

U.S. Economic Flash

Small Business Quarterly

- Demand for credit rebounds but tight supply weighs on small business activity**

Small business credit markets were undersupplied in 4Q12 as demand outstripped supply for the seventh consecutive quarter. The willingness to lend does not appear to be a function of supply, as excess reserves remain at historic levels, but rather a response to the uncertainty overhang of the 4th quarter. A highly contested and pivotal presidential election, a natural disaster and the political brinksmanship associated of the so-called “fiscal cliff” debate contributed to extremely high levels of uncertainty, according to the BBVA Uncertainty Index. However, the risk-aversion experienced in 4Q12 is unlikely to persist, regardless of Congressional action, given strong underlying current of improved consumer expectations and growing household net worth.

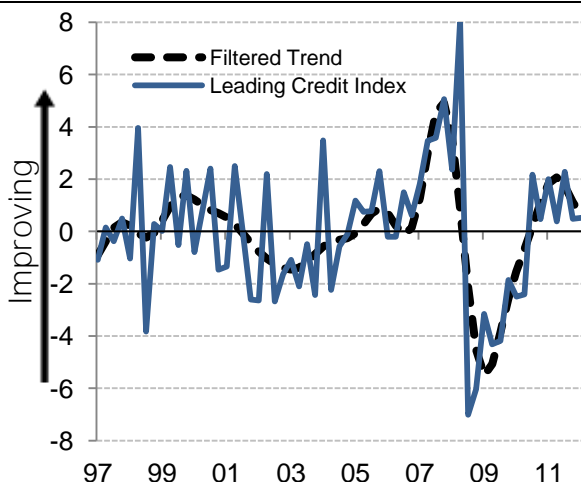
- Divergent market trends lead to higher borrowing costs and reduced construction**

The uptick in demand in the 4Q12 lead to increased borrowing cost for small businesses relative to larger firms. Higher borrowing costs coincided with a slowdown small business construction activity. Of note, the construction of special care clinic, which experienced substantial growth since the recession, contracted. In addition, positive trends in medical care facility and dinning/drinking establishment construction pivoted to the downside and are trending towards pre-recession lows. In terms of future credit market fundamentals, our leading credit index suggests credit markets will be less liquid in the short-run (chart 1).

- Government policy dominates small business expectations**

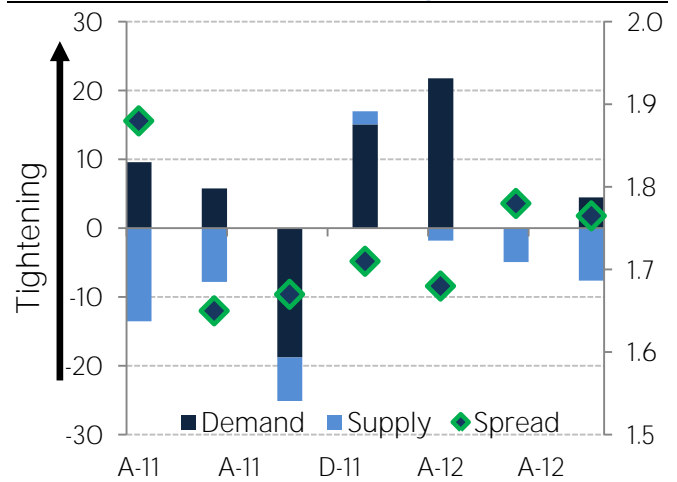
A balanced risk environment suggests moderate improvement to small business expectations in the short-run with upside potential in the medium-run. The NFIB responses to the most pressing challenges reflect concerns over regulatory and fiscal policy. In descending order of importance, small business reported taxes, government and sales as the most problematic issues. More specifically, the percentage of respondents reporting the concerns over government policies reached levels not seen since 1996. The fact that Congress still maintains an element of control over many of the fiscal and structural challenges facing the U.S. suggests upside prospects should outweigh potential risks. Nevertheless, the recent policy track record of Washington has been dismal, and while the policy environment is likely to improve, there remain key risks that could severely reduce small business optimism in 2013.

Chart 1
Small Business Leading Credit Index & Short-Run Trend



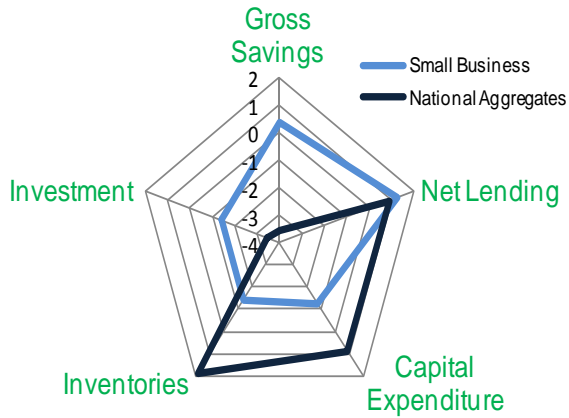
Source: Haver & BBVA Research

Chart 2
Credit Market Conditions & Small Business Spread (Spread: Small Business rate vs Large firms)



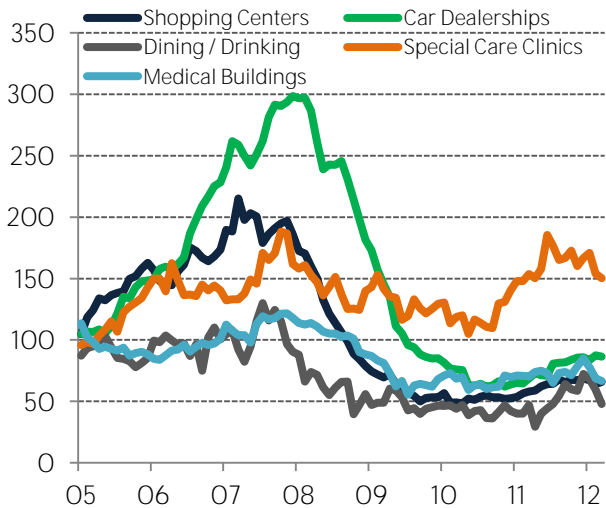
Source: Federal Reserve, Haver & BBVA Research

Chart 3
Business Activity (QoQ change)



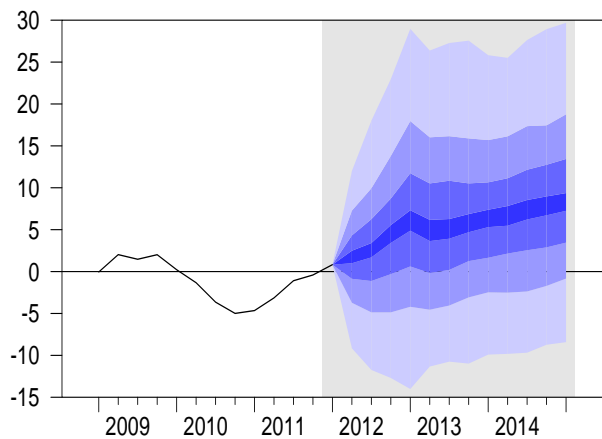
Source: Haver & BBVA Research

Chart 5
Construction Index (2005=100)



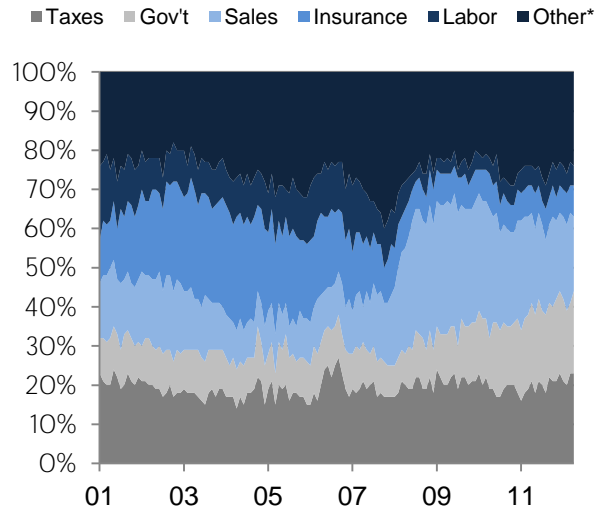
Source: Haver & BBVA Research

Chart 7
Trade Credit Forecasts, YoY % Change



Source: Haver & BBVA Research

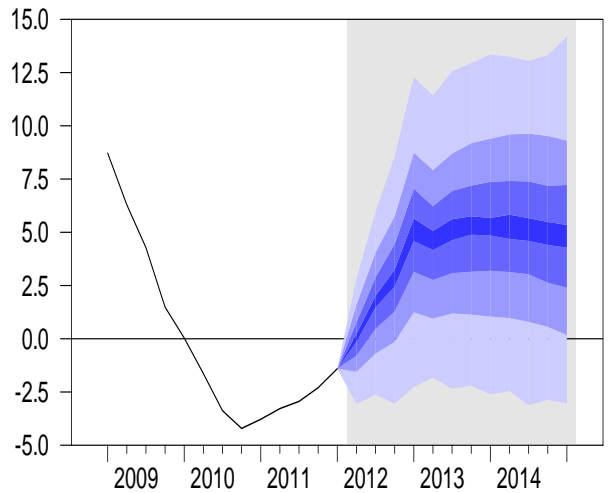
Chart 4
NFIB, Most Pressing Problems (% of respondents)



Source: Haver & BBVA Research

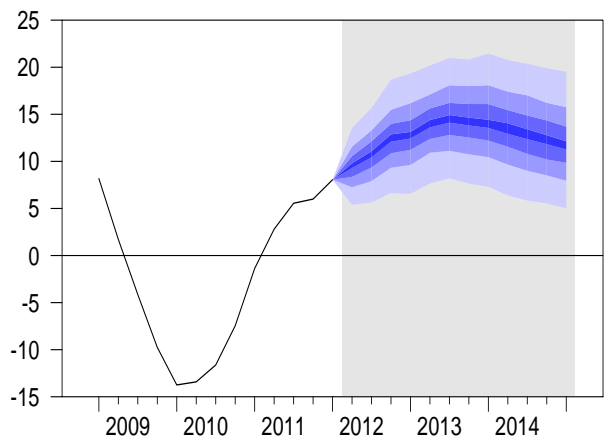
* Includes Large-firm competition, wages, interest rates, inflation and other

Chart 6
CRE Loan Forecasts, YoY % Change



Source: Haver & BBVA Research

Chart 8
Commercial and Industrial Loans, YoY % Change

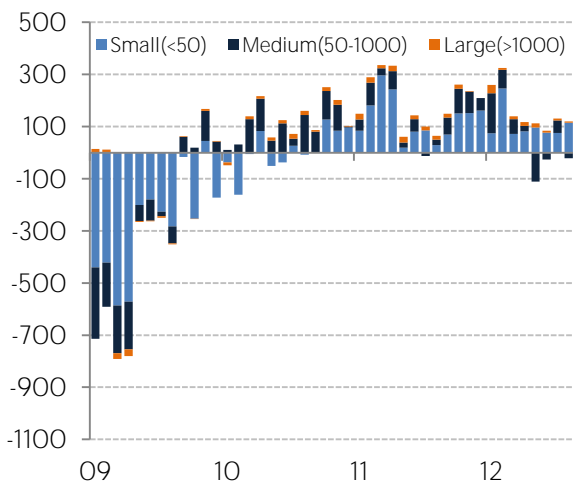


Source: Haver & BBVA Research

Small Business Employment Dynamics

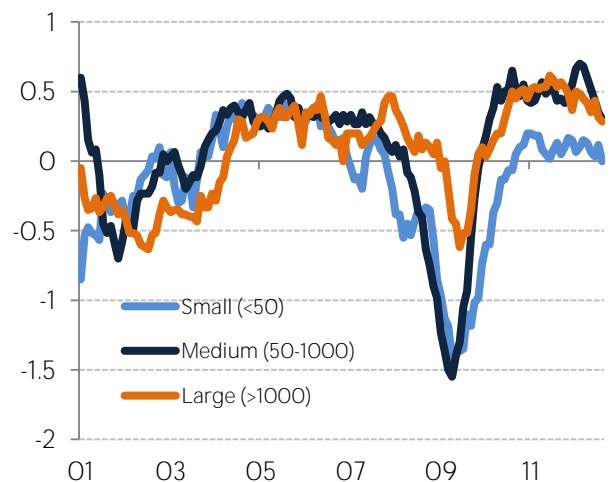
Small business employment surprised to the upside in 2012. In terms of employment gap contribution, small businesses accounted for nearly 75% of the total job creation in 2012, with an average job creation rate of 100k jobs per month. However, the 0% six-month moving average job creation rate and the deceleration in the job openings are discouraging signs. High levels of policy uncertainty, particularly in regards to Affordable Care Act and Tax policy, will likely contribute to the slowing job openings and creation rates going forward. Moreover, without greater policy clarity it is unlikely that positive consumer trends will offset growing cost-side uncertainty. Thus, if reaming policy gaps that disproportionately affect small business are ignored, the pace of small business hiring will slow in 2013.

Chart 9
Employment Gap Contribution, k



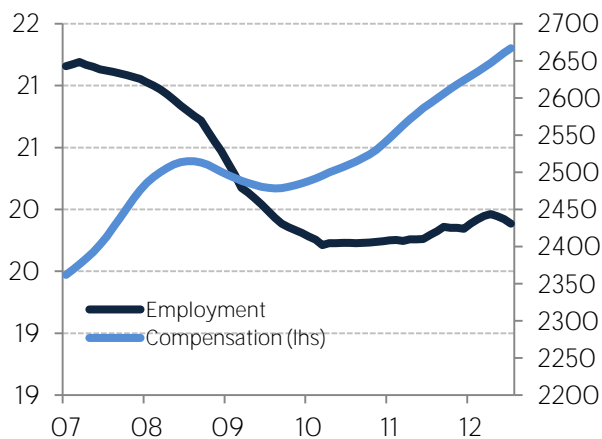
Source: Haver & BBVA Research

Chart 10
Net Job Creation Rate by Firm Size, 6mma (%)



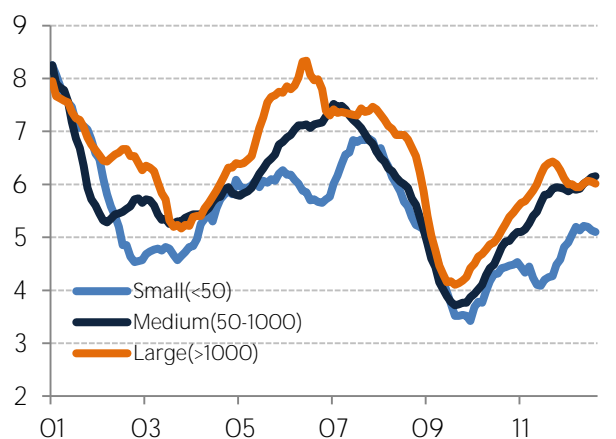
Source: Haver & BBVA Research

Chart 11
Monthly Compensation and Employment (\$&m)*



Source: Intuit & BBVA Research
 *Small Business

Chart 12
Job Openings by Firm Size, 6mma (%)



Source: Haver & BBVA Research



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