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# St. Cloud Area Quarterly Business Report, Vol. 01, No. 04

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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 and may even accelerate 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. Large increases in the leading indicators index in June and July helped push the August 1999 index to a record high. In recent months, the index has been boosted by the strong performance of the U.S. index of leading economic indicators, an increase in average weekly hours worked at area manufacturing establishments, and a surge in new residential electrical hookups. The abrupt rise in average manufacturing work hours reverses a declining trend in the workweek that was observed in the first half of 1999. A levelling off of new business start-ups has had little adverse impact on the leading indicators index in recent months. Fifty-seven 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 11 percent who expect conditions to worsen. Forty-three percent of surveyed businesses in the St. Cloud area expect to add employees over the next six months. Approximately two-thirds of survey respondents expect employee compensation to rise in the next half-year. Shortages of qualified workers continue to be a primary factor tempering local economic growth. Half of the businesses responding to the survey believe it will become more difficult to attract qualified workers over the next six months. This compares to a forty-four percent response to the same survey item reported in the July 1999 **St. Cloud Area Quarterly Business Report**. Area firms are moderately concerned about the effects of rising interest rates on their company's profitability. Approximately one out of every three businesses responding to the survey indicated increased interest rate concerns over the next six months. Survey responses also indicate that area firms are less optimistic about current and future national economic conditions than they were three months ago.

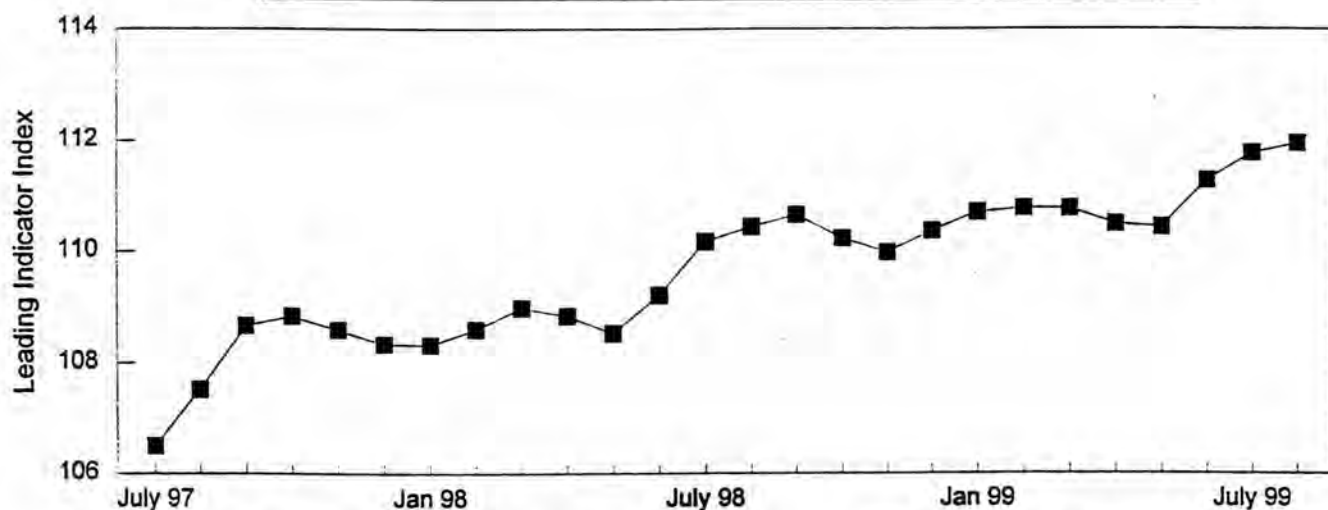
*St. Cloud Index of Leading Economic Indicators*

The most recent **St. Cloud Index of Leading Economic Indicators** indicates that local economic activity should continue to expand and may even accelerate over the next four to six months. The index has increased sharply in recent months, reaching a record high in August.

Contributing to the strong growth in the index is a rising U.S. index of leading economic indicators, a lengthening average manufacturing workweek in St. Cloud, and growing new residential electric hookups. New business start-ups in the St. Cloud area have had a neutral effect on the index in recent months. 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) Aug 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 Economic Indicators**, the St. Cloud economy has experienced moderate economic growth throughout 1999. For the year ending August 1999, St. Cloud nonfarm employment expanded by 1.4 percent. By comparison, state and national employment grew at 1.8 percent and 2.2 percent rates, respectively. Both state and local employment growth has slowed since August 1998. One year ago, nonfarm employment was growing at a 2.7 percent rate in both St. Cloud and Minnesota.

The decrease in Minnesota's nonfarm employment growth rate appears to be primarily an outstate phenomenon. Twin Cities metropolitan area employment growth for the year ending August 1999 was 2.8 percent--identical to its corresponding rate one year earlier. A lack of qualified workers continues to constrain economic growth in the St. Cloud area. Shortages of workers in the skilled crafts appear to be particularly acute outside of the Twin Cities metro. The divergence in employment growth between the Twin Cities and other parts of the state may suggest that outstate Minnesota is bearing a disproportionate share of the burden of worker

shortages. Understanding why the Twin Cities (and also Rochester) has fared better than the rest of Minnesota is key in developing solutions to the outstate labor shortage.

With its higher wage structure, it is understandable why the Twin Cities is attractive to workers who are either willing to commute or relocate to the metropolitan area. Higher employee compensation (and the net migration and commuting associated with it) probably does not entirely explain the differential in employment growth rates between the Twin Cities and the rest of Minnesota. Perhaps Twin Cities employers have done a superior job at digging deeper in the labor pool to attract workers (for example, using seniors, former welfare recipients, and physically & developmentally disabled persons), but why this seeming advantage over outstate employers continues to persist is unclear. Twin Cities metro area businesses have also been very successful in recruiting college and university graduates from outstate schools. A special question of the **St. Cloud Area Business Outlook Survey** gives a preliminary indication of the extent to which area firms are interested in recruiting and retaining area college graduates as full time employees. About thirty percent of area firms indicated that their efforts aimed at recruiting area college graduates have intensified in recent months. A similar percentage of firms indicate that these efforts will increase further over the next six months. According to the **St. Cloud Area Profile, 1999-2000**, the three area four-year colleges and universities graduated over 3,200 students in the 1997-98 academic year. St. Cloud Technical College graduated a total of 1,158 in the three year period from 1993-95. It appears that area business leaders, representatives of institutions of higher learning, and future college graduates could benefit greatly from improved coordination of graduate recruitment and retention efforts.

St. Cloud's leading growth sectors over the past year have been transportation & public utilities, general merchandise stores (primarily large department stores), health services, and educational services. Employment growth in these sectors has been 4.6%, 10.9%, 4.1%, and 6.6%, respectively. The robust growth in these sectors is not surprising. For instance, St. Cloud's large retailers are faring well and its reputation as a regional health care center seems to be confirmed by these employment growth numbers. Although area construction has cooled from its sizzling double-digit annual employment gains of 1998 and early 1999, construction employment still grew 3.4 percent over the last twelve months. Despite a recent rise in interest rates, St. Cloud's construction sector continues to grow at a robust pace. Indeed, the U.S. Department of Commerce reports that St. Cloud residential building permits surged over the summer months. This portends a healthy construction sector well into 2000.

The local, state, and national manufacturing sectors showed signs of weakness in late 1998 and early this year. In recent months, however, area manufacturing has bounced back. While manufacturing employment *declined* two percent nationally and 0.4 percent in Minnesota, St. Cloud manufacturing employment increased 0.8% in the year ending August 1999. This rebound may be related to the recent opening of the New Flyer production facility. Average weekly hours worked at area manufacturing plants averaged 42.9 in August, up from a low of 40.9 hours in March. The recent surge in manufacturing activity bodes well for the St. Cloud area economy in the fourth quarter of 1999 and early next year. One surprise is that average hourly earnings at manufacturing facilities in the St. Cloud area were no higher in the summer of 1999 than they were in the corresponding period one year earlier. This information suggests that area

manufacturers have perhaps not felt the worker shortage as intensely as other local employers. While average hourly earnings in manufacturing have slipped in recent months, fifty-three percent of firms responding to the **St. Cloud Area Business Outlook Survey** indicated that employee compensation had increased in September 1999 from its level three months earlier and two-thirds of responding firms expect to further increase compensation over the next six months. Note that average hourly earnings primarily reflect wages & salaries and overtime earnings of hourly production workers, while employee compensation also includes the value of fringe items such as health and retirement benefits. Indeed, manufacturing wages could be affected by changes in the composition of local firms and changing overtime patterns (which are still slightly below Summer 1998 levels).

Although most of the local economy is faring quite well, there are a few soft spots. One is relative weakness in retail trade (outside of general merchandise retail). While total retail employment is up by 1.2 percent for the twelve months ending August 1999, this growth is due to a 10.9 percent rise in general merchandise (primarily large department stores). The remainder of the local retail sector (which accounts for 85 percent of total retail employment), has experienced an actual *decline* in employment by 0.3 percent. It is unclear whether this is due to new competition from national franchises, the unavailability of qualified workers, seasonal shifts in employment demands at area firms, or some other explanation. Another soft sector of the regional economy is St. Cloud metro government employment which, in a continuation of an observed trend of the latter half of the 1990s, experienced employment declines of 4.6 percent in the year ending August 1999.

Most non-sectoral labor market indicators confirm a healthy local economy. The August 1999 St. Cloud Metropolitan Area unemployment rate was 2.2 percent--about the same as one year earlier. New unemployment insurance claims in the St. Cloud area were considerably lower in the summer of 1999 than they were one year earlier. Help wanted lineage in the *St. Cloud Times* was about 5 percent higher this summer than during the corresponding period in 1998. Although the dynamics of the local labor shortage are not easily understood, these indicators, along with the survey data reported in the **St. Cloud Area Business Outlook Survey**, continue to support the notion that the local labor shortage will persist well into 2000. Future volumes of the **St. Cloud Area Quarterly Business Report** as well as the **38th Annual Economic Education Winter Institute**, held at St. Cloud State University on February 24-25, 2000, will continue to probe the dimensions of local, regional, state, and national labor shortages.

#### ***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-six 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 optimistic about future business conditions. Although the diffusion index for current business conditions in June 1999 is 21.1, much lower than the corresponding index from the June survey, it is unclear whether this represents increased concern on the part of area businesses or, alternatively, reflects steady growth in the St. Cloud area this summer. 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. Fifty-seven percent of area firms expect the level of business activity for their company to increase over the next six months compared to 18 percent expecting a decrease in activity. While the diffusion index for future business activity has decreased from 52.5 in June 1999, it still remains at a healthy 39.2 in the most recent month. This decline in the diffusion index might arise from an unobservable seasonal effect (survey results have not been seasonally adjusted). Comments from area firms include, "the level of business activity today which we are experiencing will be hard to improve upon--I cannot believe at this time it can be maintained for a long period of time." Also, "we need to find niches others are not filling to remain competitive. This has caused us to look at national markets." And, "housing affordability continues to be a problem on the local, state, and national level." Finally, one area firm reports that "all forecasts indicate another strong year for 2000."

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. Forty-five percent of surveyed firms expanded company payroll employment over the past three months, and forty-three 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. Fifty-five percent of survey respondents indicate that it was more difficult to attract qualified workers in September than it was three months earlier. This percentage is up from 42% in June. In addition, half of survey participants expect the labor shortage to worsen over the next six months. One area firm notes that "both our business and our customers are experiencing unusually high employee turnover over the past 6 months. People at the center of the pay scale who are not highly productive are being hired by competitors at pay rates toward the top of the scale. Our problem is discovering the proper method to motivate staff to increase production which will allow us to compensate them 20% more than we are paying today without causing the gross profit to suffer." Another small firm writes that "...the increase in competition for employees in St. Cloud made it very difficult to find qualified applicants. (We) hired two employees in the last year--one from Duluth and one from Motley--by advertising in newspapers from those places."

The worker shortage appears to be causing a predictable increase in employee compensation in the St. Cloud area. Fifty-three percent of firms surveyed reported higher levels of employee compensation in September than three months earlier and two-thirds expect to pay higher wages and benefits six months from now. Area firms are having only limited success passing higher costs on to final customers. While 29% of surveyed firms report that prices received in September were higher than in June, 60% indicate no change in prices received. Firms may be expecting slight improvements in this area in the future. Thirty-seven percent of respondents believe the prices they receive for their products will be higher six months from now.

A marked change in area firms' views of national economic conditions was observed in the most recent survey. While thirty-one percent of surveyed firms believe that national business activity in September was improved over its level three months earlier, only 18% expect national business conditions to be improved six months from now. Indeed, 16 percent of surveyed firms expect national economic conditions to deteriorate over the next six months. The diffusion index regarding future national business conditions decreased from 13.5 to 1.8 in the most recent survey.

Concerns about the effects of rising interest rates on the national economy helps explain why area firms are increasingly anxious about U.S. and local business conditions. Special question 1 asked area firms to evaluate their concerns about rising interest rates on their company's profitability. Thirty-eight percent of surveyed firms indicated increased concerns about the effects of rising interest rates on company profitability in September relative to three months earlier. Thirty-five percent of respondents also indicated increased concern over the effects of rising interest rates over the next six months. One area firm noted the effect rising interest rates might have on used equipment sales. Another firm noted that rising rates may make housing less affordable. Another firm writes that "higher interest rates could slow building of new homes affecting local work."

Higher interest rates do appear to be a threat to the local economy. To the extent that higher rates slow the national economy, this will indirectly affect business activity in St. Cloud. Higher rates might slow construction spending and result in a dollar appreciation, making exports less attractive. Many analysts expect rising interest rates to cause declining equity values. The extent to which this could impact local spending will be closely watched in coming months.

Two key local sectors to watch in coming months will be construction and finance, insurance, & real estate. These rate-sensitive sectors account for 13.7% and 10% of *new* job growth in the economy, respectively. This is far greater than their employment shares in the local economy (approximately 4.5% for construction and 4% for finance, insurance & real estate). Assuming that current employment patterns continue, if rising interest rates lead to a slowdown in these two sectors, it will have a disproportionately large impact on new job creation in the St. Cloud area. Rising rates may also cause considerable harm to the agricultural sector and could restrain the resurgent growth in area manufacturing. Fortunately, as yet there is no direct evidence that area firms are experiencing any major distress associated with these concerns.

Quantitative results from special question 2 were discussed earlier in this report. Approximately thirty percent of surveyed firms indicated increased interest in attracting and/or retaining recent graduates from St. Cloud area colleges and universities. A similar percentage of firms expect a further increase in these efforts over the next six months. Improving the educational mix of the local labor force would clearly boost average area incomes and help relieve the labor shortage. Difficulty in attracting and retaining employees from area colleges appears to be a frustration for many area employers who use a variety of recruitment tools. Surveyed firms were asked to explain their company's efforts to attract graduates from St. Cloud area colleges. These comments are as follows:

"We contact St. Cloud Technical College primarily for our specialty skills needs."

"Seventy percent of our employees are St. Cloud Technical College graduates. We are presently searching for a person with business or a human resources degree and are having a difficult time. Most difficult is locating a HR person with energy and attitude to recruit staff."

"St. Cloud Technical College has discontinued the program in electronics in which we used to get our service technicians."

"Talking to instructors and professors one year prior to students' graduation to recruit the top students."

"Do not require college degree for employees."

"Work with department heads and placement offices."

"We have and will continue to advertise in the *St. Cloud Times* as well as keeping local colleges aware of our needs."

"Internships and part-time jobs while in school."

"Career fair, employment forecasting, and site visits. St. Cloud area business needs to expand its recruitment efforts with an upper Midwest campaign endorsed by city leadership."

"Internships."

"We try to be involved at all four schools."

"We are not actively recruiting employees with advanced degrees. We need entry level clerical/computer skills."

"Placement office, Atwood Center (SCSU) kiosk, SCSU newspaper, speak to professors--need for additional workers in all areas of employment--we want to reach more students!!"

"There are no schools teaching (our company's trade)."

"We set up interviews on campus."

"Posting our positions in grad bulletin."

"We have our name posted at St. Cloud Technical College on a regular basis."

"We work directly with both St. Cloud Technical College as well as SCSU regarding intern positions as well as full time employees."

"We primarily use internships as a way to attract students. This allows the student and our organization the ability to look at each other and determine if there is a good fit. We have several employees we have hired this way."

Look for the next **St. Cloud Area Business Outlook Survey** in December and the accompanying **St. Cloud Area Quarterly Business Report** (including the **St. Cloud Index of Leading Economic Indicators**) in January 2000.



**TABLE 1--CURRENT BUSINESS CONDITIONS\***

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary September 1999	September 1999 vs. Three Months Ago				June 1999 Diffusion Index <sup>3</sup>
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index <sup>3</sup>	
What is your evaluation of:					
level of business activity for your company	10.9	30.9	58.2	21.1	67.8
number of employees on your company's payroll	12.7	41.8	45.5	32.8	42.4
length of the workweek for your employees	7.3	72.7	20.0	12.7	22.0
capital expenditures (equipment, machinery, structures, etc.) by your company	7.3	63.6	29.1	21.8	28.8
employee compensation (wages and benefits) by your company	0	47.3	52.7	52.7	57.6
prices received for your company's products	9.1	60.0	29.1	20.0	20.3
national business activity	7.3	47.3	30.9	23.6	33.9
your company's difficulty attracting qualified workers	3.6	41.8	54.5	50.9	39.0
SPECIAL QUESTION 1: Your concerns about rising interest rates on your company's profitability.	5.5	49.1	38.2	32.7	NA
SPECIAL QUESTION 2: Your company's interest in attracting and/or retaining recent graduates from St. Cloud area colleges as full time employees.	1.8	58.2	29.1	27.3	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 September 1999	Six Months from Now vs. September 1999				June 1999 Diffusion Index <sup>3</sup>
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index <sup>3</sup>	
What is your evaluation of:					
level of business activity for your company	17.9	25.0	57.1	39.2	52.5
number of employees on your company's payroll	7.1	50.0	42.9	35.8	44.0
length of the workweek for your employees	8.9	76.8	14.3	5.4	5.1
capital expenditures (equipment, machinery, structures, etc.) by your company	10.7	50.0	39.3	28.6	33.9
employee compensation (wages and benefits) by your company	0	33.9	66.1	66.1	61.0
prices received for your company's products	1.8	58.9	37.5	35.7	25.4
national business activity	16.1	51.8	17.9	1.8	13.5
your company's difficulty attracting qualified workers	3.6	46.4	50.0	46.4	42.4
SPECIAL QUESTION 1: Your concerns about rising interest rates on your company's profitability.	7.1	48.2	35.7	28.6	NA
SPECIAL QUESTION 2: Your company's interest in attracting and/or retaining recent graduates from St. Cloud area colleges as full time employees.	1.8	57.1	30.4	28.6	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