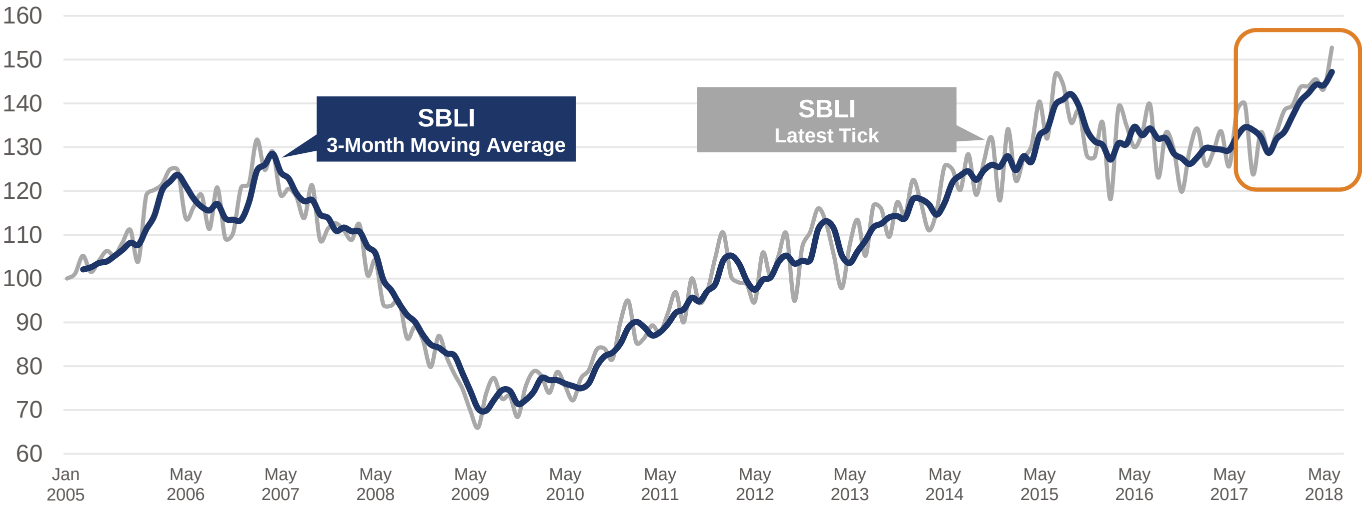
PayNet® Strategic Insights

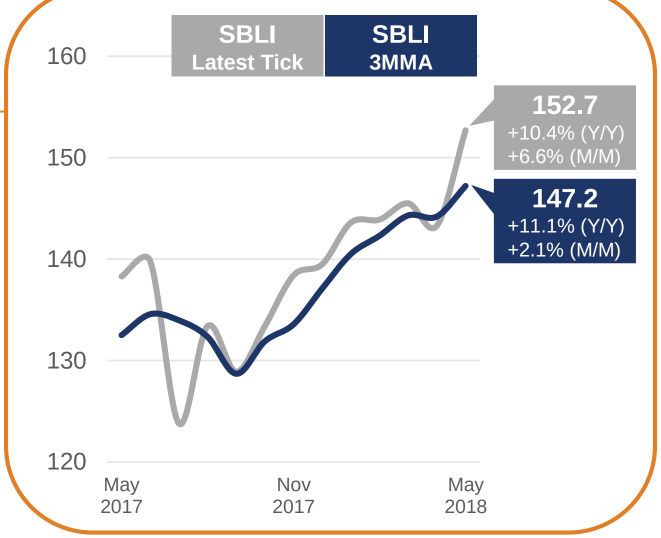
July 2018

Main Street Lending Reaches New Heights

Thomson Reuters / PayNet Small Business Lending Index (SBLI)*



A Closer Look at the Past Year



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

Index Analysis

The Thomson Reuters / PayNet Small Business Lending Index (SBLI) surged more than 9 points to 152.7 in May, a new series high. The SBLI is up over 10% compared to its year-ago level and has risen consistently since October 2017. The SBLI 3-month moving average also rose in May and is up more than 11% on the year.

Regional Story: Lending rose in all ten of the largest states on a year-over-year basis, with double-digit gains in Texas (+12.9% Y/Y) and North Carolina (+12.3% Y/Y). On a monthly basis, lending expanded in all but three of the largest states, though all declines were modest: Ohio (-0.2% M/M), Michigan (-0.2% M/M), and Georgia (-0.1% M/M). Notably, Illinois' SBLI has risen on an annual basis for nine consecutive months after falling in each of the previous 25 months.

Industry Story: The majority of industries saw lending expand on an annual basis in May, led by Transportation & Warehousing (+15.0% Y/Y), which grew at its fastest pace in nearly three years. All four of the industries that declined year-over-year are service sector industries, while goods sector industries (including Construction and Mining) experienced healthy gains. One industry to watch is Agriculture (+3.7% Y/Y), which has seen Y/Y improvement for seven consecutive months but may begin to feel the pinch of increased trade restrictions.

Economic Context

The U.S. economy has experienced solid economic growth in the first half of 2018, in large part due to sustained expansion in the small business sector. According to the National Federation of Independent Business ("NFIB") Small Business Optimism Index, one in three small business owners surveyed indicated that now is a good time to expand, the highest share in the survey's history. Similarly, a recent survey by TD Bank found that nearly half of small businesses have plans to apply for credit in the next year, more than double the percentage who said the same in 2017. However, planned federal interest rate increases appear to be spurring small businesses to pull forward borrowing plans to avoid facing higher rates down the road, which means credit demand may moderate in the months ahead. Overall, however, the outlook for small businesses lending is bright, and the surge in lending activity that has occurred over the last 6–9 months shows no signs of abating.

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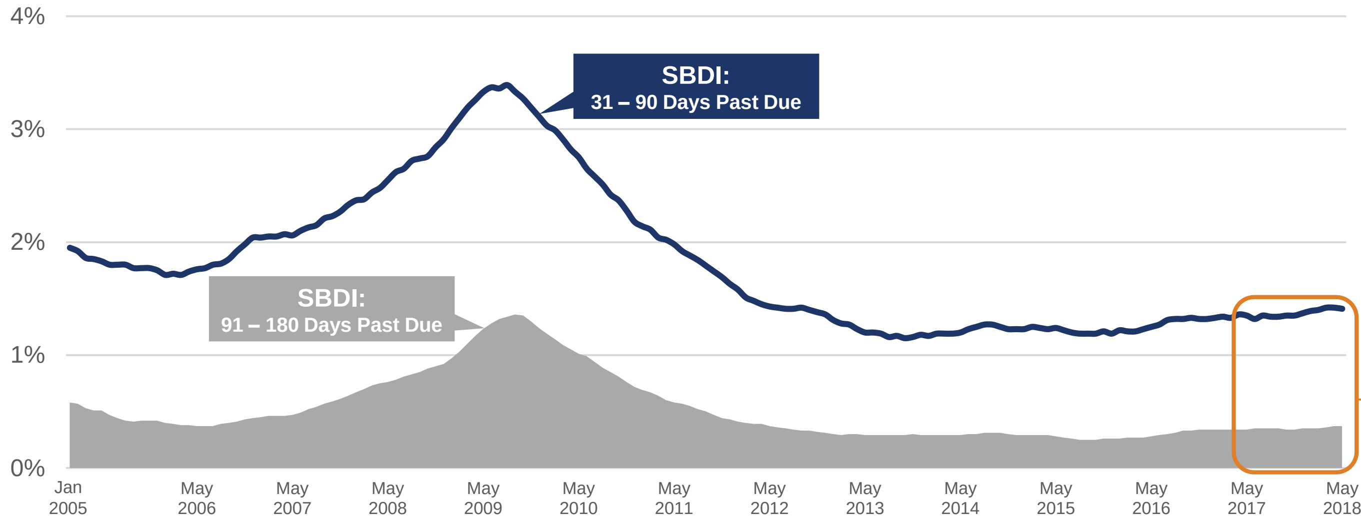
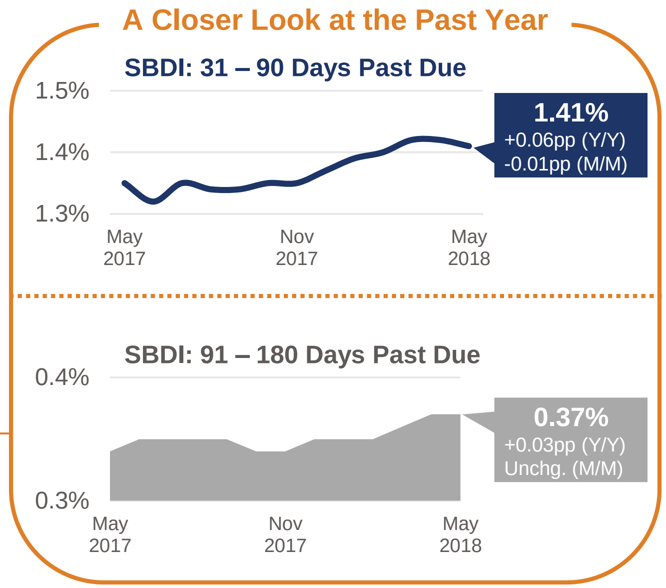
Strong Financial Health Persists

Thomson Reuters / PayNet Small Business Delinquency Index (SBDI)*



*Delinquent Percentage of Small Business Loans, Seasonally Adjusted Index



Index Analysis

The Thomson Reuters / PayNet Small Business Delinquency Index (SBDI) 31–90 Days Past Due edged down to 1.41% in May but remains six basis points above its year-ago level. The SBDI 91–180 Days Past Due held steady in May but has risen three basis points over the last 12 months.

Regional Story: In May, delinquencies fell in eight of the ten largest states on a monthly basis, but only two of these states saw delinquencies fall compared to last year: Pennsylvania (-6bp Y/Y) and California (-3bp Y/Y). Three states experienced double-digit delinquency increases compared to a year ago, most notably Florida (+16bp Y/Y), where Y/Y delinquencies have risen for 22 consecutive months. Conversely, Texas has seen delinquencies fall in each of the last six months.

Industry Story: Most large industries saw delinquencies rise on an annual basis in May, led by Health Care (+10bp Y/Y), which increased at its fastest rate in over a year. The only industry to experience a decline in delinquencies on a year-over-year basis was Transportation (-56bp Y/Y), marking its tenth consecutive Y/Y decline. Regarding defaults, over half of the industries saw decreases from year-ago levels, including Finance (-26bp Y/Y), which has fallen for four consecutive months after increasing in each of the previous 18 months.

Economic Context

Despite rising federal interest rates, strong fundamentals in the U.S. economy continue to buoy financial health among small businesses. Measures of overall financial stress in the economy have edged down in recent months, including the Kansas City Fed Financial Stress Index, which fell from -0.37 in April to -0.54 in May. However, in light of rising inflationary pressures, the Federal Reserve recently accelerated its rate hike schedule and now expects to raise rates a total of four times in 2018 (indeed, the Fed could be pushed to raise rates even more frequently if inflation pressures continue to mount). While planned rate hikes can increase financial stress over time, an unexpectedly rapid pace of rate increases could catch borrowers off-guard and have a more significant detrimental impact on financial health. For now, however, small business financial health remains quite strong, suggesting that continued growth in small business C&I lending activity is likely.