Summary of Economic Activity

Economic conditions have remained unchanged since our previous report. Employers continue to report tight labor markets, although the pace of wage growth has slowed. Contacts reported slowing price increases and plans to accept tighter profit margins in order to maintain prices. Consumer spending was mixed, with reports of continued price sensitivity but demand slightly outstripping expectations. The real estate sector saw rent growth flatten and homebuying demand slow, but demand for industrial and retail space rose. Manufacturing growth declined, and lending conditions remained stable. The overall outlook rose slightly thanks to expected improvements in input prices, labor costs, and demand.

Labor Markets

Employment remains unchanged since our previous report, with contacts reporting tight labor markets but varying turnover rates. Several contacts reported challenges in hiring enough workers to meet demand, but an increased share reported more success in retaining employees. A restaurant contact in Memphis estimated 60% of restaurants in the area are understaffed and 80% have reported difficulty filling jobs. A logistics contact in Little Rock saw more rotation in and out of the company, while an employment contact in Memphis reported that more clients are staying at their current jobs. An agriculture contact reported a sharp increase in the number of firms using temporary visa worker programs for the first time.

Wages have grown slightly since our previous report. In contrast with the past few reports, contacts have reported minimal increases in wages. A healthcare contact in Louisville reported labor costs have been lowering reimbursements and pushing profit margins to just above break-even, while a retail contact in St. Louis has not been able to pass labor costs on to customers, which threatens the viability of their business. A construction contact in St. Louis reported that higher labor costs coupled with declining demand have placed a strain on the company.

Prices

Prices have increased modestly since our previous report. Overall, contacts reported slowing price increases and projected lower rates of price growth in the year ahead. This year, 63% of respondents reported an ability to pass on costs, down from 82% a year ago. Some industries expect to see the pace of price increases slow more than others, with retail respondents projecting a 4% increase this year, compared with 14% a year ago. However, some industries expect to see prices increase by more than the previous year, with tourism respondents projecting increased prices of 5.2% this year, compared with 0.3% a year ago. A contact in the hotel industry estimated they would pass on 60-70% of costs to consumers. A contact in the automobile sales industry reported that increased inventory levels led to more competitive market pricing, keeping prices lower. Firms, especially smaller ones, reported accepting tighter profit margins instead of increasing prices.

Consumer Spending

District general retailers, auto dealers, and hospitality contacts reported mixed business activity and a mixed outlook. January real sales tax collections increased in Kentucky, Missouri, and Arkansas relative to December and decreased in West Tennessee. Retailers in St. Louis noted generally lower business activity due to customers cutting back on spending because of higher prices. District auto dealers reported generally steady business activity due to increased inventory, though they expected business activity may slow in the upcoming months due to higher interest rates. An auto dealer in Louisville reported they have been seeing new vehicle sales rates slowing. A restaurant in Memphis noted that demand continues to be steady even with food costs surging. District hospitality contacts noted that business activity was generally mixed, with demand moderated by rising costs.

Manufacturing

Manufacturing activity growth has modestly declined since our previous report. Firms have reported modest decreases in new orders and production. Contacts reported that international shipping costs are returning to their pre-pandemic levels. Similarly, prices for raw materials are falling but have yet to return to pre-pandemic levels. The labor market for manufacturing remains tight as firms look to hire more workers. On average, firms reported they expect slight increases in production, capacity utilization, and new orders in the coming quarter.

Nonfinancial Services

Activity in the nonfinancial services sector has remained stable since our previous report. Air freight and passenger traffic has remained stable, but trucking services in the Memphis and St. Louis areas reported decreased pay per load, increased fuel costs, and parts shortages. In the Louisville area, investment in infrastructure sparked investment opportunities in freight transportation. A Memphis-area wedding planner reported a decline in spending on 2023 weddings, noting that couples are choosing less expensive options and spending wedding funds on honeymoons and house purchases instead.

Nonprofit firms that provide housing experienced steady funding and scaled up construction in the Memphis area. In the St. Louis area, nonprofit contacts in arts and public policy faced competition for volunteer labor. Rural healthcare in the Memphis area continued to face funding challenges and reduced the number of services and beds in response. While education contacts in the Louisville area reported depressed university enrollment, enrollment in community college increased due to new programs that reduced tuition costs.

Real Estate and Construction

Residential real estate rental rates have continued to stagnate since our previous report. Multiple residential real estate contacts reported that the rate increases of the past year are being met by resistance and families are staying in their current rentals. Residential real estate inventory has continued to increase since the previous report, as homebuyer demand slows. Some real estate contacts reported signs of increased demand in recent weeks due to some relative stabilization in mortgage rates.

The commercial real estate sector has been mixed. Office demand remains low, but industrial demand remains high despite increased rents. Retail real estate has improved since the previous report, and one contact reported retail projects are back in demand for the first time since before the pandemic. Construction demand has slowed, with contacts reporting that many projects are on hold as investors wait out market uncertainty about rate hikes. One St. Louis contact reported increased construction activity as interest rates flattened.

Banking and Finance

Banking conditions in the District remain stable since our previous report. Overall loan demand remains largely unchanged from the past quarter. Commercial and industrial loan demand saw a small decline, while demand for mortgage loans moderately increased with the dip in the 30-year fixed mortgage rate. Despite this recent growth, Memphis banking contacts expect mortgage lending to slow down in the coming month. Contacts also expect margins on interest-bearing deposits to contract as federal funds rate increases ease up and the resulting pressure from competition requires banks to pay higher interest rates. Credit and asset quality remain strong, and delinquency rates showed no significant change from the past quarter.

Agriculture and Natural Resources

District agriculture conditions have declined moderately since our previous report. The number of acres of winter wheat planted in the District this season has increased by 27% compared with this period a year ago. These increases range from 15-55% across District states with the lone exception of Arkansas, which saw a moderate decrease of 14%. District contacts are no longer optimistic on the outlook for the rest of the year, due to concern about the increased cost of inputs, especially labor. Additionally, contacts noted sales were either at or below expectations, and some contacts expressed concern that higher interest rates were putting additional strain on their balance sheets.

Natural resource extraction conditions increased moderately from December to January, with seasonally adjusted coal production rising just under 10%. However, January production decreased moderately by 11% compared with the previous year. ■