Burgundy Book

A report on economic conditions in the Louisville zone

Fourth Quarter 2013

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.

Business Contacts Expect Conditions to Improve During 2014

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

Business contacts in the Louisville zone remain optimistic. A November survey suggests a larger percentage of contacts expect improving economic conditions in 2014 (49 percent) than worsening conditions (12 percent).

Louisville's third-quarter nonfarm employment growth (compared with a year earlier) surpassed the nation's growth for the sixth consecutive quarter. In the third quarter, the Louisville zone's unemployment rate averaged 7.7 percent, down slightly from the second quarter (8.1 percent).

Despite robust export growth, manufacturing employment slipped in the third quarter in Kentucky. Manufacturing activity was a bit stronger in Indiana.

Residential construction activity and single-family house prices posted solid gains in the third quarter in most areas. Activity in the commercial and industrial sphere also continues to improve.

In the second quarter of 2013, Indiana's per capita income was up a healthy 2.4 percent from a year earlier—appreciably stronger than in Kentucky and the nation. Households in the zone continue to reduce their outstanding mortgage and credit card debt balances.

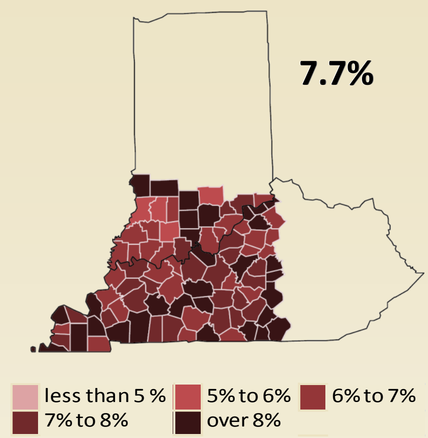
Third-quarter earnings at Kentucky and Indiana banks were essentially unchanged from the second quarter. Most Louisville zone bankers surveyed expect steady to improving loan demand over the first half of 2014.

This year's corn and soybean harvests exceeded expectations with record production and yields. Kentucky coal production in the third quarter was up sharply from a year earlier.

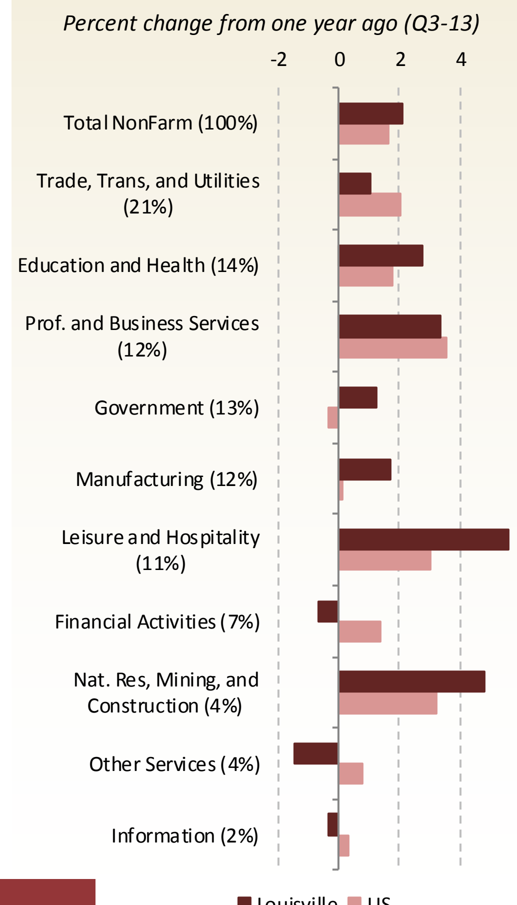
This report is published by the Federal Reserve Bank of St. Louis

Data Snapshot

County unemployment rates (SA, Q3-13)



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 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 November 1 and November 15.

If you're interested in becoming a member of our panel, follow this link to complete a trial survey:

http://research.stlouisfed.org/beigebooksurvey/

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

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

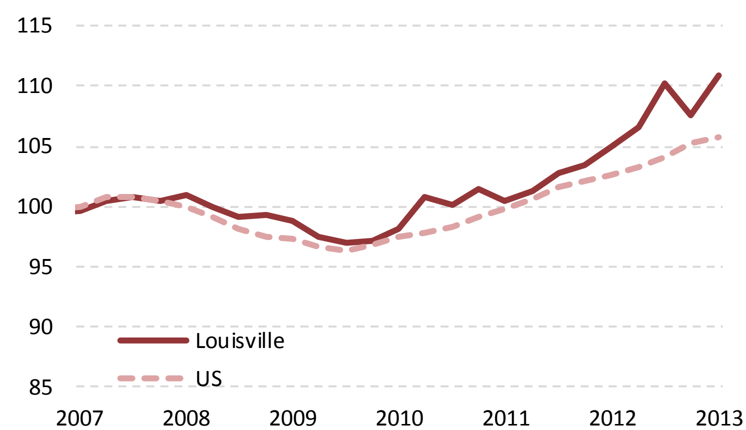
Despite Optimism, Uncertainties Surround 2014 Labor Market Plans

By Maria A. Arias, *Research Analyst*

> *"The massive Ohio River Bridges Project will continue to drive economic activity in the Louisville metro area, including southern Indiana, particularly as it relates to construction spending and employment."*
>
> —Louisville area real estate broker
>
> *"We are experiencing a shift to digital solutions, [and] there is a shortage of IT talent, which is driving up wage expectations."*
>
> —Louisville area manufacturer

Leisure and hospitality employment shows stready growth

Leisure and hospitality employment, SA (Index 2007 = 100)



Source: BLS.

- Anecdotal evidence suggests the labor market outlook will remain mostly unchanged or fare slightly better during the remainder of this year and through 2014: 63 percent of contacts expect no change in employment and 22 percent expect an increase in employment.
- The private sector continued to drive employment growth in both Louisville and Owensboro during the third quarter, while the government sector grew faster in Evansville and Bowling Green. Elizabethtown, however, continued to experience negative job growth (see table).
- The leisure and hospitality sector, which comprises 10.4 percent of Louisville's nonfarm employment, was the fastest-growing sector during the past year. The sector's employment grew 5.7 percent since 2012:Q3, compared with nonfarm employment's growth rate of 2.1 percent during the same period (see figure).
- A majority of contacts indicate that uncertainties surrounding government regulations (such as the Affordable Care Act and the Dodd-Frank Act), and uncertainties regarding the strength of economic growth, have affected their plans to further increase their payrolls: 65 percent expect labor costs to increase in 2014, while 33 percent expect costs to remain about the same as during 2013.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q3-13) (%)	8.0	7.3	7.3	7.7	6.9	7.3
Nonfarm employment (Q3-13)	2.1	-0.1	0.5	-0.5	2.3	1.7
Goods-producing sector	2.6 ▼	-2.0	0.9	1.3	-1.5	1.2
Private service-providing sector	2.1	1.0	0.0	-0.9	3.5 ▲	2.2
Government sector	1.3	-2.6 ▲	2.1	-0.9	3.0	-0.3

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.

Manufacturing Growth Has Slowed after Recent Boom

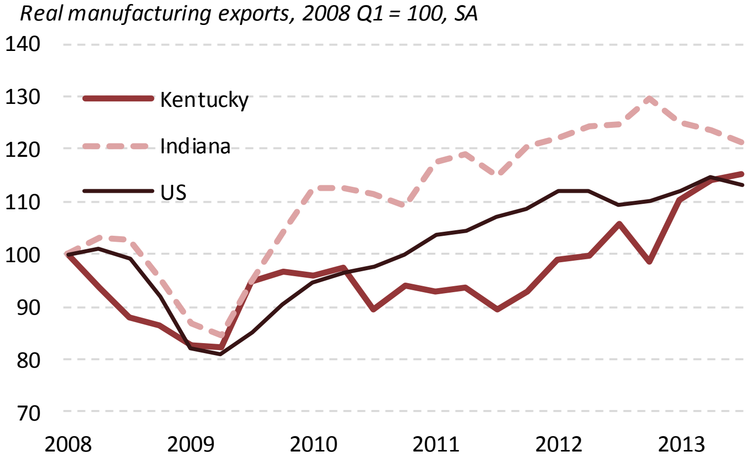
By Yang Liu, *Senior Research Associate*

> *"The railway industry is seeing the highest intermodal shipping volume in U.S. history during October ."*
>
> — Louisville area transportation executive
>
> *"For the first time in 25 years, we don't plan to buy new [machinery]."*
>
> — Louisville area transportation executive

- Although Louisville's manufacturing employment is up 1.7 percent compared with a year ago, the trend of strong growth may have changed: Louisville's manufacturing employment continued to contract (-1,400 jobs) in the third quarter of 2013.
- Nondurable goods employment growth in Louisville and Kentucky dropped compared with a year ago. The contraction in Kentucky is seen as a significant decline compared with the previous quarter. Nondurable goods employment experienced similar downward movement at the national level (see table).
- Kentucky's real manufacturing exports in the third quarter increased for the third consecutive quarter. Currently Kentucky's exports are 15 percent above the prerecession level. Indiana's manufacturing exports declined for three quarters in a row since a peak in late 2012. Despite this downward trend, Indiana's exports remain 21 percent above its prerecession level (see figure).
- Despite significant declines from the previous quarter, durable goods earnings in Kentucky remained strong. Its year-over-year growth rate is just under 5 percent in the second quarter.

Manufacturing exports in Indiana remain strength despite downward trend

Real manufacturing exports, 2008 Q1 = 100, SA



Source: World Institute for Strategic Economic Research.

	Louisville	Kentucky	Indiana	US
Manufacturing employment (Q3-13)	1.7 ▼	-0.9 ▼	0.4	0.1
Durable goods	3.5 ▼	-0.1 ▼	0.5 ▼	0.4
Nondurable goods	-1.6	-2.2 ▼	0.1	-0.5
Manufacturing earnings (Q2-13)	--	3.5 ▼	2.7	1.7
Durable goods	--	4.9 ▼	0.7	1.6
Nondurable goods	--	1.1	7.2	2.0

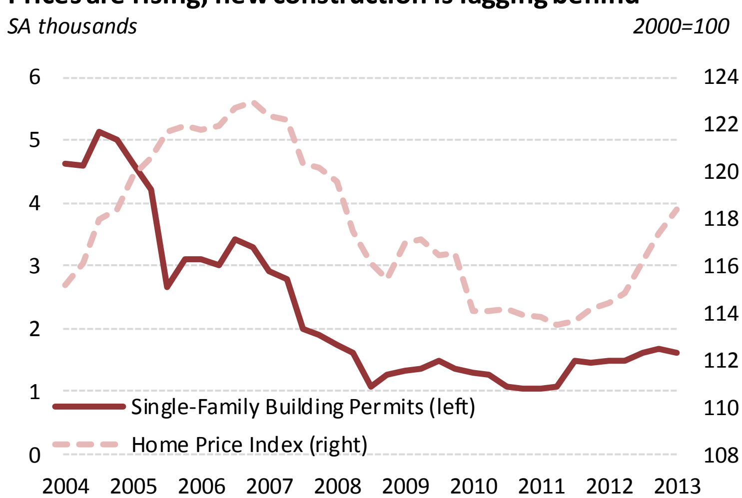
Note: Values are percent change from one year ago. Arrows indicate a significant (± 1 standard deviation) change from the previous quarter; see appendix for notes and sources.

Home Prices Are Moving Up

By Li Li, *Senior Research Associate*

> *"The residential housing market will continue to improve, albeit at a reduced pace until the spring of 2014. Single-family foreclosures and short sales will decline steadily until the inventory of distressed properties clears the system."*
>
> — Louisville area contact
>
> *"The local market is cursed with too much rental and home values that are static at the very best."*
>
> — Central Kentucky area banker

Prices are rising; new construction is lagging behind



Source: CoreLogic and Census Bureau.

- "The overall residential market is going back to the pre-recession level," said a regional contact in Louisville. The home price index in the third quarter has returned to the level in the third quarter of 2005. Anecdotal evidence indicated that as the median and mean home prices have picked up, the listing prices are going up as well.
- New construction has not kept pace with strong demand for single-family housing (see figure). According to contacts, one contributing factor is the weak residential refinancing market after the increase in mortgage rates this summer. Single-family building permits in Louisville dropped by about 5 percent from last quarter.
- The retail real estate market continues to improve. Third-quarter vacancy rates remain as low as the previous quarter. A contact in the Louisville area commented that retailers are looking at sites again to open new units.
- The trend of e-commerce and online retailing is increasing the demand for warehouse space. To catch up with same-day delivery, Amazon.com has a large industrial construction project in Louisville. A contact reported that the overall industrial market in south Indiana has also improved.

Non-residential market (Louisville, Q3-13)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	4.4	15.7	9.8	5.5
Asking rent *Percent change from one year ago*	2.2 ▼	1.2	1.1 ▼	4.0

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

Residential market (Q3-13)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	3.4	-4.8 ▼	-1.9	3.4	11.8
Single-family building permits	8.3	-11.6	5.0	-8.2	23.3
New and existing home sales	18.1	--	--	--	11.4

Note: Values are percent change from one year ago. Arrows indicate a signficant (±1 standard deviation) change from previous quarter. See appendix for notes and sources.

Consumers Continue to Shed Debt

By Bryan Noeth, *Policy Analyst*

"Most households continue to hold off on purchasing large-ticket items and… taking on additional debt… At some point, [these items] will need to be replaced, and houses will...need to be updated... that is the only reason we hope to see some uptick in lending activity."

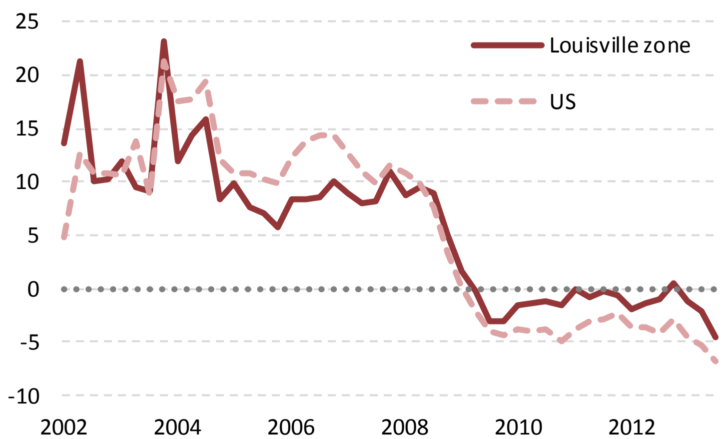
– Louisville area banker

"The enthusiastic acceptance of the new models is a foundation for optimism in the luxury import segment of the automotive industry...This is demand-driven growth fueled by the feeling of optimism among affluent clients."

– Louisville area auto dealer

Homeowners continue to deleverage

Average mortgage debt, percent change from one year ago



Source: FRBNY Consumer Credit Panel, Equifax

- Income growth in the Louisville zone was slow in the second quarter. Income grew at 2.4 and 1.8 percent in Indiana and Kentucky, respectively, over the year.
- Households continued to repair balance sheets. Credit card debt was down across the zone (see table), continuing a lengthy trend of consumer debt deleveraging. Anecdotal evidence suggests that households are still weary of purchasing big ticket items.
- While yearly growth was still positive across the zone for auto loans, this growth was much lower than the same time last year. Dealers say that uncertainty has kept potential buyers at bay. Although, anecdotal evidence suggests higher-end vehicle sales have been strong in October and November.
- Households across the zone and the nation on average lowered their mortgage debt in the third quarter of the year (see figure). Low demand for mortgages and homeowners paying down existing mortgages were potential reasons bankers cited for the decrease.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q2-13)	--	2.4	1.7	1.9
Per capita debt balances (Q3-13)				
Mortgage	-4.7	-5.4 ▼	-4.8 ▼	-6.8
Credit card	-5.1 ▼	-8.4 ▼	-7.4 ▼	-5.4 ▼
Auto loan	3.9 ▼	5.1 ▼	2.8 ▼	4.3
90+ day delinquency rates (Q3-13) (%)				
Mortgage	2.2 ▼	2.6 ▼	2.2 ▼	3.8 ▼
Credit card	6.4	7.2	7.0	9.1
Auto loan	2.6	3.1	3.1	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.

Louisville Zone Bankers More Optimistic About Loan Demand

By Michelle Neely, *Economist*

"We are just now starting to really come out of the recession and it is beginning to show in loan demand."

– Southern Indiana banker

"We've seen overall improvements in appraised values (outside of southern Indiana), allowing borrowers to refinance for a better rate or term and even take cash out on the property."

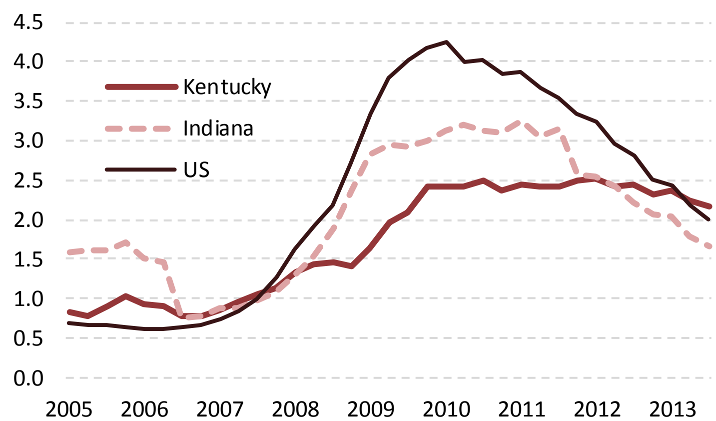
– Louisville area banker

"Commercial lending is picking up. New car loans are stronger. Deposits are solid, although low interest rates are keeping profit margins modest."

– South central Kentucky banker

Nonperforming loans still trending down

Nonperforming loan ratio at commercial banks, percent



Source: FRED.

- Most Louisville zone bankers surveyed expect steady to improving loan demand over the first half of 2014, and all bankers responding indicated they expect the creditworthiness of borrowers to stay the same or improve in that time period.
- Earnings were basically flat on average at Indiana and Kentucky banks in the third quarter. Nevertheless, Indiana banks continued to outperform their District and U.S. peers.
- Increases in net interest margins and reductions in loan loss provisions were offset by increases in net noninterest expenses at banks in the two states, resulting in a slight decline in return on average assets (ROA) in Kentucky and no change in Indiana.
- Loan quality improved again in the third quarter in both states. The ratio of nonperforming loans to total loans declined 7 basis points in Kentucky to 2.17 percent, while the nonperforming loan ratio fell 14 basis points to 1.66 percent in Indiana. A reduction in nonperforming real estate loans was largely responsible for the asset quality improvement in both states. Coverage ratios—loan loss reserves divided by nonperforming loans—also rose in both states.

Banking performance (Q3-13)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	0.89 ▼	1.09	0.94	1.01
Net interest margin	3.86	3.76	3.74	3.85
Nonperforming loans / total loans	2.17	1.66	1.95 ▼	2.01 ▼
Loan loss reserve coverage ratio	75.12	98.80	79.89	85.07

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

2013 Harvest Characterized by Extraordinary Corn and Soybean Production

By Lowell R. Ricketts, *Senior Research Associate*

"We couldn't have asked for a better year. We could see the potential of the seed technology and the land. The ingredients were there and it played out better than we could ever have hoped."

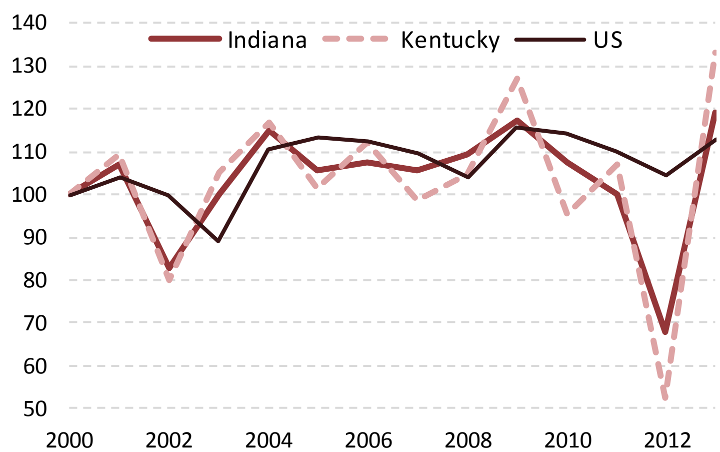
— Southwest Kentucky farmer

"Cooler temperatures and adequate rainfall has made everybody's crop really good."

— Western Kentucky farmer

Corn yields bounce back to historic highs

Index, 2000=100



Source: USDA/NASS.

- Agricultural bankers surveyed in the zone expect some positive developments in the fourth quarter relative to the same time last year. Bankers surveyed expect available funds and loan repayments to increase over last year values. Bankers expect levels of loan demand, farm income, and capital expenditure to be similar to levels seen last year.
- The corn and soybean harvests exceeded expectations with record production and yields (see table). The gains recorded for corn production in Kentucky and Indiana greatly exceeded those of the nation. The soybean harvest for these two states was also exceptional, with an average gain of 26 percent, double that of the gain nationally.
- Corn farmers have been on a roller coaster ride with regard to yields over the past couple of years (see figure). The 2012 corn crop for the region was decimated by drought and had some of the worst yields seen in recent history. This year's harvest was the exact opposite, with cooler growing temperatures and record yields.
- The consistent decline in Kentucky mining and logging employment (see table) has continued to taper off in the third quarter. Additionally, Kentucky coal production was close to 7 percent greater than during the same quarter last year.

	Indiana	Kentucky	US
Natural resources (Q3-13)			
Mining and logging employment	2.4	-8.3 ▲	3.3
Coal production	3.3	6.7 ▲	1.8
Production (2013)			
Corn	69.1 ▲	137.8 ▲	29.8 ▲
Cotton	--	--	-24.3
Rice	--	--	-5.4
Sorghum	--	--	68.3
Soybean	14.5	36.7	7.4

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

Table Sources

Bureau of Labor Statistics

Manufacturing employment: total, durable, and nondurable goods.

Bureau of Economic Analysis

Manufacturing earnings: total, durable, and nondurable goods.

Notes

Real manufacturing exports are defined as total dollar amount of exports by the manufacturing industries, deflated by the chained price index for exports of goods and services.

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).

Manufacturing earnings is the sum of wage and salary disbursements, supplements to wages and salaries, and proprietors' income less contributions for government social insurance.

Real Estate and Construction

Table Sources

CoreLogic

Home price index, including distressed sales.

Census Bureau

Year-to-date single-family building permits.

National 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 geographical 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.

Census Bureau

Homeownership rates.

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.

Homeownership rates are the proportion of households in each area that are owners. It is calculated by dividing the number of households that are owners by the total number of occupied households.

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 non performing 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 expenditures 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.

USDA

Crop production, August forecast