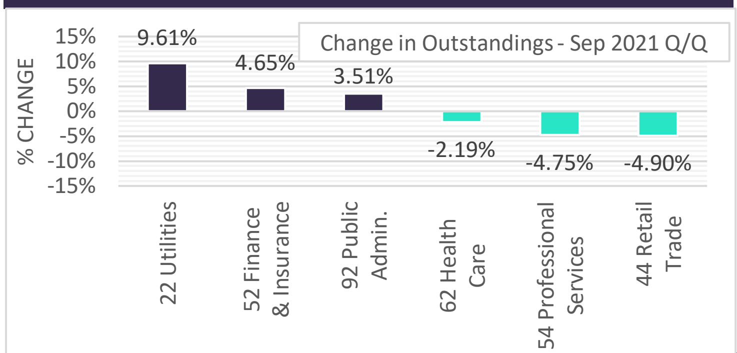
Commercial Credit Quality Bulletin

October 2021

Commercial Loan Credit Quality Remains Stable Despite Broader Economic Weaknesses and Uncertainties

Third-quarter real GDP is projected to increase a meager 1.3%, down from a forecast of 6% made two months earlier. The spread of the Delta COVID-19 variant, supply chain bottlenecks, and high inflation have all tempered the once strong economic recovery. While banks that shared third-quarter earnings so far continued to release loan loss reserves, a slowing economy complicates the outlook for commercial loan growth and credit quality. For now, problem C&I and CRE loans are predominantly concentrated in a handful of distressed sectors, such as Lodging and Oil & Gas. Short-term C&I delinquencies, which spiked unexpectedly last month, quickly resolved in September, representing a possible aberration rather than signifying a more troubling vulnerability in the commercial loan market. C&I loan growth was essentially flat in the quarter that ended in September, with large balance increases in the Finance & Insurance and Utilities sectors offset by declines in the Retail Trade and Professional Services industries.

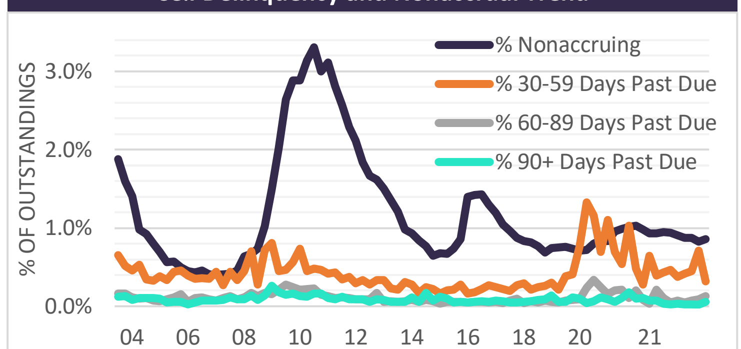
C&I Loan Growth – By NAICS Industry Sector



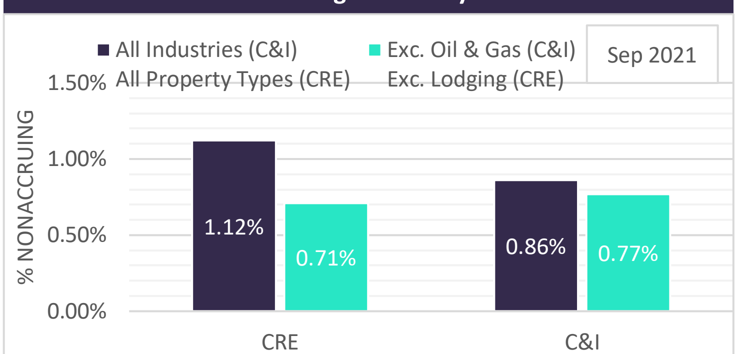
While the overall change in C&I loan balances (excluding PPP loans) was essentially flat in the third quarter, a handful of large industries realized meaningful growth during the period. Finance & Insurance (+4.65% q/q) remains one of the fastest growing segments of C&I lending. Conversely, balances were down quarter-over-quarter across half of the NAICS industry spectrum, led by a sharp decline in the Retail Trade (-4.90% q/q) industry.

The spike in short-term C&I delinquencies observed last month appears to have been an aberration, as the percentage of C&I loans past due 30–59 days fell in September to a level in line with the trend seen throughout the first half of the year. The C&I nonaccrual rate was 0.86% in September, down 2 basis points from June and down 13 basis points when compared to the previous September. However, C&I nonaccruals remained slightly elevated relative to pre-pandemic levels.

C&I Delinquency and Nonaccrual Trend



C&I and CRE Nonaccruing Loans – By Vulnerable Sector



While overall commercial loan asset quality remains stable, we continue to observe high levels of nonaccruing loans in the Oil & Gas sector (for C&I loans) and the Lodging sector (for Commercial Real Estate). Excluding Lodging loans, the CRE nonaccrual rate in September falls by nearly half, which reveals the high volume of problem loans concentrated in the Lodging property type. The C&I nonaccrual rate exhibits a similar, although less pronounced, improvement when Oil & Gas loans are excluded from the mix.

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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