NFIB Small Business Economic Trends - April

Embargoed Tuesday, May 8 at 6 a.m.

(Based on 1554 respondents to the April survey of a random sample of NFIB's member firms, surveyed through 4/29/18)

Overview

The Index of Small Business Optimism increased slightly in April to 104.8, a gain of 0.1 points. The Index has been higher only 20 times out of the last 433 surveys.

- Labor quality remained the #1 problem for the fourth straight month.
- Reports of improved earnings trends were the highest in survey history.
- Reports of compensation increases held at the highest level since 2000.
- Reported job creation posted another solid gain.

Hiring plans remained strong, as did reports of actual net increases in employment over the past few months. The increase in new business establishments is running well ahead of eliminations, a real boost to new employment. Reports of labor quality as a top business problem remained at record levels. On Main Street, there was no slowdown in reports of improving sales trends and reports of capital outlays rebounded to strong levels after a minor decline in March. Cash flows from solid profit trends and tax cuts are supporting higher spending and hiring without debt, boosting this recovery to the second longest expansion in history.

Small Business Optimism and Ten Components

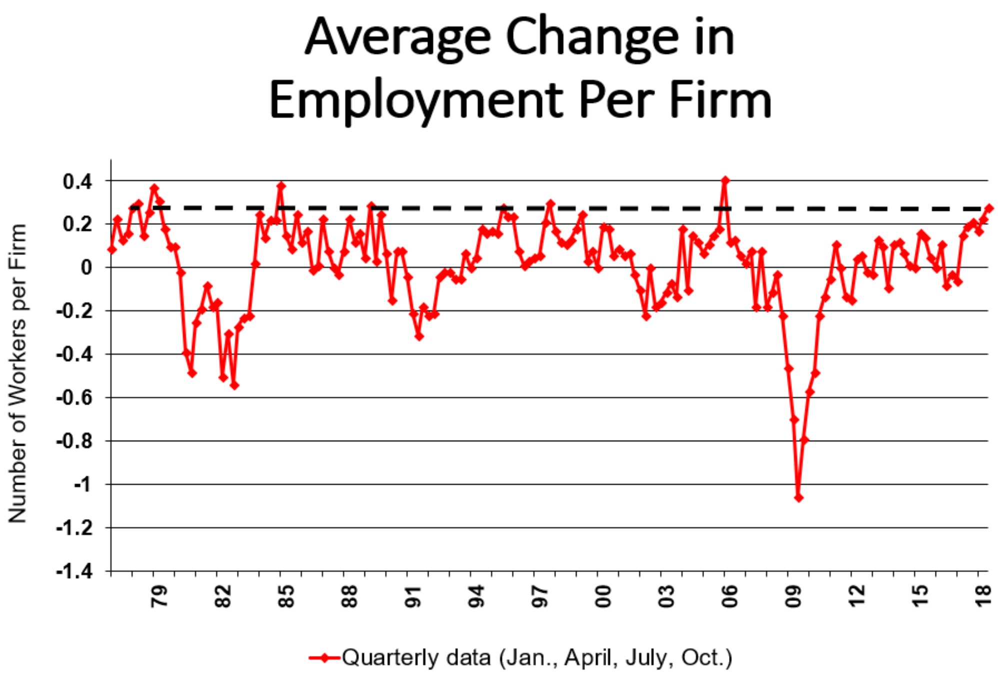
Index and Components	April	Change	Share of Change
Job Creation Plans	16% (net)	-4	*%
Capital Expenditure Plans	29%	3	*%
Inventory Plans	1% (net)	0	*%
Job Openings	35%	0	*%
Inventory Satisfaction	-4% (net)	2	*%
Good Time to Expand	27%	-1	*%
Expect Better Business Conditions	30% (net)	-2	*%
Sales Expectations	21% (net)	1	*%
Expect Easier Credit Conditions	-6% (net)	0	*%
Actual Earnings Trends	-1% (net)	3	*%
Index of Small Business Optimism	**104.8**	**2 +0.1**	**100%**

[Column 1 is the current reading, column 2 the change from the prior month, column 3 the percent of the total change in the Index accounted for by each component; "*" means the percent <0.5% or not a meaningful calculation. Index is based to the average value in 1986, components are not. The term "net" means that the percent of owners giving an unfavorable answer has been subtracted from the percent of owners giving a positive or favorable response. For some questions, there is no "unfavorable" response category]

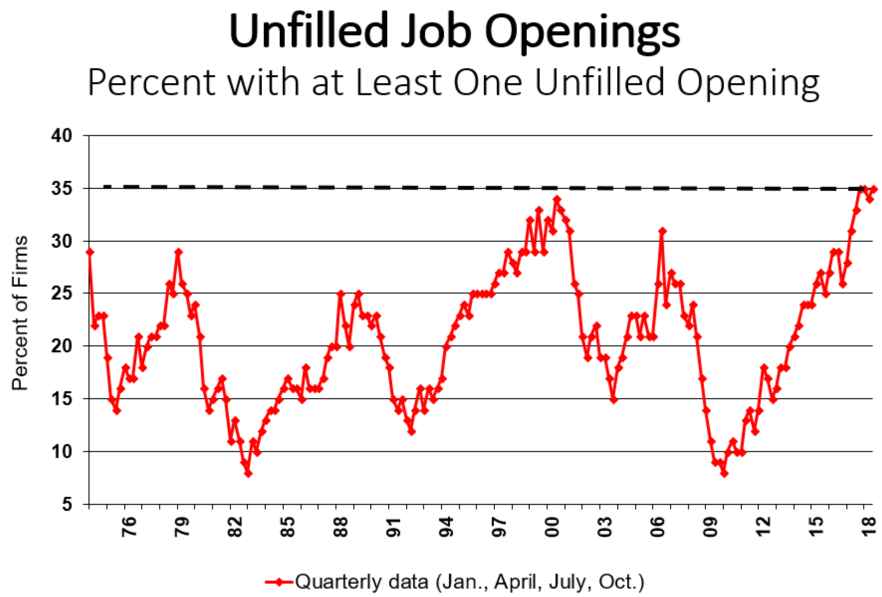
LABOR MARKETS

Reports of employment gains remain strong among small businesses, inconsistent with the BLS report for March employment gains. Owners reported adding a net 0.28 workers per firm on average, the third highest reading since 2006 (down from 0.36 workers reported last month, the highest since 2006).

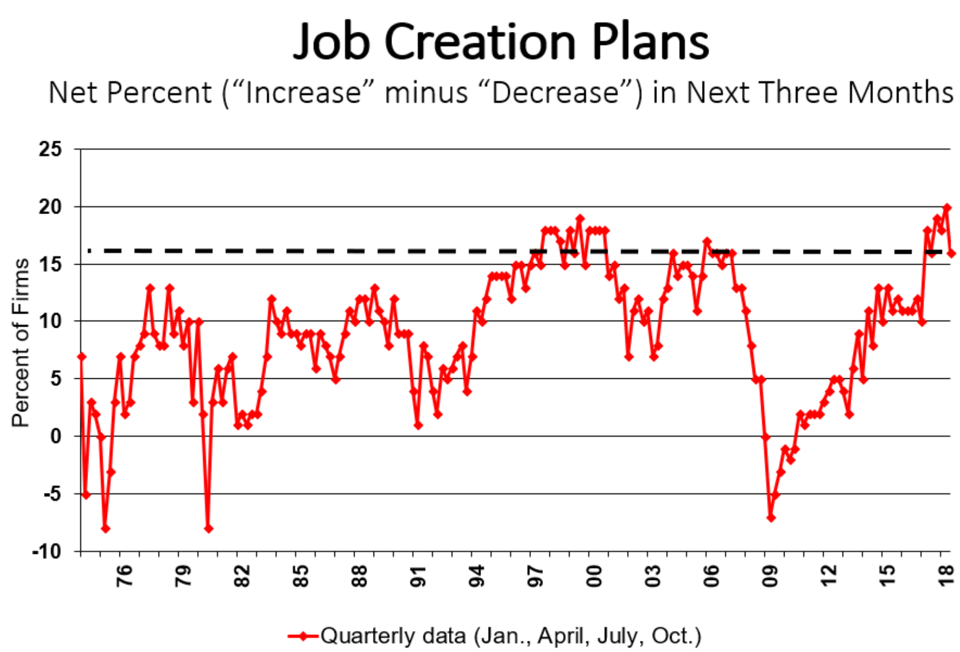
Sixteen percent (up 2 points) reported increasing employment an average of 2.7 workers per firm and 9 percent (unchanged) reported reducing employment an average of 2.5 workers per firm (seasonally adjusted).



Fifty-seven percent reported hiring or trying to hire (up 4 points), but 50 percent (88 percent of those hiring or trying to hire) reported few or no qualified applicants for the positions they were trying to fill. Twenty-two percent of owners cited the difficulty of finding qualified workers as their Single Most Important Business Problem (up 1 point), exceeding the percentage citing taxes or regulations. Shortages of *qualified* workers are clearly holding back economic growth.



Thirty-five percent of all owners reported job openings they could not fill in the current period, unchanged and tied with March 2018, July and October 2017 for the highest reading since November 2000. Twelve percent reported using temporary workers, up 2 points. Reports of job openings were most frequent in construction (48 percent) and manufacturing (48 percent). The inability of construction firms to organize teams is slowing the construction of new homes at all levels.

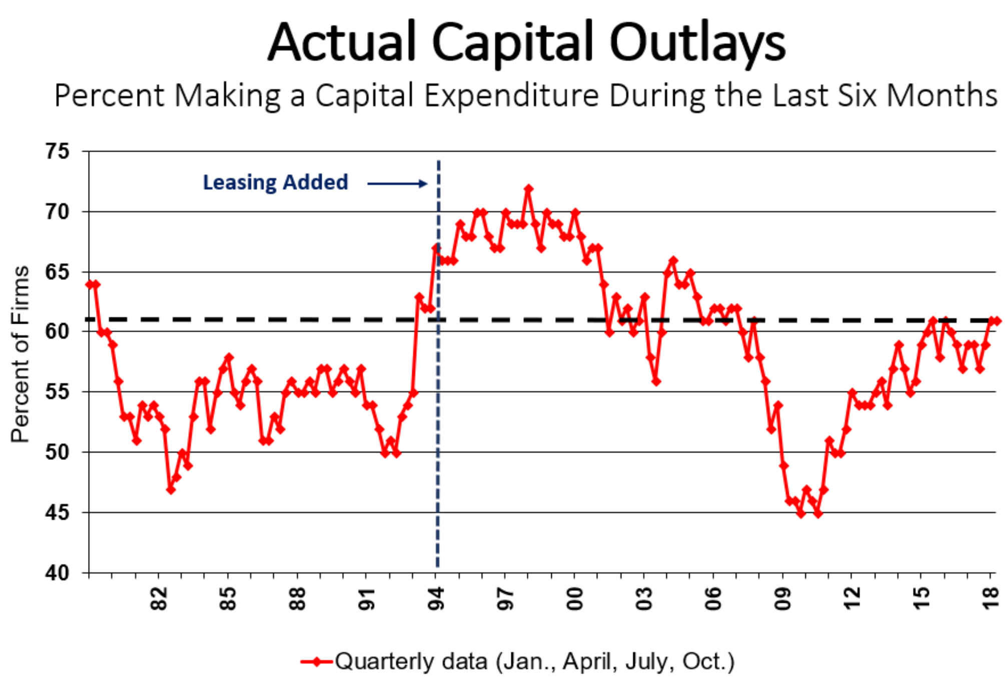


A seasonally-adjusted net 16 percent plan to create new jobs, down 4 points from March but historically strong. Not seasonally adjusted, 27 percent plan to increase total employment at their firm (down 3 points), and 3 percent plan reductions (up 1 point). In some industries, nearly half the firms have unfilled openings, especially severe in construction and manufacturing.

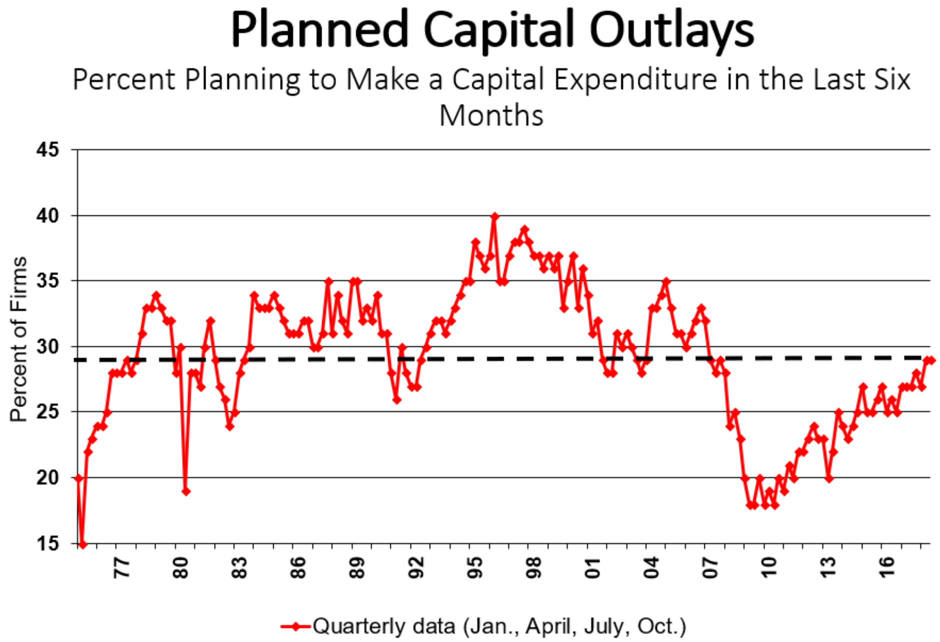
Labor markets are very tight, for both skilled and unskilled workers. Expected real sales volumes and reports of positive sales trends were very good and growth has been solid, leaving labor demand historically very strong.

CAPITAL SPENDING

Sixty-one percent reported capital outlays, up 3 points. Of those making expenditures, 43 percent reported spending on new equipment (up 4 points), 27 percent acquired vehicles (up 3 points), and 16 percent improved or expanded facilities (unchanged). Five percent acquired new buildings or land for expansion (down 3 points) and 15 percent spent money for new fixtures and furniture (up 3 points). Non-residential fixed investment has grown at a better than 6 percent rate for the past 5 quarters (compared to under 1 percent in 2015 and 2016) and small business has made a major contribution.



Twenty-nine percent plan capital outlays in the next few months, up 3 points. Plans were most frequent in manufacturing (38 percent) where additional capacity and productivity-enhancing investments are needed and construction (32 percent) where labor-saving investments are needed to increase the number of housing starts and completions. Hiring difficulties will lead firms to engage in more training and adopt more labor-saving technology to support growth and serve growing numbers of customers.

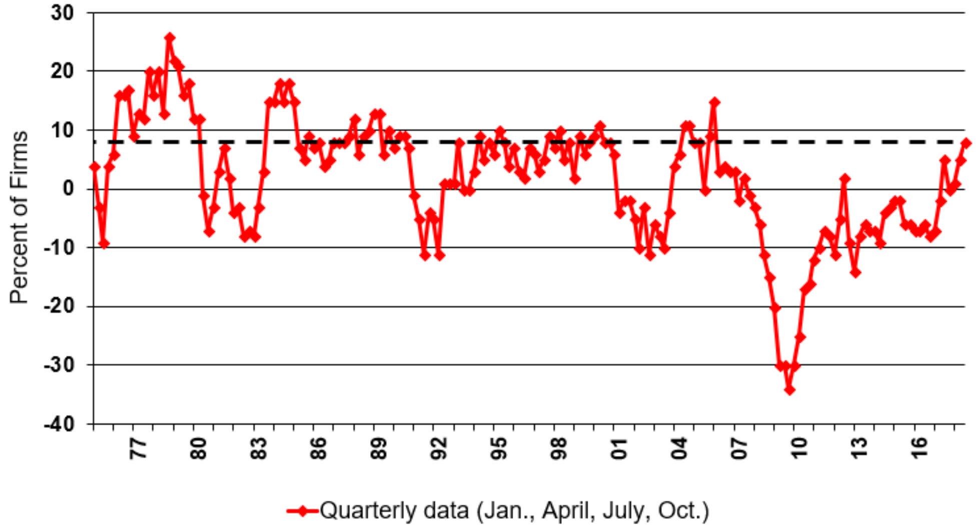


SALES

A net 8 percent of all owners (seasonally adjusted) reported higher nominal sales in the past three months compared to the prior three months, unchanged and the fifth consecutive strong month. After a blow-out holiday season, consumer spending slowed in the first quarter according to the Bureau of Economic Analysis, contributing to a weaker first quarter GDP number. But on Main Street, there was no slowdown in reports of improving sales trends. Customers (consumers and other businesses) turned out in numbers that rivaled performances turned in all year, and March data indicated that the consumer is back, which will boost the second estimate of first quarter growth.

Actual Sales Changes

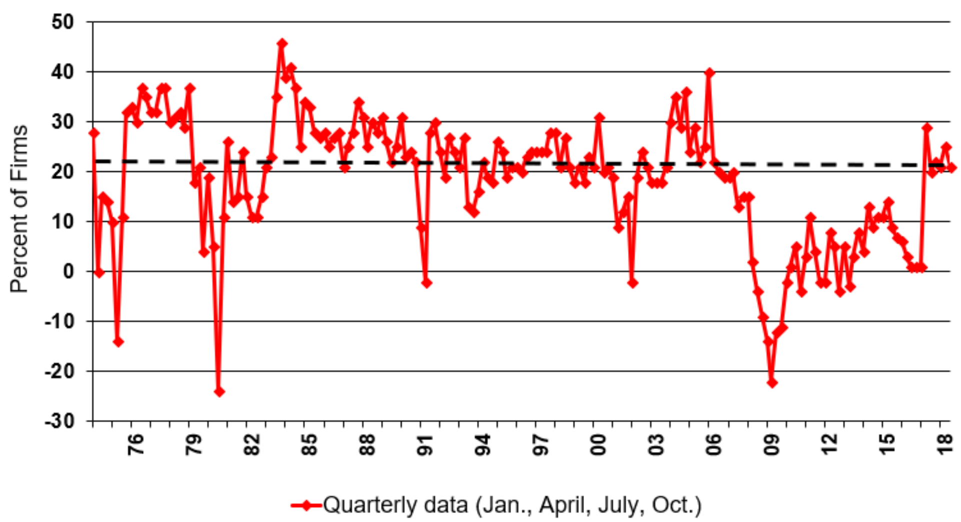
Net Percent ("Higher" minus "Lower") the Last
Three Months Compared to the Prior Three Months



The net percent of owners expecting higher real sales volumes rose 1 point to a net 21 percent of owners. Fifty-nine percent of construction firms and 56 percent of manufacturing firms expect higher real sales volumes in the coming months. The average family saw wages and salaries grow last year. Gains are likely to increase for many families this year due to tax cuts. Consumer sentiment has remained solid, anticipating continued good spending in the coming months.

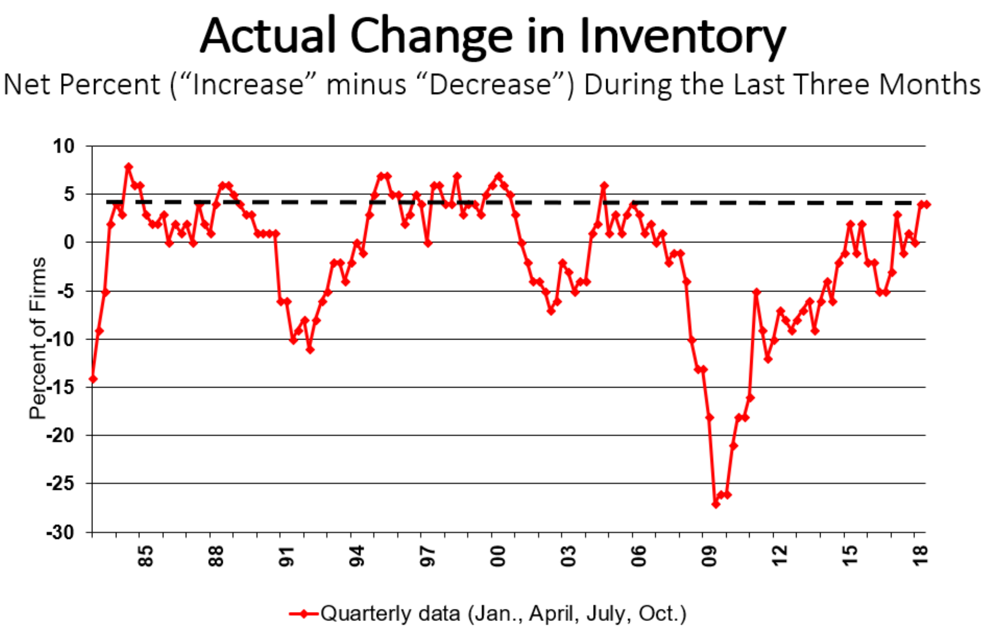
Sales Expectations

Net Percent ("Higher" minus "Lower") in the
Next Three Months

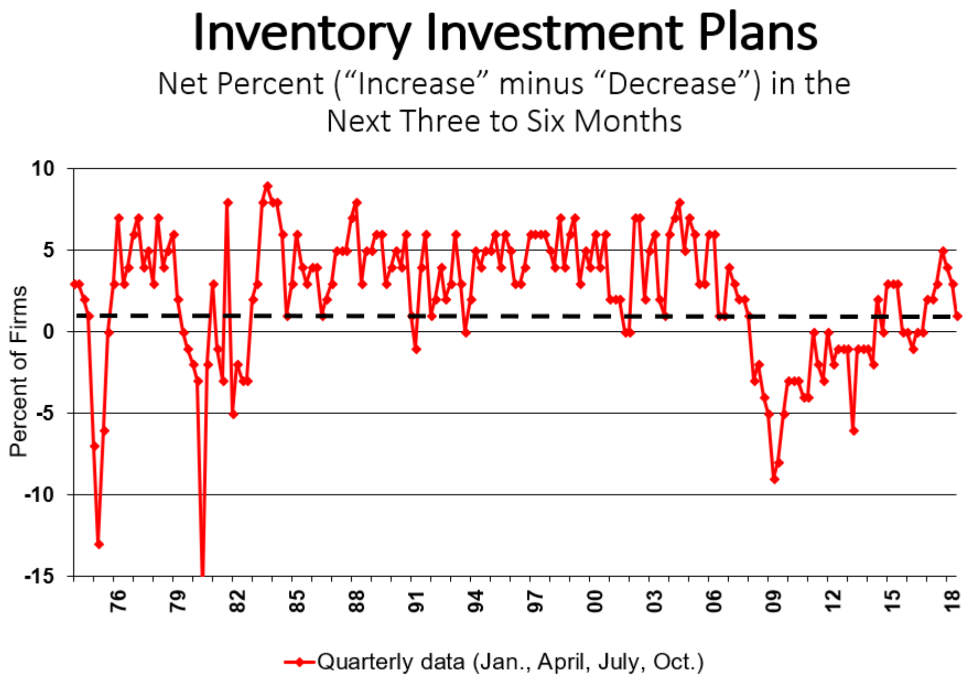


INVENTORIES:

The net percent of owners reporting inventory increases rose 1 percentage point to a net 4 percent (seasonally adjusted), positive and extending a four month run of substantial inventory building (a boost to GDP growth).



The net percent of owners viewing current inventory stocks as "too low" (a positive number means more think stocks are too low than too high, a positive for inventory building) improved 2 points to a negative 4 percent. The build in inventory is clearly not excessive in the minds of owners expecting continued strong sales.



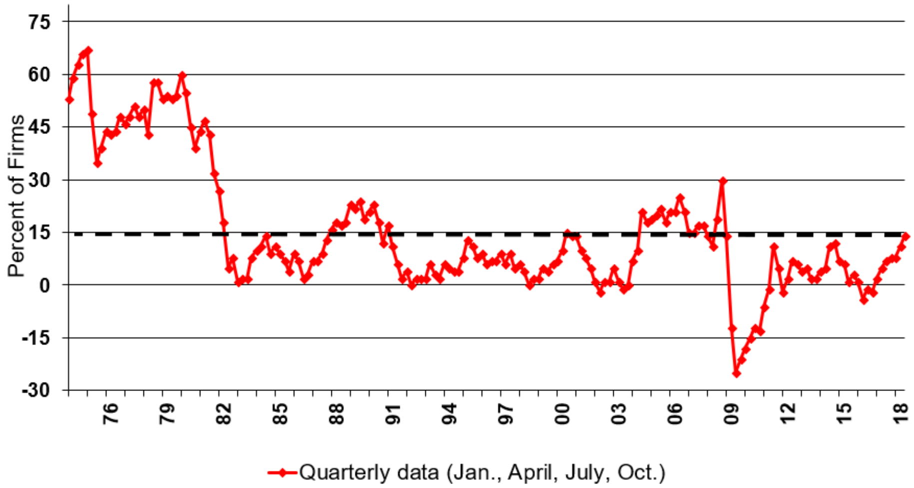
The net percent of owners planning to build inventories was unchanged at 1 percent, the eighteenth positive reading in the past 19 months. This has been very supportive of GDP growth over that period.

INFLATION:

The net percent of owners raising average selling prices fell 2 points to a net 14 percent seasonally adjusted, breaking a steady march to higher levels that started in November of 2016. The Federal Reserve's target of 2 percent inflation (based on the headline Personal Consumption Deflator) has not been reached, but it is close. But, if Main Street slows the frequency of its price hikes, reaching the goal will become more difficult. Unadjusted, 9 percent of owners reported reducing their average selling prices in the past three months (up 1 point), and 26 percent reported price increases (unchanged).

Actual Price Increases

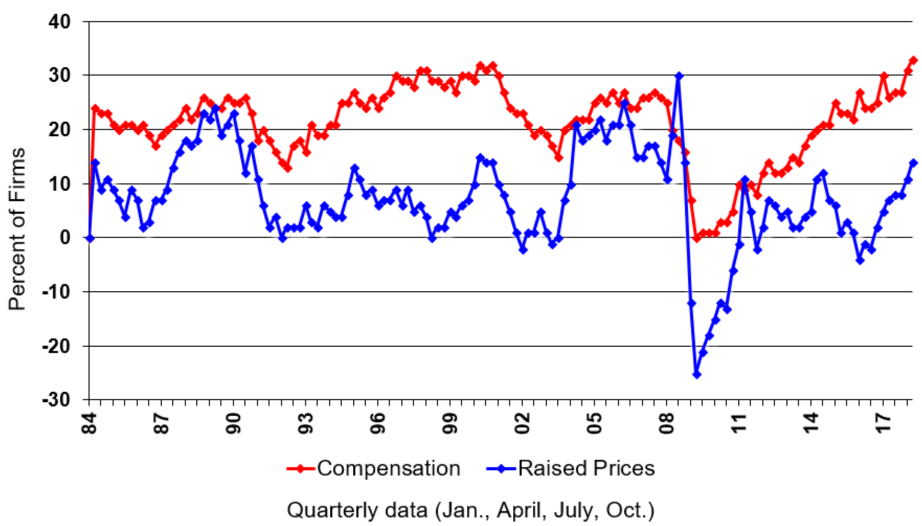
Net Percent ("Higher" Minus "Lower")
Compared to Three Months Ago
(Seasonally Adjusted)



Seasonally adjusted, a net 22 percent plan price hikes (down 3 points). With reports of increased compensation running high, there is more pressure to pass these costs on in higher selling prices, although tax cuts and growing operating profits alleviate some of this pressure. Still, as the gap between the percent raising compensation and raising prices closes, more of these costs will be passed on to customers. The NFIB data predict a PCE inflation rate of 2.1 percent in the months ahead.

Changes in Prices and Labor Compensation

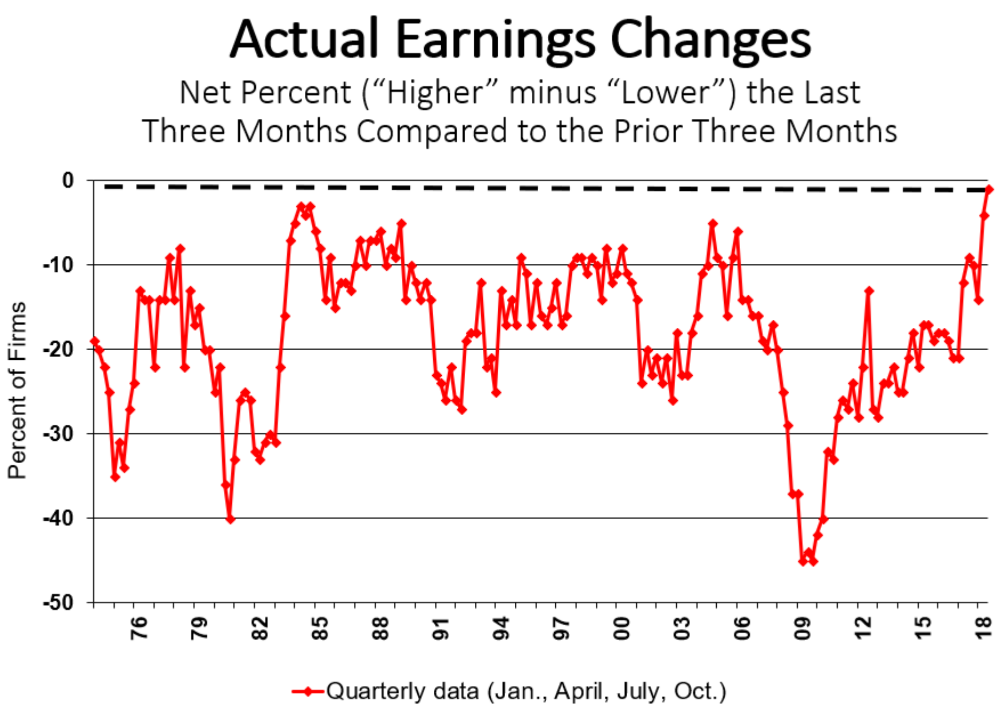
Net Percent ("Higher" minus "Lower") Compared to Three Months Ago



COMPENSATION AND EARNINGS:

Reports of higher worker compensation were unchanged at a net 33 percent, the highest reading since 2000. Although government reports of wage and salary gains remain historically low, they are the best in a long time and don't include benefits. Historically wage gains were larger, but that was in environments with much higher inflation. Plans to raise compensation rose 2 points to a net 21 percent, historically high, but below its recent peak of 24 percent in January.

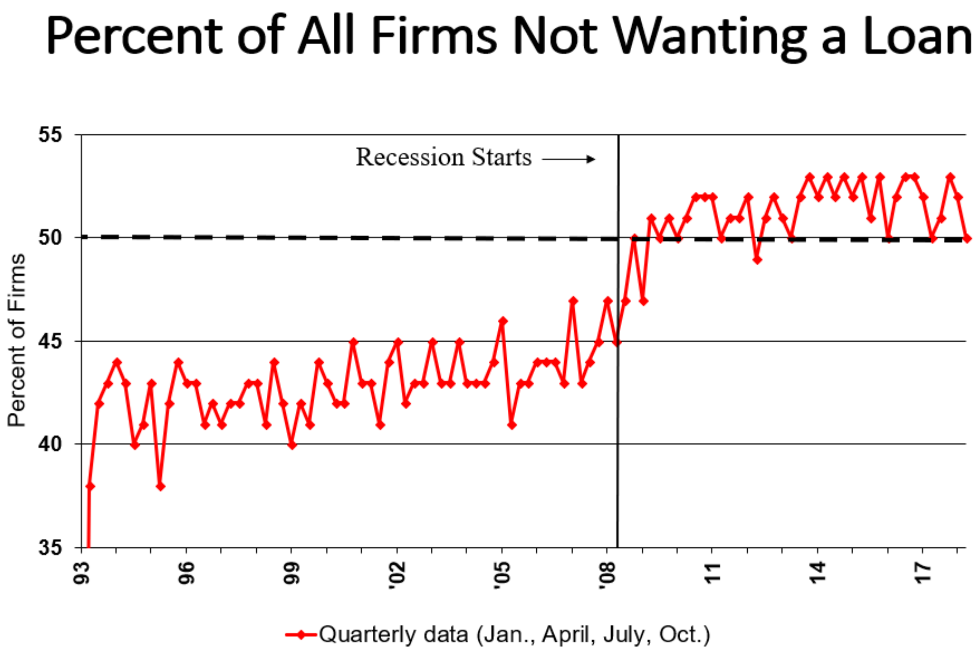
Owners complain at record rates of labor quality issues, with 88 percent of those hiring or trying to hire reporting few or no qualified applicants for their open positions. Twenty-two percent (up 1 point) selected "finding qualified labor" as their top business problem, more than cited taxes, weak sales, or the cost of regulations as their top challenge.



The frequency of reports of positive profit trends improved 3 percentage points to a net negative 1 percent reporting quarter on quarter profit improvements, the best reading in the survey's 45 year history. Although the new tax law will impact profits this year, much of the current improvement is due to gains in operating profits and stronger sales. Sales gains from stronger growth fall to the bottom line before costs such as rising labor costs catch up. Overall, the new tax law and the strong economy are very supportive of profit improvements.

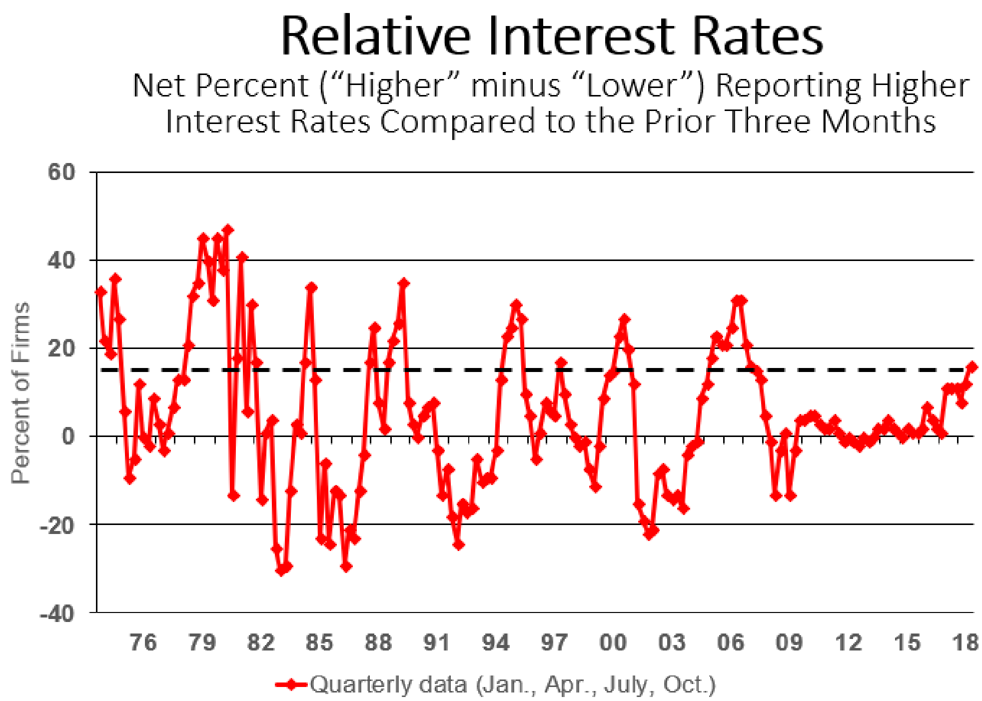
CREDIT MARKETS:

Four percent of owners reported that all their borrowing needs were not satisfied, unchanged and historically low. Thirty-two percent reported all credit needs met (up 1 point), and 50 percent said they were not interested in a loan, up 3 points but one of the lowest readings since 2010. Only 2 percent reported that financing was their top business problem compared to 18 percent citing taxes, 13 percent citing regulations and red tape, and 22 percent the availability of qualified labor. Weak sales garnered 8 percent of the vote, down 3 points and only 3 points above the 45 year record low reading. Five percent reported loans "harder to get," historically low. In short, credit availability and cost are not issues and haven't been for many years, even with the Federal Reserve raising interest rates.



Thirty-one percent of all owners reported borrowing on a regular basis (down 1 point). The average rate paid on short maturity loans was up 30 basis points at 6.4 percent, rates are rising gradually with Fed policy moves. In anticipation of the Federal Reserve rate hikes, borrowers have increased their demand for fixed rate loans with longer maturities.

As the Federal Reserve moves away from its focus on keeping rates low, more firms are reporting changes in the interest rates they pay. For those experiencing a rate increase, not a happy event, but not an impediment to borrowers who now see much higher rates of return on investments in a growing economy with lower tax rates. Bigger picture, it is important to be returning the job of capital allocation to markets and interest rates, and not Federal Reserve policy. We have twice experienced in recent times the cost of interest rate suppression, “too low for too long.”



THE LARGER PERSPECTIVE:

GDP growth for the first quarter came in at 2.3 percent, considerably shy of the 2.9 percent “guess” by the New York Federal Reserve but well above the Atlanta Federal Reserve’s 2 percent “guess.” Most observers feel the economy was much stronger in the first quarter of 2018, although consumers did slow spending considerably in January and February after their holiday binge. March has come in better, and that will show up in the second estimate. After the cold weather pause, it appears consumer spending is back on track. Business invesment grew just above a 6 percent rate, 1.5 points faster than the average in this recovery. Small business capital spending has also picked up the pace. GDP growth for the first quarter will likely be revised up, as consumers were back spending in March, and exports grew substantially while imports (a negative for GDP arithmetic) slowed.

Federal Reserve policy now revolves around two issues. First, will inflation finally hit the Federal Reserve’s 2 percent target? Second, will they raise interest rates even faster if economic growth runs at 3 percent or better (as even the CBO forecasts) and inflation starts to pick up? Removing the “punch bowl” just when the party is really hopping is a habit, and responsibility, of the Federal Reserve. Currently the Federal Reserve plans two more rate hikes this year, but if inflation finally starts to run, more are possible – unless it decides to let the economy "run hot" with more inflation. Inflation pressures on Main Street remain "moderate," even falling back a bit in April.

Overall, the outlook remains exceptionally positive. Forecasters have the growth pace near 3 percent, even with the weak start in the first quarter (which will likely be revised up). The main impediment to growth will be the short supply of labor, which plagues all industries but especially manufacturing and housing. House prices are rising sharply but are not directly included in the inflation measures. Housing starts are still running below the estimated 1.5 million needed based on demographics. This pressure will show up in rents and ultimately in the PCE inflation measure. That said, 2018 will be "lookin' good."

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NFIB began surveys of its membership in October 1973. Surveys were conducted in the first month of each quarter through 1985 when monthly surveys were instituted. The first month in each quarter is based on between 1,200 and 2,000 respondents, while the following two monthly surveys contain between 400 and 900 respondents. The term "net percent" means that the percent of owners giving an unfavorable response has been subtracted from the percent giving a favorable response. If, for example, 20 percent reported that they were going to increase the number of workers at the firm and 5 percent reported an intention to reduce the number of workers, the "net percent" would be 20 percent – 5 percent or a net 15 percent planning to expand employment. These figures are seasonally adjusted unless noted. The graphs show quarterly data (first survey month in each quarter), updated when available by subsequent monthly surveys.