12-16-2012

# St. Cloud Area Quarterly Business Report, Vol. 14, No. 4

King Banaian
*St. Cloud State University*, kbanaian@stcloudstate.edu

Richard A. MacDonald
*St. Cloud State University*, macdonald@stcloudstate.edu

# ST. CLOUD AREA QUARTERLY BUSINESS REPORT

St. Cloud Times

VOL. 14, ISSUE 4 / SUNDAY, DEC. 16, 2012


# ST. CLOUD AREA LOGS SOLID QUARTER

## UNCERTAINTY CLOUDS OUTLOOK


### ABOUT THE AUTHORS

**KING BANAIAN**
Department of Economics,
St. Cloud State University,
320-308-4797

**RICH MACDONALD**
Department of Economics,
St. Cloud State University,
320-308-4781


King Banaian specializes in analyzing data and writing about it in the second portion of this report. Rich MacDonald collects and analyzes responses to the St. Cloud Area Business Outlook Survey, covered in an early portion of the report. Only MacDonald has access to the confidential list of surveyed businesses and the returned surveys. Questions about the survey can be directed to him. Special questions asked in the survey may at times deal with public policy but do not reflect a political agenda of either of the authors.

### EXECUTIVE SUMMARY

Above-average growth in area employment continued over the recent quarter as labor market conditions in Central Minnesota stayed stronger than is observed elsewhere around Minnesota. Combined with solid survey responses and favorable movements in the St. Cloud Index of Leading Economic Indicators and the Probability of Recession Index, area economic performance is expected to remain strong over the next several months. The one area of uncertainty that clouds the local outlook is the unknown resolution of concerns related to the "fiscal cliff." At the time this report was written, there was no agreement between Congress and the president that would prevent the economy from this potentially contractionary fiscal policy.

Area private sector employment grew at a 3.1 percent rate over the year ending October 2012. While this represents a deceleration in area private employment growth from last quarter's report (when private sector job growth was 4.2 percent), this is much stronger than the long-term trend. While it remains to be seen whether next quarter's annual data revisions will confirm this rapid growth in the St. Cloud area, there is little doubt that a full-blown expansion has taken hold in Central Minnesota.

Employment in the education and health sector led the local job gains at an annualized pace of 5.9 percent. This was followed by the professional and business services, leisure and hospitality, financial activities, and construction sectors of the local economy. Each of these sectors experienced year-over-year job growth in excess of 3.5 percent. Together, these rapid growth sectors account for nearly 40 percent of local employment. In addition to a decline in government employment (which fell by 2.1 percent over the past year), the one trouble spot in the local labor market is manufacturing. Local manufacturing employment contracted by 1.2 percent over the last 12 months.

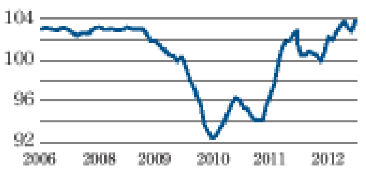
The October 2012 local unemployment rate was 5 percent, a reduction from the 5.1 percent rate recorded one year earlier. The number of people unemployed in the St. Cloud area actually declined from one year ago, despite an increase in the area labor force. With 5,405 unemployed workers, St. Cloud now has more than 2,000 fewer people unemployed than in October 2009 (when we were in local recession and area unemployment totaled 7,446).

The St. Cloud Index of Leading Economic Indicators rose slightly in the latest quarter, now reaching its historical high. Two of four indicators in the index were positive. The St. Cloud Probability of Recession Index stood at 35.5 percent in September, placing the chances of recession at slightly better than 1 in 3.

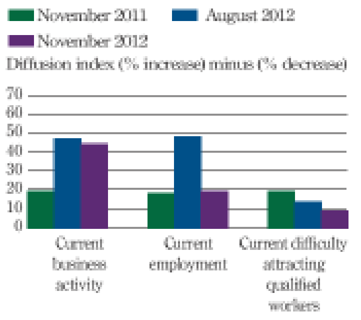
Sixty percent of 82 surveyed firms experienced improved business activity over the past three months, while only 16 percent reported decreased activity. This is the strongest performance ever recorded in

ST. CLOUD INDEX OF LEADING ECONOMIC INDICATORS

Six-month moving average




KEY RESULTS OF SURVEY




our November survey of current business activity. With 32 percent of firms reporting increased employment over the past quarter (and 12 percent reporting a reduction in employment), the index on current employment is the highest recorded in the November survey since 2005. More than one-third of survey respondents report higher employee compensation over the past three months, and no firms cut back on wages, salaries and benefits. Area employers did find it less difficult attracting qualified workers last quarter. The index on this survey item fell to 9.8 from a value of 13.2 one quarter ago.

The future outlook is about what we would expect during this stage of a local expansion. While the six-month-ahead outlook in the November survey is always seasonally weaker than what can be expected in our next two quarterly surveys, it is still worth noting that 50 percent of surveyed firms expect improved business conditions by May and only 13 percent expect weaker conditions. Likewise, the outlook on area employment, employee compensation and difficulty attracting qualified workers is about what can be normally expected.

Expected capital expenditures are at the highest recorded level since February 2008. Thirty-seven percent of surveyed firms plan to increase capital spending over the next six months. Improvements in economic activity don't appear to be putting pressure on prices. The index on future prices received continues to be well below what has been experienced over the past two years.

In special questions, 54 percent of survey respondents are "very concerned" about the fiscal cliff and 26 percent are "moderately concerned." Only 6 percent of firms are "not at all concerned." In a second special question, 45 percent of firms report an increase in regulatory/licensure requirements over the last 12 months. No area firm reports a decrease in regulation. One-quarter of firms indicate regulation has affected employment levels at their business in the last year. Finally, area firms were asked to provide an open-ended response to how the outcome of the Nov. 6 election will affect their business planning.


COLLABORATING PUBLISHERS

St. Cloud State University
Center for Economic Education
Department of Economics
School of Public Affairs

Greater St. Cloud Development Corp.
320-253-1424


# THE ST. CLOUD AREA BUSINESS OUTLOOK SURVEY

### CURRENT ACTIVITY

Tables 1 and 2 report the most recent results of the Business Outlook Survey. Responses are from 82 area businesses that returned the recent mailing in time to be included in the report. Participating firms represent the diverse collection of businesses in the St. Cloud area. They include retail, manufacturing, construction, financial, health services and government enterprises both small and large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Survey responses from Table 1 are, on balance, stronger than we have found in the November Current Business Conditions survey in recent years. This quarter's diffusion index on current business activity is much higher than it was one year ago. In November 2011, this index had a value of 19.8; this year's reading is 43.9 (the highest number ever recorded in November). A diffusion index represents the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given quarter. For any given item, a positive index usually indicates expanding activity, while a negative index implies declining conditions.

At a value of 19.5, the current employment index is substantially lower than the record high survey value recorded last quarter. Some of this decline is seasonal and some of it reflects strong local employment performance last summer. Note that


**See QBR, Page 2F**


TABLE 1-CURRENT BUSINESS CONDITIONS

| | November 2012 vs. three months ago | | | | |
|---|---|---|---|---|---|
| | Decrease (%) | No Change (%) | Increase (%) | Diffusion Index[3] | August 2012 Diffusion Index[3] |
| What is your evaluation of: | | | | | |
| Level of business activity for your company | 15.9 | 36.6 | 59.8 | 43.9 | 46.1 |
| Number of employees on your company's payroll | 12.2 | 56.1 | 31.7 | 19.5 | 47.3 |
| Length of the workweek for your employees | 13.4 | 74.4 | 12.2 | -1.2 | 23.7 |
| Capital expenditures (equipment, machinery, structures, etc.) by your company | 7.3 | 58.5 | 32.9 | 25.6 | 25 |
| Employee compensation (wages and benefits) by your company | 0 | 63.4 | 35.4 | 35.4 | 40.8 |
| Prices received for your company's products | 8.5 | 78 | 12.2 | 3.7 | 4 |
| National business activity | 13.4 | 41.5 | 34.1 | 20.7 | 27.6 |
| Your company's difficulty attracting qualified workers | 6.1 | 75.6 | 15.9 | 9.8 | 13.2 |

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

Source: St. Cloud State University Center for Economic Education, Department of Economics and School of Public Affairs

### MORE ONLINE

The St. Cloud Area Quarterly Business Report has been produced four times each year since January 1999. Electronic access to all past editions of the QBR is available at http://repository.stcloudstate.edu/scqbr/.

# QBR

From Page 1F

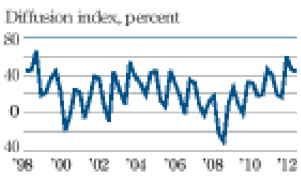
TABLE 2-FUTURE BUSINESS CONDITIONS

| | Six months from now vs. November 2012 | | | | |
|---|---|---|---|---|---|
| | Decrease (%) | No Change (%) | Increase (%) | Diffusion Index[3] | August 2012 Diffusion Index[3] |
| What is your evaluation of: | | | | | |
| Level of business activity for your company | 13.4 | 32.9 | 50 | 36.6 | 19.7 |
| Number of employees on your company's payroll | 9.8 | 56.1 | 31.7 | 21.9 | 13.2 |
| Length of the workweek for your employees | 9.8 | 69.5 | 18.3 | 8.5 | 0 |
| Capital expenditures (equipment, machinery, structures, etc.) by your company | 6.1 | 53.7 | 36.6 | 30.5 | 17.1 |
| Employee compensation (wages and benefits) by your company | 0 | 57.3 | 40.2 | 40.2 | 40.8 |
| Prices received for your company's products | 7.3 | 63.4 | 23.2 | 15.9 | 14.5 |
| National business activity | 11 | 39 | 35.4 | 24.4 | 15.8 |
| Your company's difficulty attracting qualified workers | 1.2 | 79.3 | 14.6 | 13.4 | 14.5 |

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

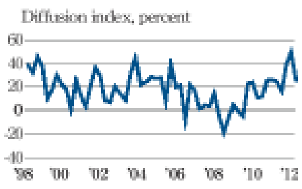
Source: St. Cloud State University Center for Economic Education, Department of Economics and School of Public Affairs

CURRENT BUSINESS ACTIVITY



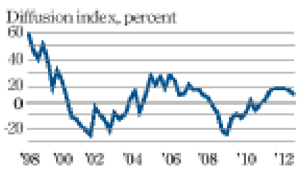

this quarter's employment index is higher than it has been in any November survey since 2005. Other labor indicators found in Table 1 are generally favorable. While it is always difficult to interpret the index on the length of the workweek, the index measuring employee compensation is the second-highest value recorded in six years. As can be seen in the nearby chart, the item on current difficulty attracting qualified workers has declined over the past two quarters. Historically, this item has shown a close correlation with local economic activity, so its recent movement is well worth watching.

CURRENT EMPLOYMENT




All other items in Table 1 have remained fairly steady over recent quarters. The index on current prices received continues to suggest that area firms are having little success passing on higher prices to customers. In addition, the national business activity and capital expenditures indexes have changed very little over the past few quarters.

CURRENT DIFFICULTY ATTRACTING QUALIFIED WORKERS




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

» No commercial activity and the available work is hard to come by. People are nervous and aren't spending as much at this time.

» Medicare fees must be legally adjusted back to acceptable levels before the end of the year. This very often happens right at the end of the year, but if it doesn't it will be very difficult to make up the differential and still give the quality of care we deliver.

» The truck driver shortage and high fuel costs will affect more than just those of us in trucking in the future! Most everything revolves around the price of shipping but rarely does anyone think of this. We need to attract more drivers to our industry. EPA regulations have taken a truck price from $100,000 four years ago to $140,000 today! The consumer will ultimately pay for these price increases to trucking.

» Interstate Highway 94 for shipment of our equipment and getting to Minneapolis and the airport needs to be three lanes and not a parking lot.

» EPA did not grant a waiver regarding the Renewable Fuels Standard (RFS), so ethanol industry is mandated to use 42 percent of the tight corn crop for fuel, further driving record-high feed costs even higher.

» (Our) business is seasonal. Our first quarter is usually the volume quarter. If economic troubles keep people away in the first quarter, it could trash the year.

» A decrease in fuel prices would have an immediate positive impact and a increase in fuel will have an immediate negative impact. We distribute products nationally, so as carriers such as UPS charge more or less for fuel, it has immediate impacts on customers budgets/spending ability.

» The strong farm economy, especially in western Minnesota, has positively affected our business again this year.

» CONGRESS AND THE PRESIDENT.

» The city of St. Cloud is planning a new 130,000-square-foot fitness/community/aquatic center. Including the fitness portion of this project at taxpayer expense will hurt all existing fitness centers in the area. The new center will not pay real estate taxes and will drain funds from the community. My business includes a fitness center and it will have a drastic effect on us. Our businesses are being hurt by being forced to pay sales tax in order to build something that will compete against us and the fact that they are tax exempt is unfair competition. The city should not build a fitness center — it is not only unfair, it is not needed and not affordable.

» We have just landed three large jobs that are expected to start immediately. We have not seen a large project start and continue through the winter for over four years. We take that as a sign the economy is improving since our costs for winter construction can add up to 30 percent to our contract.

» No ability to finance growth. Banks are shut down for assuming any risk.

» 80-85 percent of revenue comes (on a political cycle) so business is at the lowest level for the two-year cycle for the next six months.

» Very difficult to find employees who want to contribute and go the "extra mile." It seems they're more interested in what the employer will do for them.

» The Democrats are correct: "There is an educational deficiency in this country." The lazy and uneducated are holding this country back. How about a career path for every welfare recipient with a timeline! Or you lose your welfare benefits.

## Future Outlook

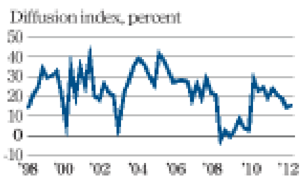
Table 2 reports the future outlook for area businesses. Similar to last quarter, the index on future overall business activity reflects a normal seasonal pattern. At a value of 36.6, this index is about the average November response over the past several years (although it is well above the November 2008 reading of 11.4 when the financial crisis and national recession clouded the local economic outlook). Likewise, the index on future employment is about what can ordinarily be expected during normal times in the November survey.

FUTURE CAPITAL EXPENDITURES


With one exception, the remaining items in Table 2 remain near their recent averages. The one item that shows substantial improvement (see accompanying chart) is the index on future capital expenditures. This index typically shows no particular seasonal pattern, so that it is at its highest level in several years suggests area firms will be adding to additional productive capacity to accommodate higher expected future demand. Of course, interest rates remain at historically low levels and banks are flush with cash, so increased capital spending seems inevitable.

One area in which firms would no doubt wish to see an improvement is in future prices received. As can be seen in the accompanying chart, despite measured improvement in local economic performance, area firms continue to expect difficulty raising prices. By comparison, the future prices received index in November 2005 (when the area economy was experiencing rapid growth) was 44. Its current value is 15.9.

FUTURE PRICES RECEIVED




## Special Questions

For several weeks, the lead story in the national media has been the impending "fiscal cliff" that would be encountered on Jan. 1, 2013, if Congress and the president can't agree to a policy course that would prevent an automatic reduction in federal spending, an increase in payroll and income tax rates, and a rescission of emergency unemployment insurance benefits.

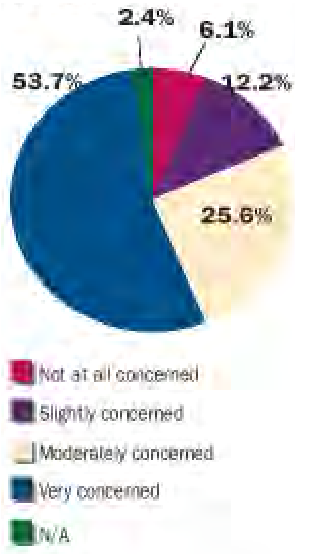
While a long-term benefit of spending cuts and tax increases would be a reduction in federal budget deficits, most observers appear to be concerned that this potentially contractionary fiscal policy would reverse the fragile national recovery and return the U.S. economy to recession.

For example, Global Insight, the national forecasting service used by the State of Minnesota in establishing an economic outlook to gauge its state revenue forecast, estimates that national output would decline at an annual rate of 3.6 percent in the first quarter of 2013 in its worst case fiscal cliff scenario. (By comparison, third quarter 2012 annualized output growth was recently reported as 2 percent.) Indeed, it appears that uncertainty associated with the fiscal cliff is already hampering business investment and hiring decisions. With this in mind, we decided to survey area business leaders about the extent to which they were concerned about the fiscal cliff.

**We asked:**

**QUESTION 1**

**The "fiscal cliff" refers to the potential contractionary fiscal policy that would automatically kick in on Jan. 1 if Congress and the president don't enact legislation to change the course of federal tax and spending policy. To what extent is your business concerned about this "fiscal cliff?"**




NOTE: Numbers may not add up to 100 due to rounding.

More than half of surveyed firms are "very concerned" about the fiscal cliff and 26 percent are "moderately concerned." Only 6 percent of firms are "not at all concerned." As usual, written comments tell an interesting story. **These comments include:**

» Our business follows broad economic growth and therefore will suffer if a deal isn't passed before end of year.

» Don't believe it will occur. I think it's political posturing.

» Our customers' ability to repay their loan to us may change if they lose their job or pay significantly higher taxes all of a sudden.

» Either the can will get kicked down the road or changes which do not affect our industry will occur.

» We have no idea what's going to happen. We have put a stop on all extra spending.

» The combination of tax increases and spending cuts will hurt the recovery and business and consumer confidence.

» This creates huge uncertainty, and makes it hard to plan for business growth.

» Private firms are spending less because of not knowing what may happen.

» Tax increases to the business and workers will affect the outcome to our company's profitability and increase burden to all employees, which may reduce spending. The lack of attention to spending will continue to weaken the dollar.

» I think people will pull back and wait and see. It may not have a big effect to a lot of people, but they will be worried.

» Pure and simple, allowing our country to go over the fiscal cliff will lead to a recession and a dramatic increase in unemployment. Inaction is not an option.

» We are a small business (and are) concerned about the outcome.

» We don't have a lot of confidence that either side will compromise. If not, we believe the current administration will willingly suffer a recession to move forward their agenda. A recession, even for a couple of quarters, will certainly hurt our faltering recovery.

» The ripple effect if tax cuts expire will have a negative impact on our business.

» Too many unknowns?

» Won't happen; "created" crisis.

» Maybe I'm overly optimistic, but I am expecting Congress to reach some sort of compromise on the "fiscal cliff." My bigger concern is lessening our budget deficit, which will require both tax increases and decreased spending.

» The uncertainty of liability is holding me back from adding additional staff until we know what is happening.

» STOP KICKING THE CAN DOWN THE ROAD.

» Would lead to a reduction in funding for our organization.

» Plans for capital expenditures for equipment and a small building expansion have been shelved. Our concern is a "band-aid" fix by the administration and Congress and will take a year to get it figured out. Not going to risk our capital until we know what the "fix" will be.

» Along with the rising corporate taxes we are afraid of the St. Cloud real estate taxes with their aquatic center expenses.

» We will be responding to the investment and tax-related concerns of our clients with more face-to-face contact and making appropriate changes to all investment portfolios.

» I don't think we will

See QBR, Page 3F

# FISCAL CLIFFS AND THE END OF HOLIDAYS

Local economic data sometimes comes with a long lag. One piece that comes very late is area personal income [1], reported in late November of the following year. That data shows St. Cloud-area personal income of $6.7 billion in 2011, up from $6.36 billion in 2010. Of the total, $5.34 billion comes from earnings derived from employment, including self-employment. Farm income doubled in the area between 2009 and 2011, accounting now for $205 million. Another $391 million comes from proprietor income; this figure includes most small businesses in the area.

Per capita personal income rose to $35,253 in 2011 from $33,622 in 2010 and $32,898 in 2009. If we adjust those numbers for inflation we get $30,764 in 2011, $30,086 in 2010 and $29,869 in 2009 (in 2004 dollars.) The rise in real per capita income is therefore 2.25 percent in 2011, a very healthy number.

However, the calculation of personal income includes a deduction for the employee contribution to Social Security. In late 2010, Congress and President Obama agreed to a stimulus that included a reduction in Social Security taxes of 2 percent on the employee side. (Social Security and Medicare are funded by a tax on payrolls that is legally borne half by employees and half by employers.) By doing so, personal income is raised temporarily while the payroll tax holiday is in place. It is lowered when this tax holiday ends, which it is scheduled to do at the end of December 2012. (The 2010 agreement covered one year and the two parties agreed to a second year in December 2011.)

This 2 percent is part of the "fiscal cliff" being debated in Washington (which is described earlier in this report). While we cannot be sure what agreement comes out of current negotiations, we note that neither party is arguing in favor of extending the holiday. This will have the effect of removing some income from area residents.

How much? The personal income report indicated that $55.4 million less Social Security and Medicare taxes were paid in 2011 than 2010 from employees and the self-employed (who pay both halves of the payroll tax.) At the same time, $21.8 million more was paid by employers in payroll taxes. Had employees in 2011 paid at the same rate as in 2010 — like employers did — their Social Security contributions would have risen. The sum of these two numbers, $77.2 million, or $406 per person, may be a fair estimate of the impact of the tax holiday on the St. Cloud economy. The Joint Economic Committee of the U.S. Congress has estimated the number for a median Minnesota taxpayer to be $1,140 [2].

That figure now sits as a potential reduction to area per capita income in 2013. Any optimism that might be carried into the new year from this report should be tempered by that fact.

[1]Source: http://www.bea.gov/newsreleases/regional/lapi/lapi_newsrelease.htm

[2]Source: http://blogs.wsj.com/economics/2012/12/04/payroll-tax-cut-bolsters-social-security-report-argues/?mod=WSJBlog

# QBR

From Page 2F

see an immediate impact if we fall off the cliff, but I do believe long term (1 year) it will affect our business.

» Long-term business decisions are difficult to gauge with this level of tax uncertainty. It is affecting even short-term decision making.

» We believe this has the potential to significantly hurt our ability to continue to invest in our business at the levels we are used to.

» I expect Congress and the president to solve this.

» See possible change in pre-tax employee benefits and if that changes, our benefit package will need to be evaluated and changes made.

» We will be directly impacted by (federal) sequestration through a reduction of Medicare payment for health services.

» We work for other businesses. As they contract activity due to uncertainty, we get hurt.

» It seems that the majority of our customers are waiting for this to be resolved and are not placing orders until it is.

» Further uncertainty, lack of confidence.

» Uncertainty and lack of confidence in our nation's leadership could paralyze our economy.

» The president's current course of no spending cuts and increased taxation should concern everyone.

» Some federal grants may be impacted and we will lose revenue.

» A significant increase in taxes will decrease buyers' ability to purchase homes.

» I'm sick of sending tax dollars to Washington with nonproductive people receiving benefits from my work.

» If people are more heavily taxed or laid off as a result of Obamacare, they won't be buying houses!

» Another recession could be very serious for our business.

» The tax breaks have been good.

» This has potential to change the economic landscape.

» Loss of sales. Increase in payroll tax.

» Our business relies on the success of others and if they pull back, it will hurt us.

Over the years, area business leaders have anecdotally expressed mounting concerns regarding the regulatory/licensure requirements faced by their firm. Of course, regulation attempts to achieve a variety of social goals, but it also typically interferes with economic efficiency. Among other things, an increase in business regulation causes an increase in firm costs and makes them less competitive. While one often hears about expanded regulations, we seldom hear about a decrease in regulatory/licensure requirements. With this noted, we asked area firms the following question:

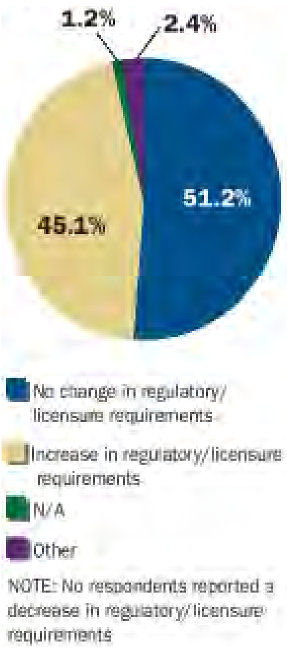
### QUESTION 2

**To what extent has your business experienced a change in regulatory/licensure requirements over the last 12 months?**

Forty-five percent of firms experienced increased regulations over the last 12 months and no firms reported a decrease in regulation. Fifty-one percent of firms report no change in regulations. While policymakers often pay lip service to the importance of deregulation and the need to help firms become more competitive, deregulation seems to not have been enjoyed by any local firms.

**Written comments include:**

» Things will change with the advent of the Affordable Care Act, and fees are already going




down.

» Truck hours of service renewed regulation. EPA regulations affecting truck and trailer costs.

» We have more government regulators visiting our shop and charging us for said visits. Fee-driven regulators.

» This is the result of the clients we serve and their customers need for compliance and security.

» The federal government is increasingly hostile to business, and will likely be worse for the next four years, which will significantly reduce profitability.

» Government is always looking for ways to get a few extra dollars from businesses.

» Our business is highly regulated and we have noticed that this has increased. I believe that some states are increasing regulations as a revenue enhancement.

» Paying income taxes is easy when profits are available to pay. Increased regulations have definitely reduced our income, and more importantly, limited our ability to grow to create the income to pay taxes to begin with.

» OSHA fall protection requirements, and EPA regulations on lead paint have required significant investments in training, equipment and ongoing record keeping. Following the recent elections, I expect this trend of increasing regulation to continue.

» The passage last year of the consumer finance protection and oversight laws have hurt our business and consumers, the same people it was designed to protect.

» If the government's new mandates for lifts for pools is not repealed, it will cause a severe financial hardship.

» Our business (line) will not be impacted as much as the banking side of (our business), which may have significant impact from Basel III capital proposals.

» Increased sales tax scrutiny.

» More and more costs.

» More EPA regulations will have significant impact.

» We do local deliveries that are regulated by DOT. DOT regulations never decrease.

» Increased training requirements for new appraisers. College requirements for all certified appraisers.

» More changes in food labeling.

» A huge increase in cost.

» Real estate delayed with Dodd-Frank regulations.

» 401(k) reporting.

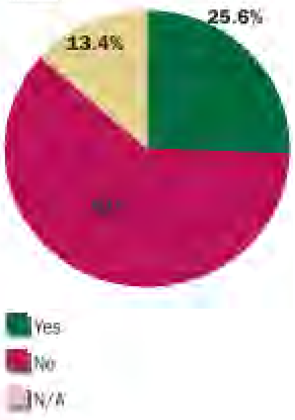
» Continued implementation of massive Dodd-Frank regulations.

Job creation seems to be at the top of everyone's economic wish list. Public policy has largely focused on fiscal stimulus (in the form of increased spending and reduced taxes) and expansionary monetary policy (interest rates are historically low). These measures have been largely aimed at increasing aggregate demand in response to overall economic weakness. Not often found in the policy discourse is the effect of regulation/licensure requirements on business hiring practices. Because regulations increase business costs, they run the risk of displacing workers (or causing other undesirable outcomes — such as reduced worker compensation and/or reductions in labor productivity — in labor markets). We decided to ask firms if a change in regulations has affected employment levels at their business over the past year.

**We asked:**

### QUESTION 3

**Has a change in regulatory/licensure requirements affected employment levels at your business over the past 12 months?**




Regulation has not affected employment at most firms, but one-quarter of surveyed firms indicate that this has affected their hiring. While some firms indicate that regulatory compliance measures have probably added to their employment levels (for example, financial services firms often report the need to hire compliance officers), most firms appear to indicate that business regulation increases their costs, reduces productivity and constrains their ability to grow and add workers.

**Written comments include:**

» Cost of additional regulation continues to slow growth.

» (Our) industry is suffering a HUGE shortage of (workers) because of over regulation!

» Has kept us from aggressively expanding our fleet.

» When they stop (at our business), it's unannounced. It's usually for a half-day plus and takes our fabricators away from their tasks. These people don't care about our deadlines, etc. Very frustrating.

» Air quality requirements that are stricter than OSHA. City water requirements that are stricter than others and all this requires added personnel to work on their types of requirements.

» It is harder to attract and retain people. I think unemployment reduces incentive for people to get a job.

» Changes in regulation/licensure requirements increase costs. These costs restrict growth of our company.

» We are less likely to add new staff because of the increased regulations and the difficulty in understanding how these regulations affect us.

» This will require us to charge higher prices for the goods and services we provide.

» Because we have about 85 employees, we are looking really hard at regulations, especially Obamacare and what the final cost will be.

» Due to pool drain code changes we lowered hours to help offset the costs.

» We have 48 employees and stopped hiring to stay under Obamacare 50 or more requirements.

» Local and state.

» Our drivers are required to have DOT physicals. Under a new DOT point system, our best and longest employed driver will not be issued a medical certificate until he undergoes a "sleep study." He refuses to do this so will probably lose his job. This

See QBR, Page 4F

# QBR

From Page 3F

employee has never missed a day or ever been late for work. Average time behind the wheel is 3-4 hours per day. Classic example of over regulation!

» It will in the future.

» Real estate transactions longer to complete and kills some deals.

Finally, we occasionally ask an open-ended question to evaluate topical business issues. Since the survey was distributed after the Nov. 6 election, we decided to ask how the results of the election will affect area firms' business planning. While little changed at the federal level (although President Obama's re-election confirms that the health care overhaul law will go forward), the Minnesota Legislature is now controlled by a DFL majority. So, we thought we would ask area business leaders how the election results will affect their business planning.

**We asked:**

**QUESTION 4**

**In what ways, if any, will the results of the Nov. 6 election affect business planning at your firm?**

**Comments include:**

» The results, either way, will not affect business planning significantly.

» We will make no changes. We will stay small, no extra employees and no pay increases.

» It won't.

» Less confidence in a business friendly environment. Fear of higher taxes and ObamaCare is here to stay!

» We expect higher taxes and increased regulation, which may reduce the amount of investment in future business.

» Uncertainty, time to sit back and see what happens — limit hiring (ObamaCare) and capital expenditures, conserve cash. Tax implications result in additional dividends in 2012 and limiting future dividends.

» We will ready ourselves for higher taxes in Minnesota; this will decrease our likelihood of making investments in Minnesota if it occurs.

» Need to develop relationships with new legislators and educate them on the importance of and the needs for (our business).

» Everything is on hold — no unnecessary spending.

» Like most, we are in a wait-and-see mode.

» More regulations, more anti-business in both Minnesota and federal level.

» We need to wait and see about taxes, health insurance and any other surprises that may be coming.

» We will have to plan for more increased cost resulting from more regulations both on the federal and state levels.

» Probably none at all.

» ObamaCare — not sure how the Minnesota Exchange will operate and the monies that will be needed to operate the exchange — where are the funds going to come from. With the uninsured at under 10 percent in Minnesota seems crazy to set-up an exchange when most of those uninsured individuals could get state assistance.

» We are taking a "wait and see" attitude for our planning. We are especially concerned about the Minnesota impact.

» We will be growing but with fewer employees. Election has caused tremendous amount of uncertainty with regards to taxes, interest rates.

» Concerned about impact of ObamaCare, costs and client costs which will impact use of our services.

» Since we provide services to healthcare providers, we now know that the previous changes planned to take effect, will occur, so we can now plan services for those specific future events (i.e. required reporting, notifications, etc.).

» Orders are slowing down. It appears the election results are impacting demand. We respond to demand.

» ObamaCare concerns me.

» Now more caution.

» We are planning on increased federal and state regulations, especially from OSHA. The election results have not impacted our expectation for volume of business in 2013.

» The unknown of taxes will stop all plans that have been made until the unknown is known.

» NO PLAN FROM CONGRESS. HOW DO WE PLAN?

» We have now shifted our planning into an ultra-conservative mode. ObamaCare, additional taxes as the result of the financial cliff we face, additional regulatory requirements promised by this administration will force us to store cash and limit hiring instead of making capital expenditures.

» We will not offer new full-time positions due to health care costs. Instead we will utilize part-time positions to fill our needs.

» At this time our planning process and decisions will stay the course that we laid out a few months ago. Any significant changes that may occur will take at least a year to have any effect. But we will be paying attention to what is happening and adjust accordingly.

» No specific changes to our business plan other than increased focus on our clients and anticipating changes in the financial markets.

» If anything, it has complicated our strategic planning. Some initiatives are on hold pending a clarification particularly at the federal level.

» We are reassessing our plans for capital spending. It is somewhat likely that we will decrease our capital investments as a result of tax policy changes and overall economic activity.

» With the all Democratic Legislature, we expect more public spending on infrastructure (and) other projects.

» Too soon to tell as the bulk of our business is … with other companies. So far business has been strong so we hope that continues.

» The results of the election will likely have little effect on my business planning. Every four years there is much anticipation about the potential change in government officials. In my opinion, once the election is over, most businesses continue on to do what is in their best interest.

» No change.

» Increases probability that health care coverage will be extended and some number of currently and newly covered will be covered by products available through health exchanges.

» Hiring freeze. Uncertainty of health care and tax costs.

## TABLE 3 - EMPLOYMENT TRENDS

| | St. Cloud (Stearns and Benton) | | | 13-county Twin Cities area | | | Minnesota | | |
|---|---|---|---|---|---|---|---|---|---|
| | 15-year trend rate of change | October '11-October '12 rate of change | October'12 employment share | 15-year trend rate of change | October '11-October '12 rate of change | October '12 employment share | 15-year trend rate of change | October '11-October '12 rate of change | October '12 employment share |
| Total nonagricultural | 1% | 2.3% | 100% | 0.5% | 1.1% | 100% | 0.5% | 1.3% | 100% |
| Total private | 1% | 3.1% | 84.6% | 0.5% | 1.1% | 86.7% | 0.5% | 1.4% | 84.8% |
| Goods producing | 0% | 0.1% | 19.7% | -1.6% | -0.9% | 13.4% | -1.4% | 1.1% | 15.2% |
| Construction/natural resources | 1.2% | 3.9% | 5.1% | -0.8% | -1.4% | 3.3% | -0.1% | 3.9% | 4.2% |
| Manufacturing | -0.3% | -1.2% | 14.6% | -1.9% | -0.8% | 10% | -1.8% | 0.1% | 11.1% |
| Service providing | 1.3% | 2.8% | 80.3% | 0.9% | 1.4% | 86.6% | 0.9% | 1.3% | 84.8% |
| Trade/transportation/utilities | 0% | 2.8% | 20.4% | -0.4% | -0.8% | 17.7% | -0.3% | -0.1% | 18.2% |
| Wholesale trade | 0.9% | 3.0% | 3.9% | 0.1% | -0.5% | 4.6% | 0.1% | 1% | 4.6% |
| Retail trade | -0.8% | 2.9% | 12.8% | 0.3% | 0.3% | 9.7% | -0.4% | -0.8% | 10.2% |
| Trans./warehouse/utilities | 1.9% | 2.3% | 3.7% | -1.1% | -4.0% | 3.4% | -0.4% | 0.6% | 3.3% |
| Information | -1.3% | 2% | 1.5% | -1.0% | -0.4% | 2.1% | -1% | 3.1% | 2% |
| Financial activities | 1.7% | 3.7% | 4.1% | 0.9% | 1.9% | 8% | 1% | 1.7% | 6.5% |
| Professional & business service | 4.2% | 5.2% | 9% | 1% | 3% | 15.8% | 1.1% | 1.9% | 12.5% |
| Education & health | 2.9% | 5.9% | 18% | 3.3% | 3.2% | 16.3% | 3.3% | 3.9% | 17.9% |
| Leisure & hospitality | 1.2% | 3.6% | 8.6% | 1% | 0.5% | 8.8% | 0.6% | -1.3% | 8.3% |
| Other services (excluding govt.) | -0.5% | 1.1% | 3.3% | 1.2% | 2.3% | 4.6% | 0.5% | 0.3% | 4.3% |
| Government | 1.0% | -2.1% | 15.4% | 0.4% | 0.7% | 13.3% | 0.4% | 0.8% | 15.2% |
| Federal government | 1.8% | -0.8% | 2.1% | -0.6% | -2.4% | 1.1% | -0.5% | -2.4% | 1.1% |
| State government | 1.4% | -6.6% | 4.5% | 0.9% | 1.8% | 4% | 1% | 0.0% | 3.7% |
| Local government | 0.7% | 0% | 8.8% | 0.2% | 0.7% | 8.2% | 0.2% | 1.5% | 10.3% |

Note: Long-term trend growth rate is the compounded average employment growth rate in the specified period.

Sources: Minnesota Department of Employment and Economic Development and author calculations.

See QBR, Page 5F

# QBR

From Page 4F

» We will be using less part-time employees and focus on fewer employees that are full-time.

» Not sure yet.

» None.

» More conservative.

» We are anticipating more regulations and added costs to do business at federal and state levels.

» Pushing ahead with products/services needed by health care reform.

» It has not changed our business plan. We continue to be cautious and conservative with our resources.

» We will attempt to sell the business ASAP because of clearly increasing capital gains rates.

» Stock market went down; still uncertainty over Democrats and GOP working together. All their bickering stalls decisions related to NCLB and other programs.

» We will not add to payroll with the coming federal health care system and the increase in employee costs.

» Tax policy can have a very large impact on housing. The mortgage interest deduction could be affected.

» Uncertain about ObamaCare costs for my staff?

» Planning for higher taxes and increased health care cost means fewer new employees and no capital expenditures.

» We're just trying to stay ahead of the endless regulatory mandates and descent into socialism!

» Potentially more opportunities in the marketplace.

» We will be more conservative — no major purchases or expansion plans.

» Hope it will not affect business.

» Not at all, we will continue business as usual.

» No effect. We are dealing with more issues related to the continuing drought than we have been affected by the election.

» Ask me after Jan. 1.

» Difficult to plan the unknown.

» Will keep number of employees less than 50.

» It won't really affect our planning. Our goals have not changed.

» Election has no effect on planning.

## TABLE 4 - OTHER ECONOMIC INDICATORS

| | 2011 | 2012 | Percent change |
|---|---|---|---|
| St. Cloud MSA labor force<br>October (DEED) | 107,811 | 108,691 | 0.8% |
| St. Cloud MSA civilian employment #<br>October (DEED) | 102,259 | 103,286 | 1% |
| St. Cloud MSA unemployment rate*<br>October (DEED) | 5.1% | 5.0% | N/A |
| Minnesota unemployment rate*<br>October (DEED) | 5.4% | 5.2% | N/A |
| Minneapolis-St. Paul unemployment rate*<br>October (DEED) | 5.4% | 5.2% | N/A |
| St. Cloud-area new unemployment insurance claims<br>August-October average (DEED) | 796 | 802 | 0.8% |
| St. Cloud Times help-wanted ad linage<br>August-October average | 1,777 | 2,239 | 26% |
| St. Cloud MSA residential building permit valuation<br>In thousands, August-October average (U.S. Department of Commerce) | 3,952 | 7,101.3 | 79.7% |
| St. Cloud index of leading economic indicators | 96.9 | 103.1 | 6.4% |

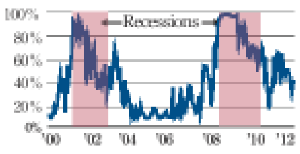
MSA = St. Cloud Metropolitan Statistical Area, composed of Stearns and Benton counties.
# - The employment numbers here are based on household estimates, not the employer payroll estimate in Table 3.
* - Not seasonally adjusted
** - October 2001=100
N/A - Not applicable

## TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

| Changes from July to October 2012 | Contribution to LEI |
|---|---|
| Help-wanted advertising in St. Cloud Times | 2.32% |
| Hours worked | -1.4% |
| New business incorporations | 0.98% |
| New claims for unemployment insurance | -1.48% |
| Total | 0.42% |

## PROBABILITY OF RECESSION

Four-six months ahead




## THE DATA MOVES TO EXPANSION

Our last report showed a surprising amount of strength in the St. Cloud economy. We did not expect it to continue at its rapid pace; it was almost too good to be true. While the numbers in Table 3 are not as strong as our September report, they are still remarkable. Private sector job growth continues above 3 percent, with only manufacturing employment declining across all private sectors. Most rapid growth was found in health and education sectors, in professional and business services, in financial activities, in leisure and hospitality and in construction. A 2.1 percent decline in government sector employment, mostly from state of Minnesota employment, brought overall employment growth to 2.3 percent. That growth is significantly faster than in the rest of the state and almost three times that in Minneapolis-St. Paul.

Local area unemployment stood at 5 percent in October, below the 5.2 percent for the state and for the Twin Cities. As seen in Table 4, civilian employment rose 0.8 percent (we again note that this number represents St. Cloud area residents working, while the data in Table 3 is for employment at St. Cloud businesses.) Some of our local area indicators were up sharply, including a 26 percent increase in help wanted ad linage from year-ago levels and an almost 80 percent increase in the value of building permits for residences in the area. Unemployment insurance claims were up slightly, though.

Over the last year the St. Cloud Index of Leading Economic Indicators has moved up sharply, reaching a 6-month moving average not seen since we developed the series. However the most recent quarter had mixed data, with two series rising and two falling, as seen in Table 5. While new claims for unemployment insurance rose and hours worked in manufacturing declined — both in part due to the Verso shock — new business incorporations and help-wanted advertising linage grew in the quarter. The result is a relatively mild increase. Many of the Verso employees, because of severance pay, do not yet receive unemployment insurance. Verso recently reported [1] $16 million paid in severance and benefits to former employees.

As we noted from Table 3, the area economy has fared better than the state economy generally, though growth was up significantly. Wages and salaries in the state are up 4.3 percent versus a year earlier. Yet the Minnesota component of the Mid-American Business Conditions Index was below a growth-neutral reading for all of the previous quarter. This weighed on our St. Cloud Area Probability of Recession index, which registered a 35 percent probability of recession in the most recent observation. This says that a slightly more than 1 in 3 chance of a recession in the next four to six months. We do not believe this is really the case. The Federal Reserve Bank of Philadelphia's State Coincident Index for Minnesota shows continued mild increases of 0.4 percent in the last quarter and 3 percent in the last year. Its leading indicator series for Minnesota has slowed precipitously but as of yet has not turned negative. Certainly, Minnesota is growing a bit more slowly than it did in the first half of the year, but we see no cause for panic.

Overlaying this entire discussion is the situation in Washington, as a host of tax provisions are set to expire and an agreement from 2011 could lead to a significant hit to area personal income and to the state budget. Minnesota's Office of Management and Budget (MMB) warned in early December that the "fiscal cliff" could lead to 70,000 fewer jobs in 2014 in the state and raise its unemployment rate to more than 7 percent. The 2011 agreement calls for "sequestration" of $1 trillion in spending, which MMB says would reduce federal grants to the state by 17 percent, or $129 million. And this does not include the reduction to personal income from the end of the Social Security payroll tax holiday discussed elsewhere in this report. Many economists argue that "going over the cliff" would result in a recession in the first half of 2013. We are inclined to agree.

The unemployment rate will continue to be a focus of most business leaders and economic observers, as its decline has been slow and stubborn. While businesses report expansion of sales and investment, jobs continue to be a focus. The national numbers will be distorted in the next few months by the impact of Hurricane Sandy, though retail hiring for an early Thanksgiving may have the opposite impact. After we had thought the elections would bring some certainty for business leaders regardless of the outcome, other events have kept the crystal ball cloudier than we would like. Still, our business leaders seem to feel that if we don't encounter a fiscal cliff, the environment is ripe for growth for their firms, and the hard data we have agrees with them.

[1] Source: http://knsiradio.com/news/local/verso-reports-third-quarter-loss

### IN THE NEXT QBR

Participating businesses can look for the next St. Cloud Area Business Outlook Survey in February. The next St. Cloud Area Quarterly Business Report will appear in the St. Cloud Times on Sunday, March 24.