MAIN ST REPORT

Your window into small business health

Q2 2016

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About the report

Developed by Experian®, the leading global information services company, and Moody's Analytics, the new Experian/Moody's Analytics Main Street Report brings deep insight into the overall financial well-being of the small business landscape, as well as provides commentary around what certain trends mean for credit grantors and the small business community as a whole. Key factors that comprise 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 conditions improved in the second quarter, with the exception of some specific segments, as delinquency and bankruptcy rates declined. Sentiment among small businesses is positive with 11 percent of small businesses planning to increase employment and 26 percent considering additional capital investment. Businesses have access to plenty of credit with utilization rates remaining low. However, the overall positive outlook could rapidly change in the event of increased interest rates and slow economic growth. Agriculture and construction credit remain bright points in the small business credit outlook. Despite some downside risks, the sectors remain stable, and well positioned for growth.

Small Business Credit Conditions in Q2 Positive

Delinquencies

Overall small business delinquencies decreased slightly from last quarter, carried lower by falling levels in every stage of delinquency. The total bankruptcy rate fell as well although at a slower pace than a year ago. Current credit conditions for small businesses are stable or improving across most of the country.

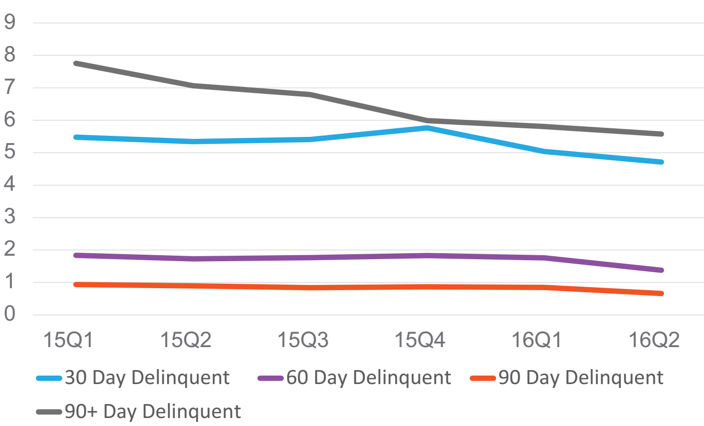
Regional perspective

States in the Upper Plains and Mid-Atlantic regions experienced some of the largest increases in small business bankruptcy rates in the country. At the other extreme, businesses in the Southeast and Southwest, with the exceptions of Nevada and Oklahoma, saw declining bankruptcy rates for small businesses. Oklahoma is still reeling from the decline in oil prices, which last quarter had a major impact on delinquency rates in the transportation and utility industries. The outlook for Oklahoma remains negative as these factors are not likely to dissipate in the near term.

The District of Columbia led declines in bankruptcy rates across the country with a drop of 6 basis points. The improvement was broad-based with bankruptcy rates falling across the construction, finance, retail and services industries. DC's bankruptcy rate is below the national average and likely to remain there as the business climate in the district improves and the federal government's presence remains a steadying force for businesses.

Small Business Delinquencies Improving

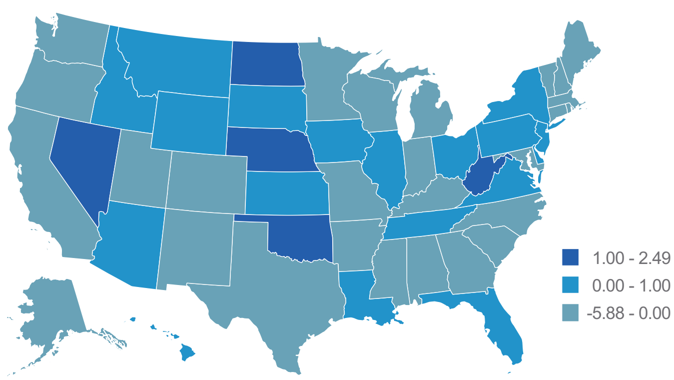
% small business credit trades…



Source: Experian, Moody's Analytics

Small Business Bankruptcy Steady or Improving

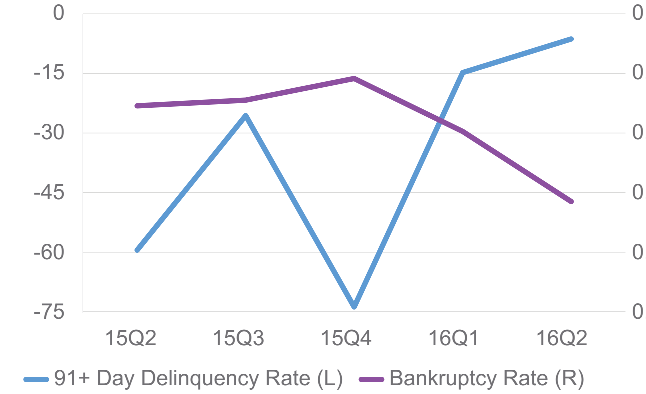
Qtr/qtr difference in bankruptcy rates by state, basis points



Source: Experian, Moody's Analytics

Bankruptcies Fell Fastest in DC in Q2

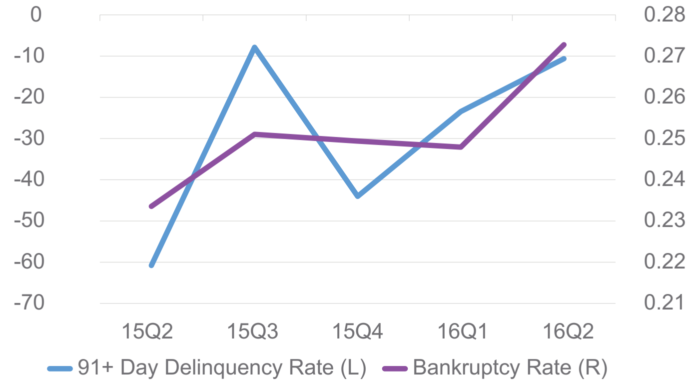
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

West Virginia Bankruptcies Rose Fastest

Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

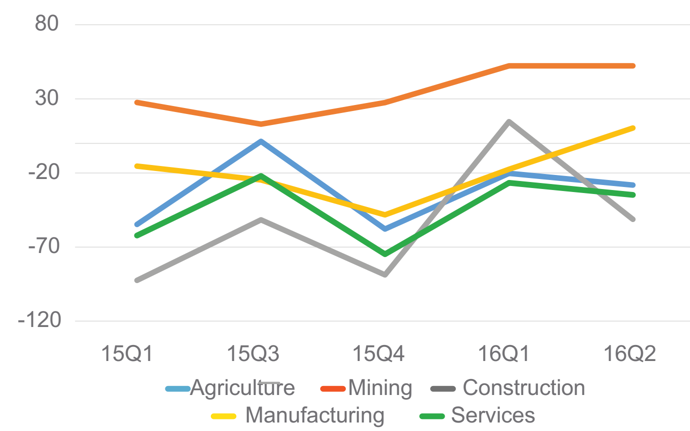
West Virginia has the distinction of having the highest bankruptcy rate of any other state. In addition, bankruptcies in West Virginia rose faster than any other state in the second quarter with an increase of 3 basis points. The increase was driven by the state's large exposure to the mining and transportation industries which have been hammered as the price of coal has declined.

Shifting industry patterns

The mining industry -- which includes petroleum and gas exploration -- experienced the sharpest increase in severe delinquencies and bankruptcies in the second quarter across all industries. The transportation and utility industries also experienced a decline with the average severe delinquency rate increasing by 30 basis points during the quarter after logging declining delinquency rates for five consecutive quarters. The increase in transportation industry delinquency rates was largest in Oklahoma where the rate rose by over 2.2 percentage points. Texas also experienced a large increase in severe delinquencies in the transport/utility industries category.

Mining Delinquencies Deteriorate Further

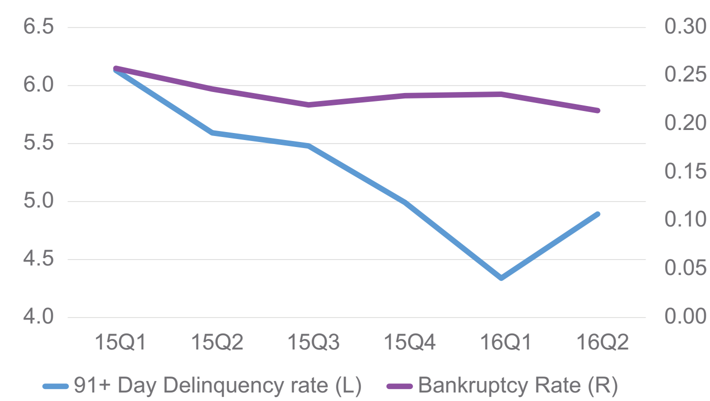
Qtr ago difference in 91+ day delinquency rate, basis points



Source: Experian, Moody's Analytics

Transport/Utility Bankruptcies Trend Lower

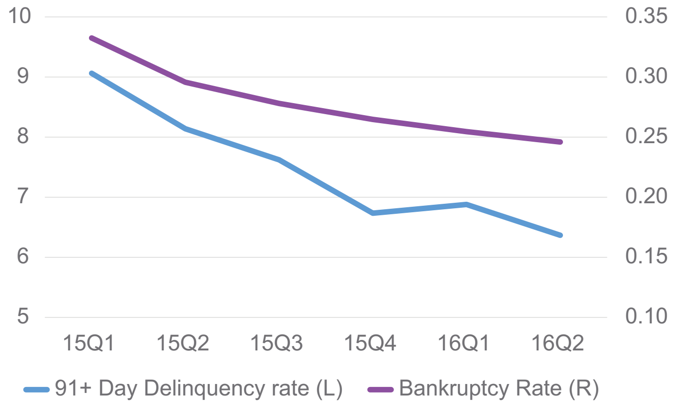
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Construction Industry Bankruptcies Improve

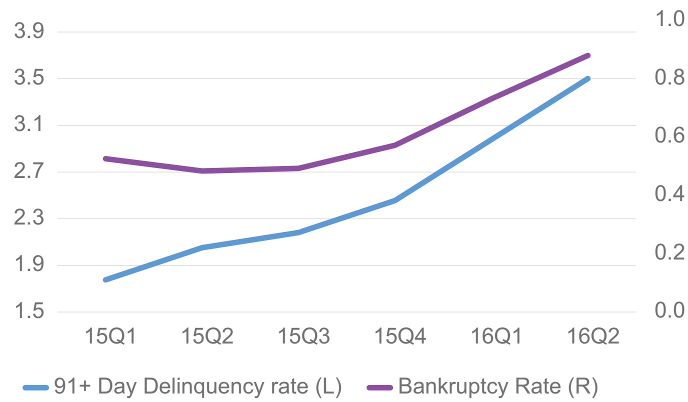
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Mining Industry Bankruptcies Continue Ascent

Qtr ago difference in rates, % of outstanding trades, basis points



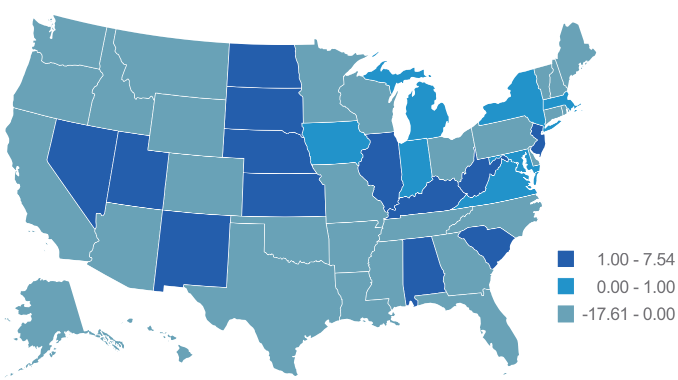
Source: Experian, Moody's Analytics

On a more positive note, the construction industry has experienced six consecutive quarterly declines in severe delinquency and bankruptcy rates. Construction has seen the strongest improvement with severe delinquencies dropping by nearly a third in the last year and a half. Strong new home sales and construction spending are improving construction company financials across most of the country.

Despite the upbeat news, there are pockets of deterioration. Construction bankruptcy rates remain high in West Virginia and New Mexico with rates of 0.59 percent and 0.44 percent, respectively. Bankruptcy rates along the Eastern seaboard tend to be below the national average. New Jersey and South Carolina both experienced bankruptcy rate increases of 3 basis points. Overall, construction credit is well positioned as construction spending is forecast to rise through 2017, and as new home sales are on a steady upward trajectory in most parts of the country.

Construction Bankruptcies Rise in Midwest

Qtr/qtr difference in bankruptcy rates by state, basis points



Source: Experian, Moody's Analytics

Construction Put in Place Levels Off in 2016Q2

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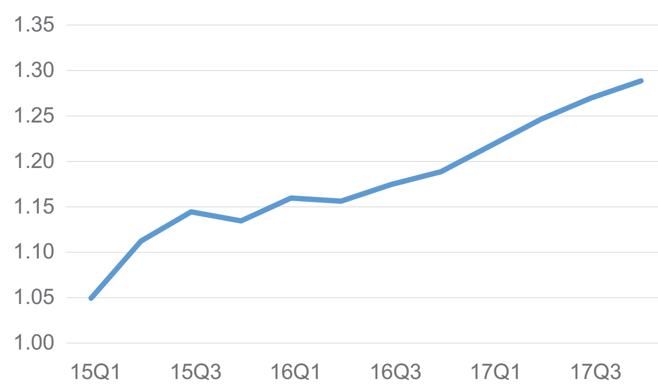


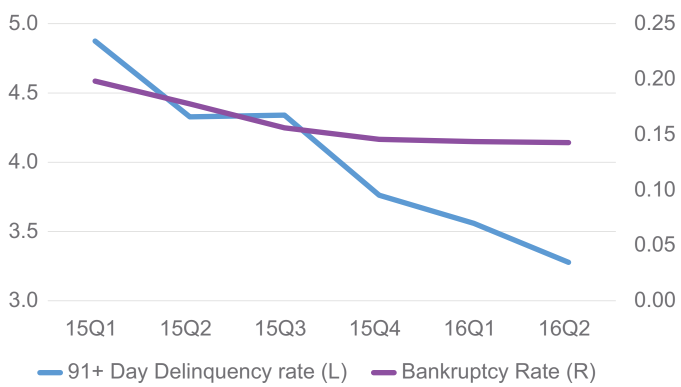
Source: Census Bureau, Moody's Analytics

Despite the dip in commodity prices over the last year, severe delinquencies in the agricultural sector remain low as do bankruptcies. Agriculture has been one of the strongest credit sectors among small businesses with some of the lowest delinquency and bankruptcy rates. Prices received by farmers were up 2 percent in May following a slight gain in April. The positive change in prices received by farmers in the first two months of the second quarter likely helped to push delinquencies lower.

The situation for the agriculture industry has not been consistent across the country, however. Many of the states in the Mid-Atlantic and Northeast regions experienced increasing bankruptcies. This was offset by declining bankruptcy rates in many of the states in the Southeast and the West. The average bankruptcy rate for the Agriculture and Forestry industry was 0.12 percent nationally, but several states, Arkansas and Wisconsin being the most notable, had much higher bankruptcy rates in the second quarter with rates of 0.60 percent and 0.27 percent, respectively.

Agriculture Bankruptcies Stable Overall

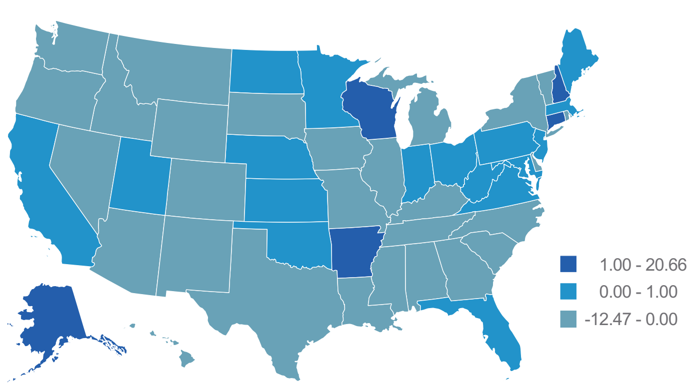
Qtr ago difference in rates, % of outstanding trades, basis points



Source: Experian, Moody's Analytics

Agriculture Bankruptcies Rise in the East

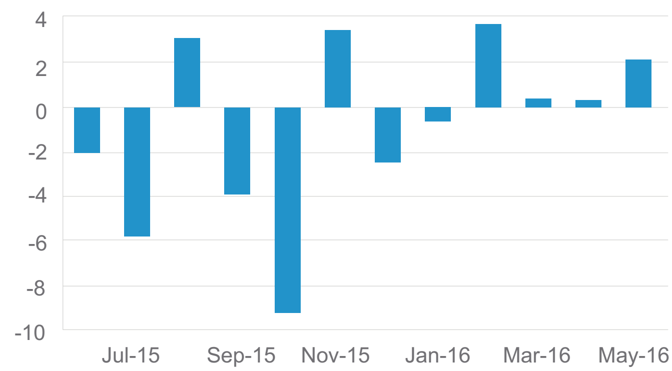
Qtr/qtr difference in bankruptcy rates by state, basis points



Source: Experian, Moody's Analytics

Agriculture Prices

% change



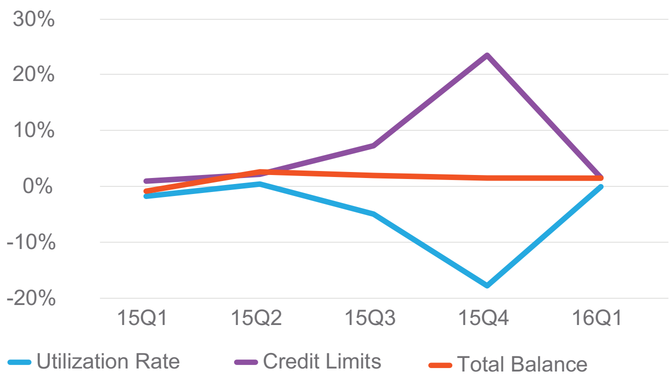
Credit quality

In June, the National Federation of Independent Businesses reported that around 11 percent of small businesses were planning to increase employment, and 26 percent were planning to increase capital expenditures. Given the market correction that began the year, these trends are not surprising. However, these numbers do not reflect small business sentiment following the outcome of the U.K. referendum. Sentiment in the Northeast may suffer the most, given that many U.S. goods and services bound for the U.K. originate there. While small business confidence could fall as a result of the vote, credit conditions are unlikely to be impacted significantly as businesses have shored up their credit positions in recent quarters.

The average credit utilization rate for small businesses was fairly steady in the second quarter, compared with the first quarter. The utilization rate dropped a mere 7 basis points from the first quarter, but was down almost 22 percent from the same period a year earlier. The modest decline in utilization is the result of a slight increase in credit limits and a steady increase in balances. After the large increase in credit limits last quarter, limits next quarter are likely to remain modest. With slower economic growth reported for the second quarter, balance growth is likely to slow leaving utilization rates steady.

Agriculture Bankruptcies Rise in the East

Qtr ago % change



Source: Experian, Moody's Analytics

Risks

Risks permeate the small business credit market at the moment, both to the upside and to the downside. Looking first at the downside, the risks to the outlook include slow growth domestically, slowing growth abroad, and weak commodity prices. Upside risks include rising interest rates and the strengthening labor market.

With the market volatility experienced in the first quarter having died down, the primary risk for the small business credit outlook comes from slowing growth. Second quarter GDP was reported to have grown by an annualized 1.2 percent, kept down primarily by declines in fixed investment and inventories. This could cast a pall over the economy and affect expectations of future growth.

Exports contributed positively to economic growth in the second quarter, but this is not a certainty going forward given global economic uncertainty. Europe will be left in a state of limbo as Britain maneuvers towards its exit from the EU. Italian banks still present large downside risks given the bad debts they have on their books. Japan is experiencing slow growth in output as well as prices, and has pushed back the timetable on a planned sales tax increase. Growth in China picked up slightly earlier this year, but could fall back into the malaise of last year if confidence doesn't return. All of these factors present downside risks to small U.S. businesses which export goods or services. More broadly, all businesses may be affected as domestic sentiment is impacted by events abroad.

Small businesses have been particularly vulnerable to falling commodity prices over the past year. Oil prices have regained some ground but are still well below their levels of two years ago. Agricultural commodity prices have been hard hit as supplies remain high and investors shift their focus to other assets. This has been offset to some degree by the prices received by farmers which have grown in the last four months.

The Federal Reserve began raising interest rates in December, and could raise rates two times in 2016 presenting what is, in the short term, a slight upside risk. While rising rates will increase the cost of capital and quell demand in the long term, they could lead to a temporary boost in spending as consumers and businesses look to take advantage of cheap financing before it evaporates. Overall, rising rates could provide a short term jolt, lifting cash flows to firms and helping to alleviate rising delinquencies in some sectors.

The labor market is currently a bright spot for the economy and small businesses specifically, and therefore is a strong upside risk. The labor market has continued to show resilience in the face of recent headwinds, adding 287,000 jobs in June 2016 following a meager 11,000 gain in May. The stronger labor market data has dispelled fears of a recession in the near term and is propping up confidence in the economy. Ultimately, positive labor market trends should boost small business confidence as well.

The risks to small business are numerous this year, but the resilience of the job market will serve as a strong buffer. We expect the labor market to continue its upward trajectory pushing up wages and consumer activity — and small business confidence along with it.

Outlook

Main Street business credit performed well in the second quarter, with delinquencies declining and bankruptcy rates continuing to fall. Several industries including construction and agriculture have experienced significant improvement. Small businesses have an abundance of available credit which will be used to fuel growth as the labor market improves and incomes rise.

Overall, the outlook for small business credit is positive as delinquencies and bankruptcies are low, and businesses have plenty of available credit. The upside and downside risks are fairly well balanced and should remain that way for the foreseeable future.

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