MAIN ST REPORT

Your window into small business health

Q3 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

Talk of a trade deal helped to shape the narrative for the third quarter, but there is more at play for small businesses than trade. Delinquency rates fell across most industries, but agriculture-related industries like construction and transportation had a rough quarter. A rising number of small businesses seeking credit should help to keep performance around current levels.

	Buckets	Q3 18	Q2 19	Q3 19
Moderately Delinquent	31-90	1.63%	1.64%	1.53%
Severely Delinquent	91+	3.40%	3.24%	2.81%
Bankruptcy	BKC	0.16%	0.16%	0.16%

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

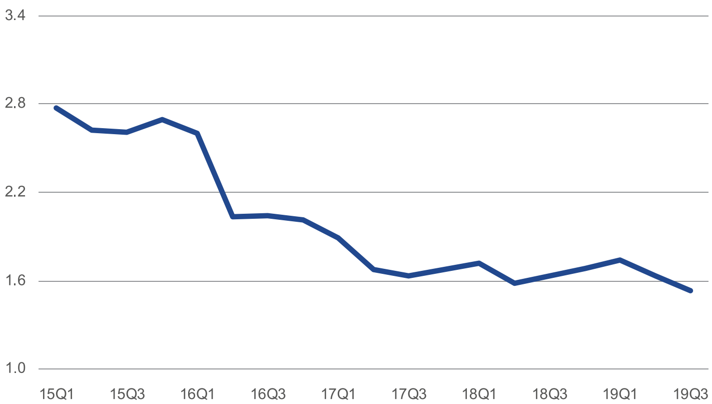
The universe of small business borrowers is growing

The seasonality was just what the second quarter needed to push down delinquency rates in a quarter with uncertainty running high. The question that remained was, how will the third quarter be able to continue the streak of performance improvement?

Business additions in the quarter had the effect of pushing an already low moderate delinquency rate, defined as 31–90 days past due (DPD), of 1.64 percent in the second quarter down to 1.53 percent in the third quarter of 2019. This is a series low and shows that small business lending performance has held up nicely, even when faced with flagging confidence among small business owners driven by policy uncertainty. Growth in the number of small businesses seeking credit as shown in our dataset and the Small Business Administration (SBA) loan level data served to drive delinquency rates down and balance growth up in the quarter. Lagged data coming out from the Bureau of Labor Statistics (BLS) seems to support the notion of a growing number of new businesses who could be pursuing credit, which bodes well for small business lending.

Third quarter balances crowd out delinquency

31-90 DPD for small businesses, % of balance



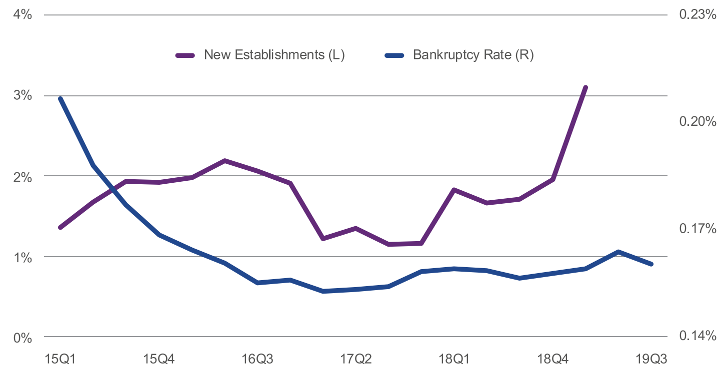
Source: Experian, Moody's Analytics

The number of bankruptcies was nearly unchanged in the third quarter from the second, moving to 12,868 from 12,861. This served to push down the bankruptcy rate from 16.3 basis points in the second quarter to 16 basis points, flat, in the third quarter. Here we see that the addition of new businesses is serving to continue the trend of low bankruptcies among small businesses. Since the bankruptcy rate is based on the number of bankruptcies, and this number was nearly unchanged from the second quarter we can reasonably assume that the bankruptcy rate was set to decline with natural growth in the dataset.

The BLS produces data on new establishments which we use to check our bankruptcy rates. The BLS releases this data with a lag, but we can see that in the first quarter of 2019 the BLS saw a 3.1 percent increase in the number of newly formed establishments. This is good news as it provides some evidence that we can assume our bankruptcy rates are reasonable in an environment of growth in businesses. As the BLS new establishments number rises we would expect that our bankruptcy rate would remain constant or decline. With new establishments rising at their fastest rate in at least a decade, it is reasonable to expect bankruptcy rates to be pushed down provided the BLS doesn't revise this print.

Static Bankruptcy counts help the rate

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

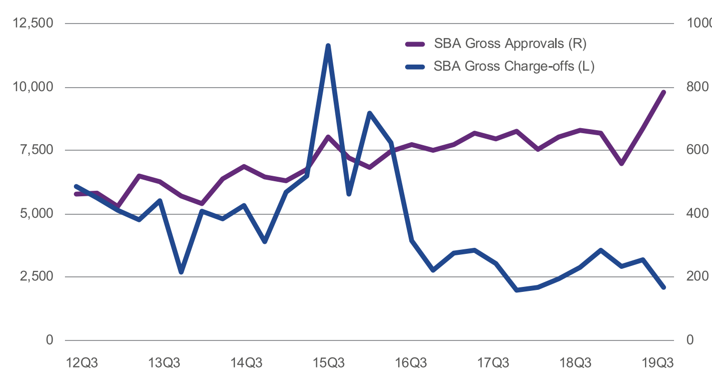


Source: Bureau of Labor Statistics, Experian, Moody's Analytics

Continuing with the theme of notable data events this quarter, the SBA has reported charge-offs at their second lowest level since the first quarter of 2008. The reported charge-offs of $168 million were down 30% from the same quarter last year. The primary reason we have looked to the SBA data in the past was to check on our balance growth numbers to see if they were in line with what the SBA was reporting. Since we had a data change this quarter, we again turned to the SBA as a benchmark to see what their growth rate looked like for the third quarter. The SBA saw approvals rise 16.7 percent year over year in the third quarter, coming in at $9.8 billion.

SBA Charge-offs return to floor

SBA Gross Charge-offs and Gross Approval, $ Millions



Source: Small Business Administration, Moody's Analytics

Seasonality goes to bed

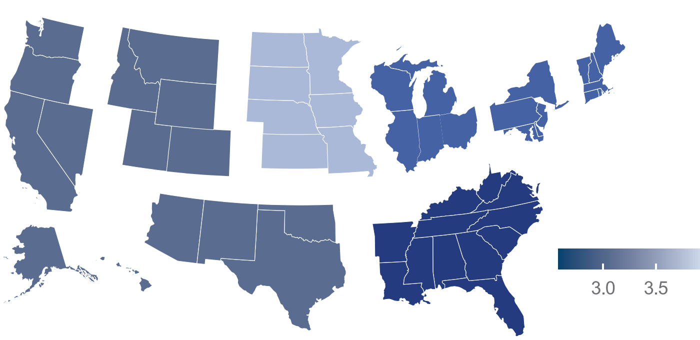
The Seasonal effects which had boosted performance in the second quarter have, for the most part, faded or diminished across industries. Mining and Wholesale were the only industries to get a notable performance boost from seasonality for the quarter. Other industries had minimal seasonal impacts for the third quarter. Next quarter, seasonal effects should act as a drag on performance, pushing delinquencies in several industries such as agriculture, construction, and retail, higher. There could also be some payback in the fourth quarter after this quarters data changes. These types of changes will be a drag on performance going into the end of the year, but unlike in the second quarter these won't be the underlying cause of movements that we will see.

Weakness is confined to a few corners

Moderate delinquency rates — defined as 31–90 DPD — were lower across most of the country in the second quarter. Only one region saw performance deterioration which was attributable to businesses in the agriculture, mining, construction, and transportation 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.

Construction goes its' own way

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 fell in the second quarter, declining to 1.65 percent. Performance was mixed among industries in the region. One developing trend in the region were the rising delinquencies in the services sector. Moderate delinquencies among services businesses were up to 1.51 percent from 1.47 percent in the second quarter. This is the third straight quarterly increase in services delinquencies for the region and came in spite of the new accounts added into the data for the quarter.

Great Lakes: Credit performance in the Great Lakes region improved mildly in the third quarter, with 31–90 DPD delinquencies falling to 1.59 percent from 1.61 percent in the second quarter. This completely reversed the rise that the region saw in the first quarter. Similar to the Plains region, the Great Lakes saw rising delinquencies in the construction, transportation, and wholesale industries. This wasn't enough to stop the improvement elsewhere pushing the regions' delinquencies lower though.

Mideast: The Mideast region saw minor improvement in the third quarter as moderate delinquencies edged down to 1.60 percent from 1.63 percent in the second quarter. Results across industries in the region were mixed, but notably transportation delinquencies declined 28 basis points to close out the quarter at 1.19 percent. This was without an influx of new data into the industry in the Mideast.

New England: New England's small-business credit performance for the third quarter edged higher to 1.35 percent from 1.34 percent in the second quarter. Results across industries came in mixed, with little to speak of in the way of notable movements one way or the other. New England tends to be a steady region for small business credit performance, and the third quarter was no exception.

Plains: The Plains region saw its' 31–90 DPD rate rise to 2.03 percent in the third quarter from 1.87 percent in the second quarter. The Plains region was the beneficiary of changes in agriculture linked industries in the second quarter but gave back most of these gains in the third quarter. The financial services, retail and services industries were the only areas where the Plains was able to mitigate the trend of rising delinquencies in the third quarter.

Much of this is payback from the second quarter, but the region likely won't see stable numbers until a trade agreement is struck between the US and China to take the pressure off the region's agriculture producers.

Rocky Mountain: Moderate delinquencies in the Rocky Mountain region fell in the second quarter, moving from 1.89 to 1.76 percent. Moderate delinquencies are down almost 20 percent from this time last year. The data adjustment this quarter affected the services industry in the region pushing the moderate delinquency rate down 6 basis points to 1.19 percent. Given that the services industry tends to be the largest by counts it carries quite a bit of weight in determining whether a region sees performance improve or deteriorate in any given quarter. So these additional accounts served to offset the mixed movements in other industries in the region and push overall delinquency rates lower.

Southeast: Moderate delinquencies in the third quarter for the Southeast were down from 1.33 percent in the second quarter to 1.22 percent. Performance improvement was across all but one industry, construction. Despite the weakness in construction in the quarter the industry only saw performance deteriorate 6 basis points to 2.56 percent. The Southeast remains the region with the lowest moderate delinquency rate in the country and there doesn't appear to be weakness developing in a meaningful way to derail the region's position.

Southwest: Delinquencies in the Southwest fell in the second quarter to 1.78 percent from 2.15 percent in the second quarter. The Southwest had looked to be an area of weakness in the fourth quarter of 2018 and first quarter of 2019 but has since shown signs of reversing that trend. The Southwest was aided in the quarter by the addition of new data, which was particularly impactful for pushing down the region's severe delinquency rate. This is important to keep in mind as delinquent balances in the region have not fallen, they've just been hidden under new balances, particularly in the third quarter.

New products have been a boon

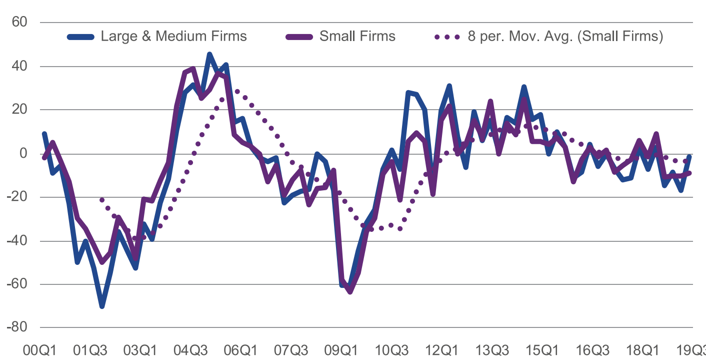
Rumors of a phase one deal between the US and China in their ongoing trade spate has helped financial markets move to new highs. This should help to alleviate, in the fourth quarter, some of the deterioration in confidence that had been seen in survey data from small businesses.

The news on the trade front seems to go back and forth regularly enough that the common narrative is still that businesses are in a wait and see mode before making any big moves. This is logical though there are some areas where it may not be the case.

One such area comes from the SBA, where the addition of a new term option for SBA loans may also be continuing to play a role in new balance growth as the addition of a 25-year loan could entice small businesses wanting to spread the cost of investment over a longer time horizon into financing with an SBA loan. This has continued to push up average terms in new SBA approved loans and reduce the payments necessary for small businesses to make longer term investments. This is a positive factor in the short term as there seems to have been some pent-up demand for such a product.

Data from the senior loan officer survey, however, indicates that lenders aren't necessarily seeing higher demand for Commercial & Industrial (C&I) loans. The 8-period moving average of senior loan officers reporting higher demand for C&I has been negative for over two years now and a reversal doesn't seem imminent.

Loan Officers still report lackluster demand



Senior Loan Officers reporting higher demand for C&I Lending, % Net

Source: Federal Reserve, Moody's Analytics

Q3 is set around new credit lines

The third quarter was defined around a series of balance and new business events which appear extraordinary and complicate the creation of insight into small business credit markets. Several narratives are jostling for the top spot. But as has so often been the case it seems to come back to small business will carry on with business as usual.

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