

OPTIMISM STILL SPRINGS THIS FALL FOR SMALL AND MID-SIZE BUSINESS OWNERS

ANALYSIS BY **Gus Faucher** PNC Chief Economist

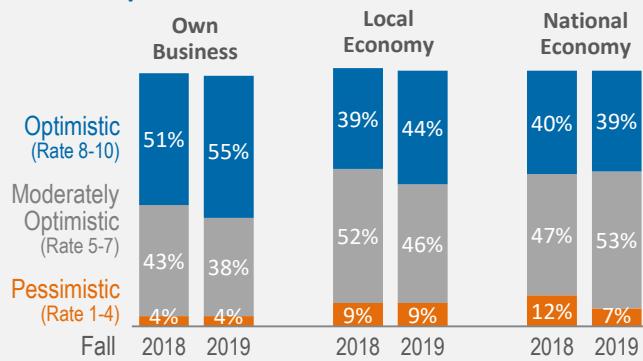
U.S. economic fundamentals remain solid, despite slower economic growth and the ongoing trade war between the U.S. and China. On the plus side, consumers remain in good shape, contributing to an increase in optimism among small and mid-size business owners. Consumer spending bounced back in the second quarter after weak growth in late 2018 and early 2019, and consumer fundamentals are good, with solid job growth and good wage gains. However, new tariffs on more Chinese-made goods that took effect at the beginning of September, with another round of tariff hikes scheduled for December, are likely to hit consumers hard over the next year unless pending trade talks lead to a softening or delay of the impact.

PNC expects the current economic expansion, already the longest in U.S. history, to last at least into 2020. PNC expects a continued slowing in U.S. economic growth, as tariffs, the uncertainty surrounding the trade war, generally weak global economic conditions, and fading fiscal stimulus all weigh on growth. PNC does not expect an outright recession in the near term, but the uncertainties contribute to a higher risk of recession in either 2020 or 2021. The potential timing and duration of any downturn depends in large part on how businesses and consumers adjust to trade disruptions. For now, both businesses and consumers remain confident.

KEY FINDINGS: OUTLOOK FOR NEXT SIX MONTHS

Despite pricing pressures and tariff concerns, measures of optimism are approaching the record-setting highs measured in spring 2018, according to the latest PNC survey of small and mid-size business owners and executives. Optimism for business leaders' own company is particularly strong at 55 percent compared to one year ago (51%) and nearing the record high from spring 2018 (58%).

Percent optimistic about...



Business leaders' views about their local economy are positive with optimism reaching 44 percent, nearing the record-high spring 2018 measure (48%). Thirty-nine percent of respondents describe their outlook for the national economy as highly optimistic. Those pessimistic about the national economy hit a survey record low of seven percent.

Nearly two-thirds (63%) of small and mid-size business leaders expect their company's sales to increase, little changed from fall 2018 (64%), but below the spring 2018 record high (69%). However, 52 percent expect their profits to increase, down from fall 2018 (59%). Respondent expectations for the next six months also shifted from growth to stability regarding the business's need for financing (79% vs. 62% in fall 2018), the cost of employee health care (54% vs. 42% in fall 2018), business leader compensation (70% vs. 62% in fall 2018) and business leader retirement savings (67% vs. 59% in fall 2018).

PROFIT EXPECTATION



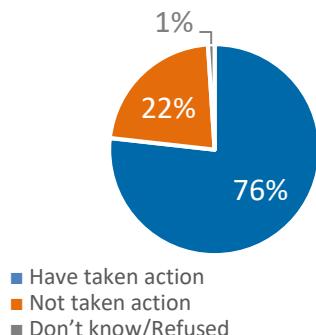
Supplier
Price
Increase

PRICE PROMOTION

A majority (53%) of small and mid-size business owners and executives anticipate paying higher prices to suppliers over the next six months, unchanged from a year ago. Supplier price increases are expected most by industries that are the biggest purchasers of goods: manufacturing (64%); wholesale and retail (61%); and construction (57%). Only 41 percent of respondents from the services sector anticipate rising costs from suppliers.

The number of respondents expecting to raise prices that they charge their customers held steady (42% vs. 45% in fall 2018). Among businesses that expect to raise prices, the share of those anticipating increases of 3 percent or more jumped significantly to 63 percent (51% in fall 2018). Their reasons for price increases include favorable market conditions that support such actions (40%), rising non-labor costs (30%) and rising labor costs (28%). Trade tariffs are also expected to increase both supplier prices and prices respondents charge their own customers (please see Tariff Toll section on the next page).

Retaining/Attracting Employees



FINDERS KEEPERS

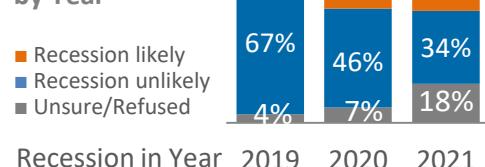
Thirty-three percent of small and mid-size business leaders plan to increase the number of full-time employees within the next six months, tying the survey record high from spring 2005, while those expecting to reduce the number of full-time employees remains at three percent, near the survey low (2% spring and fall 2018).

Nearly half (47%)—a record high for the survey—say it's harder to find qualified employees than it was six months to a year ago, with 54 percent having increased wages/salaries, up from 44 percent in fall 2018. In addition, 31 percent have allowed more flexible work arrangements, 27 percent have increased benefits, and 25 percent have offered or increased bonuses.

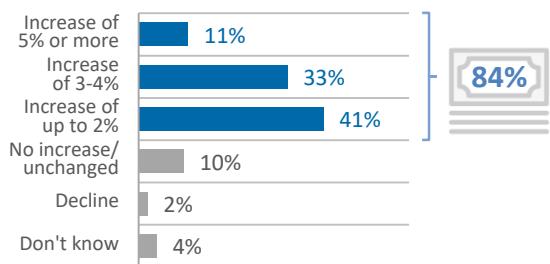
RECESSION IMPRESSIONS

What is the likelihood of recession? Sixty-seven percent of respondents say a recession is unlikely and 30 percent say it is likely before the end of 2019. But there is a shift in the outlook for a recession in 2020, with businesses split on their outlook: 46 percent believe it is unlikely, while 47 percent believe it is likely. Looking further out, optimism wanes, with only 34 percent believing a recession is unlikely in 2021.

Likelihood of Recession by Year



Expectations for Consumer Prices in Next 12 Months



INFLATION CONSTERNATION

Expectations for consumer prices are important indicators of future inflation, and 84 percent of respondents expect these prices to go up over the next 12 months. The share of business leaders expecting inflation of three percent or more jumped to 43 percent (37 percent in fall 2018), with 33 percent expecting three- to four-percent inflation and 11 percent anticipating five percent or higher.

TARIFF TOLL

Small and mid-size business leaders continue to be sharply divided on the impact of increased U.S. tariffs on goods from other countries, even if other countries retaliate with increased tariffs on U.S. goods/services. Levels of support are little changed from fall 2018 with more than four in 10 (42%) in support (41% in fall 2018), one-third (33%) against (31% in fall 2018) and nearly a quarter (24%) uncertain (27% in fall 2018).

Business leaders are split on their expectation regarding the impact of the U.S. tariff policy on supplier prices with about four in 10 (38%) who expect an increase, a similar number who do not expect an increase (42%) and two in 10 who don't know or feel it is too early to tell. Fewer (33%) anticipate passing on price increases to customers. Nearly half (49%) believe tariffs will have no impact on their company's sales; however, those who expect an impact are split with 17 percent expecting an increase in sales and 13 percent expecting sales to drop, a jump from fall 2018 (8%).

The vast majority of respondents (87%) have made no changes to their business in response to tariffs. Among the one in 10 who have made changes, five percent made new investments or hired while the same number delayed or cancelled investments or hiring as a result of tariff negotiations.

Increased Tariffs

