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Small Business Checkpoint

Small business credit crunch?

19 April 2023

Key takeaways

- Regional bank failures have sparked concerns of a significant tightening of credit conditions for small businesses. How worrying is this?
- The good news is that latest Bank of America internal data suggests that small businesses, including those in California, saw little interruption to their operations in March, with spending growth in line with recent trends. Notably, payroll spending growth ticked up even as wage inflation decelerated in March, pointing to resilient small business hiring despite the uncertainties.
- In our view, banks had already started to tighten lending conditions in 2022 and recent developments point to a continuation rather than acceleration of this trend. Tighter credit could eventually weigh on business activity but we note that small businesses still rely more on larger banks for credit, and C&I loan growth at these banks has remained intact so far.

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.

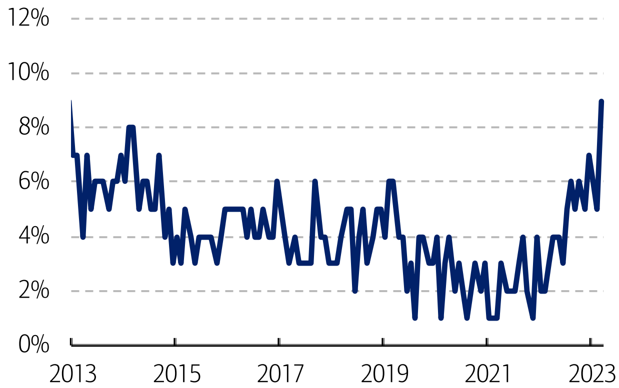
Credit availability is crucial for small businesses as a tool to finance operating expenses and capital investments. As a result, the recent news of three regional bank failures sparked worries of a significant tightening of credit conditions. In fact, the March National Federation of Independent Business (NFIB) survey already showed a jump in the share of small business respondents reporting that credit was harder to get (Exhibit 1), reaching a 10 year high. How concerning is this?

Bank of America data points to little disruption to small businesses

One way to estimate the potential impact of tightening credit conditions on small businesses is to look at small business spending, since funding shortages will likely lead to a reduction in expenses. The good news is the latest Bank of America internal data suggests that small businesses, including those in California, saw little interruption to their operations in March. Payments growth, which includes automated clearing house (ACH), cards, wires, checks and person-to-business, was in line with recent trends (Exhibit 2).

Exhibit 1: Percent reporting that credit was harder to get last time Net (SA, %)

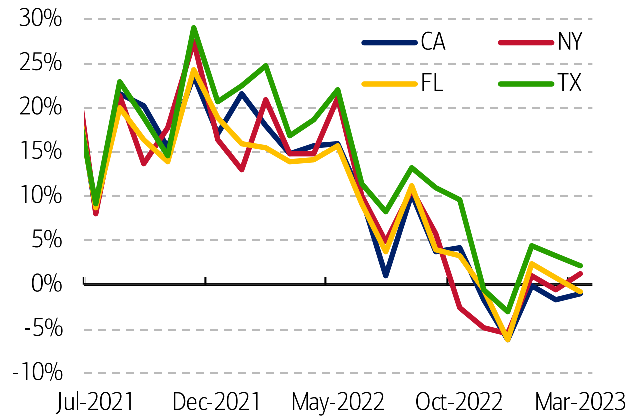
March NFIB survey showed a jump in the share of small business respondents reporting that credit was harder to get



Source: National Federation of Independent Business

Exhibit 2: Small business payments per client in select states (%YoY)

Spending from New York and California businesses saw little disruption to previous trends



Source: Bank of America internal data

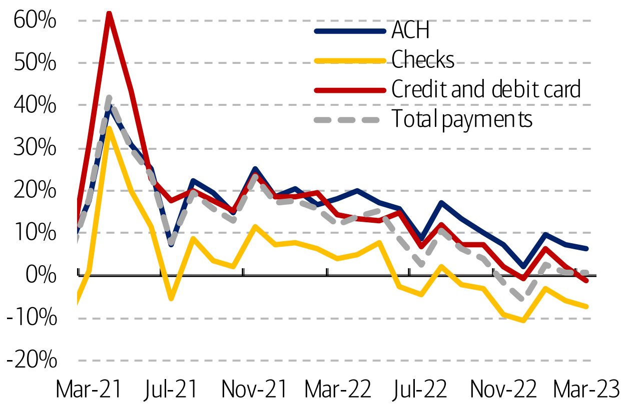
Specifically, Bank of America internal data shows that total payments per small business client grew by 1% year-over-year (YoY) in March, in line with the prior month (Exhibit 3). Credit and debit card spending per client, which includes a bigger share of discretionary spending, did slip into negative territory at -1% YoY. However, we think the slowdown in card spending was a continuation of the downward trend, likely due to the squeeze from higher necessity spending, such as rent and payrolls, instead of an inflection point in reaction to recent news.

The geographical breakdown reveals a particularly interesting finding: total payments per small business client in California and New York, where businesses are more likely to be exposed to the recent fallout of regional banks, are broadly in line with less impacted states such as Texas and Florida (Exhibit 2). In fact, payments per client in California and New York even improved slightly in March, although this might partly be driven by small businesses shifting some of their spending to their accounts at larger banks.

Payroll spending offers further grounds for optimism. We find that small businesses' payroll payments per client were up over 4% YoY in March, a one percentage point uptick from February (Exhibit 4). The growth rate in payroll spending ticked up even as wage inflation decelerated in March, which we believe underlines the resilience in small business hiring and suggests business owners continue to have fairly constructive outlooks.

Exhibit 3: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)

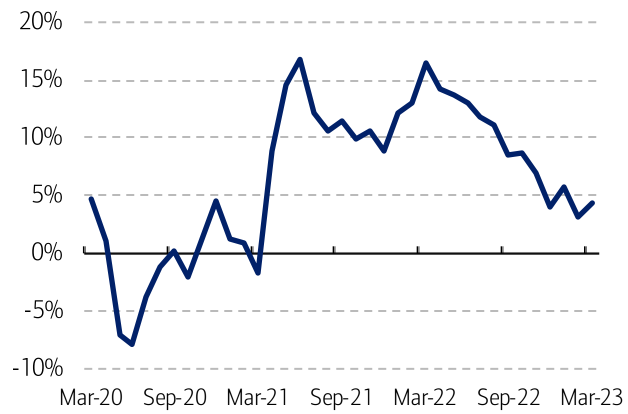
Total payments per small business client grew by 1% YoY in March



Source: Bank of America internal data

Exhibit 4: Growth in small business payroll payments (% YoY, 3-month moving average)

Small businesses' payroll payments per client growth increased in March



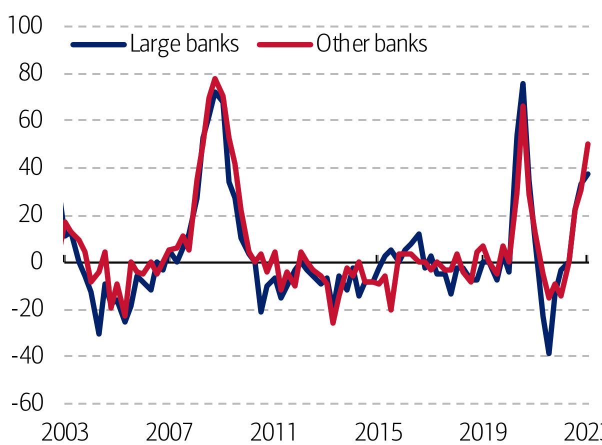
Source: Bank of America internal data

Continued tightening of credit conditions could gradually weigh on small businesses

While small businesses saw no meaningful interruption to operations in March, one question is whether there may still be a sharp tightening in credit conditions that could tip the balance. Banks had already started to tighten lending conditions in 2022 and recent developments following the regional bank failures point to a continuation, rather than acceleration, of this trend.

Exhibit 5: Net percentage of banks tightening commercial and industrial (C&I) loans to small firms: large banks vs. other banks

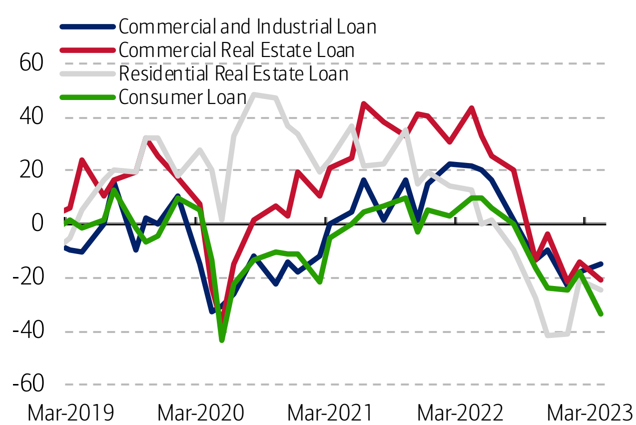
The latest reading shows more banks are tightening lending standards



Source: Federal Reserve Board, data as of 1Q prior to regional bank failures.

Exhibit 6: Dallas Fed Banking Conditions Survey: index of loan volume (<0 means decreasing volume)

Recent developments seem to have not accelerated ongoing tightening credit conditions



Source: Dallas Fed. Survey period = March 21-March 29 2023

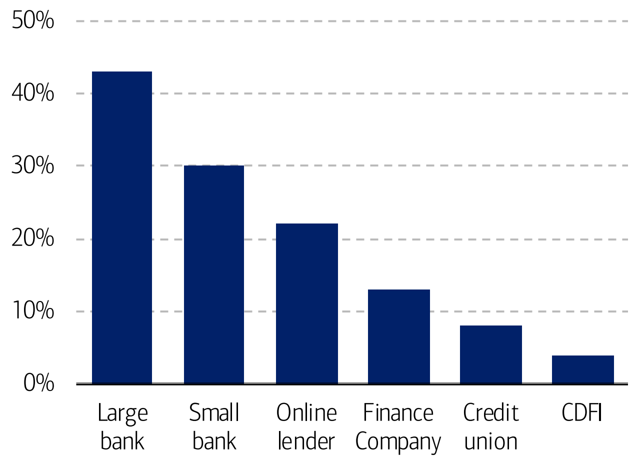
Let's first look at small business lending conditions prior to March. As shown by the Senior Loan Officer Opinion Survey (SLOOS), the net percentage of surveyed banks that were tightening commercial and industrial (C&I) loans to small firms turned positive in the third quarter of 2022. It then continued to edge up in the latest 1Q 2023 reading that was released in February. Note that a positive reading means there are more banks tightening standards than easing them (Exhibit 5).

The next SLOOS survey will be released in May and will capture results following the regional bank news. However, the recent Banking Conditions Survey by the Dallas Fed can provide some early insights. With results collected between March 21 and March 29, the Dallas Fed report showed a further decline in loan volume.

We make two additional observations on the Dallas Fed report. First, details suggest the decline in overall loan volume was primarily driven by a steep contraction in consumer rather than commercial loan volume. Second, for C&I loans, which are more relevant for small businesses, loan volume continued to contract (i.e. with a negative reading of the index) but at a slower pace than in the prior few months (Exhibit 6), suggesting recent news did not put additional pressure on lending conditions. The caveat is that this survey only focused on banks in the Texas region and each region will likely feel the impact very differently, as Texas should be less impacted by the regional bank fallouts than places like California and New York.

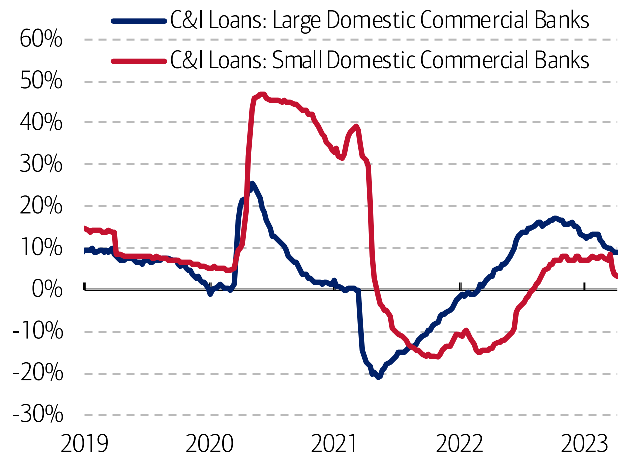
Putting it all together, we think the ongoing tightening of credit conditions could gradually weigh on business activities but recent developments did not accelerate this process. Moreover, small businesses still rely more on larger banks for credit (Exhibit 7) and loan growth at larger banks seems to have remained fairly intact so far: latest weekly data from the Federal Reserve Board shows that C&I loan growth at large domestic banks even rebounded slightly on a YoY basis for the week of April 5 (Exhibit 8).

Exhibit 7: Source of funding for small businesses that applied for a loan, line of credit, or cash advance (% of firms)
Small businesses still rely more on larger banks for credit application



Source: Federal Reserve Board 2023 Small Business Credit Survey

Exhibit 8: Commercial and industrial loans volume growth at large and small domestic commercial banks (weekly data, %YoY)
C&I loan growth at large domestic banks rebounded slightly on a YoY basis for the week of April 5



Source: Federal Reserve Board

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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