

Q ST. CLOUD AREA QUARTERLY BUSINESS REPORT

VOL. 9, ISSUE 3 • OCTOBER 2007

UNSETTLED FUTURE CREATES CHALLENGES

New recession model, survey numbers signal sluggish '08 start

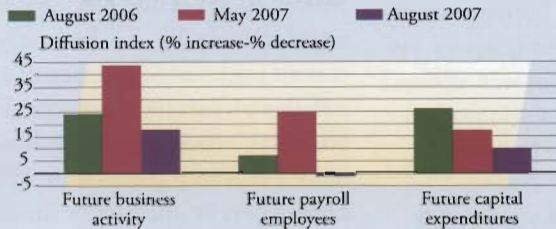
EXECUTIVE SUMMARY

The forecast of St. Cloud-area economic activity is clouded by weakness as area firms expect an ongoing struggle in finding their footing in an uncertain economy. While area employment grew at a more rapid rate in the past 12 months than observed elsewhere in the state, the rate of local job growth is still well below its long-term trend path. In addition, various indicators from the St. Cloud Index of Leading Economic Indicators and the St. Cloud Area Business Outlook Survey suggest local economic sluggishness will last through the end of the year. Results from the most recent survey of area business leaders are among the weakest ever recorded, and virtually all local data point to ongoing weakness in local economic activity.

A new model designed to estimate the probability of a local recession in six to nine months suggests extreme caution is in order, as we can no longer rule out the possibility of local recession in coming months. And, while this quarter's leading economic indicators index remains flat, future readings are likely to turn negative as some indicators in the index are already known to decline in future months.

Forty-eight percent of surveyed firms report an increase in economic activity in the past three months, while only 16 percent report a decrease. However, sur-

KEY RESULTS OF SURVEY



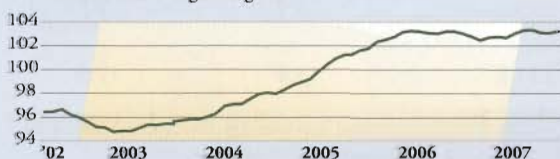
veyed current employment conditions are the weakest summer reading ever recorded, as only 23 percent of the 90 firms that returned this quarter's St. Cloud Area Business Outlook Survey increased hiring in the past three months and 13 percent trimmed employment. In addition, current employee compensation numbers are the lowest since summer 2003.

Of greater concern is anticipated weakness six months from now. Results from the survey of expected future business conditions are the weakest recorded in the nine years the survey has been conducted! Indexes on expected future business activity, projected payroll employment and planned capital expenditures are at the lowest levels ever observed. For the first time, more firms expect to decrease employment than expect to increase hiring in six months' time. In addition, only 22 percent of surveyed firms plan to increase capital purchases in the next six months while 12 percent of firms plan to reduce capital expenditures.

Firms report that ongoing weakness in the housing sector as well as financial market volatility are continuing to have an adverse impact on business conditions. In special questions, 18 percent of survey respondents report construction in downtown St. Cloud is having an unfavorable impact on their company and 12 percent of firms indicate this is having a favorable effect.

INDEX OF LEADING ECONOMIC INDICATORS

Six-month moving average



COLLABORATING PUBLISHERS

ST. CLOUD STATE UNIVERSITY
A tradition of excellence and opportunity
 Center for Economic Education
 Department of Economics
 Social Science Research Institute



THE PARTNERSHIP
 St. Cloud Area Economic
 Development Partnership
 President: Tom Moore
 320-656-3815

ABOUT THE AUTHORS



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



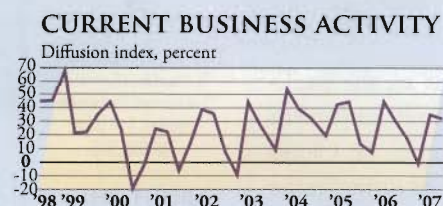
RICH MACDONALD
 Assistant professor,
 St. Cloud State University
 Economics Department
 Vice president,
 Program, National Council
 on Economic Education
 320-308-4781

Looking to the future, only 6 percent of firms surveyed expect the downtown development to be unfavorable, and 49 percent anticipate this will have a favorable effect.

CURRENT ACTIVITY

Tables 1 and 2 report the most recent results of the business outlook survey. Responses are from 90 area businesses that returned the recent mailing in time to be included in the report. Participating firms represent the diverse businesses in the St. Cloud area. They include retail, manufacturing, construction, financial, health services and government enterprises of sizes ranging from small to large. Survey responses are strictly confidential.

Survey responses suggest in the past three months the St. Cloud area experienced economic conditions slightly below normal for this time of year. The current activity diffusion index is 32 in this quarter's survey. This is about the same as was reported one year ago — about 10 points lower than normally occurs in the summer survey.



About the diffusion index

The diffusion index represents the percentage of survey respondents who indicated an increase minus the percentage indicating a decrease.

Responses suggest labor market challenges as the current employment diffusion index (with a value of 10) is the lowest summer reading ever recorded and the employee compensation index is the lowest observed since summer 2003. While some firms report difficulty attracting qualified workers, there is no apparent general labor shortage in the St. Cloud area.

Firms' capital expenditures continue to be weak. Only 30 percent of surveyed firms increased capital purchases in the past three months, and 11 percent decreased purchases. Area pricing pressures have moderated considerably in the past year, as the current prices-received index of 11 suggests inflationary pressures have subsided for local businesses. Finally, national business conditions remain a concern, as 23 percent of firms report an increase in their evaluation of national business activity, but 14 percent report a decrease in this measure.

OUTLOOK

The St. Cloud Area Business Outlook Sur-

vey has been conducted every three months since December 1998. Since the survey's first mailing, the area economy has experienced a period of unsustainably rapid growth, a 21-month recession (exacerbated by the closing of Fingerhut), and a period of fairly normal growth in which some sectors of the economy outperformed others. During the nine years of the survey, clear patterns (seasonal, cyclical and otherwise) have emerged for many of the survey questions. Indeed, because the same eight questions have been asked every quarter, we have a good sense of how specific items should be expected to behave each quarter. It is for this reason that this quarter's numbers on the future business outlook (shown in Table 2) are of some concern. The diffusion index on future business activity expected six months from now is the lowest recorded. To be sure, some of this expected slowing is seasonal, but with only 39 percent of firms expecting increased activity and 21 percent expecting a decrease in activity, the first quarter of 2008 could have a slower start than has been seen in many years.

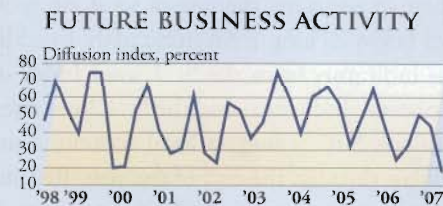


TABLE 1—CURRENT BUSINESS CONDITIONS

	August 2007 vs. Three months ago			Diffusion Index ³	May 2007 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)		
What is your evaluation of:					
Level of business activity for your company	15.6	36.7	47.8	32.2	35.0
Number of employees on your company's payroll	13.3	63.3	23.3	10.0	15.0
Length of the workweek for your employees	7.8	74.4	17.8	10.0	6.2
Capital expenditures (equipment, machinery, structures, etc.) by your company	11.1	58.9	30.0	18.9	10.0
Employee compensation (wages and benefits) by your company	2.2	68.9	28.9	26.7	35.0
Prices received for your company's products	12.2	62.2	23.3	11.1	17.5
National business activity	14.4	50.0	23.3	8.9	7.5
Your company's difficulty attracting qualified workers	4.4	75.6	17.8	13.4	17.5

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: SCSU Center for Economic Education, Social Science Research Institute and Department of Economics

Weakness is expected in the labor market. There, the diffusion index of Survey Item 2 is negative for the first time ever! Never before have more firms reported an expected decrease in their work force than expected an increase. In addition, the workweek is expected to decline and the worker compensation index remains sluggishly low. At 11.1, the index on expected difficulty attracting qualified workers is at its lowest level since fall 2004.

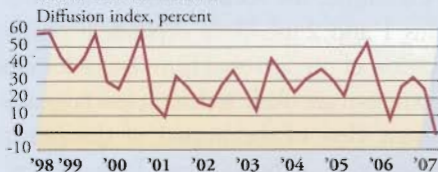
WHAT IS AFFECTING YOUR COMPANY?

Firms were asked to report any factors affecting their business. Comments were decidedly focused on weakness in the housing industry. Once again, this quarter was marked by concerns for this industry by firms outside of the housing sector. Comments include:

- "The economy doesn't seem very strong. If it continues a downward spiral, our customers will not have the available funds (to use our services)."
- "Our company received more business due to storm damage in our area (construction related)."
- "Local economy very much impacts our business! Much softer first half 2007 vs. 2006."
- "Residential sales and residential appraisal work has slowed considerably. The acquired and foreclosed properties must be worked through (sold) before any improvement is seen in our market."
- "Our company is directly related to the building industry. When it rebounds, so will our sales."

- "Last year (was) the worst year in 10 years. This year is a very close second."
- "... Mortgage fraud will have an impact on how (my company is) regulated in the next several years."
- "With residential sales/construction/development down, we are feeling the effects."
- "Slow residential building economy is really starting to affect our sales. That division of our business is down 20 percent."
- "The declining housing market is having a big economic impact on our business. It is also causing the competition to be very aggressive and sometimes less than friendly or honest. I believe the homeowners need to be extremely alert to costs to watch out for their best interest. Not all companies are leading exemplary business lives!"
- "Slowdown in residential construction impacting business. 2007 legislative changes will increase cost of doing business. We are also monitoring impact of drought and severe weather on our customers."

FUTURE PAYROLL EMPLOYMENT



Pricing pressures are expected to continue to moderate, as the index on prices received in Table 2 is at its lowest level in four years. National business activity is expected to remain positive, but the diffusion index of 14.4 is the second-lowest number recorded on this item during the past 18 quarters. Last, but not least, is the troubling weakness in expected capital purchases. As much as any other survey item, the index of planned capital expenditures is a leading indicator of what firms expect for business

activity in the near future. Firms that are concerned about future demand for their products that already have current slack in capacity utilization are likely to defer capital purchases to a future period. With only 22 percent of survey respondents expecting to increase capital purchases (and 12 percent expecting to decrease), the index on

expected capital expenditures is the lowest recorded. (The last time it was close to being this low was in summer 2002, when we were well into an extended recession). We will try to get more information about the nature of this slowdown in capital expenditures in next quarter's St. Cloud Area Business Outlook Survey.

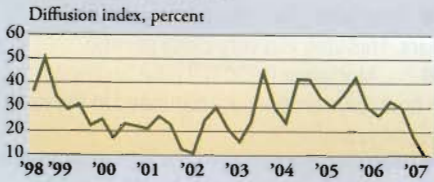
TABLE 2-FUTURE BUSINESS CONDITIONS

What is your evaluation of:	Six months from now vs. August 2007			Diffusion Index ³	May 2007 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)		
Level of business activity for your company	21.1	37.8	38.9	17.8	43.7
Number of employees on your company's payroll	20.0	57.8	18.9	-1.1	25.0
Length of the workweek for your employees	16.7	73.3	6.7	-10.0	7.5
Capital expenditures (equipment, machinery, structures, etc.) by your company	12.2	63.3	22.2	10.0	17.5
Employee compensation (wages and benefits) by your company	0	57.8	40.0	40.0	37.5
Prices received for your company's products	5.6	63.3	24.4	18.8	28.7
National business activity	8.9	53.3	23.3	14.4	21.2
Your company's difficulty attracting qualified workers	3.3	78.9	14.4	11.1	27.5

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: SCSU Center for Economic Education, Social Science Research Institute and Department of Economics

FUTURE CAPITAL EXPENDITURES



SPECIAL QUESTIONS

This summer has been marked by a variety of highly visible development projects around the St. Cloud area that have led to temporary construction-related dislocations. Of particular note have been projects in downtown St. Cloud. Some observers have attributed some downtown business closings to the extraordinary volume of construction taking place there. We asked businesses about the extent to which ongoing construction in downtown St. Cloud is impacting their business (directly or indirectly). Despite the negative publicity that has been associated with high-profile downtown business closings, it is noteworthy that many area companies report favorable effects of the downtown construction projects. Indeed, while most surveyed firms indicate no direct or indirect impact, almost as many claim a favorable impact as claim an unfavorable impact.

QUESTION 1: To what extent is ongoing construction in downtown St. Cloud currently impacting (either directly or indirectly) your business?

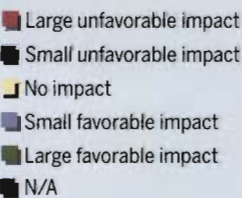
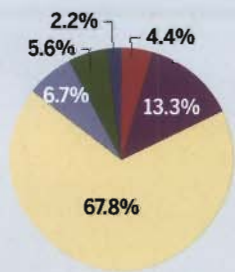
Comments reveal a variety of ways in which surveyed firms are being impacted by the construction projects. Comments include:

■ “(Our company) provided limited product to both construction sites.”

■ “Some businesses along St. Germain

Street are very difficult to reach, and I’m sure (this has) a large unfavorable impact”

■ “Some of our competition has secured work, which means they don’t bid other work.”



■ “Construction has a direct effect on our business.”

■ “Drop-off (in our) business ... significantly decreased.”

■ “Renovation of several downtown commercial buildings has produced new (product sales for our firm).”

■ “We are far enough away on Second Street, but know businesses which are losing customers every day.”

■ “We are one of the contractors.”

While short-term impact of the downtown construction projects has had an adverse impact on some businesses, half of surveyed firms expect long-term impact of these projects to be favorable. Only 5.5 percent (six firms total) expect an unfavorable long-term impact of the economic development work downtown. This is dwarfed by 49 percent of firms who expect at least a small favorable impact in the long run.

QUESTION 2: What do you expect the long-term impact of the construction projects and associated economic development in downtown St. Cloud will be for your company?

Comments suggest direct and indirect long-term effects:

■ “More business, more employees, more housing needs!”

■ “It will bring more people to the St. Cloud area (with) spendable income.”

■ “Business growth means new clients for our services.”

■ “Economic development downtown will benefit this community.”

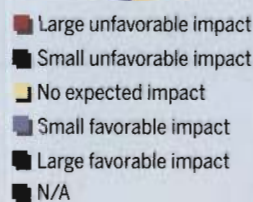
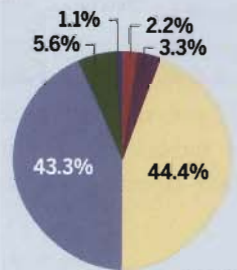
■ “We will be forced from our location. Perhaps that will be a positive impact.”

■ “New customers for (our business).”

■ “It will be good for the health of our entire community to have a stronger downtown business district!”

■ “We are excited to watch downtown St. Cloud transform and hope it will spur more investment and construction.”

■ “None of the changes impact our busi-



*Numbers may not add up due to rounding.

ness directly, unless we have to sell — may make our site more salable.”

■ “May encourage other development in the area which may or may not require our products.”

■ “We expect to get some work out of these projects.”

■ “Improvements can only enhance the business climate for all involved.”

■ “Economic health of the community impacts the medical community. People tend to let their health go when their finances are down.”

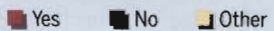
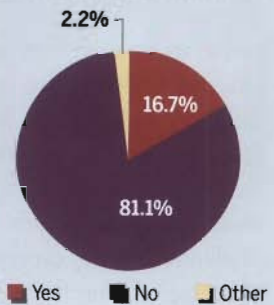
Of course, the results from special questions 1 and 2 are likely dependent on the location of the surveyed firm. Firms located downtown are likely to have a less favorable current view of the impact of downtown construction, although their long-term expectation is likely to be less predictable. We therefore asked firms the following:

QUESTION 3: Is your business located in downtown St. Cloud?

In raw numbers, 15 of the 90 firms returning this quarter’s survey are located downtown while the rest are located elsewhere. (Two

firms report being just outside the downtown area.) A simple cross-tabulation of results from the first three questions suggests a disproportionately large number of firms that reported a current unfavorable impact of downtown construction are indeed located downtown. For example, five of the 16 firms that are being adversely impacted are downtown. Only two of the 15 downtown survey respondents expect long-term unfavorable effects, while nine of the 15 firms anticipate a favorable long-term impact of the downtown construction and economic development.

In the past couple of months, U.S. (and global) financial markets have been characterized by notable volatility as intraday (and interday) variation of tradable financial instruments has gone through periods of rather extreme and abrupt price movements. Underlying much of this volatility have been concerns about credit quality (especially in the subprime mortgage market) that have



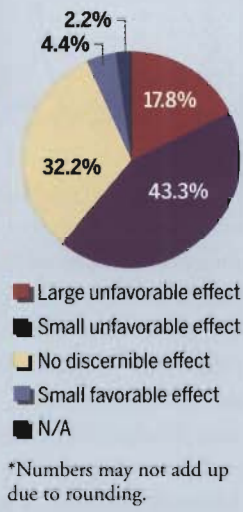
FIRMS WERE ASKED TO WHAT EXTENT VOLATILITY IN FINANCIAL MARKETS was affecting their business. Sixty-one percent said it is having either a large or small unfavorable effect. The responses range across all sectors, suggesting the concerns about the potential negative impact of this volatility are genuine.

led to a reduction in liquidity throughout financial markets. The Federal Reserve has recently taken steps to give banks increased access to liquidity — with the hope of heading off any systemic effects that might arise from a market perception of a general credit crisis. As of the writing of this report, the Fed was attempting to balance liquidity concerns with the ongoing objective of containing inflationary pressures. To complicate matters, the Fed and its leader, Ben Bernanke, do not want to be perceived as a central bank that writes a de facto insurance policy in protection of imprudent financial market practices. While the market now clearly expects a cut(s) in the federal funds interest rate target in the coming months, such a cut had not happened as of early September. Only recently have comments from Fed officials suggested they now see an increased risk of recession (thus leading to a pre-emptive cut in interest rate targets). We expect rates to fall in the coming months, in large part because evidence is now mounting that difficulties in the housing market (and on Wall Street) are no longer confined narrowly to the housing and financial activities sectors. Indeed, it now appears that Main Street is feeling the effects of some of these pressures. Such is apparently the case in the St. Cloud area. We asked area firms to report the extent to which recent volatility in financial markets was affecting their business. Only one-third of survey respondents report this is having no discernible effect on their company. Indeed, 61 percent of firms respond that this is having either a large or small unfavorable effect on their business. These responses range across all sectors of the local economy, suggesting the more broad-based concerns about the potential negative impact of this volatility are genuine.

QUESTION 4: To what extent is recent volatility in financial markets having either a direct or indirect effect on your business?

Comments include:

- “Major adverse effect on home financing.”
- “Instability of mortgage financing (is) adding to housing construction problems.”
- “Major long-term impact — concerned about negative feelings moving economy to recession.”
- “Multi-family housing financing is tougher to get. Banks are cautious with any housing projects.”
- “The volatility has eroded the ‘wealth’ factor, i.e. customers feel less wealthy.”
- “New residential housing is critical to our business. Any rebound will be mitigated by volatility in financial markets.”
- “If capital investment decreases due to financial reasons or market weakness, fewer people will purchase our equipment or projects will not be funded. The drop in ethanol values has delayed or canceled some projects.”
- “The mortgage crisis is impacting new development.”
- “The world is not coming to an end, but if you listen to the media you would say it is. Residential housing will rebound in 18-24 months and the Fed will likely decrease interest rates in the next six months.”
- “Loose lending practices have a negative effect but must get under control before healthy growth can begin.”
- “Some people are stating that they are not doing home improvement because they are uncertain of the market.”
- “(We) have a solid balance sheet and very high credit rating. This will help us in the long run.”
- “People are less likely to buy (our products).”
- “Activity levels down; type of business



less favorable and riskier impact is pervasive through the real estate, lending and construction industries.”

■ “Home building in St. Cloud is down significantly due in part to higher interest rates.”

A NEW MODEL

We have decided to try a variation in the leading economic indicators model for the St. Cloud area. The model is still in an experimental phase, but we are sufficiently comfortable with the results that we are providing it now. Also, due to the increased possibility of an area recession early next year, a second indicator seemed desirable.

Researchers studying the ability to forecast recessions have turned their attention away from index numbers to a measure of probability. Some regional forecasters have begun to offer a probability of recession instead. A reading of .24, for example, would mean that we foresee a 24 percent chance of recession in the next four to six months. For the most part, readings above 20 percent would be considered signals of concern that a recession is forthcoming. Readings higher than 50 percent are quite rare before one enters a recession, but tend to occur while the economy is in one. During periods of expansion, we expect this model to give probabilities of recession that are less than 10 percent.

In the process of developing this model we had to establish reference dates for the area economy. We have monthly data on employment and related variables dating back to 1988. Using a series of tests and filters, we determined that the St. Cloud area was in three recessions during this period: October 1989 to April 1990, May 1996 to January 1997, and May 2001 to February 2003.

The first period came before the national recession between June 1990 and March 1991 but appears to have similar roots in a slowing manufacturing sector. The second downturn occurred while there was no interruption in the national economy.

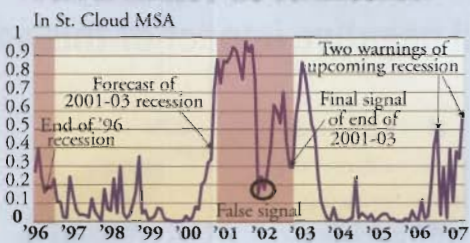
The last downturn locally started two months after the national recession began but, due to the closing of Fingerhut and its effects, lasted for 21 months. (The national recession lasted only eight.)

Using those three recessions as benchmarks, we proceeded to fit a probability model to the local area using the same four variables that are used in our leading indicators series. We also employ the U.S. purchasing managers' index, as the local economy is more goods-producing than the U.S. as a whole and thus depends more on goods orders. The model is intended to give a projection of the likelihood of recession six to nine months from the most recent data points. The model was estimated using data from 1996 through 2006.

Our results show that the latter two recessionary periods were preceded by signals of probability more than 40 percent, and we thus take that as our "red light" signal. A probability of more than 20 percent would be considered a yellow light to indicate caution, but we note that the model in 1998 and 1999 gave false signals of recession (that is, it indicated recession without one occurring within nine months). Because the model shows a good amount of volatil-

ity in readings, we employ a three-month moving average to reduce the effect of an outlier.

PROBABILITY OF RECESSION



The model flashed a red light for the last recession in December 2000, with a probability of recession of 72 percent and a three-month average of 46 percent. It called for the end of the 1996-97 recession in July 1996, a full six months before that ended. In the 2001-03 recession, the probability first moved below 40 percent in June 2002, but then moved above that level in four of the next eight months. The model had trouble registering a consistent green light in 2003, but this was also true for national and other regional models. For the time being, we will proceed with this while experimenting with other indicators that might have fit the 2003 recovery better.

RECESSION BY YEAR END?

The current readings for this model indicated the first red light was in February 2007, with a 52 percent probability of recession shown. We also had readings of 44 percent in March and 39 percent for July (the most recent month at the time of this writing). The average of the past six months is 28.4 percent, actually higher than the average of the nine months before the 2001-03 recession. Combined with our original leading indicator series and the results of the St. Cloud Area Business Survey, we conclude that the local economy is vulnerable to a recession before year-end 2007.

We note that these readings come before the onset of the subprime mortgage troubles nationally in August. As stated above, the downturn that we have noted in housing since mid-2005 has now affected the availability of credit to subprime and prime borrowers in housing and nonfinancial business markets. Commercial paper, critical to some firms in managing short-term liquidity, has become far less available than it had been even in July.

In a speech Aug. 31, Federal Reserve Chairman Ben Bernanke reiterated that the August crisis "had appreciably increased the

**TABLE 3-
EMPLOYMENT
TRENDS**

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend growth rate	July '07-July '07 growth rate	July '07 employment share	15-year trend growth rate	July '06-July '07 growth rate	July '07 employment share	15-year trend growth rate	July '06-July '07 growth rate	July '07 employment share
Total nonagricultural	2.2%	1.5%	100%	1.6%	0.9%	100%	1.6%	0.7%	100%
Total private	2.3%	1.2%	86.9%	1.7%	0.9%	87.3%	1.7%	0.6%	85.9%
Goods producing	2.0%	0.9%	23.6%	0.5%	-1.8%	16.2%	0.7%	-1.5%	17.7%
Construction/natural resources	3.1%	0.3%	5.7%	3.3%	-1.1%	5.0%	2.9%	-1.1%	5.3%
Manufacturing	1.7%	1.1%	17.9%	-0.4%	-2.1%	11.2%	0	-1.6%	12.4%
Service providing	2.2%	1.7%	76.4%	1.9%	1.5%	83.8%	1.8%	1.2%	82.3%
Trade/transportation/utilities	0.9%	2.0%	21.3%	1.2%	1.0%	19.0%	1.2%	0.1%	19.1%
Wholesale trade	2.1%	0.5%	4.4%	1.6%	0.7%	4.9%	1.4%	0.5%	4.8%
Retail trade	0.4%	2.3%	13.8%	1.4%	0.4%	10.4%	1.3%	0.7%	11.0%
Trans./warehouse/utilities	1.8%	2.8%	3.1%	0.4%	3.1%	3.7%	0.4%	-2.5%	3.3%
Information	1.4%	5.3%	1.3%	0.2%	-4.8%	2.2%	0.3%	-1.7%	2.0%
Financial activities	4.5%	1.7%	4.6%	1.8%	1.4%	8.0%	1.9%	1.2%	6.6%
Professional & business service	5.7%	2.3%	8.4%	2.2%	1.9%	14.8%	2.5%	1.4%	11.9%
Education & health	3.2%	-0.7%	14.1%	3.3%	4.0%	13.4%	3.3%	3.4%	14.9%
Leisure & hospitality	2.7%	0.9%	8.8%	2.3%	1.6%	9.5%	2.0%	1.4%	9.5%
Other services (excluding govt.)	1.6%	2.1%	4.7%	1.7%	-0.8%	4.2%	1.3%	-1.7%	4.2%
Government	1.3%	3.7%	13.1%	1.3%	1.1%	12.7%	1.0%	1.3%	14.1%
Federal government	0.3%	2.9%	1.7%	-0.1%	-1.2%	1.2%	-0.3%	-1.2%	1.2%
State government	1.2%	5.5%	3.0%	1.9%	1.1%	3.7%	1.3%	1.1%	3.2%
Local government	1.5%	3.3%	8.5%	1.3%	1.5%	7.8%	1.1%	1.6%	9.8%

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

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

downside risks to growth.” Because home equity has become much more liquid due to financial innovation, he observed, the impact of the housing sector on household consumption is far greater now than in the past. In more normal times this is a good thing, as it allows households to smooth consumption when they have an interruption to income such as job loss. But it also means that household consumption will drop more now, when housing prices decline, than it did in earlier housing sector crises.

The August consumer confidence index report from The Conference Board showed a marked decline in confidence and in expectations of future labor market conditions but no change in expectations for future income. The current national economic expansion has seen less growth than the postwar average, but consumption has grown closer to the average level. Thus the current business cycle has been fueled by consumption more than usual; if consumption should falter due to softening home prices, the economy will be at great risk.

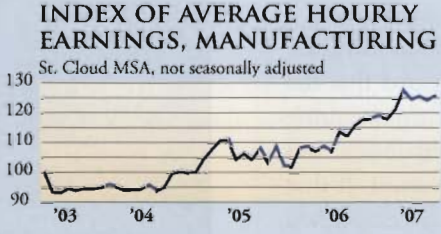
The state economy has softened substantially. Table 3 on the previous page shows that private employment in the 12 months to July 2007 grew only 0.6 percent in Minnesota. St. Cloud’s private employment rate was double the state rate. St. Cloud has so far managed to avoid the declines in manufacturing employment experienced elsewhere in Minnesota, and its construction employment has stabilized for the time being. Public sector employment was up 3.7 percent from July 2006 to July 2007. The information and business services sectors also saw substantial gains. Nevertheless, overall employment rose 1.5 percent in the 12 months to July 2007 and private sector employment rose only 1.2 percent.

An interesting phenomenon in St. Cloud has been the increasing wages in the manufacturing sector. Since January 2006, the average hourly wage in that sector has risen about 24 percent in nominal terms. Some of this is perhaps due to the changing composition of manufacturing employment, for example with the addition of jobs at the new Arctic Cat facility. It also may reflect the impact of continuing difficulties attracting qualified workers in our surveys.

TABLE 4-OTHER ECONOMIC INDICATORS

	2007	2006	Percent Change
St. Cloud MSA labor force July (Minnesota Workforce Center)	106,236	104,971	1.2%
St. Cloud MSA civilian employment # July (Minnesota Workforce Center)	101,748	101,277	0.5%
St. Cloud MSA unemployment rate* July (Minnesota Workforce Center)	4.2%	3.5%	NA
Minnesota unemployment rate* July (Minnesota Workforce Center)	4.3%	3.7%	NA
Minneapolis-St. Paul unemployment rate* July (Minnesota Workforce Center)	4.2%	3.6%	NA
St. Cloud-area new unemployment insurance claims May-July average (Minnesota Workforce Center)	867.3	696.0	24.6%
St. Cloud Times help-wanted ad linage May-July average, in inches	5,285	5,751	-8.1%
St. Cloud MSA residential building permit valuation In thousands, May-July average (U.S. Department of Commerce)	11,754.3	14,565.7	-19.3%
St. Cloud index of leading economic indicators July (St. Cloud State University)**	103.2	102.8	0.4%

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
 ** - January-March 2001=100
 NA - Not applicable



Local job growth was unable to keep pace with the increase in the size of the labor force described in Table 4. The number of St. Cloud residents working grew 0.5 percent (including those working outside of our metro area.) The local area’s labor force grew 1.2 percent, meaning our unemployment rate rose in the past year. These last two data points are for St. Cloud households, as opposed to St. Cloud businesses measured in Table 3. One interpretation of the data is the slowing of the Twin Cities economy this spring has had the effect of slowing employment of St. Cloud-area workers, while area businesses are still finding pockets of labor to employ from outside the St. Cloud area. As we have noted in previous reports, demographic trends do not project to those other counties providing growing pools of labor.

Other local data show weakness across the board. New claims for unemployment insurance in May, June and July jumped almost 25 percent from last year’s levels. Help-wanted advertising linage in the St. Cloud Times, a positive contributor to the

St. Cloud Area Leading Economic Indicators in many past reports, declined more than 8 percent in the same period.



As noted before, local construction employment has stabilized. But the level of residential building permits has declined to levels not seen since 1999. The Federal Reserve’s Beige Book reported in July that “commercial construction contacts in Central Minnesota ... saw slowing growth.” Some inventory may still be waiting for buyers and completion, and it is possible that some construction firms are hoarding labor. But these data and the troubles in the mortgage market would portend that the worst may be forthcoming in construction.

Two of four local indicators for the St. Cloud Area Index of Leading Economic Indicators were negative in this quarter. Hours worked in manufacturing and new business incorporations have contributed negatively to the index, while help-wanted advertising and new unemployment insurance claims made positive marks. Both of these latter indicators, however, have since turned down.

Both of these indicators are lagged in the index, meaning we can expect them to contribute negatively to the next reading in October. For this reason as well, we believe the St. Cloud economy is at heightened risk of entering recession around the end of 2007.

We are not in the habit of predicting events in the national economy, but a few observations would reinforce our points on the local economy. At its Sept. 18 Federal Open Market Committee meeting, the Federal Reserve lowered the federal funds rate target by 50 basis points. Indeed, the average daily federal funds rate averaged 4.92 percent from Aug. 10 to the end of the month, suggesting the Fed had already eased without announcing the change. Treasury bill rates plummeted in the month as well, as investors sought safe assets. The events indicate a broader credit crunch that will likely harm business investment going forward.

If the credit crunch should lead to sharp declines in manufacturing employment nationwide, it could be expected that the national economy would go into recession. But manufacturing employment did not recover during the current expansion, and thus might have few jobs to shed in a new downturn. If that is the case, the manner in which recession dates are established by the National Bureau for Economic Research might lead it to conclude no recession has occurred. The same is true for the St. Cloud economy, where manufacturing as a share of total employment has not recovered from the 2001-03 recession. Usually manufacturing employment will begin to turn down before employment elsewhere, as you can see in the past two recessions (we do not have data before 1990), but there was no pickup in 2004-05 from which a new downturn can be marked.

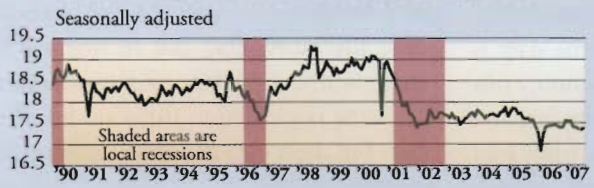
TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

Changes from May to July 2007	Contribution to LEI
Help-wanted advertising in St. Cloud Times	0.79%
Hours worked	-0.63%
New business incorporations	-0.12%
New claims for unemployment insurance	1.74%
Total	1.78%

*Numbers may not add up due to rounding.

Thus, we believe any local recession, if it does come, will be unlike previous recessions. The areas to be affected now would be areas usually impervious to recessions, such as finance and retail trade. We would not expect it to be very sharp in its decline, but sluggishness may take a substantial amount of time to overcome.

SHARE OF ST. CLOUD EMPLOYMENT IN MANUFACTURING



Thus, we believe any local recession, if it does come, will be unlike previous recessions. The areas to be affected now would be areas usually impervious to recessions, such as finance and retail trade. We would not expect it to be very sharp in its decline, but sluggishness may take a substantial amount of time to overcome.

IN THE NEXT QBR Look for the next survey in November and the accompanying St. Cloud Area Quarterly Business Report in the January-March ROI Central Minnesota. Businesses that wish to participate in the survey can call the St. Cloud State University Center for Economic Education at 320-308-2157.

DESTINATION Greater St. Cloud Area of Central Minnesota

Want to grow your business?

The St. Cloud Area Economic Development Partnership can help with site selection, financial incentives and business development resources.



Visit our website at scapartnership.com or call 320.252.2177.



THE PARTNERSHIP
A progressive approach to growth & development