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ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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Executive Summary
Continued strength of the St. Cloud area economy should endure throughout Summer 2000 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. While the leading indicators index has leveled off in recent months, it remains well above its year earlier level. The St. Cloud area economy continues to grow very rapidly. For example, for the year ending February 2000, St. Cloud Metropolitan Statistical Area (MSA) job growth was still expanding at a vigorous 3.2 percent rate, surpassing the 2.4 percent growth rate for Minnesota and the 2.0 percent U.S. growth rate. The St. Cloud area employment growth rate also exceeded the 2.6 percent rate experienced in the Twin Cities, but trailed job growth of 3.8 percent in Rochester. It is apparent that St. Cloud ended the decade of the 1990s as it began–as one of the strongest economies in the upper Midwest.

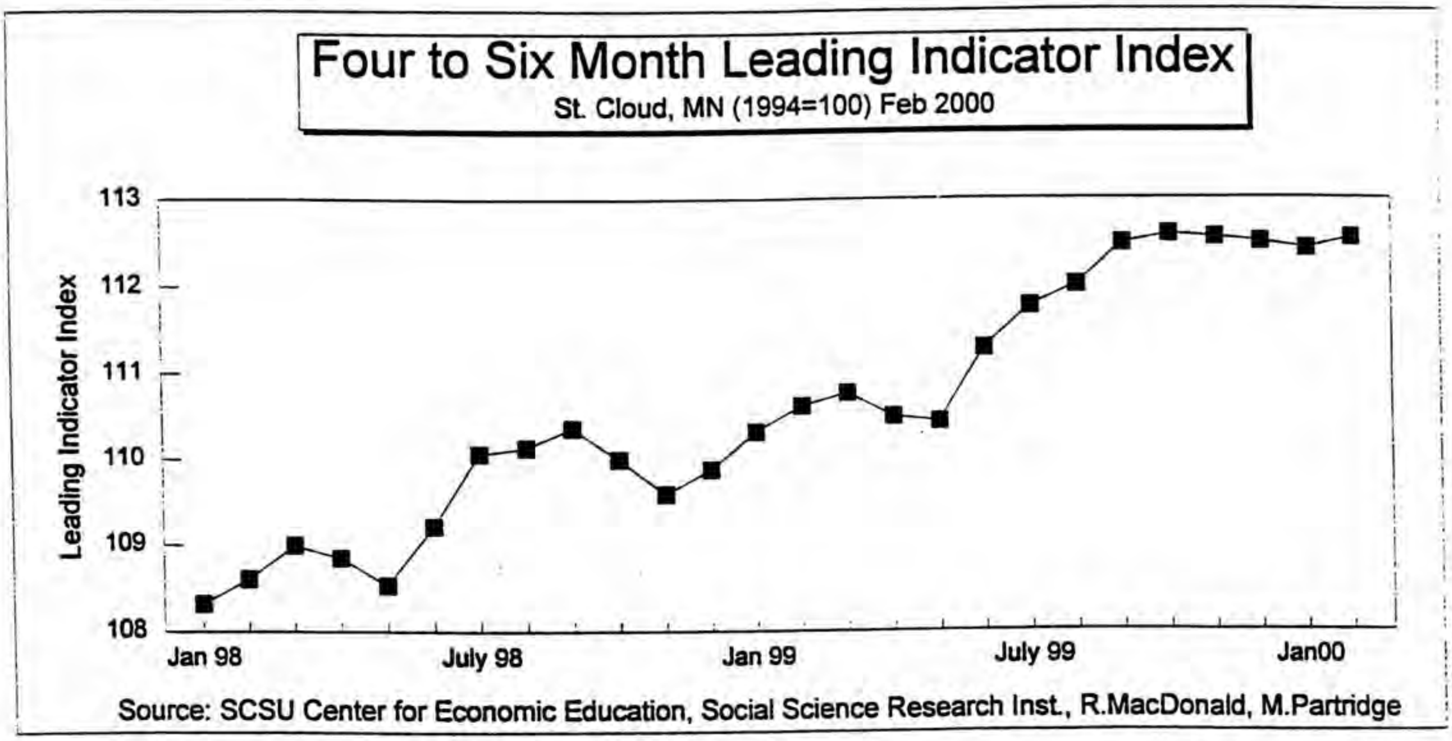
Seventy-eight percent of area businesses participating in the **St. Cloud Area Business Outlook Survey** expect an increase in the level of business activity for their company over the next six months. This compares to only 3 percent who expect conditions to worsen. Approximately six out of every 10 surveyed businesses 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 a primary factor tempering local economic growth, the area labor shortage does appear to be moderating. Although 34 percent of local companies expect increased difficulty attracting qualified workers over the next six months, this number is down from 50 percent six months ago and a one year earlier response of 65 percent. Firms responding to the survey lend support to the Federal Reserve's concern about rising inflationary pressures. Thirty-four percent of area firms expect to increase prices over the next six months. This is the highest value for this item since the survey was initiated in December 1998.

A special question in the March 2000 **St. Cloud Area Business Outlook Survey** asked St. Cloud area businesses to assess how the proposed commuter rail line between St. Cloud and the Twin Cities would affect the area business environment. Answers to this question were mixed, with 26 percent of respondents indicating that the rail line would "somewhat worsen" the area business

environment and 40 percent expecting it to "somewhat improve" area business conditions.

St. Cloud Index of Leading Economic Indicators

The February 2000 **St. Cloud Index of Leading Economic Indicators** forecasts that the pace of local economic activity will remain steady into Summer 2000. This is an encouraging sign given the current robust level of economic growth. The index is being lifted by the rising U.S. index of leading economic indicators and new residential electric hookups in St. Cloud. A recent downward movement in new St. Cloud area business start-ups and in the average manufacturing workweek have been offsetting factors. While the **St. Cloud Index of Leading Economic Indicators** has been relatively flat since September 1999, it remains at a historically high level. As a rule of thumb, three consecutive positive changes in the index suggest an expanding economy, while three consecutive decreases suggest a contracting economy and/or a slowing of economic growth.



Recently released revisions of area employment growth numbers confirm that the St. Cloud economy has been red hot over the last couple of years. Earlier this year, the U.S. Bureau of Labor Statistics *significantly* upgraded their estimate of local job growth dating back to 1998. St. Cloud MSA employment is now reported to have grown 3.5% in 1998 and 4.7% in 1999. This is much faster than employment growth of 2.1% and 2.8% in the Twin Cities for the comparable period. The pace of St. Cloud area employment growth was also much greater than the 2.6% and 2.1% growth in 1998 and 1999, respectively, for the entire state of Minnesota. It is apparent that St. Cloud ended the decade as it began--as one of the strongest economies in the upper Midwest.

For the year ending February 2000, St. Cloud MSA job growth was still expanding at a vigorous 3.2% rate, surpassing the 2.4% growth rate for Minnesota and the 2.0% U.S. growth rate. The St. Cloud area employment growth rate also exceeded the 2.6% rate experienced in the Twin Cities, but trailed job growth of 3.8% in Rochester.

The rapid rate of St. Cloud area job growth suggests that area businesses have found a way to attract workers. While companies responding to the **St. Cloud Area Business Outlook Survey** have consistently reported the difficulty they are having finding qualified workers, the revised employment growth numbers indicate that area businesses have been reasonably successful in finding employees. A key ingredient in attracting and retaining labor is competitive compensation packages. To that end, a majority of survey respondents have recently increased employee compensation (and a majority are expecting to further increase compensation in the near future). These efforts may now be paying off. Only 27 percent of surveyed businesses report more difficulty attracting qualified workers compared to three months ago. In addition, only 34 percent expect to find it more difficult to find workers six months from now. These numbers are down sharply from the levels reported one year ago. While many businesses in the St. Cloud area are having significant difficulties attracting qualified workers, these problems appear to be softening. Recent increases in residential electrical hookups suggest that there has been an increase in net worker migration into St. Cloud. This is further evidence of a recent moderation of labor-force shortages.

Changes in regional commuting patterns could also reduce labor shortfalls. However, it is unclear whether the degree of out-commuting of St. Cloud residents to the Twin Cities has recently changed. In the most recent **St. Cloud Area Business Outlook Survey**, area business persons were asked their opinion regarding the proposed Northstar commuter rail line between St. Cloud and Minneapolis. Despite a slightly favorable overall bias, most survey respondents did not voice strong opinions on the potential effect of the proposed line on the local business community. The mixed responses likely reflect the variety of potential alternative impacts of the proposed line. For example, by increasing the attractiveness of St. Cloud as a community in which to live, this project could increase in-migration, helping the business community attract additional workers and consumers. This would be very favorable for many area businesses. On the other hand, more St. Cloud residents may choose to work in the Twin Cities, further exacerbating local labor shortages. This is likely to have an unfavorable impact on local firms.

An in-migration of workers could help increase the average skill level of the area labor pool, which, along with increased competition for workers, will help drive a higher local wage scale. Both developments could be favorable for the St. Cloud area, which historically has had a relatively low level of income. For example, data from the U.S. Bureau of Economic Analysis show that St. Cloud metropolitan area per capita income was 75 percent of the state average in 1997. In addition, St. Cloud ranked 277 out of 315 MSAs in terms of per capita income. This places St. Cloud in the company of communities such as Charleston, SC and Grand Forks, ND. It also ranks St. Cloud below such cities as Jackson, MS and Birmingham, AL. Finally, per capita incomes in the St. Cloud area are lower than other Minnesota MSAs. For example, the Twin Cities is 26, Rochester is 51, and Duluth is 191 on the list of per capita incomes in the rankings of 315 MSAs. While this is neither a ranking of relative living standards nor a quality of life measure, it does point out one of the weaknesses of the St. Cloud area economy. Of course, whether a commuter rail line is the best solution to this problem is uncertain.

St. Cloud economic growth is broad-based across most sectors. A typical indicator of a future regional economic downturn is unbalanced sectoral growth. Such unbalanced growth is not evident in any of the employment data released in early 2000. St. Cloud's high growth sectors include local government, finance, insurance & real estate, and services. Employment in these three sectors grew at a rate of 8.8%, 7.0%, and 6.9%, respectively, in the year ending February 2000. Rapid growth in the local government and service sectors is a relatively recent phenomenon. While St. Cloud manufacturing employment is growing at a more moderate 2.1% rate over the last twelve months, this compares very favorably to a slight 0.4% increase in Minnesota and an actual 0.8% decline nationally. As noted in past editions of the **St. Cloud Area Quarterly Business Report**, the relative prosperity of local manufacturing is a sign of a healthy St. Cloud business environment.

The only sectors of the St. Cloud area economy to experience declining employment over the last year were construction (-4.7%) and the state government sector (-7.9%). While local employment in the state government sector has been abnormally volatile in recent months, this does not appear to be of widespread concern. Declining employment in the construction sector probably reflects a "breathing spell" from the incredible pace of local construction activity that was observed in 1998 and 1999, especially for commercial projects. While recent interest rate hikes could produce slower growth in the local construction sector, there is as yet no direct evidence that this is happening. U.S. Department of Commerce residential building permit data even suggest that residential construction in 2000 will exceed the levels of the prior two years. Indeed, the value of residential building permits during the December 1999-February 2000 period is 140% above the level experienced four years earlier.

Retail employment expanded 0.6% in the year ending February. This continues a flat trend dating back to late 1995. February 2000 retail employment in the St. Cloud area is actually below its level in February 1996. Economic theory predicts that sluggish retail employment growth will arise from a tight labor market. Relatively low-paying sectors (such as retail) will have the most difficult time attracting and retaining qualified workers.

Other indicators also suggest a healthy local economy. New unemployment insurance claims in the St. Cloud area are at historically low levels. For example, in the three month period ending February 2000, new St. Cloud area unemployment claims are approximately one-half the level experienced during the same period a year earlier. The February 2000 St. Cloud metropolitan area unemployment rate was 3.4%, a decline from the 4.0% rate in February 1999. In the quarter ending February 2000, help-wanted ad linage in the *St. Cloud Times* is about even with the corresponding period in 1998-1999. Note, however, that help-wanted ad linage is actually 52% above the level of the December 1995-February 1996 period, further illustrating the strong local labor market. Finally, respondents to the **St. Cloud Area Business Outlook Survey** remain very optimistic regarding future business activity. Perhaps the only plausible threats to continued local economic growth are further Federal Reserve tightening measures, rising fuel prices, and/or an abrupt adjustment in the stock market. Even these threats do not appear to be weighing too heavily in the minds of area business persons.

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 **St. Cloud Area 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, 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 businesses remain extremely optimistic about future business conditions. The diffusion index for current business conditions in March 2000 is 35.6, well above the 21.9 and 21.1 figures recorded in the December and September 1999 surveys, respectively. The diffusion index is measured as the percentage of respondents reporting an increase minus the percentage reporting a decrease. Thus, a widening of this number is a very encouraging sign. The March 2000 diffusion index for the future business outlook remains high at 74.6. Seventy-eight percent of surveyed firms expect their company's business activity to increase over the next six months. Only 3 percent expect a slowdown. This is a continuation of the strong company performance that has been observed in prior editions of the **St. Cloud Area Quarterly Business Report**. Note that the results in this report have not been seasonally adjusted. Some businesses indicate that business activity is expected to improve for seasonal reasons while others anticipate a seasonal slowdown.

One area business indicates that while they are experiencing a seasonal increase in business, "this current increase is more than seasonal and continues the long term growth of the area." Another business notes that "improved weather conditions allow us to have a great start on 2000 business. As long as interest rates and (materials prices) remain affordable we will do OK. So far fuel pricing has not been a negative factor for us." But improved weather is not good for all St. Cloud area businesses. One area firm points out that "we are currently in our busiest three months, but a warm winter and late Easter are difficult on (our) industry." Another firm notes that it is concerned about interest rates and gas prices. Mergers and buyouts are affecting the business of another area company. This company wonders "who is doing business with whom these days? Who controls the business that is sent our way?" This same company notes that technology is an important factor in their business. Yet another St. Cloud area firm remarks that their "customers are not buying *any* new equipment. This is based on the sudden increase in (energy) prices plus the fact that customers are (working down inventories that were accumulated) because of Y2K concerns." However, one area firm sums up their outlook by simply noting that their business is "NUTS in the spring."

The current and future outlook for potential employees improved in March 2000. The diffusion index for the current number of employees on company payrolls improved from 1.8 in December 1999 to 10.2 in the current survey. In addition, 58 percent of surveyed firms expect to increase payrolls over the next six months. No firms expect a decrease in employment. One strategy that area firms plan to use to meet rising demand is to increase the length of the workweek of their employees. Almost 30 percent of area firms expect to increase the length of the workweek over the next six months. Only one firm expects a decline in average hours worked. Area firms are still acquiring physical capital at about the same rate as in previous surveys. Slightly less than one-third of the survey respondents expect to increase capital outlays over the next six months. One area firm notes that it is building a new multimillion dollar structure.

Consistent with past surveys, the majority of surveyed firms indicate that they are either increasing or plan to increase employee compensation in the near future. Only one firm expects to reduce compensation over the next six months. This trend, while contributing to a potential erosion of profit margins, is a primary reason why area companies are beginning to see a moderation of local worker shortages. Profit margins need not shrink if firms can pass on higher labor and non-labor costs to their customers. Area companies responding to the **St. Cloud Area Business Outlook Survey** show stronger signs than ever that they believe that price increases can be achieved over the next six months. Thirty-two percent of firms were charging higher prices in March than three months earlier, and 34 percent of firms expect to increase prices over the next six months. These numbers are the highest recorded since the survey's inception in December 1998. The prospect of accelerating prices and wages is, of course, the reason that the Federal Reserve has increased interest rates five times since last summer. Many national observers think that future rate hikes are also coming. Despite this, several responding firms remarked on their limited ability to raise prices. One firm notes that "it is normally impossible to...increase...rates because the largest...company in the (industry) has only approximately a 3% market share." Another area financial firm points out that "although interest rates have increased, the margins have been getting tighter due to competition. Thus, one could say that the 'price received' for our product has decreased." Finally, one survey respondent notes that the company sales plan "calls for increased sales to offset continued decrease in pricing...."

Despite media reports highlighting concerns about interest rate hikes, financial market instability, and rising fuel prices, area firms remain confident that national business activity will remain strong. Almost 36 percent of respondents indicated that they expect national business activity to improve over the next six months. Only 8.5 percent of firms believed that there would be a decrease in activity over the next six months. Indeed, the diffusion index on future national business activity is at an all-time high, an interesting result considering all of the uncertainty reported in the media. One area firm notes that "financial market activity has definitely had a negative effect on consumer confidence."

Area employers are still finding it difficult to attract qualified employees. Twenty-seven percent of surveyed firms reported that it was more difficult to find workers in March than it was three months earlier. Thirty-four percent of responding companies expect it to be more difficult attracting qualified employees six months from now. One area firm noted a "huge" concern with attracting qualified workers. Another firm indicated that "human resources are a major factor in what we do–qualified and 'committed' people are hard to come by these days." While these numbers justify a continuing concern about area worker shortages, other evidence suggests that the labor shortage is moderating. The January 2000 **St. Cloud Area Quarterly Business Report** suggested that we were seeing the first signs of a reversal of the trend toward tighter labor markets. The diffusion index on the survey question relating to future anticipated worker shortages decreased to 34.6 in December 1999, down from 46.4 three months earlier. The March 2000 survey confirms the continuation of this trend. The diffusion index on this item has now declined to 25.4. A similar observation can be made for the survey item relating to current worker shortages in March 2000. A moderation of the labor shortage in the St. Cloud area will be a welcome sign for area employers.

This month's special question asked area employers to evaluate the impact the proposed rail line between the Twin Cities and St. Cloud would have on area businesses. There was no particular consensus among area firms on the effect that the Northstar line would have on their companies. While 46.6 percent of surveyed firms answered that they believe the commuter rail line would either "somewhat improve" or "greatly improve" the St. Cloud area business environment, 29.3 percent of respondents disagreed. These firms believed that the rail line would either "greatly worsen" or "somewhat worsen" the area business environment. Support for the proposed rail line appears to be much lower among the St. Cloud area business community than it is among the general public. A February 2000 Minnesota Poll, published in the March 12 edition of the *Star Tribune*, reported that 69 percent of Minnesotans supported commuter rail on existing freight tracks. The results of the polling did not reveal significant differences in opinion between Twin Cities residents and those of outstate Minnesota. While the special question in the **St. Cloud Area Business Outlook Survey** did not specifically ask whether surveyed business persons supported or opposed the proposed commuter rail line, it does appear that area businesses do not support the project to the extent that is reported in the broader *Star Tribune* poll.

Written responses of surveyed firms covered a wide range of concerns. For example, one theme was that a commuter rail line would produce a closer link between St. Cloud and Twin Cities labor markets. One respondent suggests that "I think it will help people who live here and work in the Minneapolis/St. Paul metropolitan area." Another respondent notes that "if the commuter rail line is as affordable and ran with the efficiency planned–I believe it will attract more of the local labor force to the metro area. As proven, the wages for workers are much higher in the metro–which in turn makes it harder for the St. Cloud business owner to compete." A similar theme was echoed by many other surveyed firms. One firm summed up these concerns by stating "why do we want to encourage people to work in the Twin Cities rather than in St. Cloud?" Finally, one respondent noted that "I believe that there would be increased business activities for St. Cloud from metro area firms relocating to this area; but I think with that an increase in salary will be needed to meet the metro level in order to keep employees."

The responses to this question appear to depend on the nature of the surveyed firm. Retail firms and those who earn their living in the local housing market appeared to see the commuter rail proposal much more favorably than those firms who are fearful of losing workers to the Twin Cities. Since the rail line will likely expand local consumer markets as well as increase the demand for St. Cloud area housing, these responses are not a surprise. But housing prices may worsen the "affordability" problem that has concerned many community leaders. One issue that this survey has raised is that efficient commuter rail service between St. Cloud and the Twin Cities increases the likelihood that St. Cloud would become an extended suburb of the Twin Cities.

Such a possibility would have profound repercussions for the community beyond those which directly affect the area business environment.

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

TABLE 1–CURRENT BUSINESS CONDITIONS*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary March 2000	March 2000 vs. Three Months Ago				December 1999 Diffusion Index[3]
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	
What is your evaluation of:					
level of business activity for your company	18.6	25.4	54.2	35.6	21.9
number of employees on your company's payroll	16.9	54.2	27.1	10.2	1.8
length of the workweek for your employees	8.5	72.9	16.9	8.4	3.6
capital expenditures (equipment, machinery, structures, etc.) by your company	10.2	55.9	32.2	22.0	18.2
employee compensation (wages and benefits) by your company	0	45.8	52.5	52.5	49.1
prices received for your company's products	8.5	52.5	32.2	23.7	18.2
national business activity	11.9	54.2	27.1	15.2	10.9
your company's difficulty attracting qualified workers	11.9	59.3	27.1	15.2	38.1
SPECIAL QUESTION: Given its potential impact on sales, labor availability, taxes, and local amenities, how do you believe a proposed commuter rail line from St. Cloud to the Twin Cities would affect the St. Cloud Area business environment?	Generally Worsen 3.4	Somewhat Worsen 25.9	No Net Effect 24.1	Somewhat Improve 39.7	Greatly Improve 6.9

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 March 2000	Six Months from Now vs. March 2000				December 1999 Diffusion Index[3]
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	
What is your evaluation of:					
level of business activity for your company	3.4	16.9	78.0	74.6	74.5
number of employees on your company's payroll	0	40.7	57.6	57.6	43.6
length of the workweek for your employees	1.7	67.8	28.8	27.1	16.4
capital expenditures (equipment, machinery, structures, etc.) by your company	8.5	59.3	30.5	22.0	30.9
employee compensation (wages and benefits) by your company	1.7	35.6	61.0	59.3	67.3
prices received for your company's products	1.7	55.9	33.6	31.9	30.9
national business activity	8.5	47.5	35.6	27.1	21.8
your company's difficulty attracting qualified workers	8.5	55.9	33.9	25.4	34.6

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*