experian™ Moody's Analytics

MAIN STREET REPORT

Your window into small business health

Q1 2021

Small business credit performance declined with a seasonal decline in balances

Executive summary

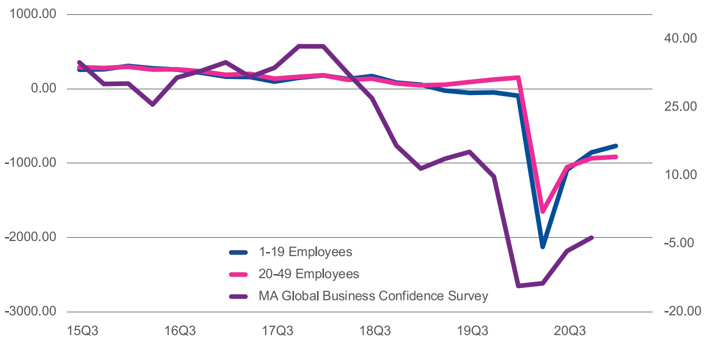
Seasonal patterns in small business borrowings moved against credit performance in the first quarter. Moderate delinquencies at 1.28 percent are still well below their year ago levels of 1.61 percent. Pent-up savings, massive fiscal support, and the winding down of the Covid-19 pandemic will be the driving forces for the economy and small businesses going forward in the post-pandemic recovery.

	Bucket	Q1 2020	Q4 2020	Q1 2021
Moderately Delinquent	31-90	1.61%	1.21%	1.28%
Severely Delinquent	91+	2.68%	2.06%	2.06%
Bankruptcy	BKC	0.16%	0.16%	0.15%

Vaccinations will lead to recovery

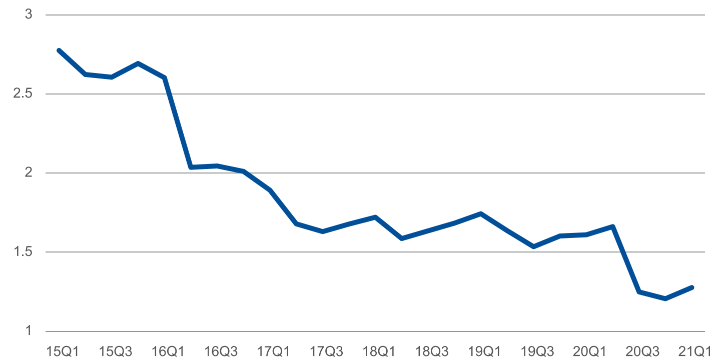
Small businesses with less than 40 employees added 277,000 jobs in the first quarter. By the end of 2021 the economy is slated to add nearly 5 million jobs as businesses reopen. Reopenings will accelerate as summer arrives and, with it, herd resiliency. The U.S. is slated to be among the first countries in the world to reach a 70 to 85 percent level of vaccinated individuals which we use to denote herd resiliency. Additionally, the Biden administration has passed the American Rescue Plan (ARP), which provided nearly $2 trillion of additional stimulus to the economy. On top of the ARP the American Jobs Plan and American Families Plan, currently proposed by the administration would add another $4.5 trillion of government spending if passed as proposed. Vaccinations leading to herd resiliency, massive government spending, and trillions of dollars in excess savings will combine to set up the U.S. economy and small businesses for success moving forward.

Small businesses add employees in Q1
Change in employee counts, (000s, YoY Chg.)



Source: ADP, Moody's Analytics

Delinquencies tick up after PPP induced drop...
31-90 DPD for small businesses, % of balance



Source: Experian, Moody's Analytics

Delinquencies hit a seasonal bump

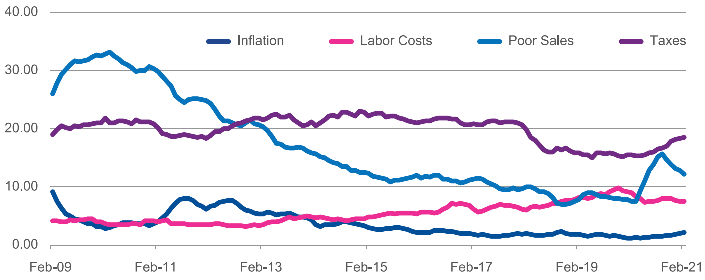
The 31-90 days past due (DPD) delinquency rate on small business credit ticked up to 1.28 percent in the first quarter. This is up from 1.21 percent in the fourth quarter and down from 1.61 percent in the first quarter of 2020. The first quarter saw the expansion of Covid vaccine distribution throughout the country. Delinquencies will move up over the coming quarters but will be contained across most industries as consumers have $2.3 trillion in excess savings as a result of the pandemic. As vaccinations continue to allow for economic reopenings, services businesses will be able to return to profitability and service their loans and lines of credit. Thus far, performance has been aided by government support, but the release of excess savings and return to normal operations following the achievement of herd resiliencyearly in the third quarter will sustain small business credit moving forward.

Despite a narrative that inflation is rapidly developing, much of what has been seen is the result of base year effects. As seen in the NFIB survey's report of the most important problems on business owner's minds, inflation barely registered as of the February survey. Small business owners are likely to increasingly report inflation as an issue, particularly those in the industries facing commodity price spikes, such as construction. However, as supply-side constraints ease and base year effects pass, this is unlikely to surpass previous highs for reported inflation worries. Excluding a brief period in 2008, reports of inflation as a primary concern among small business owners, have been confined to single-digit territory.

More small business owners are likely to worry over wage inflation, distinguished as labor costs in the NFIB survey. As seen in the NFIB data, worries over labor costs are closer to the forefront of business owners minds' than inflation. The employment cost index has consistently reported wages rising at a 3 percent level. If this were to pick up, labor costs could quickly rise and reach double-digit levels as a reported problem for small businesses.

Inflation is a low priority for small businesses

Businesses reporting their primary concern, Net %



Source: National Federation of Independent Business (NFIB)

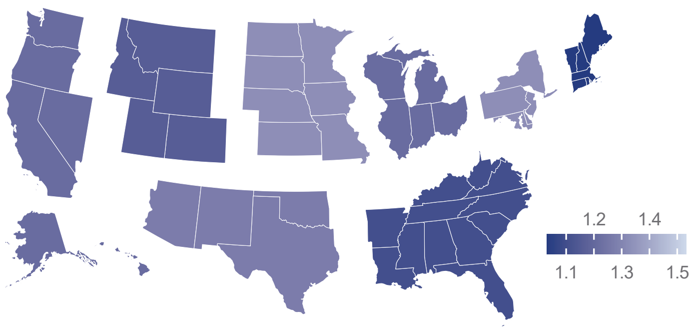
Regional performance declines, with one exception

Moderate delinquency rates rose in all but one region across the country in the first quarter, with the Southwest the only region to buck this trend. We focus on the 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 considered are Far West, Great Lakes, Mideast, New England, Plains, Rocky Mountain, Southeast, and Southwest. Worsening performance wasn't entirely unexpected as seasonal borrowing patterns saw first quarter balances drop 1.5 percent from the fourth quarter. This made the denominator for the moderately delinquent rate less favorable and more difficult for small business performance to log another quarter of improving performance.

Performance fell as seasonal patterns hit balance growth

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 region were up in the first quarter, from 1.21 to 1.26 percent. Most industries in the Far West region experienced an increase in moderate delinquency rates. The mining, transportation, and retail industries moved against this trend to help keep moderate delinquencies in check. However, the slight rise in moderate delinquencies for services businesses is difficult to offset for any region, given that it is typically the largest industry in any region.

Great Lakes: The Great Lakes region saw moderate delinquencies rise from 1.19 percent to 1.26 percent in the first quarter. The bankruptcy rate for the region fell from 14 to 13 basis points. Moderate delinquencies were held down from rising further as services was one of the two industries in the Great Lakes region to fall in the first quarter, the other being mining, which has a small footprint in the region.

Mideast: Moderate delinquencies in the Mideast rose from 1.39 to 1.51 percent. The Mideast's bankruptcy rate fell from 16 to 15 basis points, matching the nation as a whole. An 8 basis point decline in the moderate delinquency rate for the services industry was offset by larger increases across other industries in the Mideast. Mining and financial services were the other industries to see downward movements in the Mideast for the quarter. However, the small exposure to mining in the Mideast and the already low moderate delinquency rate for financial services left little to provide assistance to credit performance.

New England: The moderate delinquency rate in New England rose from 1.01 to 1.05 percent in the first quarter. Improved performance in the services and retail industries was more than offset by performance deterioration in construction and manufacturing industries. Lower volatility that is typical of services industry performance and the higher volatility that characterizes the retail, construction, and manufacturing industries drove this result.

Plains: The moderate delinquency rate in the Plains region rose from 1.41 to 1.52 percent in the first quarter. The agriculture, wholesale, and retail industries led moderate delinquency rates higher among Plains region industries. The services industry in the Plains region was nearly unchanged in the first quarter allowing the wholesale and retail industries to dominate the direction of change for delinquencies.

Rocky Mountain: Moderate delinquency rates rose modestly in the Rocky Mountain region in the first quarter, from 1.20 percent to 1.21 percent. Agriculture, construction, and retail were the only industries in the Rocky Mountain region to see performance deteriorate in the first quarter. However, the construction and retail industries have the second and third largest small business borrowings in the region so the moves there have an outsized influence. As is true across regions, the services industry is the largest but a small performance improvement wasn't able to offset the weakness in the construction and retail industries.

Southeast: Moderately delinquent balances in the Southeast rose to 1.16 percent in the first quarter, from 1.05 percent in fourth quarter. The services industry saw moderate delinquency rise 15 basis points from the fourth quarter. Most other industries had small upward movements in moderately delinquent balances. Manufacturing and wholesale businesses were the only industries to see rates decline.

Southwest: Moderate delinquencies in the Southwest fell from 1.32 percent to 1.31 percent in the first quarter making the Southwest the only region in the country to see a decline in moderate delinquencies in the first quarter. Performance across industries was mixed, though the rise in the moderately delinquent rate for the services industry makes the region's performance all the more impressive.

Massive pent-up savings set to drive the economy forward

The macroeconomic backdrop for small businesses is one of strength for sales and credit performance. Real GDP grew at an annualized rate of 6.4 percent in the first quarter led by consumers, business investment and homebuilding. A continuing inventory drawdown bodes well for future growth as businesses will need to rebuild the inventories drawn down over the past year. Real GDP is on track to rise 7 percent in 2021 and 5 percent in 2022.

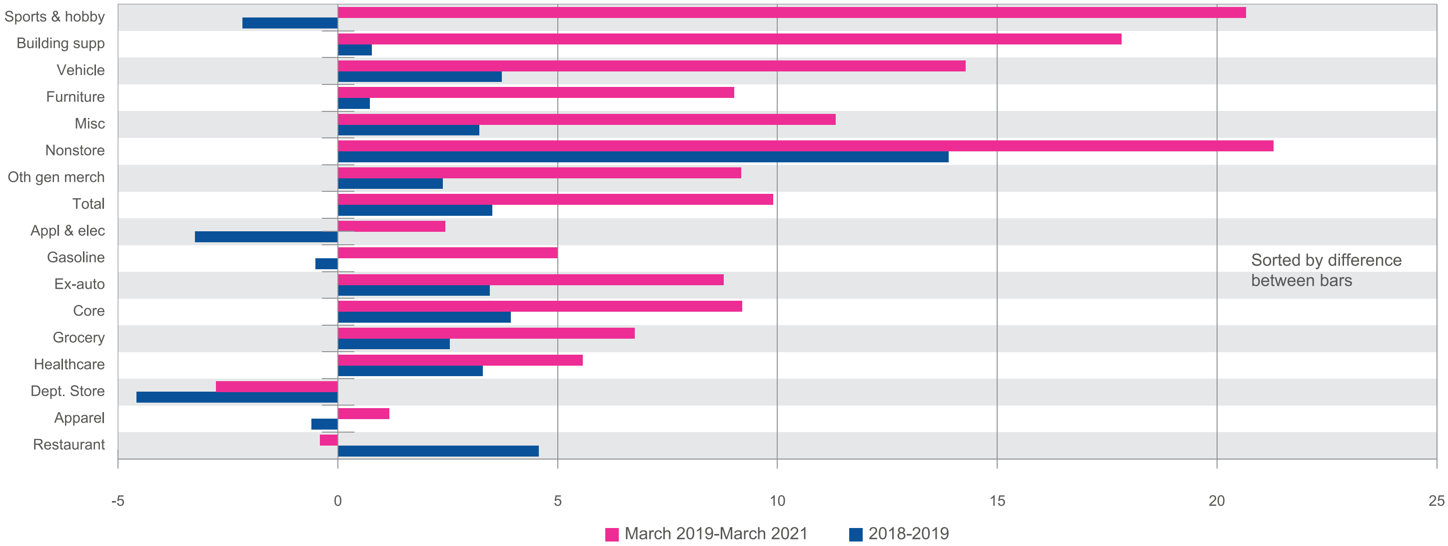
Moody's Analytics is forecasting the labor market to end 2021 more than 4 million jobs shy of pre-Covid-19 levels. This is even after the economy gains nearly 5 million jobs throughout the year to end at an unemployment rate of 5 percent. A return to full employment should be achieved by mid-2023 on the back of strong economic growth and the unleashing of excess savings by high-income households.

This unleashing of pent-up savings will come after households were able to amass vast savings while sheltering in place during the pandemic. These savings come from government stimulus support as well as money not spent on services which otherwise would have been consumed. We estimate that pent-up savings now amount to nearly $2.3 trillion, representing more than 10 percent of U.S. GDP. We are anticipating roughly 1/3 of these funds will be spent over the next year, powering higher growth. However, as much of these savings are held by higher-income households some of this money will be saved for the long-term, in retirement accounts, for example. Nonetheless, spending on travel, recreation, eating out, healthcare, and personal services should accelerate quickly following the U.S. reaching herd resiliency early in the third quarter.

Roaring retail results in the form of business-to-business sales for March are one sign of the rapid spending that will characterize the pandemic recovery. Up 17.5 percent from a year ago, sales at retailers benefitting from reopenings far outpaced sales to retailers that serve the work-from-anywhere demand, which rose 7.2 percent. Since the beginning of the pandemic, this was the first month that we observed such an outcome.

Retail Performance Strong and Variable

Retail sales, annualized growth

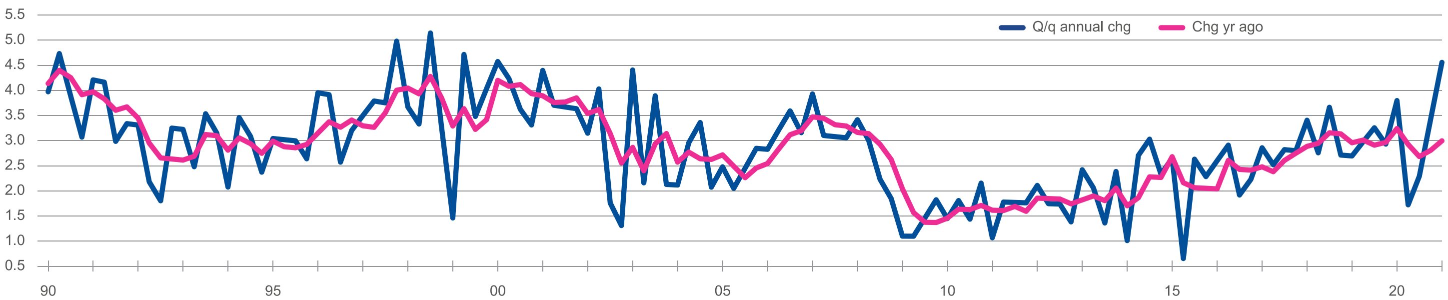


Source: Census Bureau, Moody's Analytics

The core consumer expenditure deflator, the inflation measure used by the Federal Reserve to help determine monetary policy, jumped in March and is close to the Fed's 2 percent through business cycle target. This is overstating inflation which is likely to moderate by year end once base year effects wind down. Large moves in commodity prices should also settle down later this year as supply side issues get straightened out. Wage growth for private sector workers, as measured by the employment cost index, has remained steady at 3 percent on a year over year basis. Further wage growth could see businesses raise prices faster, which isn't out of the question given strong growth on the horizon. The Fed may be underestimating how quickly inflation is set to accelerate, in spite of well anchored inflation expectations.

Wage Growth Holds Firm

ECI, private industry wages, %



Source: BLS, Moody's Analytics

Services consumption driven growth will power the economy and small business

The first quarter brought with it a seasonal reduction in outstanding borrowings for small businesses, nudging up moderate delinquency rates. Multiple stimulus packages during the COVID-19 pandemic and the pent-up savings in the hands of consumers have set the stage for strong growth over the next few years as consumers demand the services they have gone without during the pandemic. This strong growth and the accompanying labor force recovery will ensure lenders provide small businesses the funds they need to continue operating or expand their businesses.

MAIN STREET REPORT

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 (e.g., credit balances, delinquency rates, utilization rates, etc.) and macroeconomic information (e.g., employment rates, income, retail sales, industrial production, etc.).

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