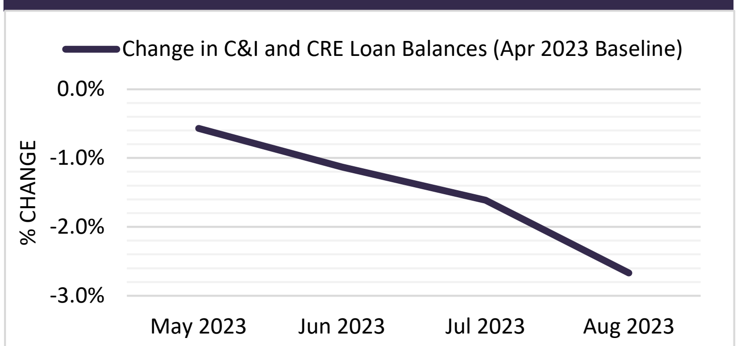
Commercial Credit Quality Bulletin

September 2023

Bank Commercial Lending Volume Plummets Despite Resilient Macroeconomic Backdrop

Bank commercial credit quality remained largely stable through August 2023. Major indicators of credit risk for Commercial & Industrial and Commercial Real Estate loans remain near historical lows. A resilient macroeconomic backdrop has prognosticators raising the odds of a soft landing, fueled by strong household spending and a strong labor market. While steady commercial credit performance and asset quality are a welcome respite for bankers, they face no shortage of concerns including declining net interest margins, rising unrealized losses on securities impacting liquidity, and rising corporate bankruptcies, which will ultimately pressure commercial credit quality. Corporate bankruptcies are rising at their fastest pace since 2010, up 17% month over month in August and double the year-ago level.

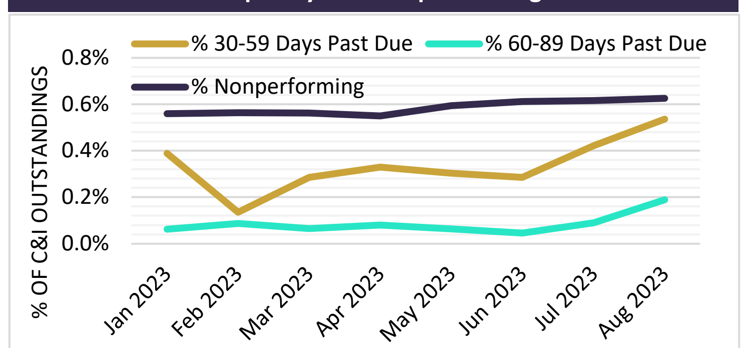
Commercial Loan Growth Trend



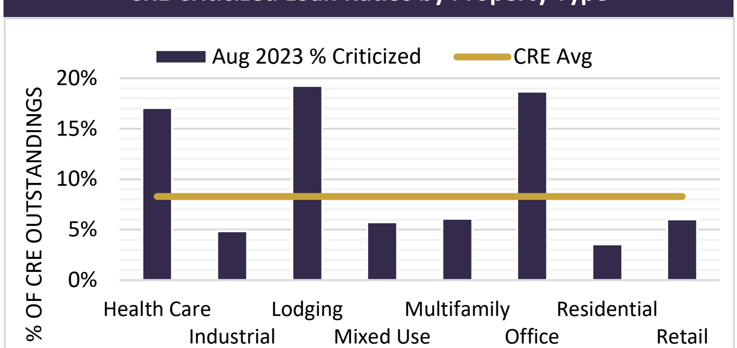
With the chart on the left, we use April 2023 as a base and compare the loan balance at the end of each subsequent month to the base month. You can see that for each month the balances continue to drop, and for the last month the pace of the decline has accelerated. According to the latest Fed Survey, the decline is the result of two factors: (1) as interest rates have climbed, the increased cost of borrowing has led many companies to put off financing new projects; and (2) higher-than-normal deposit outflows have commercial banks reexamining their loan portfolios and shedding borrower exposure that carries excessive risk or is no longer part of the bank's strategic focus.

On the right, we are showing the recent trend in loan performance. Non-performing (90+ days past due plus Nonaccruals) have inched up ever so slightly, but short- and medium-term past dues (30–59 days and 60–89 days respectively) have spiked this past month. Throughout the COVID-related period, delinquencies have been extremely volatile. But this month we're seeing an increase in past dues that has gone above the 0.50% threshold. The increase is primarily driven by the Transportation (truck and air) and Construction (highway and electrical contractors) sectors.

C&I Delinquency and Nonperforming Trend



CRE Criticized Loan Ratios by Property Type



One measure of credit quality is criticized loan balances (borrowers rated Special Mention, Substandard, Doubtful, and Loss). With the chart on the left, we are showing percent criticized for major property types in the columns compared to the overall market average. Three property types are well above the average but are moving in opposite directions. Lodging is high but has been steadily improving. The issues with Office have been well documented. Relatively new to rising levels of criticized loans is Healthcare, as staffing shortages for physician offices are limiting patient visits and lowering 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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