Key takeaways: Slower growth ahead

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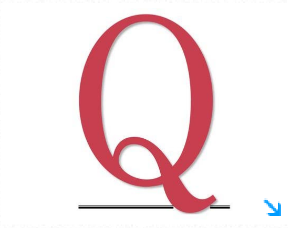

(Photo: Times graphic)

St. Cloud-area employment growth was flat over the most recent 12 months as job gains in the goods producing, health/education and financial activities sectors were offset by weakness in the professional/business services, information, leisure/hospitality and government sectors. Business optimism remains solid — although slightly weaker than last year at this time — but the leading economic indicator series has gone sideways for more than a year. A growing share of area firms has begun to increase prices over the past three months.

1. Overall job creation in the St. Cloud area was unchanged from one year earlier in the 12 months through April 2015. Private sector job gains — which account for 85.1 percent of area workers — were up 0.3 percent over the past year. The April unemployment rate in the St. Cloud area was 3.8 percent, down from 4.3 percent a year ago.

2. The health care and education sector added 737 new jobs over the past year — a growth rate of 3.5 percent. Employment in the mining/logging/construction sector — construction likely accounts for most of this sector in the St. Cloud area — grew at a 4.9 percent rate. Professional and business services employment contracted by 9.1 percent.

3. The St. Cloud Index of Leading Economic Indicators was slightly higher in the latest quarter, but three of the four indicators were essentially flat. The small 0.15 percent increase in the index is attributable to somewhat higher new filings for business incorporation in the St. Cloud area.

4. The future outlook of area businesses remains solid, according to the St. Cloud Area Business Outlook Survey. Fifty-nine percent of surveyed firms expect a future increase in business activity, and 42 percent expect to expand payrolls. Fifty-nine percent indicate they expect pay to be higher, and 30 percent of surveyed firms expect to be able to increase prices. Thirty-eight percent of surveyed firms have found it to be more difficult to attract qualified workers in the last quarter, a trend they expect to continue throughout 2015. There was less optimism about the national economic outlook than in previous reports.

5. More than one-half of firms responding to special questions indicate that they have no workers who were born in other countries on their payroll. About one-third of firms report that between 1 and 5 percent of their workforce were born in another country. Thirty-eight percent of firms indicate "language" is a barrier to employing immigrant workers. One-third of firms find "education/skills" to be a barrier in their decision to

employ immigrant workers. Almost 30 percent of firms have not attempted to hire immigrant workers, and 13 percent have encountered no barriers. "Culture" and "work ethic" were cited as an employment barrier by only 15 percent of surveyed firms. Less than one-fourth of survey respondents think the availability of new immigrants might reduce the local labor shortage.

What the data mean: Pricing power, employment growth offset flat conditions

Data from the Minnesota Department of Employment and Economic Development showed no growth in employment in the St. Cloud area for the 12 months to April 2015. Private sector growth was a very slow 0.3 percent. Construction, manufacturing, education and health sectors, and wholesale trade employment grew significantly in the last year but was offset by declines in professional and business services, retail trade and information technology employment. The professional and business services sector includes temporary help services. The "temp help" data in St. Cloud are not separately available.

In contrast, job gains in Twin Cities employment services (chiefly, temporary help services) rose 6.9 percent. An optimist would say in St. Cloud this went down because those workers took up permanent positions.

After some time in 2012-13 when St. Cloud grew faster than elsewhere in the state, the growth has rotated to elsewhere. Table 3 shows that Minneapolis-St. Paul area employment grew 1.8 percent. Employment (not shown) in other Minnesota metropolitan statistical areas was also stronger than St. Cloud. For example, employment in the Mankato MSA was up 0.7 percent, the Duluth-Superior MSA experienced 0.7 percent job gains and Rochester MSA employment was up 0.6 percent.

Labor supply in the area grew 0.5 percent in the 12 months to April, while employment expanded 1.1 percent (see Table 4 nearby). Note that the employment measure in this table reflects the number of St. Cloud residents who are working regardless of where they work, as opposed to Table 3 which reports employment at firms in the St. Cloud area, regardless of where those workers came from. The faster growth for employment over labor supply means the local unemployment rate fell to 3.8 percent. This is the lowest reading for April since 2000, a period characterized by very tight labor markets. A recent survey (see footnote) of the National Federation of Independent Businesses showed that 53 percent of firms it surveyed nationally either hired or tried to hire in the first quarter of 2015 but that "44 percent reported few or no qualified applicants for the positions they were trying to fill."

Other evidence on labor markets in Table 4 confirms that area businesses are trying to keep workers and find more. New claims for unemployment insurance fell over the last year, while help-wanted linage in the St. Cloud Times rose. The Conference Board reports that there are more online job openings in Minnesota than there are unemployed persons in the state. On the other hand, there have been almost no permits taken out for residential construction in the area since December. The St. Cloud area Index of Leading Economic Indicators was virtually unchanged over the year, as it has been for now about 18 months.

Table 5 shows the details of the LEI, which rose 0.15 percent in the last quarter. The entire gain is accounted for by a higher rate of incorporations of new businesses in the area. The other three indicators were virtually unchanged.

It would be understandable for a more pessimistic reader to be concerned about the St. Cloud economy after seeing a flat LEI series, flat employment and the standstill in residential construction. We are concerned as well. But one must place in the balance

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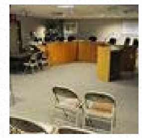

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against these negatives the tightness of the labor market, the formation of new businesses, better perceived pricing power and continued growth of employment of area citizens, which should give rise to increases in personal income and retail sales — particularly in combination with survey responses indicating higher compensation. Alas, those last two measures are only reported with significant lags, making it harder to say whether the civilian employment data should make us a little more optimistic. So we remain cautious, perhaps a little more so than last quarter.

Footnote: www.nfib.com/Portals/0/PDF/sbet/sbet201505.pdf

Capital expenditures, labor conditions remain strong

Current activity

Tables 1 and 2 report the most recent results of the St. Cloud Area Business Outlook Survey. Responses are from 69 area businesses that returned the recent mailing in time to be included in the report. Participating firms are representative of 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. Note that this quarter, nine new firms were added to the survey list. The addition of these firms does not appear to have materially affected overall survey results, but a breakdown of the difference between new respondents' answers and those from our traditional set of respondents is available upon request.

Survey responses from Table 1 are mostly higher than three months ago, but six of the eight responses are weaker than last May's results. For example, this quarter's diffusion index on current business activity is 52.2, which is well above its 30.7 reading from last quarter (which is a normal seasonal result). But, last year the index number was 59.7. In May 2014, 67.7 percent of firms reported improved business conditions while 8 percent reported a decrease in activity. This May, 62.3 percent of firms report an increase in business activity, and 10.1 percent are experiencing worse conditions. Note that this reading is still much higher than the lowest recorded in the May survey (index of 9.6 in May 2009), so this is a reminder that the area is still experiencing positive (albeit slower) growth. 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.

Labor market conditions with surveyed firms remain strong. While the index on employment is somewhat lower than one year ago, the hiring in the most recent quarter looks to have been strong. The survey item on the average length of workweek measure rebounded from last quarter, and the employee compensation index was steady. Area firms continue to struggle with attracting qualified workers. Worker shortages were reported by 37.7 percent of surveyed firms.

As shown in the accompanying figure, the index number on the capital spending item was weaker in the most recent quarter. With a reading of 24.6, the value of this item (which has never shown a pronounced seasonal pattern) is the lowest recorded since November 2013. Still, this quarter's capital spending results are superior to the negative readings recorded during the Great Recession years.

Revised GDP figures suggest that the national economy contracted in this year's first quarter. The list of potential causes is long: Bad weather, a West Coast dockworkers' strike, an appreciating dollar and residual effects of an abrupt drop in oil prices are commonly cited as the reasons for this temporary drop in national output. So it comes as no surprise that local firms' perception of national business activity is weaker than one year ago. With a value of 27.5, the current national business activity index is the lowest recorded in the May survey since May 2009 (when the index was at -7.5).

Finally, we have been watching the local economy for signs of price increase as the labor market tightens and full employment approaches. This quarter's prices-received index (see accompanying figure) is the highest recorded value since May 2005. This increase in pricing power at local firms could be a good sign — although it could also simply reflect general inflationary pressures. We will keep a watchful eye on this index in coming quarters.

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

Is the city of St. Cloud going to provide free water/sewer and property insurance to the new aquatics center? Will these funds come out of the general fund and not the sales tax fund? If so, this is unfair to the taxpayers — both the citizens and other businesses that have to charge more because they don't get "free" insurance and water. This is unfair competition and a misrepresentation of the funding for the aquatics center if the city is paying these expenses out of its general fund.

Governor not being reasonable.

We interact with regulatory agencies and we are finding that their workforce is not well-trained.

The company is growing but we will put expansion money into the other two (facilities) for this year. So my plant will not grow but the other two will, and that will not show on the area statistics.

An increase in goods being shipped and roads being built is having a positive impact on our company.

The only people being serviced by the health care plans today are the doctors, hospitals, and health organizations benefiting from increased revenue. It sure isn't the small employers!

I'm having difficulty finding experienced employees. I'm considering hiring a partner that is experienced in (the work my firm does).

Future outlook

Table 2 reports the future outlook for area businesses. While the six-month-ahead local outlook remains solid, a few of the categories in the table are slightly weaker than they were one year ago. We noted last quarter that a weaker future outlook could be indicative of a maturing local expansion.

The index on future overall business activity is slightly lower than was reported last quarter (this commonly occurs in our survey) and is below the number recorded one year ago. At a value of 52.2, the future business activity index is the lowest May reading since May 2011. Still, nearly 60 percent of surveyed firms expect increased activity in six months, and only 7.2 percent expect conditions to worsen. Forty-two percent of firms expect to expand payrolls over the next six months, and five firms expect to trim employment.

As can be seen in the accompanying figure, the future employment index has leveled out in recent quarters. The index on length of the workweek is the highest it has been since February 2014. Almost 60 percent of surveyed firms expect to pay higher wages by November. As can be seen in the accompanying figure, the future employee compensation index continues to inch higher. The national business activity index is weaker than one year ago and is the weakest May reading since 2009.

Capital spending is expected to pick up by November as 38 percent of firms anticipate increased investment over the next six months. The reading on this index is the strongest recorded since February 2014. Local firms may be expecting to increase capital spending before the Federal Reserve begins policy normalization over the next year. Similar to what was seen in the current conditions index, future prices received are somewhat elevated from previous surveys. Thirty percent of surveyed firms expect to receive higher prices in six months' time, and only three firms expect lower prices. Much of this may go to pay for higher wages, as almost 60 percent of firms expect to raise compensation in the next six months.

Finally, the area labor shortage is expected to continue into November 2015. Thirty-five percent of surveyed firms expect increased difficulty attracting qualified workers over the next six months, and no firms expect the worker shortage to diminish. With a value of 34.8, the May 2015 reading on this item is only slightly below what was recorded one year ago.

Survey results for special questions

Employers weigh in on role of immigrants in local workforce

As we note at the beginning of this report, the St. Cloud-area population structure continues to undergo change as several hundred potential new workers come to Central Minnesota each year from other countries. The employment experiences of these new entrants to the workforce are no doubt wide and varied. We asked area businesses to report on their employment of immigrant workers. We asked:

What share of your company's workforce consists of workers who were born in other countries?

More than 50 percent of firms employ no immigrant workers, and another 32.4 percent indicate that 1-5 percent of their workers are from other countries. There were 8.8 percent of firms reporting 6-10 percent of their workers are immigrants. Few local firms employ a larger percentage than this. Comments on this question include:

Small staff — all have been here a long time — low turnover.

None ever apply. *(Two others gave similar answers.)*

Lots of Somalis here now.

To my knowledge, one employee.

We only have nine employees. We have had foreign workers in the past, just not now.

We place the best candidates possible — matching skills and experience to the positions we have.

Small percentage today, but growing. Expect the percentage to be more than 10 percent in 2020.

We have a few, but not many.