



Burgundy Book

A report on economic conditions in the Louisville zone

First 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.

Louisville Experiences Healthy Growth; Business Contacts Remain Optimistic

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

Business contacts in the Louisville zone remain an optimistic bunch. A February survey suggests 60 percent of contacts expect economic conditions in 2014 to be somewhat better or better than last year; only 12 percent expect that conditions will be worse or somewhat worse.

In the fourth quarter of 2013, nonfarm employment in the Louisville MSA exceeded the nation's growth for the seventh consecutive quarter. Owensboro registered both stronger employment growth and a lower unemployment rate than Louisville and the nation.

The Louisville zone's unemployment rate averaged 7.5 percent in the fourth quarter, down modestly from its third-quarter average (7.7 percent).

Residential construction activity and home sales posted solid gains in most areas. However, house price growth lagged the national rate; increasing by about 3 percent in Louisville and Evansville in 2013 and declining in both Clarksville and Elizabethtown.

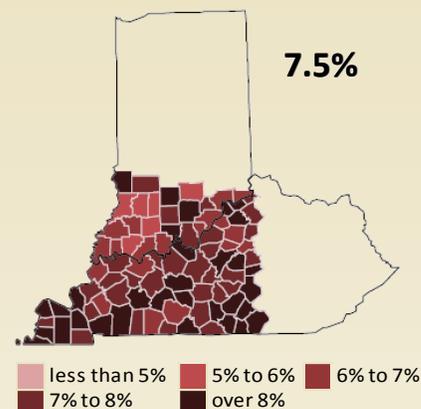
Indiana's per capita income growth slowed modestly in the third quarter, while Kentucky's growth picked up at a healthy rate from a year earlier. Indiana and Kentucky households reduced their credit card balances at a rapid rate in the fourth quarter.

Fourth-quarter profits (return on average assets) at Kentucky and Indiana banks were essentially unchanged from the third quarter. Although Indiana banks were more profitable than their Eighth District peers in the fourth quarter, Kentucky banks were less profitable.

Lower commodity prices have put pressure on farm incomes. Indiana and Kentucky coal production in the fourth quarter was up sharply from a year earlier.

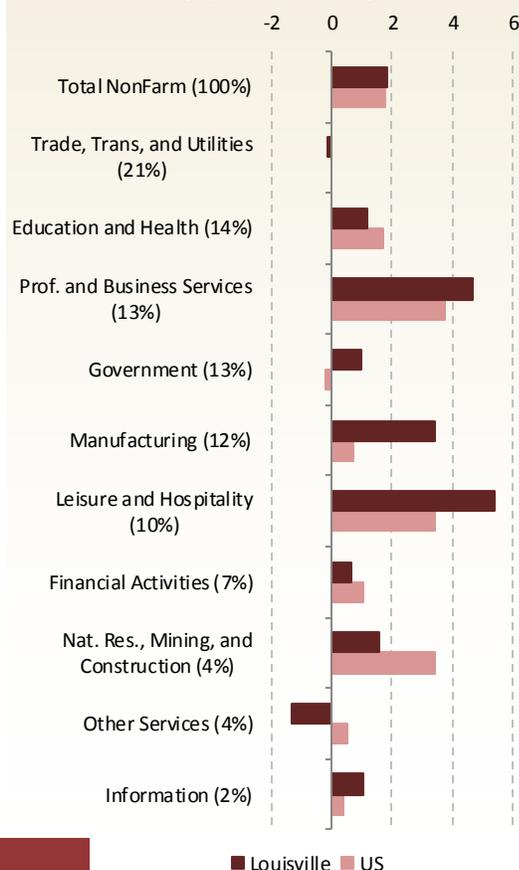
Data Snapshot

County unemployment rates (SA, Q4-13)



Nonfarm payroll employment by industry

Percent change from one year ago (Q4-13)



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 February 1 and February 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.

Employment in the Louisville Zone Remains Above National Average

By Brian Greaney, *Research Associate*

“Still unsure about the housing recovery. Is it really recovering in our area? Additionally, still unsure how health care costs are going to impact us.”

—Louisville area construction company owner

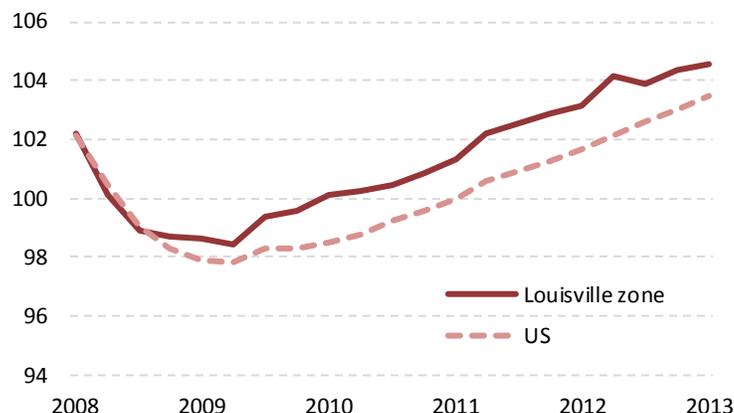
“Business spending remains somewhat tepid amidst continued concerns over tax policies, government spending, debt ceiling negotiations, and government regulations on businesses both large and small. The inability to comprehend the full impact of health care costs in the future has sidelined business expenditures in the near term.”

—Louisville area real estate broker

- The unemployment rate in four of the zone’s five MSAs decreased relative to the previous quarter. The exception was Elizabethtown, where the unemployment rate remained unchanged.
- The decline in the zone’s unemployment rate was at least partially driven by an increase in economic activity, as reflected in employment (see table). Evansville had the largest decline in its unemployment rate (0.5 percent) and was the only MSA to experience a significant decline.
- While there was mixed employment growth relative to the national average across MSAs, the zone’s overall labor market continues to outpace the national average (see figure). Anecdotal evidence suggests modest employment growth is likely during the next year: 36 percent of business contacts expect employment to increase, while 55 percent of contacts expect it to remain unchanged.
- Year-over-year growth in average hourly earnings of employees was below the national average of 2.1 percent in all of the MSAs except for Evansville, where it was 2.5 percent. Wages declined moderately in the Louisville MSA by 2.1 percentage points. Anecdotal evidence suggests that this trend may reverse in the upcoming year: 55 percent of business contacts expect wages to increase in the next 12 months, while only 3 percent of contacts predict a decline.

Local labor market still stronger than the nation

Nonfarm payroll employment, SA (Index 2007=100)



Source: BLS.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q4-13) (%)	7.7	6.8 ▼	7.2	7.7	6.8	7.0
Nonfarm employment (Q4-13)	1.9	-0.4	1.5	0.1	2.6	1.8
Goods-producing sector	3.0	-1.4	0.0	2.6	-0.3	1.7
Private service-providing sector	1.8	0.3	1.3	0.1	3.6	2.2
Government sector	1.0	-2.4	3.5	-1.4	2.2	-0.2

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.

Automotive Sector Continues To Drive Manufacturing Growth

By Yang Liu, Senior Research Associate

“I expect to see continued localization of vehicles and parts. This will help keep the local automotive suppliers’ business robust and aggressive through 2015.”

— Louisville area maintenance service executive

“The new demand for aluminum [from automotive sectors] will catalyze a series of investments which will be substantial for the region and state.”

— South central Kentucky manufacturer

Manufacturing employment remained strong despite recent slowdown

Louisville MSA, percent change from one year ago



Source: BLS.

- Anecdotes suggest automobile manufacturers are expanding in the Louisville area. According to government statistics, each new automotive job generates 0.9 spin-off jobs in the Louisville area (see appendix).
- Our contacts suggest that cold weather disrupted production in south central Kentucky in January and February. For example, a food manufacturer lost a significant amount of inventory due to a power outage. Other manufacturers saw the cost of natural gas rise significantly.
- Manufacturing employment has grown for 3 years in a row. The growth slowed since mid-2012, but it bounced back a little in the fourth quarter of 2013. Louisville’s nondurable goods sector contracted 2.3 percent, but the durable goods sector remained strong (see figure).
- Kentucky’s manufacturing employment dropped slightly during the fourth quarter. A contraction in the nondurable goods sector was the driving factor. Indiana’s manufacturing employment grew 0.6 percent, just below the national rate (see table).
- Kentucky’s manufacturing exports increased 23.7 percent, significantly higher than the previous quarter and the national average (see table). Exports of transportation equipment were the major contributor.
- Indiana’s manufacturing exports dropped by 2 percent compared with a year ago (see table). Declines in chemical and nonelectrical machinery exports were the driving factors.

	Louisville	Kentucky	Indiana	US
Manufacturing employment (Q4-13)	3.5	-1.2	0.6	0.7
Durable goods	6.5	0.3	0.6	1.1
Nondurable goods	-2.3	-3.8 ▼	0.7	0.0
Manufacturing exports (Q4-13)	--	23.7 ▲	-2.1	3.2

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.

2013 Ended with Gains but Snow Mitigated Home Sales in the Start of 2014

By Li Li, Senior Research Associate

“The weather has definitely impacted December and January sales, so I am expecting a spring bounce.”

— Louisville area builder

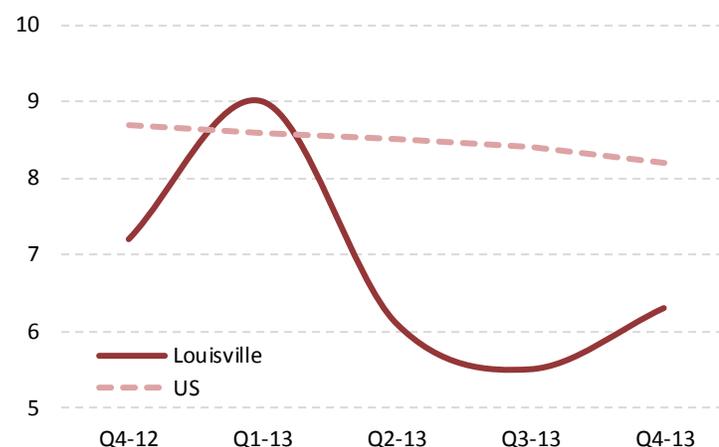
“Spec home loans are still very soft and our standards are still tight for any new builders. Refinancing has slowed down and competition for purchase financing is strong.”

— Louisville area banker

- The residential housing market finished with gains in 2013. Home sales in Louisville were up by about 16 percent compared with 2012—the best sales volume since 2006 (see table). A contact noted that the rise in prices was driven by low inventories. At the same time, home buyers and investors are cautious because of the concern over higher interest rates in 2014.
- The growth of single-family building permits stabilized in 2013. However, current construction activity is weak. With the severe weather in the beginning of the year, homebuilder confidence for new single-family homes dropped in February.
- The industrial market performed well in 2013: Leasing activities have increased. Over the past year, vacancy rates declined significantly compared with nation (see figure). Positive growth of existing companies in Louisville was said to be the leading factor. Contacts predict that 2014 will be another great year for this segment. As future growth is expected, contract and speculative construction activities have increased.
- Construction showed activity in both multifamily commercial sectors. South central Kentucky saw new construction for multifamily units. Hardin County, Kentucky, also enjoyed a busy commercial construction season.

Industrial vacancy rates drop below national rates in 2013

Vacancy rates, percent



Source: Cassidy Turley.

Non-residential market (Louisville, Q4-13)

	Apartment	Office	Retail	Industrial
Vacancy rate (%)	4.5	15.7	9.6	6.3
Asking rent	2.3	1.3	1.1	19.7
Percent change from one year ago				

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

Residential market (Q4-13)

	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	3.2	-8.8	-1.1	3.0	11.5
Single-family building permits	8.2	-10.7	17.6	0.8	20.1
New and existing home sales	16.3	--	--	--	9.0 ▼

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.

Households Shedding Credit and Mortgage Debt While Buying Cars

By Elise A. Marifian, *Research Associate*

“There is a substantial upswing in the Bowling Green area, with major retailers opening in the past few months and more nearing completion. Numerous new restaurants are nearing completion and job fairs have been held to support needed hiring.”

– Louisville zone contact



Source: BLS.

- Per capita personal income grew slightly in the third quarter in Indiana and Kentucky. Relative to one year ago, incomes are up 1.9 percent in Indiana and 2.8 percent in Kentucky, which is just below the national rate. However, other information suggests that some households may be in worse financial condition in 2013 than in 2012; for instance, a contact reported a significant increase in the number of delinquent water/sewer customers whose service was shut off in the Louisville metro area.
- Credit card and mortgage debt continued to decline across the zone (see table).
- Year-over-year auto loan debt balances, although positive, are slightly lower than in the previous quarter. Dealers noted good sales in December and January and reported consistently low inventories, partly due to a weather-related slowdown in parts deliveries to manufacturers.
- Holiday season retail employment growth was strong in most zone MSAs relative to 2012 (see figure). The exceptions were Bowling Green and Elizabethtown; however, anecdotal evidence indicates a possible turnaround in Bowling Green for the upcoming year.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q3-13)	--	1.9	2.8	2.9
Per capita debt balances (Q4-13)				
Mortgage	-4.1	-3.7	-4.1	-4.8 ▲
Credit card	-4.7	-5.6 ▲	-5.3 ▲	-4.9
Auto loan	3.3	3.8	2.5	4.4
90+ day delinquency rates (Q4-13) (%)				
Mortgage	2.2	2.4	2.2	3.5 ▼
Credit card	6.5	7.3	7.0	9.1
Auto loan	2.8	3.2	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 See Some Uptick in Economic Activity

By Michelle Neely, *Economist*

“Overall economic activity seems to be increasing slowly. Automotive orders have picked up significantly across the board, which has helped many of our local industries that support automotive.”

—Western Kentucky banker

“We have seen some loan growth, but the banks are taking business from each other. Not many new projects are going through planning and zoning meetings.”

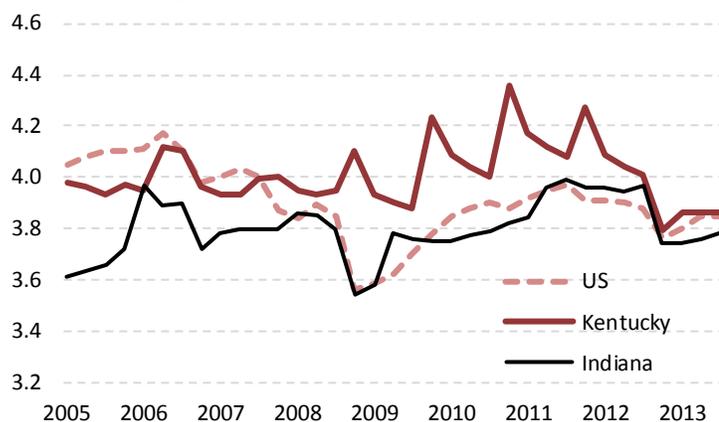
—Southern Indiana banker

“Bankers are hearing from customers regarding flood insurance premiums due to changes in the Flood Insurance Program. Flood insurance premium shocks continue to be felt by borrowers whose homes require flood insurance.”

—Louisville area banker

Net interest margins inching up

Net interest margin at commercial banks, percent



Source: FRED.

- Most Louisville zone bankers surveyed expect loan demand and the creditworthiness of borrowers to be unchanged in the first half of 2014.
- Earnings ratios changed little, on average, at Indiana and Kentucky banks between the third quarter and year-end 2013. Indiana banks' average return on average assets (ROA) exceeds District and US peer levels, while Kentucky banks' average results are lower than District and US peers (see table).
- The trend in ROA largely reflects movements in net interest margins (NIMs). After declining for much of the past two years, margins are steadying or rising slightly (see figure). The average NIM for Kentucky banks at year-end 2013 essentially matched the average for US peers, while Indiana's average NIM was just above the US peer average.
- Nonperforming loans as a percentage of total loans fell sharply between the third and fourth quarters in both Indiana and Kentucky. The nonperforming loan ratio declined 10 basis points to 2.07 percent in Kentucky in the last quarter. In Indiana, the ratio fell 17 basis points to 1.48 percent, an average that is well below the District's average of 1.77 percent and the nation's average of 1.82 percent (see table).

Banking performance (Q4-13)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	0.88	1.09	1.03	1.01
Net interest margin	3.86	3.78	3.77	3.85
Nonperforming loans / total loans	2.07	1.48 ▼	1.77 ▼	1.82 ▼
Loan loss reserve coverage ratio	75.36	103.38	79.89	89.01

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

Record Harvest Slashes Commodity Prices; Decline of Mining Industry Slows

By Lowell R. Ricketts, *Senior Research Associate*

“Those in our region are faced now with a contracted market and prices that are predicted to be below the cost of production. We are looking at an extraordinarily tight situation for 2014.”

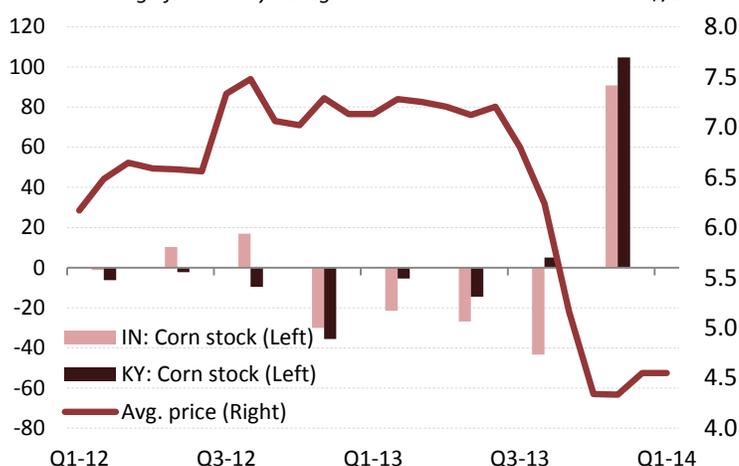
— Central Kentucky Farmer

“Corn prices got too high a couple of years ago, and that wasn’t good for anybody. The biggest problem is that our input costs have gone up. We’ll just have to figure out how to make a living at \$4 per bushel.”

— Southern Indiana Farmer

Corn supplies swell as price hits rock bottom

Percent change from one year ago



Source: USDA/NASS.

- Following a remarkably strong harvest, December 2013 corn inventories almost doubled their size relative to the same time in 2012 (see figure). In response, the average corn price in January for Kentucky and Indiana declined 36.2 percent from a year ago. Inventories may remain high as some farmers have decided to hold on and wait for higher prices.
- Agricultural bankers surveyed in the zone expect mostly positive developments in the first quarter of this year relative to the same time in 2013 (see right table). Bankers surveyed expect farm income, as well as the rate of loan repayment and the supply of loanable funds, to increase. In contrast, more respondents expect loan demand to fall relative to the same time last year.
- Kentucky coal production increased relative to a year ago for the first time since the third quarter of 2011 (see left table). However, payroll employment in the industry continued to decline in the fourth quarter of 2013, albeit at the slowest rate since the second quarter of 2012.
- Annual red meat production in Kentucky was close to 30 million pounds less than in the previous year (see left table). Indiana has over three times the total production of Kentucky and the two states combine for around 5 percent of total U.S. production.

	Indiana	Kentucky	US
Natural resources (Q4-13)			
Mining and logging employment	5.3	-4.2 ▲	4.3
Coal production	7.2	7.0 ▲	0.5
Red meat production (2013)	0.5	-5.4	-0.5
Share of national production	3.6	1.1	100
Winter wheat, area planted (2014)	-8.5 ▼	-14.3	-2.8

Note: Values (except for production shares) 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.

Louisville zone Ag. bankers' expectations Q1-14 vs. Q1-13

	Lower	Higher	Net
Loan demand	17	0	-17
Available funds	0	17	17
Loan repayments	0	33	33
Farm income	0	33	33
Capital expenditure	17	17	0

Note: Percentage of responses. 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.

World Institute for Strategic Economic Research

Manufacturing exports: dollar value, and metric tons.

Notes

Manufacturing exports are defined as the total dollar amount of exports by the manufacturing industries.

Bureau of Labor Statistics RIMS II multipliers show that each additional job in the motor vehicle, body, trailer and parts manufacturing industry will generate 0.9235 new jobs in the Louisville MSA.

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.

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 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 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 National Agricultural Statistics Service (USDA/NASS)

Red meat production and winter wheat plantings.