Small Business Checkpoint

A deeper look at payroll spending

19 July 2023

Key takeaways

- With labor market conditions remaining a focal point of the economy, Bank of America internal data suggests that small businesses continue to spend on payrolls in June, although at a slower pace than the beginning of the year. With wage inflation still high, this moderation has likely been driven by slower hiring.
- Small businesses in the lodging and restaurant sectors have seen the strongest payroll payments growth through 2023, underscoring the relative strength in leisure services. Meanwhile, payroll spending was weakest in finance, insurance, and real estate, reflecting early signs of softness in higher-income industries.
- Besides payroll spending, total payments per small business client contracted by 3% year-over-year (YoY) in June. This is no great surprise, as businesses face increasingly tight profit margins: according to Bank of America internal data, the ratio of inflows to outflows in small business checking and savings accounts dropped below 1 last month - the lowest June reading in five years.

Small Business Checkpoint is a regular publication from Bank of America Institute. It aims to provide a real-time assessment of small business spending activities and financial well-being, leveraging the depth and breadth of Bank of America's proprietary data. Such data is not intended to be reflective or indicative of, and should not be relied upon as, the results of operations, financial condition or performance of Bank of America.

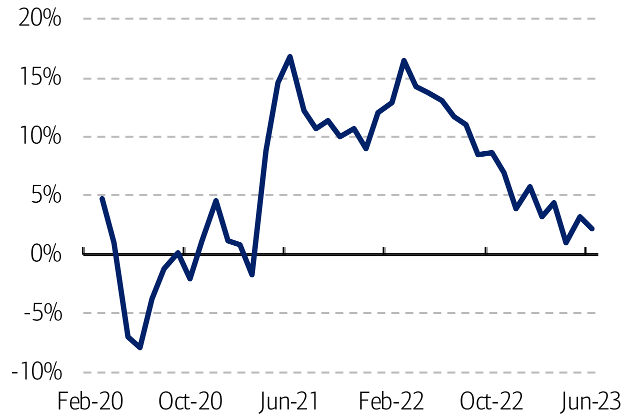
Small business payroll payments still up on one year ago

Bank of America internal data suggests that small businesses continued to spend on payrolls in June, although at a slower pace than at the beginning of the year. Specifically, payroll payments per small business client were up 2% year-over-year (YoY), a slight moderation from 3% YoY in the prior month. That said, growth has been on a downward trend since early 2022, moderating from the peak of 16% YoY in March 2022.

Because payroll payments are a function of both the number of employees and wages, it is important to look at both components. Both average hourly earnings (AHE) data and the Employment Cost Index from the Bureau of Labor Statistics suggest that wages have moderated slightly from their peak but remain stubbornly elevated at above 4% YoY. This suggests that the slowdown in small business payroll payments growth over the last year has largely been driven by slower hiring.

Exhibit 1: Growth in small business payroll payments (% YoY, 3-month moving average)

Payroll payments per small business client were up 2% YoY in June



Source: Bank of America internal data

Exhibit 2: Average hourly earnings (%YoY, data as of June 2023) and Employment Cost Index for wages and salaries (%YoY, data as of 1Q 2023)

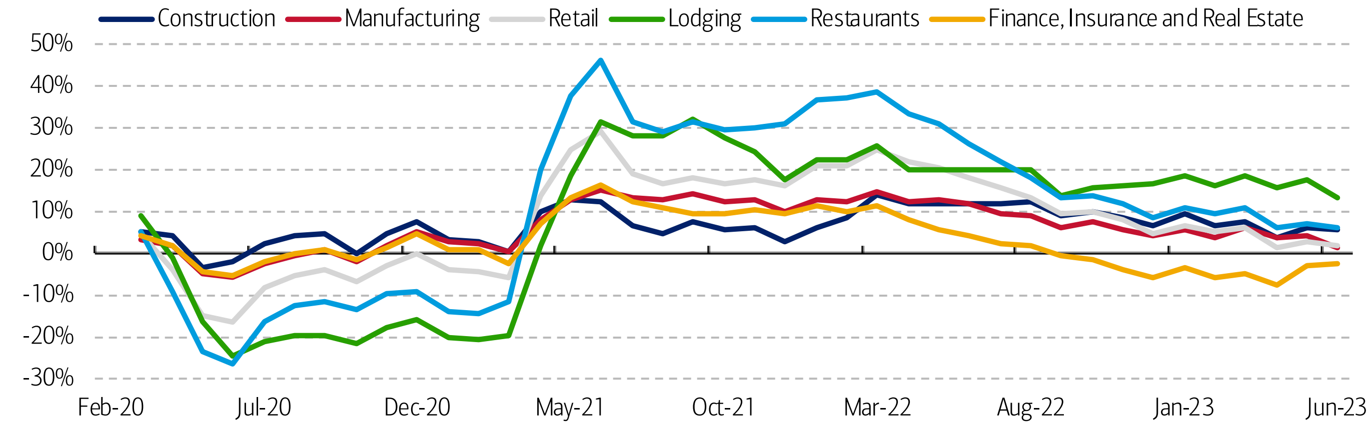
Both measures of wage inflation remain elevated

Source: Bureau of Labor Statistics

Among major sectors, small businesses in lodging continue to see the strongest payroll payments growth, up 13% YoY (Exhibit 3). This is followed by 6% YoY growth in both the restaurant and construction sectors. By contrast, small businesses in the finance, insurance, and real estate sectors are seeing payroll payments contract, down 2% YoY in June.

We make two observations on the divergence between sectors. First, leisure services sectors continue to outperform all other sectors. As consumer spending for such services is still elevated, demand for workers in industries like lodging and restaurants remains relatively more resilient. Second, as discussed in our recent Consumer Checkpoint, despite the overall resilience of the labor market, small cracks are appearing at the higher end of the income spectrum. As a result, we think it is reasonable to expect hiring activities in finance, insurance and real estate firms, which skew to higher incomes, to show the weakest momentum.

Exhibit 3: Growth in small business payroll payments by select sector (% YoY, 3-month moving average)
Small businesses in the lodging sector continue to see the strongest payroll payments growth, up 13% YoY



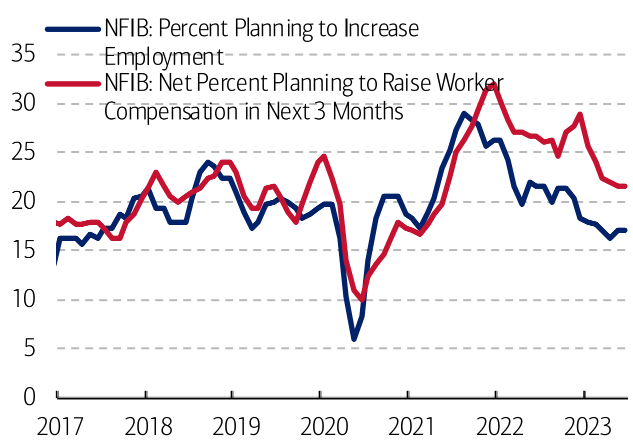
Source: Bank of America internal data

Looking ahead, small business payroll payments could moderate further if hiring and wages both ease. According to the latest survey from the National Federation of Independent Business (NFIB), the net percentage of small businesses planning to increase employment was 17% in June, while the net share of businesses planning to raise worker compensation stood at 22%, both five percentage points lower than the same time last year (Exhibit 4).

Profit squeeze weighs on overall small business payments

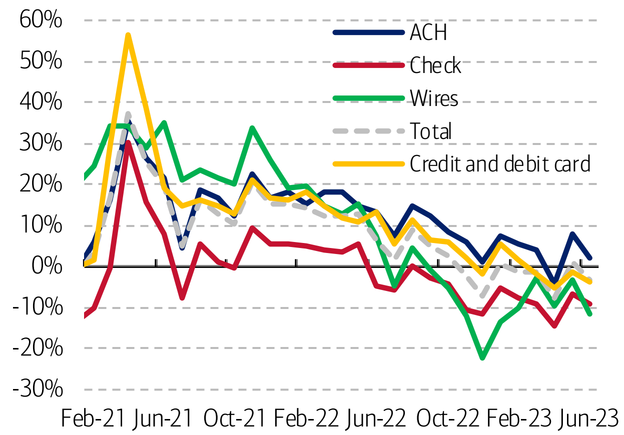
Looking more broadly, we find that small business total payments pulled back in June. According to Bank of America internal data, total payments per small business client, which includes automated clearing house (ACH), credit and debit cards, wires, checks and person-to-business payments, contracted by 3% YoY in June.

Exhibit 4: National Federation of Independent Business (NFIB) survey on employment intentions (3-month moving average)
Fewer small businesses plan to increase employment or to raise worker compensations than a year ago



Source: NFIB

Exhibit 5: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)
Total payments per small business client contracted by 3% YoY in June



Source: Bank of America internal data

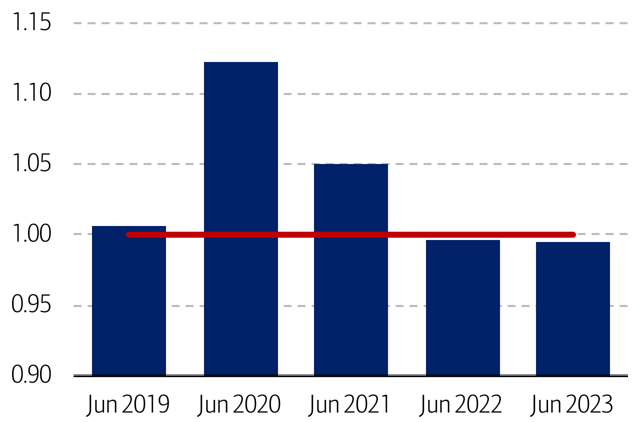
By component, ACH payments per small business client remained positive at 2% YoY in June. Given that such payments capture bigger-ticket items like rent and payrolls, this could point to persistent cost pressures for small businesses. Elsewhere, aggregated Bank of America credit and debit card spending per small business client contracted by 4% YoY, likely as small businesses are cautious on discretionary spending.

The easing in spending comes as small businesses face tighter profit margins compared to prior years. According to Bank of America internal data, the ratio of inflows to outflows in small business checking and savings accounts, which we view as a proxy for profits, was below 1 in June (i.e., inflows were lower than outflows), the lowest June monthly reading in the past five years.

That said, it is important to keep in mind that even as small businesses show signs of easing spending, it remains elevated by historical standards, suggesting business spending is not near recessionary levels.

Exhibit 6: Inflow-to-outflow ratio for small businesses, based on Bank of America internal data (monthly, 1+ = inflow greater than outflow)

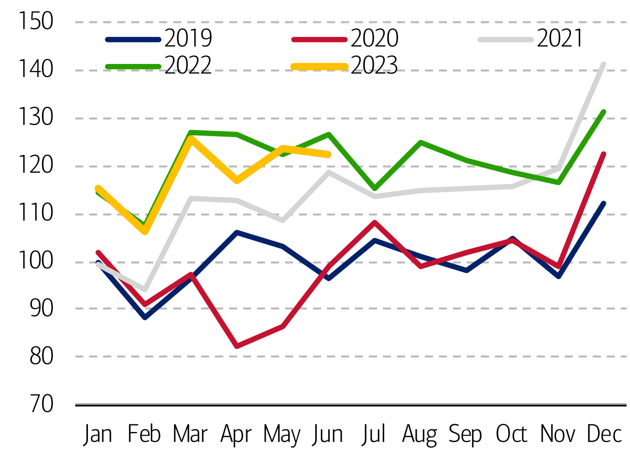
The ratio of inflows to outflows in small business checking and savings accounts was below 1 in June



Source: Bank of America internal data

Exhibit 7: Total payments per small business client (index, January 2020 =100)

The level of small business spending remains elevated by historical standards



Source: Bank of America internal data

Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on **aggregated and anonymized** selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

Any **Small Business** payments data represents aggregate spend from Small Business clients with a deposit account or a Small Business credit card. Payroll payments data include channels such as ACH (automated clearing house), bill pay, checks and wire. Bank of America per Small Business client data represents activity spending from active Small Business clients with a deposit account or a Small Business credit card and at least one transaction in each month. Small businesses in this report include business clients within Bank of America and are generally defined as under $5mm in annual sales revenue.

Payments to small business-focused hiring firms include both direct deposits through Automated Clearing House (ACH) and payments via credit and debit cards.

Unless otherwise stated, data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

Data regarding merchants who receive payments are identified and classified by the Merchant Categorization Code (MCC) defined by financial services companies. The data are mapped using proprietary methods from the MCCs to the North American Industry Classification System (NAICS), which is also used by the Census Bureau, in order to classify spending data by subsector. Spending data may also be classified by other proprietary methods not using MCCs.

Additional information about the methodology used to aggregate the data is available upon request.

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