billion in 2005, of which about $6 billion was produced in the private sector. Thirty percent of production was in goods, and 59 percent in private services. The table shows the data adjusted for inflation. Real GDP in the local economy grew an average of 4.8 percent per year from 2001-05. This is in the top quintile of growth rates for the 361 metropolitan areas of the U.S.

Manufacturing accounts for more than 21 percent of what St. Cloud produces, with slightly more in durable than nondurable goods. Key sectors include nonmetallic mineral products, fabricated metal products, and furniture and related products. That fact is important insofar as durable goods production tends to be highly cyclical. The St. Cloud economy is dependent on sales of durable goods in the U.S., making the local economy move with the national economy.

In the last column we have included data on the share of the labor force employed in each area in 2005. We can then compare the share of production and the share of employment to see which sectors are most productive. For example, while the retail sector employs 13.6 percent of workers in the St. Cloud area, the retail sector accounts for only 8.8 percent of area production. The retail sector declined in 2005; GDP measures value added by St. Cloud workers, business owners and investors, and much of what is sold in retail is produced elsewhere.

In some cases we could not divide employment into the same categories, so we left employment spread over two or more categories as shown. We can also use these data to determine the contribution of various sectors of the economy to economic growth.

For example, the information sector experienced rapid growth in the first half of the decade, but because it is still a very small sector, its contribution to GDP growth is not very large. The financial sector, however, was the largest contributor to GDP growth in 2005.

The larger share of jobs in retail and other service sectors accounts for a lower-per-worker GDP in the economy. St. Cloud produced $48,732 per worker in 2005, compared with $57,538 in Rochester, $47,142 in Duluth, $54,709 in Fargo-Moorhead and $70,711 in Minneapolis-St. Paul.

rates in the Twin Cities and state were higher. New claims for unemployment insurance in the St. Cloud area were virtually unchanged from a year ago.

The value of building permits for new residential construction in the St. Cloud area continues to decline. The U.S. Department of Commerce reported in late November that housing construction had risen, but the entire rise was due to construction of apartment buildings. Single-family housing construction nationally has fallen since early spring. Nationwide, the inventory of single-family homes for sale in October was the equivalent of 10.5 months of average sales, the largest since 1985. The recent layoffs at an area bank with a national lending department indicate we are not immune to housing market problems, even though the impact on prices in the local area is mild by national standards.

Help-wanted advertising locally rose over the year, perhaps due to difficulties local businesses have in attracting qualified workers. This increase is relatively mild, though, and in fact has fallen in more recent times on a seasonally adjusted basis. St. Cloud Area Leading Economic Indicators (LEI) has moved only 0.4 percent in the past year, representing again the concept of a pause in local growth.

The seasonally adjusted decline in help-wanted advertising and an increase in new claims for unemployment insurance led to a decrease in LEI in the past quarter, as seen in Table 5. Hours worked and incorporations remained virtually flat. We expect this year's LEI performance to be the flattest since the recession of 2002. But this does not mean we have entered a recession at this time.

Our new probability-of-recession indicator flashed readings above 50 percent in July and August before receding to 39 percent in October. The readings are consistent with findings in our last quarterly report that a recession is a very real possibility in the next four to six months.

Likewise, the Minnesota portion of the Midwest Business Conditions Index published by Creighton University indicates that unemployment is expected to rise for the balance of 2007, and that "job losses and slow to no growth in durable goods manufacturers" is to be expected.

A survey by the Minneapolis Fed in November indicated service sector output

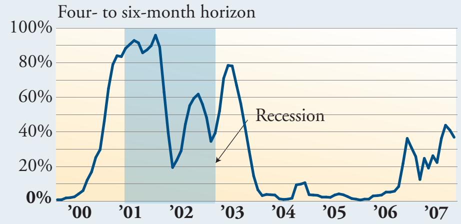
TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

Changes from August to October 2007	Contribution to LEI
Help-wanted advertising in St. Cloud Times	-0.63%
Hours worked	-0.01%
New business incorporations	0.06%
New claims for unemployment insurance	-1.24%
Total	-1.82%

should expand, and output is expected to increase in manufacturing. The November report of the Institute of Supply Managers showed manufacturing output continued to expand, though the rate of expansion has slowed through the fall.

PROBABILITY OF A LOCAL RECESSION

Four- to six-month horizon



The Federal Reserve changed its target for the federal funds rate at its December meeting to 4.25%, and has signaled that more changes may be forthcoming. The interest-rate reductions should help business investment and housing, but with a lag that likely leaves the economy soft through spring. Lower interest rates should continue the slide in the dollar as well. GDP in the U.S. improved in the third quarter by expanding exports, and area businesses that sell into international markets may do well in this environment. Those competing with imported goods are unlikely to see much relief, as most importers will prefer holding market share to raising their prices.

Most national economic forecasts look for a relatively slow recovery from the upcoming softness or recession. The consensus of the November survey of panelists of the National Association of Business Economists forecast growth only reaching 3 percent by the fourth quarter of 2008. About a third of panelists in The Wall Street Journal survey of economic forecasters foresee a recession in 2008; its consensus for the second half of 2008 is for GDP growth of 2.75 percent. All forecasts were slowly but consistently revised downward throughout fall. None expects negative growth in real GDP in any quarter in The Wall Street Journal survey. November job growth came in at 94,000 jobs, in line with expectations, after a gain of 170,000 jobs in October. These data are consistent with an economy that may slow, but is not in recession.

Most forecasts include a prediction that oil prices will fall back to $70-80 a barrel, which would reduce some pressures on area businesses. A decrease in oil prices will moderate inflation only slightly though, and persistent inflation above 2 percent will likely lead the Federal Reserve to keep federal funds rate reductions to a minimum. Increased pricing power may also indicate higher inflation expectations.

Some unusual measures have been taken to address the credit crunch, and it would be fitting with the Fed's goals for these measures to bear some of the role that interest rate cuts might otherwise provide. The Fed is now publishing in its Federal Open Market Committee minutes the projections used in setting monetary policy. The Fed expects inflation in personal consumption expenditures (its preferred measure of inflation) to fall from near 3 percent to 1.8-2.1 percent in 2008, while core inflation (excluding food, energy) would maintain at 1.7-1.9 percent. The FOMC's range of forecasts for inflation were quite narrow, but its expectations for real GDP growth were much less so.

Thus an uncertain environment faces local businesses in the first half of 2008, both locally and nationally. Higher energy and lower housing prices will be risks for negative economic growth. Long-run interest rate expectations are quite diffused among economic forecasters, further muddying the outlook. Area business leaders' responses to future national business conditions — with a balance between those expecting improvement and deterioration — is as good a statement of professional forecasters' outlook as any, and appears to be making leaders cautious. Perhaps it will be a slowdown, perhaps a pause, but it will be awhile before the future brightens.

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