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S T . C L O U D A R E A
QUARTERLY BUSINESS REPORT

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Executive Summary

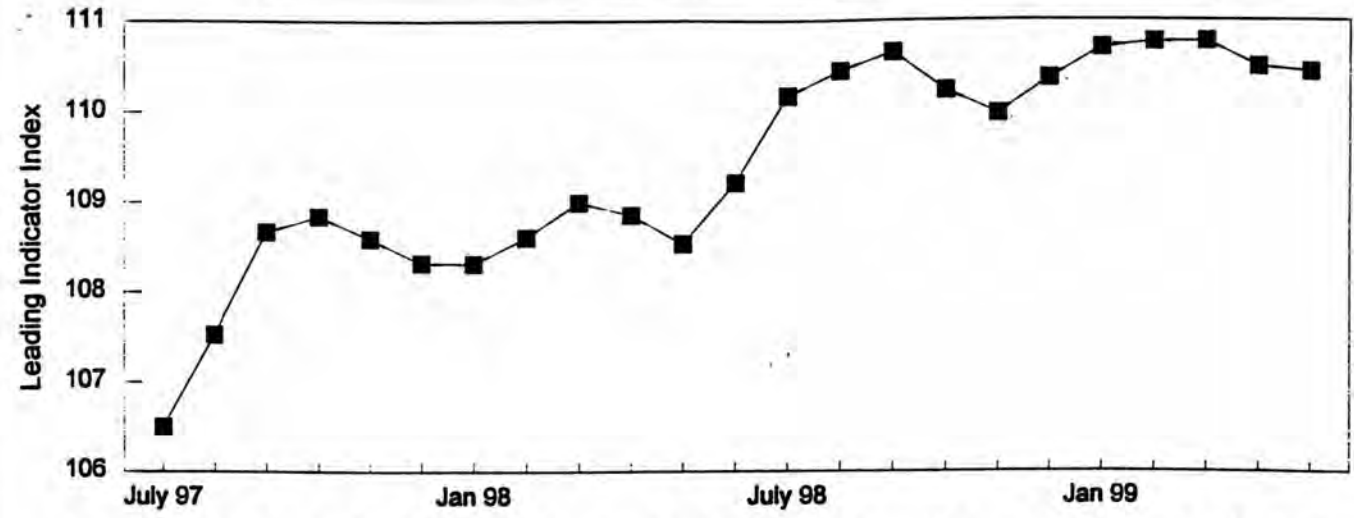
The St. Cloud area economy should continue to expand at a modest rate over the next several months according to the most recent projections of the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey**. Both instruments are designed to forecast economic conditions in the St. Cloud area over the next four to six months. Following a small increase in March, the leading indicators index decreased slightly in April and May. The May 1999 index was approximately 1.8 percent higher than its level one year earlier. In recent months, the index has been boosted by the strong performance of the U.S. index of leading economic indicators. A decrease in average weekly work hours in area manufacturing and declining new residential electric hookups late last year have contributed to a slowing of the index. Almost 64 percent of area businesses participating in the Business Outlook Survey expect an increase in the level of business activity for their company over the next six months. This compares to only 12 percent who expect conditions to worsen. Approximately half of surveyed businesses in the St. Cloud area expect to add employees over the next six months. Sixty-one percent of survey respondents expect employee compensation to rise in the next half-year. While shortages of qualified workers continue to be the primary factor tempering local economic growth, there is modest evidence that the area labor shortage is moderating. Forty-four percent of area businesses believe it will become more difficult to attract qualified workers over the next six months. This compares to a sixty-five percent response to the same survey item reported in the April 1999 **St. Cloud Area Quarterly Business Report**.

St. Cloud Index of Leading Economic Indicators

The May 1999 **St. Cloud Index of Leading Economic Indicators** indicates that local economic activity should expand modestly over the next few months. The index is being lifted by the rising U.S. index of leading economic indicators. However, decreases in the local average manufacturing workweek, along with a decline in new residential electrical hookups late last year, have acted to pull down the local index in recent months. The **St. Cloud Index of Leading Economic Indicators** is above Spring 1998 levels, but is slightly below its February 1999 peak. As a rule of thumb, three consecutive positive changes suggest an expanding economy, while three consecutive declines indicate a contracting economy and/or a slowing of economic growth.

Four to Six Month Leading Indicator Index

St. Cloud, MN (1994=100) May 1999



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

Consistent with recent movements in the **St. Cloud Index of Leading Indicators**, the St. Cloud economy has been experiencing moderate economic growth. Employment growth in St. Cloud continues to lag the stronger performances in the state and nation. Between May 1998 and May 1999, St. Cloud nonfarm employment grew at a 1.4 percent rate. This compares to 1.8% and 2.1% rates of employment growth in Minnesota and the U.S., respectively. Economic activity is also not expanding as robustly as it was at this time last year. Annual employment growth rates reported in May 1998 were in excess of 3 percent for both St. Cloud and Minnesota. Employment growth has clearly slowed since then. A key factor explaining more moderate growth appears to be a continued lack of qualified workers at existing wages, although other areas in Minnesota with more severe labor shortages appear to have fared better than St. Cloud. For example, the Twin Cities and Rochester metropolitan areas are still experiencing annual employment growth of about 3 percent, even though they each have unemployment rates that are among the lowest in the nation.

Health services and finance, insurance & real estate remain St. Cloud's fastest growing sectors. Respective employment growth in the health services and finance, insurance & real estate sectors was 5.6% and 8.1% in the year ending May 1999. Employment in the finance, insurance & real estate sector is growing at a rapid rate despite the recent national and regional consolidation of several financial intermediaries. With an annual increase of 2.7 percent, construction employment continues to expand. However, this is far below the double-digit annual employment growth rates experienced in the local construction industry in 1998 and early 1999. Higher interest rates and shortages of building supplies may be taking their toll on local construction activity. Yet, a recent surge in new residential building permits in the St. Cloud area will keep employment growth in this sector strong in coming months.

In terms of employment growth, manufacturing is certainly one of the St. Cloud area's weakest sectors. Indeed, some local manufacturers appear to be struggling to adjust to changing industry conditions and heightened global competition. The strong U.S. dollar, among other things, has

forced manufacturing enterprises throughout the U.S. to continue to search for ways to achieve efficiency gains in this ultra-competitive marketplace. Recently announced layoffs at Vision-Ease illustrate this trend. For the year ending May 1999, St. Cloud manufacturing employment declined 2.2 percent. In addition, the local average manufacturing workweek is well below the levels of the first half of 1998. Future manufacturing statistics will be closely watched to see the extent to which increased payrolls at the New Flyer bus production facility will help turn around the local manufacturing numbers. Like manufacturing, state government employment in the St. Cloud area continues to fall and the agricultural sector remains mired in a major slump. Fortunately, there appears to be little evidence that the current difficulties experienced in these three sectors have spilled over to other segments of the St. Cloud economy. One encouraging sign of improved economic health is a recent increase in local business start-ups. In addition, area retail jobs are being created more rapidly than the average of non-retail sectors in the local economy.

The two most recent editions of the **St. Cloud Area Quarterly Business Report** described a broad shortage of qualified workers as the primary factor inhibiting continued rapid growth of the regional economy. While area businesses continue to struggle to find workers, there appears to be (for the first time in several months) some indication that the labor shortage is no longer worsening. For example, the May 1999 unemployment rate in the St. Cloud metropolitan area was 2.2%, unchanged from one year earlier. In addition, new unemployment insurance claims are running above their corresponding 1998 levels so far this year. While help wanted lineage in the *St. Cloud Times* is slightly above its 1998 level, the *growth rate* of help wanted lineage is slower so far in 1999 than it was one year earlier. Although help wanted lineage has increased at a 10 percent rate so far this year, the corresponding growth rate for the first half of 1998 was between 20 and 25 percent. Finally, respondents to the **St. Cloud Area Business Outlook Survey** suggest that the labor shortage is expected to improve in six months time. While 44.1 percent of survey participants believe it will be more difficult to attract qualified workers six months from now, this represents a decrease from a 65 percent number of businesses surveyed in March 1999. The role played by seasonal factors in these responses is unclear. For example, while many participating firms report that summer is their busiest season, we are also likely to experience peak retail employment during the holiday season six months from now.

While the local labor shortage may not be currently intensifying, area businesses will need to continue to look for ways to lift the productivity of their workforce as well as identify underutilized segments of the adult population (such as the disabled and retirees) to meet their staffing needs. In a continuing trend, respondents to the **St. Cloud Area Business Outlook Survey** indicate relatively strong capital expansion plans over the next half-year. Forty-four percent of area businesses expect to increase capital expenditures in the future. In addition, thirty-seven percent of firms indicated an increase in capital purchases in June from three months earlier. Of these purchases, technology appears to be the most important. One firm reports that "a lot of our business comes from smaller communities--technological changes increase ease in working with individuals." Another surveyed firm notes that "we continue to see more pressures to spend on technology." Continued capital investment will help relieve pressures associated with the local worker shortage. In addition, firms may be able to improve their success attracting workers from outside of the immediate St. Cloud area. Responses to a special question in the

June survey suggest that firms either have not found a great deal of success finding workers outside of St. Cloud or they have not tried very hard to identify distant workers. Finally, local firms will need to discover new ways to attract and retain recent college graduates, which currently stream out of the area in large numbers. Success in this undertaking will lift productivity and allow for the adoption of new technologies. This, of course, is likely to require higher levels of employee compensation.

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 Chamber of Commerce. Survey results reported in Tables 1 and 2 reflect the responses of fifty-nine area business firms who returned the recent mailing of the business outlook survey. Participating firms are representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, financial, government, and educational 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 businesses remain extremely optimistic about future business conditions. The diffusion index for current business conditions in June 1999 is 67.8, up from 45.2 in the March survey. The diffusion index is measured as the percentage of respondents experiencing an increase minus the percentage experiencing a decrease. Thus a widening of this number is a very encouraging sign. Sixty-four percent of area firms expect the level of business activity for their company to increase over the next six months compared to 12 percent expecting a decrease in activity. While the diffusion index for future business activity has decreased from 69.3 in March 1999, it still remains at a healthy 52.5 in the most recent month. Note that survey results have not been seasonally adjusted. Many businesses (for example, those in construction, realty, etc.) indicate that business activity six months from now is expected to be slower for seasonal reasons. One area business reports that they are extremely busy with a project that runs from May through August. In addition, this business notes that it is traditionally busier in the last half of the year than it is in the first half.

Area firms expect to meet increased future output demand by hiring additional workers and acquiring more capital. Most firms do not expect the length of the workweek to expand over the next six months. Almost half of surveyed firms expanded company payroll employment over the past three months, and fifty-one percent expect to expand this further in the next six months. A moderation in the area labor shortage would be a welcome event for local businesses. While 42% of survey respondents indicate that it was more difficult to attract qualified workers in June than it was three months earlier, this percentage is down from 51% in March. In addition, 44% of survey participants expect the labor shortage to worsen over the next six months. While this points to continued difficulty attracting qualified workers, the corresponding number was 65% in March. Indeed, the diffusion index indicating future difficulty attracting qualified workers fell from 61.7 to 42.4 in the most recent survey. The bulk of written comments submitted by survey participants continue to address the area labor shortage. Comments include "finding qualified workers continues to be a significant challenge, although I do feel it will 'level' off in the next 6

to 12 months", "It's continuing to be difficult to locate and hire qualified staff. In a short period of time, this problem could begin to cause increased dissatisfaction on the part of customers", "a shortage of qualified employees is affecting our ability to really grow our company during this period of growth", and "(attracting qualified workers is an) ongoing struggle!!".

The worker shortage is causing a predictable increase in employee compensation in the St. Cloud area. Fifty-nine percent of firms surveyed reported higher levels of employee compensation in June than three months earlier and sixty-one percent expect higher wages and benefits six months from now. Despite this, the diffusion indexes on current and future employment compensation *decreased* in June from the numbers reported in the March survey. Written comments of surveyed firms reveal continuing concern for the effects of the local labor shortages. Statements such as "experiencing severe shortages in qualified field personnel...this is creating significant upward pressure on wages, yet margins have decreased due to competition" and "we continue to see increasing wage/salary pressure, at all levels of employment" are common. Another area firm reports that average wage increases of \$1.50 per hour took effect on July 1.

Area firms are having only limited success passing higher costs on to final customers. While 29% of surveyed firms report that prices received in June were higher than in March, 61% indicate no changes in prices received. Firms may be expecting slight improvements in this area in the future. Almost one-third of respondents believe the prices they receive for their products will be higher six months from now.

While 35.6% of surveyed firms believe that national business activity in June was improved over its level three months earlier, only 22% expect national business conditions to be improved six months from now. The diffusion index regarding future national business conditions decreased from 25.9 to 13.5 in the most recent survey.

Special question 2 asked participants about their company's concerns regarding access to financial capital due to bank consolidation in the St. Cloud area. While 20.3% of responding firms indicated increased concerns related to local access to financial capital, fully 69.5% reported no change in their concerns. Only 5% of surveyed firms indicated that they had increased concerns six months from now. In general, widely publicized worries about the effects of mergers of area banks appear to have had little effect on the activities of the fifty-nine firms responding to the **St. Cloud Area Business Outlook Survey**. Written comments to special question 2 were varied and included "no concerns at this time", "has not adversely affected our relationship with bankers", "Consolidations squeeze out the smaller entity. However, the smaller local banks are responsive to our needs and easier to deal with", "As part of a large national corporation, I'm not concerned", "It has become difficult to do business with a bank that was merged into a larger one", "somewhat concerned, we will remain with the merged bank until they give us a reason to leave (i.e. employee change or fee rates)", "We've changed banks", and "The new banks have become very unfriendly. Increased rates, very institutionalized".

Look for the next **St. Cloud Area Business Outlook Survey** in September and the accompanying **St. Cloud Area Quarterly Business Report** (including the **St. Cloud Index of Leading Economic Indicators**) in October.

TABLE 1—CURRENT BUSINESS CONDITIONS*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary June 1999	June 1999 vs. Three Months Ago				March 1999 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³	
What is your evaluation of:					
level of business activity for your company	5.1	22.0	72.9	67.8	45.2
number of employees on your company's payroll	6.8	44.1	49.2	42.4	27.0
length of the workweek for your employees	1.7	74.6	23.7	22.0	8.0
capital expenditures (equipment, machinery, structures, etc.) by your company	8.5	54.2	37.3	28.8	30.2
employee compensation (wages and benefits) by your company	1.7	37.3	59.3	57.6	66.2
prices received for your company's products	8.5	61.0	28.8	20.3	18.0
national business activity	1.7	49.2	35.6	33.9	22.2
your company's difficulty attracting qualified workers	3.4	50.8	42.4	39.0	45.9
SPECIAL QUESTION 1: Your company's success attracting job applicants and new workers from outside of the immediate St. Cloud area	5.1	61.0	20.3	15.2	NA
SPECIAL QUESTION 2: Your company's concerns about access to financial capital due to bank consol- idation in the St. Cloud area	3.4	69.5	20.3	16.9	NA
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 2—FUTURE BUSINESS CONDITIONS*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary June 1999	Six Months from Now vs. June 1999				March 1999 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³	
What is your evaluation of:					
level of business activity for your company	11.9	23.7	64.4	52.5	69.3
number of employees on your company's payroll	6.8	42.4	50.8	44.0	58.0
length of the workweek for your employees	8.5	76.3	13.6	5.1	17.8
capital expenditures (equipment, machinery, structures, etc.) by your company	10.2	45.8	44.1	33.9	50.0
employee compensation (wages and benefits) by your company	0	37.3	61.0	61.0	75.4
prices received for your company's products	6.8	59.3	32.2	25.4	21.7
national business activity	8.5	55.9	22.0	13.5	25.9
your company's difficulty attracting qualified workers	1.7	49.2	44.1	42.4	61.7
SPECIAL QUESTION 1: Your company's success attracting job applicants and new workers from outside of the immediate St. Cloud area	6.8	64.4	11.9	5.1	NA
SPECIAL QUESTION 2: Your company's concerns about access to financial capital due to bank consol- idation in the St. Cloud area	3.4	71.2	5.1	1.7	NA
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