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Economic Trends

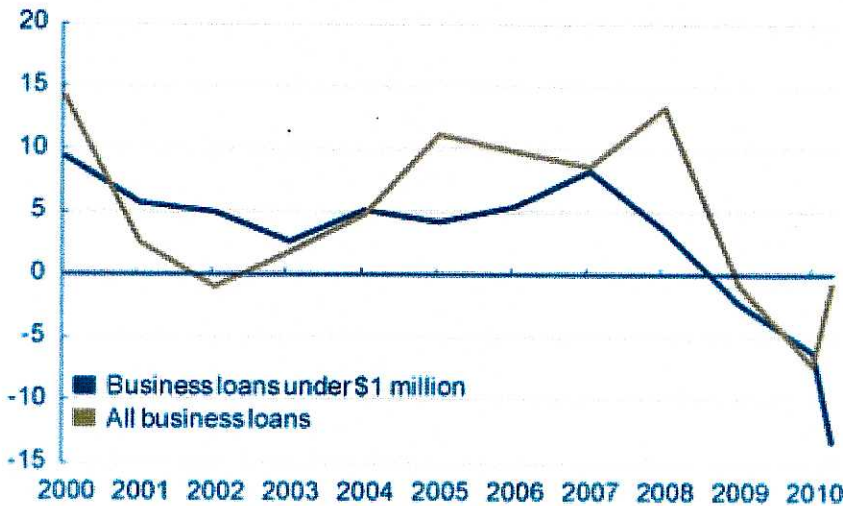
Continued Weakness in Small Business Lending

Matthew Koepke and James B. Thomson

As the economy emerges from the worst economic downturn since the Great Depression, concerns remain about the slow, ongoing weakness in credit markets, in particular, the small business loan market. The most recent data on the primary source of loans to small businesses, FDIC-insured banks and thrifts, adds credence to this concern.

Small Business Loan Balances

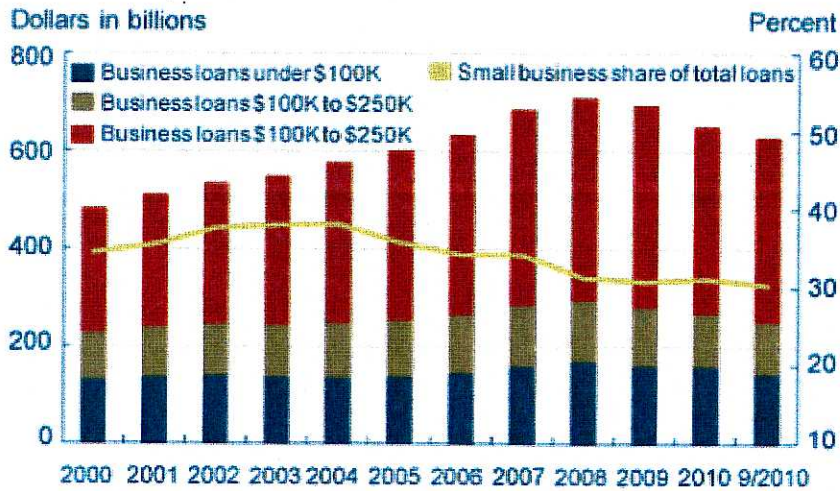
Annual percent change



Source: FDIC.

From 2000 to 2008, the overall business loan portfolios of FDIC-insured institutions grew on average 7.2 percent a year. Small business loan balances (loans under \$1 million) grew at a slightly slower annual rate of 5.5 percent over the same period. Since then, however, the business loan portfolios of FDIC-insured banks and thrifts have shrunk a total of 8.0 percent, with small business loan balances falling by nearly 8.5 percent. Third-quarter numbers for 2010 showed that overall holdings of business loans appeared to be stabilizing, but small business loan balances continued to decline at an annualized rate of 13.3 percent from the end of the second quarter.

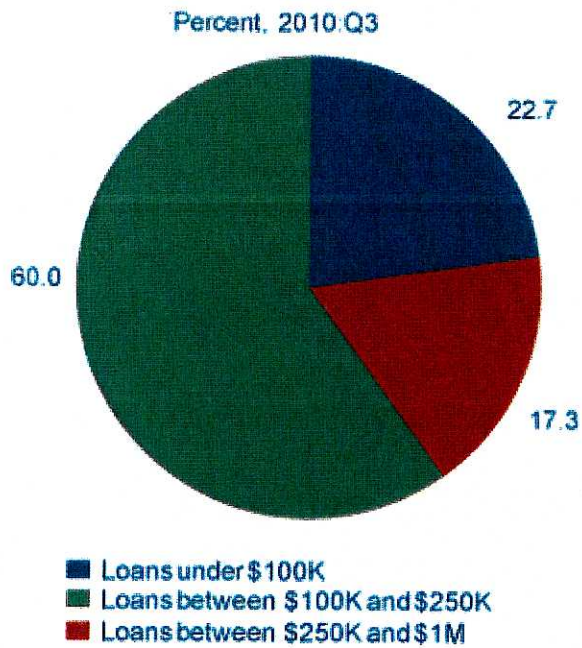
Small Business Loan Balance



Source: FDIC

Looking at the balances of small business loans held by FDIC-insured banks and thrifts we see a similar pattern. Total holdings of small business loans peaked in 2008 at \$711 billion. Since then, total holdings of small business loans have declined through the third quarter of 2010 to just under \$631 billion, with all three categories of loan size (loans under \$100,000, loans between \$100,000 and \$250,000, and loans between \$250,000 and \$1 million) experiencing the same pattern of growth and subsequent decline. Interestingly, small business loans as a share of total business loans peaked in 2004, well before the peak of the small business loan portfolios in 2008, illustrating the fact that small business loan growth lagged that of total business loans over much of the decade.

Small Business Loan Share: Amount

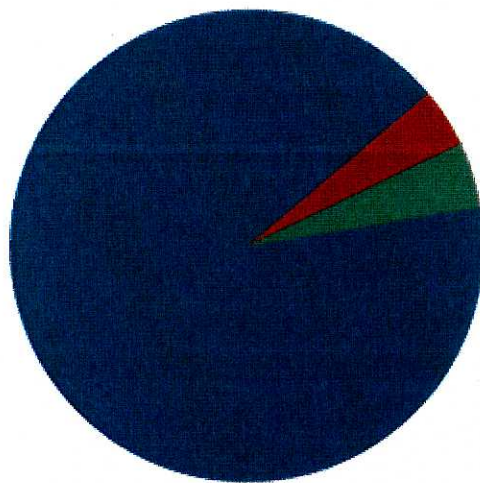


Source: FDIC.

The main driver of the changes in small business loan balances for banks and thrifts is business loans over \$250,000 and less than \$1 million. These loans account for 60 percent of the total dollar amount of small business loans held by FDIC-insured institutions but only 4.4 percent of small business loans in terms of numbers of loans.

Small Business Loan Share: Volume

Percent, 2010:Q3



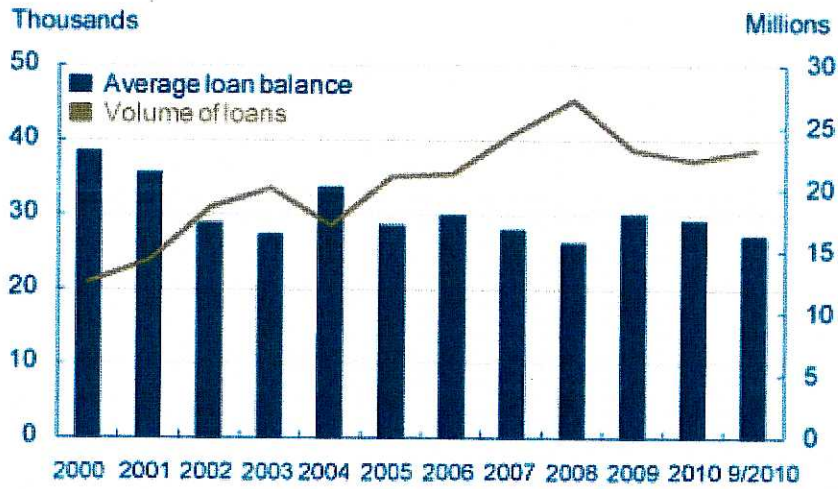
- Loans under \$100K
- Loans between \$100K and \$250K
- Loans between \$250K and \$1 million

Source: FDIC.

From the 2000 to 2008, the increase in small business loans was driven by an increase in the number of loans made. The general decline in the average small business loan made over this time period was due in large part to strong growth in the number of loans under \$100,000. While the average growth in the small business loan portfolios of banks and thrifts through 2008 was 13 percent, the number of loans under \$100,000 grew 14 percent compared to 6 percent and 7 percent for loans between \$100,000 and \$250,000 and loans between \$250,000 and \$1 million, respectively. From June 2008 to June 2010, the shrinking small business loan portfolios of FDIC-insured institutions have been driven by a combination of shrinking loan balances (falling 4 percent a year) and declines in the numbers of loans (falling nearly 9 percent a year). Again, the reversal of growth in the number of loans has been driven by the decline in the number of loans under \$100,000, which declined nearly 10 percent a year between June 2008 and June 2010. In comparison, the number of loans between \$250,000 and \$1 million fell only one percent a year and those \$100,000 and \$250,000 fell only 4 percent a year over the same time period.

The FDIC's 2010 third-quarter data showed continued decline in small business loan portfolios, as total loans declined at an annualized rate of 13 percent, falling \$22.6 billion. Continued shrinkage of small business loans held by FDIC-insured institutions in the third quarter of 2010 was due to a decline in the average loan balance, as the number of loans increased at a 15 percent annualized rate. A look behind the numbers for the third quarter of 2010 shows that the increase in the number of loans comes from growth in loans under \$100,000 (19 percent annualized); the number of loans between \$250,000 and \$1 million and between \$100,000 and \$250,000 fell more than 3 percent and 1 percent, respectively.

Small Business Loans Under \$1 Million



Source: FDIC.

Continued shrinkage of the small business loan portfolios of FDIC-insured banks and thrifts mirrors that of overall business lending by these depositories. However, the strong growth in the number of loans under \$100,000 may be the first glimmer of light at the end of the credit tunnel.