MAINST REPORT

Your window into small business health

Q2 2019

About the report

The *Experian/Moody's Analytics Main Street Report* brings deep insight into the overall financial well-being of the small-business landscape, as well as providing commentary around what certain trends mean for credit grantors and the small-business community. Key factors in the *Main Street Report* include a combination of business credit data (credit balances, delinquency rates, utilization rates, etc.) and macroeconomic information (employment rates, income, retail sales, industrial production, etc.).

Executive summary

In spite of business confidence in the second quarter being shaken by talk of trade war escalation, businesses got a helping hand from seasonal factors which combined to push delinquency rates down. New businesses continue to form, providing an opportunity for credit expansion, if these businesses can access credit. Delinquency rates fell across most industries, but agriculture's problems continued as weather and trade conditions continued to weigh on small farms. These factors won't be as helpful in the third quarter so fundamentals or confidence will need to improve to propel performance and growth forward.

	Buckets	Q2 18	Q1 19	Q2 19
Moderately Delinquent	31-90	1.59%	1.74%	1.64%
Severely Delinquent	91+	3.59%	3.35%	3.24%
Bankruptcy	BKC	0.16%	0.16%	0.16%

Small-business credit conditions are positive, but the outlook remains neutral

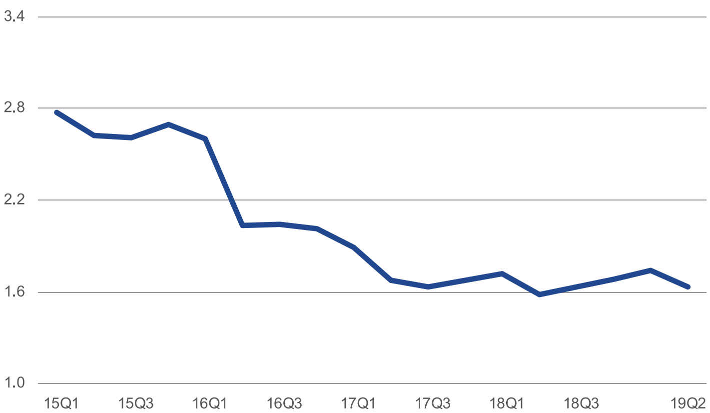
Small-business credit looks set for a shift

There's nothing wrong with getting a little boost. That's exactly what happened this quarter as small business credit enjoyed a little seasonality to push delinquency down. Moderate delinquency rates had risen for 3 straight quarters, a trend which reversed in the second quarter. In spite of business confidence in the quarter being shaken by talk of trade war escalation, businesses got a helping hand from seasonal factors which combined to push delinquency rates down.

Delinquency rates for businesses with fewer than 100 employees fell in the second quarter. The 31–90 days past due (DPD) rate decreased from 1.74 percent to 1.64 percent for the quarter. The strength of the labor market is providing the backdrop in which consumers continue to drive economic growth and demand for the products and services small businesses offer. And while wage pressures exist, they have not taken off as some predictions indicated. Rather, costs have been somewhat contained allowing proprietor income to rise, at least for non-farm businesses. These factors, and others, have combined to form a positive current environment for small business lending.

Second quarter reverses trend of rising delinquency

31-90 DPD for small businesses, % of balance

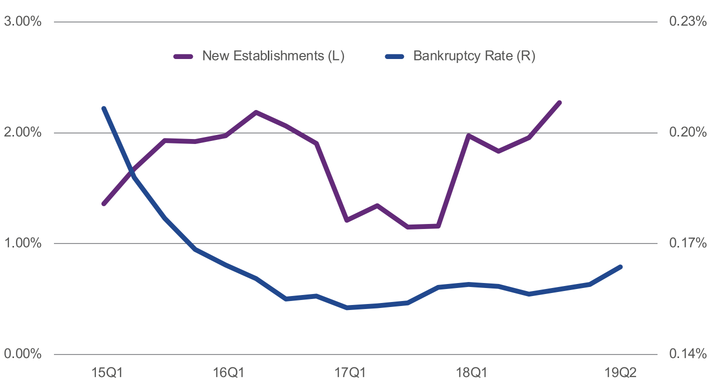


Source: Experian, Moody's Analytics

Bankruptcies at small businesses ticked up ever so slightly again in the second quarter of the year coming in at over 16 basis points. Although bankruptcy rates have left behind the floor they reached at 15 basis points, the current rate is actually a healthier rate. As this rate rises and firms exit the market, new entrants will take the place of these firms. The most recent data available, from the fourth quarter of 2018, indicates an establishment growth rate of 2.3%. Enough of these new firms will seek credit to ensure that, combined with existing borrowers increasing their borrowings, balances will grow for some time yet.

Out with the old, in with the new

Bankruptcy rate and new establishments, % of count and YoY % change

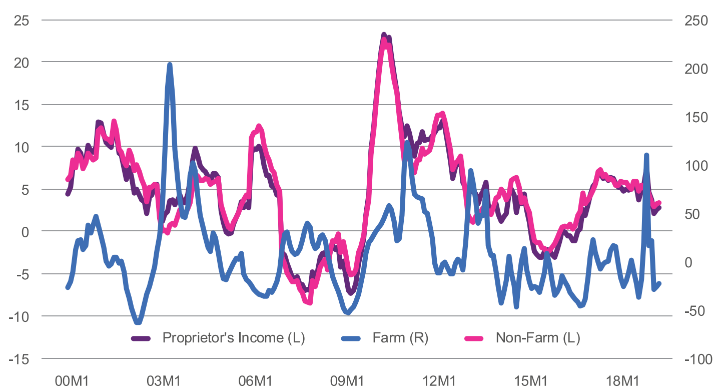


Source: Bureau of Labor Statistics, Experian, Moody's Analytics

Rising incomes have helped to offset the need for excessive lending among firms. As businesses have more income they need to borrow less which furthers their bottom line. With incomes among non-farm businesses having grown steadily for the last three years there has been a reduced need for financing among these businesses. Farm incomes have been on a bumpy ride as commodity prices have fallen. This was a trend that existed prior to the current trade environment, and which has only been aggravated by trade conflicts. Counter to the logic for other industries, Agri-business tends to pull back on spending during periods of lower income rather than lean on borrowing. This could mean that ag borrowing will be low for some time as farmers wait for resolutions on trade policy and commodity prices to rise, to get some certainty about their ability to service borrowings. This serves to depress growth at the moment but is also the reason for agriculture lending having the lowest delinquency rate among the nine major industries covered.

Proprietor's income growth set for Q2 moderation

Proprietor's Income, YoY % change



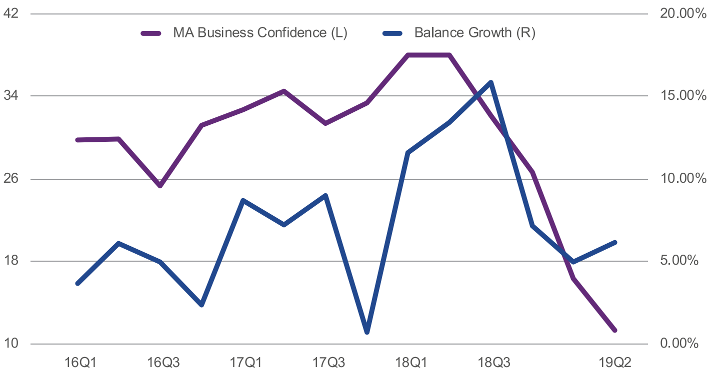
Source: Bureau of Economic Analysis, Moody's Analytics

Shaken confidence could set up a slowdown

The Moody's Analytics Survey of Business Confidence has tumbled over the last year as trade tensions have ratcheted up. As confidence falls so too will business' willingness to invest. This has contributed to lending coming off of the levels seen in 2018 when the fiscal stimulus was in full swing. In the second quarter small business lending balances were up 6.2%.

Balance growth has slowed with confidence…

Bankruptcy rate and new establishments, % of count and YoY % change

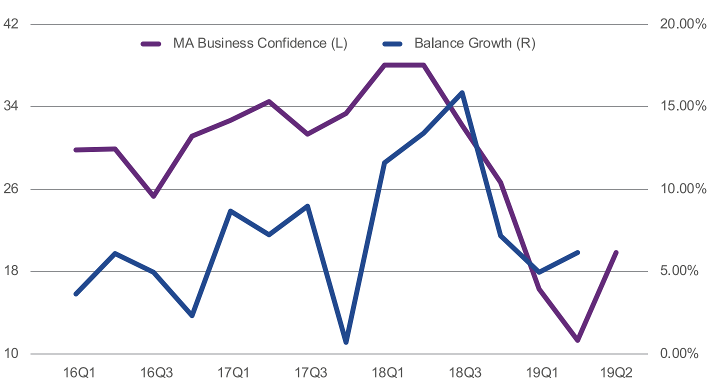


Source: Bureau of Labor Statistics, Experian, Moody's Analytics

However, confidence in July was high as businesses and financial markets anticipate a rate cut by the Federal Reserve to help offset a slowing economy. If this boost to confidence holds throughout the quarter following an interest rate cut by the Fed, it could signal that businesses will again look to increase their borrowing. This will, of course, depend on economic growth continuing. As the fiscal stimulus from tax cuts that juiced growth in 2018 fades, a new source of growth will be needed. Consumer spending may well provide that growth as a modest level of growth is being maintained, after stumbling late last year, which should serve as a source of business confidence as customers continue to spend.

Hope springs from early signs of a rebound in confidence

Bankruptcy rate and new establishments, % of count and YoY % change



Source: Bureau of Labor Statistics, Experian, Moody's Analytics

Seasonality lends a hand

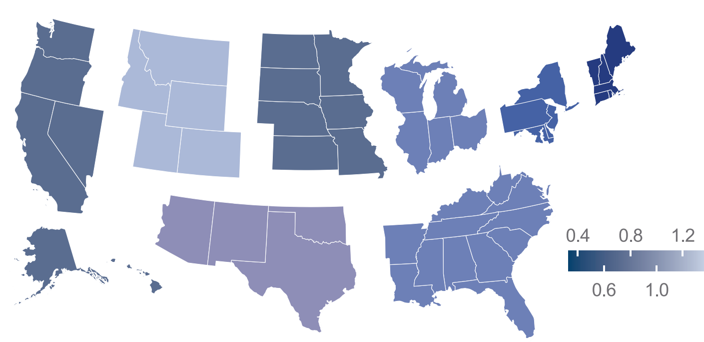
Several of the industries tracked in the small business data have seasonal trends which see their performance improve in the second quarter. Agriculture, Construction, Financial Services, and Retail can all expect a seasonal push into improvement for the quarter, and, for the most part, these industries delivered on that. Only small agriculture businesses saw a rise in delinquency, in the 31-90 DPD measure take a hit for the second quarter. Each of the other industries which get a helping hand from seasonality saw improvement, with seasonal factors actually pushing finance over the line from deteriorating to improving performance.

Trade adds to agriculture's woes

Moderate delinquency rates — defined as 31–90 DPD — came lower across the board in the second quarter. Most regions saw a performance gains which were attributable to businesses in the construction, financial services, and retail industries. We used Bureau of Economic Analysis (BEA) regions in this report to reduce some of the noise that would be observed at the state level from quarter to quarter. This allows us to identify trends that are real and developing, rather than one-off events that may turn out to be false signals. The BEA regions we use are Far West, Great Lakes, Mideast, New England, Plains, Rocky Mountain, Southeast and Southwest.

Prices weigh heavily on farm sector

31-90 DPD rate across all small business credit accounts, % of balance



Source: Experian, Moody's Analytics

Far West: Moderate delinquencies in the Far West held steady in the second quarter, falling to 1.78 percent. Performance was mixed among industries in the region. Though Agriculture fared poorly, rising to a 1.11 percent moderately delinquent rate, from 0.95 percent in the first quarter.

Great Lakes: Credit performance in the Great Lakes region improved in the second quarter, with 31–90 DPD delinquencies falling to 1.61 percent from 1.82 percent in the first quarter. This completely reversed the rise that the region saw in the first quarter. The Great Lakes region has, over the last year, seen severe delinquencies fall at a slower rate than other regions causing the region to move from 3rd to 6th in the 91+ DPD ranking.

Mideast: The Mideast had an ever so mild first quarter improvement with moderate delinquencies falling 13 basis points to 1.63 percent across all industries. The industry details from the first quarter weren't particularly promising for the region, but that appears to have been a short-lived bump in the road. Nearly every industry saw broad improvement across delinquency and bankruptcy for the quarter, the lone exception coming from the mining industry which is the smallest of the nine major industries in the region in terms of both number of firms and balances.

New England: New England's small-business credit performance for the second quarter fell to 1.34 percent from 1.49 percent in the first quarter, and is up one basis point from this time last year. The first quarter's moderate delinquency rate in the region was a mild 1.48 percent. The bankruptcy rate for New England has bucked the national trend and fallen from last year, down to a mere 14 basis points. The Transportation industry was alone in seeing a rise in moderate delinquency in the region as the moderately delinquent rate rose from 0.9 percent to 1 percent.

Plains: The Plains region saw its' 31–90 DPD rate fall to 1.87 percent in the second quarter from 2.17 percent in the first quarter. Unlike the other regions the Plains may have still gotten the ordinary seasonal dip in agriculture delinquency as the rate in the region dropped from 1.06 percent to 0.84 percent. Given the size of this change it is not likely to be maintained, especially considering agriculture is normally the most stable industry and this region has a large exposure to it. Transportation also saw a 20 basis point change as moderate delinquency rose to 1.23 percent. The other industries in the region saw declines in delinquency, particularly construction though this is likely to be a seasonal fluctuation rather than a change in trend.

Rocky Mountain: Moderate delinquencies in the Rocky Mountain region fell in the second quarter, moving from 2.14 to 1.89 percent. This is roughly in line with year ago levels. Delinquency fell across most industries, with financial services the odd man out. Moderate delinquencies rose 15 basis points for the quarter but are almost as far below year ago levels, so this is no cause for concern.

Southeast: The Southeast saw a slight decline in moderate delinquencies for the quarter, moving from 1.37 to 1.33 percent. This effectively offsets the movement of credit performance from the first quarter. Mining showed signs of weakness as balances moved into increasingly delinquent buckets, this caused the severe delinquency rate to rise from 4.4 to 5 percent in the quarter. Mining in the Southeast over the last three quarters is performing worse than at any time since our data begins in mid-2012. Performance in other industries in the region was mixed, but the changes were small or merely offsetting moves from the first quarter.

Southwest: Delinquencies in the Southwest fell in the second quarter to 2.15 percent from 2.2 percent in the first quarter. Retail and Services were the weak spots in the Southwest for the quarter, rising 20 and 17 basis points, respectively. Surprisingly, Agriculture in the region avoided the fate the industry suffered elsewhere, actually falling 4 basis points for the quarter and down 20 basis points from the second quarter of 2018.

Seasonality helps in Q2 but what will help next quarter?

With financial markets increasingly looking to policy makers to cushion the effects of a slowing global economy risks to small business seem to be concentrating around factors outside of their control. Economic fundamentals remain mostly solid, but confidence that this will be sustained in light of trade tensions and the potential for policy missteps is on thin ice.

A likely rate cut by the Federal Reserve will help to alleviate some of the concern in financial markets about a slowing of growth as the effects of fiscal stimulus fade away and a global slowdown appears all but certain. This outcome seemed nearly impossible just a couple of quarters ago and yet now the rate projections have the Fed cutting rates in 2019 and little, if any, movement in 2020. With global tensions running high the impact of any policy misstep could send financial markets into a tailspin.

Another truce was called in the US-China trade war. This led to a slight rebound in business confidence towards the end of the second quarter. If this confidence can be sustained, that is to say, if the trade war comes to an end soon it could lead to revitalized growth in business borrowings, as companies regain the confidence to invest. However, if this proves to be another short-lived break in trade hostilities it could send business confidence plummeting once again and see small businesses curtail their borrowing activity as their confidence is shaken.

Small businesses got a reprieve

Seasonal trends lent a hand to small businesses in the second quarter. Several industries were aided by seasonal trends, pushing down delinquency for the quarter. These seasonal factors combined with an economy with decent fundamentals drove the performance improvement for the second quarter. Overall, small businesses continue to display little to no signs of broad based weakness. What weakness exists is fairly well confined at either the regional or industry level, and the solid performance that has been the norm for the last several quarters looks set to continue.

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About Moody's Analytics

Moody's Analytics helps capital markets and risk management professionals worldwide respond to an evolving marketplace with confidence. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research and financial risk management. By providing leading-edge software, advisory services, and research, including the proprietary analysis of Moody's Investors Service, Moody's Analytics integrates and customizes its offerings to address specific business challenges. Moody's Analytics is a subsidiary of Moody's Corporation (NYSE: MCO), which reported revenue of $3.5 billion in 2015, employs approximately 10,900 people worldwide and maintains a presence in 36 countries. Further information is available at **www.moodysanalytics.com.**

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