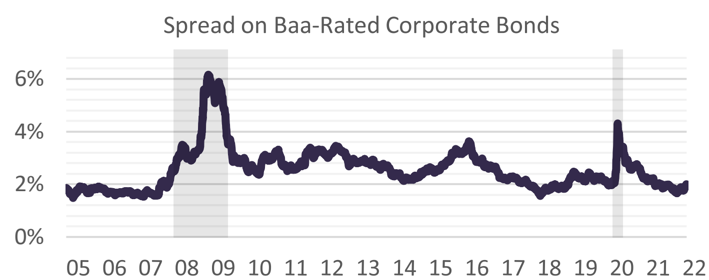
Commercial Credit Quality Bulletin

February 2022

Credit Markets Remain Calm Despite Economic Cross Currents and Equity Market Volatility

Commercial loan performance and credit quality remained solid through January 2022 despite continued economic cross currents and market volatility. C&I loans past due 30–59 days were 0.61%, up 10 basis points month over month and right about the two-year average level. Nonaccruing C&I loans were 0.60%, essentially unchanged month over month and well off the two-year average of 0.85%. And criticized commercial loan balances fell again for the 16th consecutive month and now total just 5.6% of loan balances. While by some measures equity markets experienced their worst January since 2009 – the S&P 500 index was down nearly 6% in the month and approached correction territory – several key predictors of credit default probability remained low. Changes in real GDP, the labor market, and changes in the spread on corporate bonds are all leading indicators of stress in credit markets, and all three continue to point to an economy with sound underlying strength, despite record-breaking inflation and a Fed poised to tighten monetary policy.

Market Volatility: Corporate Loan Spreads

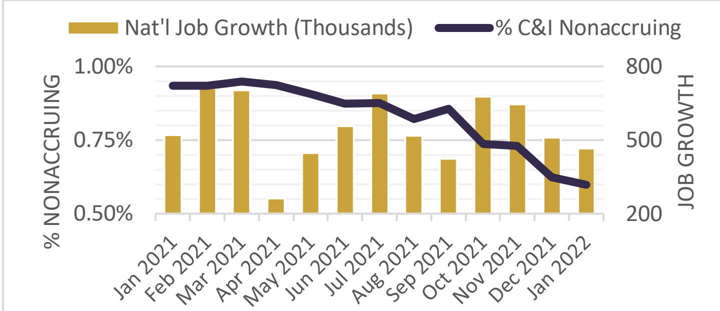


Source: Federal Reserve Bank of St. Louis, Moody's Seasoned Baa Corporate Bond Yield Relative to Yield on 10-Year Treasury Constant Maturity

Spreads on corporate credit have remained subdued despite volatility in other asset classes. Leading into the Great Recession and more recently the pandemic, the Baa spread spiked sharply when the S&P 500 index approached correction territory. While geopolitical tensions and other worries have caused the Baa spread to increase in recent days, it has largely held steady around the 2% range. And as we note further below, corporate loan default probabilities also remain low.

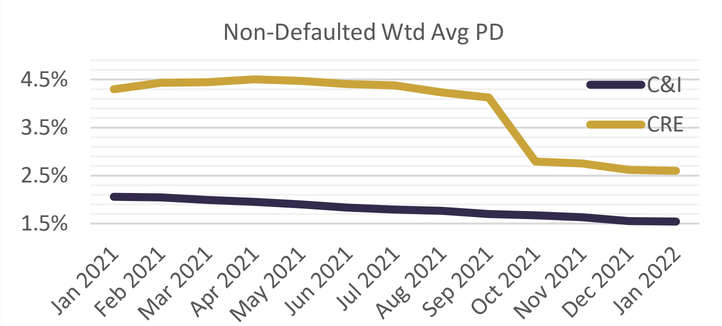
Employment is also critical to economic growth and in turn loan growth and credit quality. By historical standards, the state of the labor market is sound. The unemployment rate ticked up in January slightly to 4% from 3.9%, but this was more a function of a rise in the labor force/ participation rate. Wage growth is also strong, particularly in the service sectors. Continued strength in the job market bodes well for loan growth and performance.

U.S. Job Growth vs. C&I Nonaccruing Loans



Total nonfarm job growth sourced from the U.S. Bureau of Labor Statistics.

C&I and CRE Wtd Avg Probability of Default (PD)



The ***RMA Credit Risk Navigator, powered by AFS*** provides banks the ability to see consensus default forecasts for various loan types and industries. As commercial banks re-rated their credits and recalibrated their default models as the pandemic set in, default projections spiked across the board. Since that time, conditions have improved dramatically, with C&I default projections in the 1.5%–2.0% range and Commercial Real Estate default projections in the 2.75%–3.0% range.

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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