



# Burgundy Book

A report on economic conditions in the Louisville zone

First Quarter 2016

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.

## Kentucky and Indiana Continue To See Brisk Employment Growth in Transportation and Manufacturing

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

Although a February survey of business contacts in the Louisville zone showed a modest dip in optimism compared with three months earlier, those expecting local economic conditions to improve this year continued to outnumber those who expect economic conditions to worsen.

Payroll employment growth in the Louisville MSA in the fourth quarter exceeded the national rate for the seventh consecutive quarter. Employment growth was especially brisk in Elizabethtown. Kentucky and Indiana continue to register strong employment growth in the transportation services and manufacturing sectors. Employment in the mining and logging sector continued to fall in Indiana and Kentucky. Revisions released by the U.S. Bureau of Labor Statistics in March 2016 showed that employment growth in the Louisville MSA in 2015 was much stronger than initially reported.

The Louisville zone's unemployment rate remained at 4.7 percent in the fourth quarter of 2015, as each of the zone's MSA unemployment rates was below the U.S. rate of 5.1 percent in the fourth quarter.

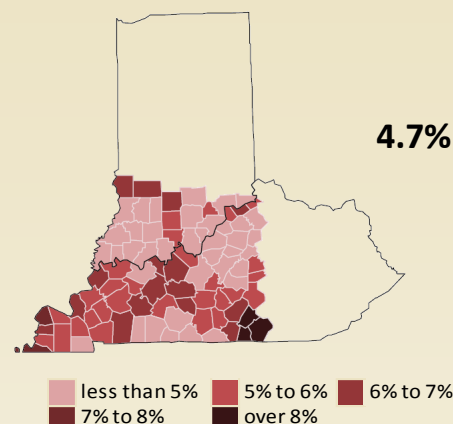
Commercial real estate activity registered healthy growth in the fourth quarter, as asking rents increased and vacancy rates edged lower in most segments. Single-family building permits increased in most areas in the fourth quarter.

Per capita automotive loan balances in the Louisville zone advanced at a sharply slower rate in the fourth quarter of 2015 compared with the previous quarter.

Asset quality improved at Indiana and Kentucky banks in the fourth quarter of 2015, but their profitability modestly trailed that of their U.S. peers.

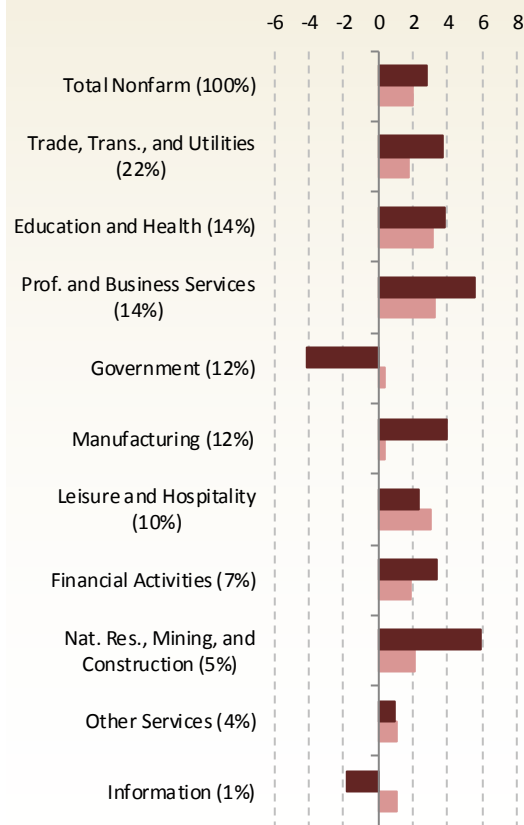
### Data Snapshot

#### County unemployment rates (SA, Q4-15)



#### Nonfarm payroll employment by industry

Percent change from one year ago (Q4-15)



## 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 the 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 February 2 and February 16.

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](mailto:beigebook@stls.frb.org).

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

## Little Slack Remains in Regional Labor Markets

By Maria A. Arias, Senior Research Associate

*“The expansion of industry in the region is expected to exert upward pressure on wages in the region.”*

—Owensboro area business contact

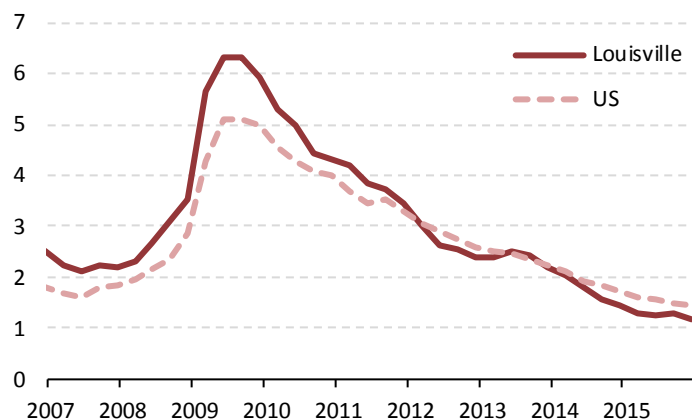
*“The pressure on wages increases as many industries continue to have to offer higher wages in order to attract and retain good workers.”*

—Louisville area business contact

- Labor market conditions are positive across the zone: The unemployment rate in all MSAs remained below the national average, and overall job growth was positive and at or above the national rate in three of the five MSAs.
- The zone continued to see a strong goods-producing sector during the fourth quarter, with employment growth in most MSAs significantly outpacing the national rate. Service-sector growth remains upbeat, with the exceptions of Evansville and Bowling Green.
- In Louisville, demand for labor is at its highest point since data began to be collected in 2005, backing anecdotal evidence of tightening labor markets. At the end of 2015, there was only about one unemployed person per job vacancy (see figure).
- Anecdotal evidence suggests demand for skilled labor will continue to put upward pressure on wage growth during the first half of 2016: Three-quarters of almost 60 business contacts surveyed reported wages in the first quarter were slightly higher or higher than they were a year ago, while the other quarter reported no change. Two-thirds of contacts expect wages will continue to move higher in the second quarter, with the remaining third expecting they will remain about the same.

### Demand for labor in Louisville higher than national average

Number of unemployed per advertised vacancy



Source: The Conference Board.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q4-15) (%)	4.5	4.1	4.7	5.0	5.0 ▲	5.1
Nonfarm employment (Q4-15)	2.8	0.1	1.4	3.9	2.0	2.0
Goods-producing sector	4.5	0.3	6.2	11.4	0.0	1.0
Private service-providing sector	3.6	0.1 ▼	0.6	3.6	3.3 ▲	2.5
Government sector	-4.2	-0.4	-1.0	-0.2	-1.0	0.4

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

## Durable Goods Manufacturing Remains Strong, but Outlook Is Mixed

By Daniel Eubanks, Senior Research Associate

*“Demand from appliance, HVAC, and auto [manufacturers] is down across the board.”*

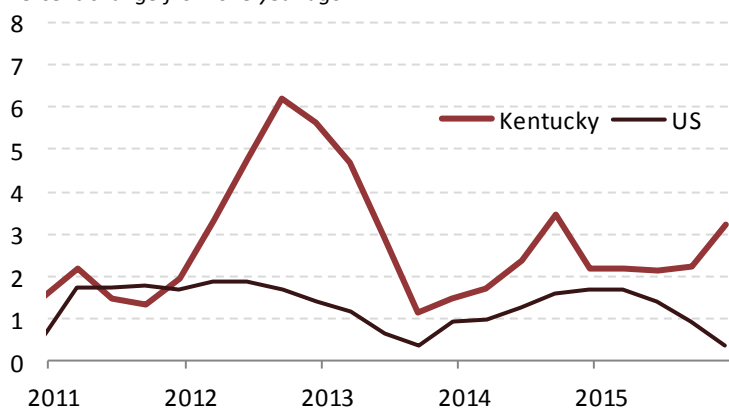
– Southern Indiana manufacturer

*“Canadian customers who pay in U.S. dollars are struggling.”*

– Louisville manufacturer

### Manufacturing employment growth in KY continues to outpace US average

Percent change from one year ago



Source: BLS

- Strong growth in durable goods manufacturing employment in Kentucky offset weakness in nondurable goods for an overall growth rate of 2.7 percent. Manufacturing employment in Kentucky has grown faster than the national average since late 2011 (see figure).
- In Louisville, durable goods manufacturing employment growth accelerated and is up 5.1 percent from one year ago.
- Despite the growth in employment, manufacturing exports from Kentucky declined 6.6 percent from one year ago. Declines were spread across a broad range of industries, but the most significant contributors were transportation equipment and computer and electronic products.
- Manufacturing contacts reported a decline in demand from a range of industries in the fourth quarter. Other contacts reported that exchange rates and conditions abroad could reduce demand in the future (see quote).
- Employment growth in the transportation sector remains robust, outpacing the national rate despite a modest slowdown since our last report.

	Louisville	Kentucky	Indiana	US
Transportation employment (Q4-15)	3.7	3.3	3.4 ▲	2.8
Manufacturing employment (Q4-15)	4.0	2.7	1.3	0.4
Durable goods	5.1	4.1	1.1	-0.1
Nondurable goods	1.9	0.2	1.9	1.0
Manufacturing exports (Q4-15)	--	-6.6	-5.8	-9.0

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

## Louisville's Commercial Real Estate Activity Strengthened

By Usa Kerdnunvong, *Research Associate*

*"Multifamily investment has reached a historic high in 2015, with a 36 percent year-on-year increase in volume."*

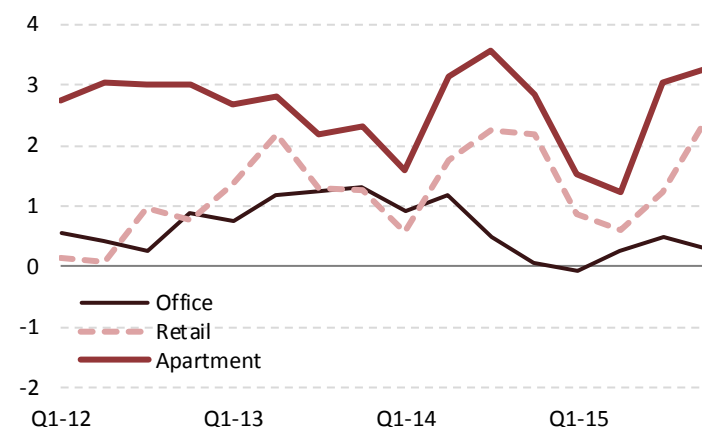
— Northwest Kentucky business contact

*"We expect more people to rent apartments as the twenty-somethings move out of their parents' homes. We are seeing more retail leasing activity. We are seeing more office leasing activity."*

— Louisville area business contact

### Commercial real estate rent growth rebounding

*Percent change from one year ago*



Source: Reis.com.

- In the last quarter of 2015, commercial real estate activity strengthened. Vacancy rates dropped in all sectors, except for the apartment sector, which stabilized. Rent growth has rebounded, with the apartment sector leading in the rate of growth and the office sector showing modest growth (see figure).
- Commercial construction activity remained strong in this quarter, with over \$135 million worth of projects currently in construction or announced to begin.
- Residential real estate activity continued to grow modestly. For the fourth quarter in a row, year-to-date home sales in Louisville increased faster than the national pace. Home prices in three of the four major MSAs in the zone increased from a year ago, although growth is still below the national rate (see table).
- Residential construction activity continued to grow modestly in most MSAs in the zone. In Louisville, the number of building permits was 8.5 percent higher than one year ago, just shy of the national rate of 9.5 percent.

Non-residential market (Louisville, Q4-15)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	5.5	14.4	9.8	4.9
Asking rent	3.3	0.3	2.5 ▲	-4.6
<i>Percent change from one year ago</i>				

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

Residential market (Q4-15)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	3.2	-0.8	2.5	3.9	5.5
Single-family building permits	8.5	-9.2	29.5	8.4	9.5
New and existing home sales	12.4	--	--	--	7.4

Note: Sales and permits data are year-to-date percent change. Prices 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.

## With Faster Income Growth, Debt Balances Rise

By Joseph McGillicuddy, *Research Associate*

*“Housing demand is up slightly [which is affecting consumer borrowing decisions at my business].”*

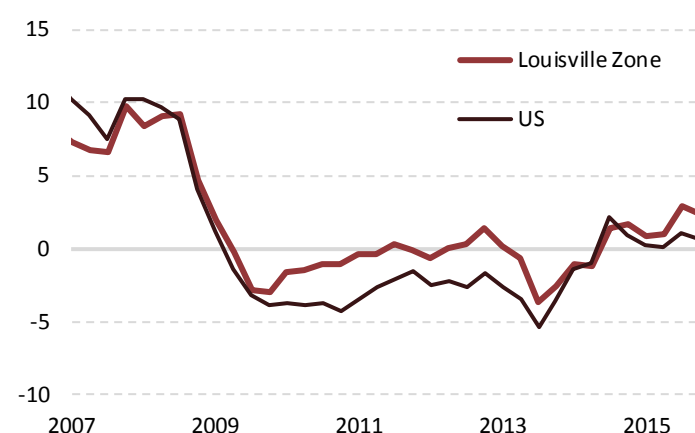
—Southwest Indiana commercial banker

*“Convention business fell short of expectations so far in the first quarter.”*

—Louisville hospitality contact

### Zone household debt balances increase modestly

Percent change in debt balances from one year ago



Source: FRBNY Consumer Credit Panel and Equifax.

- Year-over-year growth in auto debt balances within the zone dropped sharply by more than 3 percentage points to 8.3 percent in the fourth quarter. This growth rate is consistent with that of Indiana and Kentucky but more than a full percentage point below the national rate.
- Over the past two quarters, zone total debt per capita has experienced its fastest growth since the end of the recession, growing faster than the national rate but at a relatively modest rate compared with the pre-recession period (see figure). This growth corresponds to an increase in zone mortgage debt over the past two quarters. A local commercial banker contact indicated a slight increase in housing demand recently (see quote).
- Credit card debt balances in the zone were nearly identical relative to levels from one year ago.
- Zone delinquency rates were largely unchanged compared with the previous quarter. All three rates remained below the national averages. However, statewide auto delinquency rates remain elevated.
- Third-quarter personal income growth in Indiana and Kentucky accelerated slightly. Both rates exceeded the U.S. average.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q3-15)	--	4.2	4.7	3.9
Per capita debt balances (Q4-15)				
Mortgage	1.5	1.2	0.4	-0.5
Credit card	0.0	1.9	0.9	2.7
Auto loan	8.3 ▼	8.3	8.1	9.5
90+ day delinquency rates (Q4-15) (%)				
Mortgage	1.5	1.6	1.5	1.9
Credit card	6.0	5.8	6.4	7.3 ▼
Auto loan	2.9	3.6	3.2	3.1

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

## Banking Conditions Steady in Louisville Zone

By Michelle Neely, *Economist*, and Hannah Shell, *Senior Research Associate*

*“Louisville, Lexington, and Cincinnati suburbs are doing well and loan volume from those communities continues to grow.”*

—Louisville banker

*“Lower rates may be helping the home mortgage business, but they are not driving significant amounts of additional consumer spending.”*

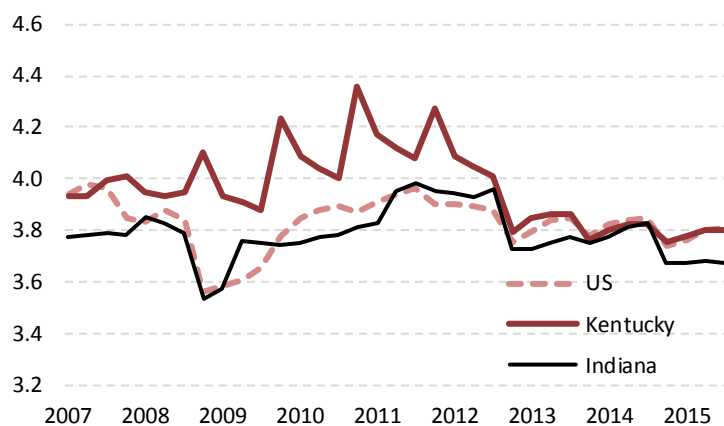
— Western Kentucky banker

*“Borrowing decisions appear to be carefully considered as consumers are choosing to pay down debt and not increase debt obligations.”*

—Western Kentucky banker

### Net interest margins flat in the fourth quarter

Net interest margin at commercial banks, percent



Source: FRED.

- Half of bankers surveyed reported loan demand was higher in the first quarter relative to the same time last year. Most respondents expect loan demand to be higher in the second quarter than it was during the same period last year.
- Consumer lending slowed slightly in the first quarter. All respondents but one reported auto loan demand was unchanged or lower in the first quarter compared with the same period in 2015. Demand for credit cards was unchanged. Several respondents noted that demand was lower for consumer loans overall.
- Return on average assets (ROA) held steady at Kentucky and Indiana banks in the fourth quarter, increasing just 1 basis point at both sets of banks. The average net interest margins at Kentucky and Indiana banks were also essentially unchanged in the fourth quarter, explaining the lack of movement in ROA.
- Asset quality improved again in the Louisville zone in the fourth quarter. The ratio of nonperforming loans to total loans fell 8 basis points at Kentucky banks and 5 basis points at Indiana banks from their third-quarter levels.
- More than half of survey respondents reported that delinquencies were about the same in the first quarter as they were at the same time last year; the rest said they were lower. Bankers expect asset quality in the second quarter to be unchanged from its year-ago levels.

Banking performance (Q4-15)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	1.03	1.08	1.05	1.11
Net interest margin	3.80	3.67	3.78	3.81
Nonperforming loans / total loans	1.11	0.92	1.04	1.07
Loan loss reserve coverage ratio	115.32	133.70	120.19	122.43

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

## Indiana Winter Wheat Planting Moves Against Trend

By Jonas C. Crews, *Research Analyst*

*“We have seen some coal mining layoffs due to EPA restrictions and low natural gas prices.”*

—Kentucky Agricultural Banker

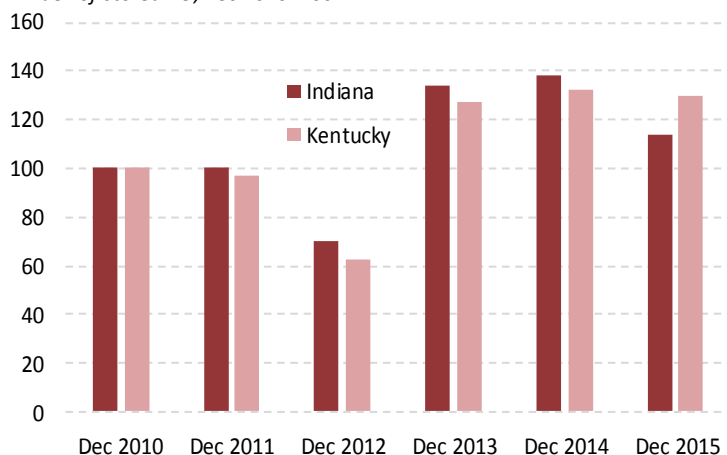
*“The net effect of reduced grain prices and reduced fuel prices is unclear at this time.”*

—Southern Kentucky contact

- While most of the country, including Kentucky, has been transitioning away from winter wheat because of low prices, Indiana farmers planted 44.8 percent more acres in 2016 than they did in 2015. December flooding may have damaged the crop, but the extent of the damage will be unclear until the plants come out of dormancy and can be analyzed.
- The effects of low crop prices and tightened profit margins are seen elsewhere for both states in the zone. With the hope of receiving higher prices when market supply falls between harvests, farmers have held significantly more corn in storage from the three harvests following the 2013 corn price drop than from the three harvests before it (see figure).
- Although falling red meat prices during 2015 balanced out the earlier fall in input prices, both states in the zone surpassed their 2014 red meat production levels. For Kentucky, the increase of 8.8 percent comes after six consecutive years of production declines.
- Coal production and mining and logging employment continued to fall in the zone during the last quarter of 2015, and many contacts are noting that environmental regulations and low alternative fuel prices remain hindrances on demand.

### Corn storage levels have remained high since price drop

Index of stored BU, Dec 2010=100



Source: USDA-NASS.

	Indiana	Kentucky	US
<b>Natural resources (Q4-15)</b>			
Mining and logging employment	-7.9	-19.6	-14.1 ▼
Coal production	-19.3	-23.6 ▼	-18.4 ▼
<b>Red meat production (2015)</b>			
Share of national production	2.9	8.8	2.3 ▲
Share of national production	3.8	1.2	100
<b>Winter wheat, area planted (2016)</b>	44.8 ▲	-1.8	-7.2

Note: Values (except for production shares) are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter or year. 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.

**Average hourly earnings** are in current dollars.

## 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

**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 Manufac-

turing); 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

### Sources

#### *Energy Information Administration (EIA)*

Coal production. Note: Production trends identified in report may be inconsistent with previous reports due to data revisions.

#### *Bureau of Labor Statistics (BLS)*

Mining and logging employment.

#### *United States Department of Agriculture (USDA)*

Red meat production, corn storage, and winter wheat estimates.