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NFIB Small Business Optimism Slips in May

Economist(s)

Mark Vitner
Senior Economist | Wells Fargo Securities, LLC
mark.vitner@wellsfargo.com | 704-410-3277

Summary

Hiring Woes Remain a Threat to the Recovery

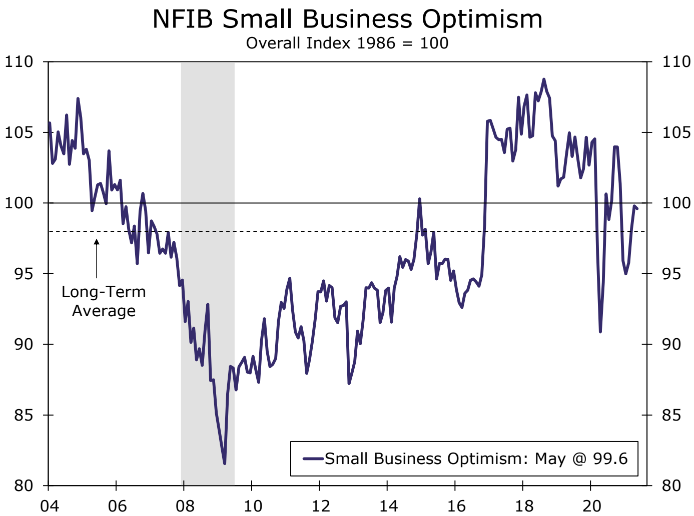
The National Federation of Independent Business (NFIB) reported Small Business Optimism fell 0.2 to 99.6 in May. While activity continues to improve for most businesses, the inability to hire workers and persistent, widespread supply-chain bottlenecks clearly present a threat to the recovery. The proportion of business owners expecting business conditions to improve during the next six months fell sharply for the second month in row, tumbling 11 points to -26%. Nearly half of all small business owners had open positions they were unable to fill and 43% plan to raise prices over the next three months. While the hiring crisis and supply-chain bottlenecks are a clear and present danger, they are also encouraging investment in new labor saving equipment, which is bolstering capital investment.

Reopening the Economy Creates a Whole New Set of Challenges

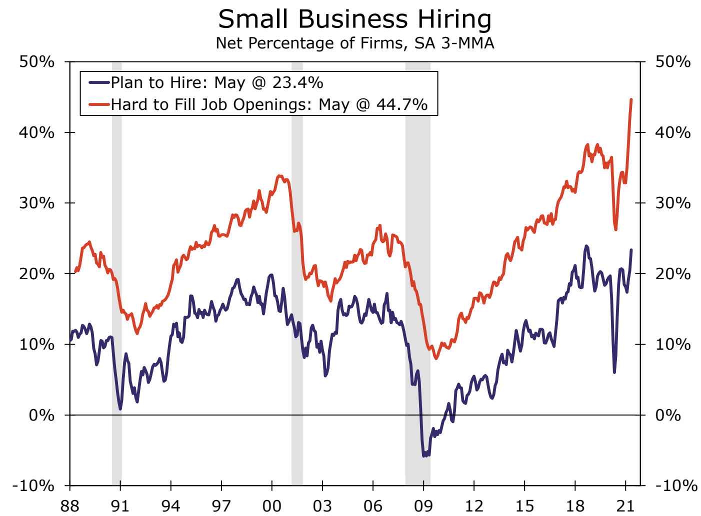
The NFIB Small Business Optimism Index came in slightly below consensus expectations in May, with the headline index falling 0.2 to 99.6. Despite the drop, small business confidence remains above its long-run average and is consistent with strong economic growth.

Business owners' more tentative view is easy to see in the underlying details of the report. Just five of the indexes' 10 components rose in May, while three fell and two were unchanged. The largest gain came from the share of business owners planning (or hoping) to increase employment, which rose six points to a net 27% in May. The proportion of firms with current job openings rose four points to 48%, while current inventories, the proportion of firms that plan to increase inventories and the share that expect real sales to improve each rose one point.

The most worrisome aspect of this morning's report is the 11-point drop in the net proportion of business owners expecting the economy to improve over the next six months. The series had fallen eight points the prior month. The slide in optimism is likely tied to the inability to hire, rising compensation costs and acceleration in inflation, which are all combining to squeezed profit margins. The share of businesses seeing earnings to improve fell four points in May to -11%.



Source: NFIB and Wells Fargo Securities

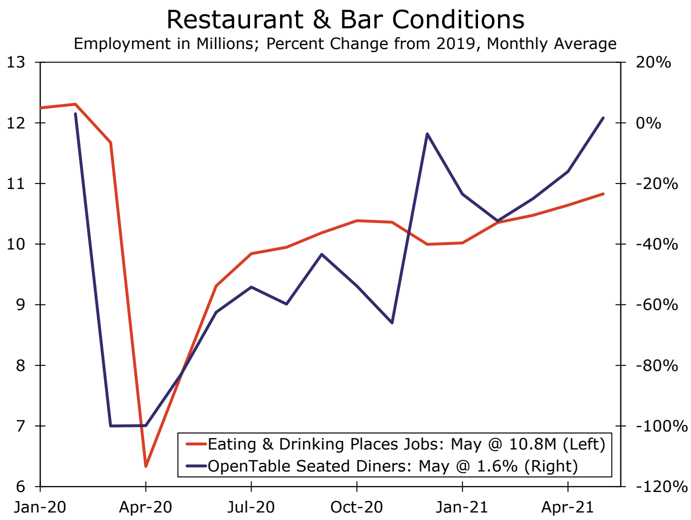


Source: NFIB and Wells Fargo Securities

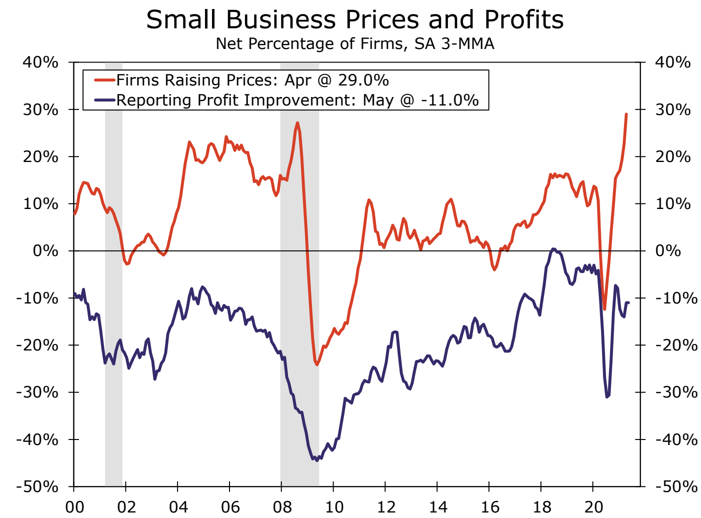
Small Businesses Need a Bigger Help Wanted Sign

Anyone who has visited, or even driven by, a restaurant, retail store, entertainment venue, construction site, warehouse or factory is keenly aware that businesses are trying to aggressively add staff. Business has clearly bounced back faster than employment, particularly at restaurants, bars, entertainment venues and other high-contact businesses. The problem is even more widespread than that, with 48% of business owners stating they had open positions in May that they could not fill and a whopping 93% of small businesses that tried to hire workers in May reporting few or no qualified applicants for those positions last month.

The inability to hire is causing businesses to curtail hours and lose business. The problem is most acute in the leisure & hospitality sector, retailing and other high-contact services, where average weekly earnings are $450 or less. Even after paying higher wages—hourly earnings in the leisure & hospitality sector have risen at a 23.6% annual rate over the past three months—the wages earned by workers in these industries come up well short of the combined $600 or more expanded unemployment benefit. The work or continue to receive benefits quandary is even a limiting influence for workers in higher paying industries, such as construction, manufacturing and logistics, given the small net benefit from working combined with associated costs for transportation and dependent care.



Source: Bloomberg LP and Wells Fargo Securities



Source: NFIB and Wells Fargo Securities

Rising Prices Are also Weighing on Small Businesses

Rising wage and compensation costs are far from the only challenge for small business owners. Input costs for virtually everything are rising and there are persistent shortages of many key products and components. Shortages and price hikes run the gamut from boxes and shipping pallets to semiconductors, appliances and a whole host of building materials. So far, small businesses have been able to pass a large portion of these higher costs onto their customers. The net share of business owners raising their average selling price rose four percentage points in May to 40%. Price hikes were most frequent in wholesale trade (65% raising prices, 2% lowering prices), retailing (53% raising prices, 5% lowering prices), and manufacturing (47% raising prices, 1 % lowering prices).

Looking ahead, a net 43% of small businesses plan to raise prices over the next three months, up seven percentage points from the prior month. Small business pricing plans have been a reliable predictor of inflation six months ahead and currently indicated the CPI is headed to the 4% range later this year.

While the challenges of reopening the economy are certainly a better problem to have than trying to figure out how to stay in business while the country worked to contain COVID, they still present an existential threat to many businesses. Small independent businesses are particularly challenged because they have less leverage than national chains to secure products and components or negotiate better prices and terms.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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