



Burgundy Book

A report on economic conditions in the Louisville zone

Second Quarter 2013

The Louisville zone of the Federal Reserve comprises southern Indiana and western Kentucky and a total population of approximately 3.4 million people, including the almost 1.3 million who live in the Louisville MSA.

Growth strengthens and business optimism returns in Louisville zone

By Kevin L. Kliesen, *Business Economist and Research Officer*

About half of business contacts surveyed expressed improving optimism about the local economy over the next three months. A sizable minority, though, expect conditions to be little changed; an even smaller minority of respondents are expecting conditions to worsen slightly during the next three months.

Total nonfarm employment in the Louisville MSA increased a healthy 3.2 percent in the first quarter (relative to the first quarter in 2012). This gain far outpaced the U.S. growth rate (1.5 percent). Gains were especially brisk in the manufacturing and leisure and hospitality industries.

The Louisville zone's unemployment rate averaged 7.9 percent in the first quarter of 2013, a bit higher than the U.S. average. Nonfarm job growth was a bit uneven across the zone, but significantly stronger than the nation's in Louisville.

Single-family home sales in Louisville in the first quarter of 2013 rose to their highest level since 2007. The industrial real estate market improved as well. House price increases across the zone mostly trailed the nation's increase.

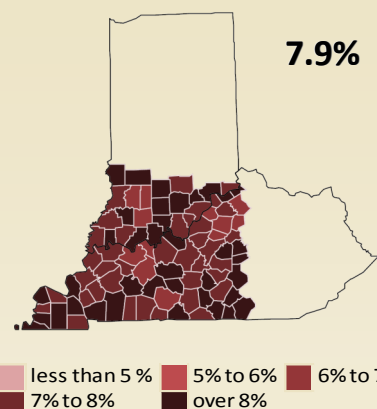
Per capita personal income growth remained strong in Indiana relative to the nation and to Kentucky. Mortgage debt continued to decline in the first quarter, as did loan delinquency rates.

Kentucky and Indiana banks reported modest declines in bank profitability in the first quarter, mostly due to net interest margin compression. Asset quality continues to improve, though.

Recent rains, though slowing spring planting, have dramatically improved pastureland conditions. Indiana and western Kentucky coal production fell sharply in the first quarter of 2013 compared with a year earlier.

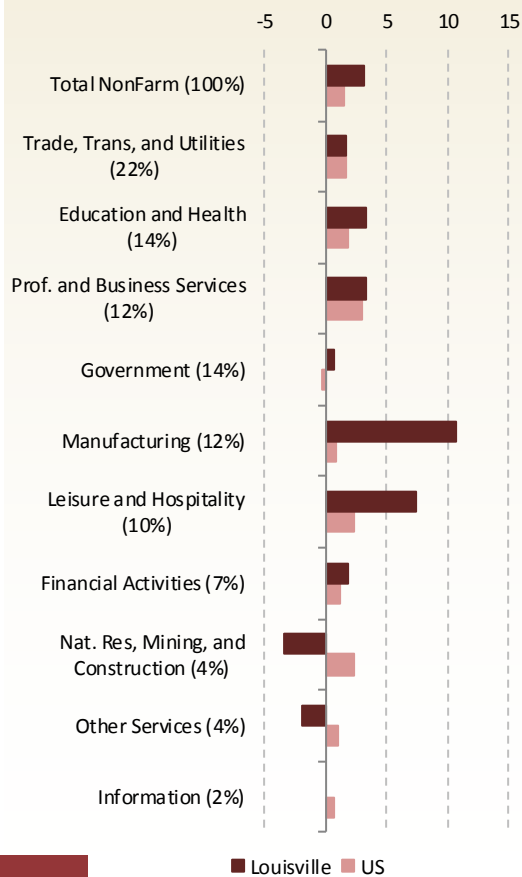
Data Snapshot

County unemployment rates (SA, Q1-13)



Nonfarm payroll employment by industry

Percent change from one year ago (Q1-13)



How to read this report

Unless otherwise noted, **city names** refer to the metropolitan statistical areas (MSAs), which are geographic areas that include cities and their surrounding suburbs, as defined by the Census Bureau.

Statistics for the Louisville zone are based on data availability and are calculated as weighted averages of either the 88 counties in the zone or the five MSAs. As of 2012, approximately 60 percent of the zone’s labor force was located in an MSA. Specifically: 39 percent in Louisville, 11 percent in Evansville, 4 percent in Bowling Green, 4 percent in Owensboro, and 3 percent in Elizabethtown; 40 percent of the zone’s labor force was located in non-metropolitan areas.

Arrows in the tables are used to identify significant trends in the data. The direction of the arrow indicates the sign (up/down) and the color indicates the economic significance (green = good, red = poor). Arrows appear only when the change from previous quarter is greater than 1 standard deviation. For example, the standard deviation of the change in the U.S. unemployment rate is 0.4 percent. If the U.S. unemployment rate declined from 8.4 percent to 8.2 percent, no arrow would appear; but if it declined from 8.4 percent to 7.9 percent, a green down arrow would appear in the table.

Selected **variable definitions** are located in the appendix.

Selected quotes from business contacts are generally verbatim, but some are lightly edited to improve readability.

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Join our Panel of Business Contacts

The anecdotal information in this report was provided by our panel of business contacts, who were surveyed between May 1 and May 15.

If you’re interested in becoming a member of our panel, follow this link to complete a trial survey:

<http://research.stlouisfed.org/beigebooksurvey/>

Or email us at beigebook@stls.frb.org.

Views expressed do not necessarily reflect official positions of the Federal Reserve System.

Strong First-Quarter Growth in Louisville’s Private Sector

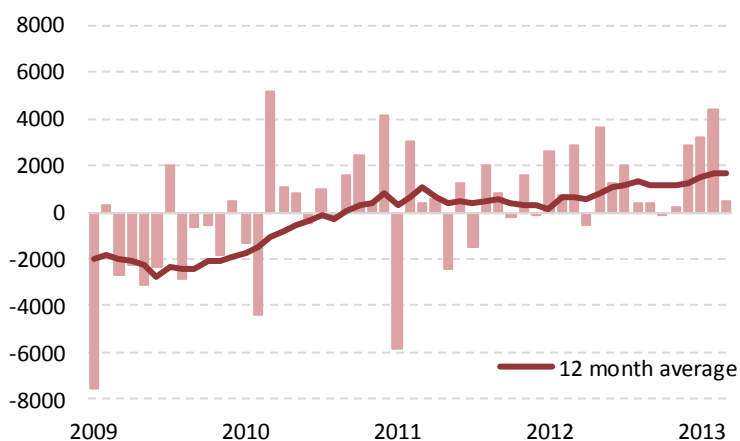
By Charles S. Gascon, *Regional Economist*

“There is a generally favorable economic mood across the region.”

—Western Kentucky area executive

Employment growth averaged 2,600 jobs in first quarter

Louisville private payroll employment, change from previous month (SA)



Source: BLS.

- Anecdotal evidence suggests moderate employment growth during the next three months: 60 percent of businesses surveyed expect their payrolls to increase, while only 10 percent expect a decline. Remaining contacts expect no change.
- With the exception of Evansville, unemployment rates in the zone’s metro areas declined modestly during the first quarter. In Evansville, the unemployment rate increased to 7.7 percent due to negative employment growth.
- Similar to our previous report, employment gains appear to be concentrated in Louisville, which added roughly 2,600 jobs per month during the first quarter. This translates into a 3.2 percent increase from one year ago, more than double the national rate of 1.5 percent.
- Labor markets in the zone’s smaller MSAs continue to experience weak growth; all areas registered growth below the national rate. In Owensboro, employment growth slowed significantly in all major sectors during the first quarter. In Evansville, employment declined in every sector (see table).
- Businesses surveyed indicate modest upward pressure on wages during the past three months: Half of contacts reported a slight increase, and the remaining contacts expect no change.

Bowling

	Louisville	Evansville	Green	Elizabethtown	Owensboro	US
Unemployment rate (Q1-13) (%)	7.7	7.7	6.9	7.2	6.6	7.7
Nonfarm employment (Q1-13)	3.2	-1.2	0.4	0.8	1.4 ▼	1.5
Goods-producing sector	7.4	-2.5	2.2	7.1	-0.9 ▼	1.4
Private service-providing sector	2.8	-0.1	-0.6	0.1	2.4 ▼	2.0
Government sector	0.6	-4.8	1.9	-1.1	1.0	-0.4

Note: Unless otherwise noted, values are percent change from one year ago. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter. See appendix for notes and sources.

Manufacturing Industry Booming in Louisville

By Yang Liu, Senior Research Associate

“Current quoting level is good and customer optimism is increasing.”

— Southern Indiana manufacturer

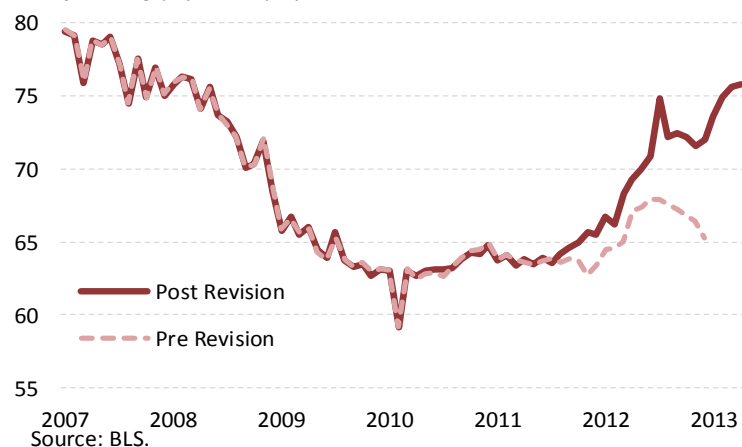
“2013 will be an even better year than 2012, which had 25% increases over previous year. For the first quarter of 2013 overall dealership average new vehicle unit sales are up 14%. Average used vehicle sales are up 20% and total dealership sales are up 23% from 2012 numbers.”

— Kentucky area manufacturer

- Measured from a year earlier, manufacturing employment growth topped 10 percent in Louisville; while Kentucky and Indiana saw moderate growth in the first quarter of 2013. Durable goods employment has increased over 18 percent in Louisville (see table).
- Manufacturing employment in Louisville increased by 3,600 jobs during the first quarter 2013: This is an 11 percent increase from the same time one year ago (see table).
- Anecdotes also suggest that automobile manufacturers in southern Kentucky are expanding and hiring. There is also a ripple effect, which is a boost to the automotive supply industry; several automobile suppliers expect to expand.
- The March 2013 benchmark employment revision indicates that Louisville’s manufacturing industry is recovering faster than originally reported. Between November 2011 and December 2012, manufacturing payrolls are 3,900 higher than the preliminary numbers indicated (see figure).
- Kentucky’s durable goods industry is particularly strong. The earnings growth rate is moderately higher than the U.S. average; moreover, its employment growth rate exceeds the national pace by a wide margin (see table).

Benchmark revision indicates stronger manufacturing growth in Louisville

Manufacturing payroll employment, SA thousands



	Louisville	Kentucky	Indiana	US
Manufacturing employment (Q1-13)	11.3	4.8	3.0	1.0
Durable goods	18.2	8.4	4.2	1.2
Nondurable goods	-0.3	-0.9	0.0 ▼	0.6
Manufacturing earnings (Q4-12)	--	7.7	6.1	6.0
Durable goods	--	11.5	7.8	7.9
Nondurable goods	--	1.4	2.3	2.7

Note: Values are percent change from one year ago. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter; see appendix for notes and sources.

Brisk Housing Market and Strong Industrial Real Estate

By Li Li, Research Associate

“Owensboro’s housing industry is in full recovery from the Great Recession .”

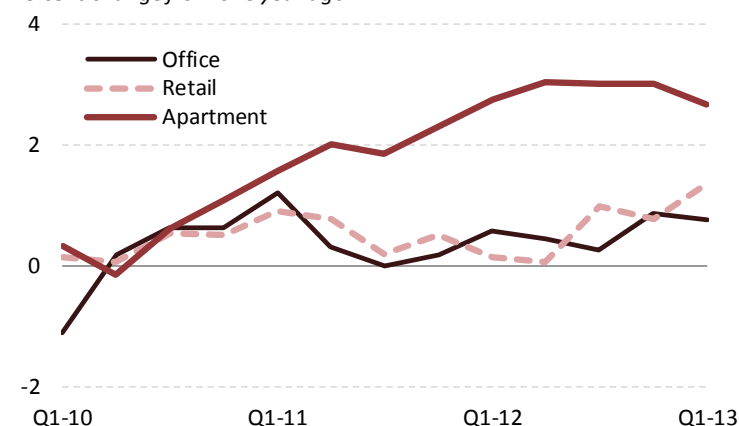
— Northwest Kentucky area contact

“People are going to have to start building [industrial space]. Our vacancies are about to be exhausted.”

— Louisville area executive

With increased single-family demand, apartment rent growth stabilized in Louisville

Percent change from one year ago



Source: Reis.com.

- The residential housing market shows signs of a sustained recovery. According to a local contact, March single-family home sales in Louisville reached its highest level since 2007. Overall, the annual growth rate of single-family home sales in the first quarter was 13 percent, about 3 percentage points above the national rate (see table).
- On the residential construction side, the growth of single-family building permits has been slow across the zone through the first quarter of the year (see table).
- The industrial real estate market in Louisville has strengthened, and contacts predicted improvements in effective rents in 2013. Contacts also reported increased demand and low inventory in the current market, which has lowered the vacancy rates in four consecutive quarters. Leasing activities remained strong as well.
- There was an uptick in construction activity. In the Bowling Green area, there were projects for retail and office space and apartment buildings underway. It was also reported that build-to-suit construction plans were made for condominiums, homes, and industrial space in the region. Moreover, Shepherdsville will see a million-dollar speculative industrial space in 2013.

Non-residential market (Louisville, Q1-13)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	4.6	15.7	10.3	6.7
Asking rent	2.7	0.7	1.3	1.7
Percent change from one year ago				

Note: Apartment, office, and retail values are from Reis.com. Industrial values are from Cassidy Turley.

Residential market (Q1-13)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	1.6	-2.1 ▼	1.5 ▲	2.6	9.8 ▲
Single-family building permits	8.4 ▼	-10.7	-44.7	10.1	25.7
New and existing home sales	13.1	--	--	--	10.3

Note: Values are percent change from one year ago. Arrows indicate a significant (±1 standard deviation) change from previous quarter. See appendix for notes and sources.

Mortgage Delinquencies Continue to Fall

By Bryan Noeth, *Policy Analyst*

“More households are reducing debt by shortening loan terms.”

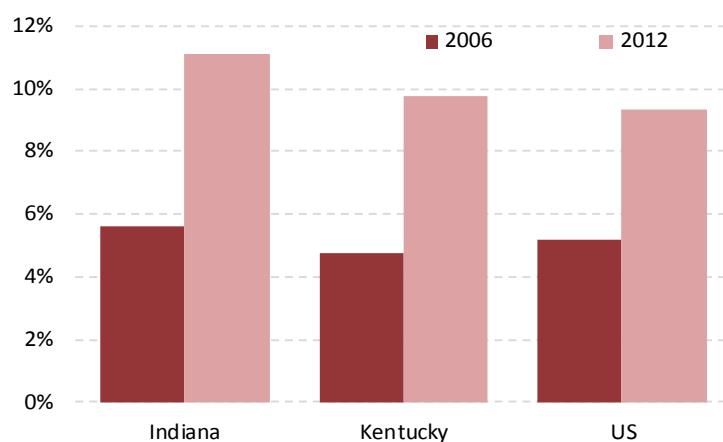
—Louisville area mortgage broker

“Households are refinancing to reduce debt service or selling assets to pay off loans.”

—Louisville area financial advisor

Student debt service is above the national average

Student debt as a percentage of personal income



Source: FRBNY Consumer Credit Panel, Equifax, and Haver Analytics.

- Income growth in 2012 was strong throughout the zone, although modestly slower in Kentucky than the nation. Initial evidence suggests that income growth slowed in the first quarter of 2013 with the payroll tax increase.
- Mortgage deleveraging slowly continued as individuals have shed 1.1 percent of their mortgage debt since the first quarter of 2012.
- Conditions improved for mortgage borrowers as the rate of balances in serious delinquency continued to trend downward in the first quarter of the year. Zone delinquency rates remained well below the national level (see table).
- Consumers lowered their credit card debts in the first quarter of 2013. However, the percent in serious delinquency increased slightly across much of the zone but remained below the national average.
- Student debt as a percentage of personal income was higher in Indiana and Kentucky than in the nation (see figure). Since 2003, student debt growth in Indiana has outpaced the growth in income at a faster rate than the nation as a whole. Delinquency rates were similar to national rates.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q4-12)	--	4.4	3.5	4.2 ▲
Per capita debt balances (Q1-13)				
Mortgage	-1.1	-2.8	-1.6	-4.5
Credit card	-3.3	-7.1	-4.9	-3.9
Auto loan	8.4	8.5	7.7	7.3
90+ day delinquency rates (Q1-13) (%)				
Mortgage	2.7	3.1	2.6	4.6
Credit card	6.8	7.8	7.5	9.8
Auto loan	2.9	3.4	3.2	3.7

Note: Unless otherwise noted, values are percent change from one year ago. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter. See appendix for notes and sources.

Indiana, Kentucky Banks Stuck in Holding Pattern

By Michelle Neely, *Economist*

“Recent regulatory changes have helped larger financial institutions and hurt smaller ones.”

—Louisville area banker

“Volume has grown at 10 percent per year. We hope to keep this flow steady and to further cross-sell new customers.”

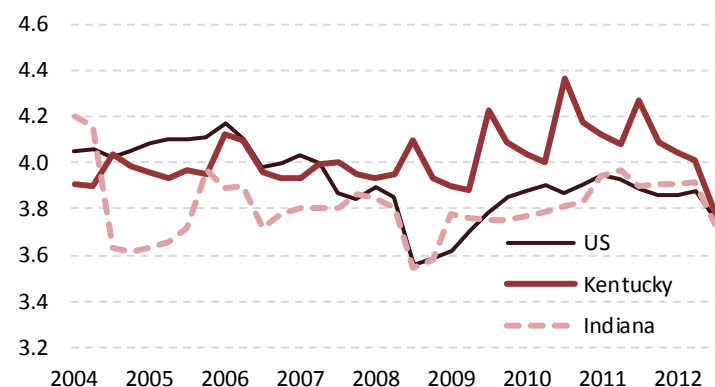
—Western Kentucky banker

“Loan demand was slow in the first quarter; however, we are seeing a slight increase in secured equipment financing. There remains strong competition for good credit deals among banks, and finance companies are entering this space with less structure and covenants.”

—Southern Indiana banker

Low interest rates, tepid loan demand put pressure on margins

Net interest margin at commercial banks, percent



Source: FRED.

- Most Louisville area bankers surveyed expect loan demand to either increase or stay the same during the next three months.
- Kentucky and Indiana were among the three District states (along with Mississippi) that experienced declines in bank profitability in the first quarter. Return on average assets (ROA) fell 7 basis points at Indiana banks and 8 basis points at Kentucky banks from year-end 2012 levels. Despite the drops, Indiana and Kentucky ranked two and three, respectively, in average ROA for the District states in the first quarter.
- Larger declines in net interest margins (a negative for earnings) than in loan loss provisions (a positive for earnings) were responsible for the drops in ROA at Indiana and Kentucky banks. Low interest rates and lackluster loan demand are causing a “margin squeeze” at many banks in these states (see figure), which is more than offsetting the improvements in asset quality that have allowed banks to reduce the funds they set aside for delinquent loans.
- Nonperforming loans ticked up slightly (4 basis points) at Kentucky banks in the first quarter, while they fell 11 basis points at Indiana banks.

Banking performance (Q1-13)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	0.94 ▼	1.05	1.01	0.95
Net interest margin	3.79 ▼	3.73	3.71 ▼	3.77
Nonperforming loans / total loans	2.36	2.17	2.31	2.47
Loan loss reserve coverage ratio	72.63	80.40	79.89	75.33

Note: Values are percentage points. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter. See appendix for notes and sources.

2013 Farm Season Off to Slow Start, Acreage on Par with Previous Years

By Lowell R. Ricketts, *Senior Research Associate*

“The fields are too wet and we have had to push back our traditional spring planting. On the upside, the rains are producing strong hay and wheat and grasses for cattle across the region.”

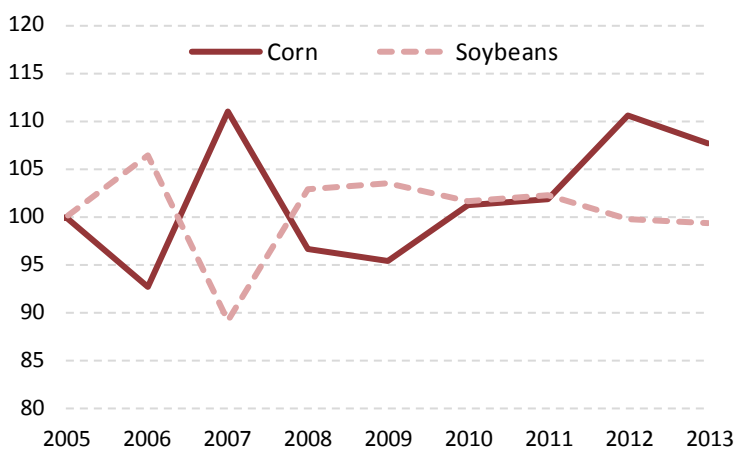
— South central Kentucky farmer

“Due to the fact that 35 to 40 percent of the corn crop is being used for ethanol production, feed prices have increased causing profit margins to shrink for my cattle feed lots. The results are fluctuations in beef cattle prices.”

— Western Kentucky farmer

Corn and soybean acreage hold steady

Acreage planted in Kentucky and Indiana, Index (2005=100)



Source: NASS/USDA.

- Indiana and Kentucky farmers plan to plant similar corn and soybean acreage in 2013 as in 2012. Overall, the volume of corn and soybean acreage planted has held steady over recent history (see figure). See the June 28 USDA report for final acreage planted.
- As in the District, pastureland in Indiana and Kentucky is in much better condition than at the same point in 2012. Roughly 30 percent more pastureland is rated as good or excellent than last year. The corn crop is also doing better, with close to 16 percent more rated in good or excellent condition.
- Around 14 percent of agricultural bankers surveyed expect to have more funds available for prospective borrowers in the second quarter than what was available last year. However, respondents expect loan demand and capital investment to be relatively the same (see right table).
- Indiana and western Kentucky coal production was 5.1 and 10.7 percent lower, respectively, in the first three months of 2013 relative to 2012 (see left table). The quarterly decline in coal production has been particularly severe in western Kentucky over the past year. Relative to recent quarters, the 10.7 percent decline marks an easing of this trend.

	Indiana	Kentucky	US
Natural resources (Q1-13)			
Mining and logging employment	-0.9	-17.9	2.0
Coal production	-5.1	-10.7 ▲	-9.3
Prospective Plantings (2013)			
Corn	-2.4	-3.0 ▼	0.1
Cotton	---	---	-18.6
Rice	---	---	-3.3
Sorghum	---	---	22.0
Soybean	-1.0	1.4	-0.1

Note: Values are percent change from one year ago. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter. See appendix for notes and sources.

Louisville zone Ag. bankers' expectations Q2-13 vs. Q2-12

	Lower	Higher	Net
Loan demand	14	14	0
Available funds	0	14	14
Loan repayments	0	0	0
Farm income	0	0	0
Capital expenditure	29	29	0

Note: Percentage of responses. See appendix for notes and sources.

Cover Page

Sources

Bureau of Labor Statistics

Unemployment rate, nonfarm payroll employment.

Labor Markets

Table Sources

Bureau of Labor Statistics

Unemployment rate. Nonfarm employment and contributions by sector.

Notes

Goods-producing sector comprises the manufacturing and natural resources, mining, and construction sectors.

Private service-providing sector includes the following sectors: Trade, Transportation, and Utilities; Information; Financial Activities; Professional and Business Services; Education and Health Services; Leisure and Hospitality; and Other Services.

Unemployment rate data are seasonally adjusted.

Manufacturing

Table Sources

Bureau of Labor Statistics

Manufacturing employment: total, durable, and nondurable goods.

Bureau of Economic Analysis

Manufacturing earnings: total, durable, and nondurable goods.

Notes

Durable goods manufacturing sector is defined by the Bureau of Labor Statistics as industries with a NAICS classification code of 321 (Wood Product Manufacturing); 327 (Nonmetallic Mineral Product Manufacturing); 331 (Primary Metal Manufacturing); 332 (Fabricated Metal Product Manufacturing); 333 (Machinery Manufacturing); 334 (Computer and Electronic Product Manufacturing); 335 (Electrical Equipment, Appliance, and Component Manufacturing); 336 (Transportation Equipment Manufacturing); 337 (Furniture and Related Product Manufacturing); and 339 (Misc. Manufacturing).

Nondurable goods manufacturing sector is defined by the Bureau of Labor Statistics as industries with a NAICS classification code of 311 (Food Manufacturing); 312 (Beverage and Tobacco Product Manufacturing); 313 (Textile Mills); 314 (Textile Product Mills); 315 (Apparel Manufacturing); 316 (Leather and Allied Product Manufacturing); 322 (Paper Manufacturing); 323 (Printing and Related Support Activities); 324 (Petroleum and Coal Products Manufacturing); 325 (Chemical Manufacturing); and 326 (Plastics and Rubber Products Manufacturing).

Manufacturing earnings is the sum of wage and salary disbursements, supplements to wages and salaries, and proprietors' income less contributions for government social insurance.

In the **contributions to employment chart**, bars represent the respective contribution of each sector to the area's total employment as a percent change from one year ago, while the line represents the net percent change from one year ago in total employment.

Real Estate and Construction

Table Sources

CoreLogic

Home price index, including distressed sales.

Census Bureau

Year-to-date single-family building permits.

National Association of Realtors

Year-to-date new and existing home sales.

Notes

Asking rent is the publicized asking rent price. Data are in current dollars.

Vacancy rate is the percentage of total inventory physically vacant as of the survey date, including direct vacant and sublease space.

New and existing home sales consists of single-family home sales.

Household Sector

Table Sources

Equifax based on authors' calculations

All figures are based on a 5 percent sample of individual credit reports. Balances are geographical averages of various debt categories. The mortgage category includes first mortgages and home equity installment loans, but home equity lines of credit are omitted. Auto loans include those financed by finance company or bank loans. Credit cards are revolving accounts at banks, bankcard companies, national credit card companies, credit unions, and savings and loan associations.

Haver Analytics

Per capita income.

Census Bureau

Homeownership rates.

Notes

The CredAbility Index is a quarterly measure of the financial condition of the average consumer. The scores are defined as follows: 90-100 implies excellent or secure, 80-89 implies good or stable, 70-79 implies weakening or at risk, 60-69 implies distressed or unstable, and 59 or below implies emergency or crisis.

Delinquency rates are calculated as the percentage of payments past due by more than 90 days, weighted by the dollar value of the loan.

Homeownership rates are the proportion of households in each area that are owners. It is calculated by dividing the number of households that are owners by the total number of occupied households.

Banking and Finance

Table Sources

Federal Financial Institutions Examination Council

Return on average assets: USL15ROA. Net interest margin: USL15NIM. Nonperforming loans: USL15NPTL. Loan loss reserve/Total loans: USL15LLRTL. Net loan losses/Average total loans: USL15LSTL.

Note: The data available in the table can be found in FRED.

Notes

Loan loss provisions are expenses banks set aside as an allowance for bad loans.

Nonperforming loans are those loans managers classify as 90 days or more past due or nonaccrual, which means they are more likely to default.

Loan loss coverage ratio is loan loss reserves divided by non performing loans.

US peer banks are those commercial banks with assets of less than \$15 billion.

Due to the seasonal nature of bank return on average assets and net interest margin, the **arrows** in the table denote significant changes from one year ago.

Agriculture and Natural Resources

Table Sources

Federal Reserve Bank of St. Louis Survey of Agricultural Credit Conditions

Agriculture Bankers' expectations of loan demand, available funds, loan repayment rates, farm income, and capital expenditures are relative to one year ago. Respondents can answer "increase," "decrease," or "no change."

Energy Information Administration (EIA)

Coal production.

Bureau of Labor Statistics (BLS)

Mining and logging employment.

USDA

Crop production.