NONCONFIDENTIAL // EXTERNAL
FEDERAL RESERVE BANK OF KANSAS CITY | December 22, 2022

kcFED Small Business Lending SURVEY

Small Business Lending Declines as Loan Demand Softens

Dustyn DeSpain
Assistant Vice President

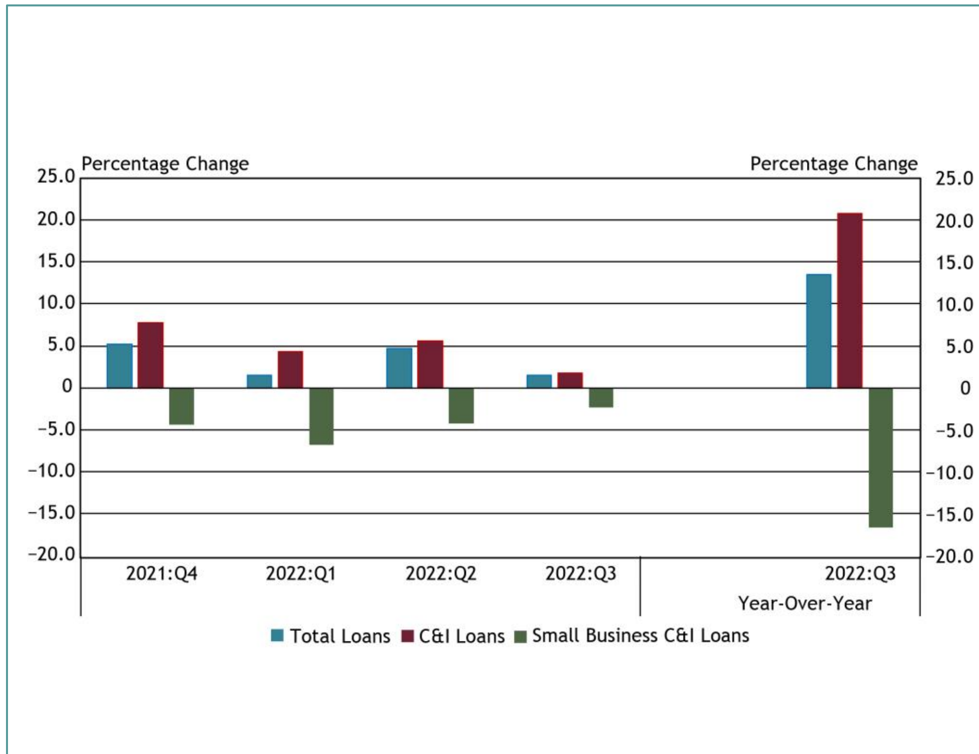
Emily Robinson
Financial Analyst

Small business commercial and industrial (C&I)[1] lending decreased in third quarter of 2022, with the 128 respondents to the survey, on net, reporting decreasing loan demand. Both outstanding and new small business lending balances decreased with new lending decreasing most dramatically by 22.1 percent year-over-year and 14.5 percent quarter-over-quarter. Respondents, on net, reported diminishing credit quality and, for the fourth consecutive quarter, noted tightening credit standards. Interest rates continued to rise with median variable rate term loans increasing by 112 basis points and variable rate lines of credit increasing by 128 basis points, which continues to be directionally consistent with federal funds rate increases of 150 basis points throughout the third quarter. While 55 percent of respondents reported that supply chain disruptions had not impacted small business lending, 34 percent indicated that the disruptions had increased loan demand, remaining consistent with second quarter survey responses.

[1] Small business lending refers to small business Commercial & Industrial lending unless explicitly noted otherwise.

NONCONFIDENTIAL // EXTERNAL

Chart 1: Outstanding Small Business Loan Balances Decrease

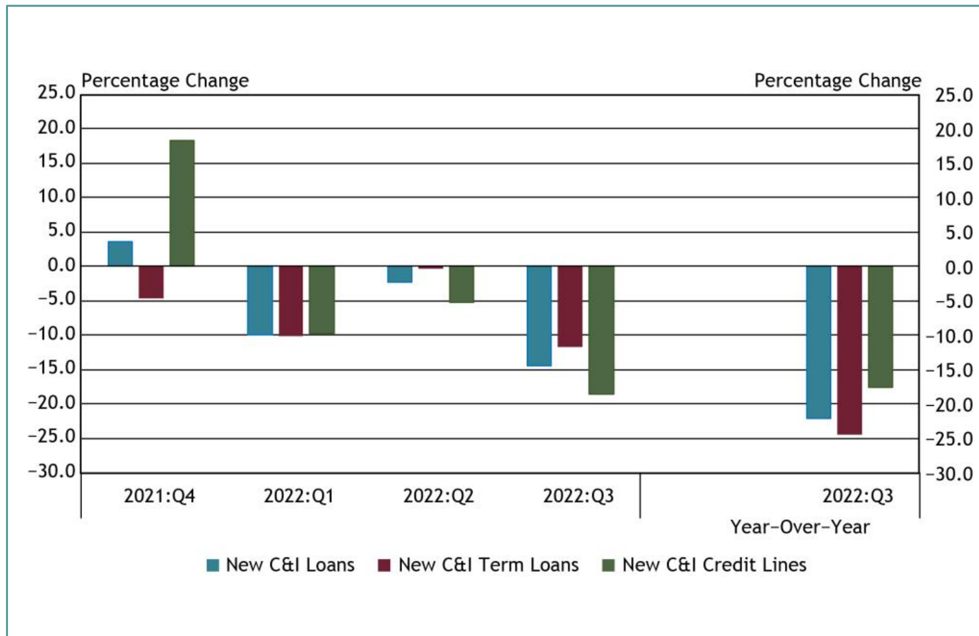


Note: Items are calculated using a subset of 97 respondents that completed the FR 2028D for the last five quarters surveyed.

Sources: Call Report, Schedule RC-C Part I, items 4. Commercial and Industrial Loans and 12. Total Loans and Leases Held for Investment and Held for Sale, Small Business Administration, and FR 2028D, items 4.b and 5.c.

In the third quarter, small business loan balances decreased 2.4 percent quarter-over-quarter, the sixth consecutive quarterly decline, and 16.6 percent year-over-year. The year-over-year decline in small business loan balances is consistent with a rising rate environment and the weaker loan demand reported, on net, by survey respondents. It is also partially attributable to the decline in outstanding Paycheck Protection Program (PPP) loans. According to the Small Business Administration, 96 percent of PPP loan balances had been forgiven as of September 2022, a 26 percent increase from September 2021. Despite the large year-over-year decrease in small business loans, total loans and total C&I loans increased 13.5 percent and 20.7 percent, respectively.

Chart 2: New Small Business Lending Declines

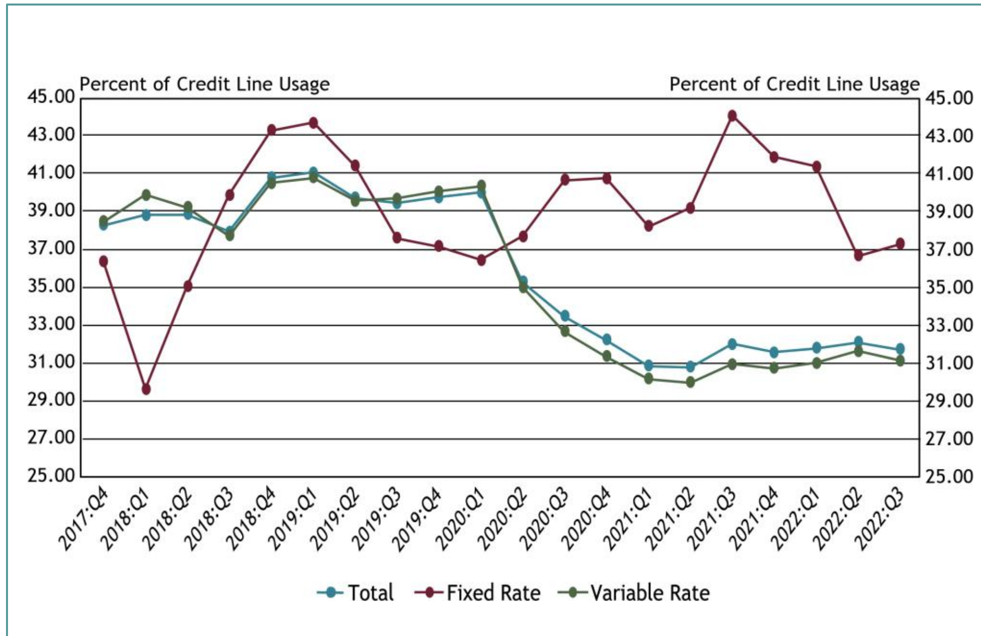


Note: Items are calculated using a subset of 94 respondents that completed the FR 2028D for the last five quarters surveyed. All loan types referenced in Chart 2 refer to small business lending.

Source: FR 2028D, items 7.b and 8.c.

New small business loan balances decreased 22.1 percent compared with the previous year, driven by a 24.5 percent decrease in new term loans and a 17.7 percent decrease in lines of credit. Quarter-over-quarter, new small business lending decreased 14.5 percent due to a 11.7 percent decrease in term loans and 18.6 percent decrease in credit lines. The decline in new small business lending is consistent with a rising rate environment and the weaker loan demand reported, on net, by survey respondents.

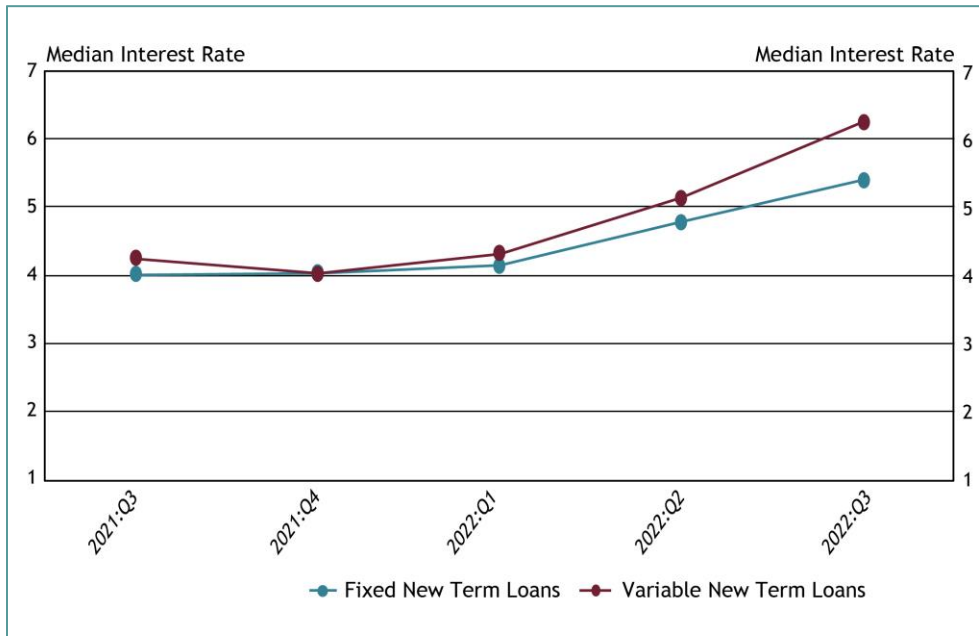
Chart 3: Credit Line Usage Remains Stable



Source: FR 2028D, items 5.b and 5.c.

Usage of small business credit lines remained stable in the third quarter at 32 percent. The use of fixed and variable rate lines of credit remained relatively unchanged when compared with the second quarter. As of third quarter 2022, respondents indicated that variable rate lines make up about 89 percent of total credit line usage.

Chart 4: Rates Increase on New Term Loans

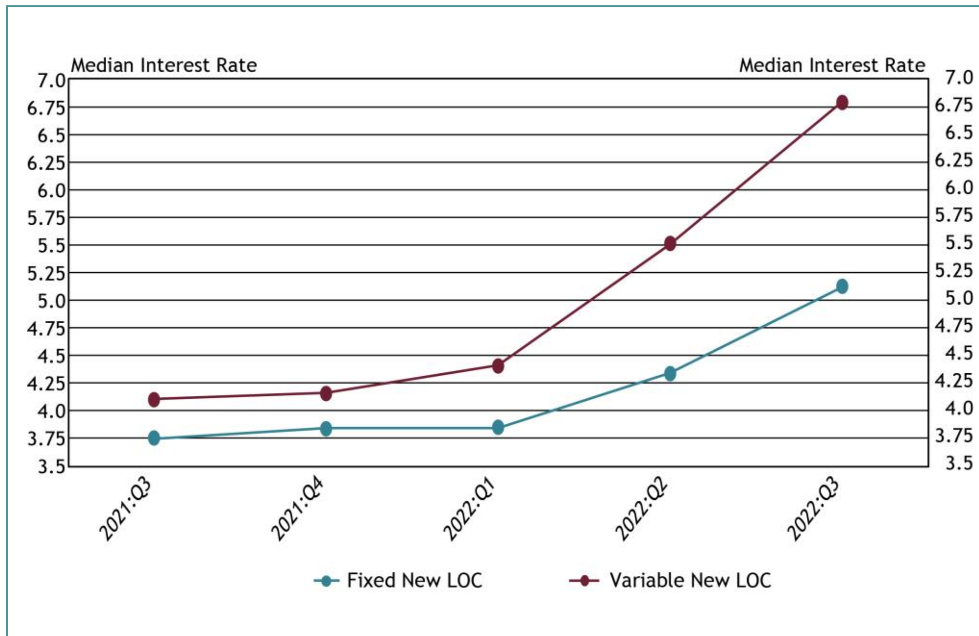


Note: Items are calculated using a subset of 94 respondents that completed the FR 2028D for the last five quarters surveyed.

Source: FR 2028D, item 7.c.

Median interest rates increased for new variable and fixed rate small business loans in third quarter 2022. The variable and fixed median rates were reported as 6.25 percent and 5.39 percent, respectively. Median interest rates for variable term loans continue to rise, increasing by 112 basis points from second quarter 2022, while fixed rate loans increased 61 basis points during the same period. Since third quarter 2021, the median interest rates on fixed and variable rate term loans have increased by about 138 basis points and 200 basis points, respectively. The rate increases are consistent with the overall rising rate environment.

Chart 5: Rates Increase on New Lines of Credit

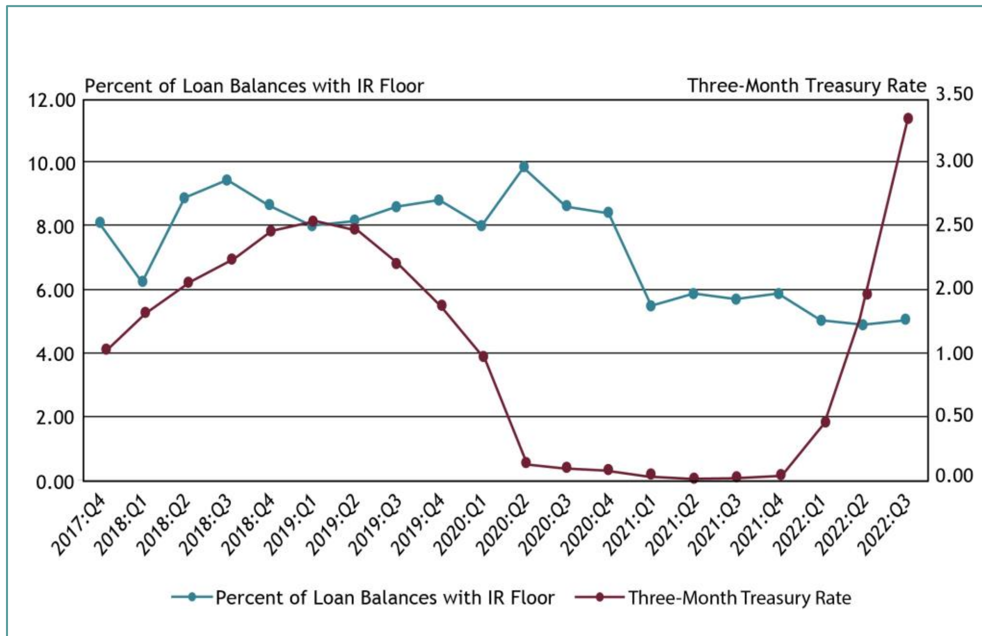


Note: Items are calculated using a subset of 94 respondents that completed the FR 2028D for the last five quarters surveyed.

Source: FR 2028D, item 8.d.

Median interest rates on new small business lines of credit increased for both variable and fixed rates in third quarter 2022. The median interest rate for variable and fixed rate lines of credit was reported as 6.80 percent and 5.13 percent, respectively. This was a 128 basis point increase for variable lines and 79 basis point increase for fixed rate lines since the second quarter of 2022. The variable rate increases are directionally consistent with the 150 basis point increase in the Federal Funds Rate during the third quarter.

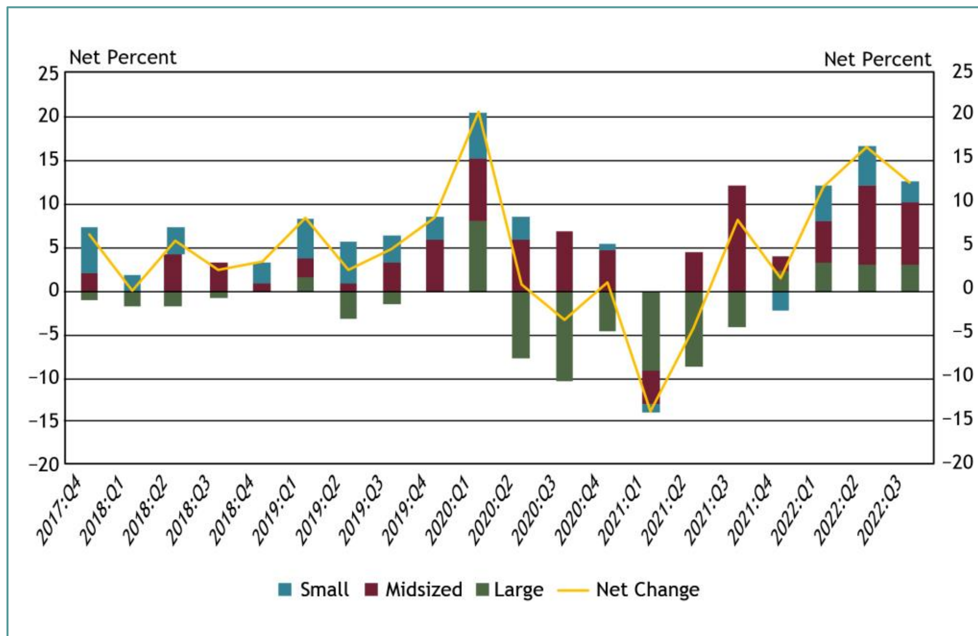
Chart 6: New Loans with Interest Rate (IR) Floors Remain Stable



Sources: FR 2028D, items 7.a, 7.f, 8.a, 8.e and Federal Reserve Bank of St. Louis, 3-Month Treasury Constant Maturity Rate.

Despite a 161 basis point increase in the three-month Treasury Rate in third quarter 2022, the percentage of new variable-rate loans with interest rate floors remained relatively stable for the sixth consecutive quarter.

Chart 7: Respondents Report Increase in Credit Line Usage



Notes: Chart 7 shows diffusion indexes for credit line usage. The diffusion indexes show the difference between the percent of banks reporting decreased credit line usage and those reporting increased credit line usage. Net percent refers to the percent of banks that reported having decreased ("decreased somewhat" or "decreased substantially") minus the percent of banks that reported having increased ("increased somewhat" or "increased substantially").[2]

Sources: FR 2028D, items 11 and 12.

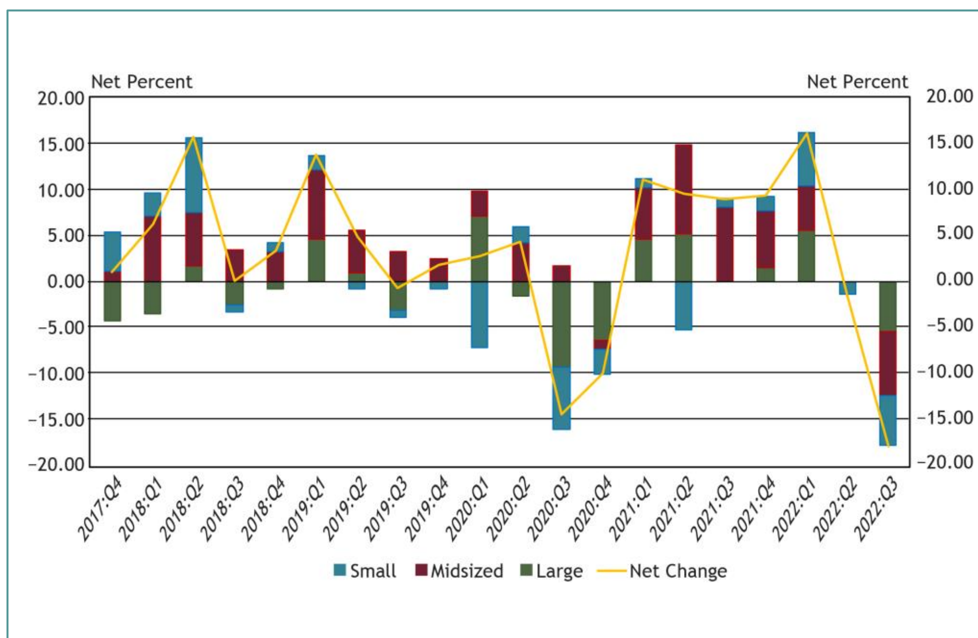
In the third quarter, about 34 percent of respondents reported a change in credit line usage, with about 13 percent of respondents, on net, indicating that credit line usage increased, a decrease from the 17 percent reporting an increase in the previous quarter. On net, increases in credit line usage were reported for all bank sizes. Of the banks reporting an increase, 43 percent cited changes in national or local economic conditions as a very important reason, while 37 percent cited changes in borrowers' business revenue or other business-specific conditions. The reported increase in credit line usage is consistent with a shift to increased debt financing observed in other key indicators such as higher consumer credit card debt. [3]

---

[2] Small banks have total assets of $1 billion or less, midsized banks have total assets between $1 billion and $10 billion and large banks have total assets greater than $10 billion.

[3] Source: FRED, Consumer Loans: Credit Cards and Other Revolving Plans.

Chart 8: All Bank Sizes Report Weaker Loan Demand



Notes: Chart 8 shows diffusion indexes for loan demand. The diffusion indexes show the difference between the percent of banks reporting weakened loan demand and those reporting stronger loan demand. Net percent refers to the percent of banks that reported having weakened ("moderately weaker" or "substantially weaker") minus the percent of banks that reported having stronger loan demand ("moderately stronger" or "substantially stronger").

Source: FR 2028D, item 13.

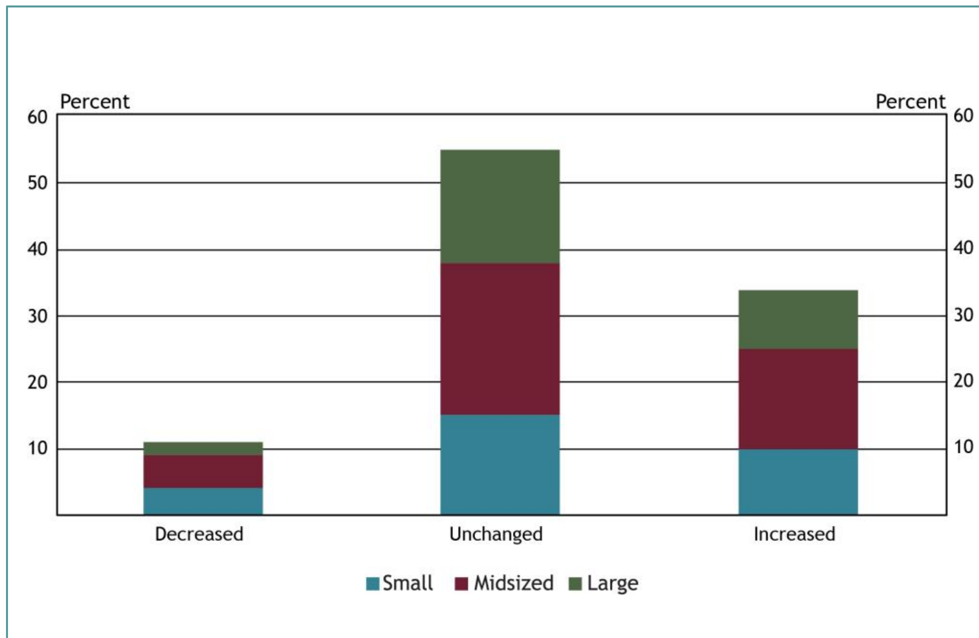
In third quarter 2022, about 45 percent of banks reported a change in small business loan demand, which is an increase of 9 percent from second quarter 2022. On net, about 5 percent of large and small banks reported weaker loan demand, while 7 percent of midsized banks indicated weaker loan demand. On net, 18 percent of respondents across all bank sizes reported a decrease in loan demand, the weakest reported loan demand since the inception of the survey. The weakening loan demand reported from respondents is aligned with the decline in new small business lending through third quarter 2022, as shown in Chart 2.

The decrease in loan demand as indicated in the survey parallels decreases also observed in the Federal Reserve Senior Loan Officer Opinion Survey (SLOOS) [4], in which 29.7 percent of respondents indicated weaker loan demand from small firms with annual sales of less than $50 million.

___

[4]Source: October Senior Loan Officer Opinion Survey on Bank Lending Practices

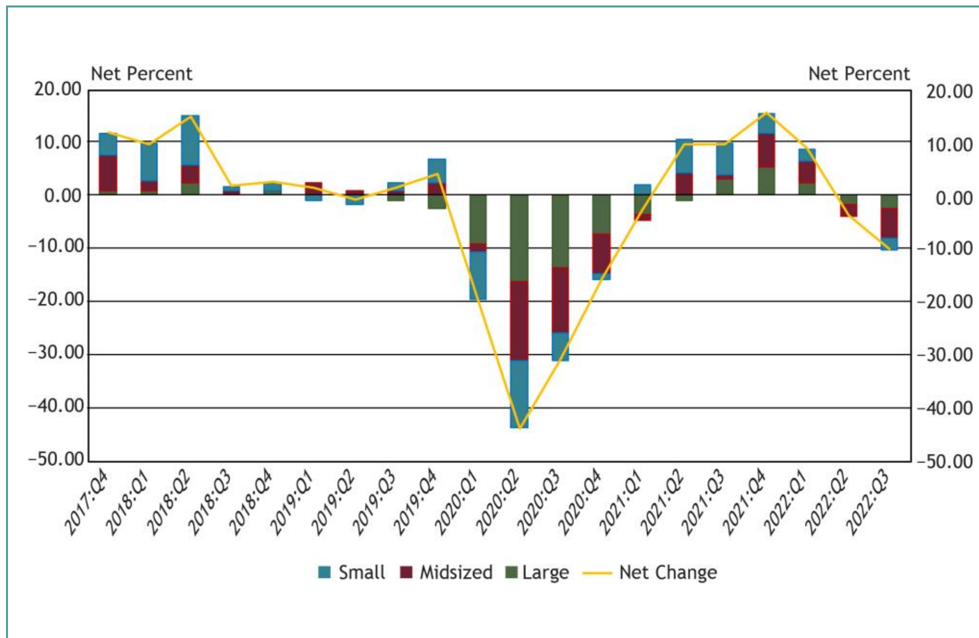
Chart 9: Supply Chain Disruptions Continue to Impact Loan Demand



Source: FR 2028D, Special Question.

Supply chain disruptions continue to weigh on small businesses with 45 percent of survey respondents attributing a change in small business loan demand to the disruptions, a 4 percent increase compared to second quarter 2022. About 34 percent of survey respondents reported the disruptions increased loan demand for small businesses while 11 percent indicated loan demand decreased. The most cited reasons for an increase in demand were related to the need for small businesses to carry more inventory due to future supply chain concerns and the need for additional capital due to increasing prices. The most cited reason for a decrease in demand was related to small businesses being less likely to start new projects due to increased costs from constrained inventories or supplier delays.

Chart 10: Credit Quality Continues to Diminish

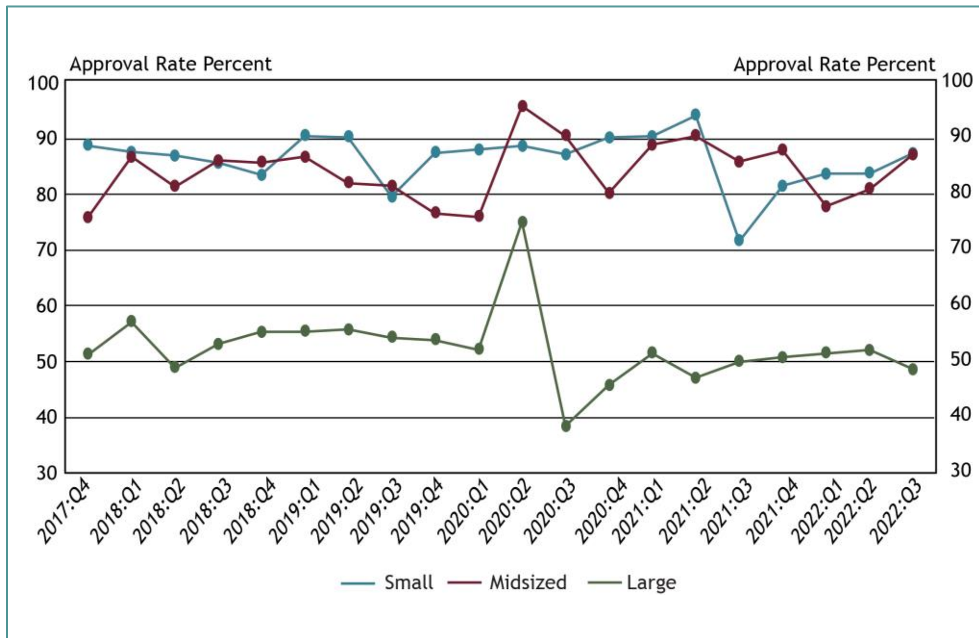


Note: Chart 10 shows diffusion indexes for credit quality of applicants. The diffusion indexes show the difference between the percent of banks reporting a decline in credit quality and those reporting improvement in credit quality. Net percent refers to the percent of banks that reported declining credit quality ("declined somewhat" or "declined substantially") minus the percent of banks that reported improving credit quality ("improved somewhat" or "improved substantially").

Source: FR 2028D, items 20 and 21.

About 10 percent of survey respondents, on net, reported a decrease in applicant credit quality, the third consecutive quarter-over-quarter decline. Small and large bank respondents reported a net decrease of about 2 percent during the period, while midsized banks indicated a net decrease of about 5 percent. Of respondents reporting a change in credit quality, whether an increase or decrease, 61 percent cited the debt-to-income level of commercial borrowers as a very important reason for the change. Other commonly cited reasons for a change were the liquidity position of borrowers, recent business income growth, and quality of business collateral.

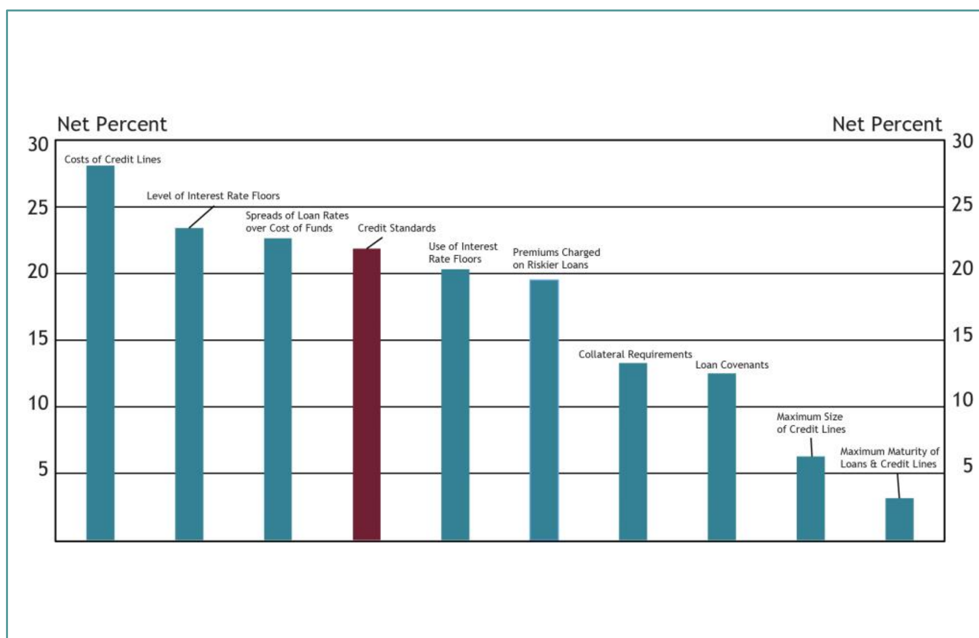
Chart 11: Loan Approval Rates Increase for Small and Midsized Banks



Source: FR 2028D, items 14.a and 15.

Despite diminishing credit quality (Chart 10) and weakening loan demand (Chart 8), application approval rates steadily increased for midsized bank respondents from 80 percent in the second quarter to 87 percent in the third quarter, while approval rates for small bank respondents increased from 83 percent to 87 percent. In contrast, approval rates for large bank respondents decreased slightly from 52 percent to 48 percent over the quarter. The two most cited reasons for denying a loan were borrower financials and credit history.

Chart 12: Banks Tighten Credit Standards and Loan Terms



Note: Chart 12 shows diffusion indexes for credit standards (red bar) and various loan terms. The diffusion indexes show the difference between the percent of banks reporting tightening terms and those reporting easing terms. Net percent refers to the percent of banks that reported having tightened ("tightened somewhat" or "tightened considerably") minus the percent of banks that reported having eased ("eased somewhat" or "eased considerably").

Source: FR 2028D, items 16, 17, 18 and 19.

About 25 percent of respondents reported a change in credit standards in third quarter 2022, up about 8.5 percent from second quarter 2022. Of banks indicating a change in credit standards, 21.9 percent, on net, reported tightening credit standards (red bar), an increase of about 5.4 percent from the previous quarter. This is the fourth consecutive quarter respondents reported tightening credit standards.

On net, respondents indicated that all loan terms tightened with the cost of credit lines and level of interest rate floors tightening the most. Respondents cited less favorable or more uncertain economic outlook and worsening industry-specific problems as the primary drivers.

Other contributors to the release include Nicholas Bloom, Dan Harbour, Thomas Hobson, Stefan Jacewitz, Alli Jakubek, Trudy Vandever, and Tony Walker.