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ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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AREA LABOR MARKET IMPROVES

FIRMS REMAIN OPTIMISTIC DESPITE GROWING COST PRESSURES

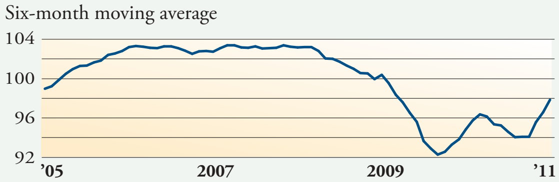
Executive Summary

Revised employment data show surprisingly strong improvement in the St. Cloud-area labor market during the past 12 months. With a 2.1 percent increase in area private-sector employment during the year ending January 2011, St. Cloud is one of the best performing metro areas in Minnesota.

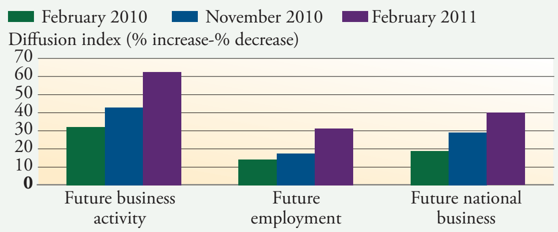
Only three sectors of the area economy experienced declining employment in the past year. These sectors (financial activities, leisure and hospitality, and other private services) represent only 16 percent of the area labor market. By comparison, two years ago (in January 2009), area private employment declined by 4.4 percent and only the education and health sector (representing 17.2 percent of employment) was experiencing job gains. To be sure, area labor market conditions have a long way to go before returning to their prerecession levels. For example, total area private employment was 80,043 in January 2011 — more than 5,500 employees fewer than the January 2007 employment of 85,612.

The St. Cloud Index of Leading Economic Indicators is growing strongly, indicating the recession is over and recovery has begun. Three of four indicators were positive. Likewise, the Probability of Recession Index has fallen to below 10 percent, meaning the economy has signaled recovery in spring. We mark April 2010 as the end of the Great Recession locally.

INDEX OF LEADING ECONOMIC INDICATORS



KEY RESULTS OF SURVEY



With 62.5 percent of 80 surveyed firms expecting improved activity in the next six months, the local outlook is the highest recorded in the winter survey since 2006. Lifting the local outlook is planned increases in hiring (the best numbers recorded in four years) and an improving national economy.

The past three months have been a relatively strong period for area firms. While survey results are always weakest during the winter season, current activity is much stronger than has been reported in the past several years. In almost every category of the local survey, reported current conditions are the strongest they have been in the winter survey since 2005.

Area firms are experiencing increased cost pressures that may be compromising profit margins across a range of businesses. While three-quarters of area firms expect increased demand for their products in 2011, only 40 percent see this as translating into improved profit margins.

Cost pressures appear to be greatest for energy, other raw materials, intermediate goods and health benefits. More than half of surveyed firms expect health benefit costs to increase by more than 5 percent this year (with 10 percent expecting cost increases greater than 15 percent). More than 11 percent of firms expect non-energy raw materials costs to increase by more than 15 percent.

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THE ST. CLOUD AREA BUSINESS OUTLOOK SURVEY

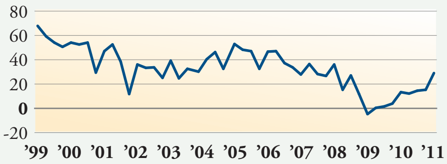
Current Activity

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 are representative of the diverse collection of businesses in the St. Cloud area. They include retail, manufacturing, construction, financial, health services and government enterprises, small and large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Survey responses from Table 1 reflect normal seasonal weakness that occurs every winter. With that noted, current conditions are the best results recorded in the winter survey for the past several years. While pockets of weakness (especially in the area housing market) remain, overall February business activity is the best we have seen since winter 2005. For example, the diffusion index on current business activity is 19, the first time this winter index has turned positive since a 6.9 reading in February 2006. In addition, the current indexes on number of employees and length of workweek have been negative each February since 2005 — this quarter, they turned (slightly) positive. A diffusion index represents the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given quarter. For any given item, a positive index usually indicates expanding activity, while a negative index implies declining conditions.

CURRENT EMPLOYEE COMPENSATION

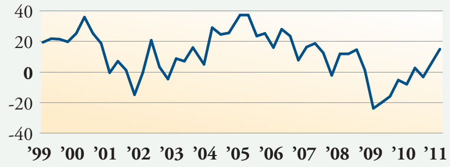
Diffusion index, percent



Among those series that show less seasonal variation, it is clear that employee compensation continues to rebound. As shown in the accompanying chart, this past quarter's employee compensation index improved to 27.5 — its highest reading in the past 30 months. These survey findings are supported by the results of this quarter's special questions (found elsewhere in this report). The prices-received index also increased from last quarter. At a value of 13.7, the prices-received index is the highest it has been since the spring 2007 survey. However, this increase may be simply a reflection of increased cost pressures at many firms. As noted in Special Questions 3 and 4, while many area firms are experiencing an improved pricing environment resulting from increased demand, many firms are simply passing along increased costs in a way that is not improving their profit margins.

CURRENT PRICES RECEIVED

Diffusion index, percent



Finally, after a surge in the capital expenditures index last quarter, firms pulled back on some of their capital spending. Last quarter, 26 percent of firms indicated increases in capital spending and only 5 percent decreased spending on machinery and equipment. This quarter, only 20 percent of firms increased capital spending, while 10 percent of firms reported decreased expenditures.

As always, firms were asked to report any factors affecting their business. These comments include:

- "Gas prices!"
- "Government regulations are increasing our costs and limiting our fee income opportunities."
- "At this time there are no special factors affecting the business. We are finishing a large

TABLE 1-CURRENT BUSINESS CONDITIONS

	February 2011 vs. Three months ago				November 2010
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	24.8	32.5	43.8	19.0	18.6
Number of employees on your company's payroll	17.5	61.3	21.3	3.8	2.3
Length of the workweek for your employees	13.8	71.3	15.0	1.2	7.0
Capital expenditures (equipment, machinery, structures, etc.) by your company	10.0	68.8	20.0	10.0	20.9
Employee compensation (wages and benefits) by your company	1.3	70.0	28.8	27.5	13.9
Prices received for your company's products	11.3	61.3	25.0	13.7	4.6
National business activity	7.5	46.3	32.5	25.0	20.9
Your company's difficulty attracting qualified workers	5.0	87.5	6.3	1.3	-3.4

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: St. Cloud State University Center for Economic Education, Social Science Research Institute and Department of Economics technology investment that will improve all areas of the company. That will allow for future growth and profitability."

- "People are still saving and paying down debt and not borrowing as in the past. All good, long term. We are starting to see people spend more, but using savings first and borrowing second."
- "Raw materials and fuel raise our prices so they could make some customers hold off on going forward with various projects. The health care issue is important to customers also."
- "We did have our best January in the last three years, so that is hopeful."
- "Our business is tied to the housing market and mortgage interest rates. We do not anticipate much of a change from the previous year."
- "Consumer confidence must improve for the construction industry (to) expect expansion, with the early signs coming in the remodel vs. the new construction."
- "Uncertainty regarding changes in health care requirements. Uncertainty regarding future federal, state and local taxes."
- "Economic uncertainty is causing us to be more cautious in the area of significant growth through acquisition than we would normally be. We are concerned about the possibility of significant inflation and much higher fuel prices. These would have a negative impact on our business. As a result of that we are reluctant to take on any long-term debt."
- "Food companies are facing significant margin pressure that eventually needs to be paid by the consumer. This inflation is the result of flawed public policy toward corn-based ethanol, driving corn prices to record levels. Now 40 percent of the U.S. corn crop is used for ethanol, which is subsidized, mandated, and with high tariffs on imports."
- "Consumers appear to have a bit more confidence in the recovery and have started to open their wallets, albeit not robust, but appear to be tired of just being frugal and want to have some fun."
- "We have to hold our prices due to competition. Our margins are going to shrink this year. We haven't given raises in three years — this year we'll have to give raises — our employees stuck with us through these tough times. We are seeing more activity in bidding — hopefully this will result in work."
- "We expect housing starts to continue to be minimal but slightly increasing. New commercial construction is having an unexpected increase in bidding activity. This may be a 'frenzy' to get quoted or locked in ahead of significant price increases."
- "Business is highly dependent on legislative health and human services funding of Medicare/Medicaid dollars. The economy also drives admissions — whether people are electing for surgeries, choosing to age in place, assisted living, etc."
- "We work for many municipal and county governments. They are all reducing project levels due to reduced revenues. I don't see this changing for a while ... I hope 2012, but likely longer."
- "I'm hoping the economy continues to turn around and that the state's deficit situation isn't as bad as predicted."

Future Outlook

Table 2 reports the future outlook for area businesses. As with Table 1, some of the items in this table follow a seasonal pattern, and others follow a cyclical pattern. The results from Table 2 are the best we have tallied since before the most recent recession. For example, the index on future business activity is 62.5. This is the highest number recorded in the winter survey since February 2006 (one year ago it had a value of 32.1). Seventy percent of surveyed businesses expect increased activity six months from now. One year ago, the corresponding number was 48 percent. Likewise, only 8 percent of businesses expect a future decrease in activity. One year ago, 16 percent of businesses expected a decline. While the accompanying chart on future business activity follows a decidedly seasonal pattern, it nevertheless shows an upward trend in activity since bottoming out in August 2008.

FUTURE BUSINESS ACTIVITY

Diffusion index, percent

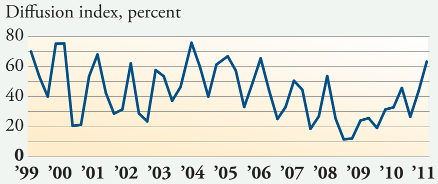


TABLE 2-FUTURE BUSINESS CONDITIONS

	Six months from now vs. February 2011				
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	November 2010 Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	7.5	17.5	70.0	62.5	43.0
Number of employees on your company's payroll	6.3	51.3	37.5	31.2	17.4
Length of the workweek for your employees	5.0	62.5	27.5	22.5	10.4
Capital expenditures (equipment, machinery, structures, etc.) by your company	6.3	55.0	33.8	27.5	18.6
Employee compensation (wages and benefits) by your company	1.3	53.8	40.0	38.7	31.4
Prices received for your company's products	11.3	48.8	35.0	23.7	30.3
National business activity	1.3	41.3	41.3	40.0	29.1
Your company's difficulty attracting qualified workers	2.5	76.3	16.3	13.8	4.7

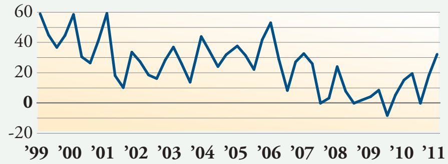
Notes: (1) Reported numbers are percentages of businesses surveyed. (2) Rows may not sum to 100 because of "not applicable" and omitted responses. (3) Diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.

Source: St. Cloud State University Center for Economic Education, Social Science Research Institute and Department of Economics

A similar seasonal pattern is found in the future employment chart. The diffusion index of 31.2 is the highest recorded in the winter since February 2007 and is well above the 14.3 value recorded one year ago. Thirty-eight percent of surveyed businesses expect to increase employment during the next six months. Indexes representing hours worked, employee compensation and difficulty attracting qualified workers display a similar pattern of continued improvement in the area labor market.

FUTURE EMPLOYMENT

Diffusion index, percent

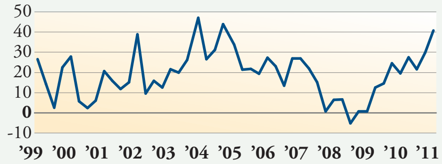


As seen in the accompanying chart, the national business activity outlook is the best it has been since fall 2004. Capital spending is also expected to pick up substantially in the next six months. Thirty-four percent of firms expect to increase capital spending while only 6 percent expect to cut back.

As reported last quarter, the future prices-received index continues to reflect rising pricing pressures at area firms. While the future prices-received index has pulled back from its surprising increase last quarter, more than one-third of surveyed firms are planning on higher prices by August 2011. This is only slightly offset by 11 percent of firms who expect reduced prices (most of these firms appear to be in the housing industry, where pricing conditions remain uncertain). In the next section, we dedicate this quarter's special questions to a discussion of the cost pressures and pricing conditions experienced at area firms.

FUTURE NATIONAL BUSINESS ACTIVITY

Diffusion index, percent



Special Questions

In December 2010, the Federal Reserve Bank of Philadelphia asked participants in its regional manufacturing survey to identify the cost pressures they were facing across a variety of resource cost items. It should be noted that the Fed survey predated much of the recent run-up in energy costs that has resulted from highly visible geopolitical events. After last quarter's surprising spike in the future prices-received index in the St. Cloud Area Business Outlook Survey, we pledged to use future surveys to try to gain a better understanding of the nature of planned price increases at area firms. Among other things, we wanted to know if planned local increases in prices were the result of increased pricing power (presumably attributed to increased demand for area firms' products) at surveyed businesses. Alternatively, we wondered if future price increases were simply a reflection of add-on pricing decisions that result from higher input costs. Of course, the latter explanation of expected price increases im-

THE STRUCTURAL CHANGE IN ST. CLOUD'S ECONOMY CONTINUES

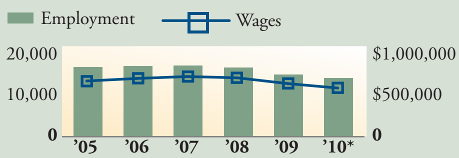
The word "recession" has the root verb "to recede." The normal state of our economy is for growth that depends on investment in human skills, equipment and technology, and the innovation and entrepreneurship of those who choose to form business ventures. We accelerate and recede from that growth through expansions and recessions.

But these expansions and recessions do not affect each sector of the economy equally. Areas that are growing may slow, while other areas will decline. That happened in this past recession as you see in the two graphs in this box. They show the change in wages and in employment in the St. Cloud area's manufacturing sector and in its education and health services sector.

The graphs make it quite clear that the recession only slowed but did not stop the growth in the education and health services sector in St. Cloud. Some of this may have been artificially helped by some educational support in the federal stimulus bill passed in 2009. Employment grew 7 percent from 2007-2010 (through the second quarter, the latest for which we have

MANUFACTURING WAGES AND EMPLOYMENT

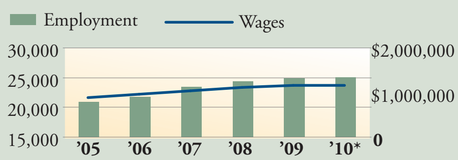
Stearns and Benton Counties



* Through the second quarter

EDUCATION AND HEALTH SERVICES EMPLOYMENT AND WAGES

Stearns and Benton Counties



* Through the second quarter

data). Wages have grown even faster, at 12 percent. This is clearly an area in which St. Cloud has found economic strength.

In contrast, the manufacturing sector — where growth has generally slowed even before the recession — saw large decreases in the number of firms, the number of workers and the wages earned during the recession. From 2007-2010, there was a 17 percent decline in employment and a 20 percent decline in wages in manufacturing in the St. Cloud area. Of the 5,600 jobs lost in the Great Recession of St. Cloud, more than 3,000 came from manufacturing and another 800 from construction. That is 68 percent of the job loss from less than 20 percent of the economy (as measured by employment).

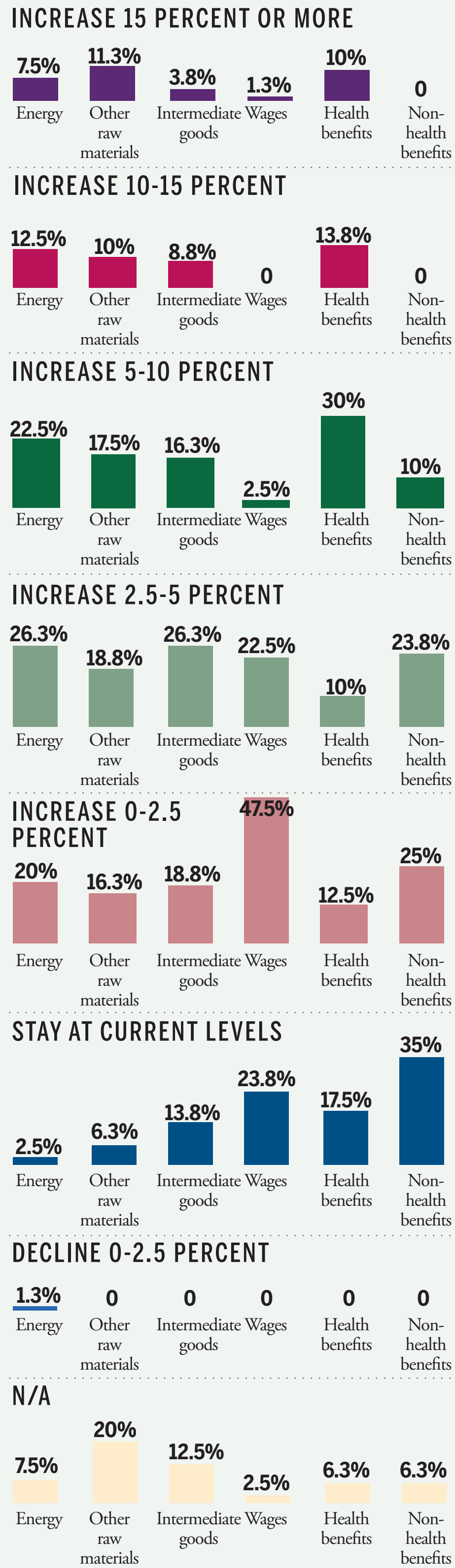
The manufacturers still operating are probably leaner, producing more and are perhaps more profitable than before. Survey responses would suggest so. But we wonder what to do about the 5,600 jobs when the expanding sectors differ from the contracting ones. Not many of the 3,800 job losers and leavers in construction and manufacturing will find employment in health services and education. Some may retrain, others will move, but many will choose careers that use their skills in lower productivity areas, likely with lower incomes as well. Faster economic growth waits for the next wave of innovation and entrepreneurship that finds a way to use those workers more productively.

plies no improvement in local profit margins — prices are being increased simply to retain existing margins.

To get more information about local cost pressures, we drew heavily on the December 2010 Business Outlook Survey of the Federal Reserve Bank of Philadelphia (see archived results at www.philadelphiafed.org/research-and-data/regional-economy/business-outlook-survey). We asked:

QUESTION 1

What percentage change in costs does your firm expect for the following categories in 2011?



The bar charts here represent percent of firms in each category. Each of the six cost categories totals to about 100 percent. In general, area firms are experiencing the greatest cost pressures in energy, other raw materials, intermediate goods and health benefits. More than half of area firms are expecting health benefits cost increases of 5 percent or more in 2011. Twenty percent of surveyed firms expect increases of energy costs of 10 percent or greater. A similar percentage of firms expect other raw materials costs to increase by at least 10 percent. These numbers are all consistent with recently observed increases in commodity prices. While wages are expected to grow more slowly than nonlabor costs, it should be noted that only 24 percent of firms expect unchanged wages. Indeed, 70 percent of surveyed firms expect wage increases of 0 to 5 percent this year. This is remarkably similar to the Fed survey, where 71 percent of firms expected wage increases of zero to five percent in 2011. 71 percent of firms expected wage increases of 0 to 5 percent in 2011.

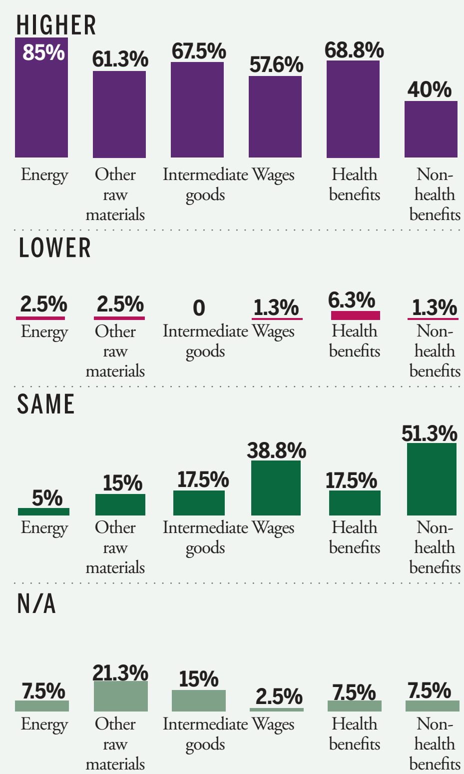
Written comments include:

- "Our company will most likely hold our retail prices to a point when we must raise them to stay above the break-even point. Due mainly to the increase of energy, health benefits and material."
- "The raw materials related to our main product are increasing at double-digit rates. We're seeing unprecedented price increases and product shortages."
- "We are seeing major increases in commodity prices. There will be significant food inflation in the future. Ethanol is an immoral public policy driving corn higher, and the Fed Reserve is creating excessive inflation with their QE2 policy."
- "Our health care benefits renewal came due February 1st at a 47 percent increase. We had to raise the employee monthly cost along with canceling the hiring of two additional staff members to offset the increase for the same coverage."
- "We have received many notices of price increases ranging from 4 to 10 percent. Steel products will again be the biggest cost increase item. Employee raises for 3/1/2011 will average 4 percent."
- "Healthcare costs are an unknown. There is too much brewing to know how it will shake out."

While Special Question 1 looks at the magnitude of expected cost changes in 2011, we also asked area businesses to indicate in which direction they expected input prices to move in 2011. The result is quite similar to those reported in the FRB Philadelphia's Business Outlook Survey. For example, in the local survey, 69 percent of surveyed firms expect higher health benefits costs. This is very similar to the Fed survey in which 64 percent of survey respondents expect increased costs of health benefits. Likewise, 61 percent of local firms expect higher "other raw materials" costs in 2011. The comparable number is 66 percent in the Fed survey. Overall, with the exception of nonhealth benefits, a majority of local businesses expect increased input costs in 2011. Of particular concern are 85 percent of area firms who expect higher energy prices. We asked:

QUESTION 2

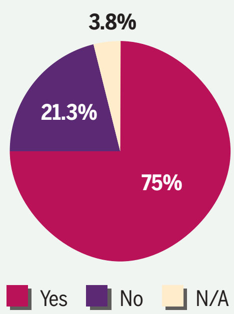
How do these expected costs compare with those in 2010?



Everything else equal, if firms are experiencing an increase in demand, then they are likely to pass on higher prices. While this may not signal improved profitability, it nevertheless represents an improvement over recessionary conditions in which firms experience reduced demand and prices may tend to fall. To try to gain an understanding of demand conditions at area firms we asked the following question:

QUESTION 3

Does your company expect to see an increase in demand for your products this year?

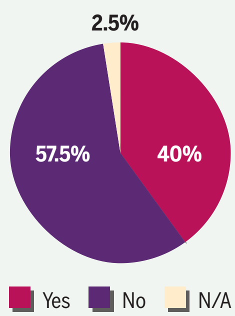


*Numbers may not add up to 100 due to rounding.

Three-quarters of surveyed firms expect to see an increase in demand for their products, while only 21 percent anticipate no increase in demand. This is, of course, a sign of the continuing recovery in area economic activity. It also suggests one of the reasons area firms are expecting to raise prices this year. However, in an environment in which input costs are also increasing, the increase in demand expected at area firms may simply give businesses an opportunity to raise prices enough to preserve existing profit margins. With this in mind, we asked a final special question:

QUESTION 4

Does your company expect to see improvement in profit margins this year?



Combined with the other information found in this quarter's special questions, the results from this question are telling. While 75 percent of surveyed firms expect increases in demand this year, only 40 percent of firms see this translating into improved profit margins. Indeed, 58 percent of firms expect no improvement in margins this year. For some area firms, cost pressures are likely to erode some of their profit margins in 2011. For other area firms, the ability to pass on price increases during a period in which input costs are expected to rise will at least help preserve profit margins. Area businesses that are expecting increased demand and improved margins are those that are poised to experience a strong 2011.

The data turn decidedly positive

Table 3 provides information on employment by industry in St. Cloud, the Twin Cities and the state. We receive revised employment data every March for the previous year, along with the January jobs numbers. The data revision was large again this year, bringing growth in employment in St. Cloud for the 12 months through January to 2.2 percent. This is more than double the long-run rate and reflects a better recovery than we had thought. All sectors in St. Cloud grew faster than their long-run trends except for financial services, professional and business services, and the leisure and hospitality sector.

The results for St. Cloud are all the more surprising given how much it outperforms the growth of the state and of the Twin Cities. The seven-county metro area had employment growth of 0.3 percent for the

TABLE 3 - EMPLOYMENT TRENDS

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend rate of change	Jan. '10-Jan. '11 rate of change	Jan. '11 employment share	15-year trend rate of change	Jan. '10-Jan. '11 rate of change	Jan. '11 employment share	15-year trend rate of change	Jan. '10-Jan. '11 rate of change	Jan. '11 employment share
Total nonagricultural	1.0%	2.2%	100.0%	0.5%	0.3%	100.0%	0.6%	0.6%	100.0%
Total private	0.9%	2.1%	82.5%	0.5%	0.3%	85.7%	0.6%	0.8%	84.0%
Goods producing	-0.2%	1.0%	18.1%	-1.7%	0.3%	12.9%	-1.4%	0.4%	14.1%
Construction/natural resources	1.4%	3.2%	3.7%	-0.7%	-1.9%	2.6%	-0.4%	-4.4%	2.9%
Manufacturing	-0.5%	0.5%	14.4%	-1.9%	0.9%	10.3%	-1.7%	1.7%	11.2%
Service providing	1.3%	2.5%	81.9%	0.9%	0.3%	87.1%	1.0%	0.7%	85.9%
Trade/transportation/utilities	-0.6%	1.9%	20.3%	-0.3%	0.4%	18.4%	-0.1%	0.5%	18.7%
Wholesale trade	1.2%	3.5%	3.8%	0.0%	1.8%	4.7%	0.3%	1.5%	4.7%
Retail trade	-1.5%	0.8%	13.0%	-0.2%	-0.1%	10.0%	-0.2%	-0.5%	10.5%
Trans./warehouse/utilities	1.6%	4.4%	3.5%	-0.9%	0.0%	3.6%	-0.2%	2.1%	3.5%
Information	-1.2%	1.6%	1.7%	-0.7%	-1.0%	2.3%	-0.7%	-0.7%	2.1%
Financial activities	2.3%	-1.2%	4.3%	0.9%	-1.6%	8.0%	1.0%	-0.8%	6.5%
Professional & business service	4.4%	3.1%	7.9%	0.9%	2.8%	15.0%	1.2%	2.3%	11.9%
Education & health	3.0%	6.9%	18.3%	3.3%	1.1%	16.1%	3.3%	2.3%	17.8%
Leisure & hospitality	1.3%	-2.2%	8.3%	0.9%	-1.9%	8.7%	0.8%	-0.8%	8.4%
Other services (excluding govt.)	0.1%	-2.3%	3.5%	1.0%	-1.7%	4.4%	0.7%	0.6%	4.4%
Government	1.5%	2.8%	17.5%	0.5%	0.0%	14.3%	0.4%	-0.4%	16.0%
Federal government	2.5%	4.0%	2.2%	-0.1%	-2.7%	1.3%	-0.2%	-2.5%	1.3%
State government	1.8%	-2.3%	5.3%	0.3%	-0.5%	4.0%	0.4%	-0.2%	3.8%
Local government	1.2%	5.5%	9.9%	0.7%	0.6%	9.0%	0.5%	-0.2%	11.0%

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.

TABLE 4-OTHER ECONOMIC INDICATORS

	2010	2011	Percent change
St. Cloud MSA labor force January (DEED)	109,961	110,133	0.2%
St. Cloud MSA civilian employment # January (DEED)	100,645	101,578	0.9%
St. Cloud MSA unemployment rate* January (DEED)	8.5%	7.8%	N/A
Minnesota unemployment rate* January (DEED)	8.7%	7.5%	N/A
Minneapolis-St. Paul unemployment rate* January (DEED)	7.7%	7%	N/A
St. Cloud-area new unemployment insurance claims November-January average (DEED)	2,196.0	1,755.0	-20.1%
St. Cloud Times help-wanted ad linage November-January average	2,308	2,236	-3.1%
St. Cloud MSA residential building permit valuation In thousands, November-January average (U.S. Department of Commerce)	1,518.0	2,241.3	47.7%
St. Cloud index of leading economic indicators January (St. Cloud State University)**	97.8	101.5	3.8%

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

year ending January 2011 by comparison. The only place where Minneapolis and St. Paul outperformed Central Minnesota is in manufacturing.

Table 4 is thus all the more interesting. The St. Cloud unemployment rate in January fell to 7.8 percent, its lowest January reading since 2008. (Local unemployment rates are not seasonally adjusted, making comparisons to other months unreliable.) The improvement came in equal parts from a rise in household employment and a decline in labor force participation. Help-wanted advertising turned up in the most recent quarter but still was down from year-ago levels, while initial claims for unemployment insurance fell by more than 20 percent. The sharp increase in the value of building permits taken out for construction was bolstered by some large permits for multifamily housing, but there was a significant increase as well if one looks only at single-family units permitted.

The rise in the St. Cloud Area Index of Leading Economic Indicators was 3.8 percent for the 12 months ending in January 2011, but that rise was not continuous. The measure rose last winter and then faded in summer and early fall before rising sharply during the past four months. As can be seen in Table 5, the recent rise was led by a sharp increase in help-wanted advertising during late fall and winter. Three of the four indicators were positive, with only hours worked in manufacturing pulling the index down.

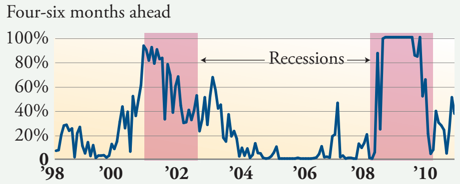
TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

Changes from November to January	Contribution to LEI
Help-wanted advertising in St. Cloud Times	4.58%
Hours worked	-0.82%
New business incorporations	0.11%
New claims for unemployment insurance	0.14%
Total	4.01%

The revised data also has improved our St. Cloud Probability of Recession Index. It now shows that the model would have forecast in April 2010 that the recession would end within four to six months. While the series has not settled to zero yet, it has not signaled a new recession either. It is more solidly positive for spring than for summer at this time, which is perhaps a good mirror

PROBABILITY OF RECESSION

Four-six months ahead

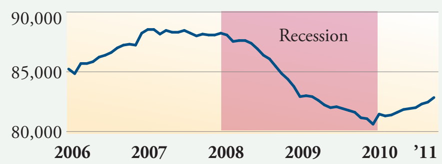


for the current mood of business leaders.

We have measured the business cycle by marking the trough of private-sector employment after adjusting for seasonality. We had held off marking this before the latest data revisions. With that data we can now say that the local recession ended in April 2010. That means the local recession was approximately two years long, making it the longest one we have observed since our employment series began in 1988. The local economy lost 7,658 private-sector jobs during the recession, and has regained 2,214 since the beginning of the recovery.

ST. CLOUD PRIVATE EMPLOYMENT

Seasonally adjusted



We are certainly far from the boom of 2006-07, where every sector was expanding and goods production was supported by speculation and low interest rates. The rise in prices discussed in our special questions tell a story of business owners who see inflation clearly ahead — particularly for raw materials and for benefits — but with less hope for passing on those costs to expand profits. With energy costs rising since that survey, the prospect for higher prices and lower profits seems higher. However, so far in this recovery nationwide, a sharp increase in business productivity (5.2 percent since the trough in the second quarter of 2009) has only given workers a 0.3 percent increase in wages adjusted for inflation. Perhaps much of that productivity has paid instead for expanding health benefit costs.

So while St. Cloud's economy has expanded in the past 12 months, we see household spending continuing to stay somewhat cautious. The payroll tax reduction from the federal government has created a small stimulus that will fade as the year carries on and news reports remind consumers that this cut expires at year-end. This should give business leaders a little pause to their business optimism, but after navigating a strong year in 2010 they may find themselves up to this challenge, too.