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# St. Cloud Area Quarterly Business Report, Vol. 4, No. 4

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St. Cloud Area
Quarterly Business Report

Fall 2002

## Inside This Issue:



Volume 4, Number 4

# St. Cloud Area Economy Plods Along

***Executive Summary***

The St. Cloud area economy continues to show the aftereffects of the Fingerhut closing. While some sectors of the local economy continue to grow at a surprisingly strong pace, retail, service, and construction sectors have shown considerable recent weakness. Despite this, results from the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey** indicate that, assuming national economic conditions do not further deteriorate, economic recovery in the St. Cloud area could begin by Spring 2003. Both instruments are designed to forecast economic conditions in the St. Cloud area over the next four to six months.

All available evidence suggests the local economy slipped into recession in the late summer of 2001 and has been unable to shake the ill effects of the negative employment shock at Fingerhut, which began in January 2002. Area employment fell by 1.9 percent over the year ending August 2002, making the St. Cloud economy the worst performer of all neighboring metropolitan areas. While the aftershocks from the Fingerhut layoffs are likely to continue to hamper a rapid economic recovery over the next few months, there are reasons to be relatively sanguine about the longer-term health of the area economy. Predictions of the **St. Cloud Index of Leading Economic Indicators** remain encouraging. The local index is currently being boosted by several of its indicators. Recent strength in new residential electrical hookups, a rise in the average workweek of area manufacturing production workers, and an increase in the number of local business start-ups all have had a favorable impact on the index.

Fifty-one percent of the fifty-three respondents to the **St. Cloud Area Business Outlook Survey** anticipate an increase in the level of business activity for their company over the next six months compared to 28 percent who expect conditions to worsen. This anticipated future growth in activity is roughly equivalent to the expectations reported in the Summer 2002 and Fall 2001 issues of the **St. Cloud Area Quarterly Business Report**. Many survey respondents report an increase in activity over the past three months. Fifty-three percent of surveyed businesses report the level of business activity in September was improved from three months earlier, while only 17 percent indicate a decline. Despite this, the gains experienced by area firms over the last three months appear to be weaker than those experienced last quarter. Employment gains, length of the workweek, capital expenditures, and prices received for surveyed companies' products were all somewhat weaker than three months ago.

A special question in the September 2002 **St. Cloud Area Business Outlook Survey** asked area businesses how they feel the projected state budget shortfall should be remedied. Forty-seven percent of survey respondents indicate state spending should be cut and taxes remain unchanged while 51% feel a mixed approach of tax hikes and spending cuts should be used. No area firm felt tax increases should be used exclusively to balance the state budget. A second special question asked businesses to what extent they have been adversely impacted by recent turmoil and volatility in financial markets. Fifty-five percent of responding firms indicate that recent events in financial markets had either a "moderate impact" or a "large impact" on their firm. Only 8% of respondents report their firm has not been affected by recent financial market uncertainty. Fully eighty-nine percent of responding firms feel they have been

Recovery could begin by Spring 2003.

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adversely impacted by recent turmoil and volatility of financial markets!

### *St. Cloud Index of Leading Economic Indicators*

The August 2002 **St. Cloud Index of Leading Economic Indicators** forecasts the St. Cloud area economy will enter expansion by early 2003. The index is designed to forecast local economic activity four to six months in the future. Figure 1 shows that the index is considerably higher than in February-its low point for the year-and has leveled out in the late summer. The local index has been boosted by a large number of new St. Cloud area residential electric hookups, an increase in the local average manufacturing workweek, and a sharp increase in the number of new local business start-ups as suggested by new registrants with the Minnesota Office of the Secretary of State. The only drag on the index has been the continuing decline in the U.S. Index of Leading Economic Indicators, which suggests the national economy will remain sluggish into 2003. To be sure, the local index is a statistical model in which current one-time events may not correspond to past economic patterns. For example, the sharp increase in new residential electrical hookups could have resulted from increased SCSU upperclass enrollments and certainly need not be due to new residents relocating to the area. Likewise, new business start-ups, which normally reflect underlying confidence in the local economy, may now relate to recently laid off workers starting a small business. Thus, caution needs to be exercised in interpreting the results of the local indicators series. As a rule of thumb, three consecutive positive changes in the **St. Cloud Index of Leading Economic Indicators** suggest an expanding economy, while three consecutive decreases suggest a contracting economy and/or a slowing of economic growth.

New residential electrical hookups have increased.

National economic outlook presents a downside risk.

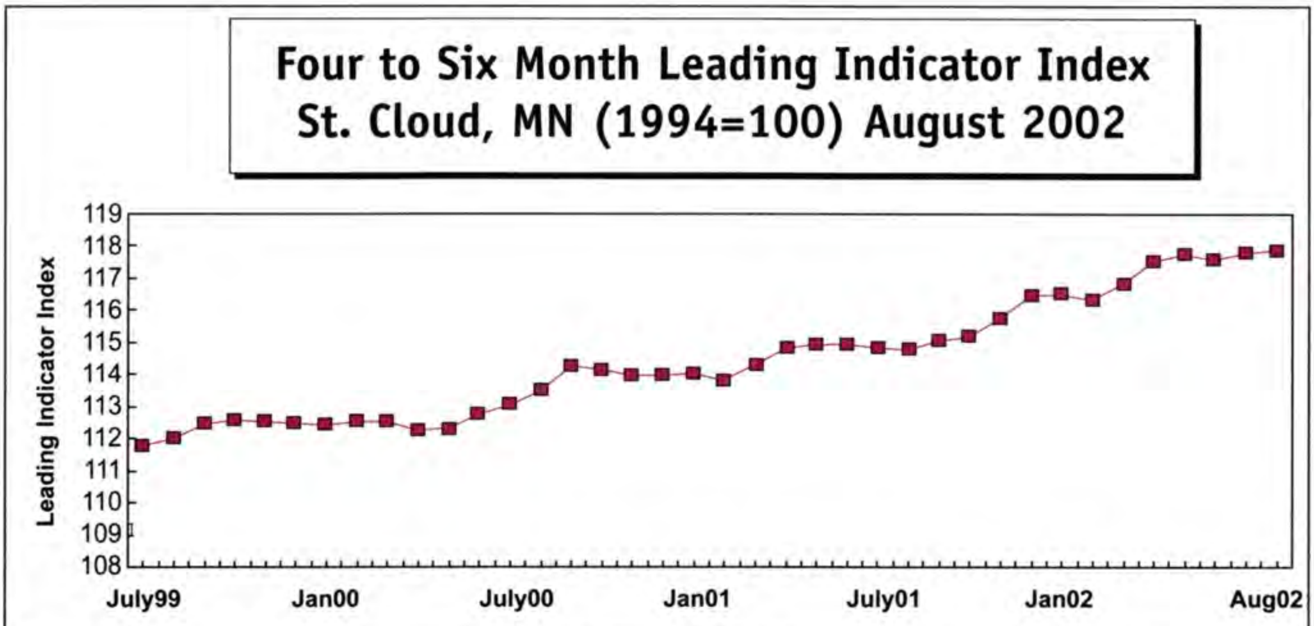
### *The St. Cloud Area Overall Outlook*

Table 1 shows employment data for the St. Cloud Metropolitan Area (MSA), Minneapolis-St. Paul (MSA), and Minnesota. Not surprising in the wake of massive layoffs associated with Fingerhut and elsewhere, St. Cloud MSA employment declined by 1.9 percent in the year ending August 2002. This is far more severe than the 0.9 percent decline recorded in the state as well as the nation (not shown). The Duluth, Rochester, and Twin Cities MSAs have all fared better than St. Cloud during this period. Similarly, in seven neighboring-state MSAs near the Minnesota border (Eau Claire, La Crosse, Des Moines, Sioux City, Sioux Falls, Fargo-Moorhead, and Grand Forks), none are currently suffering employment loss to the same degree as St. Cloud. However, it should be noted that only Sioux Falls is experiencing any real economic growth, with employment up 1.5 percent during the past year (this is actually much slower employment growth than has been observed in recent years in Sioux Falls). Indeed, the local economy's recent job growth is 4.6 percentage points below its 2.7 percent 1988-2002 long-term trend annual job growth rate. The implication is that the St. Cloud recession that began in the late summer of 2001 continued through the summer of 2002. While other Minnesota MSAs are faring better than St. Cloud, there is no clear sign that they (with the possible exception of Duluth) have emerged from recession either.

The outlook of the national economy presents a clear downside risk to local economic conditions. After a strong start to 2002, the national economy began to stumble during the summer months. While most economists continue to reject the possibility that the national economy will sink into a double-dip recession, future growth forecasts have been revised significantly downward since early summer. The general lack of national job growth has led to comparisons to the weak recovery of the early 1990s. Further complicating the national outlook is the continued weakness and volatility of the U.S. stock market. As reported in Table 6, fifty-three area businesses participating in the **St. Cloud Area Business Outlook Survey** were asked to what extent recent turmoil and volatility in financial markets has adversely impacted their business. Fifty-five percent of respondents indicated this recent financial market turmoil has had either a "moderate" or "large" adverse impact on their firm. Only 8% of responding business leaders indicate that recent financial market uncertainties have had no effect on their firms. Also weighing heavily on the national economy is the increased price of crude oil, which has surged back to the $30 per barrel range. Rising oil prices, of course, reflect the continued uncertainty surrounding Middle East oil supplies if the U.S. enters war against Iraq. Without question, there is currently more uncertainty surrounding the national economic outlook than at any time since the Asian financial crisis of 1997-1998.

July's news that Fingerhut will remain a going concern, combined with earlier reports that CompuCredit has hired hundreds of former

*Figure 1--St. Cloud Index of Leading Economic Indicators (August 2002)*




Source: SCSU Center for Economic Education, Social Science Research Inst., R. MacDonald, M. Partridge

Fingerhut lay-offs have led to a sharp decline in retail jobs.

Fingerhut employees to service their recently purchased credit card receivables portfolio, was applauded by virtually everyone. Jobs created from these interests will eventually provide a needed boost to the local economy. Yet, it appears that the new Fingerhut will only slowly ramp up production. It was not until September that Fingerhut began to advertise for new workers, and only four of these initial hires were to be at the St. Cloud facility. It is certainly understandable that Fingerhut's new management team wants to proceed cautiously, but the slow process will delay St. Cloud's economic recovery. However, the recent upsurge in new residential electrical hookups in the area suggests that very few of the laid off Fingerhut workers left Central Minnesota during the summer, which is certainly heartening news.

The overall outlook is that the St. Cloud economy will continue to plod along for the next few months. The area economy has fared better than what would normally be expected in light of the sharp blows it has endured over the last two years. Yet, without stronger direction from the national economy, there does not appear to be enough upward momentum to fully lift the local economy out recession until the first half of 2003 at the earliest.

### *The St. Cloud Area Sectoral Outlook*

Table 1 shows sectoral employment performance. Large scale layoffs at Fingerhut have led to a sharp 8.6 percent decline in total retail employment in the year ending August 2002. Indeed, local retail employment is off nearly 3,000 jobs dating to August 1999 (out of overall St. Cloud MSA employment of just over 91,000 jobs in August 2002). However, retail's woes are not exclusively confined to Fingerhut. Larger general merchandise stores shed 8.7 percent of their local workforce during the August 2001-August 2002 period, illustrating how Fingerhut's layoffs and other economic shocks are filtering through the local economy. By comparison, Minnesota's general merchandise employment has only fallen 2.7 percent. Even with these layoffs, Table 1 shows that the retail sector accounts for almost 21 percent of local non-farm employment compared to the 18 percent share for the state and Twin Cities MSA. Thus, a widespread local recovery will not likely fully take hold until St. Cloud retailers are on more solid footing.

The effects of the local recession are being felt outside of the retail sector as well. One of the best performing local sectors since the late 1980s has been the service sector (not service producing), which

Service sector employment has weakened.

includes health, business, personal, legal, and accounting services, among others. During the 1988-2002 period, average annual employment growth in this sector was remarkable at 4.8 percent per year. In 1999 alone, this sector experienced a 10 percent increase in employment, and annual job growth was never below 2.6 percent during the 1988-2001 period. Yet, in the year ending August 2002, service employment was down 0.8 percent. Local construction is another sector that continues to lag, with job growth down 1.4 percent during the most recent period. Further evidence of a softening local construction sector is the 9.9 percent decline in the valuation of new residential building permits in the June-August quarter compared to the corresponding period in 2001. Fortunately, residential building permit valuation remains 14.3 percent above the corresponding 2000 value. While the underlying fundamentals of the local economy still seem strong, several sectors will need to shake off current weakness before the economy returns to the broad-based prosperity of the last half of the 1990s.

Despite a fairly gloomy near-term outlook for most sectors, pockets of relative strength can be found in the local economy. For example, local manufacturing activity appears to be rebounding.

***Table 1--Employment Trends***

| | St. Cloud Employment Trends in Percent | | | Minnesota Employment Trends in Percent | | | Twin Cities Employment Trends in Percent | | |
|---|---|---|---|---|---|---|---|---|---|
| | Long Term Trend Growth Rate | Aug 01-Aug 02 Growth Rate | Aug 2002 Employment Share | Long Term Trend Growth Rate | Aug 01-May 02 Growth Rate | Aug 2002 Employment Share | Long Term Trend Growth Rate | Aug 01-Aug 02 Growth Rate | Aug 2002 Employment Share |
| **Total Nonagricultural** 1988-2002 | 2.70% | -1.90% | 100.00% | 1.90% | -0.90% | 100.00% | 1.90% | -1.00% | 100.00% |
| **Total Nonagricultural** 1992-2002 | 2.30% | -1.90% | 100.00% | 1.90% | -0.90% | 100.00% | 2.00% | -1.00% | 100.00% |
| **GOODS PRODUCING 1992-2002** | 2.30% | -0.20% | 24.30% | 1.00% | -2.50% | 20.90% | 0.90% | -1.60% | 20.20% |
| Construction & Mining 1992-2002 | 2.80% | -1.40% | 5.40% | 3.90% | -1.70% | 5.40% | 4.90% | -0.30% | 5.20% |
| Manufacturing 1988-2002 | 2.50% | 0.10% | 18.80% | 0.10% | -2.80% | 15.50% | -0.30% | -2.00% | 15.00% |
| Durable goods 1992-2002 | 2.60% | 0.10% | 10.30% | 0.40% | -3.60% | 9.00% | 0.30% | -1.90% | 9.10% |
| Nondurable goods 1992-2002 | 1.80% | 0.10% | 8.60% | -0.30% | -1.70% | 6.50% | -0.70% | -2.30% | 6.00% |
| **SERVICE PRODUCING 1992-2002** | 2.20% | -2.40% | 75.70% | 2.20% | -0.40% | 79.10% | 2.30% | -0.90% | 79.80% |
| Transportation & Public Utilities 1988-2002 | 2.00% | 0.00% | 3.80% | 1.60% | -6.50% | 4.70% | 1.60% | -6.30% | 5.20% |
| Trade 1988-2002 | 1.30% | -6.50% | 26.60% | 1.50% | -1.40% | 23.80% | 1.40% | -2.20% | 23.50% |
| Wholesale Trade1988-2002 | 4.10% | 1.80% | 5.80% | 1.30% | -1.70% | 5.80% | 1.20% | -2.20% | 5.90% |
| Retail Trade 1988-2002 | 0.70% | -8.60% | 20.80% | 1.50% | -1.30% | 18.10% | 1.50% | -2.20% | 17.60% |
| Finance, Insurance, & Real Estate 1988-2002 | 3.60% | 6.10% | 4.20% | 2.30% | -0.20% | 6.30% | 2.50% | -0.10% | 7.70% |
| Services 1988-2002 | 4.80% | -0.80% | 28.60% | 3.30% | 0.60% | 30.20% | 3.20% | 0.60% | 30.70% |
| Health Services 1992-2002 | 3.30% | 0.80% | 8.80% | 2.70% | 2.20% | 8.90% | 2.30% | 1.80% | 7.50% |
| Educational Services 1992-2002 | 3.30% | -2.70% | 2.90% | 3.90% | 5.40% | 1.40% | 3.90% | 5.10% | 1.20% |
| Other Services 1992-2002 | 4.70% | -1.30% | 16.90% | 3.00% | -0.40% | 19.90% | 3.20% | -0.10% | 22.00% |
| Government 1988-2002 | 1.70% | -0.10% | 12.50% | 1.80% | 1.20% | 14.00% | 2.00% | 0.10% | 12.70% |
| Federal 1992-2002 | 0.00% | -2.60% | 1.70% | -0.10% | -0.30% | 1.30% | 0.00% | -0.30% | 1.30% |
| State 1992-2002 | 1.80% | -2.60% | 3.00% | 1.10% | -0.90% | 3.00% | 1.90% | 1.00% | 3.40% |
| Local 1992-2002 | 1.10% | 1.50% | 7.80% | 2.20% | 2.00% | 9.70% | 2.20% | -0.30% | 8.00% |

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

**Table 2--Other Economic Indicators**

| | 2002 | 2001 | Percent Change |
|---|---|---|---|
| St. Cloud MSA Labor Force<br>August (MN Workforce Center) | 100,405 | 100,195 | 0.2% |
| St. Cloud MSA Civilian Employment#<br>August (MN Workforce Center) | 96,368 | 96,810 | -0.5% |
| St. Cloud MSA Unemployment Rate*<br>August (MN Workforce Center) | 4.0% | 3.3% | NA |
| Minnesota Unemployment Rate*<br>August (MN Workforce Center ) | 3.9% | 3.3% | NA |
| Mpls-St. Paul/MSA Unemployment Rate*<br>August (MN Workforce Center) | 4.0% | 3.2% | NA |
| St. Cloud Area New Unemployment Insurance Claims<br>June-August Average (MN Workforce Center) | 459.7 | 402.3 | 14.3% |
| *St. Cloud Times* Help Wanted Ad Linage<br>June-August Average | 4,257 | 4,644 | -8.3% |
| St. Cloud MSA Residential Building Permit Valuation ($1,000)<br>June-August Average (U.S. Dept. of Commerce) | 9,571 | 10,624 | -9.9% |
| St. Cloud Index of Leading Economic Indicators<br>August (SCSU) | 117.9 | 114.8 | NA |

# - The employment numbers here are based on resident estimates, not the employer payroll estimate in Table 1.
* - Not Seasonally Adjusted
NA - Not Applicable

For the year ending August 2002, local manufacturing employment was up 0.1 percent, which compares to the 2.8 percent decline in Minnesota and nearly 5 percent decline nationwide. A 0.1 percent increase may seem trivial, but as recently as December 2001, local manufacturers had cut over 6 percent of their workforce during the previous year. Further evidence of an area-wide manufacturing recovery is the nearly three hour increase in the average manufacturing workweek between March and August 2002. Local manufacturers have fared remarkably well against a strong global headwind over the last four years. Hopefully continued weakness in the national and global economy will not put an end to this fledgling recovery.

Finance, insurance, and real estate (FIRE) is another local sector that is faring remarkably well, with 6.1 percent more jobs in August 2002 than August 2001. This even exceeds FIRE's 3.6 percent 1988-2002 long-term trend growth rate. Low interest rates have produced a wave of home refinancing that has benefitted local bankers and has provided a needed boost to local real estate employment (at least for existing homes). In addition, ING Direct's local expansion has added workers to this sector, and they have recently announced further expansion plans.

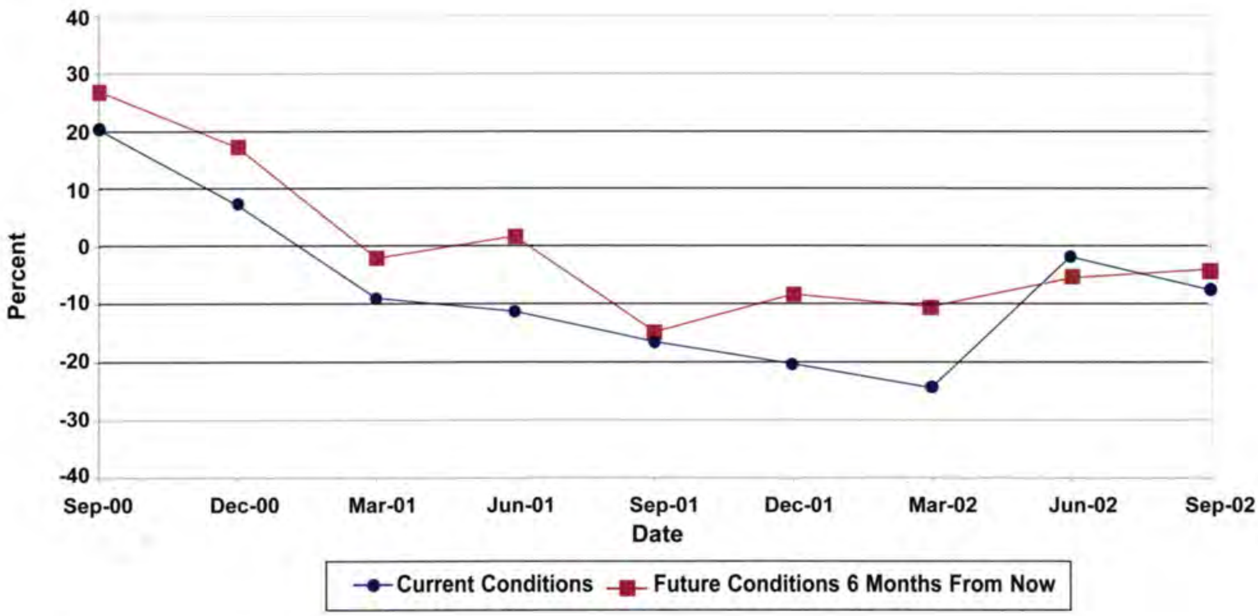
### *St. Cloud Area Labor Market Conditions*

Table 2 further confirms soft local labor market conditions. First, the St. Cloud MSA unemployment rate has increased from 3.3% in August 2001 to 4.0% in August 2002. The local increase is comparable to increases in the state and the Twin Cities MSA. Furthermore, the unemployment rate is concealing some discouraging trends. Foremost of these trends is the slowing of local labor-force growth. The area workforce has grown an unimpressive 0.2 percent during the most recent period compared to the more common 3 percent rate that was experienced in recent years. The implication is that recently laid off workers have exited the labor force either for retraining or because they are discouraged by current job prospects.

More evidence of the soft labor market is that new St. Cloud area unemployment insurance claims were up 14.3 percent in the June-August quarter compared to the similar period in 2001. At least this is an improvement from the revised 32 percent annual increase in these claims during the previous quarter. Even so, new unemployment insurance claims in the quarter ending August 2002 are up a whopping

Area manufacturing activity is rebounding.

*Figure 2--Diffusion Index for Question 8: Difficulty Attracting Qualified Workers*
*Percent Increase Minus Percent Decrease*




59 percent from the corresponding period in 2000. New help-wanted ad linage in the St. Cloud Times also declined by 8.3 percent in the June-August quarter compared to the corresponding period in 2001. Although this is not good news, it is actually an improvement from the 21 percent annual decline recorded in the immediate preceding quarter (as well as annual declines of over 30 percent recorded throughout 2001). Recent help-wanted ad linage is about 46 percent below the level recorded in the corresponding period in 1999. Some of this reflects a general migration to other venues (such as the internet) for job postings, but it also indicates a general cooling off of the local labor market from the red-hot period of the late 1990s.

Firms responding to the **St. Cloud Area Business Outlook Survey** agree that the labor market has cooled off, with only 9.4% reporting that it is more difficult to find qualified workers in September 2002 compared to three months earlier (while 17% report that availability has improved). Similarly, 9.4% expect worker availability to worsen six months in the future, while 13.2% expect qualified workers will be more plentiful in six months' time.

### *St. Cloud Area Business Outlook Survey*

The **St. Cloud Area Business Outlook Survey** is a survey of current business conditions and area firms' future outlook. It is administered quarterly with the cooperation of the St. Cloud Area Economic Development Partnership. Survey results reported in Tables 3 through 6 reflect the responses of fifty-three area business firms who returned the recent mailing. Participating firms are representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, financial, and government enterprises of sizes ranging from small to large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Area labor market conditions remain soft.

Table 3 reports survey results of area business leaders' evaluation of business conditions for their company in September 2002 versus three months earlier. For the most part, results from Table 3 compare unfavorably to those that were reported in the June 2002 survey. It appears many area firms experienced somewhat weaker business activity over the past three months. For example, the diffusion index (representing the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given category) for the level of business activity decreased from 38.6 to 35.8 in the current period. This is, however, an improvement over the September 2001 diffusion index value of 22.2. Fifty-three percent of surveyed firms reported an increase in business activity in this most recent quarter while 17% noted it had decreased. Several firms report (both favorable and unfavorable) seasonal effects while one area firm continues to indicate ongoing concerns about the "influx of Chinese manufactured products." Another firm writes "low interest rates are a big plus."

The diffusion index for number of payroll employees is lower than that reported in June, but much improved from one year earlier. The index declined from 31.6 three months ago to 24.5 in September. The corresponding index number for September 2001 (during a time when the area economy appeared to have been in the early stages of recession) was 3.7. Values for length of workweek and employee compensation are essentially unchanged from three months earlier. Most area firms responding to the survey indicate there was no change in their difficulty attracting qualified workers over the past quarter. General worker shortages experienced in the late 1990s are no longer a problem for area businesses. One area business notes "our employee decrease is loss of seasonal help-we will seek to fill additional full-time help." Another firm reports "we'll be going from 7.5 hours overtime per week to none after the first of January. First and second quarters are our slowest." Local capital spending appears to have remained fairly steady over the past three months. Thirty-four percent of responding firms increased capital expenditures last quarter while 9 percent cut back on capital purchases. One firm writes "we [just expanded our] production shop and new equipment-[this represents a] 12% increase." Another business leader notes "I believe that businesses will begin to buy more and more tech equipment in (2003) and have hired in anticipation of this. Also, there are more qualified people available now."

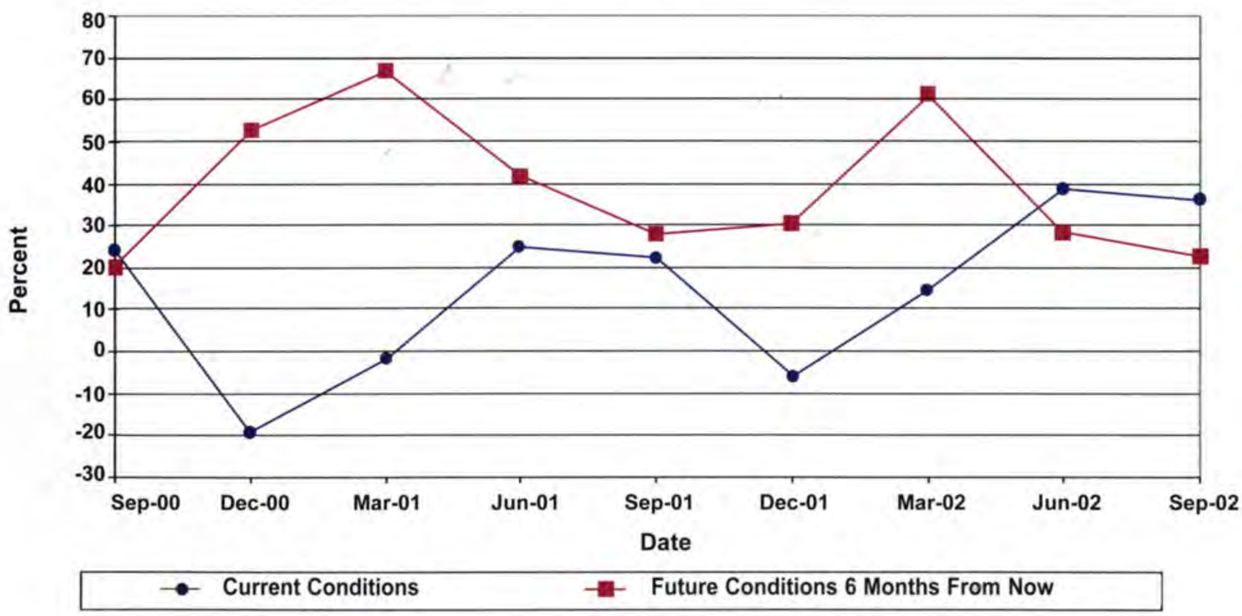
Local capital spending has been steady.

Over the past quarter, surveyed firms were markedly less successful passing on price increases to customers. The diffusion index in this category fell from 19.3 to 1.9 over the June to September period. Only 17% of respondents indicated prices received were higher in

*continued on page 11*

***Figure 3--Diffusion Index for Question 1: Level of Business Activity***

*Percent Increase Minus Percent Decrease*



### *Table 3--Current Business Conditions**

| ST. CLOUD AREA BUSINESS OUTLOOK SURVEY<br>Summary September 2002<br>*What is your evaluation of:* | September 2002 vs. Three Months Ago | | | | June 2002 Diffusion Index[3] |
|---|---|---|---|---|---|
| | Decrease (%) | No Change (%) | Increase (%) | Diffusion Index[3] | |
| Level of business activity for your company | 17.0 | 30.2 | 52.8 | 35.8 | 38.6 |
| Number of employees on your company's payroll | 11.3 | 52.8 | 35.8 | 24.5 | 31.6 |
| Length of workweek for your employees | 3.8 | 77.4 | 18.9 | 15.1 | 15.8 |
| Capital expenditures (equipment, machinery, structures, etc.) by your company | 9.4 | 56.6 | 34.0 | 24.6 | 26.3 |
| Employee compensation (wages and benefits) by your company | 0 | 67.9 | 32.1 | 32.1 | 31.6 |
| Prices received for your company's products | 15.1 | 66.0 | 17.0 | 1.9 | 19.3 |
| National business activity | 7.5 | 50.9 | 30.2 | 22.7 | 12.3 |
| Your company's difficulty attracting qualified workers | 17.0 | 71.7 | 9.4 | -7.6 | -1.8 |

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*

### *Table 4--Future Business Conditions**

| ST. CLOUD AREA BUSINESS OUTLOOK SURVEY<br>Summary September 2002<br>*What is your evaluation of:* | Six Months from Now vs. September 2002 | | | | June 2002 Diffusion Index[3] |
|---|---|---|---|---|---|
| | Decrease (%) | No Change (%) | Increase (%) | Diffusion Index[3] | |
| Level of business activity for your company | 28.3 | 18.9 | 50.9 | 22.6 | 28.1 |
| Number of employees on your company's payroll | 9.4 | 62.3 | 24.5 | 15.1 | 17.5 |
| Length of workweek for your employees | 17.0 | 67.9 | 13.2 | -3.8 | -8.8 |
| Capital expenditures (equipment, machinery, structures, etc.) by your company | 3.8 | 66.0 | 28.3 | 24.5 | 10.5 |
| Employee compensation (wages and benefits) by your company | 3.8 | 39.6 | 54.7 | 50.9 | 43.9 |
| Prices received for your company's products | 11.3 | 54.7 | 30.2 | 18.9 | 21.1 |
| National business activity | 9.4 | 52.8 | 24.5 | 15.1 | 8.8 |
| Your company's difficulty attracting qualified workers | 13.2 | 71.7 | 9.4 | -3.8 | -5.3 |

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*

## *Special Question #1: How Should Legislators Attempt to Repair the Projected State Budget Shortfall?*

A major campaign issue in political races around the state has been how candidates for political office would seek to remedy the budget imbalance that is almost certain to appear over the next biennium. At the time the survey was mailed to area businesses, the projected state budget shortfall over the next biennium stood at approximately $2 billion. Media reports since that time have suggested the number is now approaching $3 billion. In an attempt to see how area business leaders feel the projected state budget shortfall should be corrected, a special question of the **St. Cloud Area Business Outlook Survey** asked area business leaders to indicate how their business feels legislators should attempt to balance the budget in the upcoming legislative session. Results reported in Table 5 indicate that no surveyed business feels the budget should be balanced solely through tax increases. On the other hand, 47% of responding firms favor reducing state spending while leaving taxes unchanged. Fifty-one percent of respondents prefer a mixed approach-one that combines spending reductions with tax hikes.

**TABLE 5-Special Question 1-HOW SHOULD LEGISLATORS ATTEMPT TO REPAIR THE PROJECTED STATE BUDGET SHORTFALL?**

Given the recent projection of a state budget shortfall of approximately $2 billion over the next biennium, how does your business feel legislators should attempt to balance the budget in the upcoming legislative session?*

**Panel A: Survey Results**

| Maintain Current Spending Path and Increase Taxes | Reduce Spending and Leave Taxes Unchanged | Mix Reduction in Spending with Increased Taxes |
|---|---|---|
| 0 | 47.2 | 50.9 |

* reported results are percent of surveyed businesses.

**Panel B: Selected Survey Responses**
**Business leaders were asked to elaborate on their response to special question 1. These responses include:**

- Raid tobacco trust funds. Our highway network, especially in the Minneapolis-St. Paul MSA is glaringly inadequate. This requires bonding and gas tax increases...the only tax MN isn't at a competitive disadvantage vis-a-vis our neighboring states. I also believe K-16 education and (local government aid) funds are likely already cut too far. My fear is that the legislature will continue accounting shifts, robbing from work comp/unemployment reserves and undoing long overdue property tax equalization. This will make MN a lousier place to hire people and own commercial property.

- We are already one of the most highly taxed states in the nation. We need to curb spending.

## *Special Question #2: The Extent to Which Recent Turmoil and Volatility in Financial Markets has Adversely Impacted Area Businesses*

A second special question asked employers to comment on the extent to which they feel their firm has been impacted by recent turmoil and volatility in financial markets. The value of U.S. stocks has declined sharply since early 2000 and the last few months have seen extraordinary volatility in share prices. Contributing to continuing concerns about the future profitability of U.S. companies has been highly visible allegations of corporate accounting irregularities as well as associated issues related to corporate governance. Compounding the situation has been uncertainties regarding the prospects of war in the Middle East, the continuing fight against terrorist influences, and associated rises in the barrel price of oil. Lingering concerns about the profit potential of firms in the information technology sector also remain. In short, U.S. financial markets (and stock markets in particular) have experienced extraordinary instability in recent months and have, more than at any time in recent memory, carried considerable downside risks. With these concerns in mind, area business leaders were asked to evaluate the extent to which their firm has been adversely impacted by uncertain financial market conditions. The results are surprising. Forty-three percent of responding businesses indicate they have been moderately impacted by recent turmoil and volatility in financial markets. Eleven percent of responding firms report a large impact while only 8% indicate no impact. About one out of every three businesses feels the impact has been mild. Totaling up these responses, 89% of surveyed firms believe they have been adversely impacted by recent events in financial markets! The other surprise result can be found in some firms' written responses. It appears that some area firms have actually benefitted from increased uncertainty in financial markets. Results are reported in Table 6 and selected survey responses can be found below the table.

### TABLE 6-Special Question 2-THE EXTENT TO WHICH AREA BUSINESSES HAVE BEEN ADVERSELY IMPACTED BY RECENT TURMOIL AND VOLATILITY IN FINANCIAL MARKETS

To what extent has recent turmoil and volatility in financial markets adversely impacted your business?*

**Panel A: Survey Results**

| Not at All | Minor Impact | Moderate Impact | Large Impact | Other |
|---|---|---|---|---|
| 7.5 | 34.0 | 43.4 | 11.3 | 1.9 |

* reported results are percent of surveyed businesses.

**Panel B: Selected Survey Responses**
**Business leaders were asked to explain how their business has been impacted by recent turmoil and volatility in financial markets. These responses include:**

- We find it extremely difficult to obtain financing for [products we sell].
- People pulling out of market into insured saving instruments. Consumers putting consumer debt into home refinancing.
- Recession environments help increase [sales of our firm's product]. Positive for us.
- I believe people have moved out of stocks into real estate, therefore having the moderate impact.
- Client projects are delayed.
- Market volatility has greatly improved the saleability of [one of our products].
- Anytime that people have had huge capital gains wiped out, I believe durable goods purchases are the first to be abandoned. Loss of faith in corporate accounting only compounds jitters that prevent durable goods purchases.
- Sizable portion of our customers cut back the size of projects. Many put projects on hold-a 'wait and see attitude'.
- Lots of refinancing activity. More concern about people/business ability to repay debt.
- Our business has continued to grow despite the volatility.
- Business volume up-higher bracket recreational [sales] down.

*continued from page 7*

September than three months earlier (the corresponding number was 32% in June 2002). Nearly as many survey respondents experienced a decrease in prices received as experienced an increase. To the extent that these numbers suggest a weakening of profit margins, this represents yet another challenge for area firms to overcome. Finally (and perhaps most surprising), over the past three months, respondents felt the national economy improved. The diffusion index on national business activity increased from 12.3 to 22.7 during this period. Note that this is a strong improvement over September 2001 when the index stood at -22.2. Nearly one-third of surveyed businesses thought the national economy improved over the most recent quarter while only 8% thought national economic conditions had deteriorated. This may be a result of continued favorable effects of historically low interest rates which have served to offset (at least to some extent) the weakness caused by capital losses in the stock market and uncertainties about a possible U.S. invasion of Iraq. Yet, this would not be the first time respondents had a surprising outlook on the national economy. Survey respondents had a surprisingly bleak view of the U.S. economy in late 2000, well before national analysts had realized that the long economic boom of the 1990s had concluded.

Responses tallied in Table 4 paint a somewhat different picture. They are, for the most part, not substantially different than those reported in the similar table found in the July 2002 St. Cloud Area Quarterly Business Report. Summary results from questions related to survey respondents' expectations six months from now versus September 2002 are reported in this table. The diffusion index for the question that asks about the level of future business activity for area companies is 22.6 (down sharply from a value of 61.2 six months ago, but not much different from a value of 28.1 reported last quarter). Twenty-eight percent of surveyed businesses expect worsening business conditions over the next six months (this is sharply higher than three months ago when only 16 percent of firms expected weaker future conditions). In the June 2002 survey, 44% of firms expected improved business conditions in six months' time. This number has now increased to 51%.

When compared to the results of the June 2002 survey, business respondents expect a mostly unchanged (albeit soft) labor market over the next six months. For example, the index on the survey item which asks about anticipated payroll employment is down only slightly from 17.5 to 15.1 over the past three months. Only twenty-five percent of firms expect to increase hiring over the next six months (the corresponding number was 30% in June). The diffusion index on length of the workweek is improved however (although it remains negative). It should be noted that 55 percent of surveyed firms expect to increase employee compensation over the next six months and only two firms expect compensation to decline. Area firms also continue to expect little trouble finding qualified workers. The diffusion index on this item is little changed from its June value. The diffusion index on the survey item asking firms about their capital spending plans is substantially improved from the June survey. Twenty-eight percent of surveyed firms expect to increase capital purchases over the next six months while only 4% expect to cut back on capital expenditures. As observers of the national economy have remarked, any economic recovery is unlikely to be robust unless and until capital spending picks up. Going forward, this could be one of the bright spots for the area economy.

Area firms have been less able to pass on price increases.

Similar to the results reported in Table 3, area firms' evaluation of future national business activity has improved over the last three months. Last quarter, 14% of surveyed firms expected future national business conditions to weaken. In the most recent survey, only 9% of firms expected further deterioration in national conditions. The diffusion index on this question improved from 8.8 to 15.1. It should be noted that this is still markedly below the 38.8 index on this same question in the March 2002 survey. These results are surprisingly encouraging considering continued media attention on corporate accounting irregularities, persistent turmoil in U.S. stock markets, rising oil prices, and heightened uncertainty about the possibility of a war in the Middle East. Finally, area firms expectation about their future ability to pass on price increases is essentially unchanged from three months ago. Thirty percent of surveyed businesses expect improvements in prices received over the next six months.

Local firms think national business activity has improved.

An historical view of the evolution of the diffusion indexes on current and future business conditions over the past several quarters is presented in Figure 3. This shows a slight decline in the diffusion index on current business activity over the past three months. This index is now at 35.8 (its record high

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of 67.8 was recorded in June 1999, while its low of -19.3 occurred in December 2000). This period's future business activity diffusion index shows a moderate decline from last period's index. Although it remains above its all-time low of 19.7 recorded two years ago, it has slipped considerably from a value of 61.2 in March of this year. It should be noted that some of this represents a normal seasonal pattern of business activity that has now been observed over the four years that the survey has been conducted. Consequently, it would be imprudent to attribute all of this relative weakening in the future business outlook to lower demand associated with slower future general local business activity.

Participating businesses can look for the next survey at the beginning of December and the accompanying **St. Cloud Area Quarterly Business Report** (including the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey**) in late January. Area businesses who wish to participate in the quarterly survey can call the SCSU Center for Economic Education at 320-255-2157. All survey participants will receive a free copy of the **St. Cloud Area Quarterly Business Report** on a preferred basis.