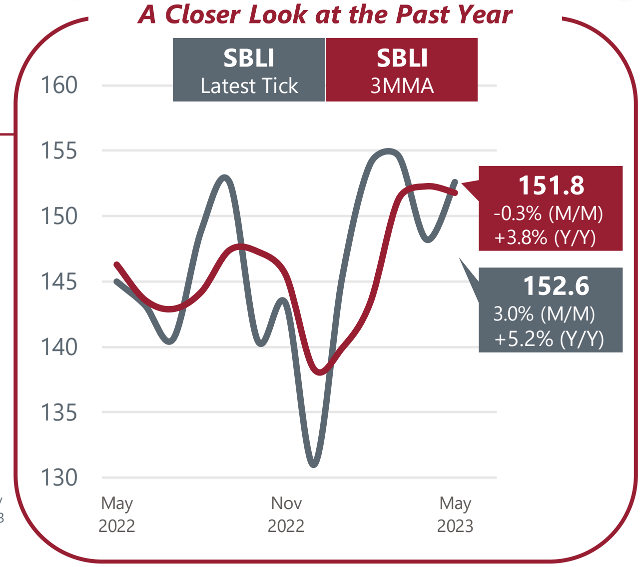
Equifax Commercial Strategic Insights: July 2023

Small Business Lending Remains Positive, but Tighter Standards Lie Ahead

Equifax Small Business Lending Index (SBLI)*



*Volume of New Commercial Loans & Leases to Small Businesses, Seasonally Adjusted Index (January 2005 = 100)

Index Analysis

The Equifax Small Business Lending Index (SBLI), a measure of nominal small business lending activity, increased 4.4 points (+3.0%) in May to 152.6 and is now 5.2% above its year-ago level. Meanwhile, the SBLI 3-month moving average ticked down 0.5 point to 151.8 and is now 3.8% above its year-ago level.

Regional Story: In May, small business lending rose in seven of the ten largest states, including Florida (+1.3% M/M), Michigan (+1.1% M/M), and New York (+0.8% M/M) experienced the largest increases. Texas (-0.2% M/M) and Georgia (-0.2% M/M) showed the largest monthly lending declines. Measured on an annual basis, lending activity was up in nine of the ten largest states, including Florida (+6.6% Y/Y), North Carolina (+5.5% Y/Y), and Ohio (+4.5% Y/Y). California (-0.4% Y/Y) was the only large state to experience a year-over-year decline in lending activity.

Industry Story: Small business lending rose on a monthly basis in 13 of 18 industries in May, led by Arts, Entertainment & Recreation (+2.3% M/M); Retail Trade (+2.1% M/M); and Administrative Support, Waste Management & Remediation Services (+1.5 M/M). Lending activity fell most in Agriculture, Forestry, Fishing & Hunting (-2.2% M/M) and Information (-1.5% M/M). Compared to a year ago, lending rose in 15 of 18 industries, most notably in Arts, Entertainment & Recreation (+31.2% Y/Y). In contrast, lending fell significantly in Transportation & Warehousing (-11.7% Y/Y).

Economic Context

The Equifax Small Business Lending Index increased in May, indicating that Main Street lending activity is still experiencing positive growth. However, the nominal SBLI is not keeping pace with inflation, and economy-wide price increases over the last two years mean that small business investment simply doesn't go as far as it once did.

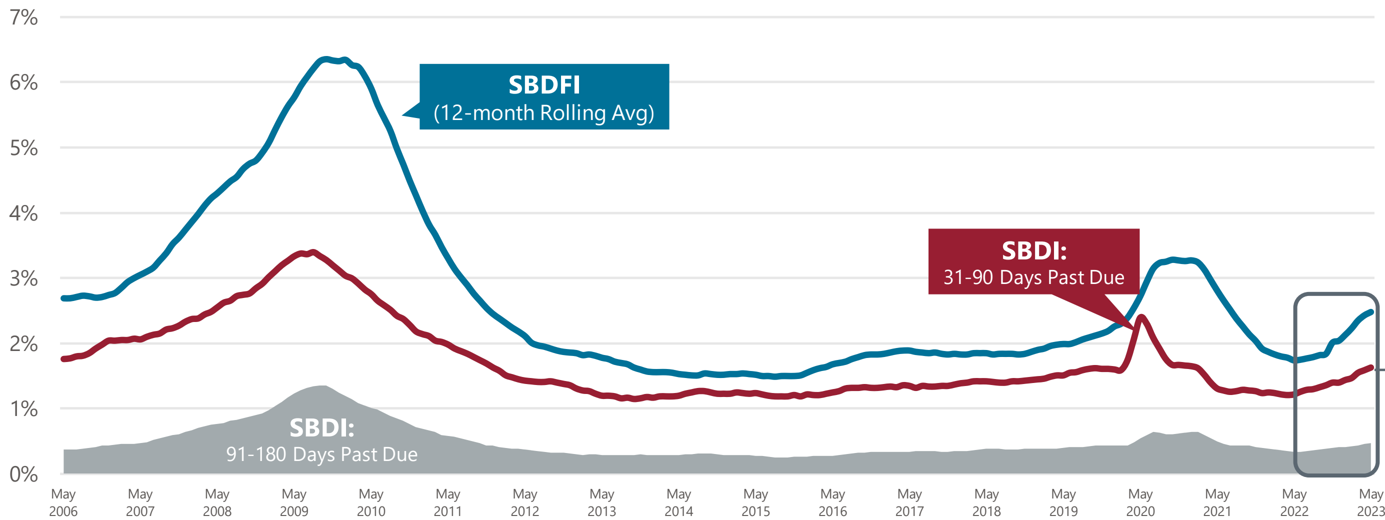
Looking ahead, given current and expected economic conditions, lenders are increasingly tightening their lending standards. For example, the American Bankers Association reported in June that business credit availability is likely to decline over the remainder of the year as banks prepare for weaker economic growth and increasing financial challenges. Other developments, such as increased pressure on bank deposits and growing turmoil in the commercial real estate market (both exacerbated by higher interest rates) will be particularly impactful for many smaller banks — and, by extension, their small business clientele. Given this context, it is not surprising that more than half of small business owners plan to delay (53%) or reduce (52%) capital spending, per a recent WSJ/Vistage survey.

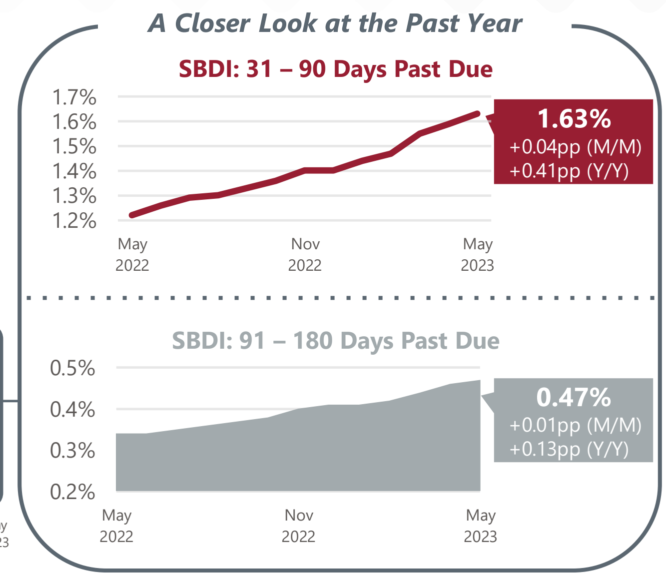
Although the Fed kept interest rates steady at its latest meeting, core inflation is still hovering around 5% while both job growth and wage growth remain strong. As such, rate hikes are likely to resume later this summer, putting additional downward pressure on small business lending.

EQUIFAX

Financial Stress Continues to Rise on Main Street

Equifax Small Business Delinquency Index (SBDI)* & Default Index (SBDFI)**





*Delinquent Percentage of Small Business Loans, Seasonally Adjusted Index | **Default Percentage of Small Business Loans & Leases, Seasonally Adjusted Index

Index Analysis

The Equifax Small Business Delinquency Index (SBDI) 31–90 Days Past Due increased 4bp in May to 1.63% and is 41bp above its year-ago level. The SBDI 91–180 Days Past Due increased 1bp to 0.47% and is up 13bp Y/Y. Defaults rose 5bp in May to 2.48% and are now 74bp above year-ago levels.

Regional Story: In May, delinquencies rose in three of the ten largest states, led by North Carolina (+7bp M/M) and Michigan (+4bp M/M), while Pennsylvania (-11bp M/M) and Georgia (-10 bp M/M) saw the largest monthly decline. On an annual basis, delinquencies increased in all ten of the largest states, led by Florida (+83bp Y/Y). Defaults rose in nine of the ten largest states in May, led by increases in Texas (+12bp M/M) and North Carolina (+11bp M/M). On an annual basis, defaults rose in each of the 10 largest states, including triple-digit increases in Georgia (+142bp Y/Y), Florida (+127bp Y/Y), and Texas (+120bp Y/Y).

Industry Story: Delinquencies rose in four of six tracked industries in May, led by Transportation (+7bp M/M). Delinquencies eased slightly in both Construction and Agriculture (-1bp M/M). On an annual basis, delinquencies climbed in all six tracked industries, led by Transportation (+151bp Y/Y) and Construction (+40bp Y/Y). Meanwhile, defaults increased in 14 of the 18 tracked industries in May, led by Transportation (+37bp M/M) and Accommodations & Food Services (+15bp M/M). Education (-4bp M/M) saw the largest monthly decline. On an annual basis, defaults rose in all 18 tracked industries, led by Transportation (+277bp Y/Y) and Accommodations and Food Services (+118bp Y/Y).

Economic Context

The Equifax Small Business Delinquency Index and the Small Business Default Index each worsened in May. Both indices have been deteriorating over the last 12 months, reflecting a combination of higher interest rates and slower economic growth that is leading to a slow but steady increase in financial stress. Sectors that are historically more sensitive to interest rates, including transportation, have fared the worst as the Fed cracks down on high inflation by tightening monetary policy, and expectations for additional rate hikes and tighter lending conditions later this year will likely lead to further increases in small business financial stress, which are currently in line with or just above pre-pandemic levels.

Notably, the economy expanded faster than expected (2.0%) in Q1, and over the last three months the labor market has averaged a solid 244,000 jobs gained per month. Still, there is evidence that broader economic conditions will worsen: the Conference Board's Leading Economic Index (which has a strong track record for predicting downturns) has been negative for the last 11 months, and per NFIB, most small business owners expect conditions to worsen over the next six months. Additionally, with core inflation still above 5%, more rate hikes later this year are likely, leading to additional financial stress in the months ahead.