



Burgundy Book

A report on economic conditions in the Louisville zone

Second Quarter 2014

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.

Despite Slower Growth, Louisville Business Contacts Remain Optimistic

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

A survey of Louisville zone business contacts showed a modestly higher level of optimism about the economy in 2014 than existed three months earlier.

The Louisville zone's unemployment rate averaged 7.2 percent in the first quarter of 2014, its lowest rate since 2008. Although nonfarm payroll employment increased in most MSAs in the first quarter of 2014, the increases generally trailed the national average.

Louisville's manufacturing employment continued to post healthy growth in the first quarter, although the rate of gain was a bit slower than in the previous quarter. Kentucky's manufacturing employment fell in the first quarter but Indiana's rose sharply.

Residential construction activity and single-family house prices declined in most areas in the first quarter, although business contacts in Louisville continued to report robust growth in the multi-family sector. Industrial construction activity has also improved, largely because of strong demand from e-commerce.

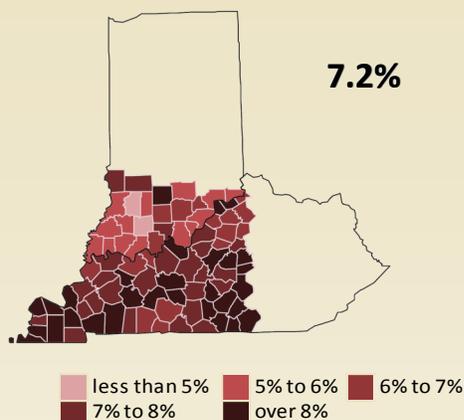
In the fourth quarter of 2013, nominal per capita income for Indiana and Kentucky rose modestly faster than the national pace. The pace of consumer auto debt, while continuing to increase, has slowed sharply over the past few quarters.

Asset quality at Kentucky and Indiana banks improved modestly in the first quarter. Although profits (return on assets) increased modestly at Kentucky banks, profits declined modestly at Indiana banks. However, the latter most likely reflected one-time, special factors.

The USDA's spring planting intentions report showed that Indiana and Kentucky farmers intend to plant fewer acres of corn but more acres of soybeans.

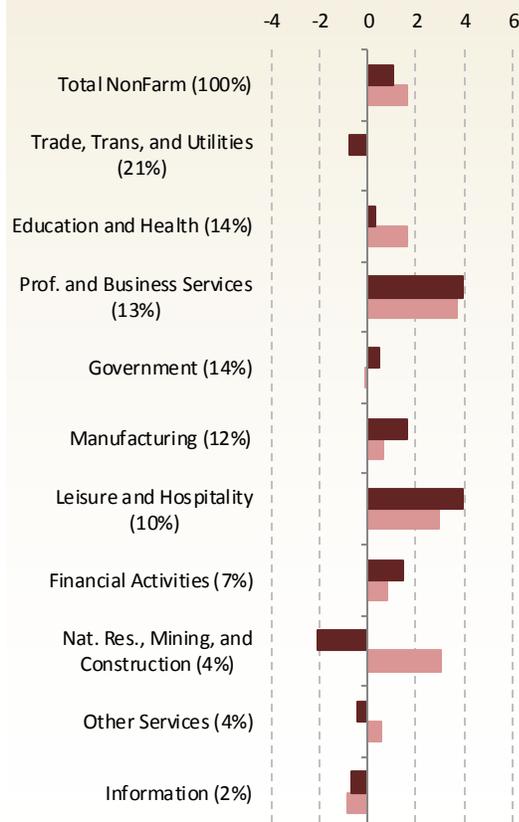
Data Snapshot

County unemployment rates (SA, Q1-14)



Nonfarm payroll employment by industry

Percent change from one year ago (Q1-14)



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 US unemployment rate is 0.4 percent. If the US 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/outlooksurvey>

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

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

Employment Growth Slowing Across Louisville Zone MSAs

By Maria A. Arias, *Research Associate*

“We are still not confident the housing market is making the same recovery here that it is making in other parts of the country. Until we get that confidence we are going to continue to be conservative in our hiring.”

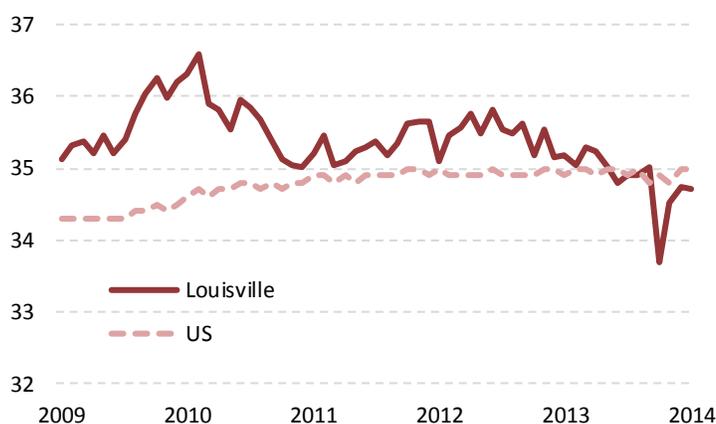
—Louisville area builder

“Competition for engineering talent is driving our labor costs up. We are [also] unable to find/hire experienced engineering staff. As a result we are hiring temporary employees to meet short-term needs and entry-level engineers who we will train to meet our long-term needs.”

—Louisville area business contact

Hours worked in Louisville continue to decline

Average weekly hours of all employees, SA



Source: BLS.

- The unemployment rate declined in all MSAs from the previous quarter, though it remains higher than the nation’s in some areas. Evansville is the only MSA to show a significant decline from the previous quarter (see table).
- Annual employment growth across the zone’s MSAs remains below the national average (see table). Bowling Green is the exception, where growth is slightly faster than the nation’s despite experiencing the largest slowdown from the previous quarter.
- While the majority of business contacts expect labor costs to remain about the same as last year through the third quarter of this year, about one-third of contacts expect labor costs to increase somewhat, citing rising wage pressures from a shortage of qualified candidates and competitive wages for high-skilled jobs.
- Average weekly hours worked by employees during the first quarter were slightly higher than the national average in Evansville, Bowling Green, and Owensboro. In Louisville, hours worked declined sharply in January due to the harsh winter conditions, but have rebounded since (see figure). Anecdotes suggest working hours are back to normal: 80 percent of contacts expect hours worked to remain the same as last year during the second quarter and 15 percent expect them to increase slightly.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q1-14) (%)	7.1	5.8 ▼	6.8	7.2	6.6	6.7
Nonfarm employment (Q1-14)	1.0	0.4	2.0	-0.2	0.3	1.7
Goods-producing sector	0.7	0.0	-1.2	-0.4	1.5	1.5
Private service-providing sector	1.2	0.6	3.2	0.7	-0.5	2.1
Government sector	0.5	0.0 ▲	0.8	-1.8	1.6	-0.1

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 and Transportation Activities Up in Louisville

By Yang Liu, Senior Research Associate

“Perhaps due to winter weather, new orders were below budget in January and February but were up dramatically in March and April.”

— Louisville area investor

“Manufacturing activity continues to be extremely strong in the region, centered primarily on the automotive industry.”

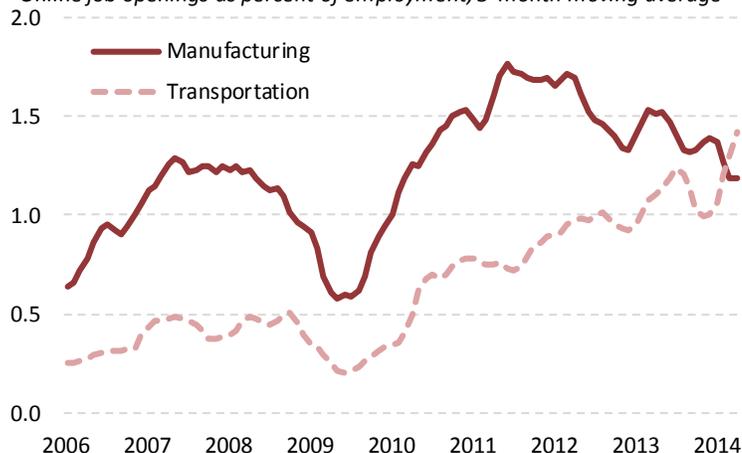
— Louisville area banker

“We are investing in enhancement to effectively address the trend in the booming e-commerce market.”

— Louisville area transportation executive

Manufacturing job vacancy rate declined in Louisville

Online job openings as percent of employment, 3-month moving average



Source: Conference Board and BLS.

- Louisville’s manufacturing employment increased 1.6 percent in the first quarter. Employment was up 2.1 percent in the durable goods sector and 0.7 percent in the nondurable goods sector (see table).
- The manufacturing job vacancy rate continued its downward trend since 2012. The transportation job vacancy rate increased sharply during the first four months of 2014 (see figure). The job vacancy rate in both sectors was below the corresponding national level.
- Our contacts saw very high coil steel shipment volume, suggesting strong automobile manufacturing activities in the Louisville area.
- Kentucky’s manufacturing employment dropped slightly during the first quarter. A significant contraction in the nondurable goods sector was the driving factor. Indiana’s manufacturing employment grew 2.6 percent, higher than the national rate (see table).
- Kentucky’s manufacturing exports increased 8.8 percent, significantly lower than the previous quarter but substantially above the national average (see table). Exports of transportation equipment was the major contributor.
- Indiana’s manufacturing exports dropped by 2.1 percent compared with a year ago (see table). Contraction in chemical exports was the driving factor.

	Louisville	Kentucky	Indiana	US
Transportation employment (Q1-14)	0.9	-0.9	0.4 ▼	2.1
Manufacturing employment (Q1-14)	1.6	-0.8	2.6	0.6
Durable goods	2.1	0.5	3.4	0.9
Nondurable goods	0.7	-3.0 ▼	0.7	0.2
Manufacturing exports (Q1-14)	--	8.8 ▼	-2.1	1.1

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.

Single-Family Construction Contracted But the Outlook Is Positive

By Li Li, Senior Research Associate

“The weather was not the major problem in Q1 [in the housing market]. People are still in a wait-and-see attitude.”

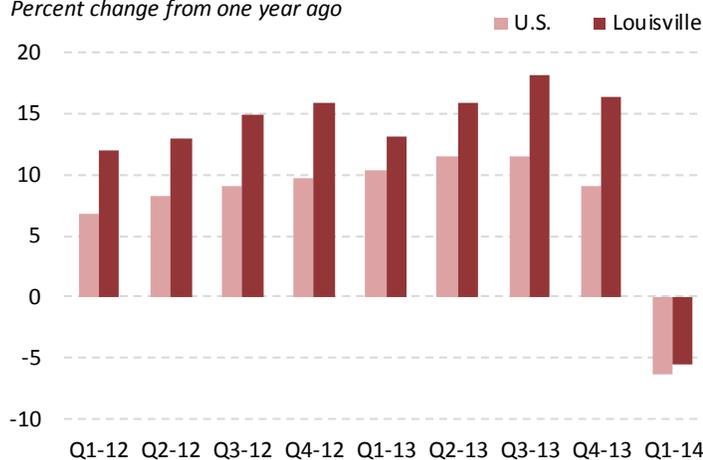
— Louisville area real estate executive

“Not enough single-family homes is causing a need for additional rental/multi-family units.”

— Louisville area realtor

Home sales plummeted in the first quarter in Louisville

Percent change from one year ago



Source: Reis.com.

- The residential market experienced a hit in the first quarter. After two years of steady growth, year-over-year home sales were negative for the first time since 2012 (see figure), mirroring the national trend. This decline is partly due to the severe weather. Single-family building permits also dropped in the first quarter by 17 percent (see table). Concerns about low inventories and the difficulty of getting loans for home builders will remain in 2014.
- Regional realtors are optimistic about the residential outlook. Distressed home sales are diminishing and demand remains high. Single-family home sales are expected to pick up in the second quarter.
- Contacts in Louisville continued to report robust growth in the multi-family sector. First-time home buyers are not active in the current market. Instead, they prefer to rent. Asking rents continue to rise. With new units becoming available, vacancy rates increased by 50 basis points from last quarter (see table). However, the rates are historically still relatively low. Contacts also reported no signs of overbuilding in the market.
- Industrial construction has improved. This is largely driven by strong e-commerce demand. The trend is expected to continue through 2014.

Non-residential market (Louisville, Q1-14)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	4.9 ▲	15.6	9.6	7.3
Asking rent	1.4	1.0	0.4	18.0
<i>Percent change from one year ago</i>				

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

Residential market (Q1-14)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	1.3	-7.4	-4.6 ▼	0.3 ▼	11.4
Single-family building permits	-17.2 ▼	-4.6	11.9	-11.9	0.0 ▼
New and existing home sales	-5.6 ▼	--	--	--	-6.4 ▼

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.

Households Increase Mortgage Debt in First Quarter

By Elise A. Marifian, *Research Associate*

“Trucks and SUVs—both new and used—continue to be strong [sellers]. Demand for new cars is slowing, but still stronger than two years ago.”

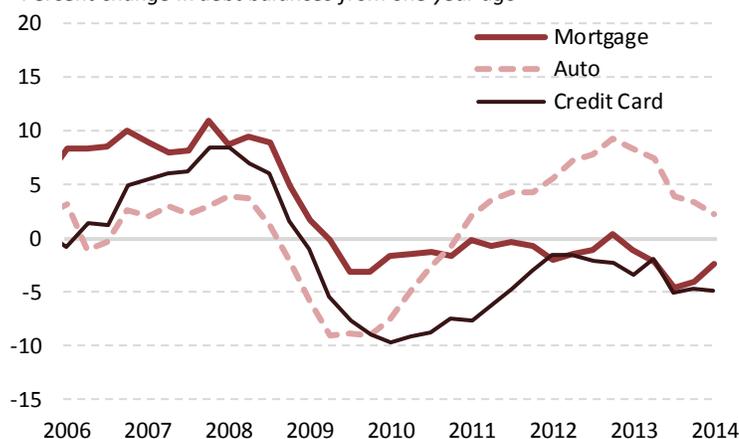
– Elizabethtown auto dealer

“Due to [poor] first-quarter weather, sales were off about 15 percent from last year.”

– South central Kentucky auto dealer

Auto debt growth slows in first quarter

Percent change in debt balances from one year ago



Source: FRBNY Consumer Credit Panel and Equifax.

- Per capita personal income grew modestly in the fourth quarter. Relative to one year ago, incomes increased 0.9 percent in Indiana and 1.3 percent in Kentucky, compared with the national rate of 0.6 percent.
- Households across the zone continued to shed credit card debt (see table). Relative to last year, first-quarter credit card debt balances were down 4.9 percent.
- Although balances are still lower than last year, households across the zone increased their mortgage debt in the first quarter (see figure).
- First-quarter auto loan debt balances increased 2.2 percent relative to the same period in 2013 (see table), although this growth has been slowing for the past few quarters. Contacts reported that auto sales declined in the first quarter relative to 2013 because bad weather in January and February reduced floor traffic. However, activity picked up in March with improved weather, and contacts expect second-quarter sales to be either the same as or somewhat better than 2013.
- Contacts throughout the zone reported new retail establishments, increased tourism activity, and hospitality venue expansions.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q4-13)	--	0.9	1.3	0.6 ▼
Per capita debt balances (Q1-14)				
Mortgage	-2.4	-1.3 ▲	-2.7	-2.1 ▲
Credit card	-4.9	-5.1	-4.8	-4.9
Auto loan	2.2	3.1	1.6	4.8
90+ day delinquency rates (Q1-14) (%)				
Mortgage	2.0 ▼	2.3	2.0	3.3
Credit card	6.3	6.8 ▼	6.7	8.3 ▼
Auto loan	3.0	3.4	3.2	3.2

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.

Asset Quality Still on the Upswing in Louisville Zone

By Michelle Neely, *Economist*

“People are more conscious of their credit scores and are still ensuring that their debt levels don’t get too high; Lessons from the recession.”

—Western Kentucky banker

“Local city assessors are, in many cases, too conservative and values are reduced. Builders are not taking as much risk.”

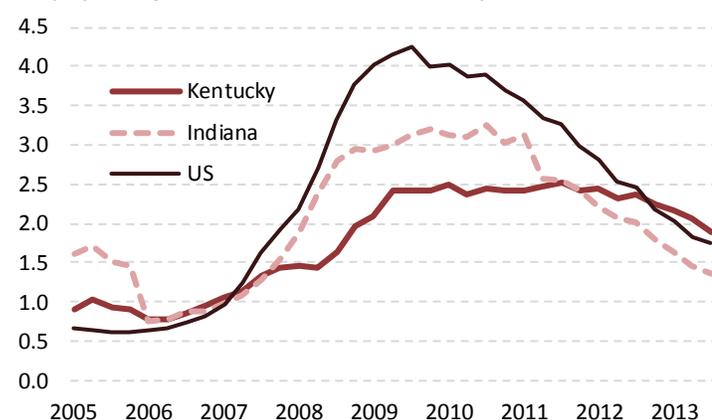
—Southern Indiana banker

“The ‘watch list’ of potential problem customers continues to shrink at my bank. Most customers who were on the list are showing marked improvements with some upgrades in their status.”

—Louisville area banker

Nonperforming loan ratios closing in on pre-crisis levels

Nonperforming loan ratio at commercial banks, percent



Source: FRED.

- Credit standards for approving new loans are expected to be unchanged over the next three months.
- The profitability of Indiana and Kentucky banks diverged in the first quarter. Return on average assets (ROA) tumbled 20 basis points in the first quarter at Indiana banks, while it rose 7 basis points at Kentucky banks. Average ROA in both states lags District and U.S. averages.
- The downturn in ROA in Indiana is mostly the result of special factors that will likely reverse in subsequent quarters. The average net interest margin (NIM) at Indiana banks declined slightly and mirrored the District result. The average NIM in Kentucky declined 10 basis points between the fourth quarter of 2013 and the first quarter of 2014, but that decline was more than offset by declines in net noninterest expenses and loan loss provisions, leading to rising profits.
- Asset quality improved in both states in the first quarter. The ratio of nonperforming loans to total loans declined 12 basis points in the first quarter at Indiana banks, and fell 18 basis points at Kentucky banks. Indiana’s nonperforming loan ratio of 1.35 percent is lower than every other District state’s ratio except Missouri’s. The ratio in Kentucky is down sharply from its year-ago level of 2.37 percent.

Banking performance (Q1-14)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	0.95	0.89	1.02	0.97
Net interest margin	3.76	3.75	3.75	3.79
Nonperforming loans / total loans	1.89 ▼	1.35	1.66	1.75
Loan loss reserve coverage ratio	82.01	112.59	79.89 ▼	92.00

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

Despite Low Prices, Farmers Make Small Shift from Corn Plantings to Soybeans

By Lowell R. Ricketts, *Senior Research Associate*

“I’m paying guys five times what I used to, but technology makes them so much more efficient. We are heading to a completely different system and the high-skilled, high-tech labor which is necessary is not readily available.”

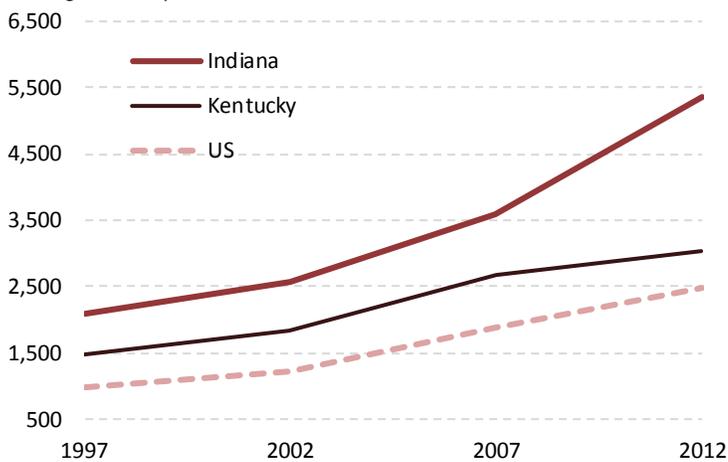
—Western Kentucky Farmer

“Land evaporates when it becomes available in our neck of the woods.”

— Western Kentucky Farmer

Land values in Indiana increase close to 50 percent

Average dollars per acre



Source: USDA Census of Agriculture, see appendix.

- Agricultural bankers surveyed expect lower capital spending by farmers and lower farm income during the second quarter (see right table). Results were mixed for the other survey categories.
- Kentucky coal production increased relative to a year ago for the first time since 2011 (see left table). Revised data for the fourth quarter of 2013 indicate that Kentucky production decreased, rather than increased.
- Employment in the Kentucky mining and logging industry declined slightly in the first quarter of 2014. This was the slowest rate of decline seen since the start of the persistent decline in the third quarter of 2012.
- In spite of lower commodity prices, farmers in Kentucky and Indiana will plant only slightly fewer acres of corn this year (see left table). Area farmers explained, “it’s an opportune time to cycle between corn and soybeans because this provides improved yields for both crops.”
- Agricultural land values in Indiana experienced faster growth over the past 5 years (see figure). Meanwhile, land values for Kentucky leveled off over the same period. Contacts in both Indiana and Kentucky claimed that land is highly sought after by both farmers and domestic and international investors.

	Indiana	Kentucky	US
Natural resources (Q1-14)			
Mining and logging employment	4.4	-1.3	4.1
Coal production	2.0	2.8 ▲	-1.1
Prospective plantings (2014)			
Corn	-3.3	-2.0	-3.9
Cotton	--	--	6.7
Rice	--	--	15.6 ▲
Sorghum	--	--	-17.1 ▼
Soybeans	5.8	3.0	6.5

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 Q2-14 vs. Q2-13

	Lower	Higher	Net
Loan demand	13	0	-13
Available funds	0	13	13
Loan repayments	0	0	0
Farm income	29	0	-29
Capital spending	29	0	-29

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 and Transportation

Table Sources

Bureau of Labor Statistics

Transportation employment: includes transportation and warehousing industries.

Manufacturing employment: total, durable, and nondurable goods.

World Institute for Strategic Economic Research

Manufacturing exports: dollar value.

Notes

Job vacancy rate is defined as the online job openings as percent of total employment in an industry.

Transportation employment in Louisville covers transportation, warehousing, and utility industries. About 90 percent of the reported jobs are contributed by transportation and warehousing industries.

Manufacturing exports are defined as the total dollar amount of exports by the manufacturing industries.

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).

Real Estate and Construction

Table Sources

CoreLogic

Home price index, including distressed sales.

Census Bureau

Year-to-date single-family building permits.

Greater Louisville 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 geographic 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.

Notes

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

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 nonperforming 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 spending 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.

United States Department of Agriculture (USDA)

Prospective plantings.

Agricultural land values taken from the Census of Agriculture. The Census is conducted every five years; the last survey was in 2012. Consequently, land values shown in the figure are only available at 5-year intervals and a linear trend was used for interpolation of missing values. Land values include the value of buildings located on the land.