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Moody's Analytics

MAIN[ST] REPORT

Your window into small business health

Q1 2017

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About the report

Developed by Experian 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 and provides commentary around what certain trends mean for credit grantors and the small-business community. Key factors of 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

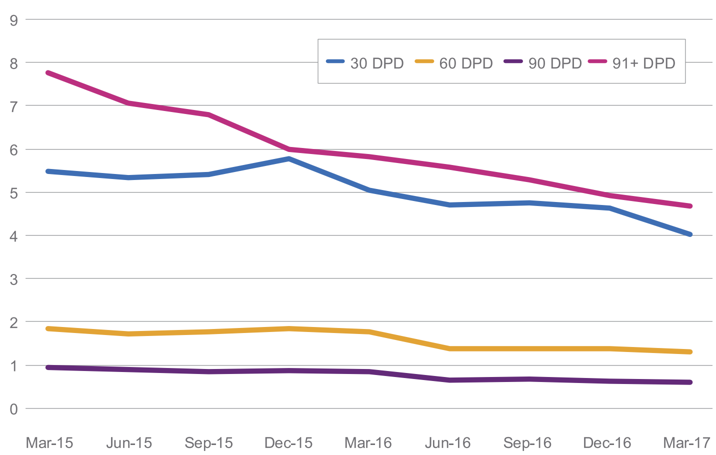
Credit utilization rates expanded briskly in the first quarter of 2017. Taken with upside risk, which at the moment outweighs downside risk, credit conditions for small businesses are looking up. Rates of severe delinquency are declining broadly, and credit constraints should ease as a result. However, balance growth is threatened by the lack of clarity regarding fiscal policies. Small-business credit will be defined this year by what happens with the potential revisions to government policies and how full or nearly full employment translates into activity for small firms.

Small-business credit conditions in Q1 broadly improved

Delinquency rates decline, and utilization's course is confirmed

Small-business delinquencies started the year off right. Both the 30- and 91+-days past-due categories declined in the first quarter, while the 60- and 90-day buckets were nearly unchanged. This continues the trend established over the last two years and was to be expected, given the continued growth in the economy.

Percent of credit trades delinquent for small businesses

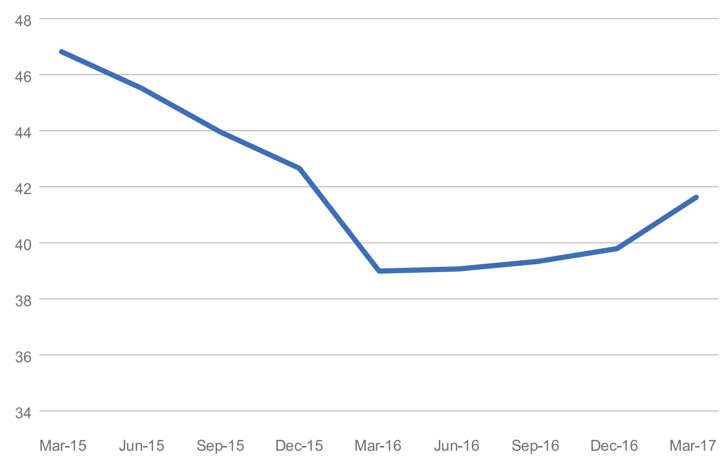


Source: Experian, Moody's Analytics

Small-business confidence has come down from recent highs, but consumer confidence has continued to rise. As talk of tax policy was pushed out of the first quarter, small businesses adjusted their confidence down. Consumers, on the other hand, were encouraged as income gains continued and the unemployment rate kept trending lower. The economy has moved closer to, or even into, full employment.

As confidence in the economy has elevated, utilization of credit among small businesses has increased. Credit balances were up 8.8 percent year-over-year, while available credit increased by 4.5 percent. Additionally, utilization rates have now risen for four consecutive quarters. Previous increases were modest, with the rate of utilization rising less than one-half of a percentage point, but in the first quarter utilization rose by 1.8 percentage points to 41.8 percent. Although a single data point doesn't make a trend, utilization rates certainly appear to have turned a corner and look set to rise going forward, provided business confidence holds up.

Utilization rate, Percent of available credit

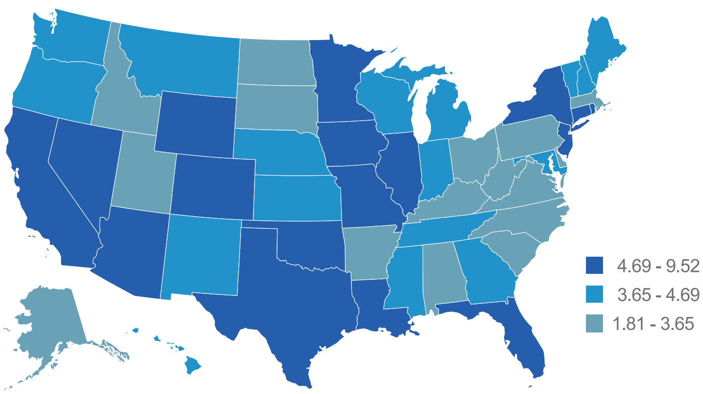


Source: Experian, Moody's Analytics

Where do the states stand?

Severe delinquencies among small businesses are highest in the Southwest and Midwest and lowest in the Northern Plains and Mid-Atlantic regions.

Percent of small businesses 91+ DPD as of 2017 Q1



Source: Experian, Moody's Analytics

The table below shows states ranked by their rate of severe delinquency. In the first quarter, South Dakota and Nevada once again had the lowest and highest rates of delinquency, respectively.

Ranking of States and DC By Lowest 91+ Day Delinquency Rate

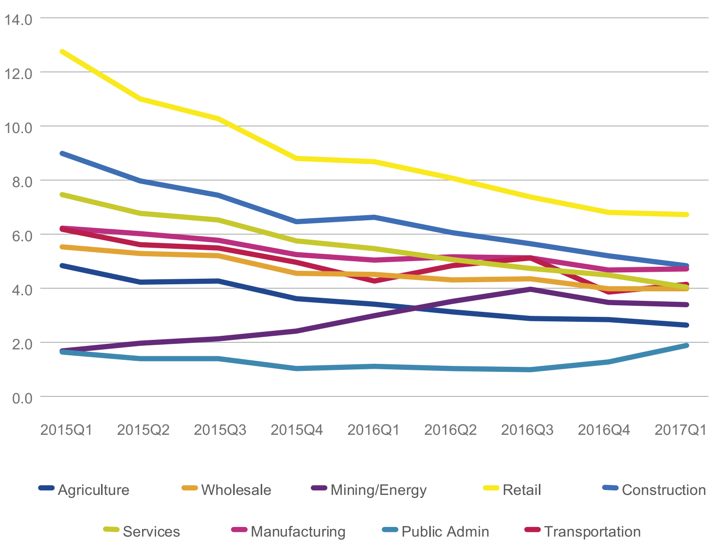
Rank	State 2016 Q4	State 2017 Q1
1	SD	SD
2	ND	WV
3	WV	NC
4	DE	MA
5	DC	ND
47	RI	CT
48	IL	AZ
49	FL	FL
50	AZ	IL
51	NV	NV

Although North Dakota had the second-lowest severe delinquency rate in the country in 2016 Q1, it moved to the fifth-lowest in the first quarter of 2017. This was driven by declines in the agriculture, construction and transportation industries. Previously, North Dakota's severe delinquency rate among businesses in these industries was 0.56 percent, 2.29 percent and 0.48 percent, respectively. In the first quarter, this shifted to 0.87 percent, 5.5 percent and 0.97 percent. These shifts were partially offset by the mining industry's decline in severe delinquency from 1.9 percent in 2016 Q1 to 1.4 percent in 2017 Q1 and a decline in the wholesale industry from 2.7 percent to 1.4 percent. The shifts in those two industries were enough to keep North Dakota among the states with the lowest rates of severe delinquency.

Farm incomes have yet to hit credit performance

Performance in the severe delinquency category improved in the first quarter across most industries, with the exception of manufacturing, transportation, retail and public administration. Meanwhile, agriculture has remained surprisingly resilient following four years of declining incomes for farmers. Credit performance is improving in most industries. As a result, credit conditions should ease for farmers in coming quarters.

Percent 91+ DPD

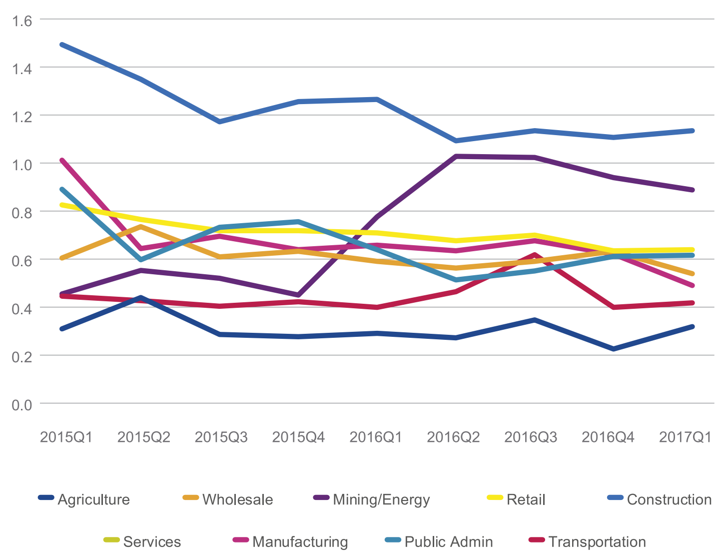


Source: Experian, Moody's Analytics

Small-business delinquencies in agriculture continued their strong performance in the first quarter, declining to 2.84 percent. This ongoing improvement comes despite a decline in farm proprietor income, which fell from more than $100 billion in the first quarter of 2013 to more than $20 billion in the first quarter of 2017. If farmers keep pulling in abundant harvests, the oversupply of agricultural inventories will continue and prices will remain low. This has placed downward pressure on farm incomes, farm balance sheets and farmland values.

Despite improvements over the last two years, retail still has the highest severe delinquency rate among industries. Retail sales came in strong in January, but lost ground in February and March. Much of this strength can be attributed to commodity prices: As of March, gasoline station sales, which rose by 14.3 percent from the prior year, were behind much of the increase in retail sales. The more recent weakness in retail sales is stemming from deflation and growth in the e-commerce sector. The retail landscape is clearly shifting, with large department stores falling out of favor and big box retailers struggling to make the transition to online shopping. As reflected by the improvement in delinquency rates, smaller retailers may be better positioned to deal with the changing environment — if they provide a unique, customized shopping experience. Smaller retailers also may benefit by selling through large online marketplace platforms offered by Amazon and eBay.

Percent 90 DPD



Source: Experian, Moody's Analytics

While retail has the highest severe delinquency rate across all industries, its 90-day delinquency performance has been relatively low and stable over the past two years. Both measures can provide meaningful insight. The 91+-day measure provides a snapshot of the amount of bad credit on lenders' books, but it doesn't distinguish loans that have gone just beyond 90 days past due from those that may have been delinquent for quite some time and potentially in the process of leaving creditors' books. In contrast, the 90-day measure can provide insight into more recent performance trends. While the levels differ across these two measures, we note that credit performance among small retailers is stable to improving.

Upside risk continues; policy risk is heightened as government deadline nears

Given global economic uncertainties, businesses and credit providers must be vigilant in their assessments of risk. Small businesses tend to rely on the owner's personal credit 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 policy uncertainty. The upside risks include rising commodity prices and a labor market approaching or at full employment.

A significant downside risk is that the Federal Reserve will tighten monetary policy faster than expected. The central bank raised interest rates in the first quarter and appears to have two more rate increases penciled in for 2017, followed by three more in 2018. If the Fed decides that overshooting its inflation target is prudent, given the shortfall in recent years, rates should be tame in the near term. However, if rates are raised too quickly as the economy moves into the later stages of expansion, businesses could pull back on their borrowing and curb credit growth.

Risks stemming from fiscal policy will remain an issue throughout the year. The treasury secretary is seeking a headline corporate tax rate of 15 percent, and general government activity could be reduced as a narrowly avoided government funding deadline was bumped to the end of September. The promise of lower taxes and a sharp rise in infrastructure spending has confidence in the economy running high. Growth in small-business credit balances could be hampered in the fourth quarter if the government shuts down and the staff of the Small Business Administration is furloughed. Even a short shutdown could result in credit growth being pushed into next year.

Commodity prices have come to a fork in the road. Oil prices are stabilizing around $50 a barrel, while agricultural commodities are still low and dampening farm incomes. Although oil prices are helping to improve the credit position of small businesses in the mining and transportation industries, prices for agricultural commodities could hit farm credit. There may be some payback in manufacturing, as oil and metals 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. Agriculture loans also are in danger of reduced performance as the drop-off in farm incomes moves into a fifth year. Going forward, commodity prices are set to help mining and transportation performance while hindering that of manufacturing and agriculture.

The labor market remains the brightest aspect of the current economic climate. Payrolls grew by 98,000 in March, and personal income numbers rose 4.6 percent in February. Combined with the low unemployment rate of 4.5 percent, this puts the economy at or near full employment. A strong labor market will generate increased demand for goods and services provided by small firms, although the higher wages paid to retain employees will cut into profit margins. On net, a stronger labor market will improve the outlook for small-business credit.

2017 could be a big year

The year started off on a positive note, with delinquencies declining and increases in both balances and credit limits. Although utilization rates have risen, small businesses are still reporting that they don't have adequate credit to expand at their desired pace. Improving economic conditions this year should allow financial institutions to further open the credit spigot and meet more of the demand from small firms. Continued improvement across industries and geographies has given lenders reason to expand as the risk profiles of small firms have strengthened. The competing dynamics of downside risks stemming from policy and the economy reaching full employment look set to drive the outlook for small-business loans in 2017.

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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