



# Burgundy Book

A report on economic conditions in the Louisville zone

First Quarter 2015

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.

## Robust Transportation and Manufacturing Fuel Rising Optimism in Louisville Zone

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

According to a February survey of business contacts, a little less than three-quarters of contacts expect local economic conditions in 2015 to be better than they were in 2014. However, some manufacturers have fretted about the recent rise in the foreign exchange value of the dollar.

In the fourth quarter of 2014, total nonfarm payroll employment in the Louisville MSA increased by 3.2 percent. Employment growth was modestly weaker in Bowling Green, Evansville, Elizabethtown, and Owensboro. Kentucky benefited from strong growth of transportation employment and manufactured exports in the fourth quarter. Indiana registered slightly stronger growth of manufacturing employment, but weaker export growth.

The Louisville zone's unemployment rate averaged 5.5 percent in the fourth quarter of 2014, its lowest rate since the first quarter of 2008. Across the MSAs, unemployment rates ranged from 5 percent in Owensboro to 5.7 percent in Louisville.

Residential real estate activity slowed in the Louisville MSA in the fourth quarter, but it was generally stronger in other MSAs. Office vacancy rates fell sharply in the fourth quarter in the Louisville MSA.

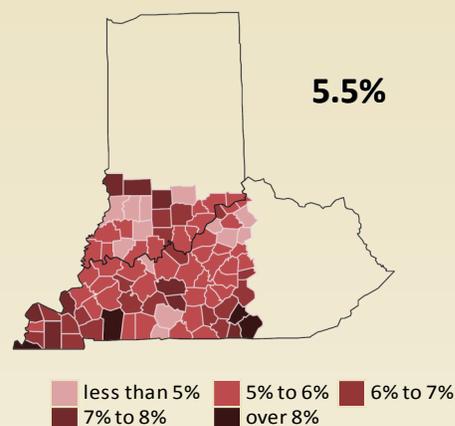
In the fourth quarter, auto loan delinquencies surged in the nation but remained unchanged in the Louisville zone.

A February survey of bankers suggests that loan demand in early 2015 is little changed from a year earlier. Indiana commercial banks outperformed their Kentucky counterparts in the fourth quarter of 2014.

Kentucky pastureland values rose at a healthy rate in 2014. Indiana's coal production in 2014 registered its second-highest total since data have been available.

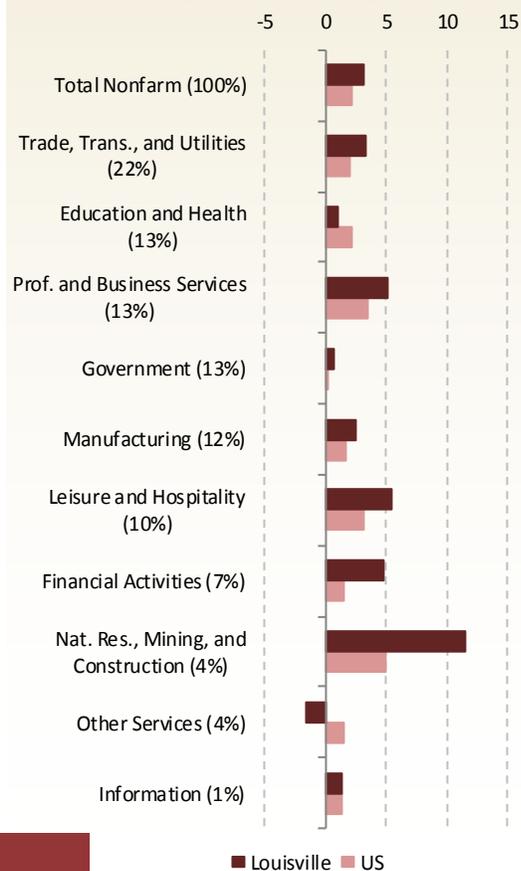
### Data Snapshot

#### County unemployment rates (SA, Q4-14)



#### Nonfarm payroll employment by industry

Percent change from one year ago (Q4-14)



## 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 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/outlooksurvey>

or email us at [beigebook@stls.frb.org](mailto:beigebook@stls.frb.org).

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

## Higher Competition for Laborers Driving Wages

By Maria A. Arias, Senior Research Associate

*"Competition for employees due to the improved economy has increased hourly pay."*

— Louisville area commercial banker

*"Our highly educated technical employees are leaving the profession for more lucrative career opportunities so the need to keep salaries high is a constant pressure."*

— Louisville area business contact

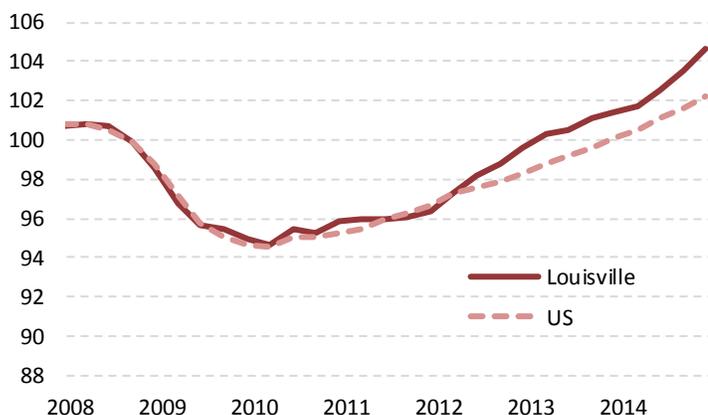
*"The tight labor market, especially in skilled labor, has a larger portion of the workforce now looking to take advantage of demand and get higher pay."*

— Louisville area manufacturer

- Business contacts surveyed in the Louisville zone have a generally positive outlook about the labor market for the first half of 2015, though several contacts cited concerns about the limited availability of skilled labor.
- Labor market performance in Louisville improved during the fourth quarter, with all sectors growing faster than the national pace (see table). Employment growth picked up from the previous quarter, and total employment levels have surpassed the pre-recession high (see figure).
- Goods-producing employment growth continued to outpace the nation in most MSAs, driven by strong growth in the logging, mining, and construction industries.
- The zone's average unemployment rate finished 2014 below the national level with significant declines in most of the zone's MSAs (see map on cover and table).
- Wages increased in all of the zone's MSAs during 2014 relative to 2013. Hourly wage gains ranged from 0.4 percent in Elizabethtown to 8 percent in Bowling Green (compared with a 2 percent average increase nationally). With consumer prices growing at a slower pace, real wages increased in most metro areas.
- Anecdotal information suggests wages continued to increase slightly throughout the first quarter.

### Louisville employment levels surpassed pre-recession high

Nonfarm payroll employment, SA (Index 2008=100)



Source: BLS.

	Louisville	Evansville	Bowling Green	Elizabethtown	Owensboro	US
Unemployment rate (Q4-14) (%)	5.7 ▼	5.2	5.1 ▼	5.6 ▼	5.0 ▼	5.7 ▼
Nonfarm employment (Q4-14)	3.2 ▲	2.6	2.1	1.9	0.9 ▲	2.1
Goods-producing sector	4.9	10.0	3.5	7.9	1.8	2.9
Private service-providing sector	3.3 ▲	0.7	2.2	2.3	1.1 ▲	2.4
Government sector	0.8	1.0 ▼	0.0	-2.1	-1.4	0.3

Note: Unless otherwise noted, values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

Exports from Kentucky Increase; Contacts Anticipate Challenges Ahead

By Daniel Eubanks, Research Associate

*“The two big risk issues for us are labor availability and costs and the impact of the dollar on our price overseas.”*

– Louisville area manufacturer

*“The biggest impact on us comes from economic weakness in Europe and Asia, as well as big increases in the US dollar making our products significantly more expensive in Asia, Canada, Australia, and Europe.”*

– Louisville area manufacturer

**Manufacturing exports surge ahead in Kentucky**

Real export value, SA (Index 2010Q1 = 100)



Source: Census Bureau.

- Kentucky continues to outpace the nation in manufacturing export growth (see figure). Indiana’s export growth rate slowed significantly from the previous quarter, but it also continues to exceed the national rate (see table). Contacts anticipate that the strong dollar and economic weakness abroad could reduce exports in the coming quarters.
- Some contacts have expressed concern that the strong dollar will reduce demand for domestic products, particularly metals.
- Durable goods manufacturing remains a bright spot in the Louisville zone. Durable goods employment in Kentucky and Indiana has grown faster than the national pace for the past two years, driven by strong growth in automobiles.
- Overall manufacturing employment growth in the Louisville zone was above the U.S. average. In Kentucky, strong durable goods employment growth was tempered by a contraction in nondurable goods.
- Transportation sector employment in Kentucky grew at its fastest pace in over a decade. Transportation employment in Louisville, which is equivalent to nearly half of transportation employment in the state, grew at its fastest pace since 2011. Both rates exceeded the national average by a wide margin.
- Some manufacturing contacts have reported increasing wages in response to tight labor market conditions (see quotes).

	Louisville	Kentucky	Indiana	US
Transportation employment (Q4-14)	6.2	6.0	3.7	3.8
Manufacturing employment (Q4-14)	2.5	2.2	3.3	1.7
Durable goods	3.3	4.1	3.2	2.4
Nondurable goods	1.1	-1.0 ▼	3.5	0.7
Manufacturing exports (Q4-14)	--	10.2	1.6 ▼	1.1

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

## Apartment Completions in Louisville Reach Record High in 2014

By Diana Cooke, Senior Research Associate

*“We’re not really getting overlooked as I think we once were.”*

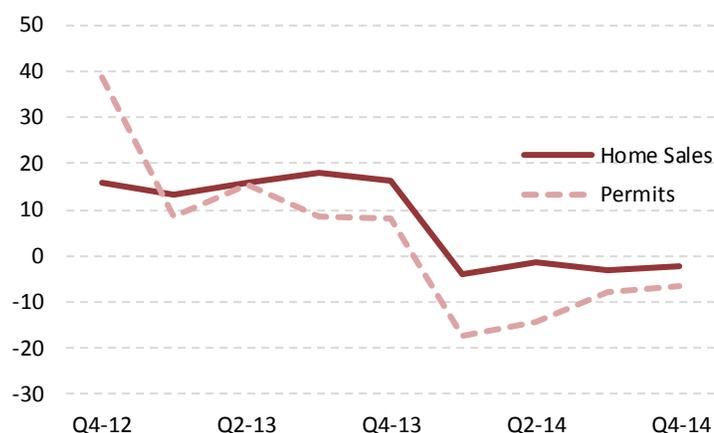
— Louisville area commercial developer

*“Regulations are increasing the cost to build new; there has been a more intense look into existing buildings.”*

—Louisville area business contact

### Home sales and permits continue to decline in Louisville

Percent change from a year ago, year-to-date.



Source: See appendix.

- Activity in the residential market was mixed across the Louisville zone. In the Louisville MSA, both single-family building permits and home sales decreased from one year ago (see figure). Single-family building permits increased in the other major MSAs in the zone.
- Business contacts in the Louisville area partially attribute the slow housing market to low levels of inventory. Considering low interest rates, many people are opting to refinance and improve their current home rather than move.
- Despite a sluggish quarter, signs of improvement continue in the residential real estate market. A developer recently undertook the development of two previously uncompleted and foreclosed condo complexes in the Louisville area.
- The industrial real estate market was strong in the fourth quarter. Asking rents increased 8.1 percent and vacancy rates decreased 9.5 percent from the same time last year.
- The apartment and retail markets remain strong. The number of apartment completions in 2014 was 6 times larger than the number in 2013. An outlet mall in Shelby County is expanding after just five months in operation.

Non-residential market (Louisville, Q4-14)	Apartment	Office	Retail	Industrial
Vacancy rate (%)	5.7	15.1 ▼	9.2	5.7
Asking rent	3.6	0.4	2.8	8.1

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 (Q4-14)	Louisville	Clarksville	Elizabethtown	Evansville	US
CoreLogic Home Price Index	3.7	0.3	-0.6 ▲	3.4	5.1
Single-family building permits	-6.7	4.8	13.0	9.9	2.1
New and existing home sales	-2.1	--	--	--	-2.8

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 previous quarter. See appendix for notes and sources.

## Low Oil Prices Affect Auto Market, Increase Consumer Spending on Entertainment

By Peter B. McCrory, Senior Research Associate

*“The consumer is using this additional cash flow [from lower oil prices] to increase entertainment purchases, dining, and some larger-ticket items.”*

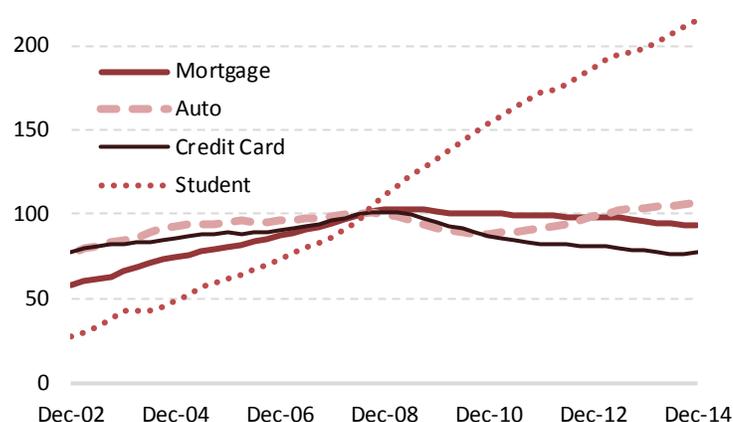
— Southern Indiana banker

*“[Lower fuel prices] are making it more challenging to sell the hybrid and electric models.”*

— Elizabethtown area auto dealer

### Student loan balances grow with no sign of abating

2008 = 100



Source: FRBNY Consumer Credit Panel and Equifax.

- Personal income growth accelerated in Indiana and Kentucky in the third quarter of 2014 (see table). Largely because of low gasoline prices, inflation slowed in the fourth quarter. Taken together, these two trends imply that real personal income likely grew at a brisk pace in the latter months of 2014.
- Mortgage, auto, and credit card debt balances—when viewed over a 12-year horizon—were and continue to be relatively flat when compared with student loan balances. Per capita student debt was twice as high in 2014 as it was in 2008 (see figure). In the fourth quarter, zone households held \$3,700 in student loans per person.
- Delinquency rates for mortgage, credit card, and auto debt balances were unchanged in the fourth quarter across the Louisville zone. However, across the nation and in every other zone in the Eighth District, auto delinquencies were up significantly in the fourth quarter (see table).
- Multiple auto dealers in the Louisville zone report lower demand for fuel-efficient cars, which they attribute to the recent decline in gasoline prices.

	Louisville Zone	Indiana	Kentucky	US
Per capita personal income (Q3-14)	--	2.5	3.7	3.2
Per capita debt balances (Q4-14)				
Mortgage	-0.9	-1.4	-0.8	-0.4
Credit card	2.3	1.1	2.1	0.7
Auto loan	5.8 ▲	7.5	6.1	8.8
90+ day delinquency rates (Q4-14) (%)				
Mortgage	1.7	1.9	1.8	2.6
Credit card	5.7	5.9	6.1	7.0
Auto loan	2.9	3.5 ▲	3.3	3.3 ▲

Note: Unless otherwise noted, values are percent change from one year ago. Arrows indicate a significant ( $\pm 1$  standard deviation) change from the previous quarter. See appendix for notes and sources.

## Bankers Look to Commercial Lending to Buoy Margins, Profits

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

*“The improving economy is positively influencing business lending in my area.”*

—Central Kentucky banker

*“With consumer purchasing increasing, local businesses are expanding inventory, but not necessarily creating major overhead with new buildings, etc.”*

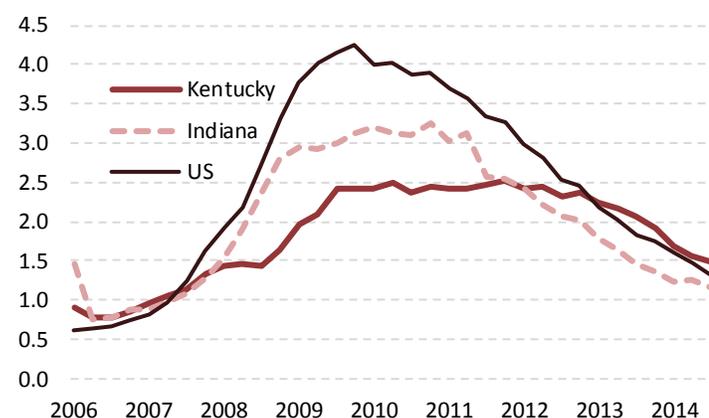
—Southern Indiana banker

*“Low interest rates continue to drive [construction in] the residential housing market for both single family and apartments.”*

—Louisville area banker

### Asset quality returns to pre-crisis levels

Nonperforming loan ratio at commercial banks, percent



Source: FRED.

- Most area bankers surveyed indicate loan demand has been and is expected to remain unchanged in the first half of 2015 when compared with one year ago. Some contacts predict loan demand will be somewhat higher in the second quarter.
- Bankers surveyed report that first-quarter demand for business lending is unchanged to slightly higher compared with one year ago; demand increases are attributed to working capital needs rather than large investments.
- Profitability measures moved in opposite directions for banks in Kentucky and Indiana. Return on average assets (ROA) ticked down 2 basis points to 0.94 percent at Kentucky banks in the fourth quarter, while it rose 3 basis points to 1.06 percent at Indiana banks.
- Net interest margins (NIMs) changed little at the state, District, and national levels in the fourth quarter. The average NIM was unchanged in Kentucky and among U.S. peers, while it increased 1 basis point in the District and 2 basis points in Indiana. Although margins have moved around over the past three years, the overall trend has been one of declining margins since mid-2011.
- Asset quality continues to improve at the state and national levels. The ratio of nonperforming loans to total loans is at its lowest level since the start of the financial crisis in the zone, the District, and the nation.

Banking performance (Q4-14)	Kentucky	Indiana	8th District	US Peer Banks
Return on average assets	0.94	1.06	1.09	1.02
Net interest margin	3.82	3.83	3.82	3.85
Nonperforming loans / total loans	1.48	1.15	1.27	1.33
Loan loss reserve coverage ratio	95.27	116.52	113.39	106.02

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

## Kentucky Pastureland Values Gain Some Positive Momentum

By Lowell R. Ricketts, *Senior Research Associate*

*“Improved profitability of beef and dairy farms has had a positive economic impact on the local economy.”*

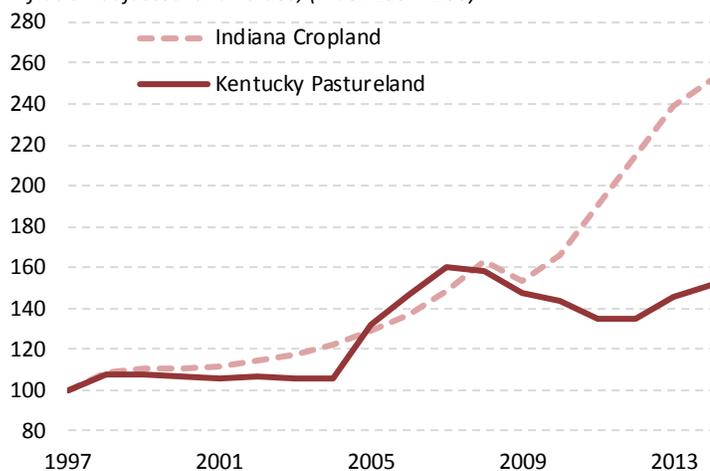
—Central Kentucky feed producer

*“Increasing price of electricity is negatively impacting chicken producers, including contract growers.”*

—Western Kentucky utility operator

### IN cropland and KY pastureland values on the rise

*Inflation-adjusted land values, (Index 1997=100)*



Source: USDA.

- For the second year in a row, pastureland values in Kentucky registered positive growth (3.8 percent). As indicated by comments from a Kentucky feed producer, input costs confronted by ranchers have gone down in tandem with commodity prices. This has been a boon for ranchers and potentially for pastureland values as well. At the same time, cropland values in Indiana increased by 5.3 percent, slower than the 13.1 percent average over the previous three years.
- Coal production in Indiana increased by 8.9 percent and reached its second-highest level since data have been available (see table). This marked a significant shift from a negative rate of growth in the previous quarter. Meanwhile, Kentucky’s production was largely unchanged from the same time last year. Mining and logging employment growth in both states was well below the rate for the nation.
- Winter wheat plantings declined in Indiana much as they have for the rest of the country (see table). Farmers have reduced plantings due to weak prices and a late corn and soybean harvest. Contrary to the trend seen for other states, Kentucky farmers planted slightly more acres of winter wheat in 2015.
- Red meat production was largely unchanged in Indiana and decreased slightly in Kentucky at the end of 2014 (see table).

	Indiana	Kentucky	US
Natural resources (Q4-14)			
Mining and logging employment	0.9	-4.9	4.8
Coal production	8.9 ▲	0.4	4.7 ▲
Red meat production (2014)	0.7	-1.0	-3.7
Share of national production	3.8	1.1	100
Winter wheat, area planted (2015)	-7.7	1.6	-4.6

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.

## 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

**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.

## Banking and Finance

### Table Sources

*Federal Financial Institutions Examination Council*

Return on average assets: USL15ROA. Net interest margin: USL15NIM. Nonperforming loans: USL15NPPL. 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)*

Winter wheat plantings, red meat production, cropland and pastureland values.

*Bureau of Economic Analysis (BEA)*

Consumer price index (used to adjust agricultural land values for inflation).

### Notes

The results of the Federal Reserve Bank of St. Louis *Agricultural Finance Monitor* are not reported due to a low response rate for the Louisville zone.

Total **red meat production** includes: beef, veal, pork, and lamb and mutton production.