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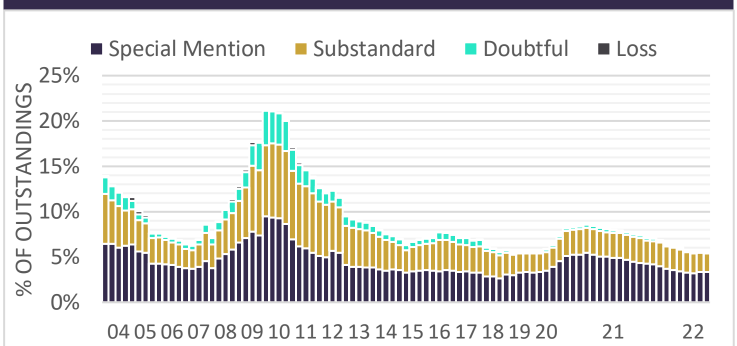
Commercial Credit Quality Bulletin

April 2022

Storm Clouds Continue to Build while Commercial Credit Quality Continues Remarkable Run

Commercial loan performance and credit quality remained sound through March 2022. Early stage delinquencies—defined as loans past due 30–59 days—remain extremely volatile, spiking to 0.64% through March from 0.33% at the end of February. This continues a trend we have seen for two years now, triggered first by the pandemic and then continuing as the economy reopened in fits and starts and continues to work through various imbalances. Some key indicators of credit risk are showing signs of normalization, such as levels of criticized loans. Other measures such as charge-offs remain near historic lows, and should also begin to normalize as economic growth slows to more normal levels and persistently high inflation takes a toll. Inflation may be showing signs of peaking as prices for gasoline, used cars, and freight have moved lower. The core CPI index rose 0.3% month over month in March, easing from 0.5% the prior month. While the odds of a medium term recession have increased the underlying economy remains quite strong.

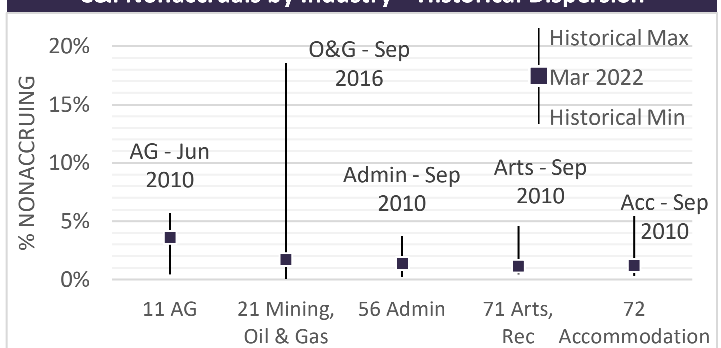
C&I Criticized Loan Trend



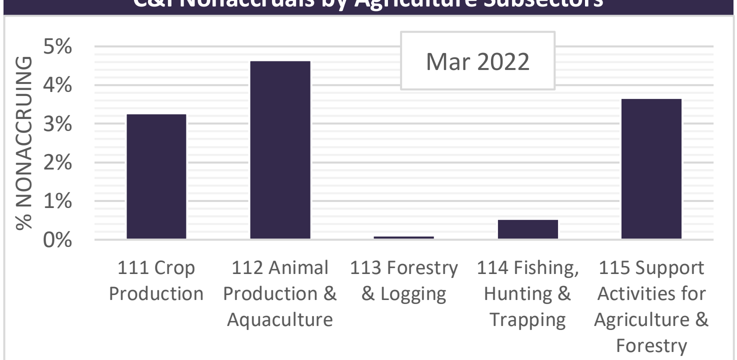
The improvement in Criticized levels (loans risk rated Special Mention, Substandard, Doubtful and Loss) appears to have leveled off. At the beginning of the pandemic, banks were unsure how their borrowers were going to fare, and they moved a substantial amount of their portfolios to Special Mention or worse. Now, much of the uncertainty has passed as companies have learned how to cope with COVID, and many of the Special Mention loans have returned to Pass status.

The historical nonaccrual performance for the current five worst performing industry sectors is shown on the right. The top of the line represents the peak value, with the bottom of each line representing the low point. The marker is the current level. These sectors, while currently well above the overall market average, are near their historical low points with one exception, Agriculture, which has been rising and is now approaching the historical highs we saw back in June 2010.

C&I Nonaccruals by Industry – Historical Dispersion



C&I Nonaccruals by Agriculture Subsectors



Agriculture is now the worst performing industry when looking at nonaccrual levels. Not all of the Agriculture subsectors are performing poorly; although the two largest subsectors—Crop Production and Animal Production—display elevated nonaccrual levels. Drought conditions, especially in the West and Midwest, are severely impacting grain crops like corn, and dairy farms are experiencing increased fuel costs, eroding their profitability.

Why RMA and AFS?

RMA and AFS are committed to providing relevant, timely, and practical credit risk solutions to banks. Combining the strengths of each to offer information and insight, RMA and AFS are ideally situated for collaborations aimed at identifying and responding to the credit risk needs of financial institutions.

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