



Burgundy Book

A report on economic conditions in the Louisville zone

Second 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.

Strong Job Growth and Rising Optimism Typify Conditions in Louisville Zone

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

According to a May survey of regional business contacts, a larger percentage of respondents expressed increased optimism about the outlook for 2016 compared with three months earlier.

Payroll employment growth was brisk in most areas of the Louisville zone in the first quarter. In the Louisville MSA, employment was especially strong in trade, transportation, and utilities; education and health; and construction. Numerous business contacts reported that they are increasing wages to attract qualified candidates.

Despite brisk job growth, the zone's unemployment rate rose from 4.7 percent in the fourth quarter of 2015 to 5.1 percent in the first quarter of 2016. Given the recent acceleration in labor force growth, this development probably reflects increased re-entry into the labor market by job seekers.

Single-family building permits increased sharply in the first quarter in the Louisville and Clarksville MSAs, but at a slower rate in Elizabethtown and Evansville. Year-to-date, the pace of home sales in Louisville is growing rapidly relative to the nation.

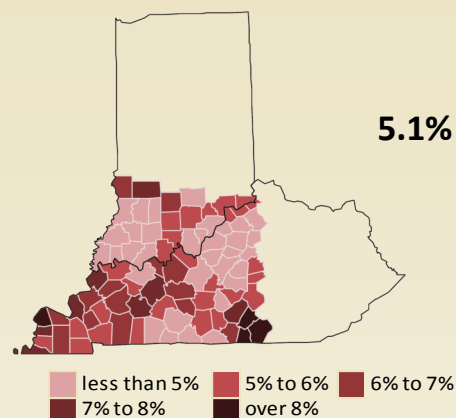
Reports from automobile dealers suggest that sales rebounded in the first quarter after a relatively weak showing in the previous quarter. Mortgage, credit card, and automotive loan delinquency rates in the Louisville zone remained low in the first quarter.

More than half of bankers surveyed expect that loan demand in the third quarter will be unchanged from a year earlier. Commercial bank asset quality at Indiana and Kentucky banks improved for the third straight year in the first quarter.

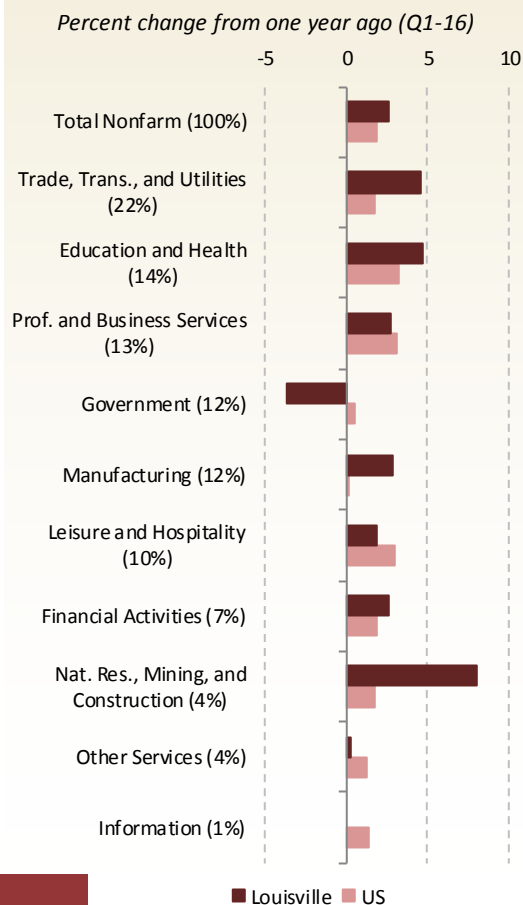
The coal mining industry in Indiana and Kentucky continued to contract in the first quarter

Data Snapshot

County unemployment rates (SA, Q1-16)



Nonfarm payroll employment by industry



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 May 3 to May 17.

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 Continues To Outpace National Average in Most MSAs

By Paul Morris, Research Associate

“Wage pressure continues to be a problem. I have not seen such drastic moves in starting wages to attract employees before.”

—Louisville area banking contact

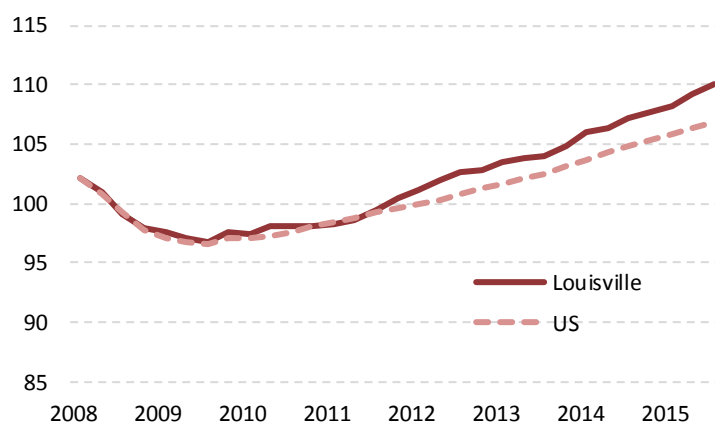
“Employment at our companies remains up compared to the same period last year. Unfortunately, it is difficult to find new workers to hire.”

—Southern Indiana area manufacturing contact

- Labor market conditions across the zone are strong: The unemployment rate in four of the five MSAs is at or below the national average, and employment growth was positive and exceeded the national average in four of the five MSAs. About a third of contacts expect employment growth at their firms to be higher in the third quarter than it was a year ago.
- The region continued to see a strong performance in the goods-producing sector in the first quarter, with positive growth that exceeded the national average in four of the five MSAs. This was driven mainly by growth in the construction industry. The private service-providing sector also remained strong, seeing positive employment growth in four of the five MSAs.
- Contacts expressed difficulty finding qualified candidates for skilled positions, which is putting upward pressure on wages: About 60 percent of contacts report that they are raising new and existing employees' wages and salaries for at least some job categories by more than in the past few years, particularly in management and professional positions.
- Anecdotal evidence suggests that an important factor leading to a shortage of qualified candidates has been a lack of specific skills and experience, with about half of contacts citing this as the number one factor.

Employment growth in Louisville is speeding up

Nonfarm payroll employment, SA (Index 2008=100)



Source: BLS.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q1-16) (%)	4.6	4.5	4.8	5.0	4.9	4.9
Nonfarm employment (Q1-16)	2.6	-0.9 ▼	2.5	4.2	2.2	1.9
Goods-producing sector	4.2	-1.0	6.6	9.1	0.9	0.7
Private service-providing sector	3.4	-0.8 ▼	2.0 ▲	4.2	3.5	2.5
Government sector	-3.7	-1.2	-0.5	1.1	-2.3	0.5

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 Growth Slow in Louisville

By Daniel Eubanks, Senior Research Associate

“Sales fell short of expectations because of weakness in commodity prices and the coal mining sector.”

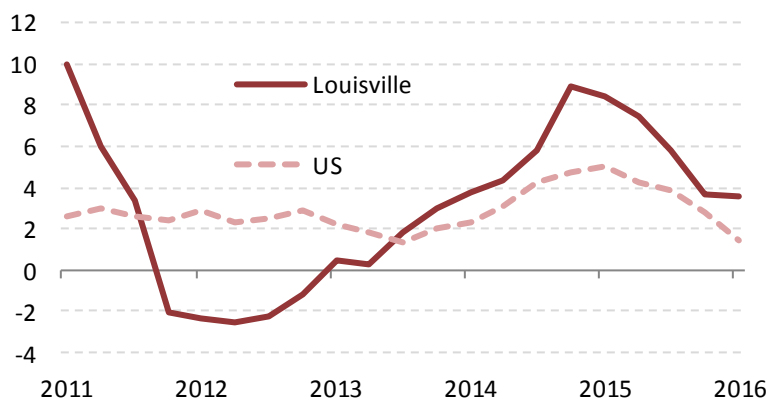
– Evansville, Indiana, manufacturer

“Lower energy prices have resulted in improved raw material pricing for petroleum-based products and lower production costs due to low natural gas prices.”

– Southern Indiana manufacturer

Transportation employment growth slows in Louisville but stays above US average

Percent change from one year ago



Source: BLS.

- Employment growth in the transportation sector slowed slightly across the Louisville zone in the first quarter, mirroring the slowdown in transportation employment growth nationwide. Despite the slowdown, the zone’s transportation sector remains relatively strong. In the Louisville MSA, transportation employment has grown faster year over year than the national average since 2013.
- Employment growth in the manufacturing sector also weakened across the zone. In the Louisville MSA, growth in the durable goods sector slowed by 1.5 percent, while growth in the nondurable goods sector slowed 0.6 percent. However, both sectors continue to grow more quickly in Louisville than the U.S. average.
- In Kentucky, nondurable goods employment contracted after several quarters of weak growth. Similarly, durable goods employment in Indiana began to contract in the first quarter.
- Despite weak manufacturing employment growth in Indiana, exports from the state increased significantly in the first quarter, driven by exports of chemical products and transportation equipment. Manufacturing exports from Kentucky were down slightly compared with one year ago.
- Manufacturing contacts report upward pressure on wages as competition for qualified workers becomes more intense. Contacts in the railroad industry report a sharp decrease in shipments of oil, coal, and related goods. A contact in trucking with ties to the energy sector reported reducing the number of drivers through attrition.

	Louisville	Kentucky	Indiana	US
Transportation employment (Q1-16)	3.6	3.0	2.8	1.4 ▼
Manufacturing employment (Q1-16)	2.8	1.5	0.1	0.1
Durable goods	3.6	2.7	-0.5	-0.5
Nondurable goods	1.2	-0.6	1.6	1.1
Manufacturing exports (Q1-16)	--	-0.9	3.2 ▲	-5.7

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.

Home Sales and House Prices Strengthen, Industrial Real Estate Activity Picks Up

By Joseph McGillicuddy, Senior Research Associate

“A lack of re-sale inventory and very slow ‘vacant’ new construction inventory are constraining sales volumes.”

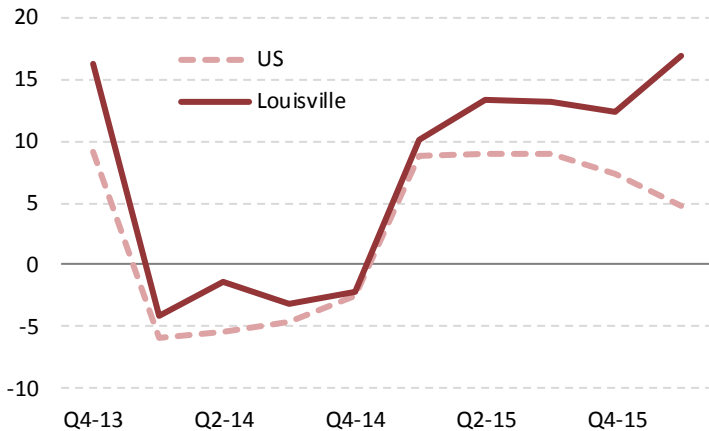
— Louisville real estate contact

“Industrial speculative development continues to be very brisk.”

— Louisville real estate contact

Home sales increasing at a faster pace than the nation's

Percent change from one year ago, year-to-date



Source: Greater Louisville Association of Realtors.

- Residential real estate activity strengthened during the first quarter. The year-over-year growth rates in Louisville house prices and year-to-date home sales both accelerated. The growth in home sales well surpassed that of the nation (see figure). House prices also continued to increase in two of the other three major MSAs but remained below the national rate. However, Clarksville house prices decreased slightly in the first quarter and have fallen 1 percent over the last four years.
- Residential construction continued to improve, driven by low inventory levels. Year-to-date building permits increased significantly from a year ago for both Louisville and Clarksville, well exceeding the nation’s increase of 14.1 percent.
- The industrial vacancy rate increased due to newly completed speculative buildings that have yet to be leased. The amount of industrial construction completed in the first quarter was at the highest level since 2008.
- Both apartment and office vacancy rates continued to decline. Several contacts noted increases in multifamily speculative building. The amount of office construction in the first quarter more than doubled that of a year ago.

Non-residential market (Louisville, Q1-16)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	5.2	14.5	9.7 ▲	5.5
Asking rent	3.6	0.8	3.4 ▲	0.0

Note: Apartment, office, and retail values are from Reis.com. Industrial values are estimates from Cushman & Wakefield.

Residential market (Q1-16)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	5.3 ▲	-0.1	2.6 ▼	4.6	6.0
Single-family building permits	28.7 ▲	56.2 ▲	9.5	8.8	14.1
New and existing home sales	17.0	--	--	--	4.8

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.

Delinquency Rates Remain Below National Average

By Rodrigo Guerrero, *Research Associate*

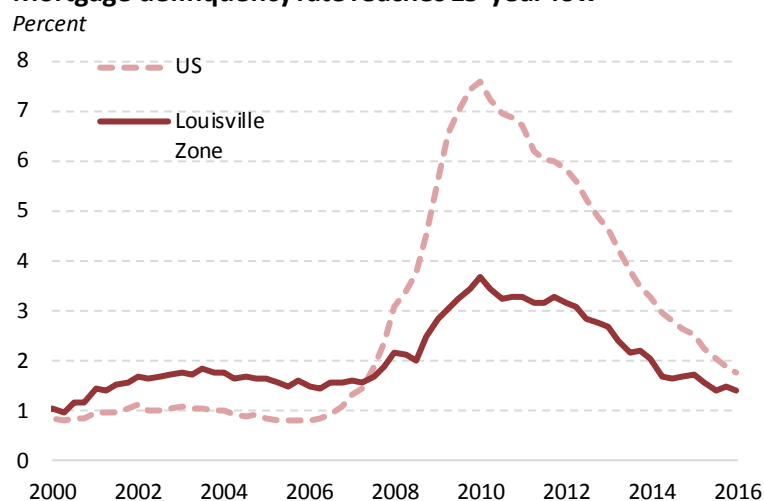
“Our retail automobile business continues to be strong.”

—Louisville contact

“Borrowers don’t want new or more debt.”

—Bowling Green commercial banker

Mortgage delinquency rate reaches 15-year low



Source: FRBNY Consumer Credit Panel and Equifax.

- Zone mortgage debt growth slowed compared with the previous quarter, although it is still above the national level of growth. Meanwhile, the mortgage delinquency rate reached its lowest value since 2000. The zone’s delinquency rate has been consistently below the nation’s since the beginning of the recession (see figure).
- Reports from auto dealers about sales halfway through the second quarter were generally positive after a relatively weak first quarter. Auto debt growth in the zone continued to decelerate and remained below national growth. The zone’s auto delinquency rate increased slightly compared with the previous quarter but remains below the national rate.
- The zone’s credit card debt growth remained more than a percentage point lower than the nation’s. Meanwhile, the credit card delinquency rate has slightly increased in the zone, as well as across Indiana, Kentucky, and the U.S. as a whole.
- Real income per capita growth slowed across Indiana and Kentucky in the fourth quarter of 2015. Indiana’s growth rate stayed below the national average while Kentucky’s remained above it.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q4-15)	--	2.4	3.7	2.7
Per capita debt balances (Q1-16)				
Mortgage	0.7	0.1	-0.4	0.0
Credit card	0.2	1.8	0.7	1.5
Auto loan	7.3	6.4	7.9	7.7
90+ day delinquency rates (Q1-16) (%)				
Mortgage	1.4	1.4 ▼	1.4	1.8
Credit card	6.2	6.0	6.6	7.4
Auto loan	3.0	3.7	3.5	3.3

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.

Louisville Banks Face Unchanging Environment

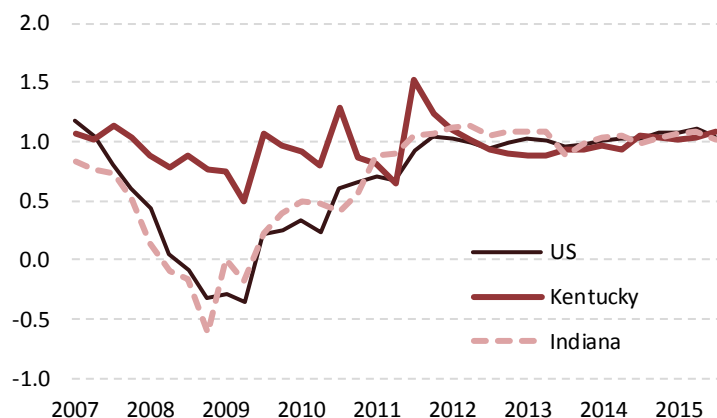
By Michelle Neely, *Economist*, and Hannah Shell, *Senior Research Associate*

“Business loan demand is not strong but steady. There are not many requests for expansion of businesses.”

—Southern Indiana Banker

ROA steady at 1 percent benchmark

Return on average assets at commercial banks, percent



Source: FRED.

- More than half of bankers surveyed reported loan demand was unchanged in the second quarter relative to the same period last year. Most respondents expect loan demand to be the same in the third quarter as one year ago.
- Consumer lending remained slower in the second quarter. Respondents reported demand for credit card and auto loans was unchanged to somewhat lower in the second quarter compared with the same period in 2015. Respondents expect loan demand will continue to be unchanged to somewhat lower in the third quarter from its year-ago level.
- Return on average assets (ROA) increased slightly at Kentucky banks in the first quarter and decreased slightly at Indiana banks. The average net interest margin was unchanged at Kentucky banks and decreased 9 basis points at Indiana banks, contributing to the decrease in Indiana banks' average ROA.
- The ratio of nonperforming loans to total loans fell 7 basis points at Kentucky banks and 4 basis points at Indiana banks from their fourth quarter levels. The average nonperforming loan ratio has declined for 12 consecutive quarters at Indiana and Kentucky banks.
- Most respondents reported that delinquencies were about the same in the second quarter as they were at the same time last year. All respondents but one expect asset quality to be unchanged in the third quarter relative to one year ago.

Banking performance (Q1-16)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	1.09	1.01	1.08	1.05
Net interest margin	3.80	3.58	3.70	3.79
Nonperforming loans / total loans	1.05	0.88	1.02	1.10
Loan loss reserve coverage ratio	123.81	137.50	120.59	118.18

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

Row Crop Outlook Improves Slightly; Coal Mining Outlook Remains Bleak

By Jonas C. Crews, *Research Associate*

“The recent rally in crop prices has improved the mood of producers in the last month.”

—Kentucky contact

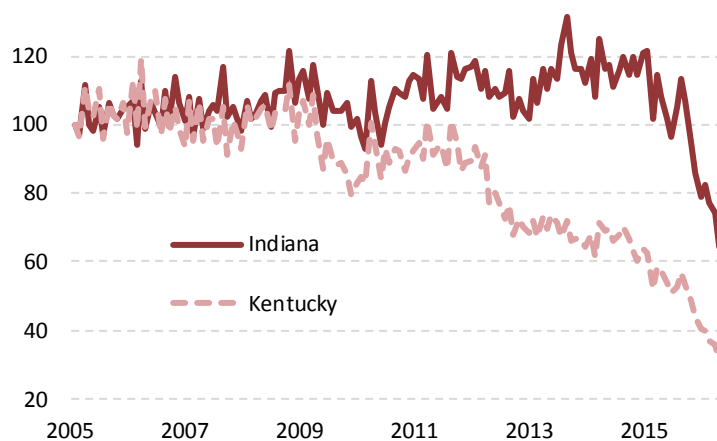
“Variable row crop costs are way down, but fixed costs keep climbing. You can cover those fixed costs in the good times, but it’s hard to now.”

—Kentucky agricultural equipment producer

- According to the USDA’s prospective plantings survey, the zone’s farmers are shifting away from soybeans and toward corn (see table). However, the nationwide increase in planned corn was not expected to be so high, and the downward pressure this put on corn prices will likely result in an actual acreage distribution closer to last year’s.
- Crop prices have begun to increase from their profit-mitigating lows, and this is leading to a less-bleak outlook among farmers (see quote). However, the capital-intensive row crop industry involves significant fixed costs that will continue to be difficult to cover unless the crop price rise continues (see quote), a future price path that is considered unlikely for the near term.
- The outlook for the coal mining industry remains bleak, as prices remain low and, because of the low prices, production continues its freefall. From the beginning of its production decline in 2011, Kentucky production has declined by more than 68 percent. Meanwhile, Indiana’s production has fallen more than 50 percent from its peak in 2013 (see figure). With prices and production at such low levels, the zone’s coal extraction and transportation firms continue to see their losses grow.

Coal production continues to plummet

Index of short tons, January 2005=100



Source: EIA.

	Indiana	Kentucky	US
Natural resources (Q1-16)			
Mining and logging employment	-10.4	-18.8	-16.1
Coal production	-30.9	-35.0 ▼	-31.2 ▼
Prospective plantings (2016)			
Corn	0.0	1.4	4.9
Cotton	--	--	0.1
Rice	--	--	5.1
Sorghum	--	--	-8.7
Soybeans	-0.9	-7.3	-2.8

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.

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)

Prospective planting.