April 11, 2017

TD Economics

Data Release: Small business confidence cools slightly but remains upbeat

- The NFIB's small business optimism index fell 0.6 points to 104.7 in March – largely in line with market expectations. Despite this being the second consecutive monthly pullback, optimism remains strong with readings above the 104-level recorded only during the early 1980s and early 2000s.

- Five of the ten sub-indicators fell on the month, two remained unchanged while the rest improved. Among the key contributors to the recent rise in optimism, expectations regarding an improvement in the economy and the belief that now is a good time to expand remained largely unchanged. Meanwhile, expectations regarding higher real sales pulled back 8 points to 18 percent, but this still marks one of the best showings in the post-recession period.

- Labor market indicators saw little movement on the month and remained largely upbeat. Plans to increase employment edged up 1 point to 16 percent, while unfilled job openings pulled back 2 points to a still-healthy 30 percent. Earnings indicators rebounded after slipping last month, with the share of firms increasing and planning to increase worker compensation up 1 and 2 points to 28 and 18 percent respectively – some of the best showings since the mid-2000s. Capital outlay plans also saw some improvement, rising 3 points to 29 percent.

- The sub-index gauging the level of uncertainty moved up 7 points to 93 – the second highest reading after the all-time high recorded during the recent election month.

Key Implications

- Despite the slight pullback in the headline index, today's report does little to disappoint as the confidence reading is still at the top end of the range of historical highs. The key message is that expectations regarding promised policy changes that will bring about improved economic fortunes remained largely unperturbed last month. Additionally, the rise in optimism has had some staying power, which has slowly translated into some improvement in investment and employment plans – a welcome development.

- The survey's labor market indicators are humming the same tune as recent payrolls reports, and point to a tightening labor market and rising inflationary pressures. With respect to the latter, rising job openings (on a trend basis) and increased concerns about the quality of labor should continue to support stronger earnings – an added element that will assist the Fed with its gradual interest rate hiking cycle.

- Going forward, the outlook will depend on how fast and how much the new administration can deliver on its promises. While businesses remain hopeful, they are still highly uncertain about the future. The failure of the bill to repeal and replace the Affordable Care Act near the end of March could result in some softness in the next report. Moreover, a turbulent political process or delays regarding the implementation of other parts of the agenda, such as tax reform, are additional risks that could further tame optimism and expansion plans in the coming months.

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