MAIN ST REPORT

Your window into small business health

Q4 2016

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About the report

Developed by Experian, the leading global information services company, and Moody's Analytics, 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 as a whole. Key factors comprised by 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, investments, etc.).

Executive summary

Small-business credit balances expanded broadly in the fourth quarter, driving delinquency rates down. Taken with upside risk, which at the moment outweighs downside risk, credit conditions for small businesses are looking up. Balances are growing in the Southeast and the West, and delinquency rates are low throughout the country. The theme for 2017 will be robust balance growth and falling delinquencies. Combined with the prospect of tax reform, small businesses look set to thrive in the near future.

Small-business credit conditions in Q4 broadly improved

Delinquency rates fall across most industries

Throughout 2016, delinquency rates fell at a slower pace than the previous year, as 2015 experienced an uptick in delinquencies from the mining and transportation/utility industries caused by lower commodity prices. The fourth quarter of 2016 saw these trends abate as delinquency rates in these industries declined sharply. This strength was likely due to the uptick in oil prices following OPEC's announcement of supply cuts over the next six months. As U.S. shale producers have become the new marginal producers, activity related to their output will shift with prices more dramatically than in previous years.

However, the decline in delinquencies was by no means the highlight of the fourth quarter. The quarter was defined by a spike in total loan balance growth, which increased 7.7 percent from the third quarter and 10.3 percent from last year. Results from the Federal Reserve's Senior Loan Officer Opinion Survey showed an increased willingness to lend in the fourth quarter. More respondents indicated that their institutions are loosening credit standards for small firms in need of commercial and industrial (C&I) loans, although the same percentage also indicated weaker demand for new loans. This seems to run counter to what we observed in terms of loan balance growth, but it could explain the slow growth of credit limits at just 1.1 percent.

Confidence may be behind the sharp increase in borrowing, as the National Federation of Independent Business Owners reported small-business confidence increased sharply in November and December. Despite this activity, utilization rates among small businesses are still below 40 percent, leaving plenty of capacity for businesses to expand using their available credit. This likely explains the lack of demand for new C&I loans, as businesses can draw on available lines of credit, which are plentiful. Although drawn balances grew, most of the capital was likely used on inventories. Investment in equipment and structures would typically translate into increased demand for new C&I loans. As a result, it may be too early to declare that the balance growth will persist.

Broad improvement across industries

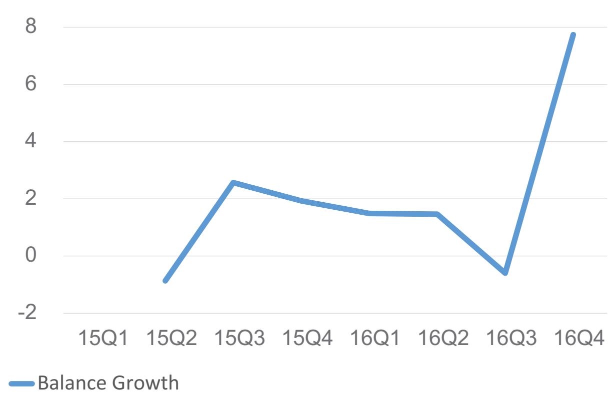
Change, q/q bps, y/y bps, y/y %

Industry	Severe Delinquencies (bps)		Balances
	q/q change	y/y change	y/y change
Agriculture/Forestry	↓	↓	↑
Mining	↓	↑	↓
Construction	↓	↓	↑
Manufacturing	↓	↓	↑
Transportation/Utility	↓	↓	↑
Wholesale	↓	↓	↑
Retail	↓	↓	↑
Financial Services	↓	↓	↑
Services	↓	↓	↑
Public Administration	↑	↑	↑
Non-Classified	↓	↓	↑

Source: Experian, Moody's Analytics

Q4 balance growth jumps

Qtr/qtr % change



Source: Experian, Moody's Analytics

Balance growth roars forward in the Southeast

Balance growth in Georgia, Alabama and South Carolina powered forward in the fourth quarter, with increases of 36.1 percent, 33.4 percent and 28.6 percent over the previous quarter, respectively — and up 41.2 percent, 25.5 percent and 59.3 percent year-over-year, respectively. All three states saw strong growth in balances among financial services companies (which was a common theme nationally), although Alabama and South Carolina saw strong growth in wholesale balances and Georgia saw a very large increase in mining balances. As a result of strong balance growth, all three states have low delinquency rates, and Georgia is the only one of the three to have a delinquency rate higher than the national average.

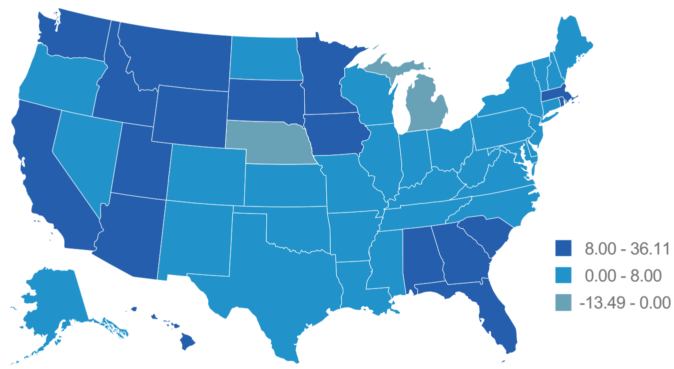
Nevada gets a reprieve

Nevada was hit hard during the Great Recession. Small businesses in the state have struggled with credit ever since, but this trend turned in 2016. The severe delinquency rate fell to 8.94 percent in the fourth quarter, the lowest level observed in the available history for the state. This was driven not only by declining balances for severely delinquent accounts, but also by the expansion of the denominator through credit growth.

Not only is this overall trend positive, but the broad-based nature of the improvement is especially encouraging. Eight of 11 industries in Nevada saw delinquency rates decline from the third quarter of 2016. The transportation/utilities and retail industries each saw their delinquencies decline more than 100 basis points. The only discouraging sector was the wholesale industry, which saw delinquency rates rise more than 200 basis points. Construction delinquencies also rose, but are still well below levels from a year ago and unlikely to rise appreciably in the near future as homebuilding improves nationwide.

Balance Growth Roars in the Southeast

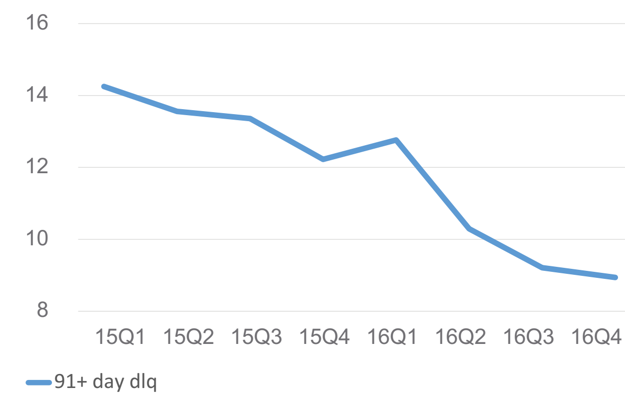
Qtr/qtr change in balance by state, %



Source: Experian, Moody's Analytics

Nevada delinquencies continue lower

Delinquency rate, %



Source: Experian, Moody's Analytics

Nevada ends the year with strong improvement

Change, q/q bps, y/y bps, y/y %

Industry	Severe Delinquencies (bps)		Balances
	q/q change	y/y change	y/y change
Agriculture/Forestry	↓	↓	↑
Mining	↓	↑	↓
Construction	↑	↓	↑
Manufacturing	↓	↓	↓
Transportation/Utility	↓	↓	↑
Wholesale	↑	↑	↑
Retail	↓	↓	↓
Financial Services	↓	↓	↓
Services	↓	↓	↑
Public Administration	↓	↑	↑
Non-Classified	↑	↑	↑

Source: Experian, Moody's Analytics

Upside risk continues to outweigh risk to the downside risks

Given global economic uncertainties, businesses and credit providers must be vigilant in their assessment of risk. Small businesses tend to rely on the personal credit of the business owner and loans as their primary sources of financing. In the event of downside shocks, these firms will be particularly vulnerable, given that they may not have the financial cushion enjoyed by larger businesses. Over the next few quarters, downside risks to small businesses include rising interest rates and changing trade policies. The upside risks include changes to the tax code and infrastructure spending, rising commodity prices, and a labor market approaching full employment.

A significant downside risk is that the Federal Reserve will tighten monetary policy faster than anticipated. This risk will become more likely under a scenario where the Trump administration enacts changes to the tax code and infrastructure investment. Such an interest rate shock could quickly cause balance growth to slow and delinquencies to rise with payments on variable rate loans and lines of credit. This could be a jolt for small business and consumption overall.

Trade policies being considered by the new administration could have significant negative impacts as well. Typically, the main impact of foreign trade is on financial services firms in the Northeast, but a trade war could have a harsh impact on businesses of all kinds throughout the country. Small retailers, for example, could be severely impacted given their exposure to imported goods. Other small businesses could see their input prices rise as well, cutting into their profit margins. This could undermine any positive shocks from expansionary policy as businesses cut back on employment and investment.

Fiscal policy will be the big question nagging at the minds of small-business owners this year. The new Trump administration ran on a platform that included retooling the tax code and government spending. The promise of lower taxes and a sharp rise in infrastructure spending has confidence in the economy running high. However, given the differences in opinion between Congress and the Trump administration, this may be slower in arriving than many people had thought. Given Republican control of Congress and the White House, changes to government spending and taxation are expected. The questions are simply when and how much.

Rising prices for energy commodities, oil in particular, will help to improve the credit position of small businesses in the mining and transportation industries. There may be some payback in the manufacturing industry, as commodities play a large input role and rising prices could cut into profits for manufacturers. This will be offset in credit markets as mining and transportation delinquencies continue to fall from highs reached in late 2015 and early 2016. This trend should outweigh the risks from manufacturing pushing down delinquencies in 2017.

The labor market remains the brightest aspect of the current economic climate. Payrolls grew by 156,000 in December, and personal income numbers rose 3.5 percent. In fact, the pace of payroll growth is strong enough that businesses of all sizes are reporting difficulty in finding qualified workers as the pool of eligible workers is absorbed. Moreover, the increase in personal incomes bodes well as firms compete for workers and for higher business receipts to follow as people increase their spending. Higher incomes will also strengthen small businesses as the labor market continues to improve. There is, of course, a tradeoff here — small businesses can be constrained by rising wages as they compete for labor with larger firms.

2017 could be a big one

Small-business credit performance improved as total balances rose. Risks appear to be weighted heavily to the upside heading into 2017. Prospects for changes to the tax code and infrastructure spending have small-business owners more optimistic than they have been in the last decade. Combine this with strong balance growth in the fourth quarter, low delinquency rates and low utilization rates, and we have the recipe for a good year. Barring some unforeseen event, 2017 is shaping up to be a strong year for small businesses and small-business credit performance.

About Experian's Business Information Services

Experian's Business Information Services is a leader in providing data and predictive insights to organizations, helping them mitigate risk and improve profitability. The company's business database provides comprehensive, third-party-verified information on 99.9 percent of all U.S. companies. Experian provides market-leading tools that assist clients of all sizes in making real-time decisions, processing new applications, managing customer relationships and collecting on delinquent accounts. For more information about Experian's advanced business-to-business products and services, visit **www.experian.com/b2b**.

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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