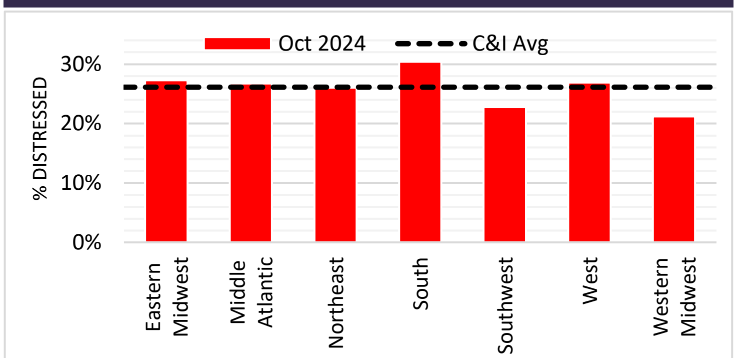
Commercial Credit Quality Bulletin

November 2024

Bank Stocks Rise on Election Results, But Uncertainties Around Credit Risks Linger

The results of the U.S. presential election had an immediate impact on financial markets, with bank stocks rallying on expectations of tax cuts and a more favorable regulatory environment. However, uncertainties around credit risks and broader economic conditions linger. Of concern is that the percentage of C&I deal volume risk rated low pass or criticized remains elevated, particularly in sectors such as retail and hospitality where consumer spending is slowing. In the CRE space, asset quality indicators may actually underestimate the true degree of credit distress in part because banks have modified troubled loans or extended maturity dates. While the benefits of easing inflation and interest rates finally starting to fall should help distressed borrowers, new questions abound now on how aggressive interest rate cuts will turn out to be and if inflation will continue its downward trend toward 2% once the new administration starts to implement new programs and policies.

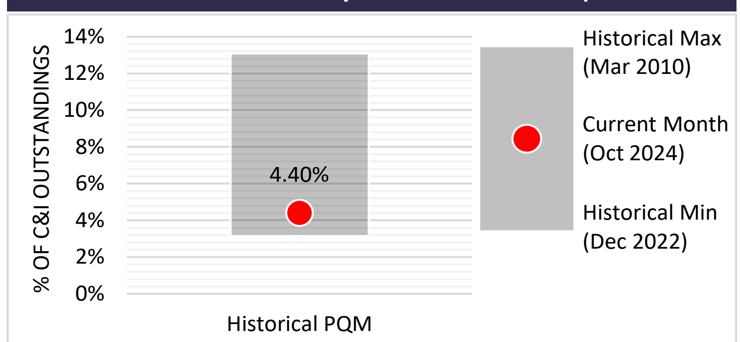
C&I Distressed Ratios by Geographic Region



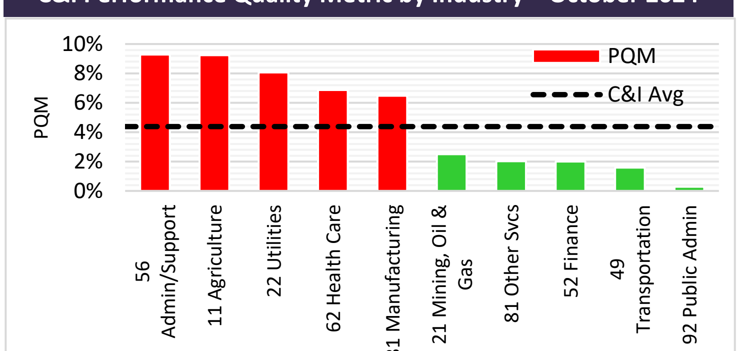
On the left we have combined the loan balances for borrowers that are risk rated low pass and criticized in order to approximate "distressed" volume. The distressed ratios are illustrated for each geographic region in the CRN database. The region with the highest distressed ratio is the South. We find that the industry mix in the South contributes to this elevated position. The southern region of the country has larger than average balances for two industries that have high levels of distressed volume, namely NAICS 32-Manufacturing and 62-Healthcare, and the South also has less exposure to 52-Finance, one of the best-rated sectors.

With the chart on the right, we debut the newest CRN measure, the Performance Quality Metric, or PQM. This metric combines CRN performance results, delinquencies, and nonaccruals with CRN credit quality and the special mention rating and is a more complete indicator of current and future loan behavior. This chart shows the historical range to date. For PQM, we reached a high watermark of 13.08% in early 2010 and a historical (∾20 year) low of 3.15% almost two years back. The current PQM of 4.40% is slightly above the latest 12-month average of 4.22% and has increased in three of the last four months.

C&I Performance Quality Metric Historical Dispersion



C&I Performance Quality Metric by Industry – October 2024



The chart on the left shows the PQM for a selected group of industry sectors for October 2024. We illustrate five sectors, starting on the far left, with the highest PQM and a second set of five sectors, to the right side of the chart, with the best PQM. The horizontal line is the overall portfolio average. Any industry sector with a column above the line is worse than average. Conversely, industry sectors with column heights below the line are better than average. Within 56-Admin, we observe an elevated PQM for Business Support and Employment Services. For 11-Ag, Tree Nut Farming is by far the worst subsector, but we are also seeing elevated PQMs for grain farming and fishing.

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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