

Economic Indicator — June 11, 2024

Small Business Optimism Up Slightly in May

Economic Uncertainty and Persistent Inflation Continue to Weigh on Outlooks

Summary

Uncertainty Abounds

Uncertainty surrounding expectations for economic growth and interest rates appears to be weighing on small businesses. The NFIB Small Business Optimism Index posted another modest gain in May; yet at 90.5, the index remains far below its 50-year average of 98. The primary stand out was a jump in the uncertainty index to its highest point since November 2020. As markets bet on when the Fed will ultimately cut rates, high financing costs are steadily chipping away at business sentiment. Sales, earnings and capital outlays also remained muted. Inflation is still the top challenge facing small businesses as the last mile back to 2% proves to be more difficult than previously anticipated. That said, compensation pressures do not appear to be a significant threat to reigniting inflation at the moment.

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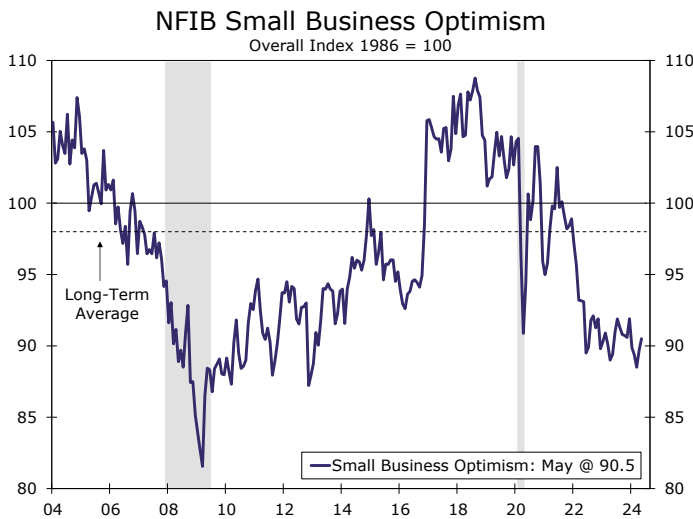
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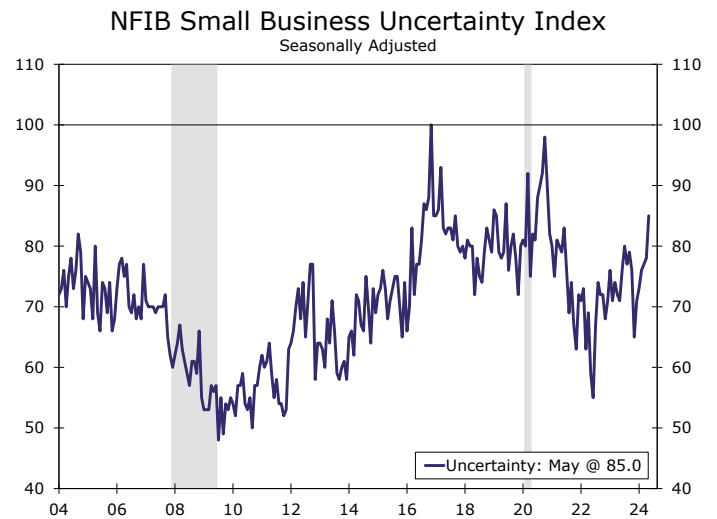
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Inflation Set for a Slow Downward Grind

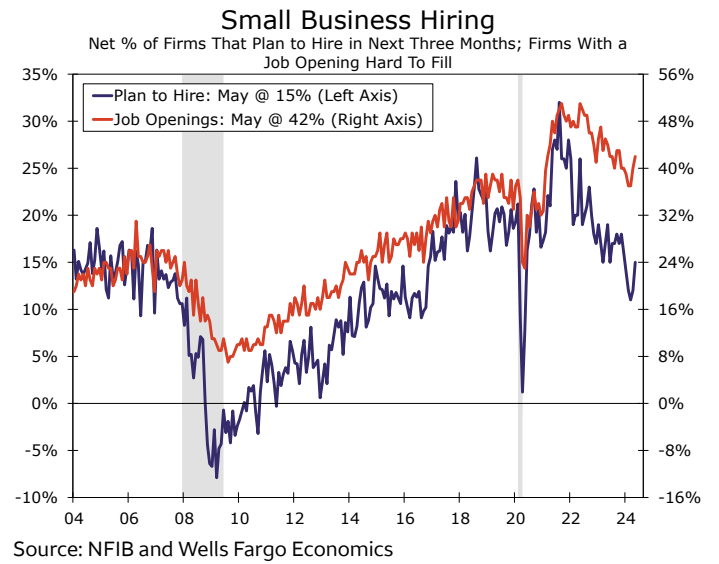
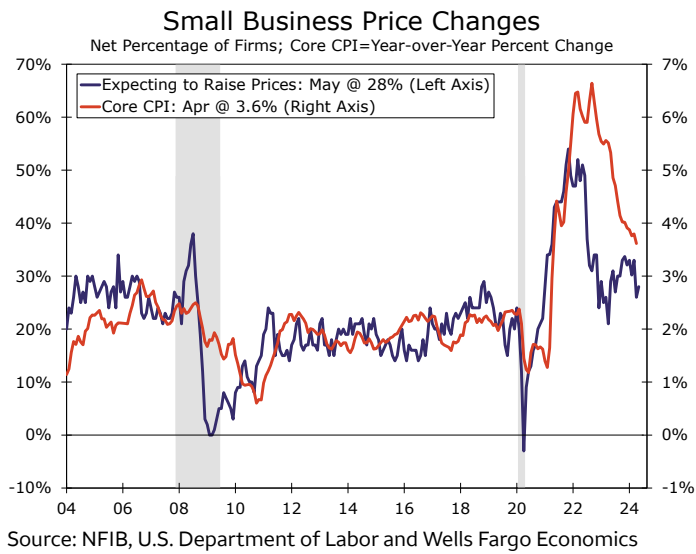
- Small business owners appear to be struggling with the cloudy path of the economy and interest rates. The NFIB Small Business Optimism Index rose for the second consecutive month in May to 90.5. That said, firms' outlooks remain quite dim, and the headline index has been stuck below its 50-year average for over two years.
- A growing number of business owners expressed uncertainty in response to at least six questions asked by NFIB, bringing the uncertainty index to its highest point since November 2020.
- Inflation is trending in the right direction, but progress is slow-going. Plans to raise prices ticked up in May as price pressures, especially for high-demand services, prove to be more stubborn than previously anticipated. As progress seemingly stalls, inflation remains the top problem facing small business owners.
- Hard data on inflation showed a welcome reprieve in April, revealing that price hikes took a step back following an especially firm first quarter. The May CPI will be released tomorrow morning. We estimate that core CPI eased slightly once again, which would solidify a return to the slow downward grind in inflation that we expect to see for the rest of the year.
- Labor quality is also top of mind for small businesses, especially those struggling with unfilled job openings amid slower labor force growth. Hiring plans notched a three-point jump in May coinciding with an upside surprise to nonfarm payrolls. That said, this series is volatile month-to-month, and the broader trend still points to waning labor demand.
- Wage pressures remain relatively muted even as May suggested an upshift in hiring plans. Firms reporting increased compensation costs fell back over the month, and plans to raise compensation reached its lowest reading since May 2021. We generally expect slowing wage growth to reduce consumer spending this year as inflation limits purchasing power.
- High financing costs are weighing on business sentiment while the Fed remains committed to extinguishing inflation. The net percentage of firms reporting higher interest rates has crept up in recent months as the average rate on a short-term loan measured 9.0% in May. Although the portion of owners reporting that financing was their top concern was relatively tame at 6%, this reading reached its highest level since 2010.



Source: NFIB and Wells Fargo Economics



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