Equifax Main Street Lending Report — February 2024

Summary for Executives

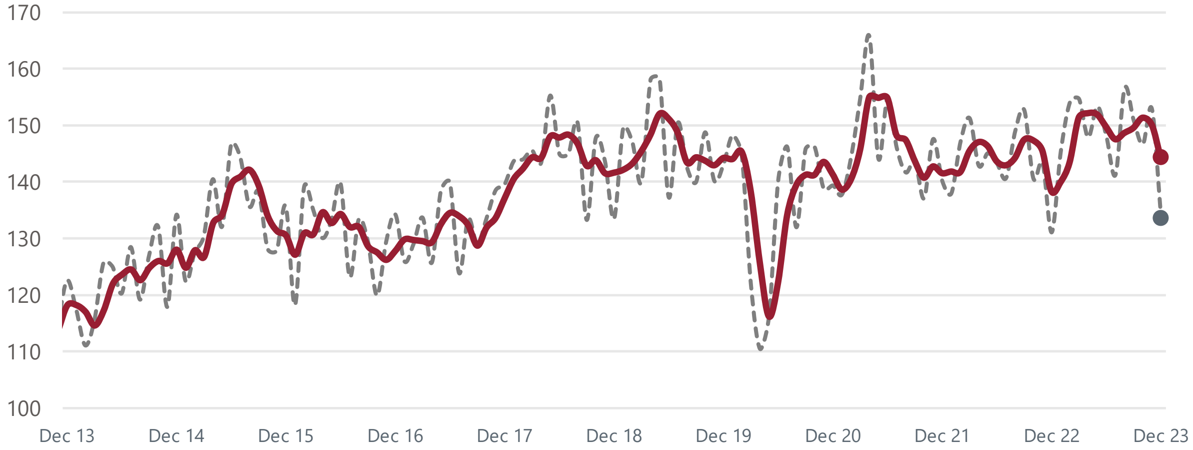
Key Takeaways

- Nominal small business lending activity fell sharply in December, pushing down the SBLI 3MMA to its lowest reading of the year. Elevated interest rates appear to be taking a toll on Main Street lending, and with the Fed sending signals that it will hold rates steady through at least the first quarter, lending activity may remain subdued in early 2024.
- Main Street financial stress continued to rise in December, with short-term and long-term delinquencies each ticking up 2bps and defaults rising 7bps. Delinquency rates are in line with pre-pandemic levels and are rising slowly, but defaults are up nearly a full percentage point compared to December 2019 and have been rising more rapidly.

Equifax Small Business Lending Index (SBLI)

SBLI			
133.5 (Level)	▼12.6% (M/M)	▲1.9% (Y/Y)	65th Percentile

SBLI 3MMA*			
144.3 (Level)	▼3.9% (M/M)	▲4.3% (Y/Y)	85th Percentile



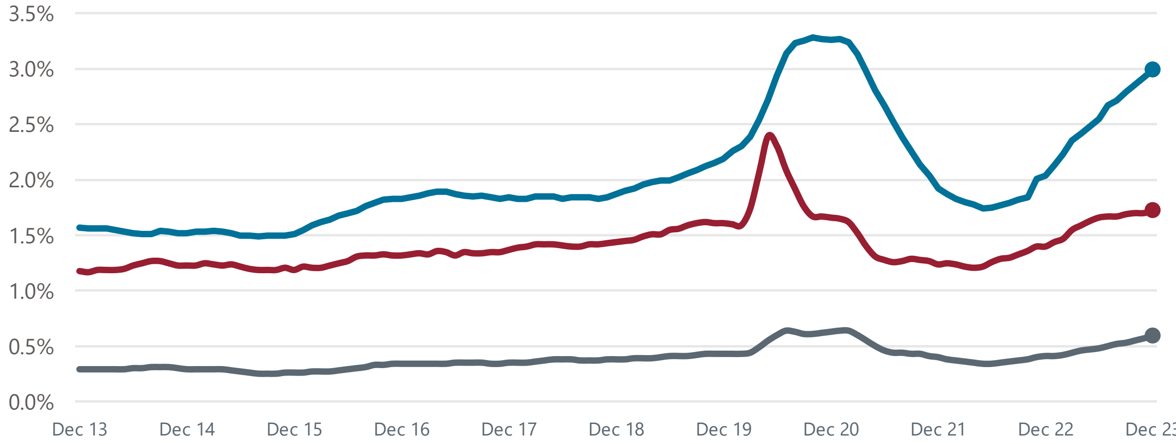
Volume of new commercial loans and leases to small businesses, seasonally adjusted index (January 2005 = 100)
*Three-month moving average

Equifax Small Business Delinquency (SBDI) & Default Indices (SBDFI)

SBDFI		
2.99% (Level)	▲7bps (M/M)	▲95bps (Y/Y)

SBDI 31-90 Days		
1.72% (Level)	▲2bps (M/M)	▲32bps (Y/Y)

SBDI 91-180 Days		
0.59% (Level)	▲2bps (M/M)	▲18bps (Y/Y)



SBDFI Calculated as a 12-month rolling average

Factors to Watch

Is a Soft Landing Now a *Fait Accompli*?

Many economists were pessimistic about the prospects of controlling inflation without triggering a recession. Have they been proven wrong?

How Long Will the Fed Wait Before Cutting Rates?

After Chair Powell poured cold water over the prospect of a March rate cut, borrowing costs are unlikely to fall materially until summer.

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Economic Trends

Economic Context

December readings of Equifax's Small Business Indices paint a mixed picture of Main Street activity and overall financial health. Headwinds generated by restrictive monetary policy have raised borrowing costs and are putting downward pressure on the demand for small business loans. Indeed, the average rate paid on short maturity loans was 9.8 percent in December according to NFIB, the highest reading of 2023.

The good news for small businesses is that the Fed is likely to cut rates this year, as core PCE inflation has fallen back to a 2.0% annualized rate over the last six months, consistent with the Fed's target. However, with the economy growing at a better-than-expected 3.3% rate in Q4 and the labor market adding nearly 250,000 jobs per month over the last six months, Fed officials are downplaying the chances of a near-term rate cut, and the market no longer anticipates lower rates in Q1 (see top chart). While a strong economy is of course a good thing for small business owners, it also means borrowing costs will remain elevated, at least for the first half of the year. Relief should be on the way later this year, however: Chair Powell continues to suggest that the Federal Funds Rate will fall by around 75 basis points by the end of 2024.

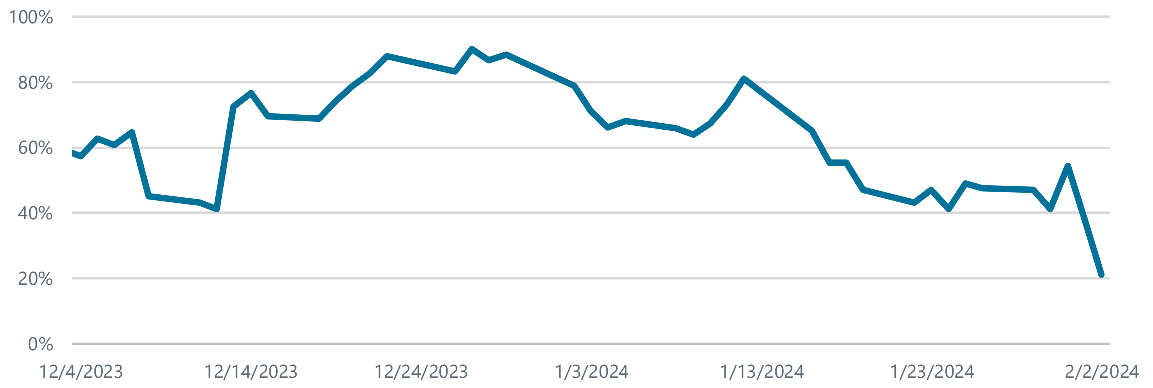
Meanwhile, financial stress continues to slowly increase on Main Street, particularly with respect to defaults. As illustrated in the bottom chart, default rates have climbed by more than a full percentage point in several industries over the last year, led by Transportation & Warehousing. Across most industries, default rates are higher-than-normal and continue to rise — in fact, with relatively few exceptions, default rates have risen every month in every industry for the last 18 months. Interestingly, delinquency rates are rising much more slowly than default rates, at a rate of roughly 1 basis point per month over the last six months.

With inflation back to near-normal levels, labor-related concerns (specifically, labor availability, labor quality, and labor cost) are once again the central challenge facing small business owners. These issues reflect a historically strong labor market in which job growth continues to surprise to the upside, as illustrated by an impressive 650,000 new jobs added in December and January. The strong labor market is buoying consumer spending and increasing small business owners' confidence about their business prospects: for example, per NFIB, near-term sales expectations are at their strongest point in nearly two years.

Still, low unemployment and strong labor demand pose challenges for the 40% of small business owners who are currently looking to hire. With the labor market exhibiting renewed strength, there is likely to be continued upward pressure on wages, which could make it more difficult for some businesses to hire and retain workers — and, potentially, reignite the embers of inflation.

Probability of a Q1 Rate Cut

CME FedWatch Tool, Probability of at least one rate cut by March 2024 Fed Meeting



Industries with Highest Annual Increases in Defaults

Equifax Default Index, Year-over-year basis point change in defaults