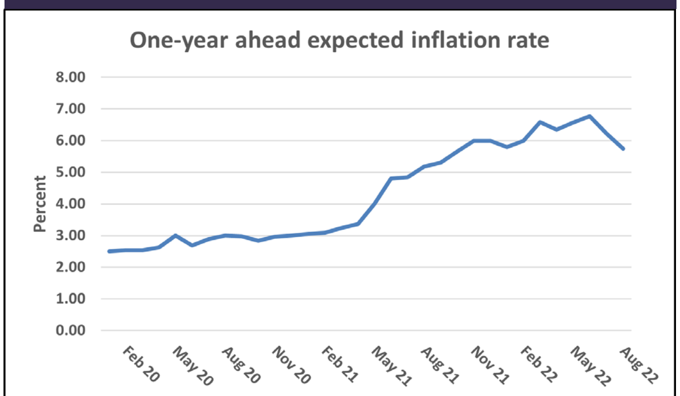
Commercial Credit Quality Bulletin

September 2022

Economic Uncertainty Persists But Commercial Credit Quality Holds Firm

U.S. bank commercial loan performance and quality remain strong. Measures of short-term (30–59 day) delinquencies and loans on nonaccrual both declined month over month. Levels of criticized loans—loans adversely rated Substandard, Doubtful, or Loss—are at the lowest levels we've experienced since the start of our reporting (2003). This favorable picture comes against a backdrop of recent disappointing news in the fight against inflation. The August inflation report came in hotter than expected last week, with the Consumer Price Index increasing 8.3% in the past twelve months, higher than the 8.1% economists had predicted. Rising prices of food and shelter served to offset recent declines in energy prices, particularly gasoline prices. Against this backdrop concerns are building that the Fed may have to hold rates higher for longer to bring down inflation, which typically is bad news for the housing and labor markets. Under this scenario it would seem reasonable to expect some level of credit normalization into 2023, including rising reserve builds. Still, at the moment commercial credit risk appears well contained within the U.S. commercial banking industry.

Survey of Consumer Expectations



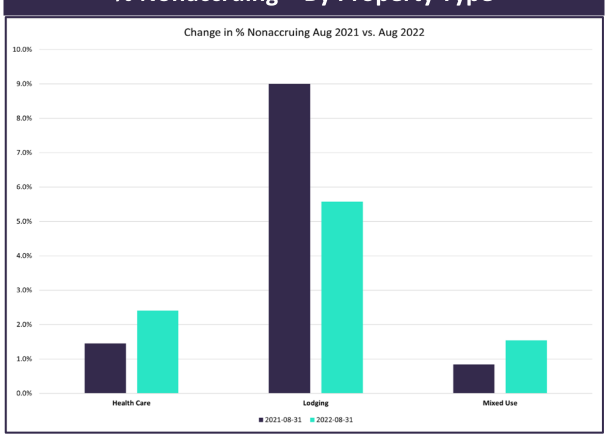
Source: Survey of Consumer Expectations, ©2013-2022 Federal Reserve Bank of New York (FRBNY).

On the chart on the left, we illustrate the trend in the one-year ahead expected inflation rate, and notably it's dropped 100 bps in the last two months. After sharply accelerating for about a year, the one-year ahead inflation rate has fallen back to 5.75%. While that level is still far too high for policy makers, declining expectations for future inflation would be an indication that markets believe the Federal Reserve's actions are working and a peak is in sight. Future inflation expectations also give insight into whether consumers believe inflation is entrenched and are starting to factor higher inflation into their everyday decision making.

While the percentage of C&I loans on nonaccrual improved again this month compared to last month and is now at 0.51%, there are a handful of sectors that are well above that mark. A few of those same sectors are actually improving; but on a year-over-year basis Agriculture and Manufacturing have deteriorated. The widespread drought and increased costs are negatively affecting Agriculture. Problems with food and beverage manufacturers have also increased.

% Nonaccruing – By NAICS

% Nonaccruing – By Property Type



For CRE loans, nonaccrual levels by Property Type improved marginally. Lodging was heavily impacted by COVID restrictions but has been recovering and is down over 300 bps this year. However, we are seeing increases in two other property types and these increases have offset the improvement for Lodging: healthcare property nonaccruals are up almost 100 bps as vacancy levels in nursing homes continue to be high; and nonaccrual balances for Mixed Use properties have nearly doubled as the slow return to office has hindered their performance.

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.

Tom Cronin, AFS, tcronin@afsvision.com ● Carly Edmondson, RMA, cedmondson@rmahq.org

www.afsvision.com ● www.rmahq.org