



Burgundy Book

A report on economic conditions in the Louisville zone

Third 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.

Manufacturing Sector Continues to Hum Along Nicely

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

In an August survey, a slight majority of Louisville zone business contacts expected economic conditions to improve over the second half of 2014.

The Louisville zone's unemployment rate averaged 6.8 percent in the second quarter of 2014, modestly below its first-quarter average (7.2 percent). The unemployment rates in the zone's MSAs ranged from 5.4 percent in Evansville to 7.2 percent in Elizabethtown.

Nonfarm payroll employment increased in most MSAs in the second quarter of 2014. Growth was the strongest in Bowling Green. In the Louisville MSA, employment growth was especially brisk in manufacturing, professional and business services, and leisure and hospitality. Indiana continued to see strong growth in manufacturing employment in the second quarter.

In the Louisville MSA, total home sales and single-family building permits declined in the second quarter, but home prices edged higher. Residential permit activity picked up in most other MSAs in the second quarter.

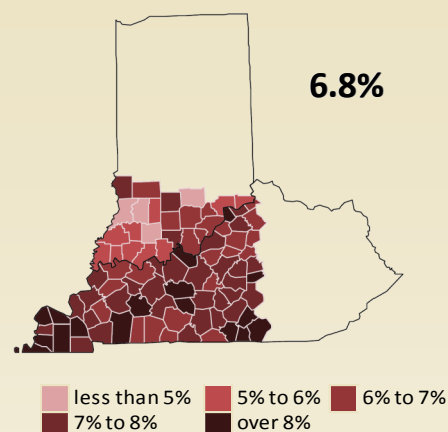
Although auto dealer contacts noted strong sales in the second quarter, the growth of auto loan balances in the major MSAs trailed the national growth rate. Household delinquency rates for mortgages and credit cards declined significantly in the second quarter.

Commercial bank profits (return on average assets) and asset quality increased at Kentucky and Indiana banks in the second quarter. A third of bankers surveyed expect loan growth to increase over the next three months.

According to the USDA's latest estimates, Indiana farmers are projected to harvest a record corn crop this fall. However, the Kentucky corn crop is projected to be significantly below last year's bumper crop.

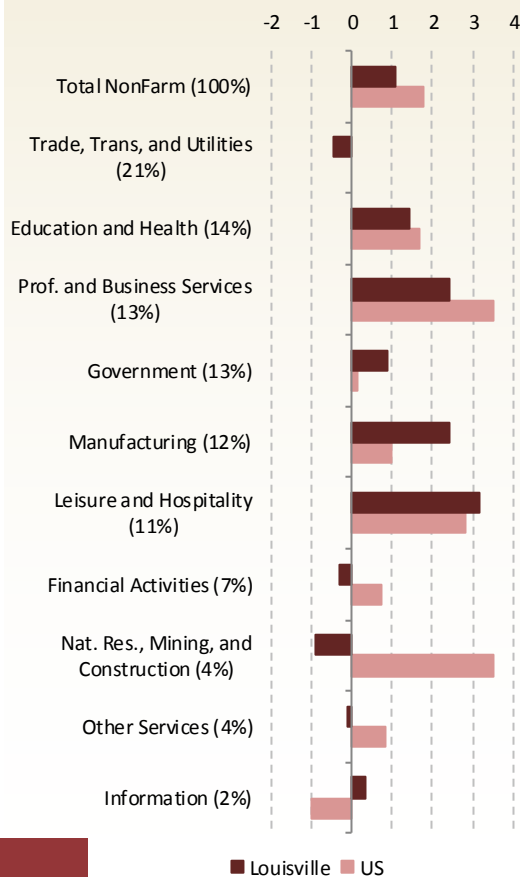
Data Snapshot

County unemployment rates (SA, Q2-14)



Nonfarm payroll employment by industry

Percent change from one year ago (Q2-14)



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 August 8 and August 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.

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

Labor Costs and Wages Expected To Increase

By Maria A. Arias, *Research Associate*

"We have had to raise wage rates to obtain individuals with qualified skills."

—Louisville area retailer

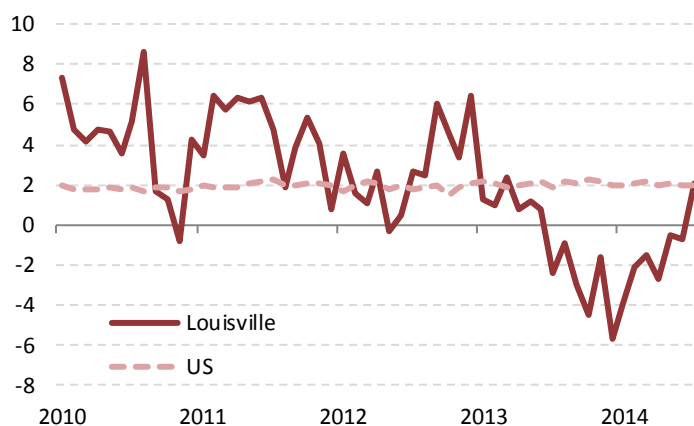
"Finding entry-level engineers has not been difficult, though their abilities are limited. Finding experienced engineers and designers has been very difficult due to the broad-based demand for their skills."

—Louisville area business contact

- The unemployment rate across the zone remained elevated relative to the national average, with the exception of Evansville. Payroll employment grew modestly in most of the zone's MSAs during the second quarter (see table).
- Business contacts in the Louisville area are moderately optimistic about the labor market conditions for the remainder of the year: 52 percent of contacts expect employment to remain the same, 38 percent expect it to increase toward the end of the year, and the remaining 10 percent expect employment to be somewhat lower than the same time last year.
- Year-over-year wage growth was mixed across the zone's MSAs during the second quarter, continuing to exceed the 2 percent national average in Bowling Green (11 percent) and Owensboro (6 percent) while declining in the remaining MSAs. Wage growth in Louisville matched the national average into the third quarter, rebounding from the decline seen through 2013 and early 2014 (see figure).
- Anecdotal information suggests wages will continue to increase slightly toward the end of the year: 57 percent of the contacts surveyed expect wages to remain the same, while 42 percent expect wages to be somewhat higher or higher than last year.

Earnings growth rebounds from prior year's lows

Average hourly earnings, percent change from one year ago



Source: BLS.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q2-14) (%)	7.1	5.4	6.7	7.2	6.7	6.2 ▼
Nonfarm employment (Q2-14)	1.1	0.3	2.1	-0.2	0.9	1.8
Goods-producing sector	1.6	-0.5	-1.1	0.0	3.6 ▲	1.9
Private service-providing sector	1.0	0.7	2.7	0.6	-0.2	2.1
Government sector	0.9	0.0	3.1 ▲	-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.

Louisville Manufacturing Improves at Steady Clip

By Sean P. Grover, Senior Research Associate

“The tight market for skilled or readily trainable labor is getting to a point where it is affecting our abilities to expand production and increase plant investments.”

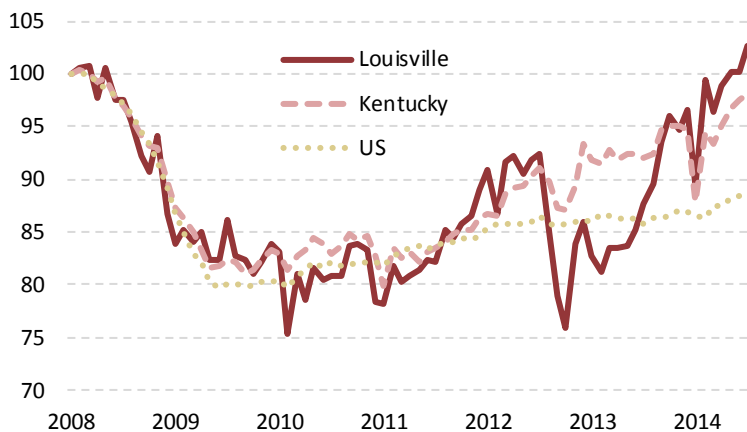
—Louisville area manufacturer

“Many of our local industries are expanding production and output, but seem to be accomplishing this by extending the work-week and hours worked by current employees, rather than hiring new employees.”

—Central Kentucky manufacturer

Aggregate manufacturing hours in Louisville swiftly outpace US

Production and nonsupervisory employees, Jan 2008 = 100



Source: BLS.

- Manufacturing employment in Louisville picked up strongly in the second quarter. The 2.4 percent reading, significantly above the national average, was led by a surge in durable goods manufacturing employment. Transportation employment in Louisville also showed solid improvement at 2.0 percent, although less than the nation’s 2.7 percent gain.
- Kentucky showed no change in manufacturing employment, with counterbalancing changes in durable and nondurable goods employment. In contrast, Indiana manufacturing employment increased 3.1 percent, led by durable goods. Kentucky showed a significant increase in transportation employment at 1.3 percent, while Indiana showed a slight decrease.
- Aggregate weekly manufacturing hours among production employees in Louisville exceeded pre-recession levels in the second quarter, strongly outpacing the national average.
- Despite strong manufacturing activity, many zone contacts expressed reluctance to expand and concern about the difficulty in finding skilled or readily trainable labor.
- Manufacturing exports improved for both Kentucky and Indiana in the second quarter. Kentucky manufacturing exports increased 11.6 percent, with strength from textiles and furniture. Indiana’s exports were led by leather products and transportation equipment, increasing 4.2 percent. Both states strongly outpaced the national average.

	Louisville	Kentucky	Indiana	US
Transportation employment (Q2-14)	2.0	1.3 ▲	-0.1	2.7
Manufacturing employment (Q2-14)	2.4	0.0	3.1	0.9
Durable goods	3.6	2.1	4.1	1.4
Nondurable goods	0.1	-3.4	0.7	0.1
Manufacturing exports (Q2-14)	--	11.6	4.2	1.4

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.

Commercial Real Estate Market Improves as Tenants Look at Downtown Space

By Diana Cooke, *Research Associate*

“Real estate is on an upswing, but feels downward pressure from the regulations affecting all areas of the process.”

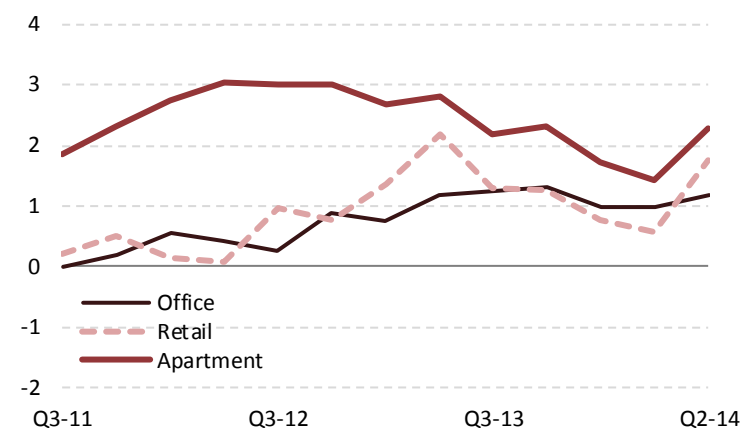
— Louisville area realtor

“With the popularity of downtown and all the activity that is taking place...I know several things that are right on the verge of happening.”

— Owensboro area contact

Uptick in rent growth in Louisville commercial real estate

Percent change from one year ago



Source: Reis.com.

- The residential market showed signs of growth in the second quarter. In the majority of the zone’s MSAs, year-over-year growth in sale prices were significantly greater than in the previous quarter (see table). In Louisville, home prices have increased 3.7 percent since a year ago.
- Contacts in the Louisville area noted that a combination of increasing demand, limited lot development, and high costs of input materials are driving sales prices higher. Realtors in the Evansville area reported pent-up demand and multiple offers on single-family homes.
- Total home sales are down 3.5 percent in Louisville (see table). Contacts attributed this decrease to tighter credit restrictions and a lack of inventory in the market.
- The commercial real estate market improved in the second quarter; the year-over-year change in asking rents increased in the office, retail, and apartment market (see figure).
- Contacts in Louisville reported that tenants are increasingly interested in the higher vacancy and compressed rental rates of the downtown office market. Construction of speculative office space in Louisville further points to a rebound in this sector.

Non-residential market (Louisville, Q2-14)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	5.3	15.3 ▼	9.5	6.6
Asking rent	2.3 ▲	1.2	1.8 ▲	15.4
<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 (Q2-14)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	3.7 ▲	-0.2 ▲	-3.1 ▲	-1.1	8.3 ▼
Single-family building permits	-14.3	2.0	21.4	3.1	0.0
New and existing home sales	-3.5	--	--	--	-5.8

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.

Income Growth Uneven Across the Zone

By Peter B. McCrory, *Research Associate*

“Overall consumer spending appears to be stronger but [consumers are] still seeking value.”

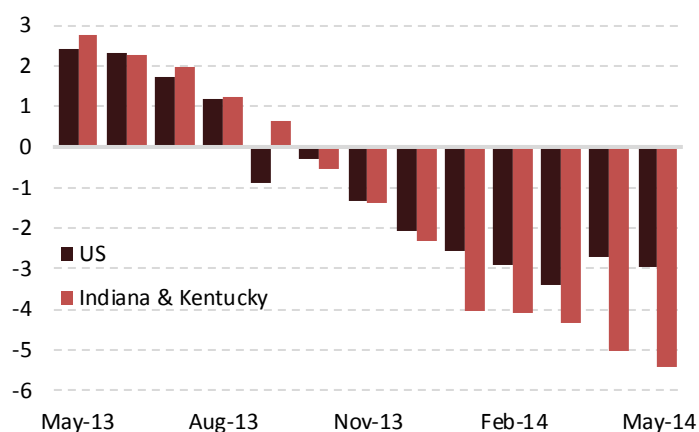
— Owensboro area banker

“We have one major employer that has been slowly doing layoffs (announced well in advance). This is causing conservative purchasing behavior.”

— Western Kentucky banker

Households reduce SNAP participation across the zone

Percent change in persons participating from one year ago



Source: USDA.

- Per capita income growth was uneven in Kentucky and Indiana in the first quarter. Relative to one year ago, Indiana’s income grew by 0.5 percent—a slight decline from its 0.9 percent growth in the previous quarter. Income grew by 2.5 percent year-over-year in Kentucky, up from the prior quarter’s 1.3 percent growth. Both states, however, trailed income growth in the nation.
- Auto dealer contacts noted that strong second-quarter sales activity made up for the rough start to the year due to inclement weather.
- In line with strong sales, households in the Louisville zone increased auto debt balances, but at less than half the rate of households across the nation. Once again, non-auto debt balances declined year-over-year as households continued to repair their balance sheets.
- In October 2013, households in Indiana and Kentucky began reducing their SNAP participation. For eight straight months, these states have outpaced the nation in reducing participation, a trend that shows no sign of abating (see figure). This suggests that households in the zone face increasingly stable financial conditions, which will likely foster improved consumer sentiment.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q1-14)	--	0.5	2.5 ▲	2.8 ▲
Per capita debt balances (Q2-14)				
Mortgage	-3.5	-2.8	-3.6	-1.8
Credit card	-3.8	-5.0	-4.0	-4.6
Auto loan	2.5	3.1	1.4	5.5
90+ day delinquency rates (Q2-14) (%)				
Mortgage	1.7 ▼	2.0 ▼	1.8 ▼	3.0 ▼
Credit card	5.9 ▼	6.2 ▼	6.2 ▼	7.5 ▼
Auto loan	2.8	3.2	3.1	3.1

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.

Banking Conditions on Upswing in Louisville Zone

By Michelle Neely, *Economist*

“People are more conscious of their credit scores and have worked harder to bring them into good shape.”

—Louisville area banker

“The market is becoming more competitive as banks that were previously sidelined due to credit and capital issues are becoming healthier and are now seeking to expand their business lending.”

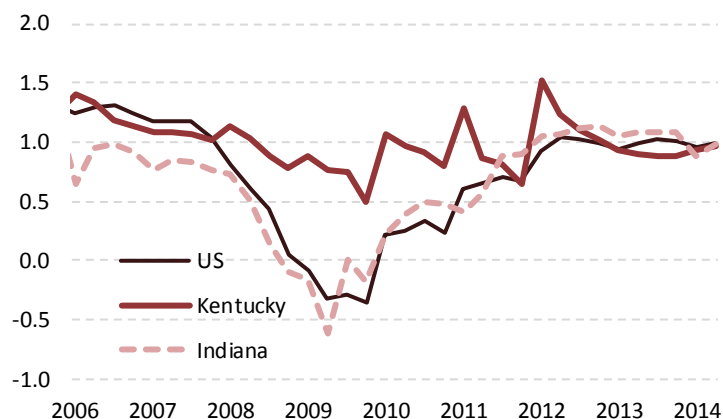
—Southern Indiana banker

“Competition for quality loans continues to be very brisk. Loan covenants are loosening for commercial and industrial loans.”

—Louisville area banker

Profit rates converge at Indiana, Kentucky banks

Return on average assets at commercial banks, percent



Source: FRED.

- One-third of bankers surveyed expect loan demand to increase over the next three months.
- Return on average assets (ROA) increased at both Kentucky and Indiana banks in the second quarter. Averages in both states lagged that of District banks overall but were on par with national peer results.
- The average net interest margin (NIM) rose slightly at Indiana and Kentucky banks in the second quarter, reversing the declines of the previous quarter. Profits rose at Indiana banks because of the increase in the average NIM as well as a sharp decline in net noninterest expenses. In Kentucky, the increase in ROA can solely be attributed to the bump in the average NIM as net noninterest expenses and loan loss provisions were basically unchanged.
- Asset quality once again improved in both states. In the second quarter, the ratio of nonperforming loans to total loans fell 11 basis points to 1.24 percent at Indiana banks and fell 22 basis points to 1.69 percent at Kentucky banks.

Banking performance (Q2-14)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	0.96	0.99	1.10	1.00
Net interest margin	3.80	3.77	3.77	3.82
Nonperforming loans / total loans	1.69 ▼	1.24	1.54	1.60
Loan loss reserve coverage ratio	89.94	115.32	79.89 ▼	95.63

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

Another Strong Harvest Expected in Indiana

By Lowell R. Ricketts, Senior Research Associate

“Reduced commodity prices are having the greatest impact at this time. Weather hasn’t been a major factor this quarter. Farm to table restaurants and farmers markets are providing good demand for fresh fruit and vegetables with some local produce being shipped as far away as Florida.”

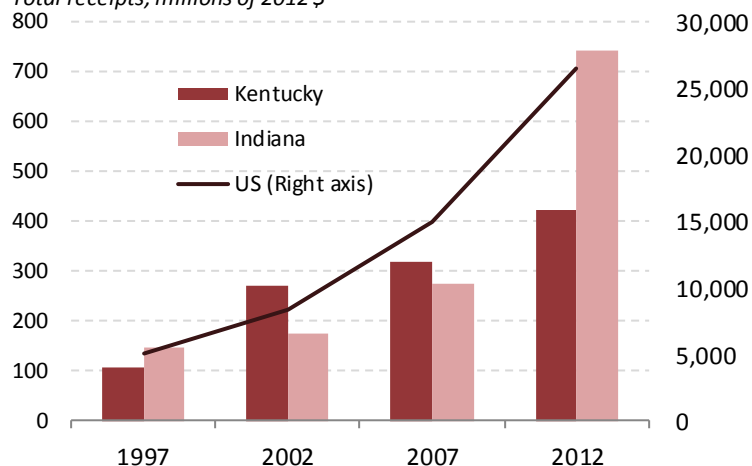
—Western Kentucky banker

“High-priced farmland, lower row crop prices and higher input prices will make it less profitable to farm during the remainder of 2014.”

— Western Kentucky banker

Farm income surges in Indiana over five-year period

Total receipts, millions of 2012 \$



Source: USDA Census of Agriculture; see appendix.

- Agricultural bankers surveyed expect that availability of loanable funds will be higher in the third quarter relative to a year earlier (see right table). Responses were mixed for the other survey categories.
- Kentucky coal production increased in the second quarter relative to a year ago, continuing the positive rebound that started in the first quarter (see left table).
- According to the U.S. Census of Agriculture, farm income across Indiana increased by 171 percent from 2007 to 2012 (see figure). This well outpaced the 77 percent growth seen for the nation overall and dwarfed the 33 percent growth for Kentucky.
- Corn production in Kentucky is expected to decline significantly relative to last year’s record harvest (see left table). However, production levels are estimated to be 11 percent higher than in 2011 and 92 percent higher than in 2012. In contrast, 2014 Indiana corn production is expected to be slightly higher than last year’s record of over a billion bushels.
- Kentucky soybean yields are projected to decline around 19 percent from their record 49.5 BU/acre in 2013. Consequently, production levels are projected to drop significantly despite the higher level of plantings.

	Indiana	Kentucky	US	Louisville zone Ag. bankers' expectations Q3-14 vs. Q3-13			
Natural resources (Q2-14)				Lower	Higher	Net	
Mining and logging employment	3.9	0.4	5.0	Loan demand	17	17	0
Coal production	6.6	4.8	0.8	Available funds	0	33	33
Production (2014)				Loan repayments	0	0	0
Corn	1.1 ▼	-17.7 ▼	0.8	Farm income	0	0	0
Cotton	--	--	35.6 ▲	Capital spending	14	14	0
Rice	--	--	20.5 ▲	Note: Percentage of responses. See appendix for notes and sources.			
Sorghum	--	--	10.3				
Soybean	5.8	-16.7 ▼	16.0				

Note: Values are percent change from one year ago. Arrows indicate a significant (± 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.

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

Manufacturing labor input is defined as the average weekly hours worked by production and nonsupervisory employees in the manufacturing industry multiplied by the monthly average of total number of production and nonsupervisory employees in the manufacturing 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.

SNAP participation.

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.

Supplemental Nutrition Assistance Program (SNAP) is a welfare program administered by the United States Department of Agriculture that provides nutritional assistance to eligible, low-income individuals and families. It is the largest program in the country's domestic hunger safety net. Participation is measured as the seasonally adjusted number of persons participating in the program.

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)

Crop production estimates.

Total farm income taken from the Census of Agriculture. The Census is conducted every five years; the last survey was in 2012. Consequently, farm receipts shown in the figure are only available at 5-year intervals and a linear trend was used for interpolation of missing values.



