ECONOMY

N.Y. Fed: Attract more creative, diverse credit to balance demands, availability

Think Strategically:
Making Burgers Out of the Bull?

Trade Tensions Grow as Feds Raise Funds Rate 0.25%; Price of Oil Nears 2018 Highs; Small Businesses Avoid Debt

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The Week in the Markets: Trade tensions, oil & increased rates impact

Are we going to watch the stock market "make burgers" out of the bull, after reaching a week, before its 429 percent total return since the current bull market began back in 2009? Most U.S. stocks were impacted by the continued trade tensions that have not subsided. This past week, the market indicators closed with mixed results, with the Dow Jones Industrial Average ending at 26,458.31, or a loss of 285.19 for the week and a year-to-date return of 7.0 percent. The S&P 500 closed at 2,913.98, or a loss of 15.69 for the week and a year-to-date return of 9.0 percent, and the Nasdaq closed at 8,046.35, a gain of 60.29 for the week and a year-to-date return of 15.7 percent.

What is driving the market sentiment:

U.S. and China trade tensions: As this saga continues to impact, and many companies have been raising concerns about how the tariffs may affect their business, it proved not enough to stave off increased interest rates from the Federal Reserve Bank.

Federal Reserve Bank interest-rate increase: The federal funds rate was increased by 0.25 percent, making the new range 2.00 percent to 2.25 percent. In the Fed's view, the U.S. economy is healthy and running at healthy levels, with unemployment at historically low levels and steady job growth. As the Fed continues to tighten its monetary policy, we will see reduced bond purchases from the Fed to curtail most of the economic incentives it was providing in the recent past.

Oil prices on the rise: The price of oil increased to $73.25 per barrel last week, which placed the price very near the highs for 2018 and just below the highest price levels since 2014. We must be reminded that the lowest price was $49.29 per barrel last October or $23.96 less, so if you usually were filling up your tank for $35, now you will feel much pain doing so.

Moreover, the impact on consumers is immediate and thus will have an impact on the inflation forecast that the Fed has been publishing.

As we have been pointing out for most of the year, the quarterly results usually translate into the entire year ending up in positive territory and, with the Dow Jones, S&P 500 and Nasdaq all with solid year-to-date returns, we do not expect the markets to end its current bull rally. This situation by no means translates into a lack of volatility, quite the contrary, as long as there are trade tensions between the U.S., China, Mexico, Canada, and the European Union, we will continue to experience volatility and price swings. In conclusion, "the stock market is not ready to make burgers out of the bull."

Final Word: Federal Reserve Bank of N.Y., P.R. small-business trends

The Federal Reserve Bank of New York conducts an annual survey of Puerto Rico small businesses to provide stakeholders, including business leaders and policymakers, with relevant information on how this sector is performing. This latest 2018 survey was conducted March through May 2018 and asked firms to report their business experiences in 2017, including the impacts from hurricanes Irma and Maria.

The report describes firms that are currently operating in Puerto Rico and does not address the critical topic of those businesses that have closed, either permanently or temporarily. We attempt to summarize some of the findings of the report.

Some of findings of the survey include:

- An increased prevalence of debt aversion among firms may be contributing to the weak demand for credit.
- The sector's size composition shifted toward more micro-revenue firms with annual revenues of $50,000 or less.
- These firms were driving strong demand for small loans of $10,000 or less.
- Hurricanes Maria and Irma affected most of the sector, whether directly through storm damage or indirectly with hurricane-related losses.
- A few firms indicated they closed permanently, attributing the closure to a lack of power, water or transportation.
- Annual revenues decreased in 2017 for a majority of firms.
- Fifty-four percent of firms reported a decrease in annual revenues in 2017.
- Operating expenses increased for a majority of firms in 2017.
- Profitability remained under pressure for firms in 2017.

What does credit demand in P.R. look like?

Quite unsurprisingly, credit demand remained low for 2017. We noted that debt aversion had been the most frequently cited reason not to apply for credit over the past three years, but it became more prevalent during 2017.

Details from the survey:

- Commercial banks continue to be the most frequently mentioned credit source.
- Government entities such as the Small Business Administration gained importance in 2017, most likely reflecting funding for hurricane recovery.
- Credit demand is primarily for small-dollar loans.
- Eighty-one percent of applicant firms applied for loans of $100,000 or less.
- Meeting operating expenses (lines of credit) was the top-ranked reason to apply for credit in all three years of the survey.

Credit availability

Contrary to what conventional wisdom may lead you to believe, credit approvals increased significantly in 2017. While the number of application rates was down in 2017, actual credit approvals increased.

Increased availability reflected in several ways:

- Firms that received full or partial funding were the highest in the past three years.
- Applicants that received full funding reached a three-year high in 2017.
- Share of businesses denied funding declined.
- Debt aversion was the top-ranked reason not to apply for credit. In 2017, it increased to 42 percent of non-applicant firms.

Impact from Hurricane Maria:

- The total number of small businesses in Puerto Rico has declined over the past decade.
- The 2017 hurricanes decreased revenues and increased expenses for a majority of firms.
- Sixty-six percent of firms reported reduced annual revenues due to the storms. However, 16 percent of firms saw a positive impact on revenues.
- Sixty-three percent of firms reported increased expenses because of the hurricanes while 13 percent of firms saw decreased costs.
- Forty-three percent of firms took on debt due to the storms.

As we review the results of the Federal Reserve Bank of New York survey, we note the significant impact it has had on Puerto Rico's credit availability, along with the demise of four large Puerto Rican banks that were taken over by the FDIC between 2010 to 2015. Thankfully for Puerto Rico, the credit union movement has provided credit among all social demographics in Puerto Rico and, unlike government banks, are unable to fill the gap. By any measure, Puerto Rico needs to have more credit institutions set up shop: Our call has to be that we need to attract even more creative and diverse credit providers to balance the demands and availability of credit.

As a final note, we must mention that the Puerto Rican entrepreneurial drive is more active and prevalent than ever, even thou the cost of borrowing is an all-time high with $50k credit facilities at anywhere from 12 percent to 20 percent in other cases.

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