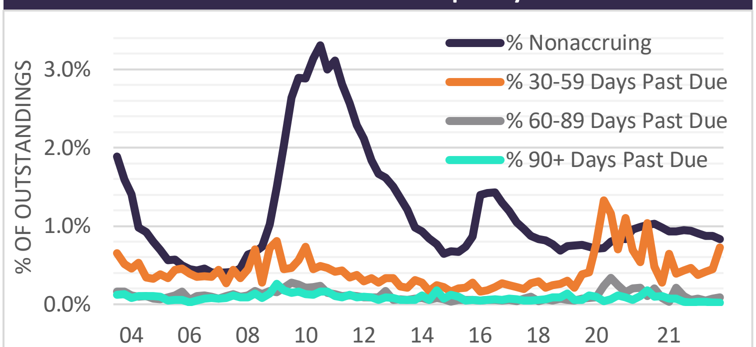
Commercial Credit Quality Bulletin

September 2021

Widespread Spike in Short-Term Delinquencies Casts Doubt on Future Path of Commercial Credit Quality

While many key indicators of commercial credit quality continued to improve through August, we were thrown a curve by a widespread spike in short-term delinquencies month over month. Loans past due one payment (30-59 days) spiked 61% from July to August, and the increase was observed across a wide range of industries. The COVID-19 Delta variant has been curbing demand for services such as travel and leisure, and while U.S. retail sales surprised to the upside in August, volatility in economic indicators remains the norm. Wide differences in global vaccination rates, fiscal policy response, and economic recovery are rippling throughout our interconnected financial markets and continue to cause disruptions in supply chain dependencies. On a positive note, criticized loans were 6.9% of total loans through August, down 14 bps month over month and 17.6% year over year. Nonaccrual loans were down 13 bps and 13.5% over the same time periods, respectively. Nonetheless, this unexpected spike in delinquencies will be worth watching.

C&I Nonaccrual and Delinquency Trend

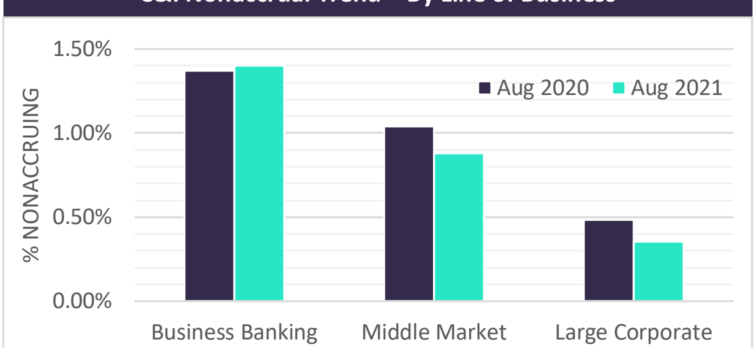


While the headline in August is the sharp increase in 30–59 day delinquencies, other measures of C&I loan quality continued to improve. For example, the percentage of criticized C&I loans – or loans rated Special Mention, Substandard, Doubtful, or Loss – has declined for 11 consecutive months, from 8.6% as of September 2020 to 6.9% as of July 2021, suggesting lenders have isolated problem credits and are gradually resolving them.

The spike in delinquencies was observed across a range of sectors. Government saw delinquencies rise to 0.71% from 0.23% last month. Many state and local governments now face severe budget challenges caused by COVID-19, as job losses and reduced economic activity result in reduced personal and corporate tax revenue. Manufacturing saw delinquencies rise to 0.76%, up from 0.23%. In particular, computer and electronic product manufacturers remain under significant pressure due to parts supply constraints.

C&I Short-Term Delinquency Trend – By OCC Industry Sector

C&I Nonaccrual Trend – By Line of Business



The chart on the left compares nonaccrual balances and trends by line of business – Business Banking (generally companies with annual sales <$20 million); Middle Market (sales between $20 mm and $200 mm); and Large Corporate (sales north of $200 million). The smaller, business banking customers have been hit the hardest and are struggling to recover. The large corporate borrowers, many with ample access to capital markets, saw the least disruption and have recovered quickly, with the middle market borrowers showing gradual improvement.

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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