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Beyond the Trends

Understanding the Commercial Economy

Spring 2022

About this report

Beyond the Trends is a quarterly report written by Experian Business Information Services. The report offers a unique view of the small business economy based on what we see in the data. With up to date information on over 25 million active businesses and how they perform from a credit standpoint. Experian will share insights and commentary on how economic conditions, public policy, and other factors might shape future small business performance.

What could dim prospects for small business growth?

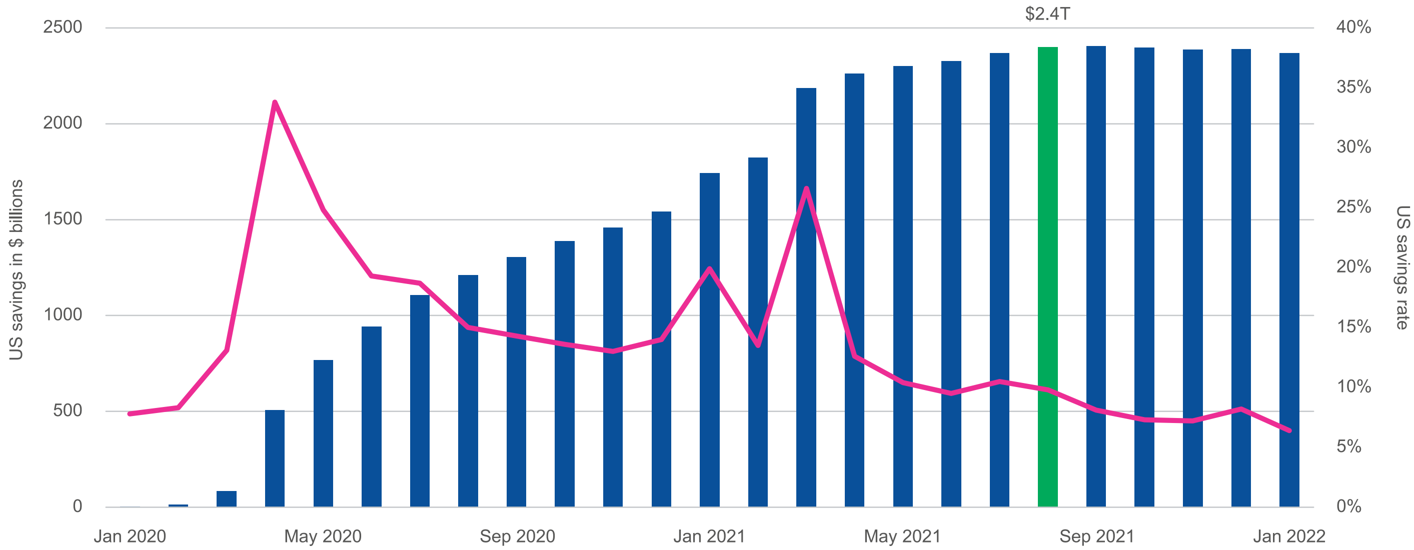
The next 12 months will be filled with headwinds and mines for small businesses. These entities have been shoring up resources, operations, building in cost increases, and creating backup supplier networks as supply chain disruption and inflation will batter the ship through 2022. Energy costs are hitting margins and impacting delivery of goods and services. US energy costs were up 27% in January according to the Bureau of Labor and Statistics. These costs have been rising sharply since March 2021 and will be exacerbated in the 1st quarter 2022 by global reaction to the Russian incursion in Ukraine. Energy supply chains will be disrupted by sanctions and higher transport costs. Consumers and small businesses will feel the pinch of lower supply and higher costs. Inflation, outside this event and on the rise, will remain above the Federal Reserve target of 2% through the end of 2022, even as the Fed raises rates and begins to reduce their balance sheet. The US supply chain will be in a slow recovery mode as infrastructure stimulus and global markets return to capacity. Small businesses are adjusting to a high demand low supply market through 2022.

The rub: US sanctions on Russia can take a year or more to create impact and activating backup delivery methods to improve US energy supply will take time. This means businesses will deal with elevated energy costs through 2022. Beyond the energy disruption, Russia supplies 35% of the U.S. palladium used to create semiconductors, and with the incursion into Ukraine, 90% of the semiconductor-grade neon used to manufacture chips in the US. This could cause significant disruption in component manufacturing and speed to AI advancement. (source: Venturebeat.com) Businesses growth will be constrained by prolonged US supply chain challenges stemmed from global conflict, pandemic, operational efficiency, warehouse space, and limited inventory availability. These risks and real limitations will cause the flow of inventory to run at reduced capacity. As manufacturing closes in on full production, the infrastructure to transport the products to wholesalers and retailers, weakened by a global pandemic and economic recession, struggled to get back on their feet. Consumer's hesitancy to return to the labor force will continue as COVID outbreaks limit the availability of workers willing to return and severely limited childcare options for those willing. These pressures created strong headwinds for the supply chain to staff a recovery. The insights shared intend to take you from a high-level macro view of the market drivers and U.S. small business commercial credit health to insights we see Beyond the Trends.

Higher consumer costs will temper spend

Consumer savings peaked in August of 2021, $2.4T was driven by wage increases and stimulus income, as price pressure put a dent in consumer purchase power. The impact will be felt for the next few years as rising costs limit the ability to put money aside for future expenditures. The consumer savings rate is now lower than pre-pandemic rates and will continue to be low as heightened inflation lingers.

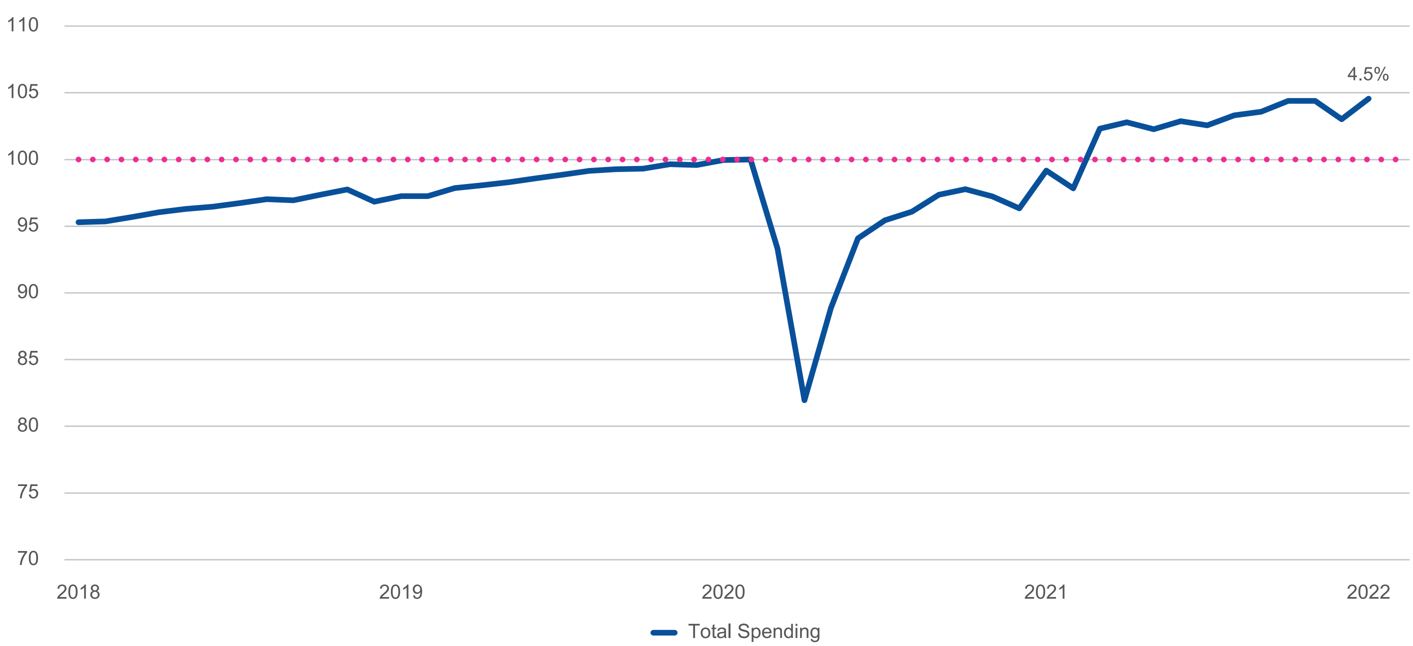
US Consumer Savings peaked in August 2021



Source: Bureau of Economic Analysis and Experian

Even with this price pressure, Consumer spend continues to recover at a good pace through 2021

US Consumer Spend — Real Consumer Spending (PCE) and Consumer Sentiment: Index Feb. 2020 = 100

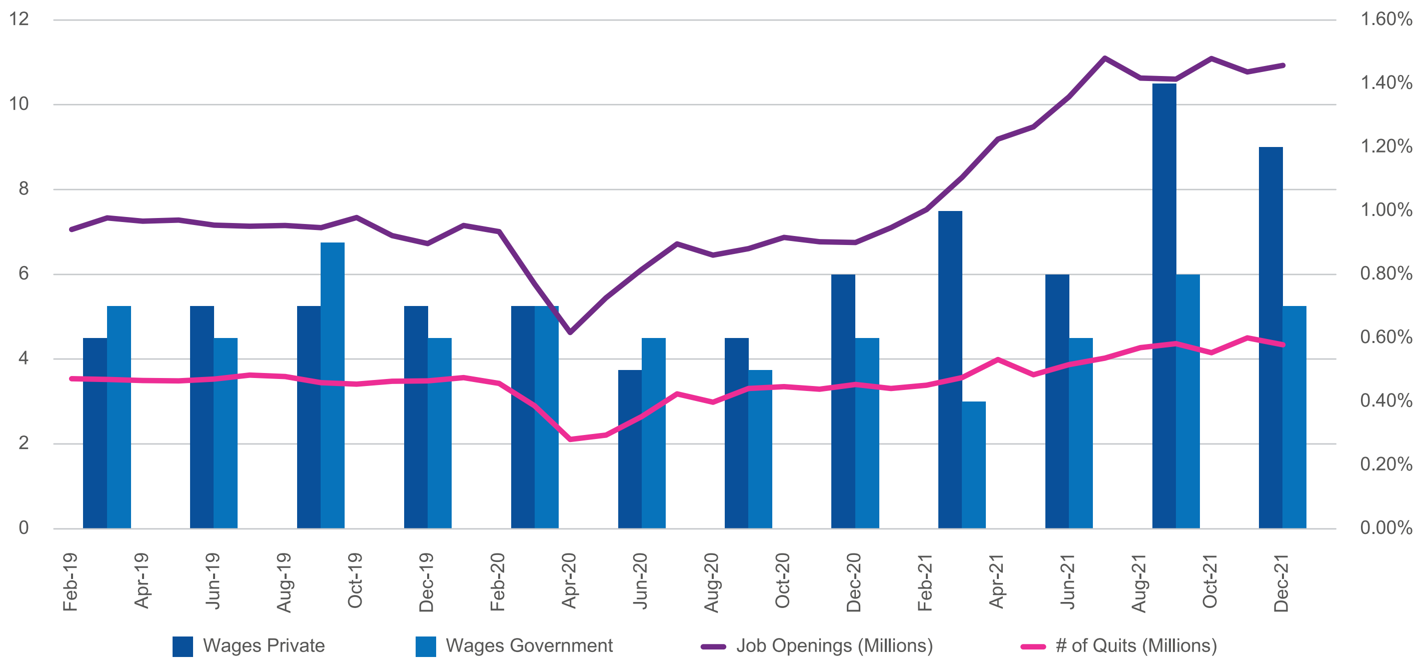


Source: Bureau of Economic Analysis, University of Michigan, and Experian

Wages have been on the rise in the US as people are slowly returning to the labor force. These participants are switch industries and even migrating to different regions of the country as lower costs of living and higher wages lure them to new jobs.

Staffing businesses to meet demand in the US has been a challenge during the pandemic. In the last year job openings have outpaced those seeking employment. This has led to wage inflation and a rise in the number of people quitting jobs for higher wages with an alternate employer or industry.

Constricted supply of labor and shrinking pool of unemployed



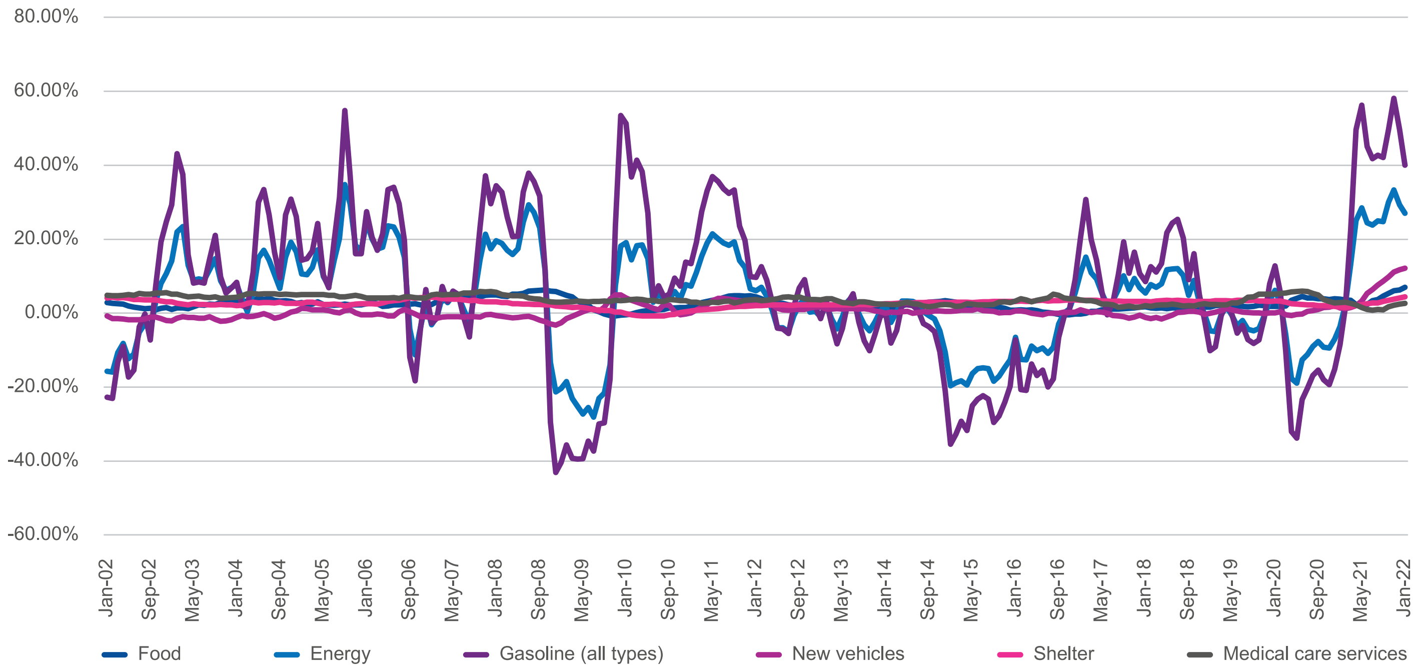
Source: https://www.bls.gov/charts/employment-cost-index/compensation-in-private-industry-and-state-and-local-government-3-month-percent-change.htm#

This has created a labor vacuum in industries led by leisure, hospitality, government, education, health, and manufacturing having the most to regain from initial COVID impact.

The rub: This wage growth, although continuing its rise, is being eaten away by inflation in the US. Employers continue to offer special incentives for candidates, but the number of open positions significantly outpaces the number of job seekers. People are reentering the U.S. job market which will continue to push the unemployment rate towards ~4% in 2022. High inflation combined with reduced benefits/stimulus will place millions of people in a tighter fiscal position which will reduce their ability to spend. These are near term risks that will impact consumer's discretionary spending willingness and capacity. This will change the labor dynamics of the US and will create pockets of full employment while other regions struggle to find workers. For the worker this means wages continue to rise as employers fight to attract and maintain a labor force.

Consumers are feeling the tangible economic strain of rising food and energy costs, increasing at rates not felt since the early 80's. (source: Wall Street Journal (2/10)) These strains are not felt evenly across income segments in the US. Low income families will feel the brunt of the impact. Twenty eight percent of low income families, making less than $40k, will suffer severe hardship as an impact of inflation versus 2% for those families making greater than $100k, according to a recent Gallup poll. Low income families will be spent 40% more on these core expenses as a percentage of core spending as discretionary funds dry up.

Core price inflation

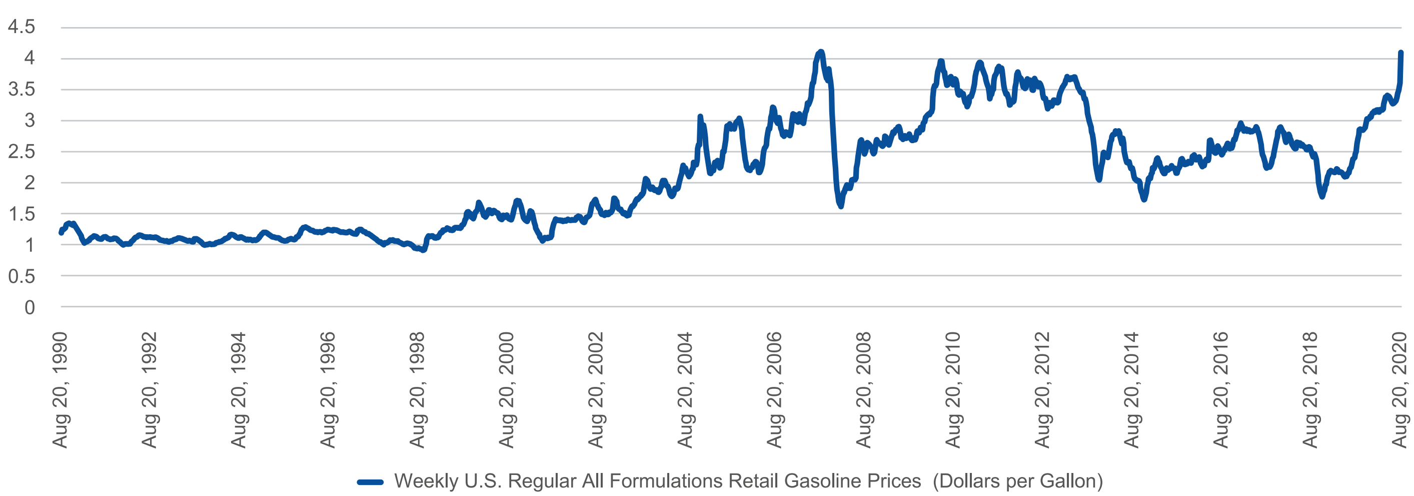


Source: https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm

Food (up 7%), shelter (up 4%), and gasoline (up 40%) costs are all rising. These costs will limit the ability of consumers to stretch their purchasing power beyond core essentials.

A spotlight on gasoline price inflation highlights the pressure on the consumer. Fuel costs are a large part of the budget and variability in this cost can push families into recessed spending.

Weekly U.S. Regular All Formulations Retail Gasoline Prices (Dollars per Gallon)

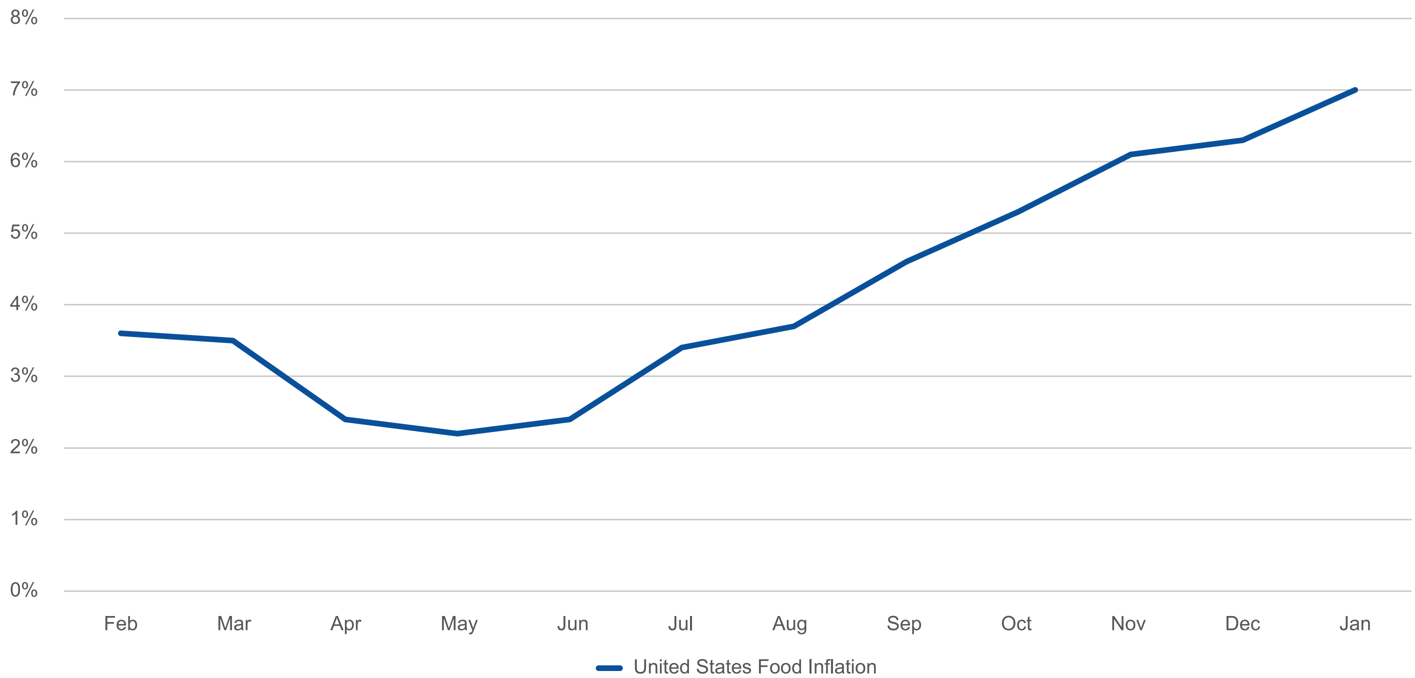


Source: https://www.eia.gov/petroleum/gasdiesel/

Fuel prices around 4 dollars a gallon, has been seen as the tipping point were alternative energy sources become more attractive and profitable for developers. We will see a resurgence in oil and gas production in the short term to fill gaps in supply and to aide in US energy independence. The pressure will continue, for consumers, through 2022 as global energy trade will be disrupted by reactive policy changes and sanctions leveraged toward Russia, a top producer and distributor of energy around the globe. Sanctions leveraged on developers and producers of Russian supplied oil and the banks that fund them will create supply shortages in the US and other regions.

Fuel impacts more than the transportation of goods. This elevated cost will impact farmers and food producing industries as the cost to produce will rise.

US Consumer food inflation

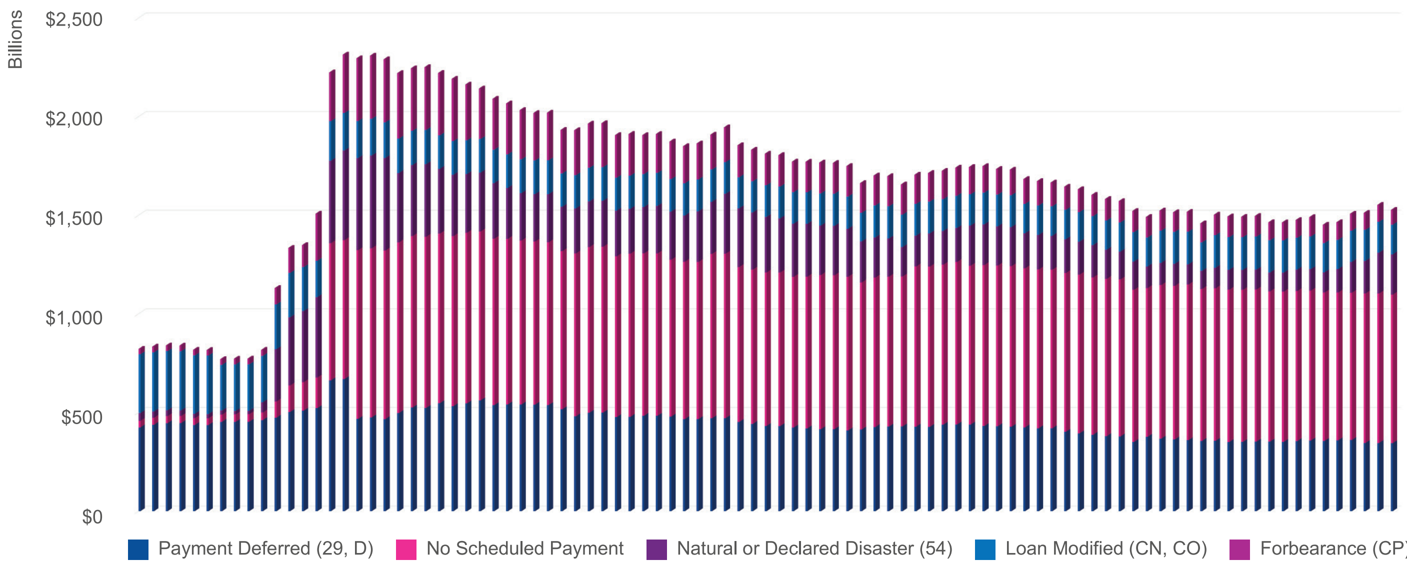


Source: U.S. Bureau of Labor Statistics, https://tradingeconomics.com/united-states/food-inflation

Food inflation, in the US, has been on the rise since the summer of 2021. The cost of food in the United States increased by 7 percent in January 2022 year over year which is the highest food inflation since 1981.

Experian sees consumers seeking unsecured credit at pre-pandemic levels, to prepare for higher price pressure, while forbearance and modification requests continue to taper. The remaining forbearance and modification activity has settled to the lowest volume since the pandemic began. Consumer reliance on credit for core expenses will increase with inflationary pressure, and this will create upward pressure on forbearance and modification programs, as consumer cashflow tightens.

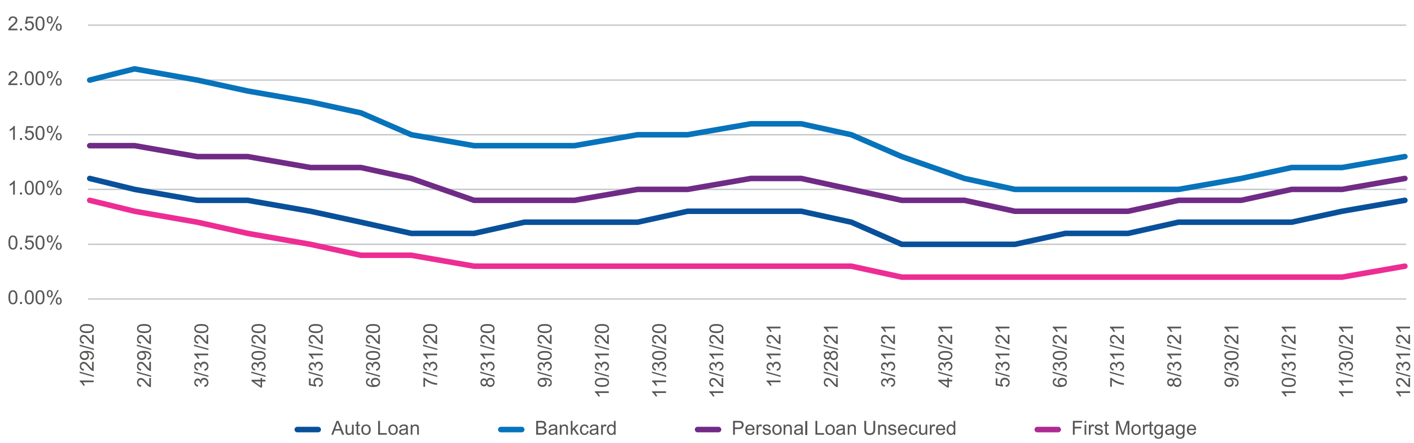
Experian State of Credit — US Change in reported forbearance or deferral by week: Balances



Source: Experian State of Market

The pressure increases as consumer reassume debt, from forbearance and modification programs that has been delayed, adding more obligations to the monthly consumer repayment schedule. We expect to see delinquencies rise through 2022.

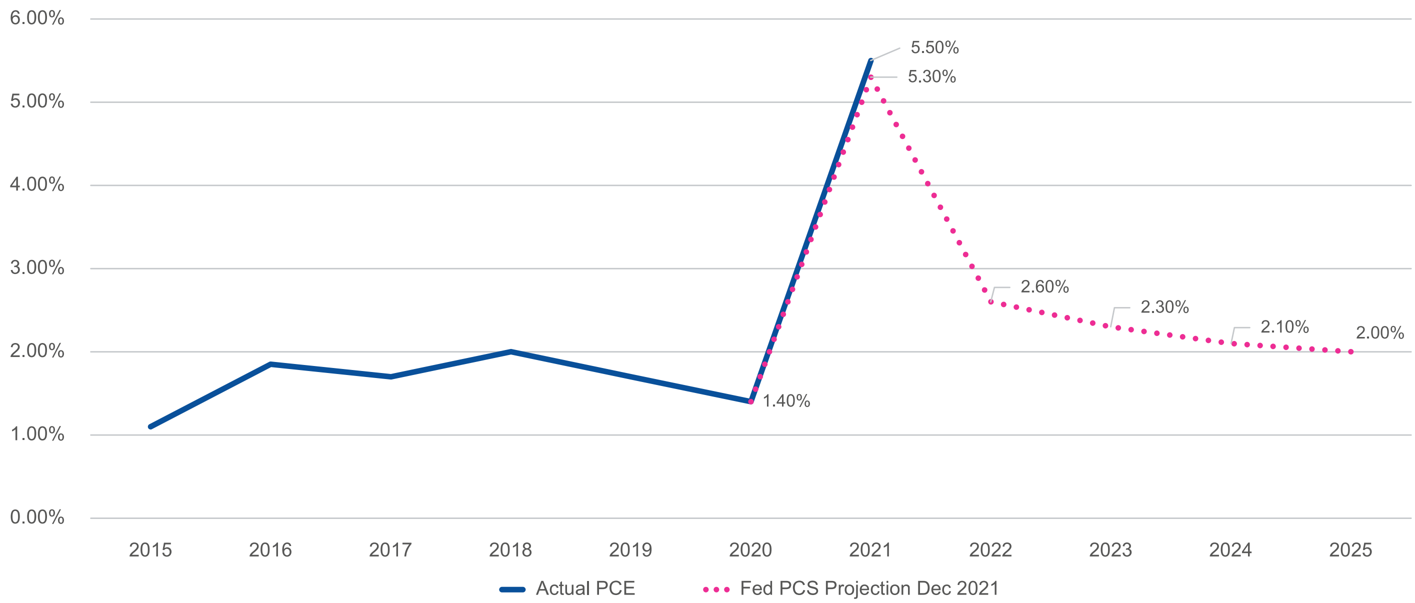
US Consumer % Balance 60+ Day Delinquency Trends Elevated



Source: Experian State of Market

The Federal Reserve will act beginning in March 2022 to address accelerating US inflation. Rates will begin to rise at a 25 bases point increments, likely 4-5 times, in 2022. Inflation is expected to be above the Feds 2% target through 2025.

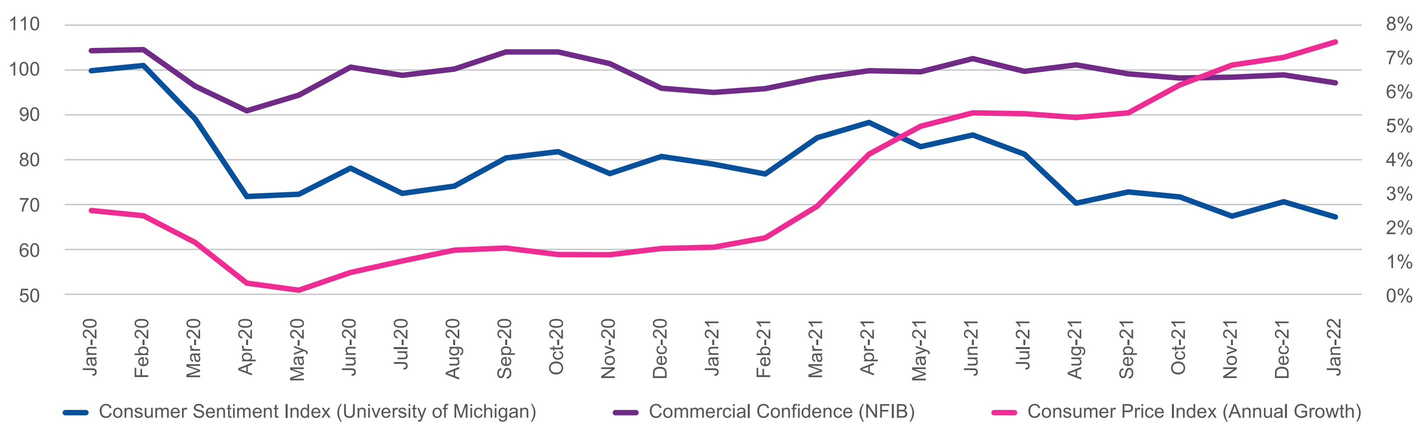
Inflation continues to rise with supply chain challenge elongation (Personal Consumption Expenditures Index)



Source: Bureau of Economic Analysis and the Federal Reserve Open Market Committee, Federal Reserve Board of Governors and Experian

Consumers need to believe the Federal Reserve actions will create change in the markets to maintain investor confidence and to keep consumers spending. Consumers are very pessimistic about the markets and don't like the inflation pressure. The higher consumer costs are putting downward pressure on consumer confidence. Small business confidence follows close behind, as businesses make future bets on inventory and growth based on consumer demand.

Commercial confidence trails consumer sentiment



Source: University of Michigan, NFIB, U.S. Bureau of Labor Statistics

Why are Small Businesses important to the market?

Small businesses in the U.S. (A corporation, limited liability company, or proprietorship with 500 employees or less) make up 99.7% of all businesses in the U.S. employing more than 60 million people in the U.S. according to the Small Business Administration. They generate almost 70% of new jobs as they expand every year, and a large portion of this job growth comes from companies with **less than 20 employees**.

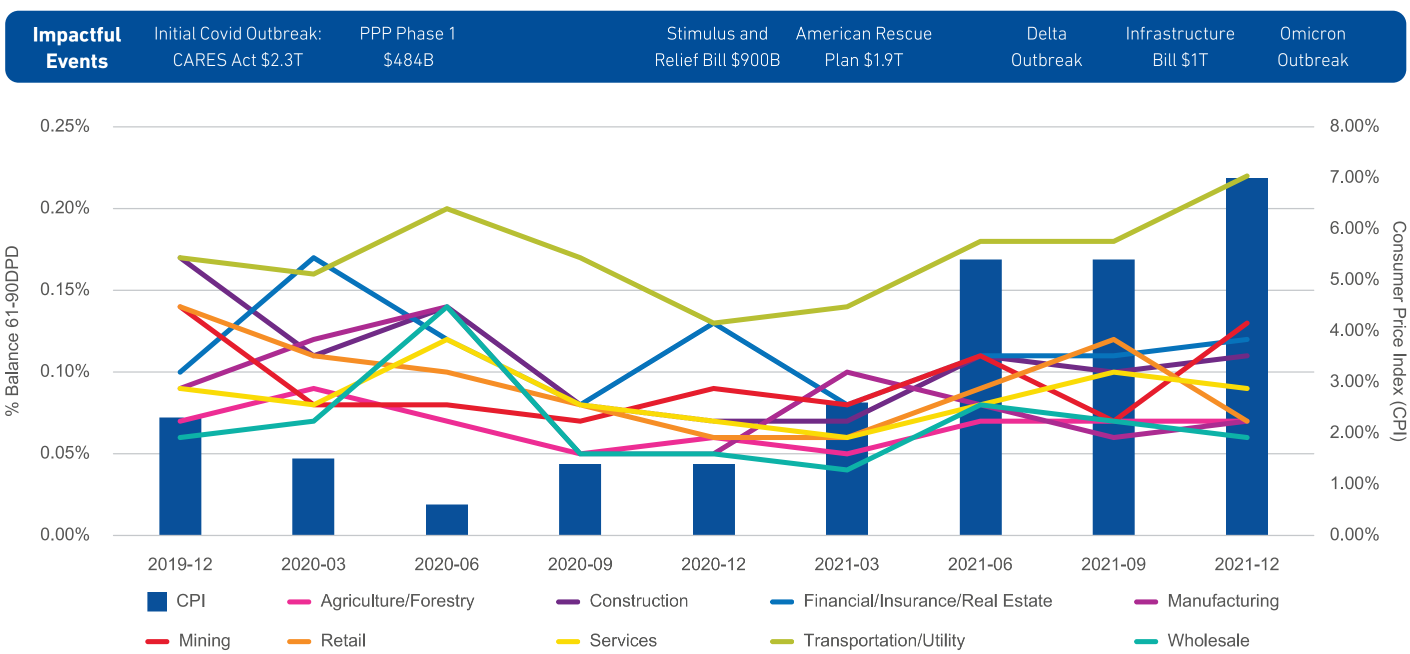
These small businesses provide essential goods and services across industries. These businesses are very inclusive of all gender and minority segments which broadens socioeconomic success, independence, and innovation. Small businesses, and the entrepreneurial spirit they present to the US market, have great influence on the health and growth of the US and global economies they serve.

What will make the lights flicker

Inflation and energy disruption impact on the US.

Inflation has had minimal impact on small business performance as US government stimulus programs kept commercial delinquencies low.

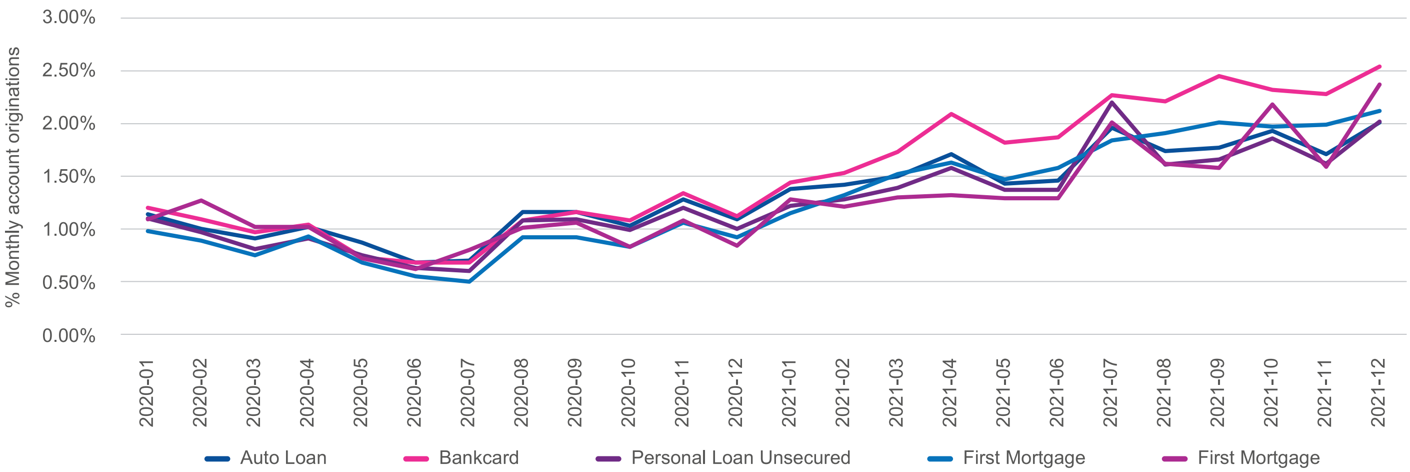
Small business lending impact — Lending delinquency by industry



The mining industry has seen volatility in availability of funding as the US struggled to find a way to push forward climate focused activities. These activities often focused on closing fossil fuel based power plants and exports. This placed a strain on the mining as well as their users the utility industry. The utility industry has also been battling regional policies placed on collection and disconnect for customers in arrears. This meant that for the past 12-18 months some utility providers are servicing customers need and infrastructure with the ability to collect from delinquent customers. Utilities follow the inflationary trend of increase as more and more customers lose the ability to repay obligations.

All these industries that make up the US supply chain are seeking private funding. During the early months of the pandemic, a business could rely on government stimulus and relief packages to supplement cashflow and limit monthly debt obligations. Businesses did not need to rely on private funding/credit to fill gaps in cashflow and payroll obligations. As the pandemic begins to decline and businesses are forecasting future environmental pressure on cashflows, those once free flowing stimulus programs are no longer available. Businesses have switched their focus to private lending at an accelerated pace in preparation for a higher cost environment that outpaces growth targets.

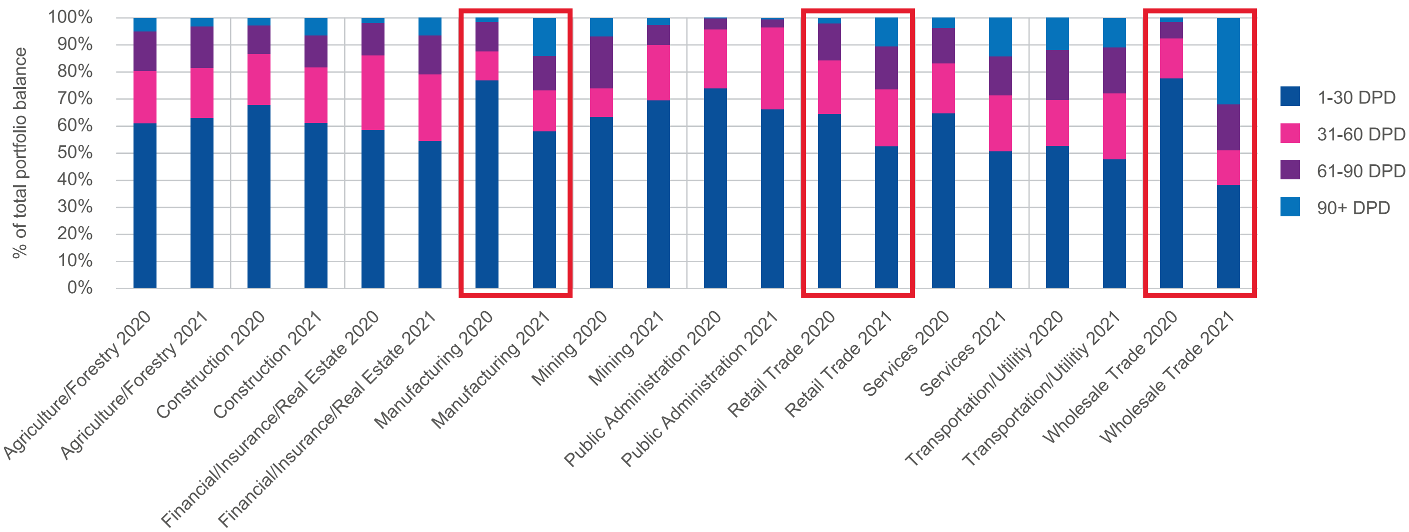
Supply Chain Industry Segment Origination Trends



Source: Experian Benchmarking

Lenders are monitoring commercial portfolio performance as inflation and other pressures curbs consumer spending. Manufacturers are working hard to cash in on higher prices and are borrowing to deliver in a high demand market. Wholesalers and retailers are stockpiling inventory to prevent shortages and the risk of disenchanted customers. Year over year delinquencies in these supply chain focused businesses have doubled as they struggle to keep up.

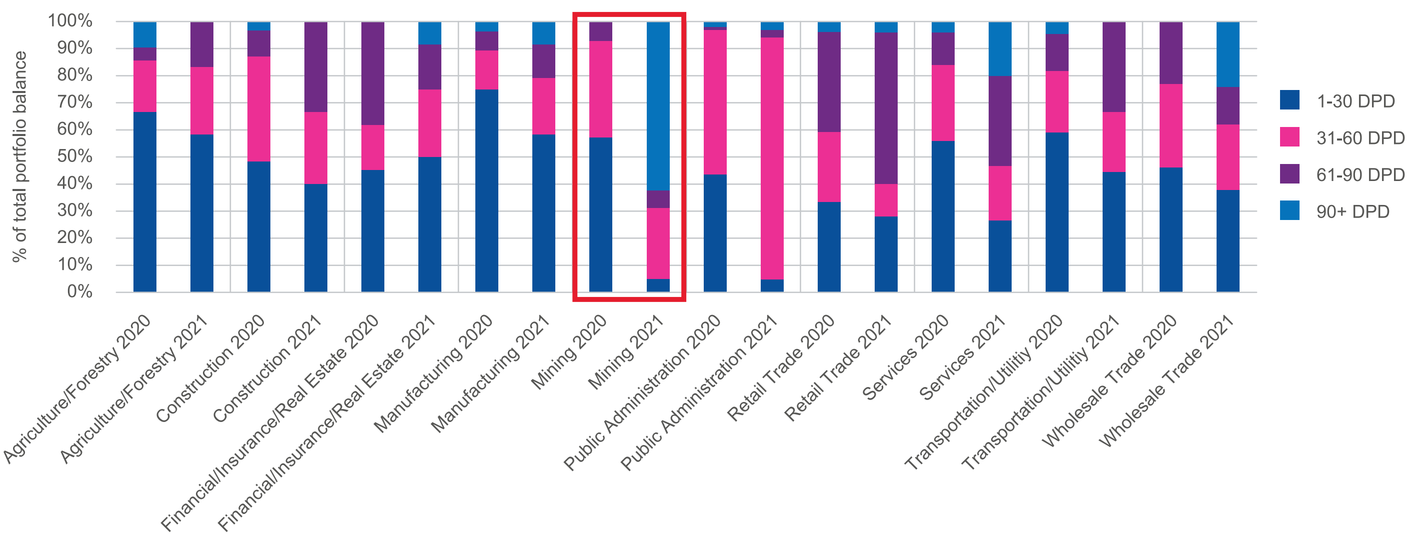
Supply chain engaged industries seeing increased delinquency rates on commercial cards



Source: Experian Commercial Benchmark

Mining saw significantly increased delinquency on their installment balances as the US pushed away from fossil fuel in 2021.

Mining seeing significant increase delinquency rates on installment loans



Source: Experian Commercial Benchmark

This industry will likely recover by the second quarter of 2022 as Russian sanctions and energy supply disruption to the globe increase as Russian and partner country exports are limited to the global market. US based fossil fuel exploration, development, and export should find new footing as they gear back up to supply market gaps at a higher global price point.

The passage of the 2021 Infrastructure Bill is expected to increase velocity to recovery. Recovery of full operation late 2022 with the expectation that further variants will not have as severe an impact on the infrastructure and flow of commodities will give consumers and investors' confidence leading to more tempered financial market volatility.

The US economy was in good shape in the 4QTR 2021. Businesses and consumers had positive cashflow and the economy was continuing its hot streak. COVID and supply chain challenges cooled growth in the fourth quarter as people stayed home from work and did not reenter the labor market and Omicron hit its peak. Explosive growth in e-commerce helped to buoy digital channels for access as consumers stayed home to avoid exposure. As the threat of infection found periods of relief, online shopping remained elevated but was down mid fourth quarter 2021.

What is on the horizon

Consumer costs related to housing, energy, food, transportation, and services will take significant proportion of discretionary spending. Consumer delinquencies are already on the rise and are expected to increase through 2022.

Changes are on the horizon. The Federal Reserve has met its employment mandate and now price inflation is their most pressing target. The Fed will begin raising rates in March and is expected to tighten its monetary policy, halting growth of its balance sheet, and looking for near term opportunities to begin reducing its assets.

Supply chain bottlenecks will continue through 2023. The weaponization of commodity availability will create volatility in manufacturing, transportation of goods and availability of services. We expect to see variability in product availability as goods are delivered which will create scenarios of oversupply of some products while others remain tied up in transit. Lenders and creditors should monitor commercial health of businesses they interact with directly and indirectly to ensure portfolio stability and accurate risk based pricing.

Foot traffic to in-person storefronts was nearly to pre-pandemic levels for most industries as consumers pushed to interact face to face. Retailers struggled to fill shelves, but strong consumer demand kept the economy growing and retailers looking optimistically to future. US GDP growth is expected to remain above 4% in 2022 returning to normal levels (2-2.5%) in 2023. Inflation will remain elevated through 2023 as consumer prices increase at rates not felt since the early 90s. Consumer's confidence is falling and spend will slow as wage increases are eroded by inflation and consumers begin to dig into their $2.3T in savings to slow the inflationary impacts to consumer cashflows.

The US remains a beacon of innovation and a bastion for entrepreneurs. New business applications are trending at almost 425k a month and nearly 40% of businesses operating in the US are less than 1 year old. To address new small businesses entering the financial market, lenders and creditors will be looking at broader ways to engage these new entities and differentiate risk earlier in the life of a business. They are recalibrating scores and looking at trends with the intent of spotlighting nuanced signals. Experian clients are excited to enhance their current strategies with non-traditional data on SMB digital availability , geolocation, COVID spread impact, macroeconomic data, social media data, firmographic data, etc. in addition to traditional credit data to differentiate the resiliency risk of a small business. Non-traditional data overlays will become critical in the assessment and pricing of risk in 2022.

US and NATO imposed sanctions pose a near term risk to US industries. As US companies lose opportunities in sanctioned markets, new investment strategies will be seen domestically as those brands look to reinvest stateside for growth. These businesses will experience disruption in their reinvestment strategies in 2022 as commodity shortages, contracting market conditions, and a decline in consumer spend will test investor confidence. Commercial industries have been resilient through 2021 with consumer spend rising because of the release of pent up pandemic demand. Rising prices for food, housing, and energy will slow this consumer spend component in 2022.

Companies should be extra vigilant during the Ukraine crisis, including small businesses. Russia has ratcheted up cyber-attacks, using Ukraine as a testing ground before releasing a torrent of malware to the west. Businesses should take necessary steps to protect against cyber risks and limit exposure should a breach occur.

Energy prices will rise dramatically, and US import and export activity will feel disruption as global partnerships will transition or are born anew. These new relationships will take time to build efficiencies and profitability. This time of transition will place upward price pressure on both consumers and small businesses. Energy focused industries will feel recovery accelerate by the second quarter of 2022. US based fossil fuel exploration, development, and export should find new footing as they gear back up to supply market gaps at a higher global price point. The increase in fuel prices will create an environment for investment in renewable energy as people and businesses will be more open to evaluate alternatives as costs grow. 2022 will be a recovery year for the US market filled with risks and big opportunities.

The lights may flicker but they will stay on!

About the author

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Brodie leads a team of statistical consultants, scientist, modelers, and engineers with diverse skills to provide clients with leading edge analytic-driven information solutions, services, and visualization of actionable insights. His is an industry expert, who speaks on behalf of Experian at industry conferences.

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