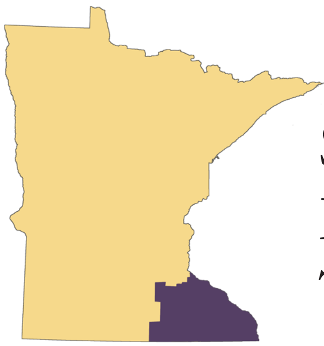

Southeast Minnesota
Economic and Business Conditions Report
Third Quarter 2016

This issue is part of a series for the six planning areas of Minnesota –
Central, Northeast, Northwest, Southeast, Southwest, and Twin Cities.
The Southeast Minnesota Planning Area consists of 11 counties:
Dodge, Fillmore, Freeborn, Goodhue, Houston, Mower, Olmsted, Rice, Steele, Wabasha, and Winona.

Office of the Minnesota
Secretary of State

School of Public Affairs
Research Institute
St. Cloud State University

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Executive Summary

Acceleration of economic growth in Southeast Minnesota is expected over the next several months according to the most recent prediction of the Southeast Minnesota Index of Leading Economic Indicators (LEI). After a quarter in which the LEI experienced a 3.18 point decline, the Southeast Minnesota leading index reversed course by rising 2.34 points in the third quarter of 2016. The increased LEI was led by a rise in the number of residential building permits in Rochester as well as higher new filings of incorporation and LLC in the Southeast Minnesota planning area. Three components of the LEI had negative readings in the current quarter. An increase in initial claims for unemployment benefits, a decline in the Minnesota Business Conditions Index (which serves as a general measure of state business conditions) and weaker consumer sentiment weighed on this quarter's index.

There were 821 new business filings with the Office of the Minnesota Secretary of State in Southeast Minnesota in the third quarter of 2016 — representing a 2.1 percent increase from one year ago. There were 65 new regional business incorporations in the third quarter, a 5.8 percent reduction from prior year levels. At a level of 519, third quarter new limited liability company (LLC) filings in Southeast Minnesota were 5.1 percent higher than the third quarter of 2015. With 198 filings, new assumed name activity was unchanged from the same quarter in 2015. There were 39 new filings for Southeast Minnesota non-profits over the three months ending September 2016—four fewer filings than one year earlier.

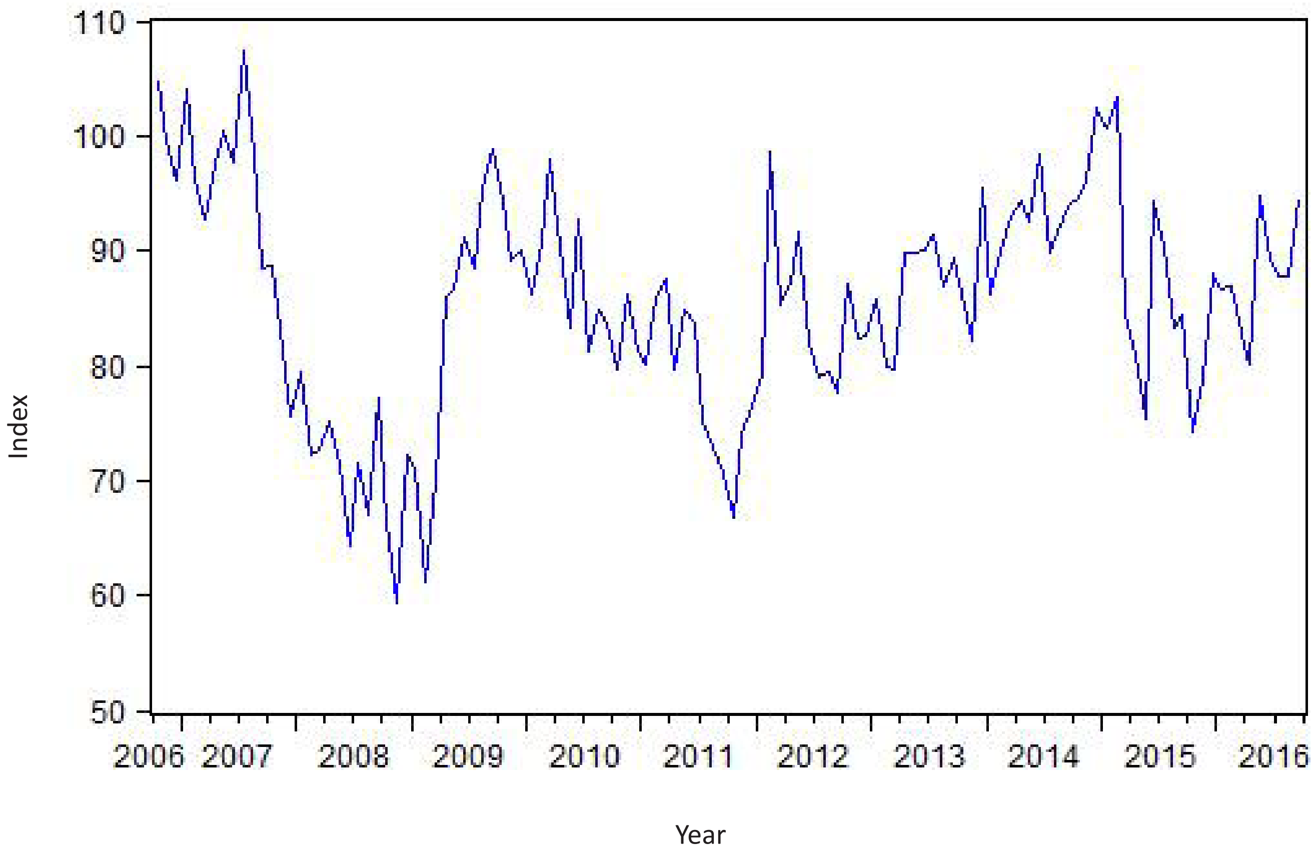
Employment of Southeast Minnesota residents fell by 0.9 percent over the year ending September 2016. Compared to September 2015, 2,415 fewer residents of Southeast Minnesota now have jobs. The regional unemployment rate was 3 percent in September, marginally higher than the 2.8 percent level recorded one year earlier. Initial claims for unemployment insurance in September 2016 were 25.3 percent higher than one year earlier. The Southeast Minnesota labor force contracted by 0.7 percent over the past year. There were 89.04 job vacancies for every 100 people unemployed in the Southeast Minnesota planning area in the second quarter of 2016. The planning area's bankruptcies continued to fall and have now reached historically low levels.

Data from the Rochester area—the largest market in Southeast Minnesota—were mostly favorable, with an increase in overall employment (along with employment growth in the key health/education sector), higher average hourly earnings, an expanding labor force, higher new business filings, and a surge in the value of residential building permits having a positive impact on the outlook. On the negative side was a shorter workweek, a higher unemployment rate, and increased initial jobless claims.

Southeast Minnesota Leading Economic Indicators Index

The SCSU Southeast Minnesota Leading Economic Indicators (LEI) index is designed to predict performance of the regional economy with a four-to-six month lead time. The LEI finished 2.34 points higher in the third quarter, and is now 12.2 percent above its level of one year earlier. As can be seen in the accompanying figure, the LEI has trended upward in 2016.

SCSU Southeast Minnesota Index of Leading Economic Indicators (December 1999 = 100)



Components of SCSU Southeast Minnesota Leading Economic Indicators Index

Component of Index	Contribution to LEI, 3rd quarter 2016	Contribution to LEI, 2nd quarter 2016
Minnesota Business Conditions Index	-2.31	0.21
Southeast Minnesota initial claims for unemployment insurance	-1.73	-5.15
Southeast Minnesota new filings of incorporation and LLCs	2.96	0.03
Rochester MSA residential building permits	4.89	0.13
Consumer Sentiment, University of Michigan	-1.47	1.6
TOTAL CHANGE	**2.34**	**-3.18**

Two of five components of the LEI had a positive reading in the third quarter. New filings of incorporation and LLC in the Southeast Minnesota planning area increased in the third quarter and Rochester metro area residential building permits surged compared to one year earlier. Recent weakness in the Minnesota Business Conditions survey (conducted by Creighton University), which serves as a general measure of state business conditions, had a negative value in this quarter's index. Decisions to consume medical services depend in part on consumer choice, so consumer sentiment is used as a national-level indicator of Southeast Minnesota business activity. Consumer sentiment weakened in the most recent quarter. Higher initial claims for unemployment insurance in recent months was also a drag on the LEI in the third quarter.

SCSU Southeast Minnesota Leading Economic Indicators Index	2016	2015	Percentage change
Minnesota Business Conditions Index September	48.4	53.0	-8.7%
Southeast Minnesota initial claims for unemployment insurance September	994	793	25.3%
Southeast Minnesota new filings of incorporation and LLCs Third Quarter	584	563	3.7%
Rochester MSA single-family building permits September	62	32	93.8%
Consumer Sentiment, University of Michigan September	91.2	87.2	4.6%
Southeast Minnesota Leading Economic Indicators Index September (September 1999 = 100)	94.6	84.3	12.2%

Southeast Minnesota Business Filings

Third quarter new business filings rose 2.1 percent to a level of 821. As can be seen in the accompanying graph, the 12-month moving total of new business filings in Southeast Minnesota has trended upward since the end of 2014. The abrupt increase in new filings in the middle of 2008 is largely a result of increased new LLC filings. This outlier (resembling a shark fin) is related to considerably higher filings in the construction industry due to legal and regulatory issues and appears to be a one-time only transitory event seen in the data in all regions of Minnesota.

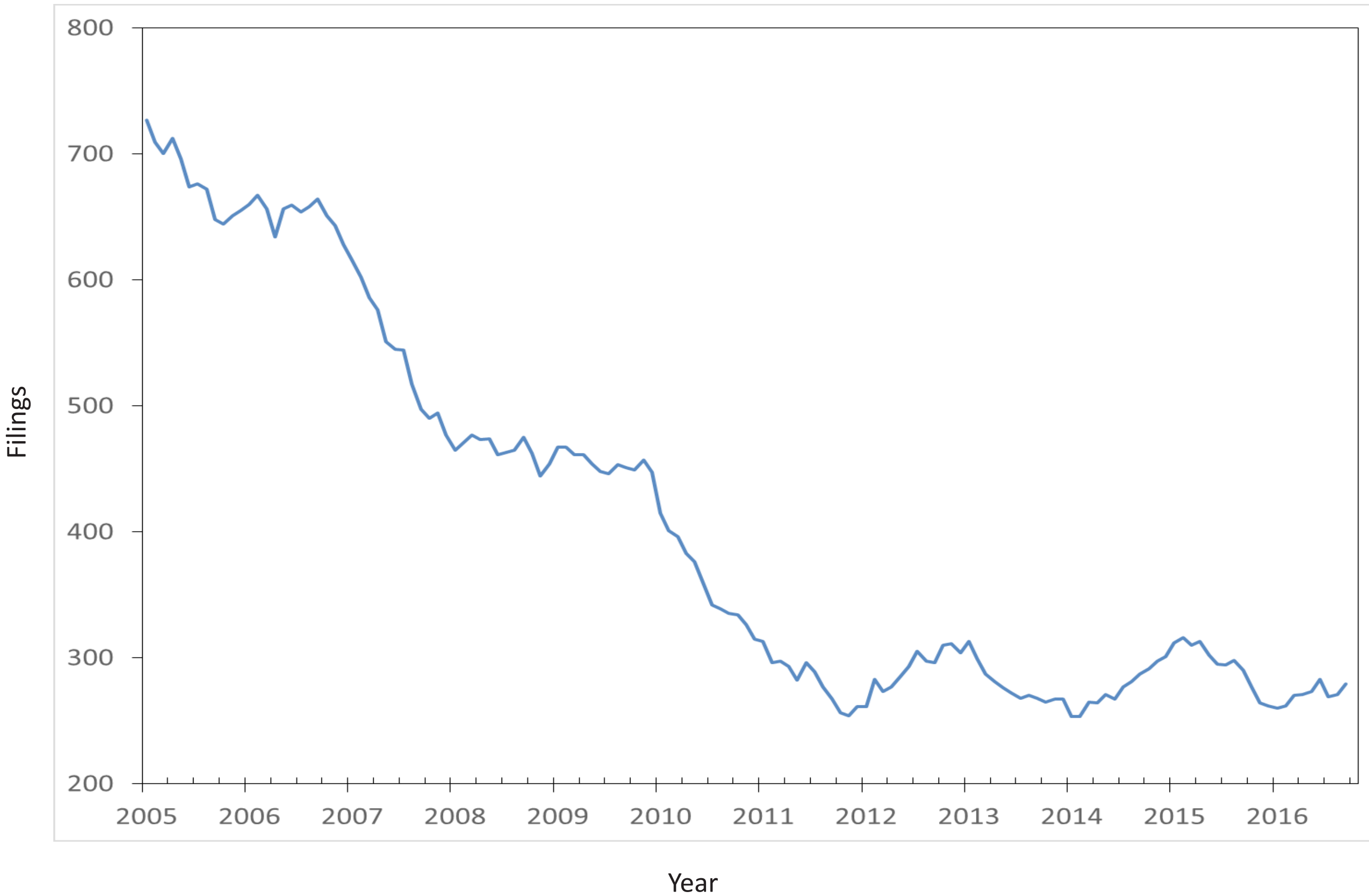
Note: The graphs in this section show the 12-month moving total for the various new business filings in Southeast Minnesota that are registered with the Office of the Minnesota Secretary of State. Doing so removes seasonal patterns in the data.

Total New Business Filings—Southeast Minnesota Planning Area (12-month moving total)

Quarter	III: 2015	IV: 2015	I: 2016	II: 2016	III: 2016	2016 Quarter III: Percent change from prior year
Southeast Minnesota Total New Business Filings	804	740	929	911	821	2.1%

New business incorporations trended downward in Southeast Minnesota from 2005 to 2012, but have fluctuated around a fairly constant trend in recent years. New incorporations fell 5.8 percent from year earlier levels in the most recent quarter.

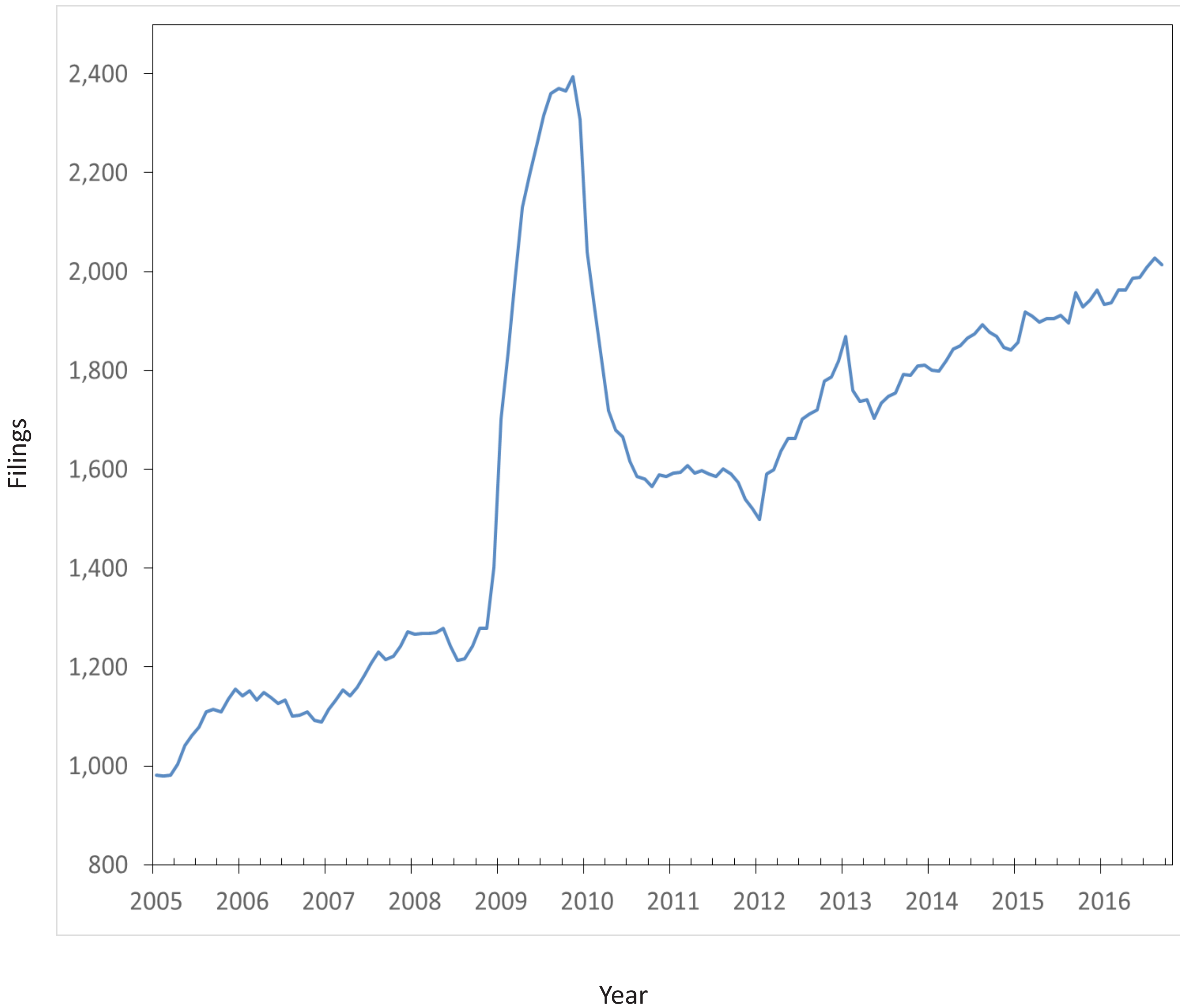
New Incorporations—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2015	IV: 2015	I: 2016	II: 2016	III: 2016	2016 Quarter III: Percent change from prior year
Southeast Minnesota New Business Incorporations	69	61	80	73	65	-5.8%

There has been a move in Southeast Minnesota, as in all of the state, away from the traditional incorporation form of business organization towards the LLC. While new business incorporations remain an important indicator of new business formation in Southeast Minnesota, LLCs are increasingly useful in evaluating regional economic performance. As seen below, there is a considerable upward trend in LLCs in Southeast Minnesota. With the exception of the outlier period in 2008-2009, new LLC formation has shown a fairly steady rate of growth since 2005. Third quarter LLC filings rose by 5.1 percent over their year earlier level.

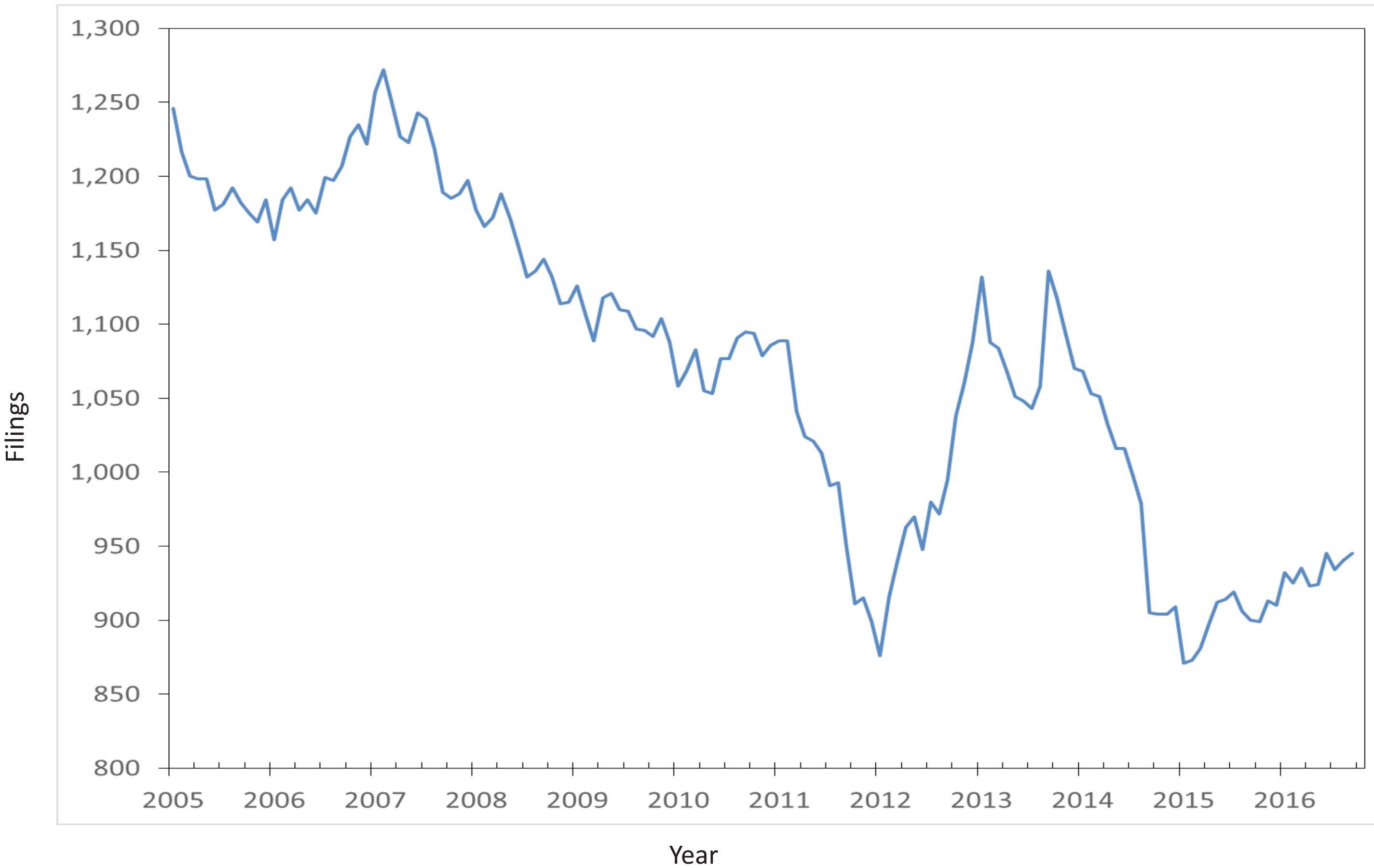
New Limited Liability Companies—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2015	IV: 2015	I: 2016	II: 2016	III: 2016	2016 Quarter III: Percent change from prior year
Southeast Minnesota New Limited Liability Companies	494	420	539	536	519	5.1%

On a year over year basis, assumed names, which include sole proprietors or organizations that do not have limited liability, were flat in Southeast Minnesota in the third quarter. As can be seen in the accompanying graph, after increasing in 2012, this series moved downward until the beginning of 2015, at which time it began to slowly trend upward.

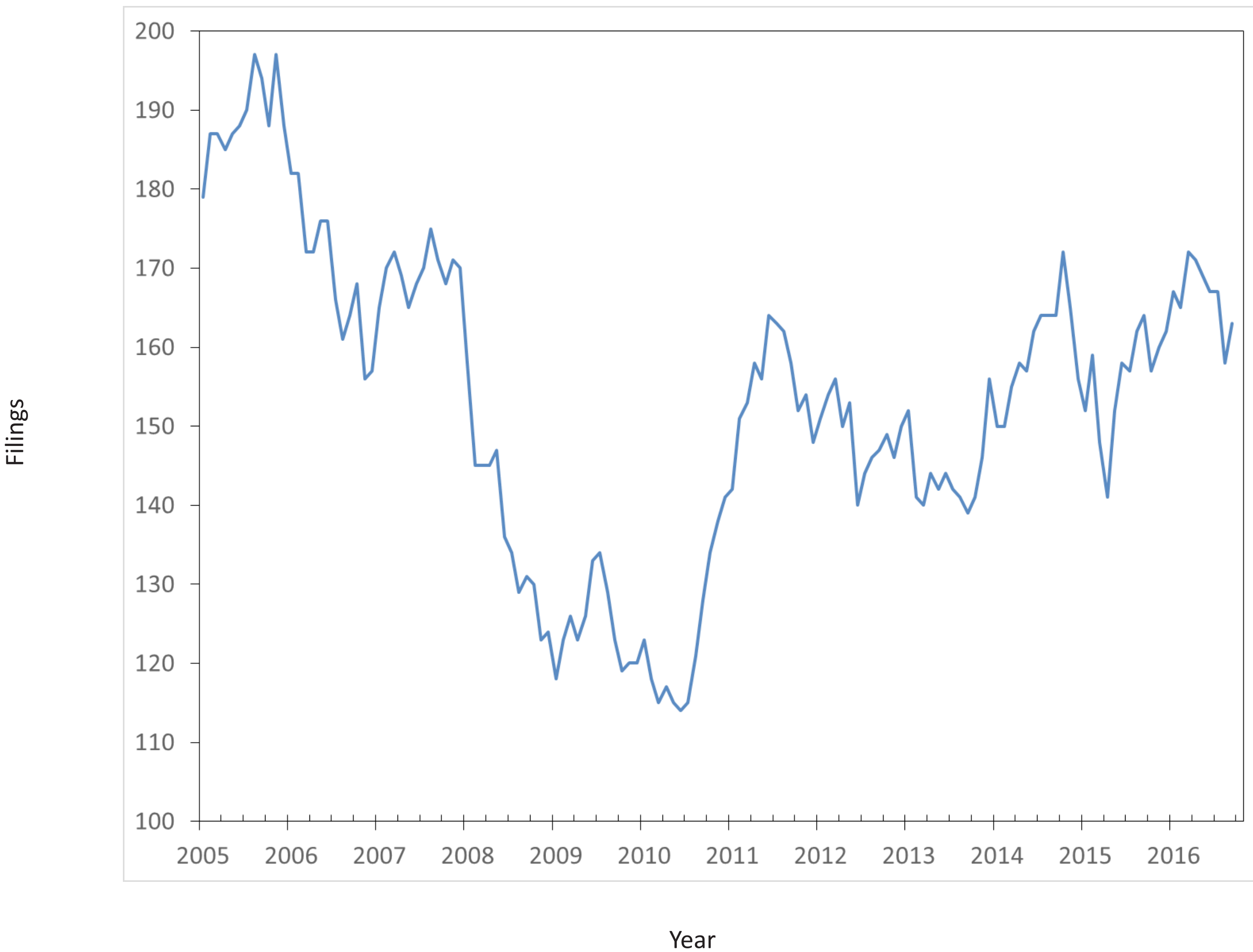
New Assumed Names—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2015	IV: 2015	I: 2016	II: 2016	III: 2016	2016 Quarter III: Percent change from prior year
Southeast Minnesota New Assumed Names	198	221	270	256	198	0%

The moving total of new Southeast Minnesota non-profits registered with the Office of the Minnesota Secretary of State has been volatile over the past several years. As can be seen in the accompanying graph, this series has turned downward in 2016. The number of newly formed non-profits totaled 39 in the recent quarter (a 9.3 percent reduction from the third quarter of 2015).

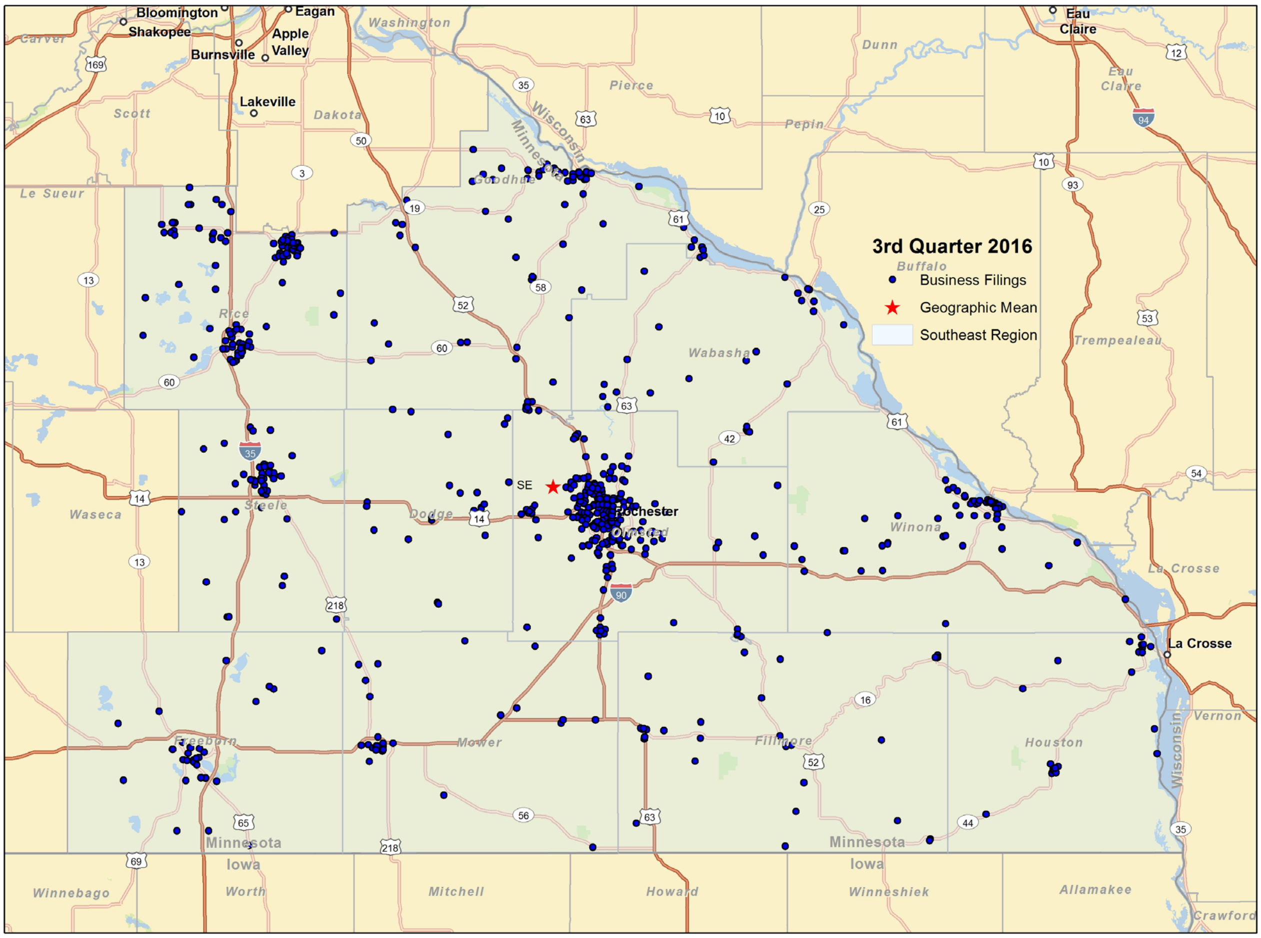
New Non-Profits—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2015	IV: 2015	I: 2016	II: 2016	III: 2016	2016 Quarter III: Percent change from prior year
Southeast Minnesota New Non-Profits	43	38	40	46	39	-9.3%

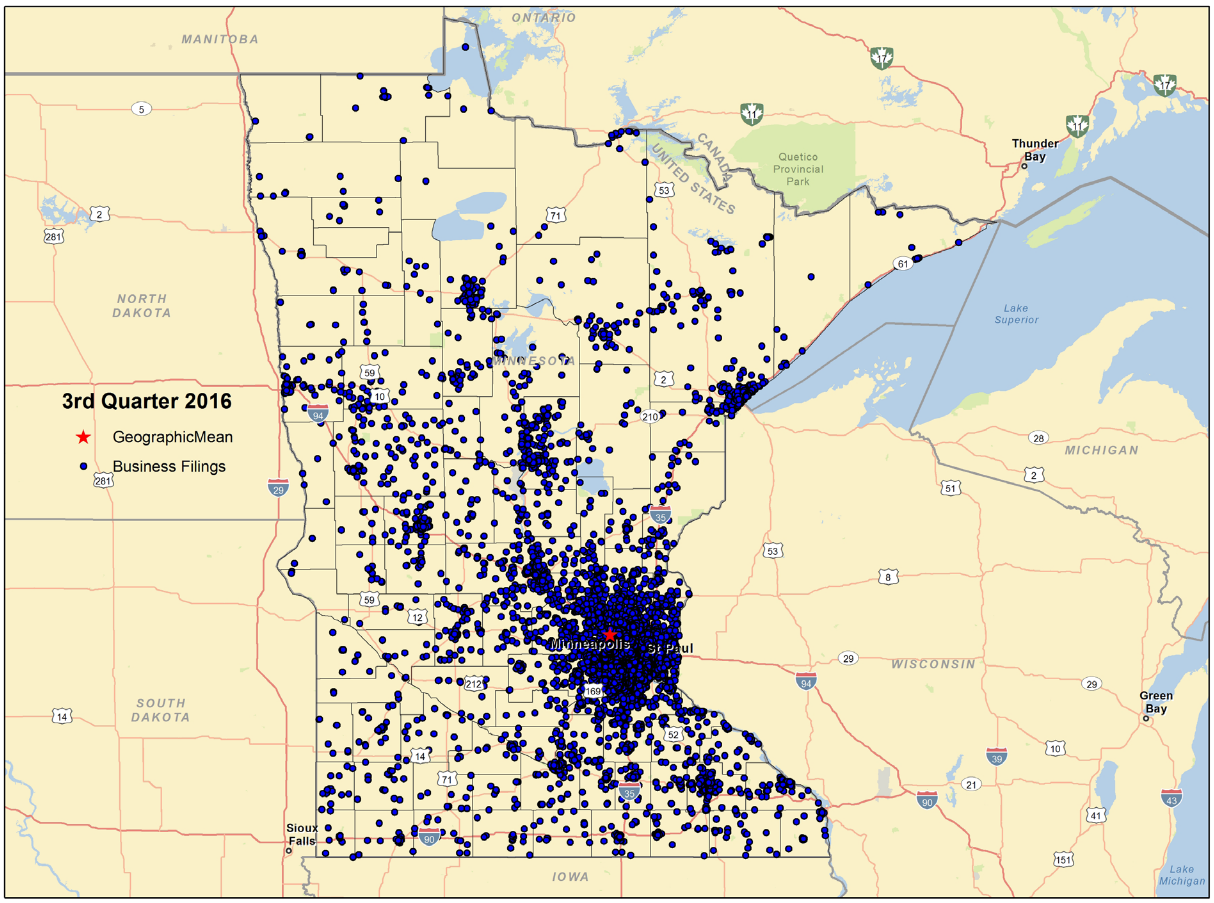
The first map shown below is a visual representation of new business filings around the Southeast Minnesota planning area in the third quarter of 2016. The densest areas of new business formation are in the Rochester metro. Owatonna, Faribault, Northfield, Albert Lea, Austin, and the river cities of Winona and Red Wing also generated multiple new business filings. Well-traveled roadways are also a predictor of new business formation in Southeast Minnesota.

Southeast Minnesota Planning Area--New Business Formation--Quarter 3: 2016



The second map shows new business filings for the state as a whole. This visual aid demonstrates the considerable extent to which the Twin Cities metro area dominates new business formation in the state. The map shows how the Twin Cities metro stretches along roadways into the Southeast, Southwest and Central planning areas. The map demonstrates the importance of cities and roadways in encouraging economic development. St. Cloud now appears to be integrated into the Twin Cities metro as the I-94/US-10 corridor continues to be a magnet for new business formation.

Minnesota--New Business Formation--Quarter 3: 2016

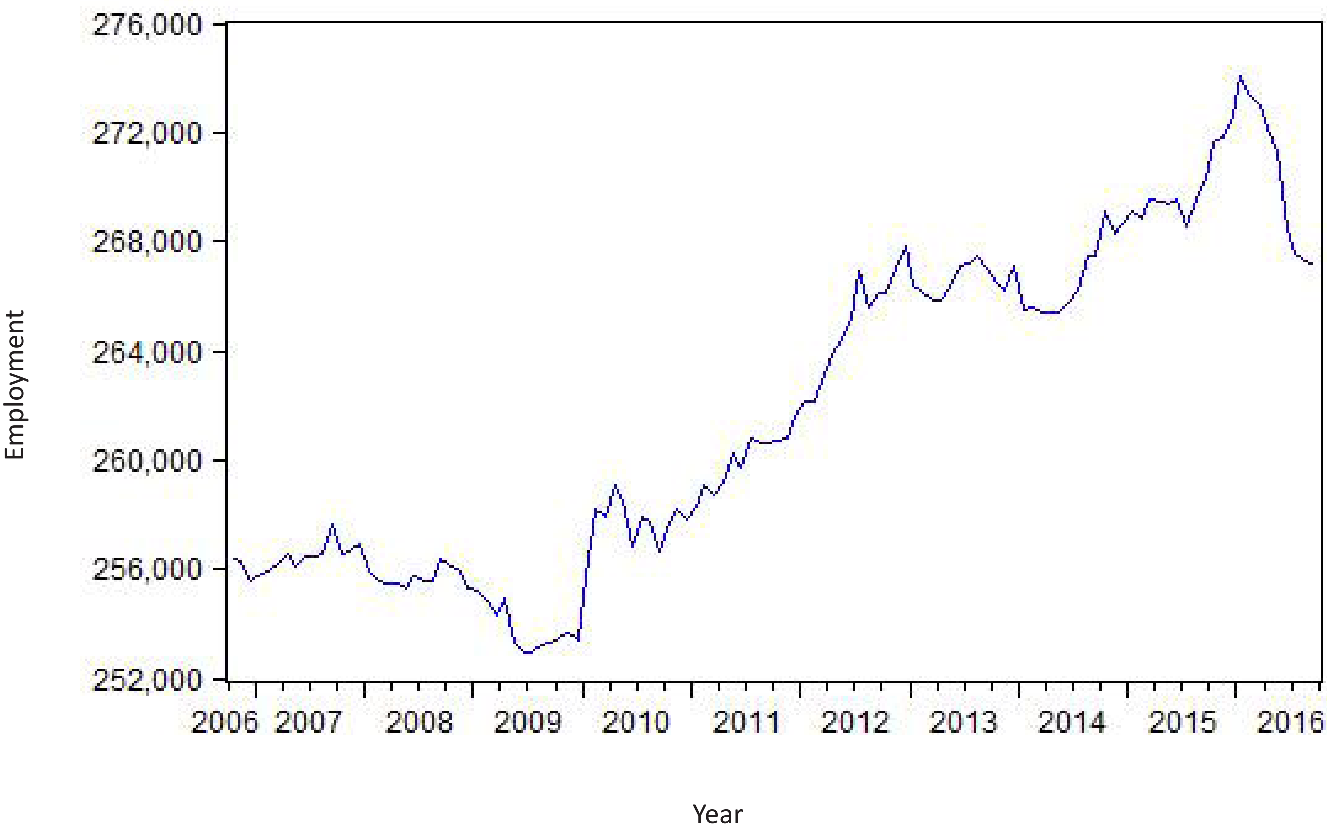


Southeast Minnesota Labor Market Conditions

Employment of those living in the Southeast Minnesota planning area fell by 0.9 percent over the past year. As shown in the accompanying graph, the 12-month moving average of total employment had been trending upward since the end of the Great Recession. But this trend appears to have been reversed in 2016.

Note: seasonally adjusted labor market data are typically not available to evaluate regional economic performance so some series have been created to illustrate seasonal patterns of the regional labor market. Graphs of these indicators are found in this section of the report. Tabular data are not seasonally adjusted.

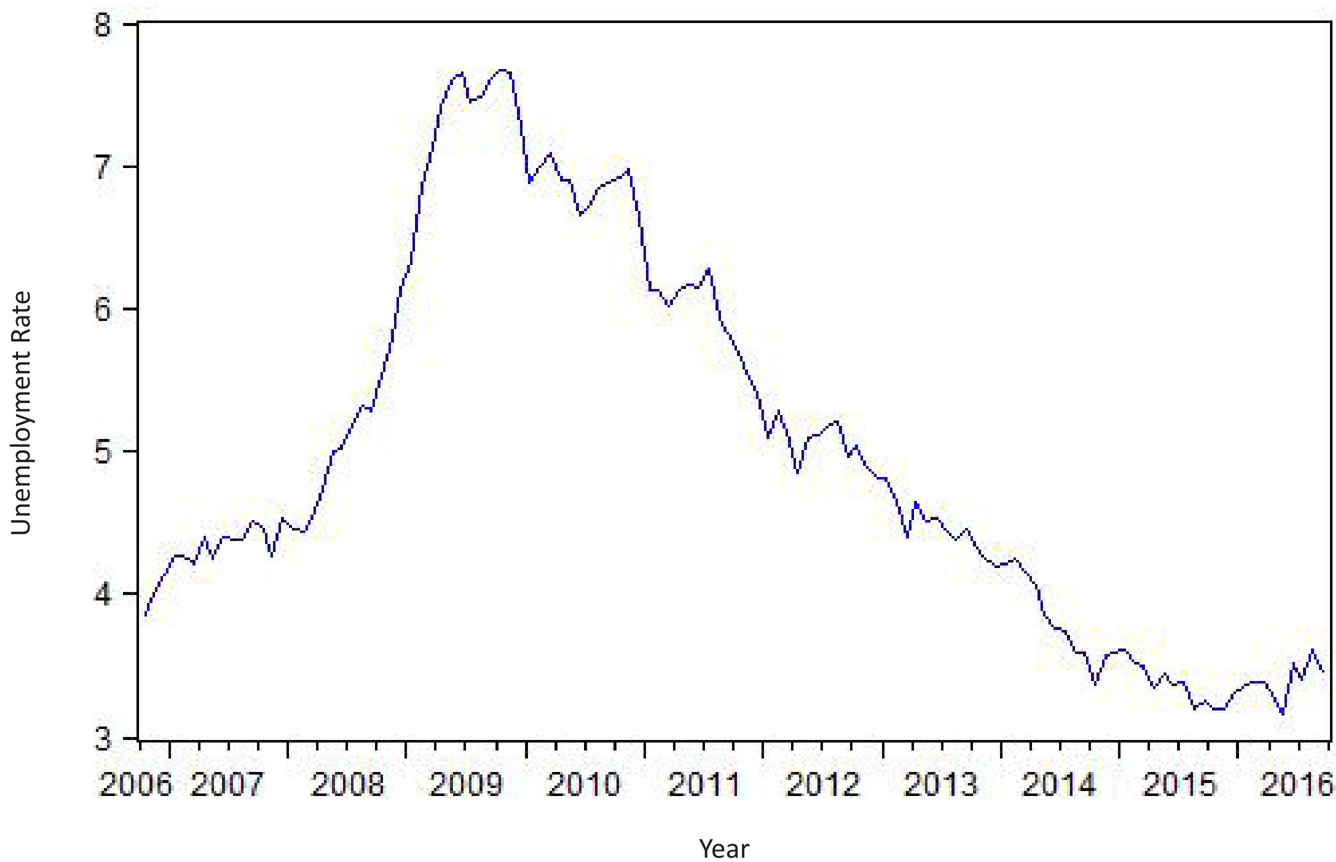
Employment—Southeast Minnesota Planning Area (12-month moving average)



Month	September 2015	April 2016	May 2016	June 2016	July 2016	August 2016	September 2016
Employment (Not seasonally adjusted)	270,085	271,392	271,831	270,627	270,080	269,279	267,670

The seasonally adjusted unemployment rate in Southeast Minnesota has started to rise over the past couple of quarters. The non-seasonally adjusted unemployment rate stands at 3 percent, marginally higher than the 2.8 percent rate observed one year ago.

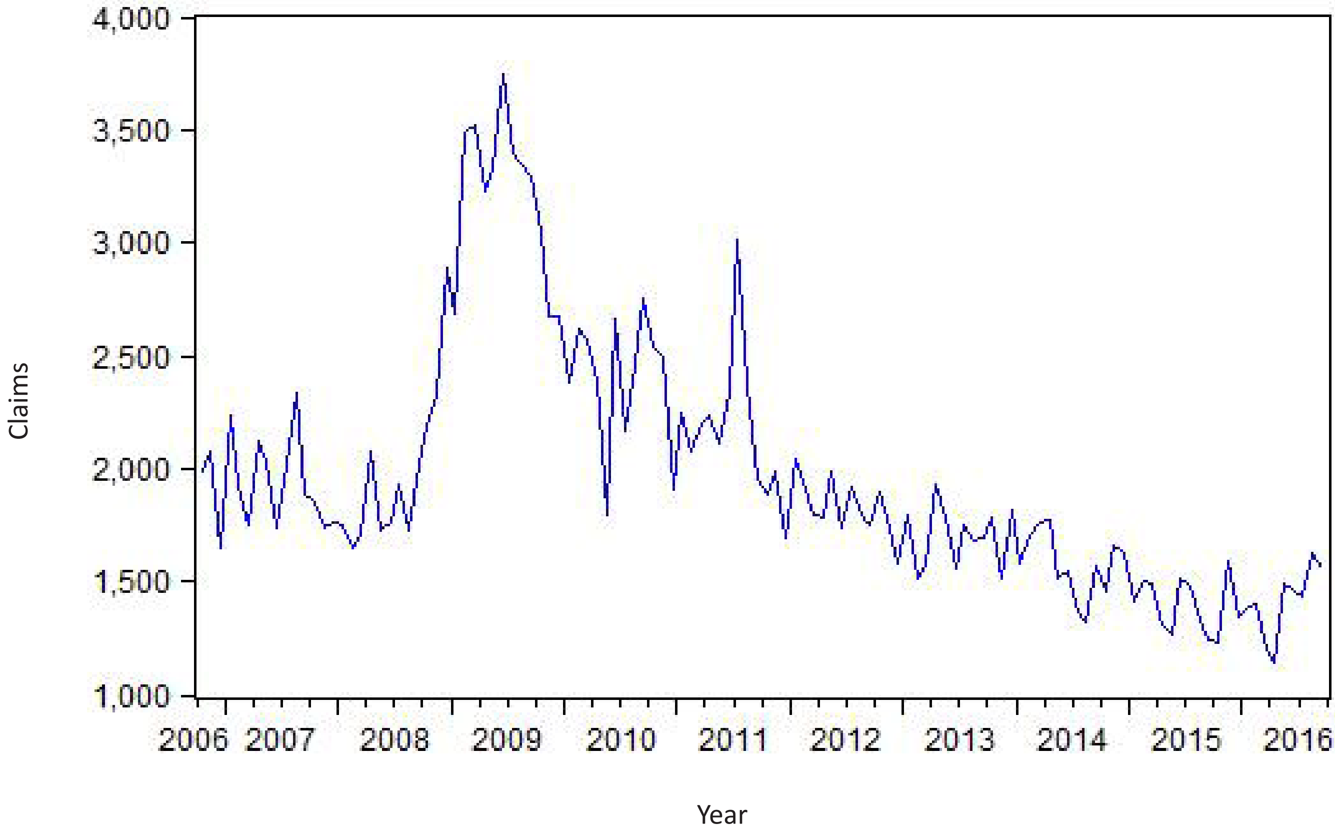
Unemployment Rate, seasonally adjusted—Southeast Minnesota Planning Area



Month	September 2015	April 2016	May 2016	June 2016	July 2016	August 2016	September 2016
Unemployment Rate (Not seasonally adjusted)	2.8%	3.2%	2.9%	3.7%	3.4%	3.4%	3%

New claims for unemployment insurance in September 2016 were 25.3 percent higher than one year earlier. On a seasonally adjusted basis, these claims appear to be increasing in recent quarters.

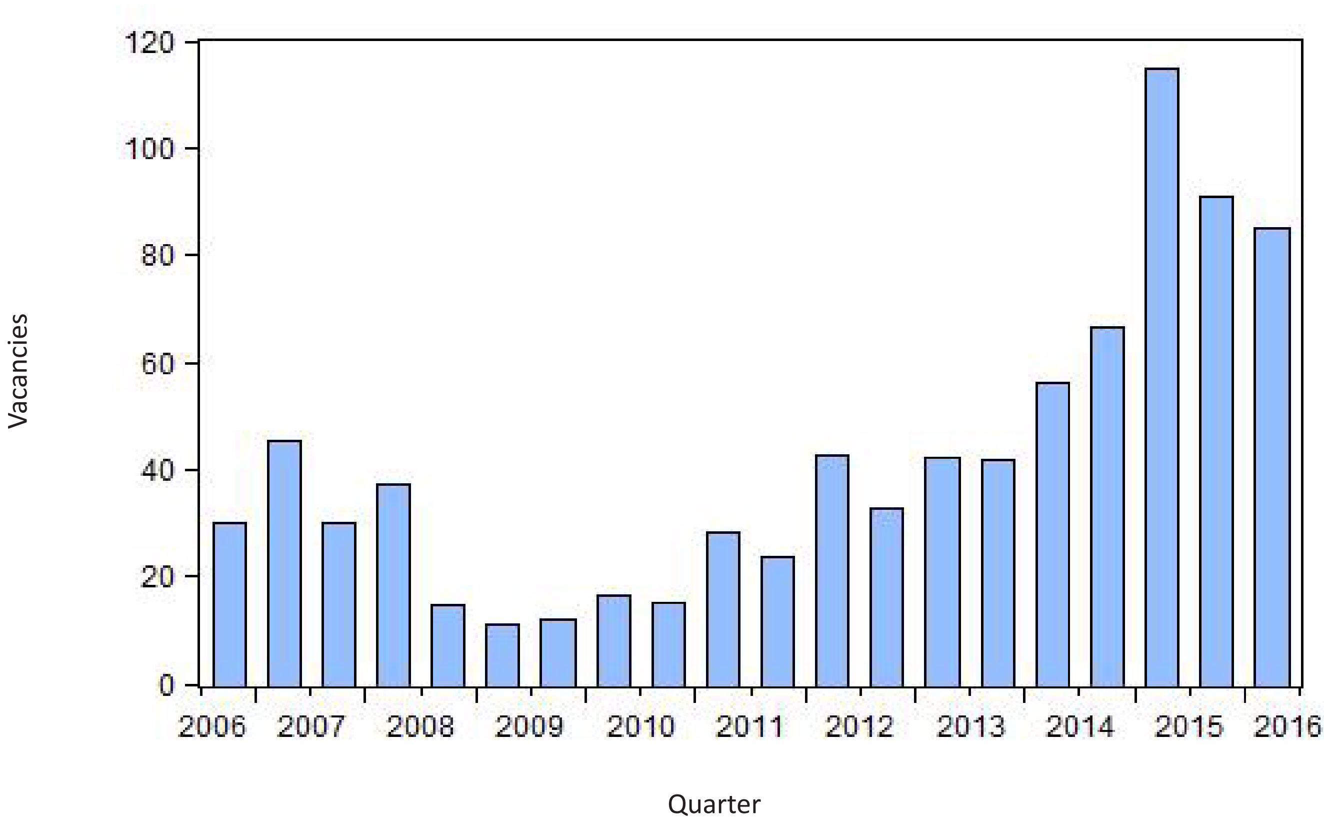
Total Initial Claims for Unemployment Insurance, seasonally adjusted—Southeast Minnesota Planning Area



Month	September 2015	April 2016	May 2016	June 2016	July 2016	August 2016	September 2016
Initial claims (Not seasonally adjusted)	793	906	1,174	1,299	1,118	977	994

The number of job vacancies per 100 unemployed has declined from its peak one year ago. However, the job vacancy rate remains elevated in Southeast Minnesota (and throughout the state). This job vacancy rate is now several times higher than it was at its low point during the Great Recession and is the second highest of Minnesota's six planning areas.

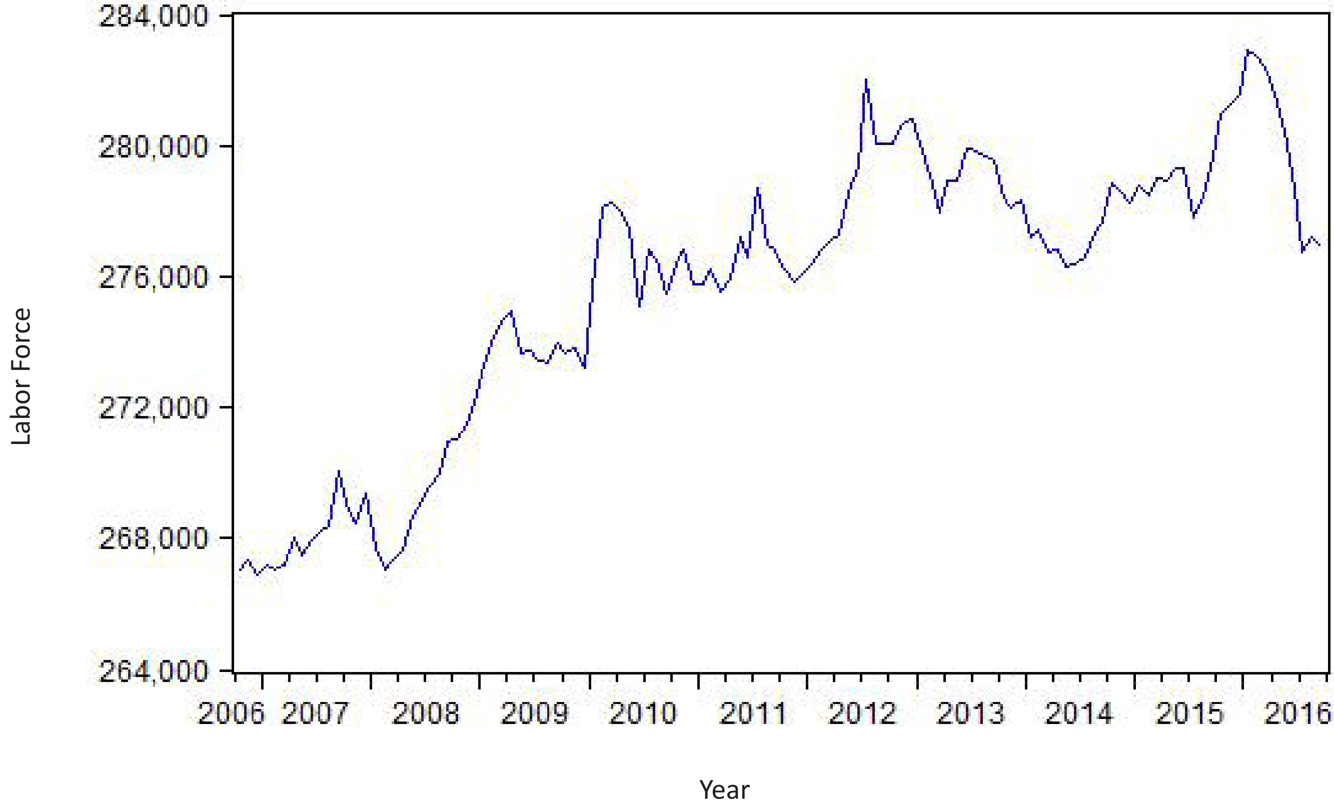
Job Vacancies per 100 Unemployed---Southeast Minnesota Planning Area



Quarter	2013:IV	2014:II	2014:IV	2015:II	2015:IV	2016:II
Job Vacancies per 100 Unemployed	49.07	59.42	78.11	119.55	105.07	89.04

The Southeast Minnesota labor force contracted by 0.7 percent over the last year. The regional labor force is now 2,077 lower than in September 2015.

Labor Force—Southeast Minnesota Planning Area (12-month moving average)

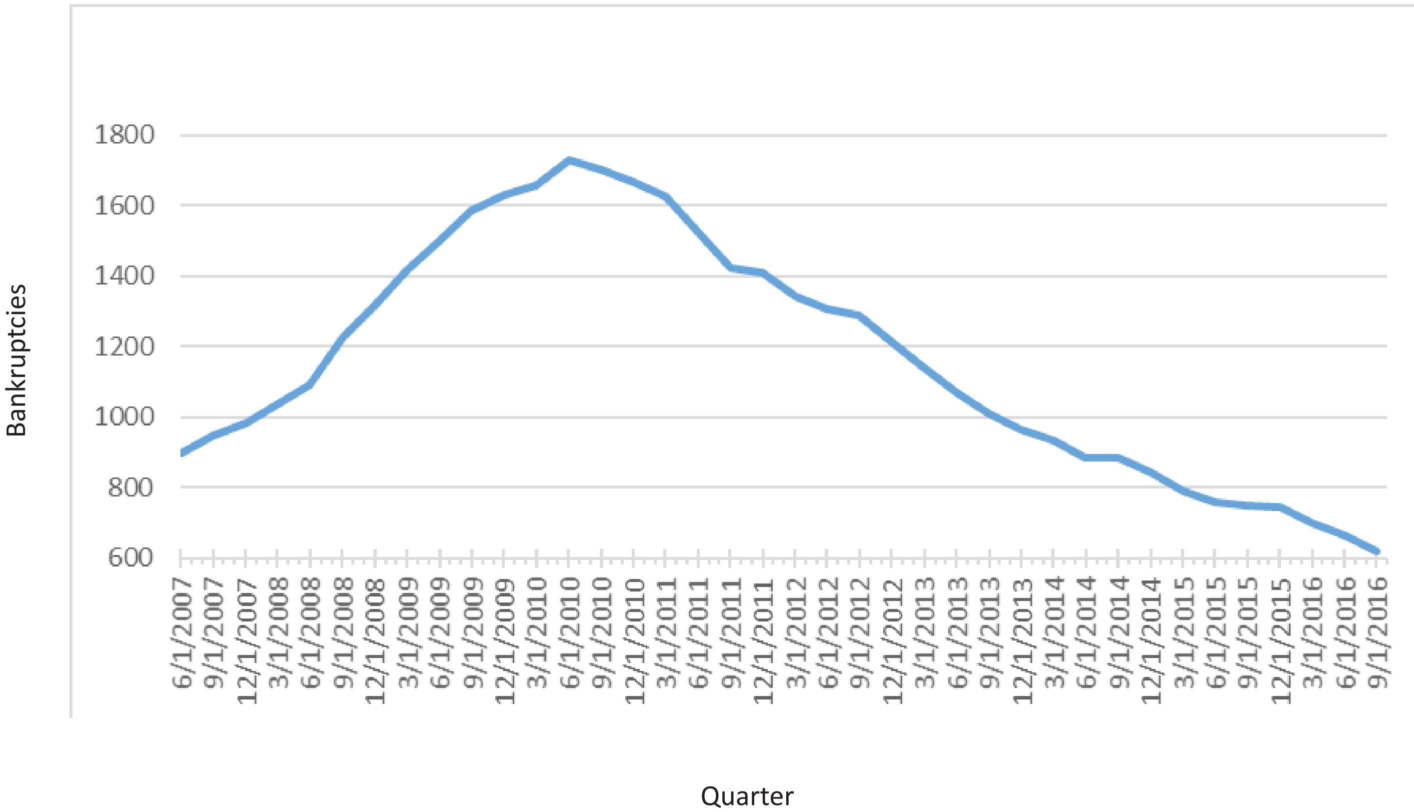


Year (September)	2011	2012	2013	2014	2015	2016
Labor Force (Not seasonally adjusted)	275,832	278,910	278,147	276,121	277,963	275,886

Southeast Minnesota Bankruptcies

The figure below shows the 12-month moving total for Southeast Minnesota bankruptcies since the second quarter of 2007 (shortly before the beginning of the Great Recession). As can be seen in the figure, this moving total increased through the second quarter of 2010, and has steadily declined since that time). With 618 bankruptcies over the past twelve months, the level of bankruptcies in Southeast Minnesota has now moved to a level that is the lowest recorded over the last nine years.

Southeast Minnesota Bankruptcies (12-month moving total)



Year (Third Quarter)	2011	2012	2013	2014	2015	2016
Annual Bankruptcies (not seasonally adjusted)	1,423	1,288	1,011	883	749	618

Economic Indicators

Rochester MSA Indicators

	Period Covered	Current Period	Prior Year	Annual Percent Change	Long-Term Average (since 1999, unless noted)
Labor Market					
Employment	September 2016 (m)	120,392	116,884	3.0% ↑	0.9%
Manufacturing Employment	September 2016 (m)	11,186	11,156	0.3% ↑	-2.7%
Educational and Health Employment	September 2016 (m)	48,354	46,608	3.7% ↑	2.8%
Average Weekly Work Hours Private Sector	September 2016 (m)	34.0	35.2	-3.4% ↓	33.2 (since 2007)
Average Earnings Per Hour Private Sector	September 2016 (m)	$34.16	$33.75	1.2% ↑	3.8% (since 2007)
Unemployment Rate	September 2016 (m)	2.8%	2.7%	NA ↑	3.8%
Labor Force	September 2016 (m)	118,474	118,030	0.4% ↑	0.6%
Initial Jobless Claims	September 2016 (m)	417	270	54.4% ↑	NA
Business Formation					
Total New Business Filings	Third Quarter 2016 (q)	413	395	4.6% ↑	327 (since 2000)
New Business Incorporations	Third Quarter 2016 (q)	33	32	3.1% ↑	46 (since 2000)
New Limited Liability Companies	Third Quarter 2016 (q)	268	250	7.2% ↑	152 (since 2000)
New Assumed Names	Third Quarter 2016 (q)	94	89	5.6% ↑	110 (since 2000)
New Non-profits	Third Quarter 2016 (q)	18	24	-25.0% ↓	19 (since 2000)
Rochester Residential Building Permit Valuation, in thousands	September 2016 (m)	25,328	8,443	200.0% ↑	NA

(m) represents a monthly series
(q) represents a quarterly series

Southeast Minnesota contains the Rochester MSA, an area that derives much of its employment from the educational and health sector. This sector continues to be a pillar of economic vitality for Rochester (and for Southeast Minnesota). Year-over-year overall employment in the Rochester area increased by 3 percent in September 2016 and employment in the key education/health sector rose by 3.7 percent (above the 2.8 percent long-term annualized growth of employment in this sector). Note that the share of employment in Rochester's educational and health sector has increased from 29.4 percent of employment to more than 40 percent since 1999. Average earnings per hour in the private sector increased over the year ending September 2016, the labor force expanded, the value of residential building permits rose, and new business filings increased. However, both initial jobless claims and the unemployment rate rose. The length of the workweek also fell.

State and National Indicators

MINNESOTA Indicators	Sep 2016	Jun 2015	Sep 2015	Change from one quarter ago	Annual Change
Nonfarm payroll employment, SA	2,905,600	2,891,800	2,859,200	0.5%	1.6%
Average weekly hours worked, private sector	34.1	34.3	33.9	-0.6%	0.6%
Unemployment rate, seasonally adjusted	4.0%	3.8%	3.6%	NA	NA
Earnings per hour, private sector	$27.33	$26.64	$26.00	2.6%	5.1%
Philadelphia Fed Coincident Indicator, MN	181.58	180.56	176.87	0.6%	2.7%
Philadelphia Fed Leading Indicator, MN	1.17	1.91	1.37	-38.7%	-14.6%
Minnesota Business Conditions Index	48.4	51.6	50.8	-6.2%	-4.7%
Price of milk received by farmers (cwt)	$17.90	$15.00	$17.80	19.3%	0.6%
Enplanements, MSP airport, thousands	1,542.9	1,726.5	1,506.7	-10.6%	2.4%

NATIONAL Indicators	Sep 2016	Jun 2015	Sep 2015	Change from one quarter ago	Annual Change
Nonfarm payroll employment, SA, thousands	144,791	144,172	142,300	0.4%	1.8%
Industrial production, index, SA	104.2	104.2	105.3	0%	-1.0%
Real retail sales, SA ($)	191,744	190,661	188,489	0.6%	1.7%
Real personal income less transfers ($, bill.)	11,966.8	11,907.8	11,745.3	0.5%	1.9%
Real personal consumption expenditures ($, bill.)	11,557.4	11,522.2	11,285.5	0.3%	2.4%
Unemployment rate, SA	5.0%	4.9%	5.1%	NA	NA
New building permits, SA, thousands	20,857	22,634	18,482	-7.9%	12.9%
Standard & Poor's 500 stock price index	2,157.7	2,083.9	1,944.4	3.5%	11%
Oil, price per barrel in Cushing, OK	$45.18	$48.76	$45.48	-7.3%	-0.7%

Across the state there was growth in payrolls, higher earnings per hour, and more average weekly hours worked in the private sector over the past twelve months. The seasonally adjusted unemployment rate rose over the past twelve months. Indicators from the Federal Reserve Bank of Philadelphia are mixed—current conditions are stronger but the future conditions index declined by 14.6 percent from one year earlier. The Minnesota Business Conditions index also turned negative this quarter. Milk prices are largely unchanged from one year ago, but are 19.3 percent higher than last quarter. Enplanements at the Minneapolis-St. Paul airport increased by 2.4 percent over the last twelve months.

The national economic indicators reported in the table are largely favorable. Over the past twelve months, stock prices rose, building permits are higher, and oil prices have continued to fall. In addition, employment, consumer expenditures, and income all experienced growth and the national unemployment rate fell. Retail sales improved. Only industrial production contracted from year ago levels.

The Southeast Minnesota Quarterly Economic and Business Conditions Report is a collaboration between the Office of the Minnesota Secretary of State and the School of Public Affairs Research Institute (SOPARI) of St. Cloud State University. All calculations and text are the result of work by SOPARI, which is solely responsible for errors and omissions herein.

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Thomson Reuters and University of Michigan, Index of Consumer Sentiment

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