Authorized Experian Direct Sales Representative

MAIN STREET REPORT

Your window into small business health

Q2 2022

MAIN STREET REPORT

Time to pull back and hit the reset button

Executive summary

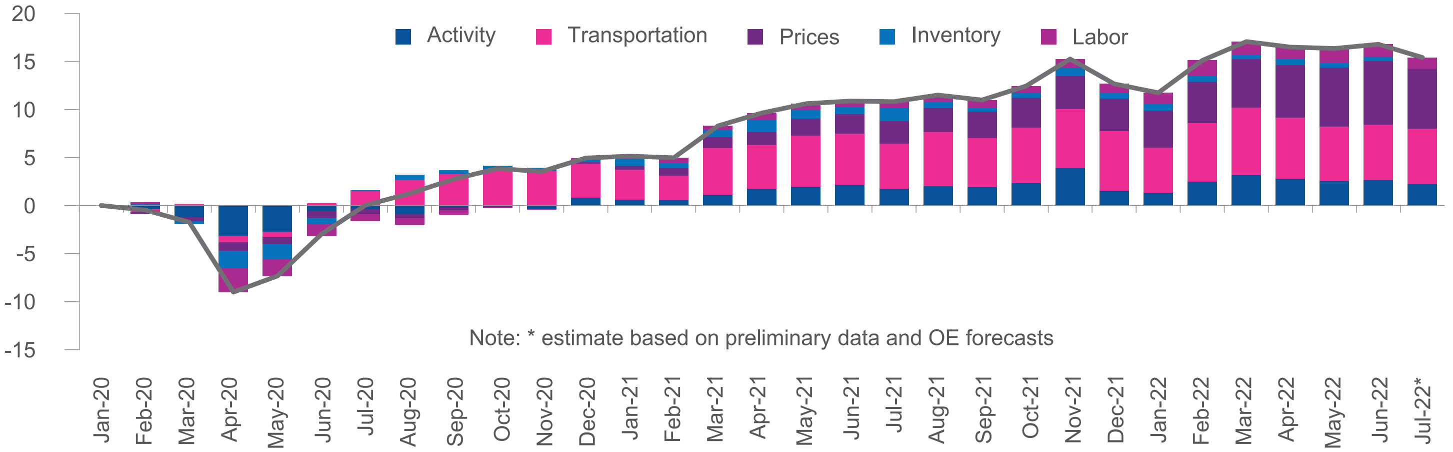
After a strong economic rebound in the wake of COVID-19, a more challenging environment and heightened recession worries are forcing small businesses to “hit the reset button”. Small business anxiety about elevated inflation and labor shortages persisted in Q2 2022, as small businesses held debt balances longer, while seeking additional credit in anticipation of a tighter lending environment.

Macroeconomic Overview

The U.S. economy suffered a second straight quarter of negative growth in Q2, enduring what many pundits would call a technical recession. However, Experian and Oxford Economics doubt the economy experienced a real recession as the labor market remained strong. Looking ahead, the economy will face strong headwinds from high inflation, aggressive Fed tightening, financial market volatility and weakening global demand. These challenges will drag on small business confidence by cooling economic activity and hiring into 2023. U.S. supply chain disruptions will continue to create a complex challenge for small businesses as they plan for the upcoming holiday season. We saw inventories swell over the summer as businesses pre-ordered for the season, but there is a cost as some will have over purchased in anticipation of disruption.

U.S.: Supply chain stress tracker

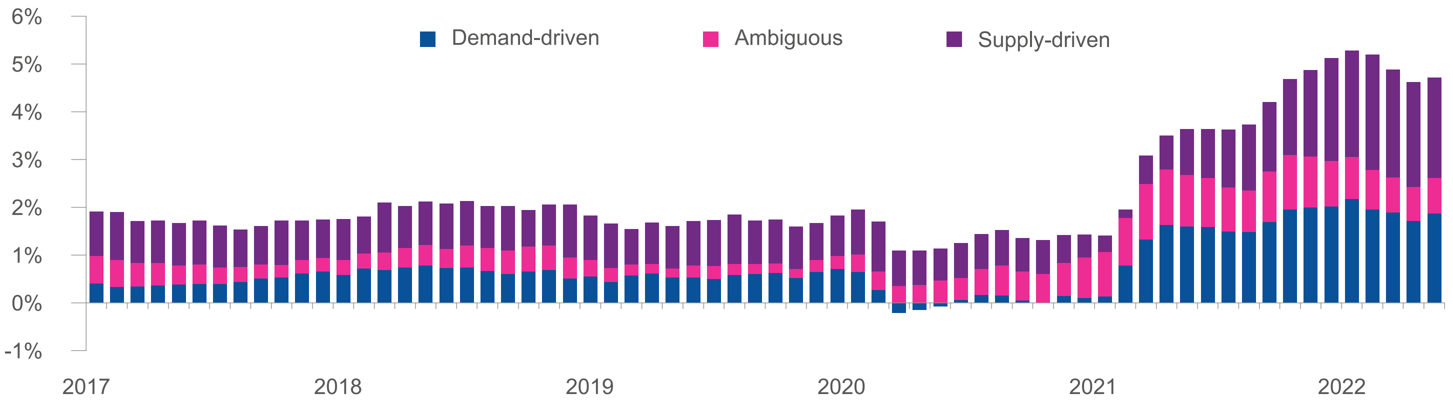
Index; > 0 = rising stress



Source: Oxford Economics and Haver Analytics

The U.S. Federal Reserve will aggressively raise interest rates to slow demand, weighing on household spending and slowing activity in interest rate-sensitive sectors such as housing.

Contributions to YOY PCE Inflation Change



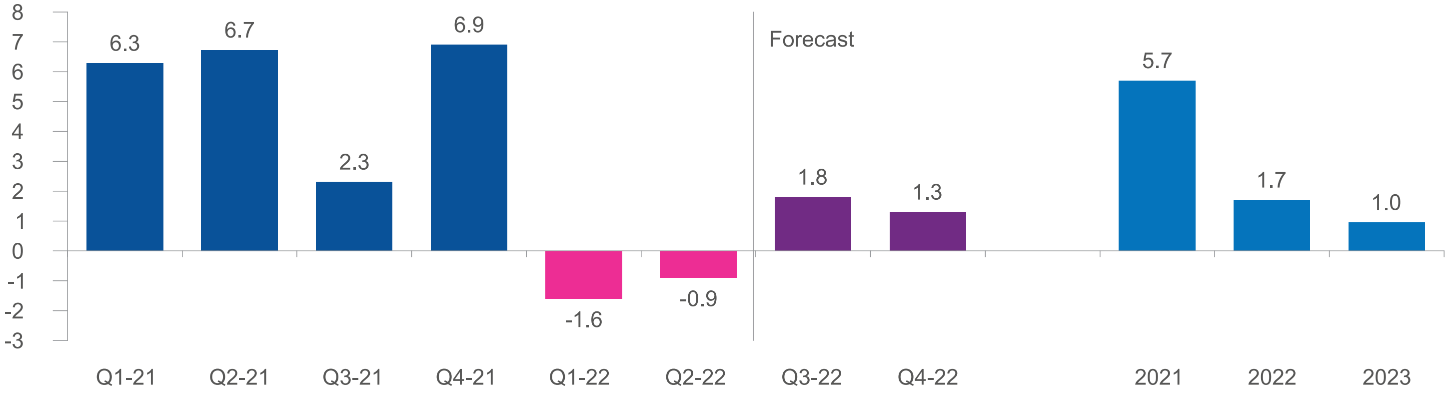
Source: Federal Reserve Bank of San Francisco

This will lead to small businesses seeing a decline in premium product purchases and services in the near term and a potential for more significant softening if monetary policy tightening by the Federal Reserve is too aggressive and excessively cools the market, significantly impacting consumer spending behavior.

While Experian and Oxford Economics continue to see a pathway to a softish landing, it's admittedly narrowing. We anticipate only a modest rebound in H2 2022 and now see real GDP growing 1.7% this year and 1% next year.

U.S.: GDP Growth

Q/Q % annualized



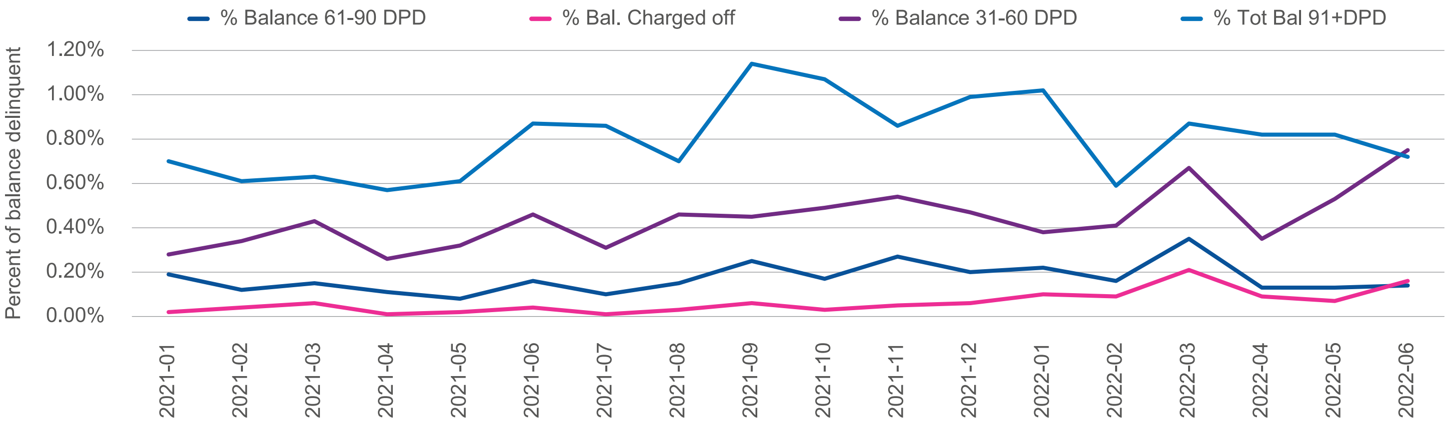
Source: Oxford Economics/Haver Analytics

U.S. business sector

The U.S. corporate sector will face a litany of challenges in the form of soaring inflation, tighter financial conditions, persistent labor shortages and supply chain challenges which will depress sentiment and weigh on profitability. Business investment is poised to advance on a modest track, forecast to grow around 4% in 2022 before cooling to under 2% as businesses temper their activity and higher interest rates make capital expenditures more costly.

The Q2 2022 Small Business Credit Sentiment Survey conveyed some warning signs regarding business credit and lending dynamics, but none were concerning enough to signal an imminent recession. Commercial installment loan origination balances moderated at the end of Q2 to just under $250,000 while early stage delinquencies (31-60 days past due) rose nearly 12%. Signs that SMB debtors were slower in repayment while rolling into later-stage delinquency slowed . The deterioration in early stage delinquency was not overly worrying because it is still near historic lows.

U.S.: GDP Growth



Source: Experian Business Information Services Commercial Benchmarking

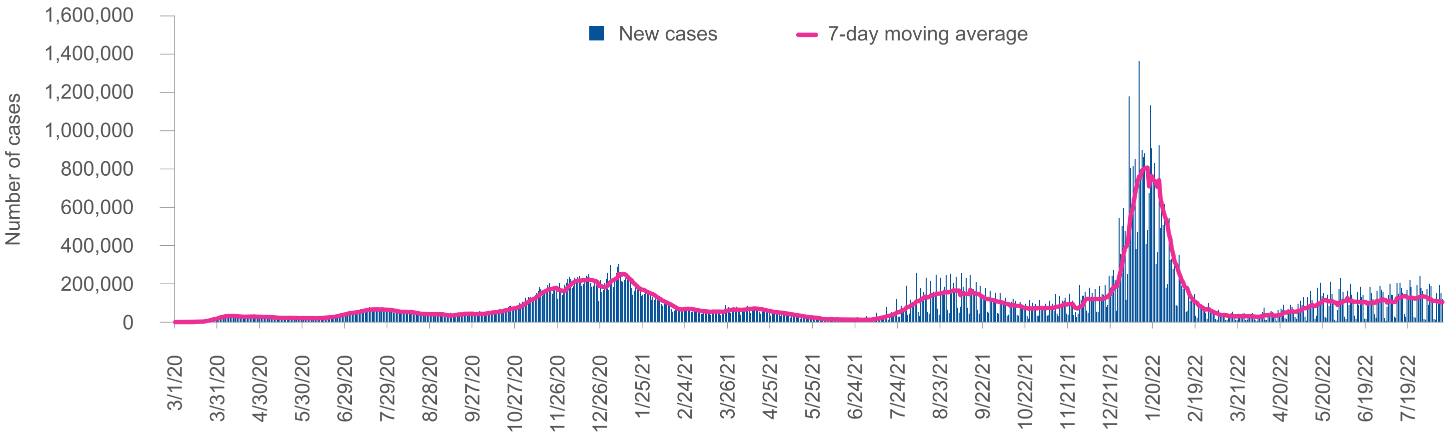
Businesses held their debt balances for longer and sought out additional credit in anticipation of a tighter lending environment that would make funding less accessible in the near term.

U.S. consumer sector

Consumers are feeling increasingly sour about high prices, but are still willing to dig into their savings and tap credit lines to maintain their living standards. Consumers have continued to release their pent-up demand for leisure and hospitality services, which has underpinned consumer spending in recent months, although the outlook for the fall is more uncertain. The results of the latest Small Business Credit Sentiment Survey support these findings, with lenders' posture still supportive of economic expansion in Q2 as credit originations rose and delinquencies only ticked up slightly.

Looking ahead, we expect the U.S. consumer will continue to push the economy forward, albeit at a modest pace. The pandemic has taken a backseat to elevated inflation and geopolitical tensions, but it remains a downside risk to the outlook.

U.S.: COVID-19 Cases



Source: CDC (Centers for Disease Control and Prevention)

While the Omicron coronavirus wave receded earlier this year, the spread of subvariants has led to a renewed increase in COVID-19 cases across the country, which official figures are likely understating.

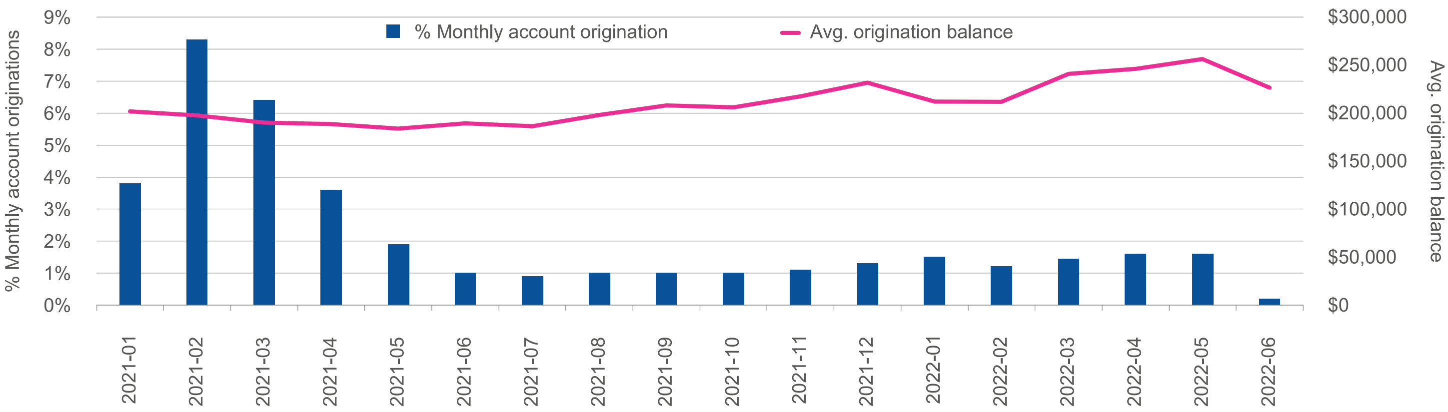
Highlight on specific pressures that affect small businesses — Recession fears are exaggerated

It will take months, if not years, before the NBER determines if the two-quarter contraction in GDP in H1 2022 aligned with other metrics that justifies an official recession call. From Experian and Oxford Economics' perspective, the economy is still on an encouraging footing as the setback in GDP reflects more idiosyncratic factors related to supply constraints than a sharp pullback in demand. What's more, the slim 0.9 decline in GDP reported for the second quarter is based on incomplete data that may yet be revised higher as more information becomes available.

More broadly, despite declining purchasing power and plunging household sentiment consumer spending, the main driver of economic output, is well ahead of pre-COVID-19 levels and above where it would be had the trend prior to the pandemic continued. What's more, a key metric, the health of the jobs market, strongly suggests that the economy is not yet mired in a slump.

Given that commercial credit tends to lead the economic cycle, the latest Small Business Credit Share data collected by Experian does not flash warning signs of a recession. Commercial installment loan originations ticked lower at the end of Q2, but loan growth remained encouraging overall. Commercial card originations, meanwhile, remained healthy with credit lines down slightly averaging $55,000 in the quarter. Delinquencies across product types are rising but not enough to portray a sharp deterioration in credit market dynamics. There are pockets of concern among certain industries, namely wholesale and retail trade, but in this moment are not overly concerning.

Commercial Origination Trends



Source: Experian Business Information Services Commercial Benchmarking

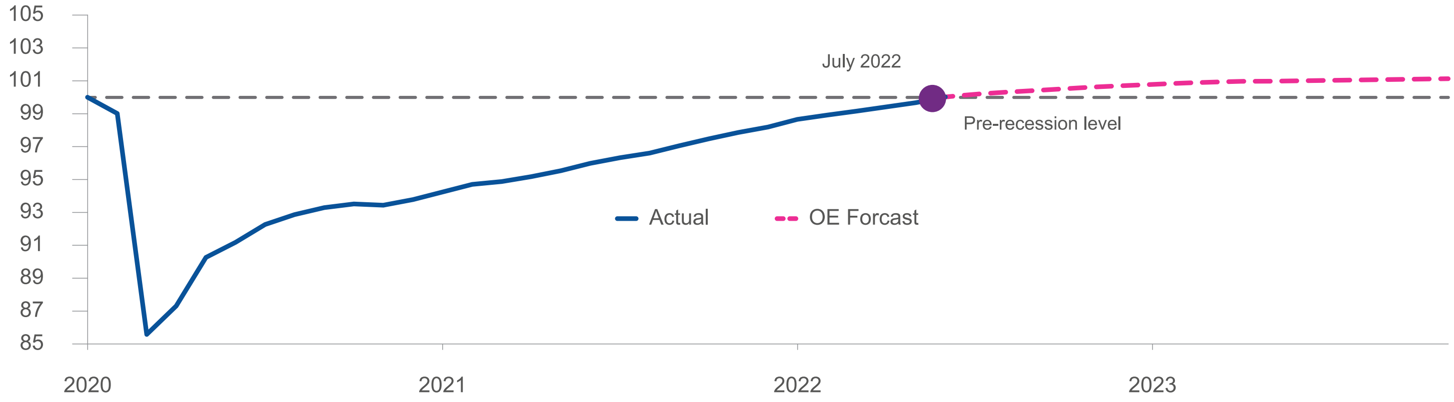
Highlight on specific pressures that effect small businesses — Labor market outlook

With the Federal Reserve having embarked on its most aggressive tightening campaign in nearly three decades, a rapidly slowing U.S. economy should bring worker demand and supply into closer balance. Experian and Oxford Economics expect a slowdown in job growth in coming quarters. On the demand side of the labor market, softer business surveys, tighter financial conditions, and slower GDP growth prospects point to cooler demand for workers in H2 2022 and 2023. On the supply side, Experian and Oxford Economics expect elevated wages and a thinning financial cushion will draw more individuals back into the labor force this year.

While a sharp rise in unemployment can be avoided, our forecast for a modest increase in the unemployment rate points to a greater risk of a recession in 2023 than 2022. Historically, a rise of 0.3ppts on average in the unemployment rate has preceded post-war recessions, and the unemployment rate has tended to reach a trough less than six months before the start of a downturn. Similarly, there has not been an episode over the past two decades where job openings have declined substantially outside of a recession.

U.S.: Employment recovery

Peak pre-recession employment = 100



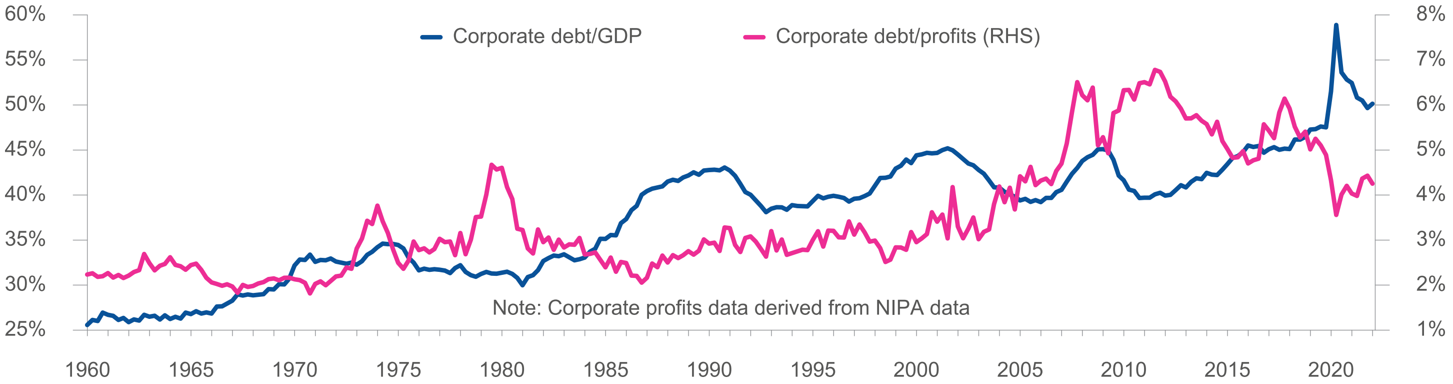
Source: Oxford Economics/Haver Analytics

Highlight on specific pressures that affect small businesses — Corporate debt vulnerabilities

Increased borrowing costs are raising corporate default concerns as outstanding nonfinancial corporate sector debt reached 50% of GDP in Q1 2022, not far below the all-time high reached in 2020. However, higher interest rates alone won't be sufficient to spur a significant jump in defaults. Businesses are well-positioned to stand the heat due to a high degree of liquid assets and long debt maturity profiles, plus healthier interest coverage and lower leverage ratios than pre-pandemic.

We think a greater risk is that if rates stay high as the economic expansion slows, weaker revenue growth could leave companies with less cash to meet their debt obligations. In such an environment, lower-quality borrowers would face the greatest risks. Experian and Oxford Economics' base case is the U.S. avoids recession, but our recession scenario indicates the spread of BBB-rated industrial corporate bond yields over the 10-year U.S. Treasury could widen to 240bps by next year. This is in line with the spike experienced at the start of the COVID-19 recession and during the 2015 oil price collapse.

U.S.: Corporate debt and profits



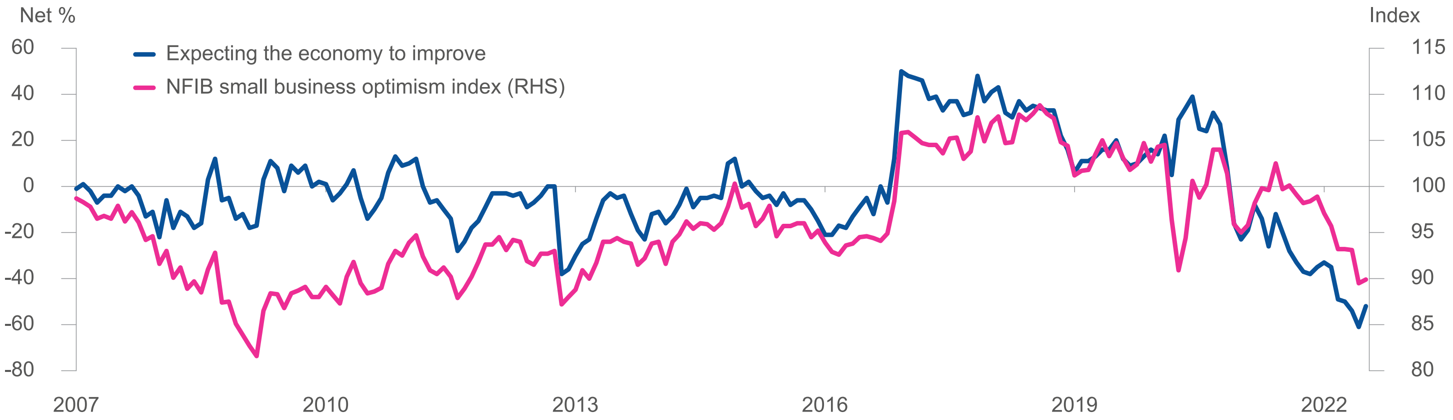
Source: Oxford Economics/Haver Analytics

Highlight on specific pressures that effect small businesses — Weak confidence

Small business sentiment is very weak compared to historical averages, weighed down by anxiety about elevated inflation and labor shortages. Indeed, the latest NFIB Small Business Optimism survey found that inflation was cited by 37% of small business owners in July as their single most important problem — the highest level since Q4 1979. An elevated 49% of owners reported unfilled job openings in July, more than 20 percentage points higher than the historical average. What's more, about half of firms continued to raise compensation, with one-in-four firms planning to raise compensation in the next three months.

Looking ahead, the persistence of price pressures and stickiness of impaired supply dynamics will keep small businesses in a sour mood. On the bright side, with labor demand remaining historically elevated, even as small business confidence remains low, Experian and Oxford Economics look for a solid, albeit cooling labor market to remain a crutch for the economy. Small businesses might resist laying employees off even if a recession materializes due to recruiting difficulties.

U.S.: Small businesses remain downbeat on the outlook



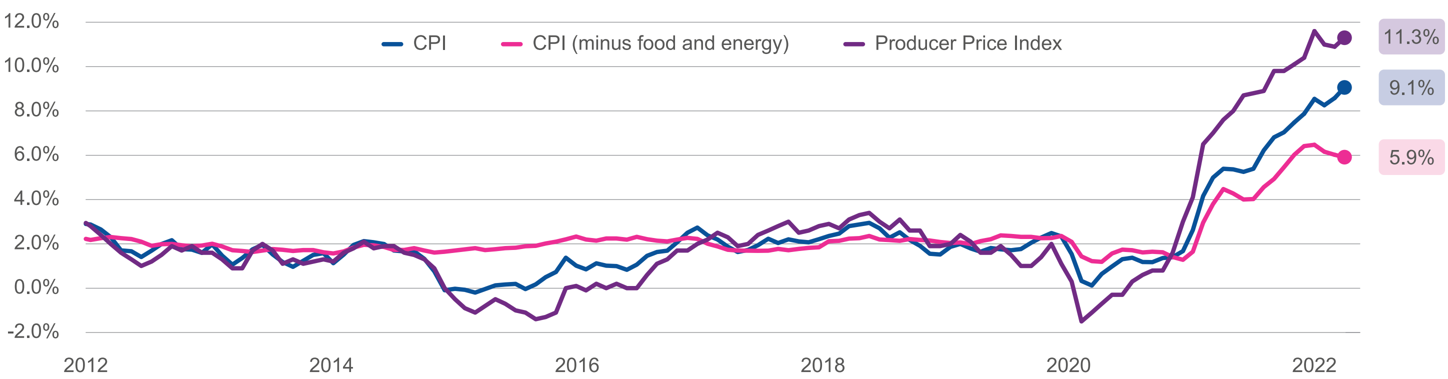
Source: Oxford Economics/Haver Analytics

U.S. regional outlook — leisure and tech support metros facing uncertainties

The striking conundrum of economic conditions across the U.S. currently is the contrast between robust U.S. economic growth — particularly consumer spending and jobs — and inflation fears, Fed tightening, supply chain challenges, and lower stock prices.

Risks, overall, are tilted to the downside. As a result of high inflation, households in all U.S. states are forecast to experience a fall in real (inflation-adjusted) personal income this year. Lower income regions will be impacted more by high inflation as their households tend to spend more on the products that have seen the highest price rises, gasoline and food.

Price Indexes: 12-month % change



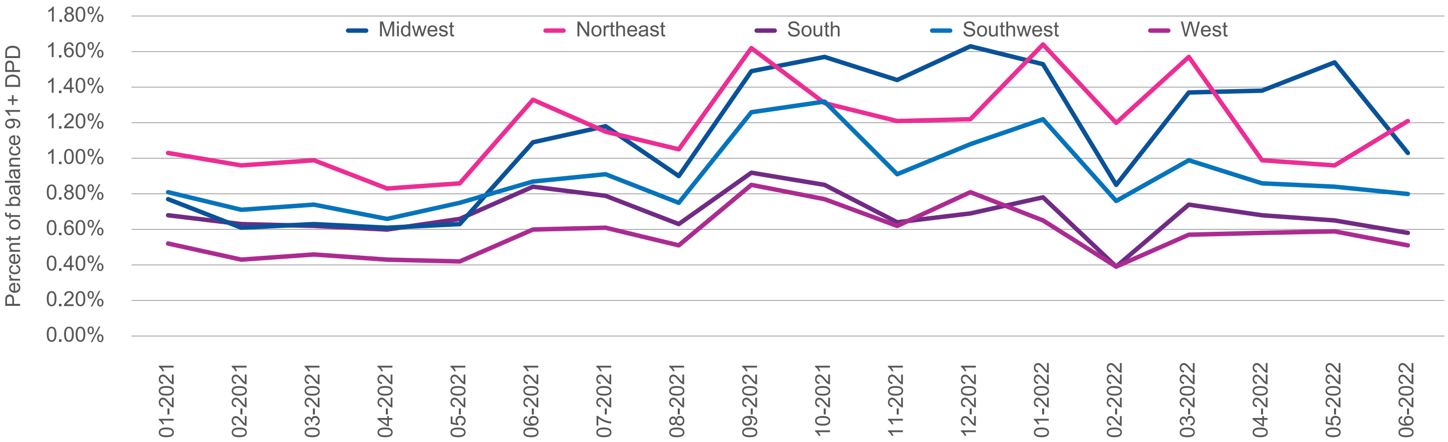
Source: Bureau of Labor Statistics and author's calculation

While domestic leisure and hospitality activity has largely recovered to pre-pandemic levels, international travel continues to struggle. Efforts by executives to kindle a "return to work" culture has stalled, pressuring economic activity in metros reliant on corporate activity.

Amid increased uncertainty, Experian and Oxford Economics now anticipate slower but nonetheless still positive GDP growth for most U.S. metros, including the 50 largest metros. GDP growth will decelerate across the country next year as the effects of the post-pandemic rebound fade and impacts of higher inflation and interest rates are felt. On the labor market front, all of the top 50 metros are still expected to see positive job growth in 2022, led by Las Vegas, Orlando, and San Francisco, as consumer spending on leisure and travel will continue to recover.

Regional lending dynamics highlighted reassuring performance, as delinquency rates on commercial installment loans remain stable in most regions, reflecting small business's need to maintain long term funding sources as a more mixed economic environment (high inventory costs, low unemployment, softening demand and fear of recession) often bring higher borrowing costs, accelerating supply side inflation and volatile cashflow expectations. The West's exposure to lingering supply chain stress remained apparent. Mining, inclusive of oil and gas, poses a threat to GDP, across the US, as the US regulatory environment poses a potential drag. Intense global macroeconomic headwinds will weigh on oil prices and constrain US oil and gas production, most significantly in the South and Midwest.

Late stage delinquency



Source: Experian Business Information Services Commercial Benchmarking

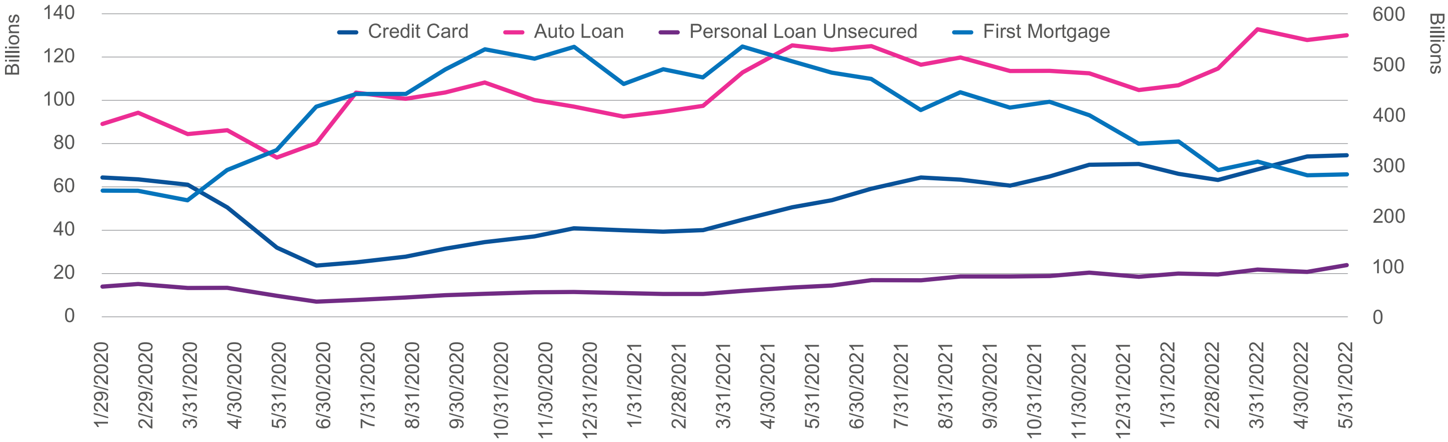
Looking past the near term, tech-centric metros will lead GDP growth through 2026. San Jose will lead spending growth among major metros in 2022 and San Francisco will lead in 2023. Most major metros will continue to out-perform the nation as a whole, not just for GDP, but in labor market terms. The handful that will not perform well are largely clustered in the Midwest (e.g. Chicago) and Northeast (e.g. Philadelphia).

Consumer trends and the effect on small business

Consumers are feeling the pinch of heightened inflation and interest payments, but recent data indicate they are willing to dig into their savings and rely on credit to maintain their spending. The latest data from the Federal Reserve shows that credit growth was on an accelerating trend through June. Households' revolving credit as a share of credit limits remained low, however, indicating that consumers, at least in the aggregate, have room to continue borrowing. The latest Experian data broadly corroborate that consumers remained willing to spend in Q2 2022 despite the more difficult economic environment. Loan originations for credit cards, auto loans, and personal unsecured loans ticked higher on a quarterly basis and supported consumer spending in the quarter.

To a small business owner, the growing equity in a home can provide emergency funding for a business and in some cases be used as collateral for a large purchase.

U.S. Mortgage originations continue fall



Source: Experian Consumer Information Services State of Credit

Mortgage loan originations declined as potential homebuyers felt the pinch of higher interest rates, which alongside sky-high home prices and an extremely low housing supply curtailed their willingness to buy homes. On the bright side, according to the Experian consumer credit data, the changing economic backdrop did not significantly change repayment behavior, though delinquencies ticked higher. Equity will continue to grow in homes, as the market remains tight, giving small business owners additional lines of credit to help buffer an environment of continually rising prices. Experian and Oxford Economics expect housing affordability to stay under pressure in the U.S. in the coming quarters as income gains will not be strong enough to offset higher mortgage rates and lofty home prices.

Broadly, consumers' tolerance to high inflation will continue to be tested, but positive fundamentals — including solid labor market gains and excess savings should underpin consumer spending, which we see growing at a modest pace in H2 2022 before slowing in 2023.

Special industry focus that affect SMBs

The danger of an investment "freeze"

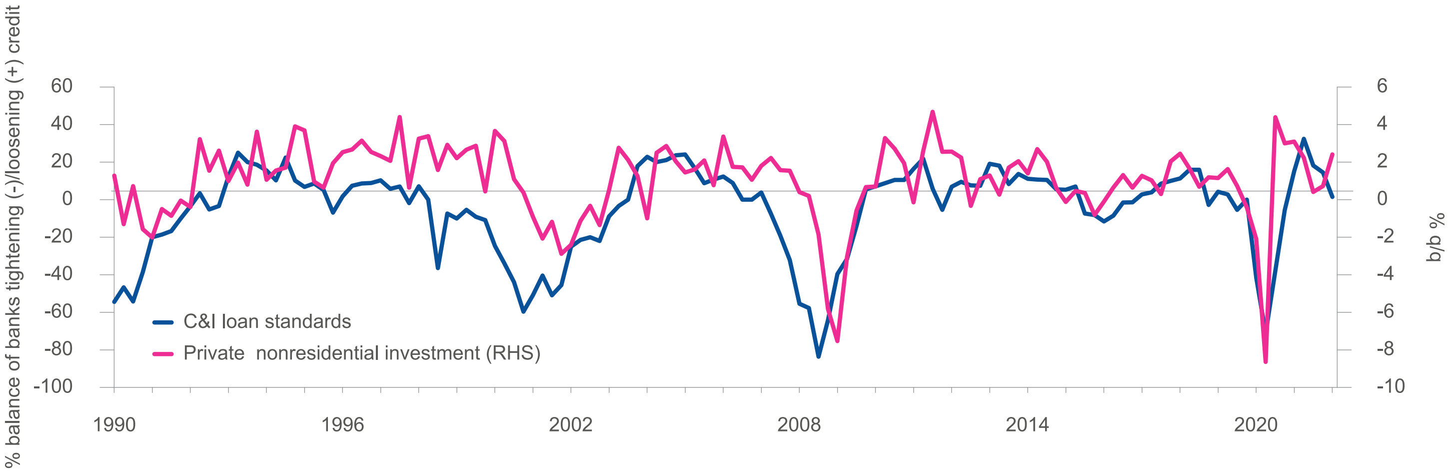
Key indicators point to slowing small business investment growth this year and languishing capital expenditures in 2023. This adds downside risks to our forecast since investment is often the key driver of downturns. In the recessionary periods since the 1980s, around half of the decline in G7 (An informal bloc of the world's most industrialized countries, including the U.S.) GDP in negative quarters came from investment, even though investment only averaged about one-fifth of GDP.

Experian and Oxford Economics advise on following developments in five key metrics to ascertain investment growth prospects: equity values, corporate profits, corporate bond yields, bank credit standards, and real (inflation-adjusted) corporate liquidity.

Right now, none of these indicators are offering very encouraging news. Particularly worrying is corporate liquidity as high inflation erodes the real value of corporate money holdings at the fastest pace since the Global Financial Crisis.

Furthermore, the latest survey of U.S. bank credit standards conducted by the Federal Reserve showed banks loosening corporate loan standards slightly in Q2. This is one of the better indicators of investment in our set, although admittedly not very timely since surveys of bank credit standards take place only quarterly. Since 1990, movements in bank standards for corporate lending in the U.S. have explained around 30% of the quarterly variation in U.S. private non-residential investment. Experian data, meanwhile, are more encouraging, indicating that SMB credit continues to flow.

U.S.: Corporate credit standards and investment



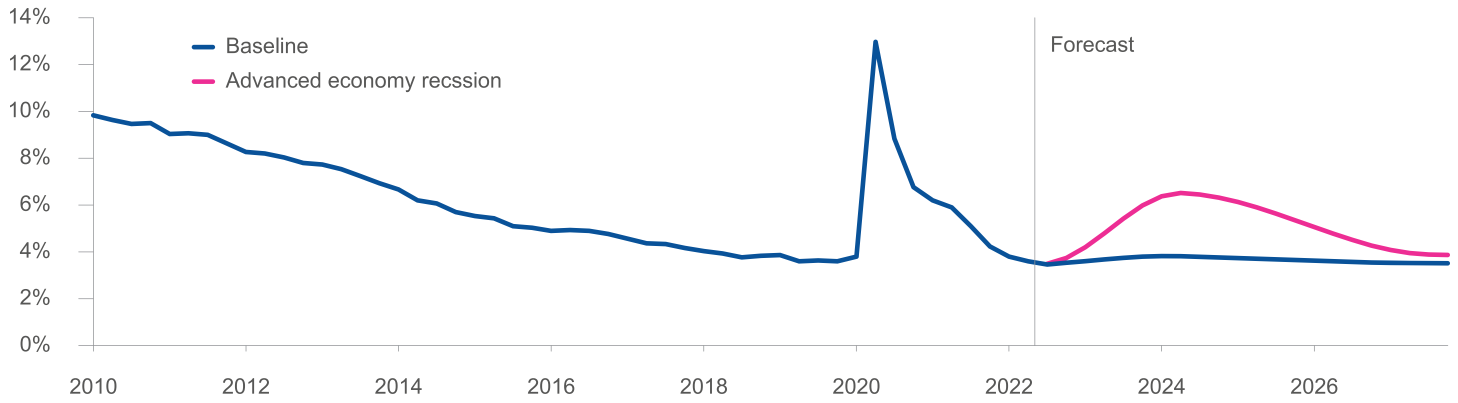
Source: Oxford Economics/Haver Analytics

If > then analysis — What if Fed policy tightening drives the economy into recession?

Amid the persistent massive overshoot of the inflation target, the Federal Reserve is understandably eager to re-establish its credibility. As a result, we have seen a spate of large rate hikes in recent months and the reversal of quantitative easing (QE). However, there is now a risk the U.S. central bank might go too far, overdoing the monetary medicine and pushing the world into an unnecessarily deep slump.

Oxford Economics has modeled a scenario where the U.S. falls into recession as a result of expeditious Fed policy tightening. At the start of the scenario, inflation surprises to the upside as the supply-chain crisis intensifies, leading to cost shocks that push producer prices higher. In turn, the Federal Reserve raises policy rates more quickly, and other central banks also bring forward policy tightening.

U.S.: Unemployment rate



Source: Oxford Economics/Haver Analytics

U.S. business and consumer sentiment deteriorates sharply and investors become more anxious about the economic outlook in this scenario. The U.S. economy is hit hard, with real GDP 2.6% below baseline in 2023 and the unemployment rate increasing significantly. Bond markets sell off sharply, equities would fall up to 20% below baseline and property markets adjust sharply as expectations align to a much more downbeat economic environment. Global growth would be feeble, coming in below 1% in 2023.

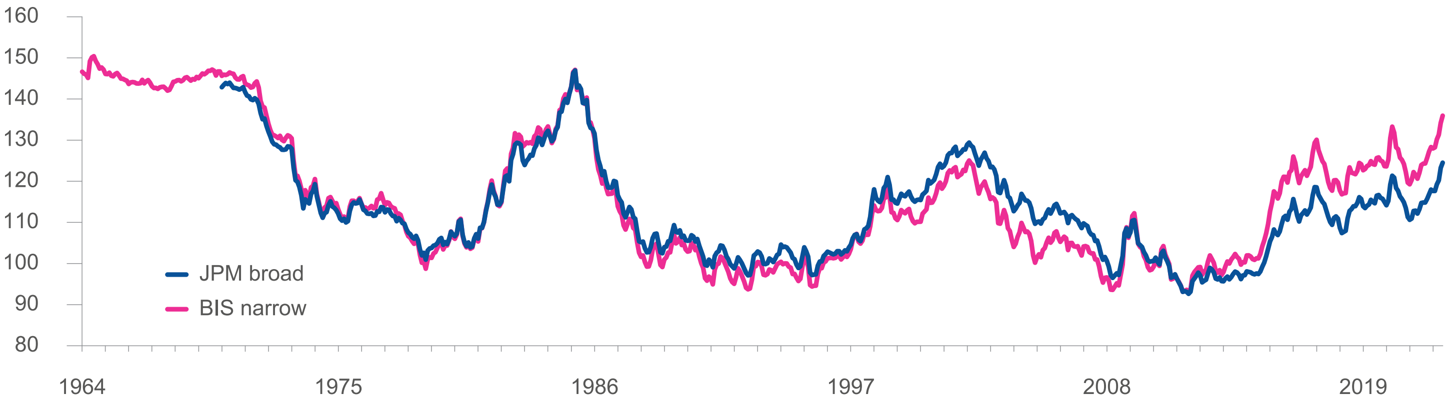
Recommended focus areas

Dollar strength will ebb, but only slowly

The dollar is probably close to a peak after its recent surge. Several factors, including rate differentials and global liquidity conditions, are likely to remain dollar supportive for some time. Experian and Oxford Economics expect only a gradual unwinding of dollar positives in 2022-2023. Recent dollar gains have mostly resulted from a combination of favorable interest rate differentials, higher global financial stress causing 'safe haven' flows into U.S. assets, and terms of trade shifts hitting competitor currencies. Rate differentials are likely to remain supportive, but our baseline forecasts suggest that factors like relative growth and stock price performance will be medium-term drags.

U.S.: Real effective exchange rates

Indices, 2010=100



Source: Oxford Economics/Haver Analytics

Recommended focus areas

Dollar strength will ebb, but only slowly

The dollar is probably close to a peak after its recent surge. Several factors, including rate differentials and global liquidity conditions, are likely to remain dollar supportive for some time. Experian and Oxford Economics expect only a gradual unwinding of dollar positives in 2022-2023. Recent dollar gains have mostly resulted from a combination of favorable interest rate differentials, higher global financial stress causing 'safe haven' flows into U.S. assets, and terms of trade shifts hitting competitor currencies. Rate differentials are likely to remain supportive, but our baseline forecasts suggest that factors like relative growth and stock price performance will be medium-term drags.

Assessing the risk of monetary policy "overkill"

The central banks' rapid policy tightening with a heavy focus on taming inflation, even as economic growth slows and some drivers of inflation weaken, raises the risk of excessive monetary and credit tightening policy on Main Street. While this outcome is far from certain, some key indicators are drawing serious scrutiny. Uncertainty about the economic outlook is running high and the surge in broad money supply growth seen in 2020 and 2021 has given way to below-average money growth, cutting the risk of permanently high inflation. Meanwhile, some segments of credit demand are flagging risk. Fiscal policy is set to tighten in 2022 and 2023, adding to the downward pressures on economic growth. Financial market volatility has spiked and asset values have fallen from recent peaks, though they remain elevated compared to pre-COVID-19 levels. Small business lenders will look at preparedness strategies to course correct, if necessary, as new market drivers emerge. Forecasting future market headwinds can be challenging given the long and variable lags between monetary policy actions and their outcomes.

Weak economic growth overseas

While Oxford Economics remains in the "no recession" camp on the U.S. economy, it is cautious about the health of key trading partners. In fact, in its latest forecast Oxford Economics lowered its world GDP growth forecast to 2.8% this year and 2.3% in 2023. Oxford Economics believes that soaring inflation and its impact on consumer's real (inflation-adjusted) and business costs will cast a dark shadow across the global economy, leading growth next year to be the lowest outside a recession year since 2008.

Risks are running high in Canada, Mexico, Europe and China — the most important US trading partners. Faster-than-expected interest rate hikes, an earlier and deeper correction in the housing market, and other headwinds will cause Canada's GDP growth to slow to near stall speed by early 2023. Meanwhile, Mexico's economic momentum is being tempered by tighter global financial conditions and slowing global growth. Across the pond, the eurozone economy is expected to slow substantially towards the end of this year and gas prices will remain substantially higher than in previous years and gas rationing this winter appears to be a possibility. Further, China is being weighed down its dynamic zero-COVID-19 policy, which, as long as it persists, seems likely to crimp private-sector growth, regardless of whether there is more fiscal stimulus.

Expectations

When will changes in consumer behavior begin to impact small business performance? Inflation has been outpacing wage increases, driving down consumer purchasing power and causing consumers to dig into savings. If this trend continues, holiday shopping will likely be slower than past years. If demand wanes and supply remains high, we could see added downward pressure on inflation later this year.

Global supply chain disruptions will be a key determinant of small businesses ability to remain open and profitable. Domestic policy will provide opportunity to some industries but have the potential to create more disruption in energy and supply chain progress.

Small businesses are well capitalized and in good health going into the fall as delinquency rates remain historically low and commercial lenders keep funding available across SMB risk tiers, albeit at rising cost. Owners have equity in homes and assets to pull from if their business struggles over the next six months. This will maintain healthy business survival rates through the initial economic cooling cycle.

MAIN STREET REPORT

About the report

The *Experian/Oxford Economics' Main Street Report* brings deep insight into the overall financial well-being of the small-business landscape, as well as providing commentary around what specific trends mean for credit grantors and the small-business community. Critical 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.).

About Experian's Business Information Services

Experian's Business Information Services is a leader in providing data and predictive insights to organizations, helping them mitigate risk and improve profitability. The company's business database provides comprehensive, third-party-verified information on 99.9 percent of all U.S. companies. Experian provides market-leading tools that assist clients of all sizes in making real-time decisions, processing new applications, managing customer relationships and collecting on delinquent accounts. For more information about Experian's advanced business-to-business products and services, visit www.experian.com/b2b.

About Oxford Economics

Oxford Economics is a trusted adviser to corporate, financial, and government decision-makers and thought leaders. Their worldwide client base comprises over 2,000 international organizations, including leading multinational companies and financial institutions; key government bodies and trade associations; and top universities, consultancies, and think tanks. Their insights into the global economic and business environment helps clients cut through market complexity and uncertainty and build a solid base for decision-making. They offer a sophisticated portfolio of subscription services, providing insights and forecasts that are delivered through reports and analytical pieces, databases, and rigorous models on 200+ countries, 100 industrial sectors and over 7,000 cities and regions.

Contact Experian Business Information Services

T: 1 877 565 8153
W: experian.com/b2b

Contact Oxford Economics

T: 646 503 30 50
E: mailbox@oxfordeconomics.com
W: oxfordeconomics.com