Small Business Lending Survey

New Small Business Lending Declines as Credit Standards Continue Tightening

by: Dustyn DeSpain, Assistant Vice President and Nicholas Bloom, Financial Analyst

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New Small Business Lending decreased by 6.7 percent when compared to the same period in 2023 and 6.3 percent when compared to the previous quarter.

New Small Business Lending[1] decreased by 6.7 percent when compared to the same period in 2023 and 6.3 percent when compared to the previous quarter. Although new lending decreased, outstanding loan balances increased by 4.4 percent when compared to the same period in 2023. Interest rates for most term loans decreased, while most rates on new lines of credit increased.

With over $74 billion in small business loans reported, the 170 survey respondents reported credit standards tightened for the tenth consecutive quarter and credit quality decreased. Credit line usage among all bank sizes[2] continued to increase, citing changes in local or national economic conditions. While loan demand decreased for the eighth consecutive quarter, loan application approval rates increased among midsized and small banks.

When compared to first quarter 2023, small business loan balances increased by 4.4 percent, C&I loans decreased by 3.5 percent, and total loans remained stable. The year-over-year increase in small business loans was comprised of increases in variable rate loans. Quarter-over-quarter, all loan categories remained relatively stable.

Quarter-over-quarter, total new small business loan balances decreased by 6.3 percent, including a 4.6 percent decrease in new term loans and an 8.3 percent decrease in new credit lines. Similarly, when compared to first quarter 2023, total new loans decreased by 6.7 percent, including a 4.1 percent decrease in new term loans and a 9.7 percent decrease in new credit lines. The decrease in new small business lending was driven by decreases in new loans across both large and midsized banks, while small banks reported increases.

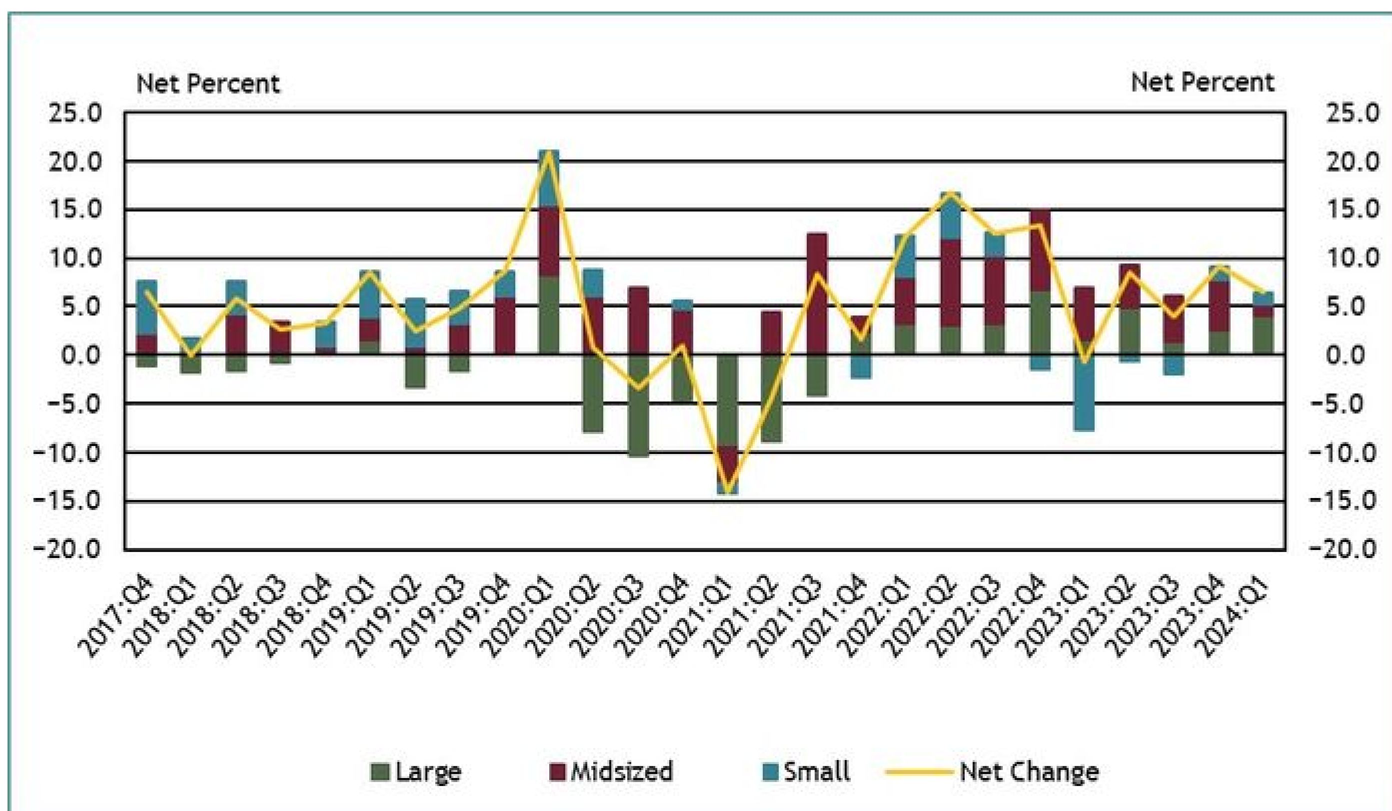
Usage of total small business credit lines continued an increasing trend for the fourth straight quarter, despite reported decreases in fixed rate credit line usage. Respondents have consistently indicated that variable rate lines make up about 88 percent of total credit line usage.

Median interest rates decreased for most new small business term loans in first quarter 2024. Fixed rates offered at rural banks represent the only reported increase. Variable rates offered at urban banks were the highest at 8.8 percent. Fixed rates offered at urban banks were the lowest at 7.9 percent. Urban banks make up about 88 percent of the subset of 107 respondents. [3]

Median interest rates increased for most new small business lines of credit in first quarter 2024. The only rate decrease was on fixed rate lines offered at urban banks. Variable rates offered at urban banks were the highest at 9.3 percent, a 26-basis point increase from the fourth quarter 2023. Fixed rates offered at urban banks were the lowest at 7.6 percent. Urban banks make up about 88 percent of the subset of 107 respondents.

Both the three-month Treasury rate and the percentage of new variable rate loans with interest rate floors remained relatively stable in first quarter 2024. The weighted average interest rate floor for new term loans and lines of credit were reported as 4.7 and 5 percent, respectively, in first quarter 2024.

Chart 7: All Bank Sizes Report Increases in Credit Line Usage



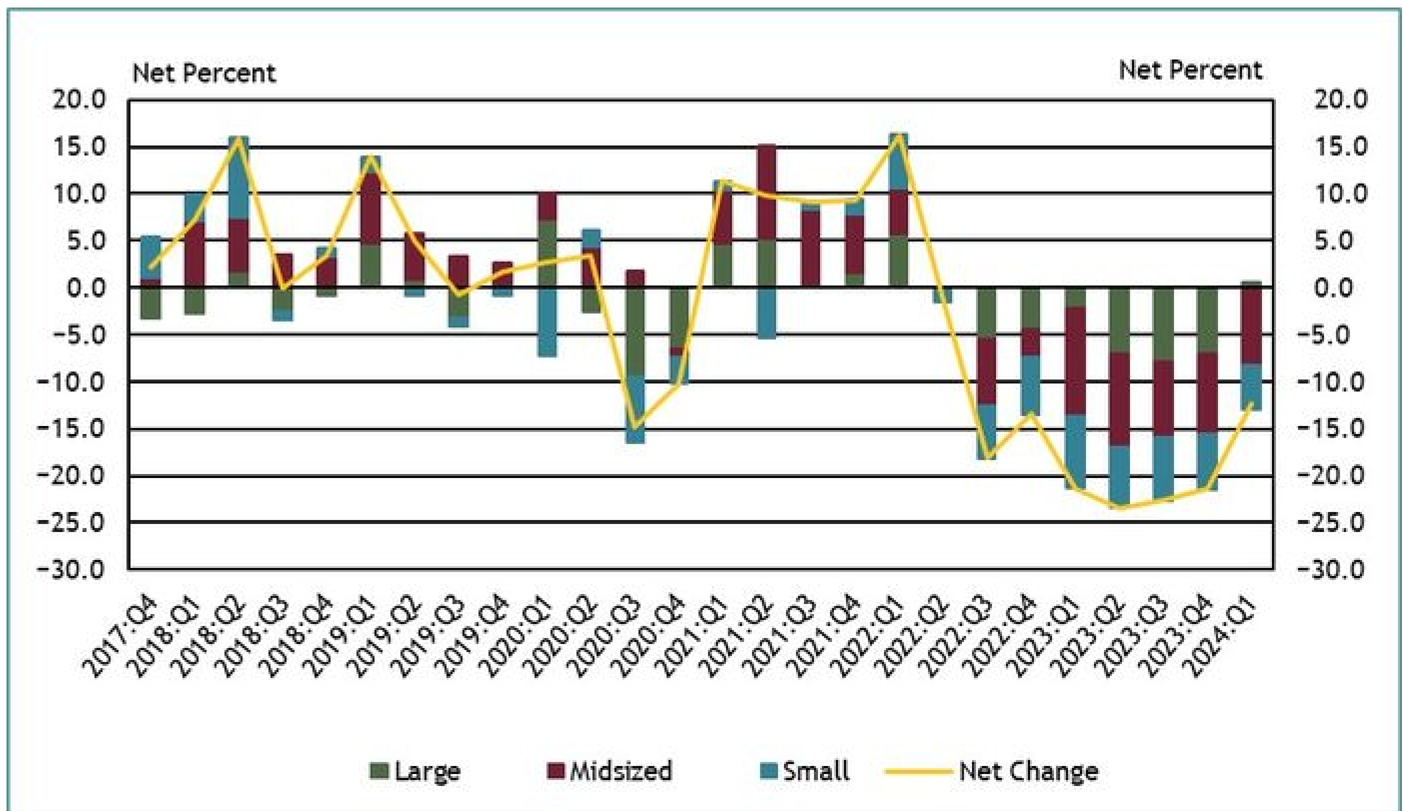
Note: Chart 7 shows diffusion indexes for credit line usage. The diffusion indexes show the difference between the percent of banks reporting decreased credit line usage and those reporting increased credit line usage. Net percent refers to the percent of banks that reported having decreased ("decreased somewhat" or "decreased substantially") minus the percent of banks that reported having increased ("increased somewhat" or "increased substantially").
Source: FR 2028D, items 9 and 10.

In the first quarter, 24 percent of respondents reported a change in credit line usage. Six percent of respondents, on net, indicated that credit line usage increased, down from 9 percent last quarter.

On net, all bank sizes reported an increase in credit line usage. Of the banks reporting an increase, about 31 percent cited changes in local or national economic conditions and changes in borrowers' business revenue or other business-specific conditions as very important reasons.

The reported increase in credit line usage is consistent with a shift to increased debt financing observed in other key indicators such as elevated consumer credit card debt. [4] Total household credit card debt continues to increase each quarter.[5]

Chart 8: Respondents Report Declines in Loan Demand for the Eighth Consecutive Quarter

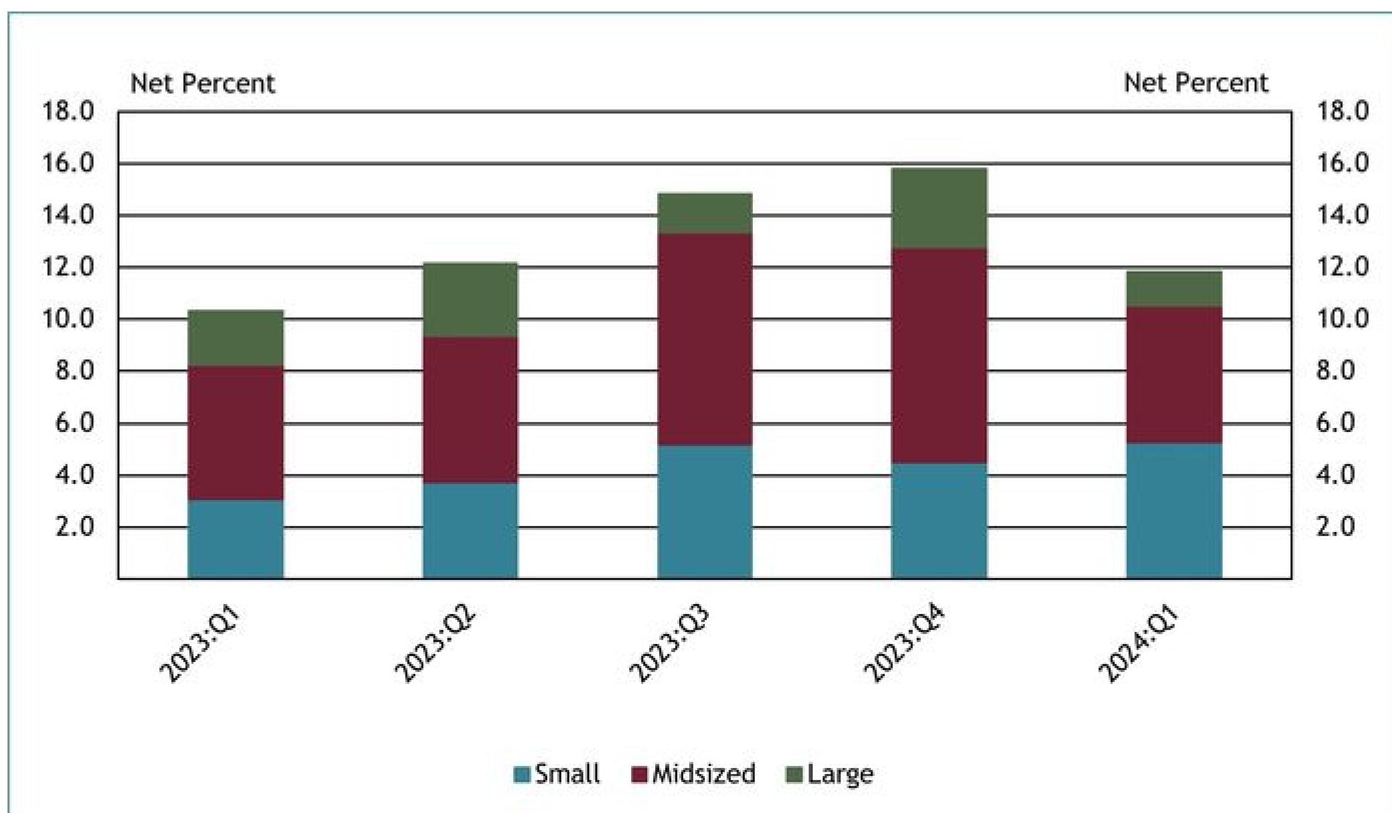


Note: Chart 8 shows diffusion indexes for loan demand. The diffusion indexes show the difference between the percent of banks reporting weakened loan demand and those reporting stronger loan demand. Net percent refers to the percent of banks that reported having weakened ("moderately weaker" or "substantially weaker") minus the percent of banks that reported having stronger loan demand ("moderately stronger" or "substantially stronger").
Source: FR 2028D, item 11.

About 37 percent of respondents reported a change in small business loan demand in first quarter 2024. On net, about 12 percent of respondents indicated weaker loan demand across all bank sizes. This marks the eighth consecutive quarter of respondents reporting a net decline in loan demand. However, large banks, on net, reported an increase in loan demand for the first time since first quarter 2022.

The timing of softer loan demand aligns with the Federal Reserve's tightened monetary policy since 2022. It is also consistent with the April 2024 Federal Reserve Senior Loan Officer Opinion Survey (SLOOS), where about 31 percent of respondents reported weaker C&I loan demand from small firms (annual sales of less than $50 million) over the prior three months.

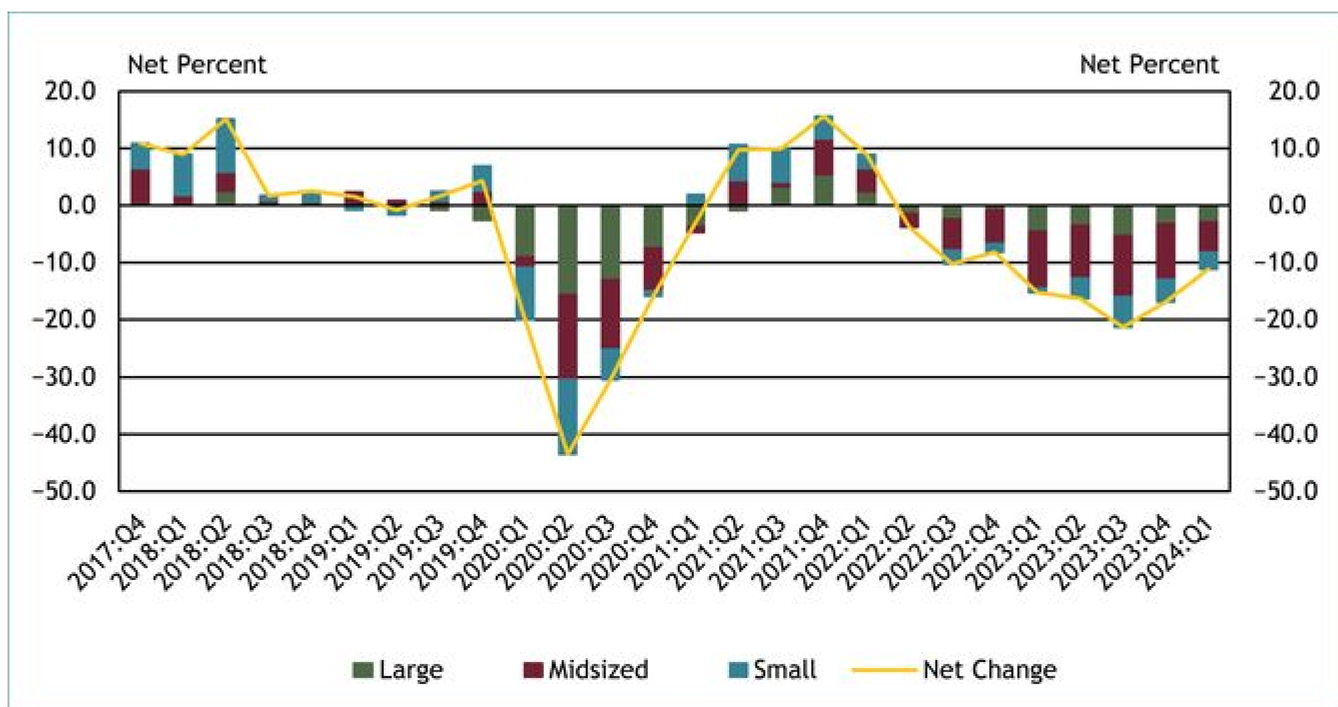
Chart 9: Banks Indicating Constrained Lending Decreases



Source: FR 2028D, Special Question.

About 12 percent of all respondents indicated their lending to small businesses was constrained by the availability of liquidity in the market in first quarter 2024. This was a decrease of 4 percent from fourth quarter 2023, halting three quarters of net increases. For the respondents who indicated lending was constrained, all cited greater competitive pressures for deposits.

Chart 10: Overall Credit Quality Declines for the Eighth Consecutive Quarter



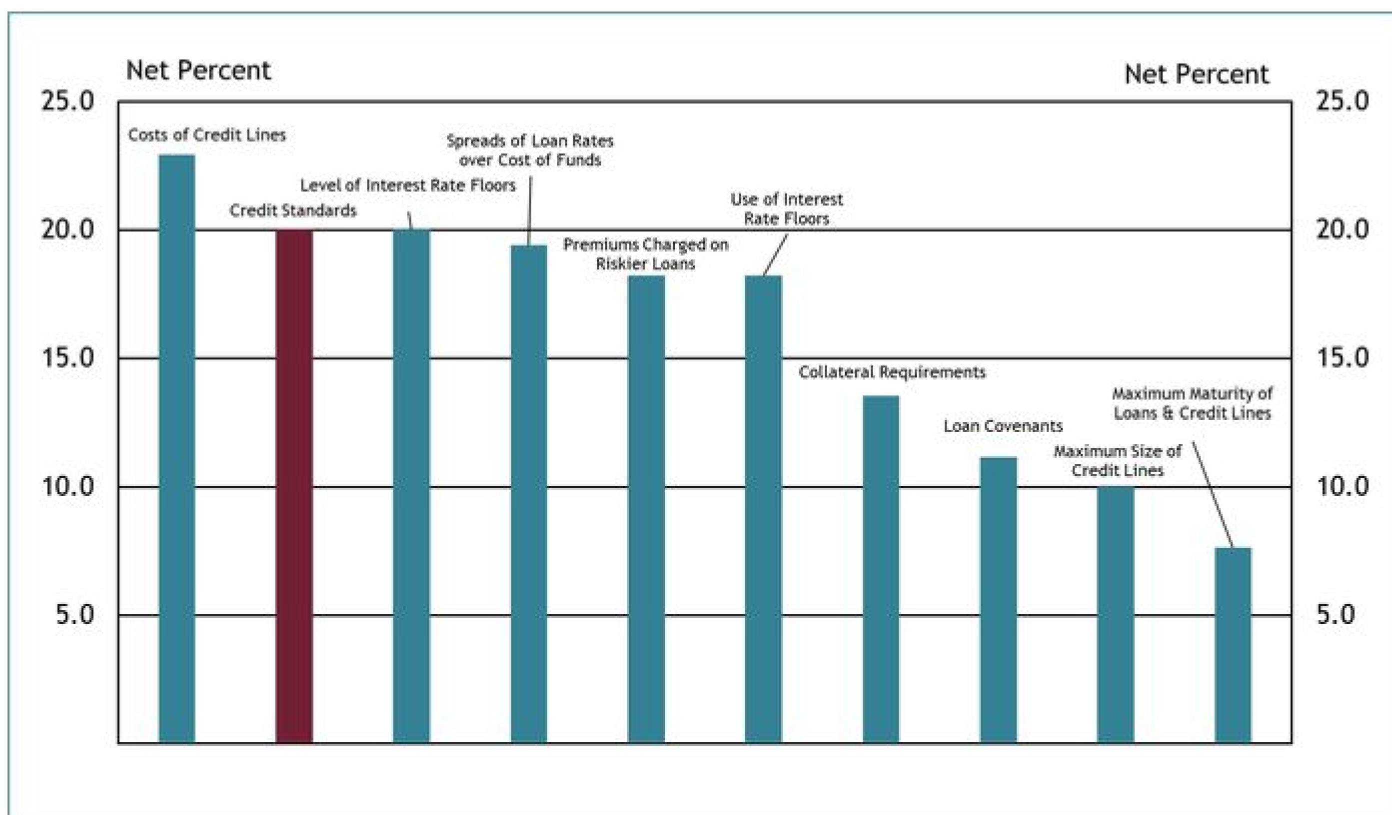
Note: Chart 10 shows diffusion indexes for credit quality of applicants. The diffusion indexes show the difference between the percent of banks reporting a decline in credit quality and those reporting improvement in credit quality. Net percent refers to the percent of banks that reported declining credit 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 18 and 19.

About 11 percent of survey respondents, on net, reported a decrease in applicant credit quality, a slight improvement from 17 percent in fourth quarter 2023. This is the eighth consecutive period in which respondents of all bank sizes, on net, reported a decrease. Of the respondents reporting a change in credit quality, whether an increase or decrease, 54 percent cited the liquidity position of business owners as a very important reason for a change. Other commonly cited reasons for a change include debt-to-income level of business owners, credit scores, and recent business income growth.

The decrease in applicant credit quality reported by firms is consistent with the negative outlook of loan availability reported by small businesses in the April 2024 NFIB Survey of Loan Availability. In addition, declining credit quality for small businesses stands in contrast to measures of credit quality for large businesses. Corporate bond spreads[6] are currently at a decades low, which could suggest that small businesses may be under more strain when compared to their large counterparts.

Small bank approval rates increased from 89 percent to 93 percent and midsized bank approval rates increased from 66 percent to 73 percent in first quarter 2024. Large bank approval rates remained stable at 49 percent. About 71 percent of respondents indicated borrower financials were the most common reason for denying a loan. Other commonly cited reasons were borrower credit history and collateral.

Chart 12: Respondents Report Tightening Credit Standards for the Tenth Consecutive Quarter



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 14, 15, 16 and 17.

About 20 percent of respondents, on net, reported tightening credit standards (red bar) in first quarter 2024. This is the tenth consecutive quarter that respondents have reported tightening credit standards and is consistent with the tightening credit standards reported in the April 2024 Senior Loan Officer Opinion Survey on Bank Lending Practices.

On net, respondents indicated that all loan terms tightened. About 80 percent of respondents cited less favorable or more uncertain economic outlook as a somewhat important or very important reason for the tightening. Other commonly cited reasons were worsening of industry-specific problems and reduced tolerance for risk.

Other contributors to the release include Alli Baranski, Lauren Bennett, Sophie Burge, Nicholas Courtney, Daniel Harbour, Jordan Pandolfo, and Stewart Pozzuto.

Endnotes

[1] Small business lending refers to commercial and industrial lending to organizations generally defined as having less than five million in gross annual revenue, unless otherwise noted.

[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] Urban and rural classification is determined exclusively by the bank's head office location and US Census Population data.

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

[5] Source: FRBNY Consumer Credit Panel/Equifax

[6] Source: FRED, ICE BofA US High Yield Index Option-Adjusted Spread.

Author

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Dustyn DeSpain is an Assistant Vice President in the Supervision and Risk Management (SRM) Division. He leads various aspects of Supervision Product Management (SPM) and oversees SRM's Statistics and Data Management (SDM) function, including authoring the Small Business Lending Survey release and administering its data collection.Mr. DeSpain joined the Bank in 2011 as an assistant examiner in the Exams and Inspections Department at the Oklahoma City Branch and earned his commission in 2013. He rotated to SPM in 2015 and was promoted to manager in 2016. In 2018, he received the Federal Reserve System's prestigious William Taylor Award for Excellence in Banking Supervision for serving as a business technology expert to influence the end vision for technology tools used by consumer compliance examiners. Before joining the Bank, he spent several years at Arvest Bank. He was promoted to his current position in August 2021.Mr. DeSpain holds a bachelor's degree in finance and a master's in business administration from the University of Oklahoma.