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Beyond the Trends

Understanding the Commercial Economy

Fall 2023

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.

Feeling generous?

Retailers are counting on it as the U.S. enters the holiday shopping season. Expectations are set for a positive season, with industry forecasts projecting a sales increase of 3.5% to 4.6% in the United States, totaling around $1.54 to $1.56 trillion. However, a few factors might dampen consumer spending, such as high interest rates, student loan payments, and rising debt payments. Consumer sentiment has been moving in a positive direction, and consumers have been putting their money where their mouth is by continuing to spend. Small businesses will count on this elevated spending to push them through an economic cycle filled with high prices, supply chain challenges, and fear of a recession. The generosity of the U.S. consumer will lay the groundwork for a smooth or rough first quarter of 2024.

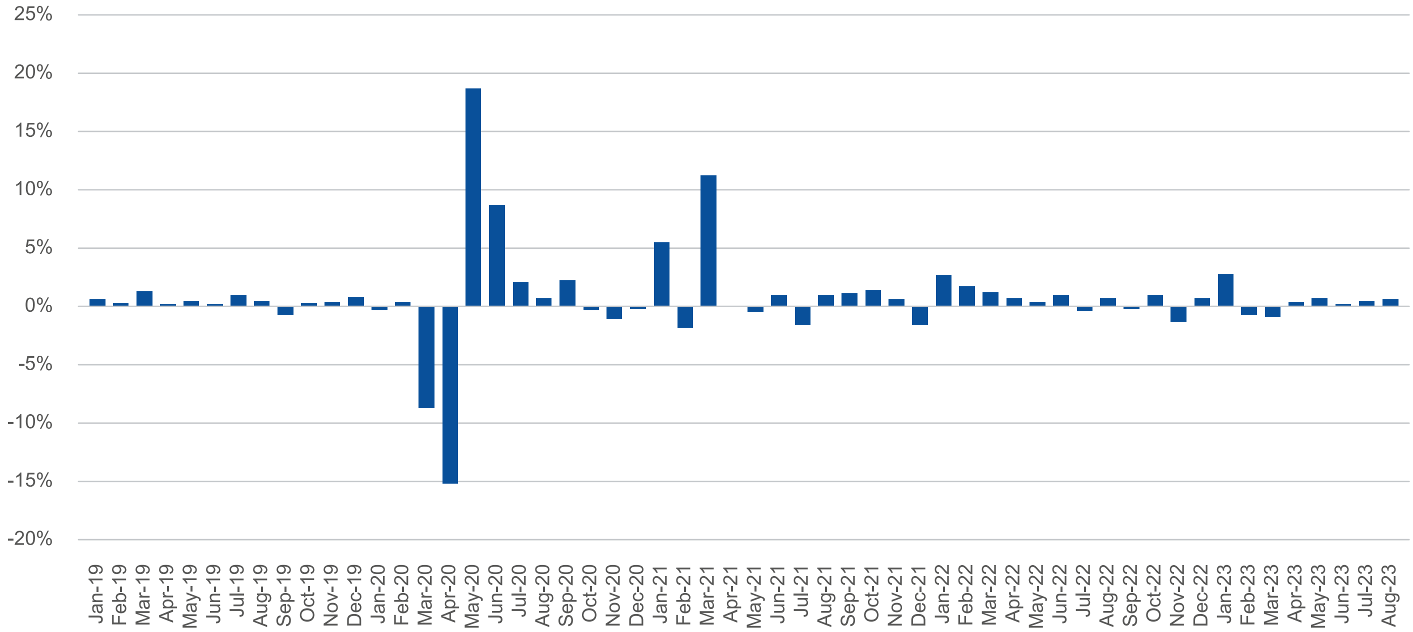
Will the kids see a lump of coal, or will Santa's sack be full?

Starting in August, I began to see holiday decor hit stores. Halloween skeletons and ghouls lined the shelves, and shelves of candy sales followed in September. Retailers were worried about consumers tightening their belts. In prior years retailers have begun to push holidays earlier in the cycle to expand the window to engage and capture discretionary spending. Who starts their shopping before black Friday? Last year highlighted American's willingness to shop early to avoid supply challenges they experienced during the pandemic and not be left with empty holiday wishes. This strategy worked for retailers as they adjusted Black Friday specials to spread well beyond that special shopping all nighter we all look forward to, to an online shopping experience that connected consumers to deals and shipped the products directly to doorsteps. Some of us enjoyed a few more hours of well-needed rest following a full day of Thanksgiving activities.

Retailers are gearing towards an aggressive promotional stance to entice consumers amidst inflationary pressures. For instance, high gasoline and food prices, along with costlier apparel, are expected to impact consumer spending negatively.

U.S. Retail sales growth

Retail sales (Month over month % change)



Source: U.S. Census Bureau

E-commerce sales are forecasted to grow between 10% to 13% year-over-year, representing a total spending of about $278 to $284 billion, a considerable hike from the previous year's growth of 8%. Online sales, which is a broader category of online spending including subscriptions, donations, and other transactions on the internet in the U.S., are projected to increase by a modest 4.8% during the crucial holiday season, with retailers expected to offer larger discounts and promotions to attract inflation-weary consumers.

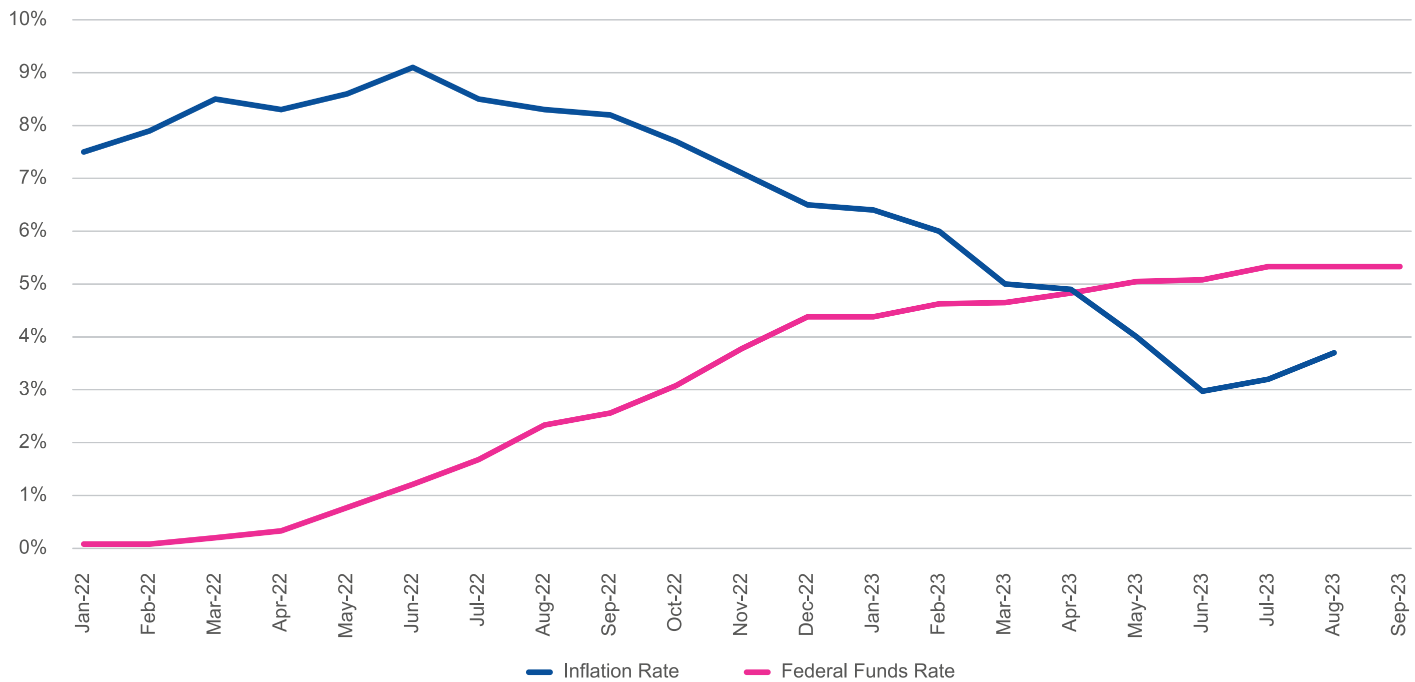
Globally, the online holiday sales for 2023 are estimated to touch $1.19 trillion, remaining flat compared to the preceding year, indicating a continuation of the sluggish retail trend observed in the first half of 2023. Spending in segments like travel is expected to see a robust 12% increase over the 2022 holiday season, and 40% of consumers are predicted to spend more overall than they did last year.

Are we healthy, wealthy, and wise?

As the economy cools, cracks begin to form in the growing U.S. economy. The heat created by full wallets and savings accounts fueling consumers' love to spend coming out of a period of pent-up demand was hit by the cooling wind of rising prices and inflation policies that made borrowing and servicing debt more expensive. Consumer sentiment was on the rise as 2023 formed, and the markets were abuzz with talk of Fed policy-busting expansion and market transformative innovation fueled by generative AI. The third quarter brought the inversion of the Federal funds rate and falling inflation.

Inversion point means Federal Reserve tightening activity at the end of its push

Closing the gap: Impact of Fed activities



Source: Federal Reserve Board of Governors

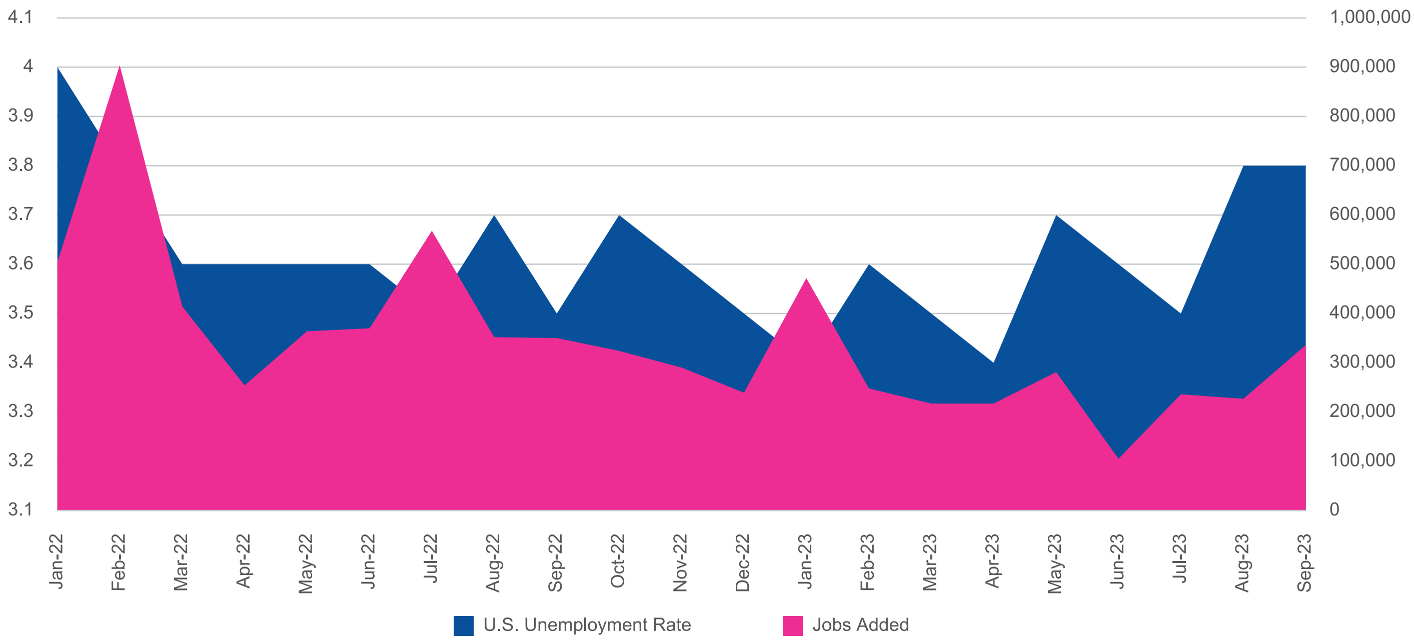
This inversion point signaled to the Federal Reserve and to the market that quantitative tightening efforts were moving in a positive direction and that the directive increase in the Federal Funds Rate activities was coming to an end.

The Fed would now need to consider where additional increases in the Federal Funds rate would place too much pressure on the marketplace where a recession would present. The rise in consumer core cost of living and monthly debt servicing activities is eating into their ability to spend on discretionary items they may have had no thought about in 2022. This worries retailers as the U.S. enters the holiday shopping season. If consumers were faced with questioning if their jobs were at risk as well as rising costs, additional scrutiny would be placed on their post-pandemic spending habits. The goals of the Federal Reserve are to control inflation as well as controlling unemployment. A positive signal for consumers has been the trend of contracting inflation while the unemployment rate remained low. This highlights the potential for a soft landing for the U.S. economy, but will we remain on this path?

In the third quarter, the unemployment rate accelerated to 3.8%.

Unemployment remains low

U.S. Job market



Source: Bureau of Labor Statistics

Wage growth slowed as businesses cooled new job offers and the quits rate stabilized. This means less resource mobility and more stability for business operations. Subsegments of industry segments executed strategic restructuring plans, returning some workers back to the market.

Potential cracks in the 2023-2024 U.S. labor market signify a confluence of structural and cyclical factors that could impede employment growth and labor market dynamism.

Here are the five potential risks:

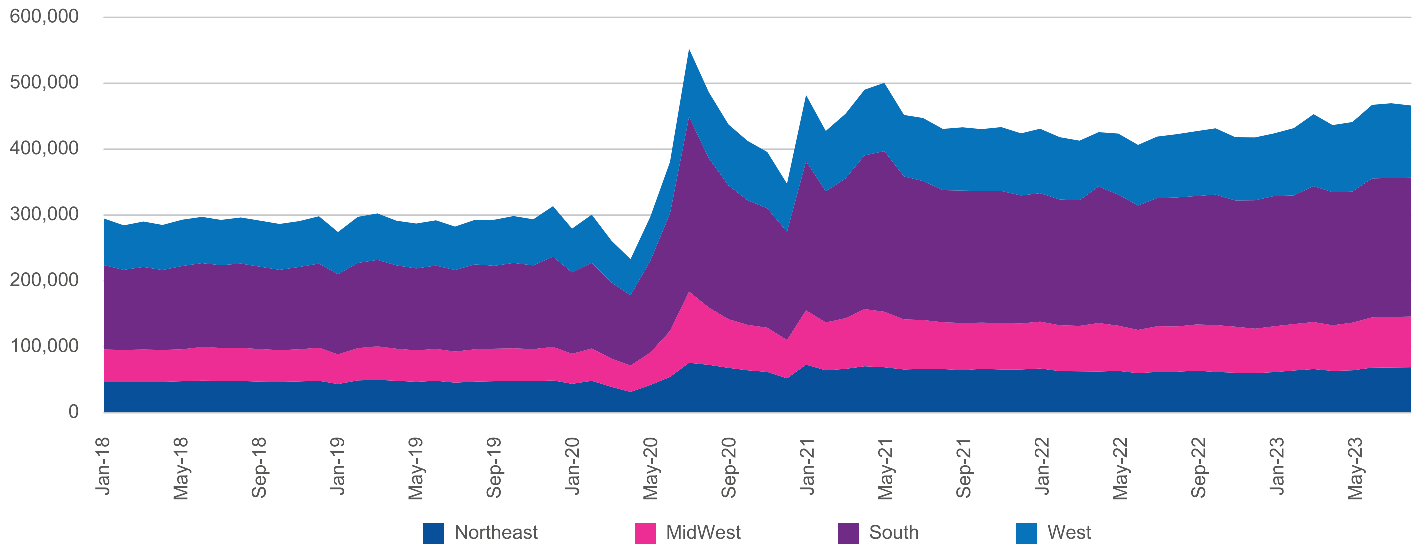
- Slowing job growth: Job growth in the U.S. is expected to slow through 2024, with nonfarm payroll employment growth rates tapering. This slowdown presents challenges in absorbing new entrants into the labor market.
- Labor market imbalances: Characterized by a mismatch between labor supply and demand for resources, will exacerbate employee restructuring activities, in response to Federal Reserve tightening measures aimed at curbing inflation. The Federal Reserve's monetary tightening measures may lead to a significant fall in labor demand as economic activity slows down. This would result in a reduction in labor demand, leading to an increase in the unemployment rate to near 5% in 2024. The imbalance underscores the delicate interplay between monetary policy, employment, and inflation, requiring nuanced policy interventions to prevent a more pronounced economic downturn and to support a balanced labor market recovery.
- Softening, but still tight labor market: The tight U.S. labor market, a result of slow labor force growth and participation rates, is likely to continue into early 2024, challenging employers to fill remaining vacancies.
- Labor supply shortages: We have observed for the past 2 years demand for workers surpassing the available talent in a geo location, leading to an increase in remote work, outsourcing, and a focus on re-skilling current employees to bridge the labor market gaps. The 2023 labor market saw a mismatch between the demand for workers and the available talent pool. This shortage is driven by a myriad of factors including demographic shifts, an aging workforce, and a competitive talent landscape. Businesses may respond by looking beyond local or even national borders for talent, increasing remote work arrangements, and outsourcing tasks. The shortages drove service and retail companies to reduce the range of products and services offered due to labor constraints.
- Fear of recession: The projected economic downturn toward the end of 2023 increased unemployment rates and created a decrease in labor force participation, as people held off rejoining the labor force. This fear of recession led to more layoffs and a subsequent rise in unemployment rates, adding downward growth pressure to the U.S. labor market.

These risks, intertwined with broader economic conditions and policy responses, may define the labor market trajectory in the U.S. for 2024. The challenges underscore the importance of initiative-taking policy measures and organizational strategies to navigate the evolving labor market landscape, maintain employment levels, and ensure sustainable economic growth.

The shear velocity of emerging business growth gathered up the unemployed who were seeking jobs and put them to work in young enterprises.

New business starts in the U.S.

New business formation applications (Seasonally adjusted)

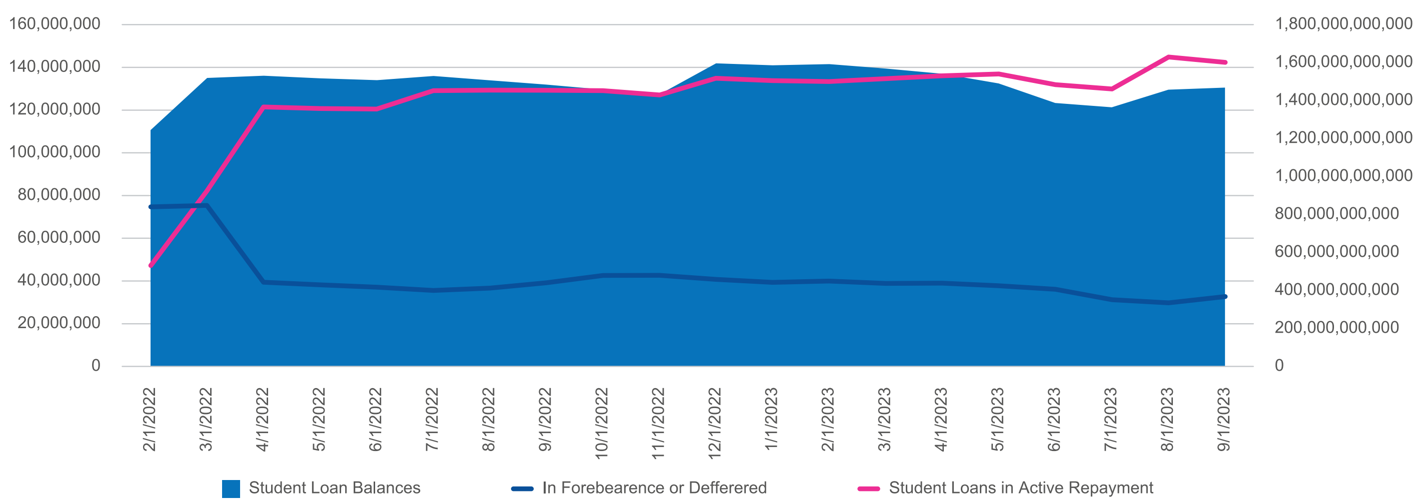


Source: U.S. Census Bureau

As small business growth accelerated and the consumer felt the pressure to reconsider spending behavior picked up after the lockdown, the administration looked for ways to free up cash flow for consumers through stimulus and loan forgiveness activities. Student loan debt, estimated at $1.7T, was an easy target to put forth for forgiveness.

U.S. Student loan debt trends

Student loan trends for consumers

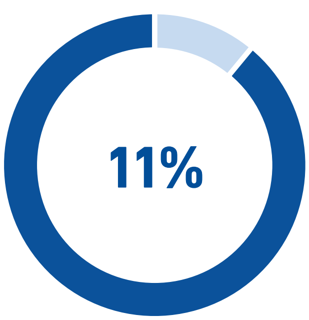


Source: Experian State of the Market

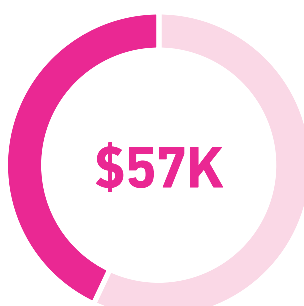
Activities followed that led us to the current resumption of debt:

- **April 2022**: The Biden administration implemented fixes to income-driven repayment (IDR) plans, developed in 2009, as part of their efforts towards student loan relief.
- **August 2022**: The president announced that single borrowers who earn under $125k qualify for $10,000k in federal student loan foregiveness while those who are married qualify for that amount if their combined income is under $250,000
- **June 2023**: The United States Supreme Court struck down the administration's student loan debt relief plan, ruling that the HEROES Act did not provide the U.S. Department of Education with the authority to cancel parts of student loans on a large scale.
- Following the Supreme Court decision, the administration initiated a process to establish a "Plan B" for mass student loan forgiveness through the Higher Education Act (HEA) instead of the HEROES Act.
- **August 2023**: The U.S. Department of Education announced that automatic discharges would begin for 804,000 borrowers who qualify for $39 billion in student loan relief because of fixes to the IDR plan.
- **October 2023**: The moratorium on student loan repayment ended, and consumers not covered under the remaining forgiveness programs resumed repayment of their student loan debt. The administration is chipping away at the remaining debt looking first at those borrows who have paid in goof faith the longest.

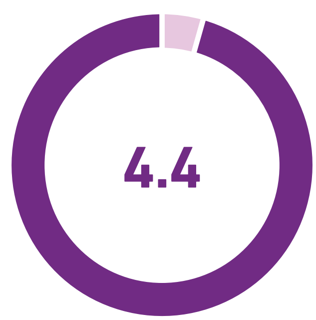
Consumers, on average, will add a debt servicing of $400 a month to other obligations. Small business owners, who have this debt obligation looming, will feel the reduction in personal cashflow. Many emerging businesses, 33% of the businesses in the U.S. are less than 1 year old, use the owner's personal cashflow and credit to get these businesses off the ground and growing.



Business owners* have an outstanding federal student loan



Average outstanding federal student loan debt per business owner



Average number of federal student loan accounts per business owner

Source: Experian Commercial Risk Database and Experian Consumer Premieres

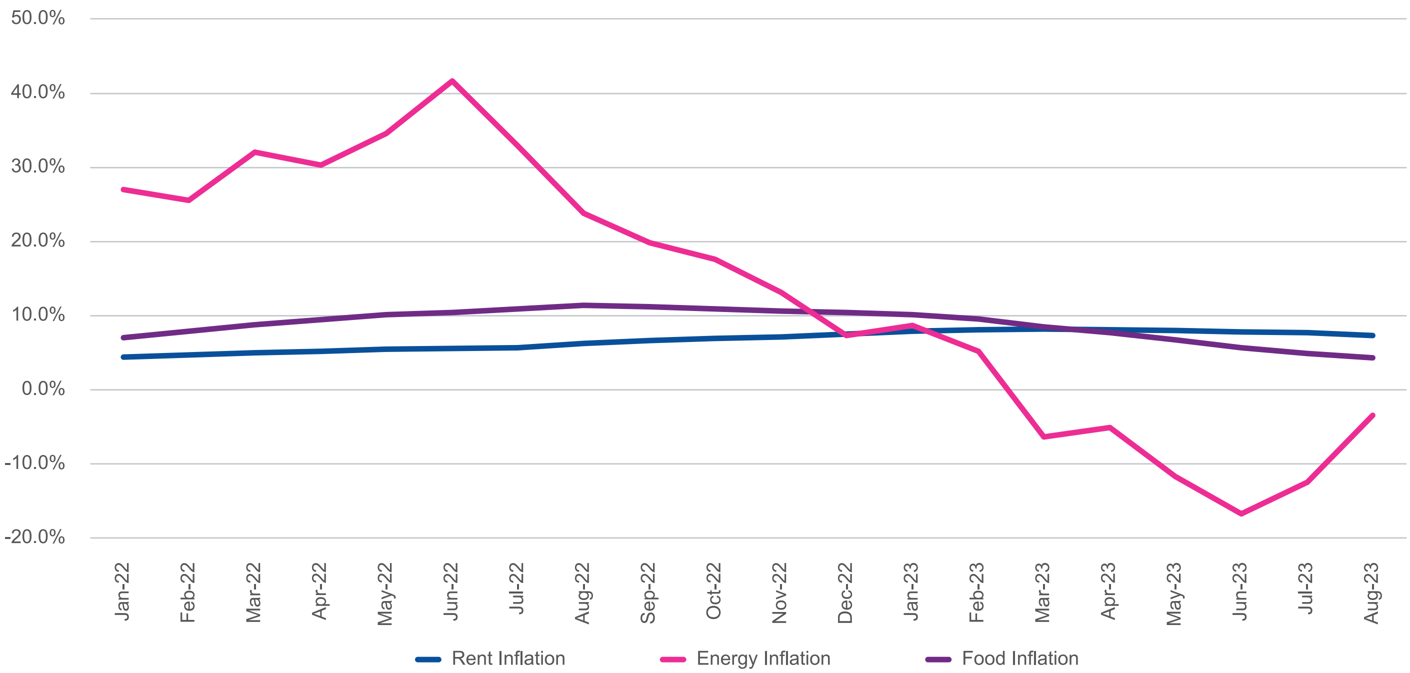
* Includes business owners identified on the Experian commercial risk database with active commercial credit.

This additional debt repayment obligation will create downward pressure on the smallest businesses trying to get their ideas and innovations off the ground. A student loan payment on top of rising prices for energy, food, and shelter will place a lump of coal in the stocking of any consumer or small business feeling generous around the holidays.

Tangible price increases are adding to consumer hesitancy to expand their current spending activities.

Hitting the wallets of the consumer

Year-over-year rate of inflation



Source: U.S. Bureau of Labor Statistics

The rise in consumer core cost of living and monthly debt servicing activities is eating into their ability to spend on discretionary items they may have had no thought about in 2022. This worries retailers as the U.S. enters the holiday shopping season.

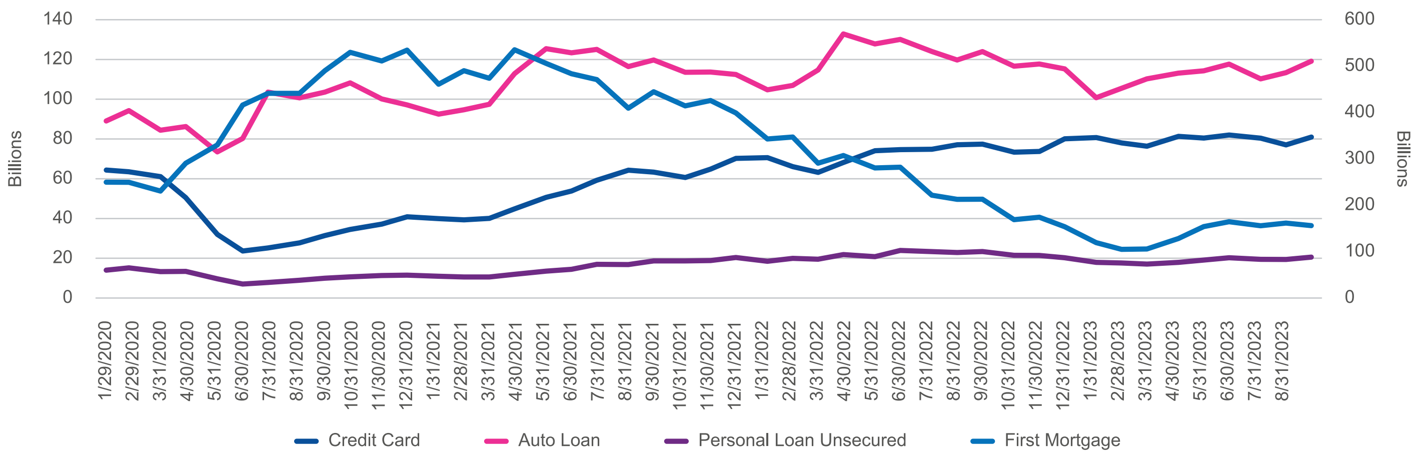
Funding the list and checking it twice

To keep cash flows in full force and consumers in stores shopping, they will need to look beyond wages to create funds to purchase. The first glance will be personal savings. Savings accounts were flush with cash coming out of the pandemic with help from government stimulus, moratoriums on debt servicing, moratoriums on repayment of utilities, and low rates. As inflation for goods and services peaked the consumers' spending power diminished, and consumer savings rates dwindled, the credit markets were the next stop to supplement cash flow for expenditures.

Credit cards and unsecured debt became the life raft of consumer spending as wages began to decrease in the second quarter.

Consumer lending origination trend

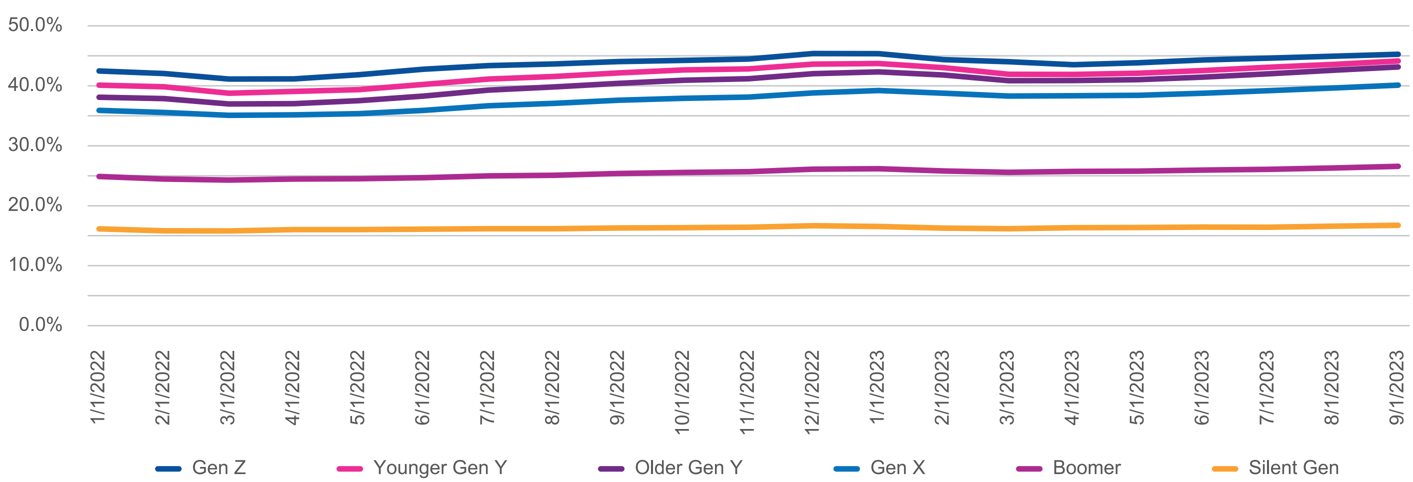
U.S. Consumer originations stabilize



Source: Experian State of the Market

Consumer utilization trend

Consumer card utilization trends by generation

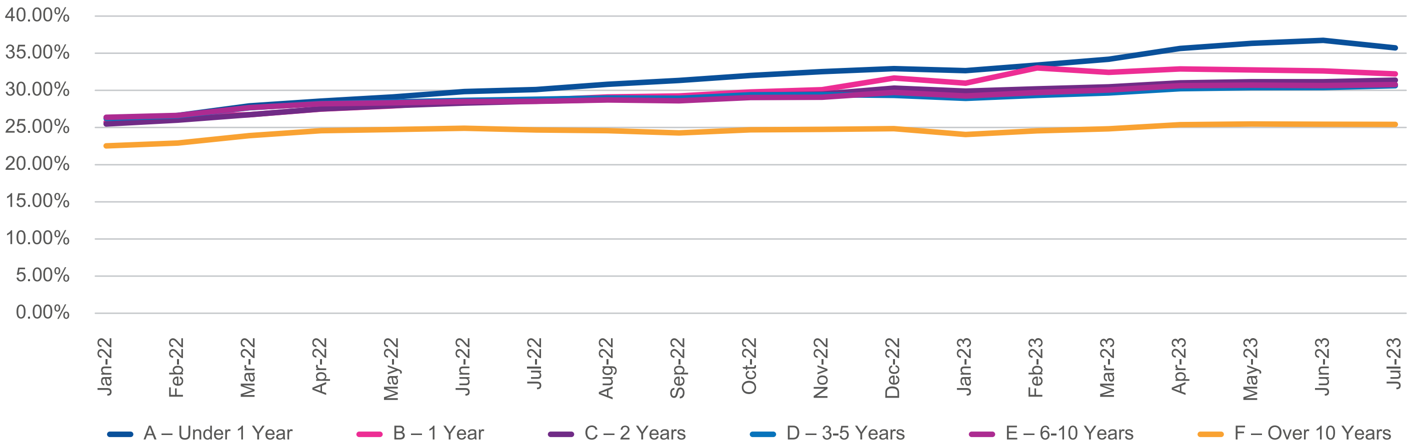


Source: Experian State of the Market

Utilization above 33% will create downward pressure on a consumer's credit score. The same effect occurs when a small business exceeds this threshold.

Small business utilization trend

Small business card utilization trends by age of business

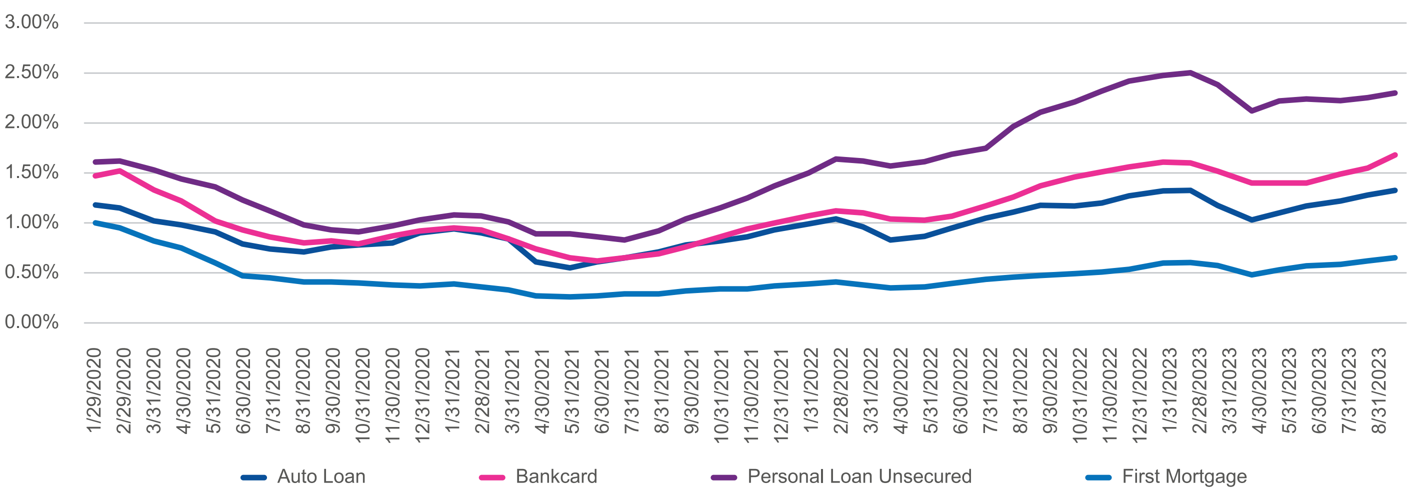


Source: Experian State of the Market

When utilization rises delinquencies often follow. Unsecured debts rose rapidly in the first through the third quarter of 2023. Markets saw this velocity because of a hot economic cycle, and they were not wrong. The trended acceleration of delinquencies was in line with the expected growth of the market, even if we were to exclude the global pandemic from the time periods in retro.

U.S. Consumer % balance 60+ delinquency rates slow pace

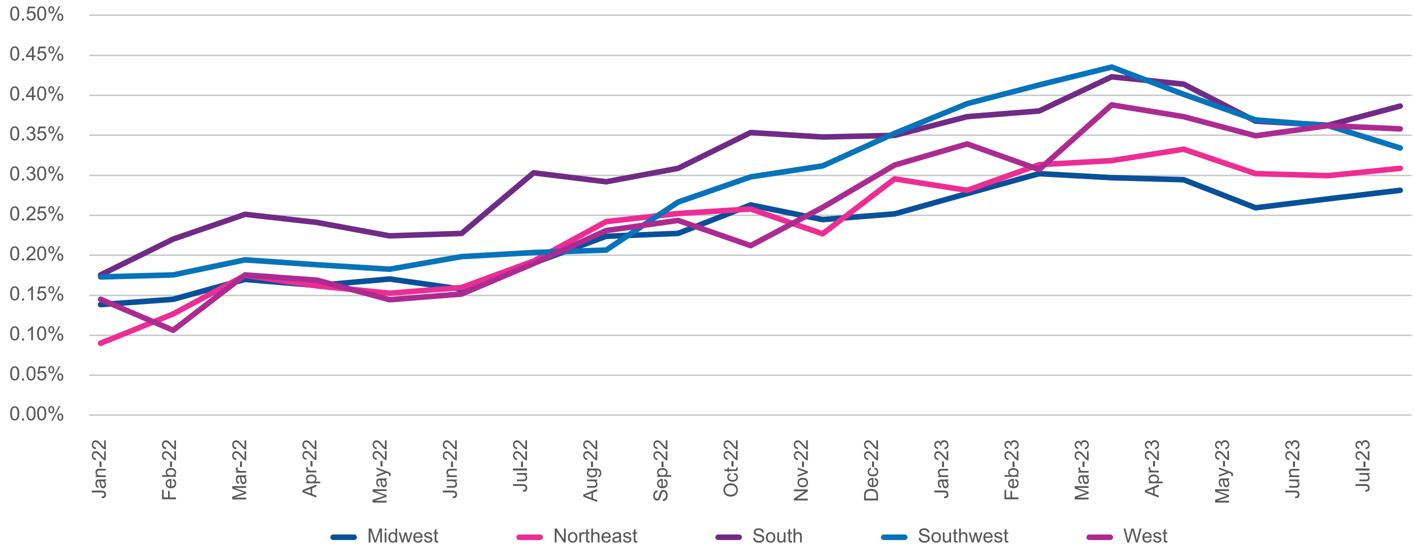
U.S. % balance 60+ delinquency rates slow pace



Source: Experian State of the Market

Small businesses reacted in a similar fashion.

Regional commercial card 60+ delinquency

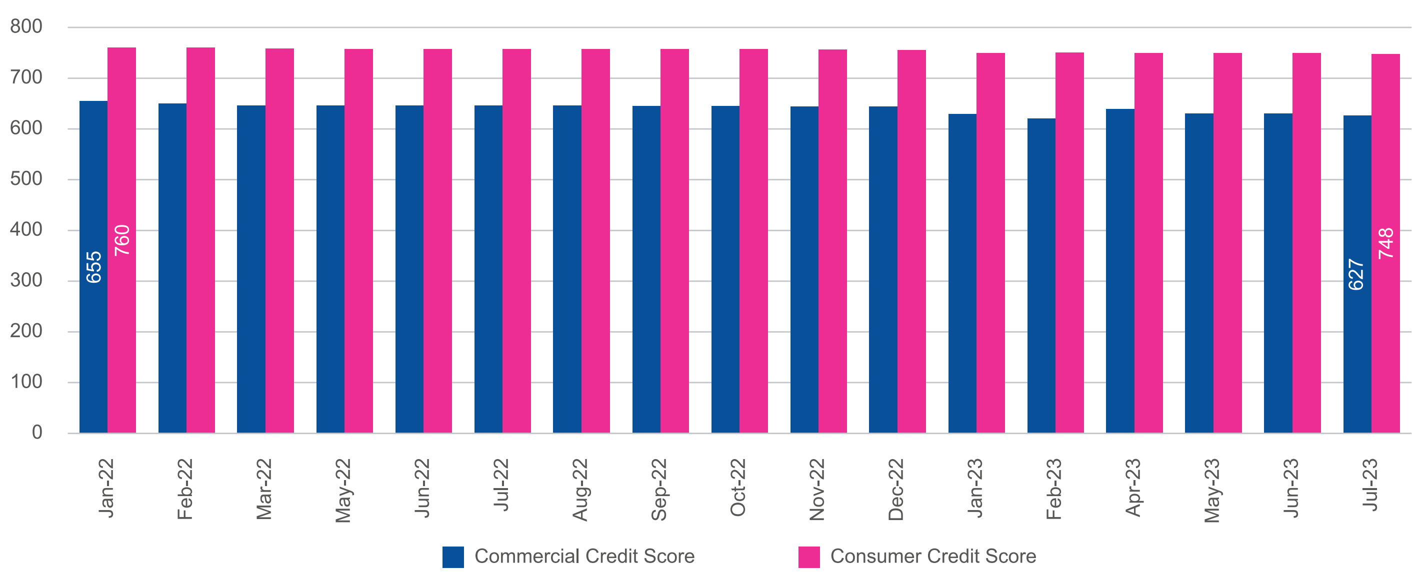


Source: Experian Commercial Benchmarking

A cyclical dynamic that is easy to highlight in the credit life cycle is the point when delinquency, utilization, and market uncertainty tip to scale into the naughty list territory, causing credit health to begin to deteriorate. This can most notably be seen in the deterioration of credit scores.

Downward trend in credit scores

Consumer and commercial score trends for business owners



Source: Experian Commercial Benchmarking

Consumer (Down 2.9%) and commercial (Down 1.3%) credit scores are beginning to see the impact of leveraging and slow repayment behaviors. As repayment behaviors adjust to a new cashflow reality, scores will begin to normalize back to a more appropriate risk representation for consumers' behavior. This trend is beginning to take shape. A score reset will mean consumers will transition back to lower-risk pricing tiers for creditors as behavior adds volatility and stress. The result is a tighter credit market, less desirable funding rates, and a reduction in the availability of credit. The holiday shopping wish list may need to be downsized.

For a small business, this loss of consumer spending power will put a damper on commercial cashflows. Small businesses that have been relying solely on transaction-style business strategies, built for a bull market, will need to address cashflow challenges through the use of credit markets or private funding. As the market cools into bear or bear cub-like in a soft-landing scenario, these options will become more difficult to acquire.

Are credit markets tightening?

% of banks reporting tightened standards on loans

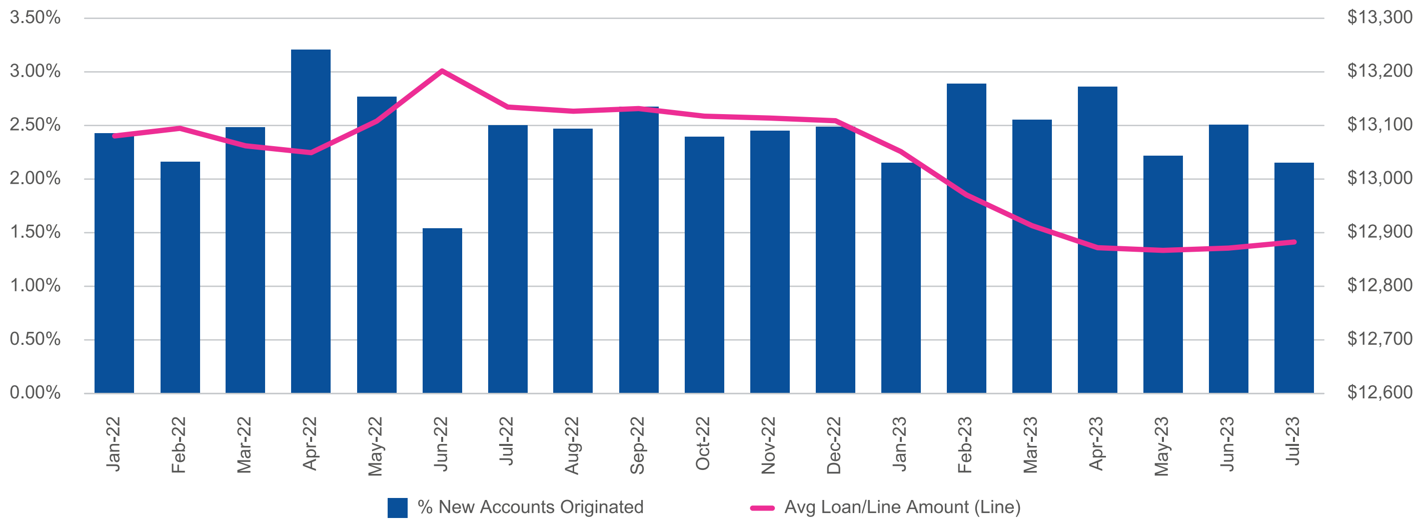
Source: Federal Reserve (Senior Loan Officer Opinion Survey)

The Senior Loan Officer Opinion survey highlights the will of lenders to tighten lending criteria within the U.S. As we speak to large financial institutions lending to small businesses, we see that trend playing out with two key initiatives. Limiting exposure through underwriting adjustments and the expansion and development of higher-risk products to capture those small businesses falling through the core product sets.

Small businesses are not feeling their needs are being met in the lending process as lenders adjust, and customers, in some instances, are forced to look outside their core lending relationship to others in the market offering products more aligned with expanded risk. The U.S. lending market for commercial credit is full and expanding its lender set, including FinTech's, subprime lenders, and an expanding list of regional banks and credit unions. Lending markets are open and provide products to small businesses to supplement investor funding gaps.

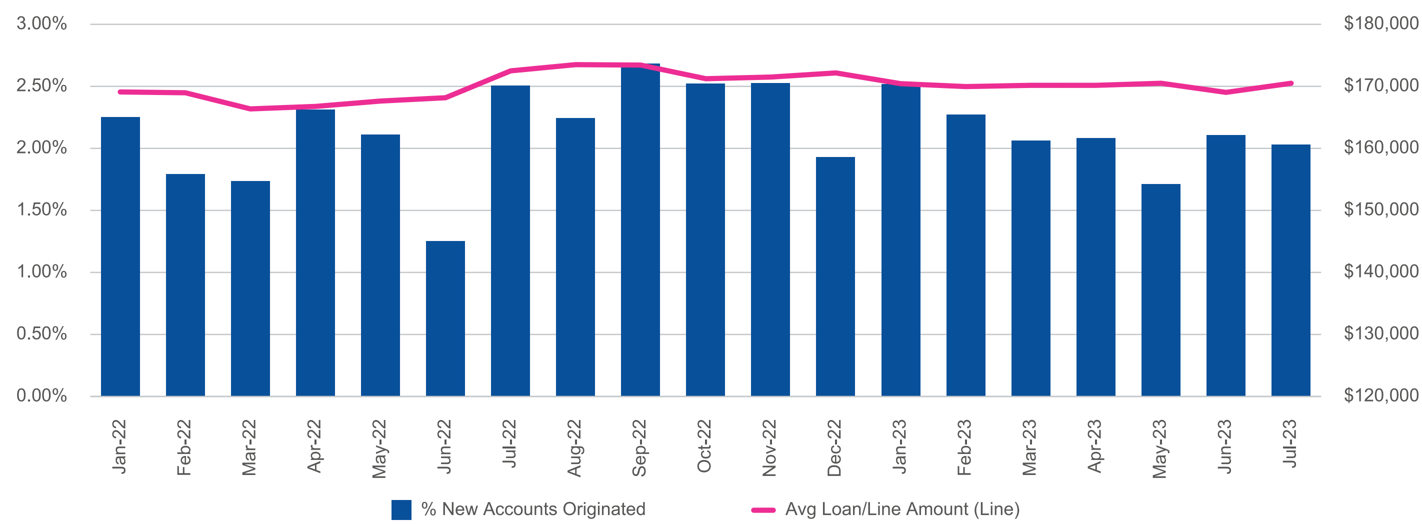
U.S. Commercial unsecured and secured lending

Commercial Card Origination Trends



Source: Experian Commercial Benchmarking

Commercial installment trends

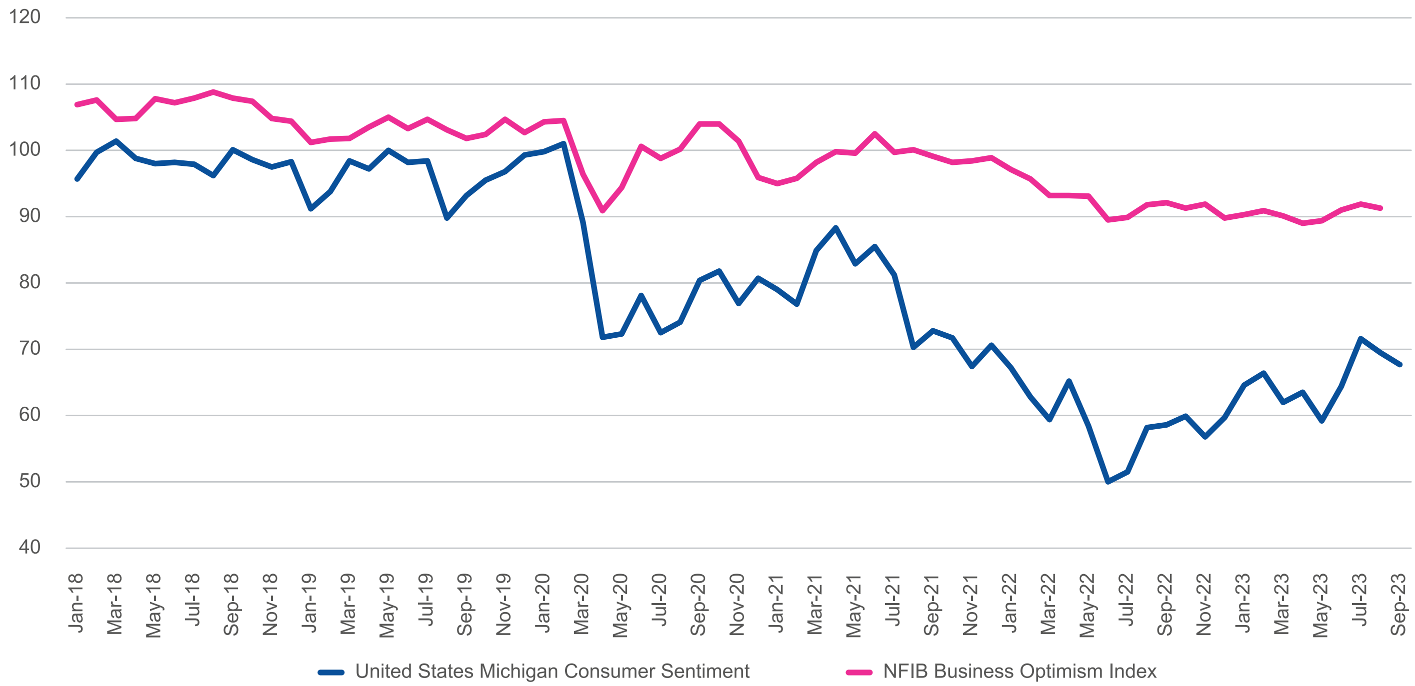


Source: Experian Commercial Benchmarking

The Small Business Administration strategy to expand support for the industry has created a safety net for small businesses to continue to thrive. This has kept commercial sentiment/ confidence higher than expected, even as foot traffic has experienced periods of volatility.

Commercial confidence chart and commercial card and installment origination trends

Consumer and Small Business Optimism



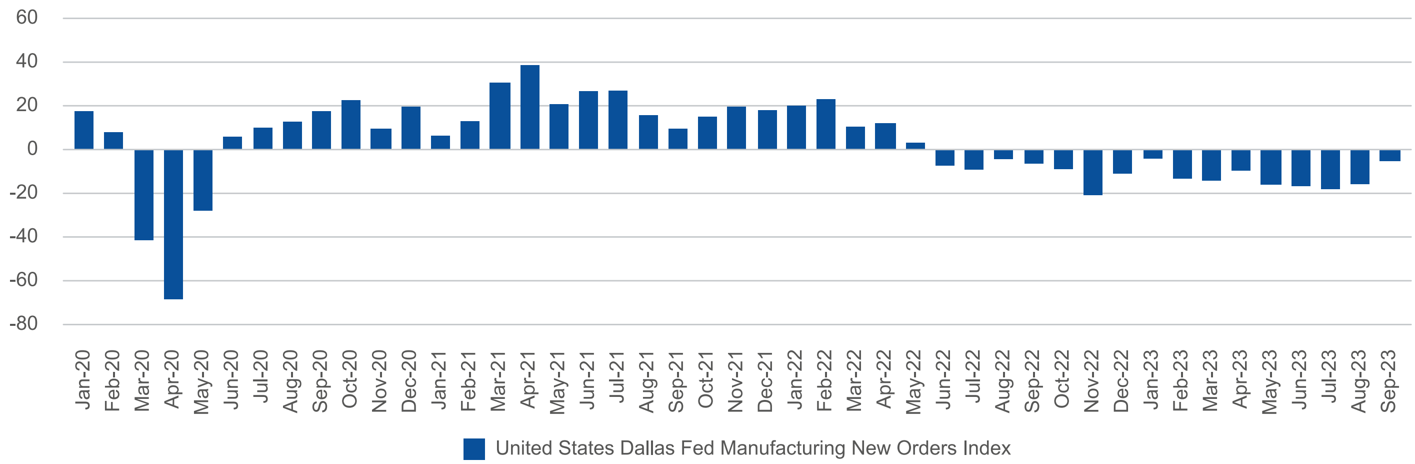
Source: NFIB, Small Business Monthly Optimism Survey, Experian Commercial Benchmarking

Holiday cheer or anxiety

Retailers are evaluating the behaviors of consumers and forecasting how many items to place in their shopping carts. Commercial inventories and factory orders have been falling as businesses, weary of an impending recession, cool ordering and rely on current stocks for the holiday.

Inventory and factory order trends

New orders



Source: U.S. Census Bureau, Dallas Federal Reserve

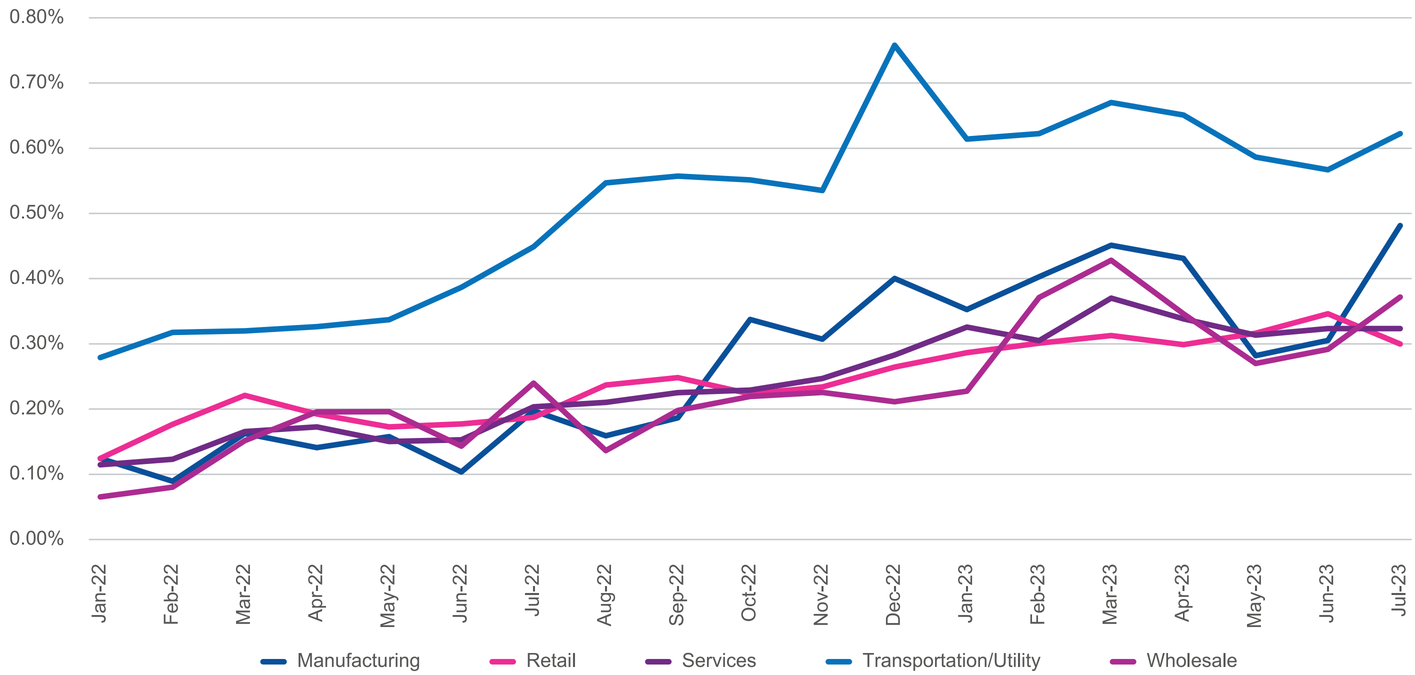
U.S. Inventory

Source: U.S. Census Bureau, Dallas Federal Reserve

The need for new warehouse space diminishes with lower restocking and new orders. Commercial construction slows, and new space orders are put on hold. The construction industry is already feeling the pressure of closing out 2023 for what may come after the first of the year. If fewer items are placed in carts because of high good pricing, fewer units, and lower volumes are needed to ship. This directly impacts the transportation industry. Logistic costs have been falling for the last year, and trucking companies big as well as independent transportation companies.

Delinquencies challenge supply chain

Supply chain delinquency 60-90 DPD



Source: Experian Commercial Benchmarking

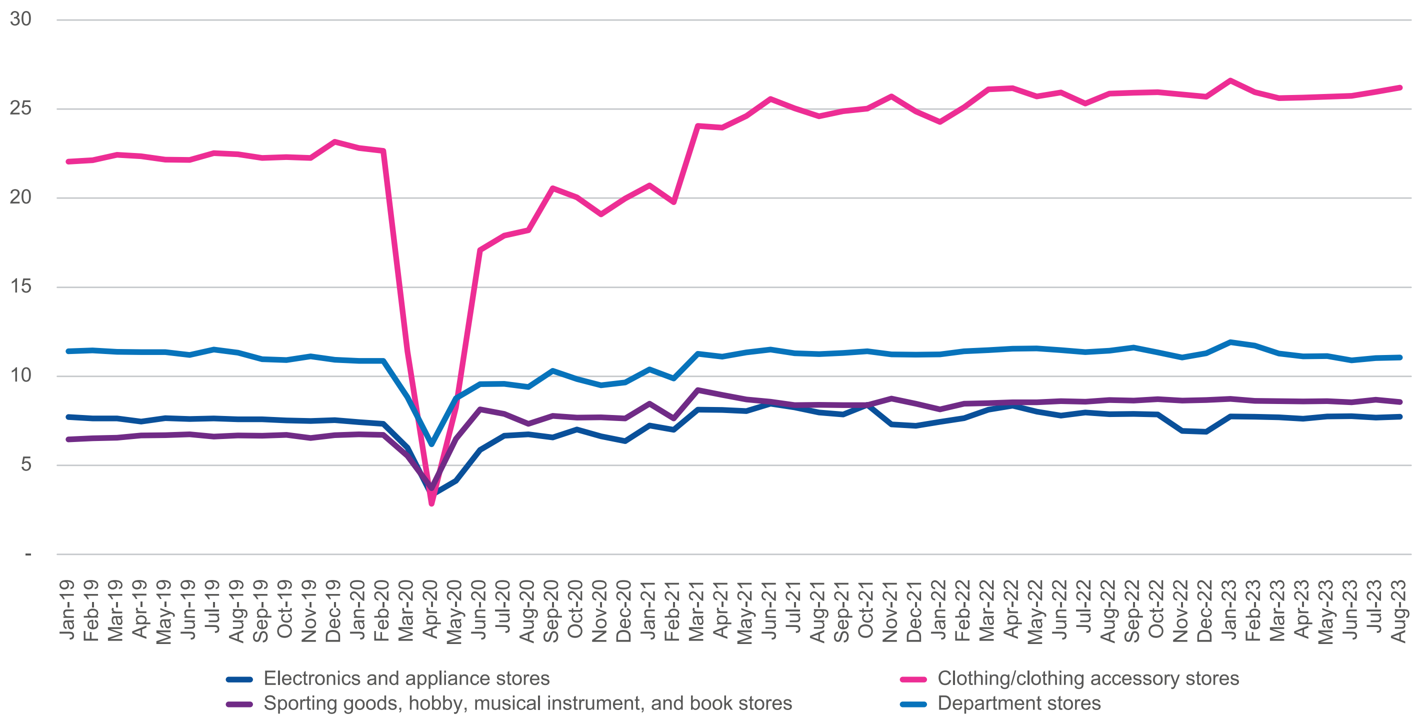
High pandemic prices create great opportunities for operators to go independent, and these new business owners were happy to take on hefty overhead during times of unusually profitable for the transportation industry. Margins are now razor-thin, and these new business owners are now upside-down. Commercial repayment behaviors are transitioning across these supply chains to support industry participants.

What would stimulate holiday cheer?

Consumers are bringing in the holidays early for small business retailers. U.S. Spending trends have been positive in the last two months of the quarter.

U.S. Retail sales growth for the holidays

Retail sales ($B) for holiday categories (Seasonally adjusted)



Source: U.S. Census Bureau

Wholesalers and retailers are engaged, and delinquency rates remain low. Does this mean that the U.S. is out of the woods? The positive progress with consumer behavior and protection of discretionary spending is keeping the door open and giving hope to businesses that the slowdown will be light and the market will continue to support them. Lenders are cautiously optimistic about the next 6 months. As we go into the holidays, they are limiting post-holiday exposure.

Gratitude, grace, and good wishes for silver bells

The 2023 holiday season in the United States paints an optimistic picture in terms of retail sales and consumer spending, with a touch of caution due to various macroeconomic factors. The macroeconomic outlook is favorable, with a healthy 7% increase in consumer spending expected, as individuals are projected to allocate an average of $1,530 for gifts, travel, and entertainment, as reported by PwC. Retail sales are anticipated to see a moderate rise of 4% during November through December, reaching a historic high of $979 billion despite this growth pace being slower compared to previous years, highlighting a resilient retail sector despite economic headwinds.

The adaptation of aggressive promotional strategies, alongside a notable increase in e-commerce sales, could potentially offset the anticipated slack in consumer spending due to inflation and other economic pressures. Small businesses will need to maintain their omnichannel approach to sales both online and in-store experiences will be critical to the cashflow-sensitive consumer. Consumers are planning to spend more than in prior years, but the number of items they can afford will be limited by rising costs and availability.

As we step into the festive quarter, let's not forget the resilient spirit of consumers and retailers alike that continues to drive the economy forward. The slight chill in the air not only heralds the holiday season but also a season of hope and recovery. **Whether you are a small business owner or a festive consumer, let the jingle of bells echo the ringing cash registers, adding a note of cheer and prosperity to the economic landscape!**

About the author

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Brodie leads a team of statistical consultants, scientists, 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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