Economic & Credit Union Update

February 2021

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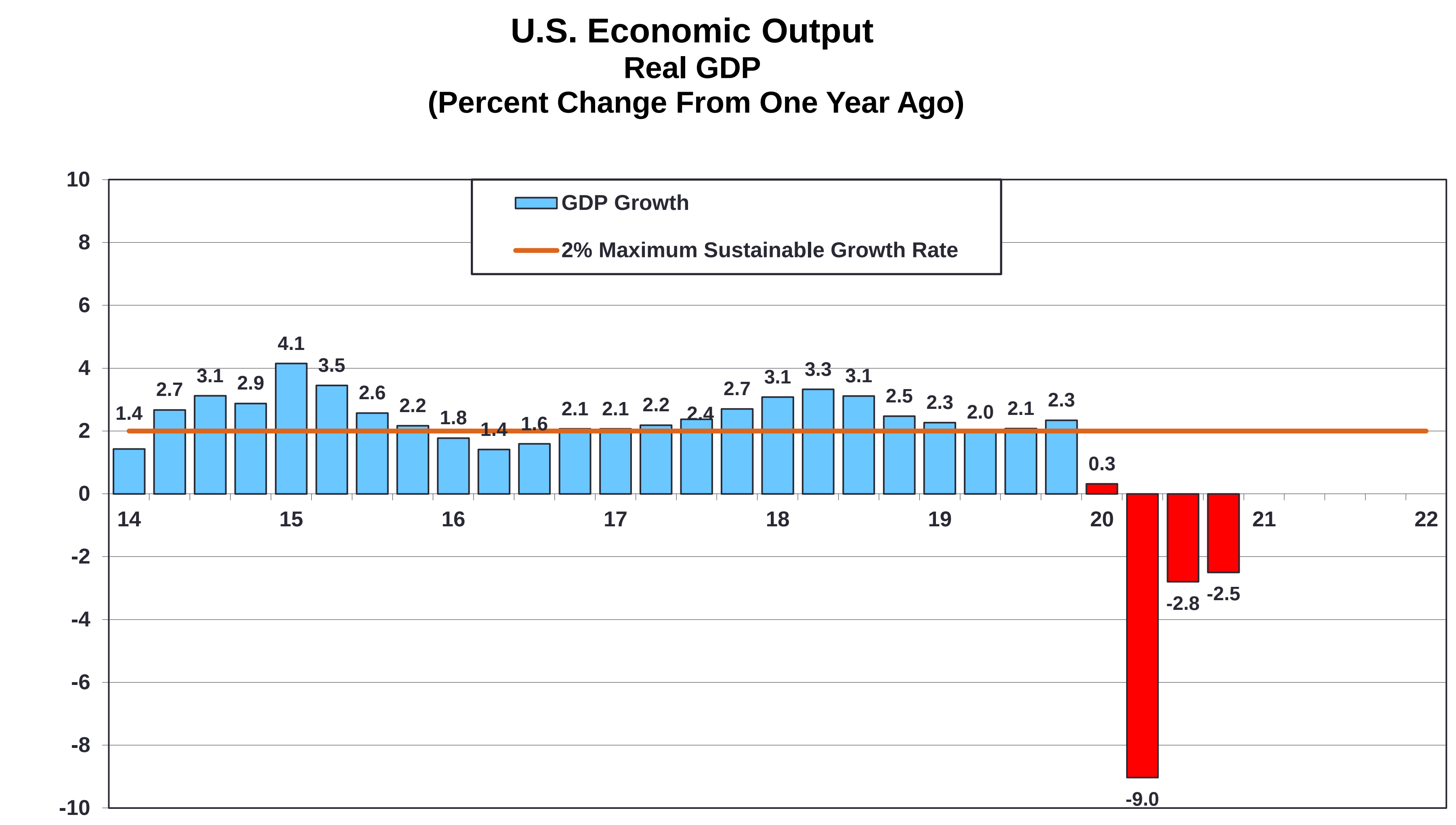
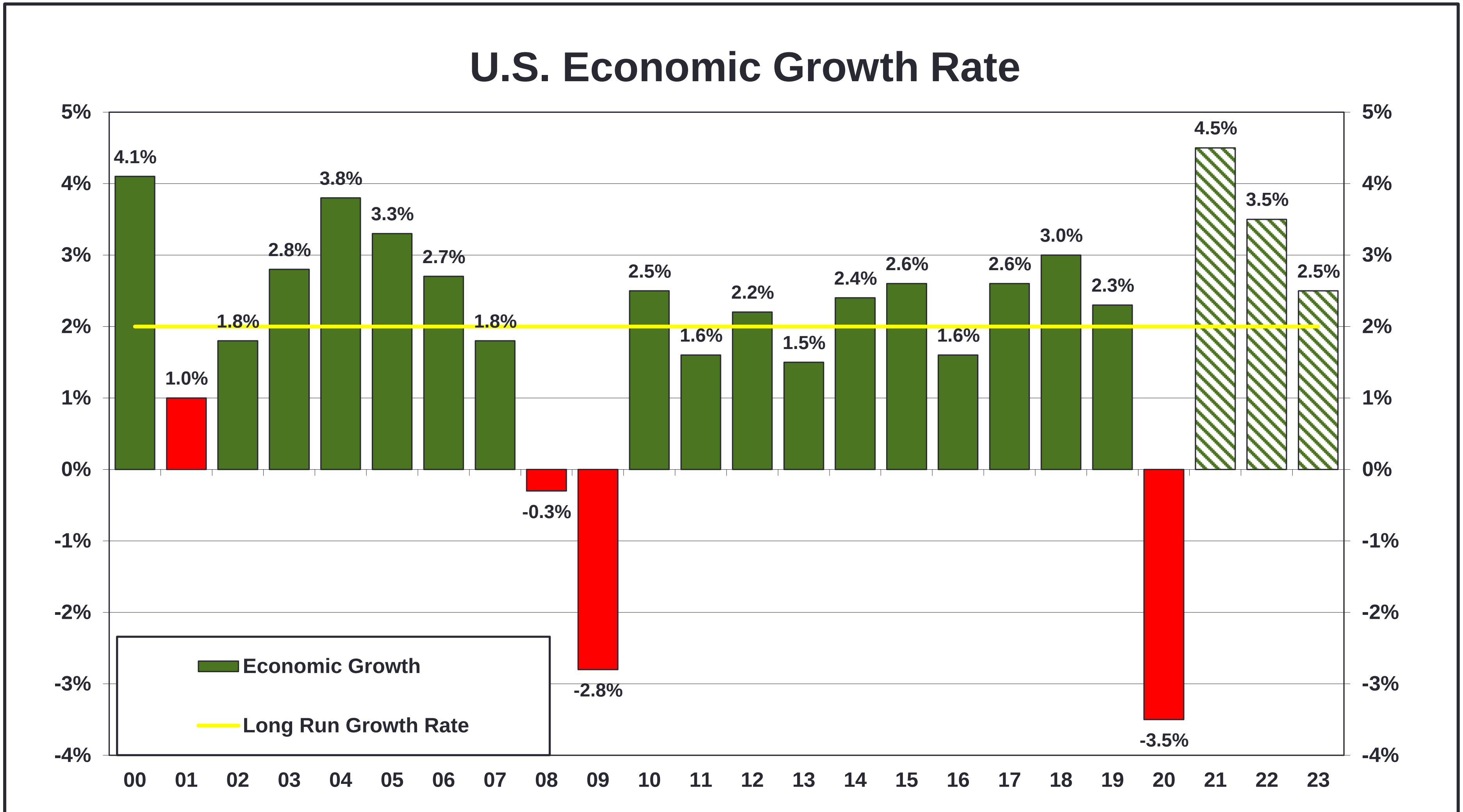
The COVID-19 Recession Reduced Output by 2.5% in the 4th Quarter of 2020 Vs. 1-Year Ago



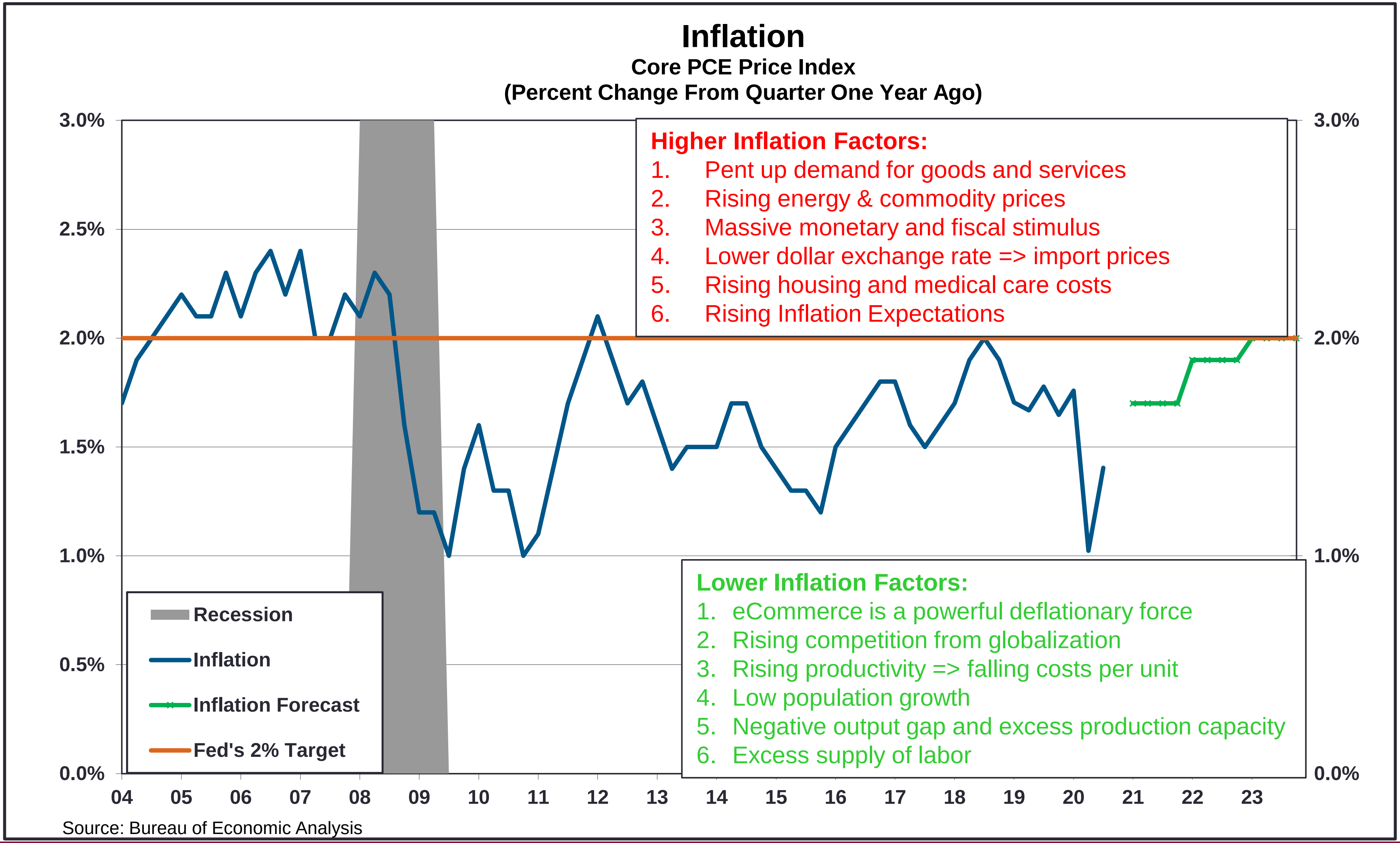
Source: Department of Commerce

Economic Recovery in 2021, around 4.5%

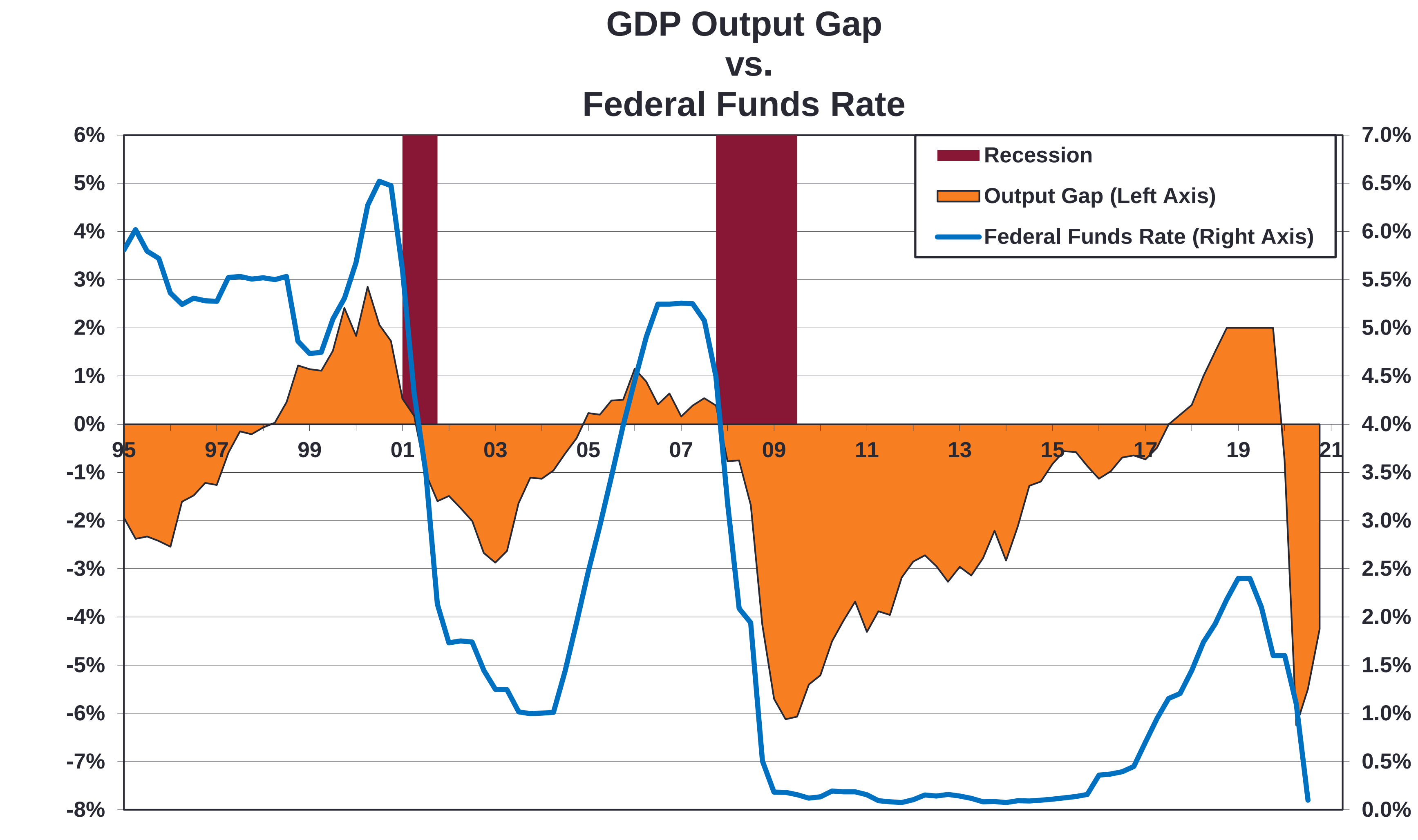


Source: Department of Commerce

Low Inflation for the Foreseeable Future

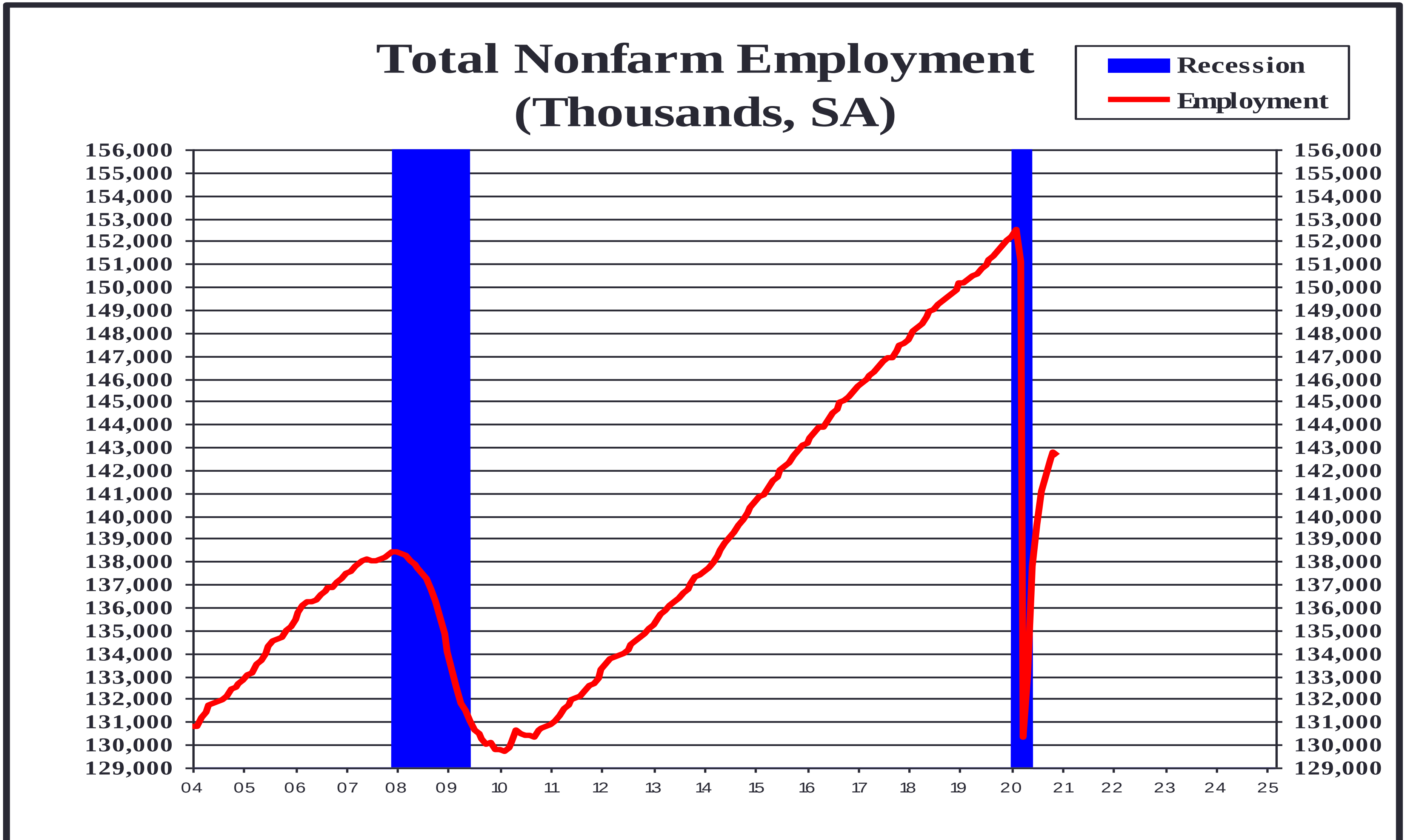


Moving from Positive GDP Output Gap in 2019 to Negative Gap in 2020 With the Economy Operating Below its Potential Level of Output



Source: CBO & Federal Reserve

9.8 million Few Americans Working Today Compared to February 2020's 152.5 million



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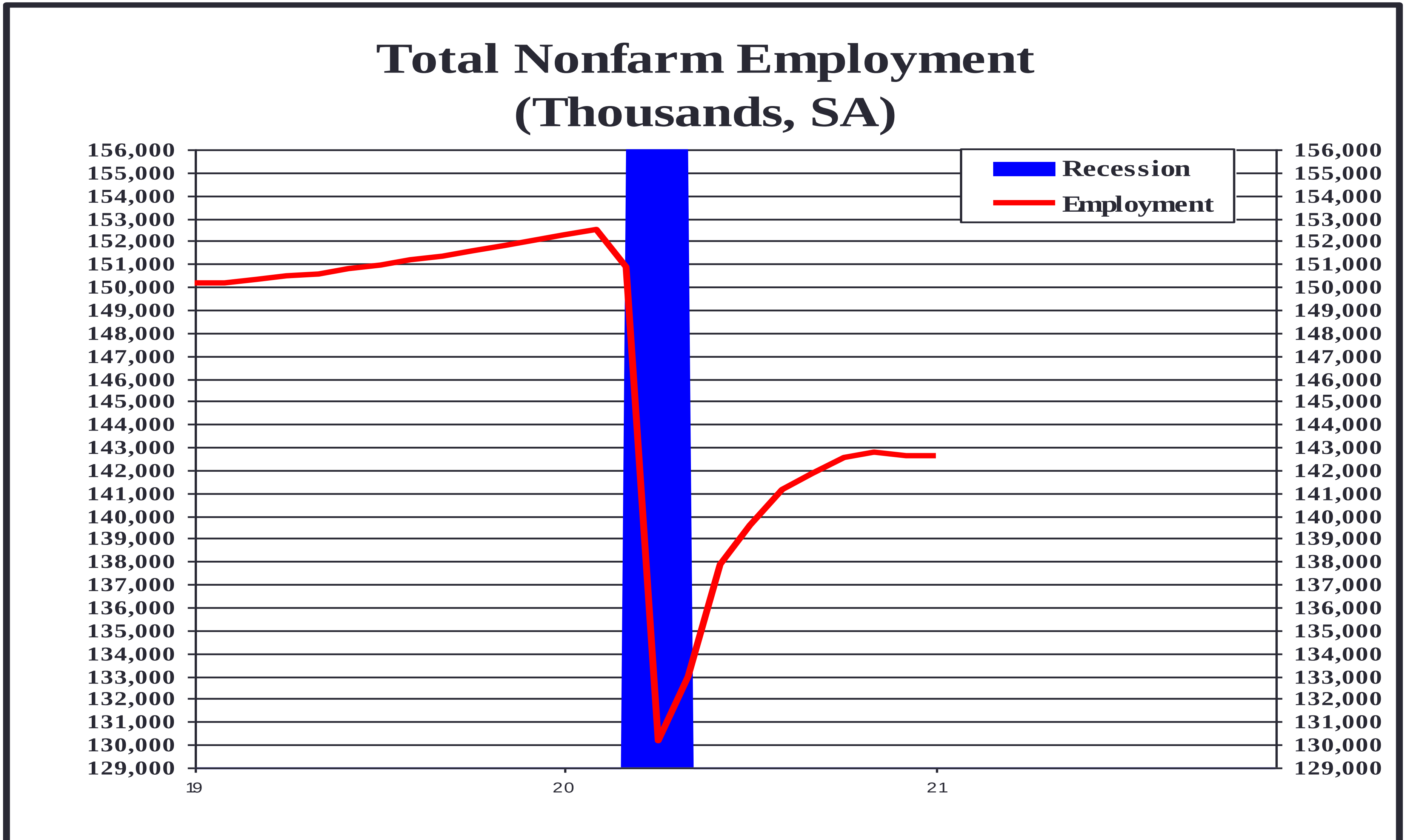
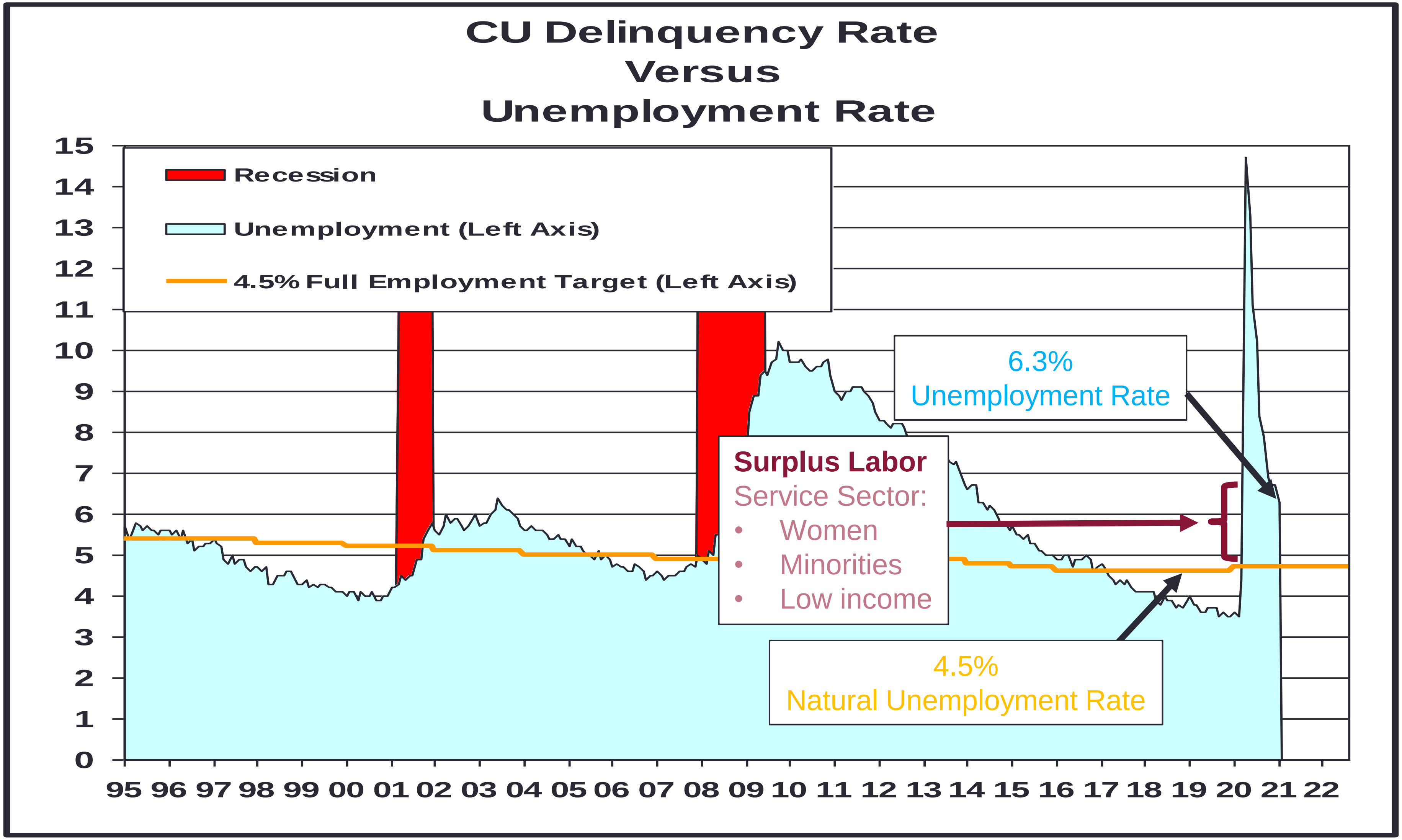
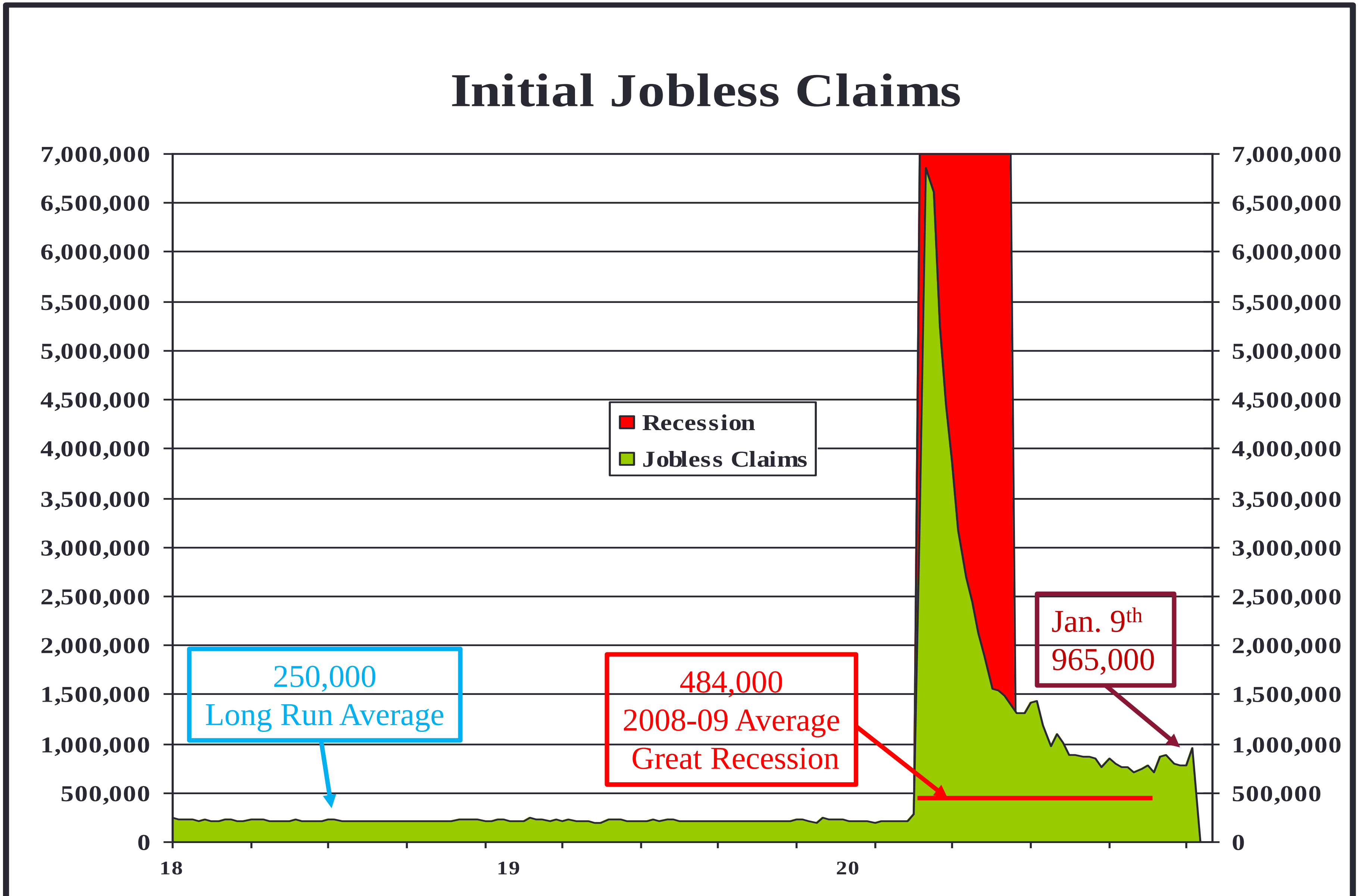


CU Loan Delinquency Rates at Record Lows

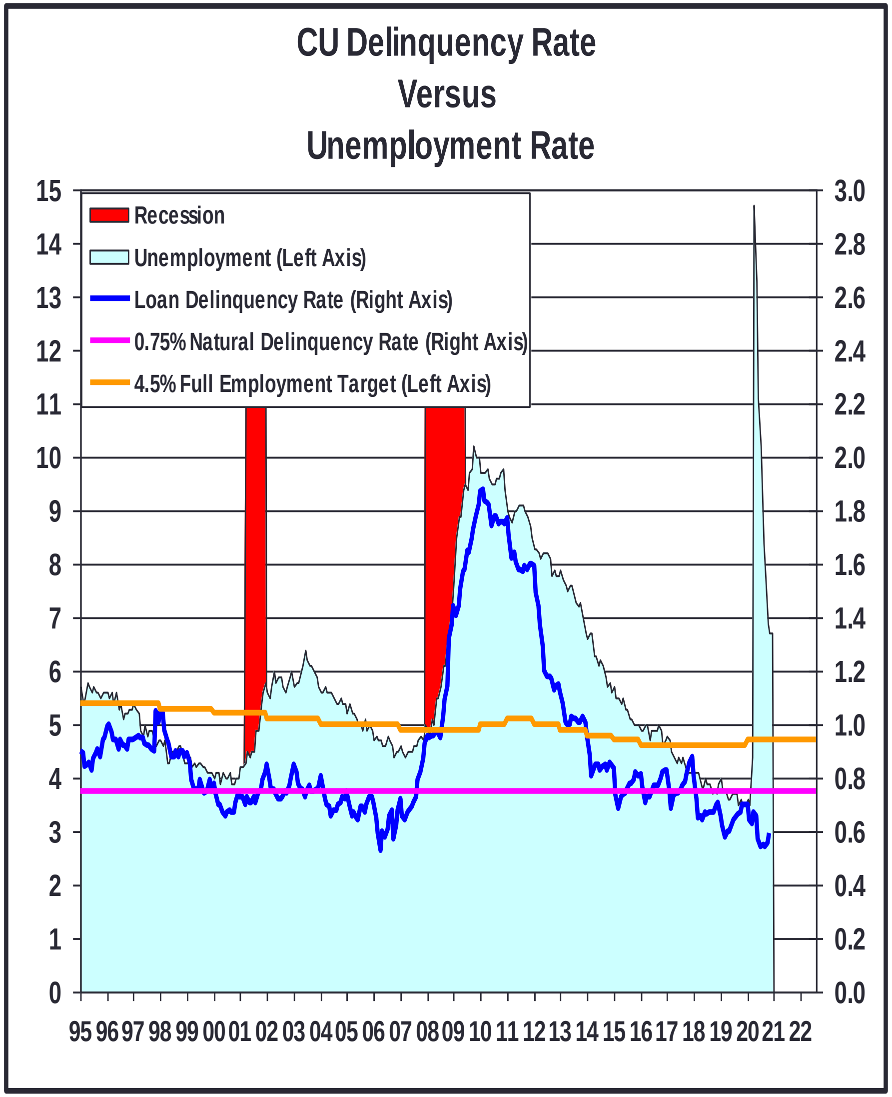


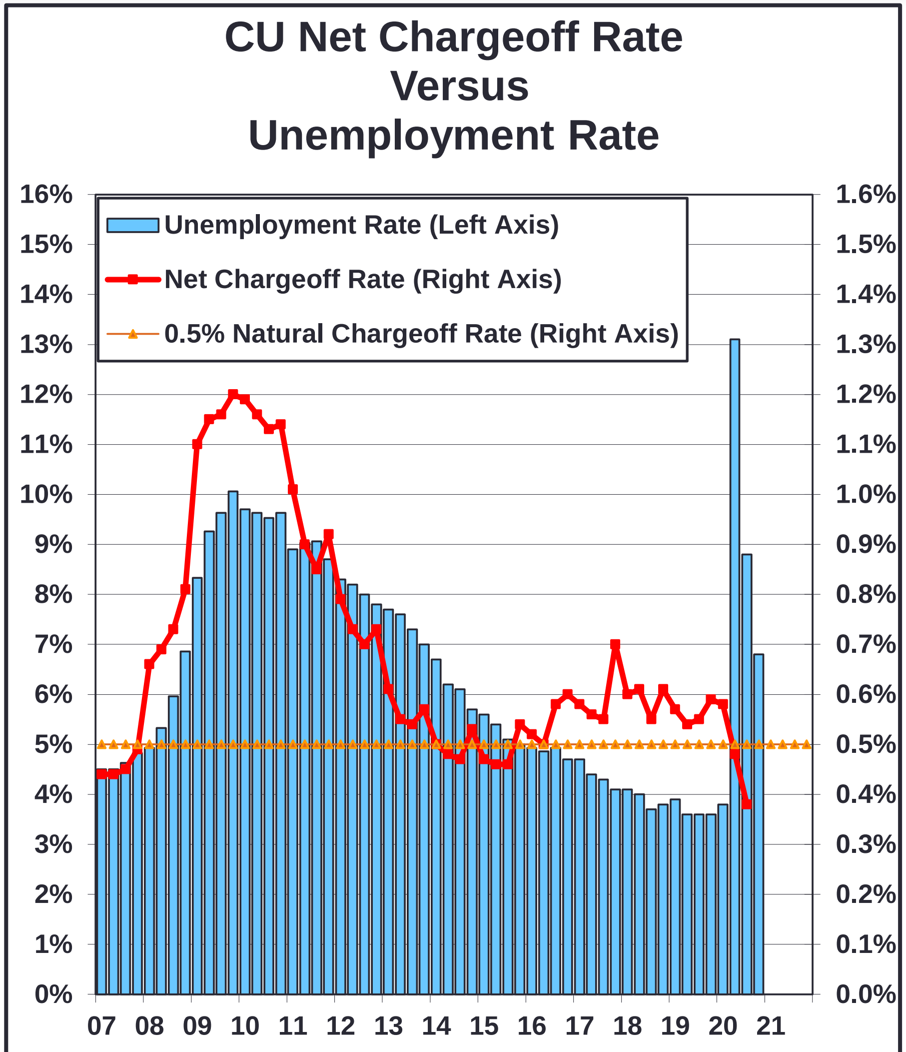
965,000 Initial Jobless Claims Last Week

2 timese the Great Recession Average



CU Loan Delinquency Rates at Record Lows
CU Loan Charge-off Rates at Record Lows





Source: Department of Labor, NCUA,CUNA

Hysteresis: The Degree to Which an Economic System Returns to Its Original State after an External Shock

Top 10 Household Behavioral Changes:

1. Increase in precautionary savings
2. More space between seats at cinemas, sporting events, airplanes, etc.
3. Fewer traveling for vacation and going out until herd immunity
4. Older generations staying at home until herd immunity
5. Less willingness to put parents in retirement homes
6. More online shopping, more online doctor visits
7. Fewer people going to fitness centers, or participating in group sports
8. More people avoiding public transportation and driving their own car
9. Health insurance premiums going up
10. Lower consumer spending

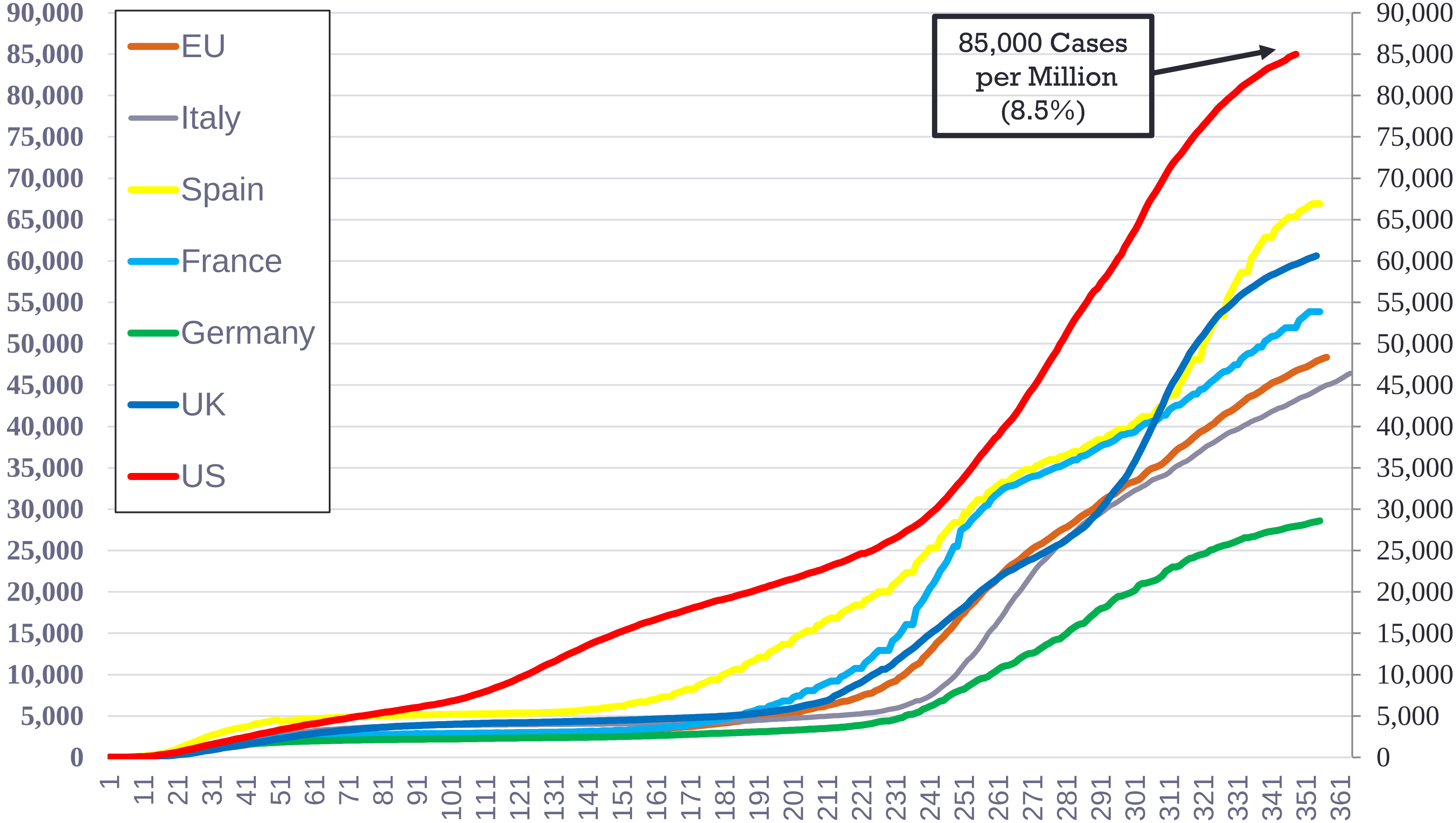
Top 10 Corporate Sector Behavioral Changes:

1. Less global business travel, more video conferencing
2. More disaster planning
3. More permanent work from home solutions
4. Staggered work schedules, more distance between seats in offices, fewer cubicles
5. Fewer stock buybacks, lower dividend payouts
6. Health insurance costs going up, higher insurance premiums
7. Increased pressure for paid sick leave
8. Increased pressure for health benefits
9. Regulations forcing corporations to hold 3 months of emergency cash.
10. Increased health safety regulations for retirement homes

Confirmed COVID Cases

Per 1 million population

(Days since reaching 5 cases per million, to February 21)

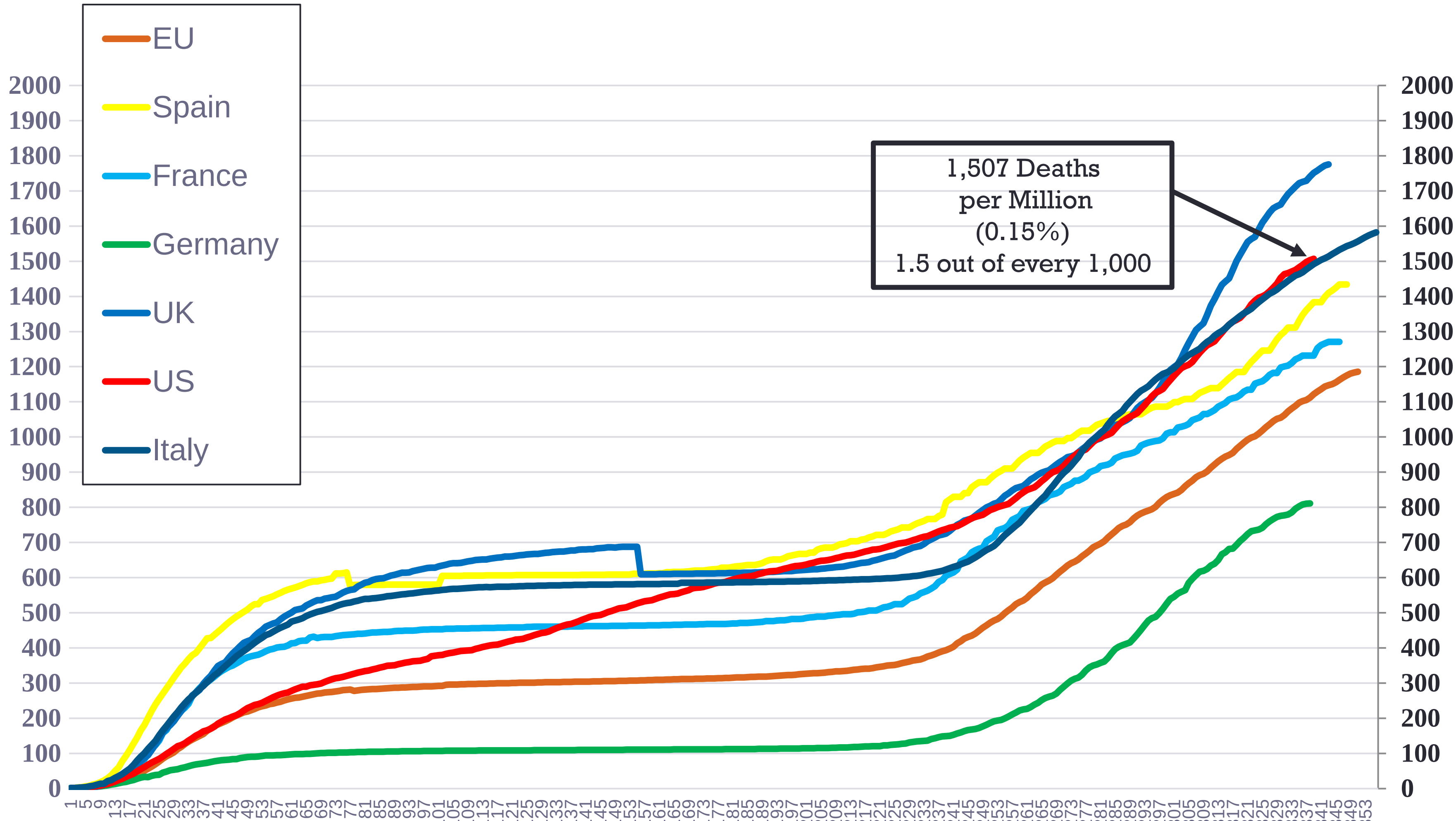


Source: John Hopkins University

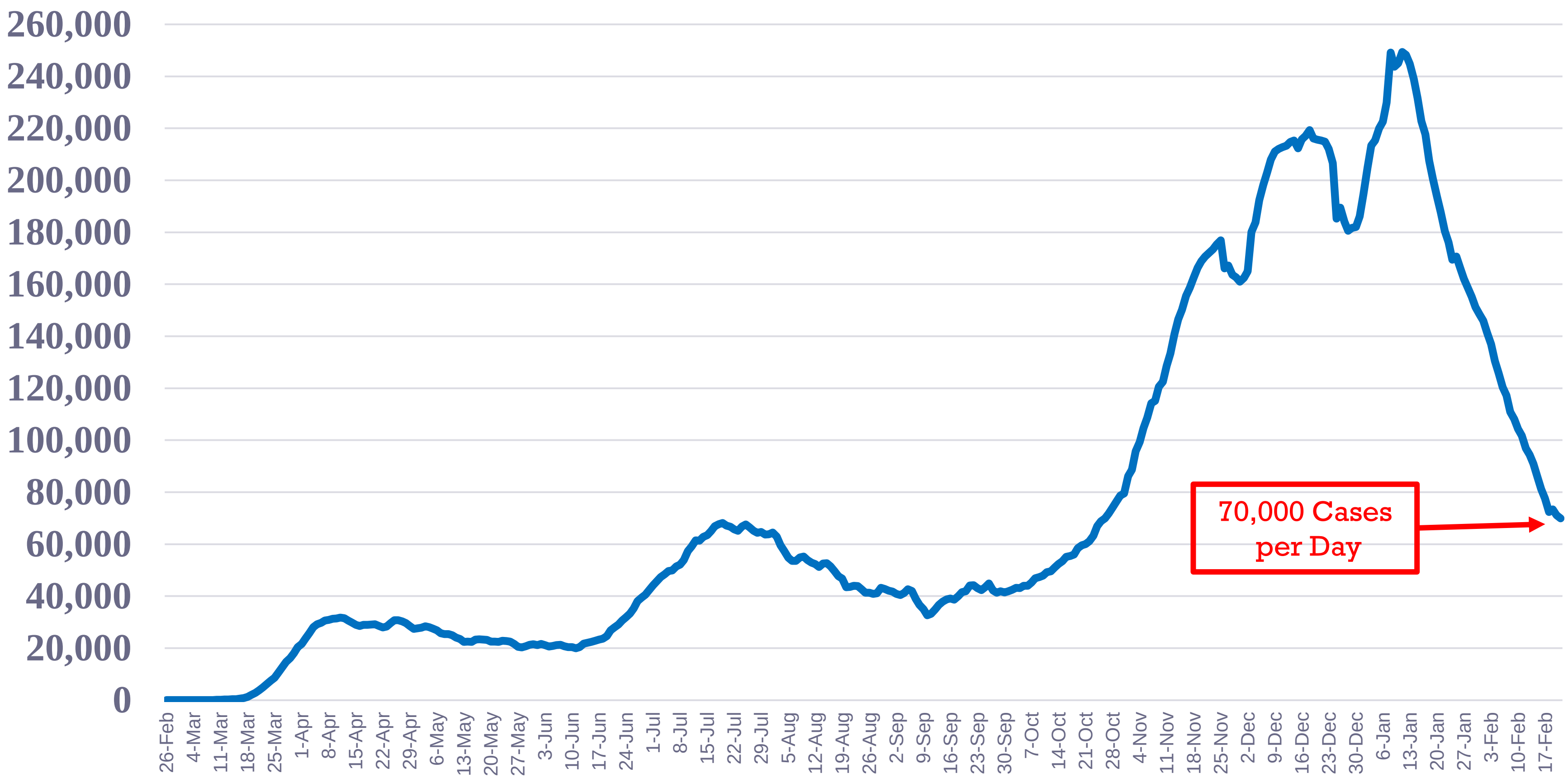
COVID DEATHS

Per 1 million population

(Days since reaching 1 death per million, to February 21)



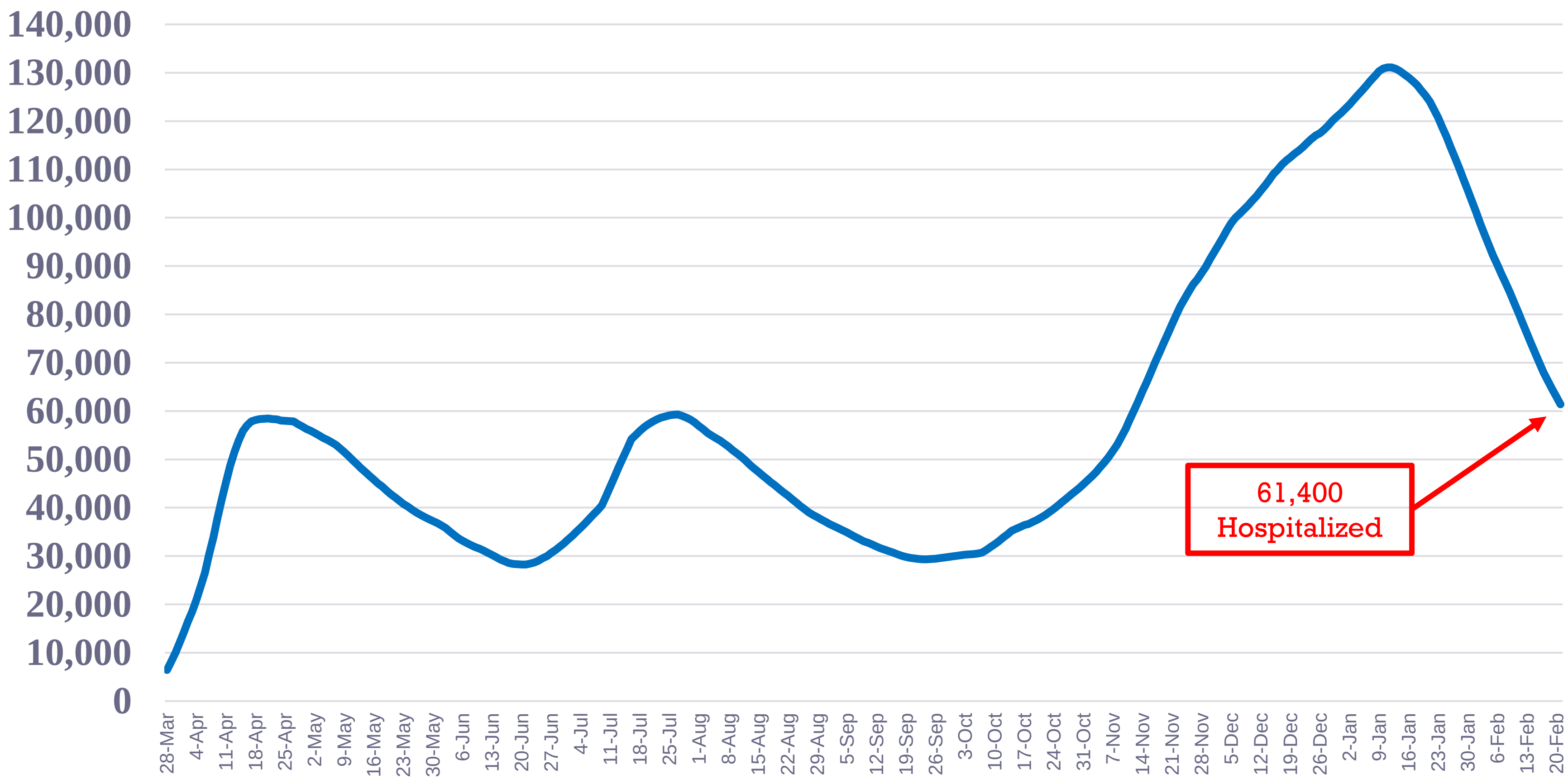
Confirmed Cases in the US per Day
to February 21
(Daily Changes, Seven Day Moving Average)



Source: John Hopkins University

Currently in Hospital to February 21

(Seven Day Moving Average)



Source: John Hopkins University

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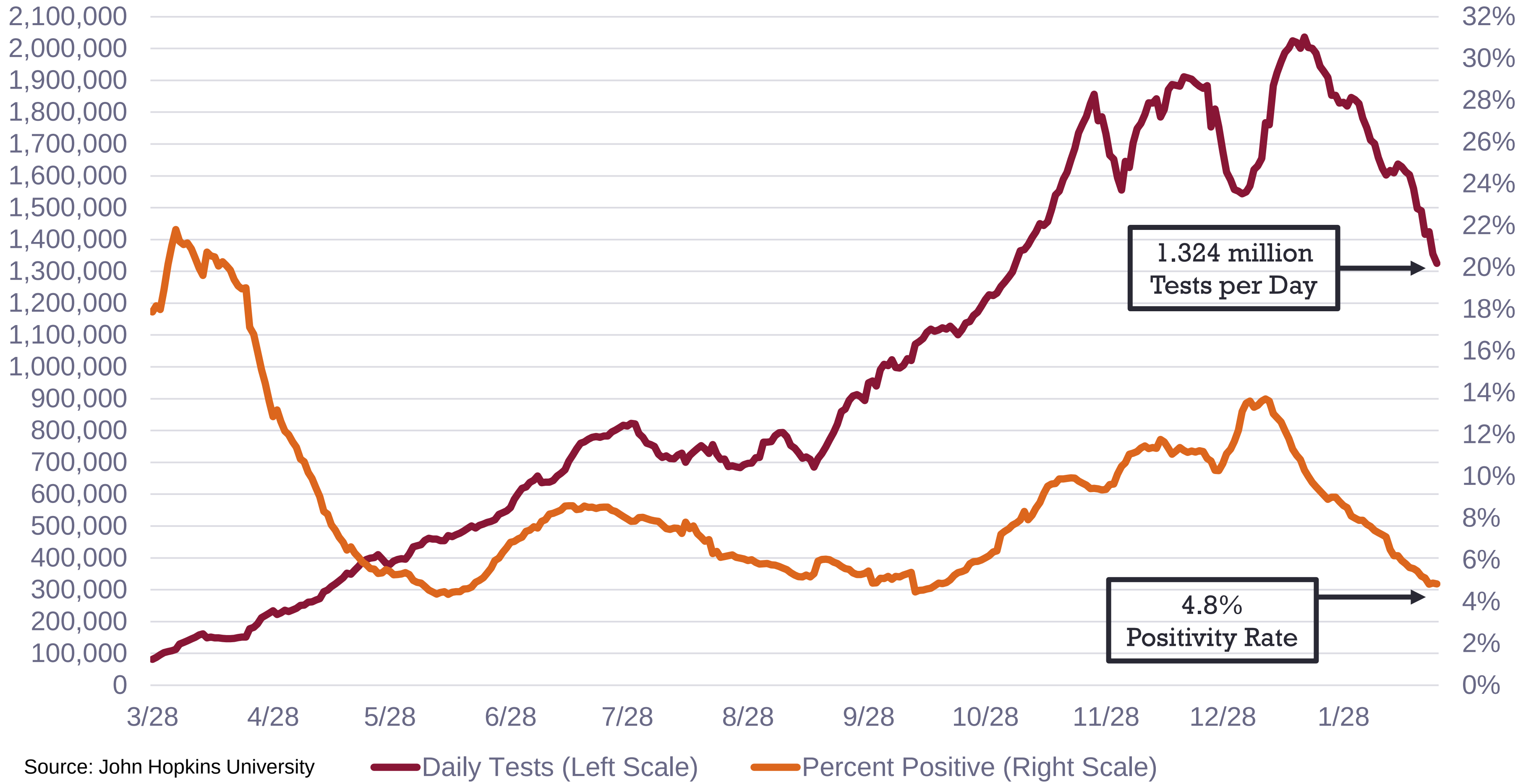
Confirmed Deaths in the US Per Day to February 21

(Daily Changes, Seven Day Moving Average)

Source: John Hopkins University

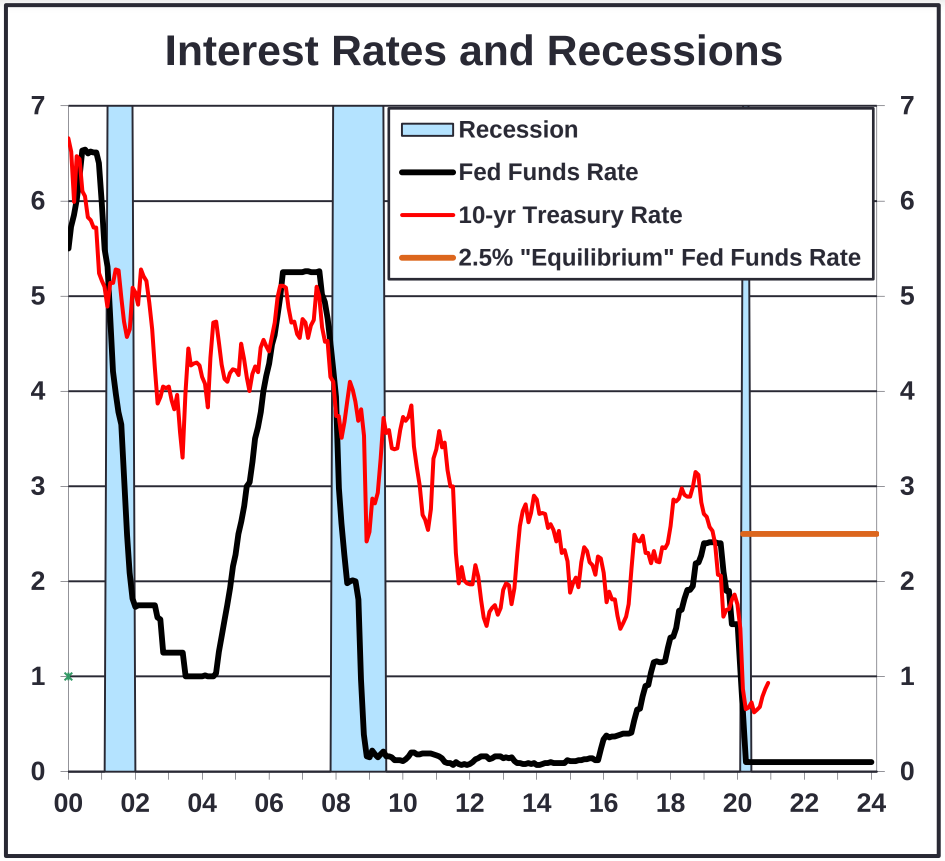
Daily COVID Tests, and Percent of Tests Positive

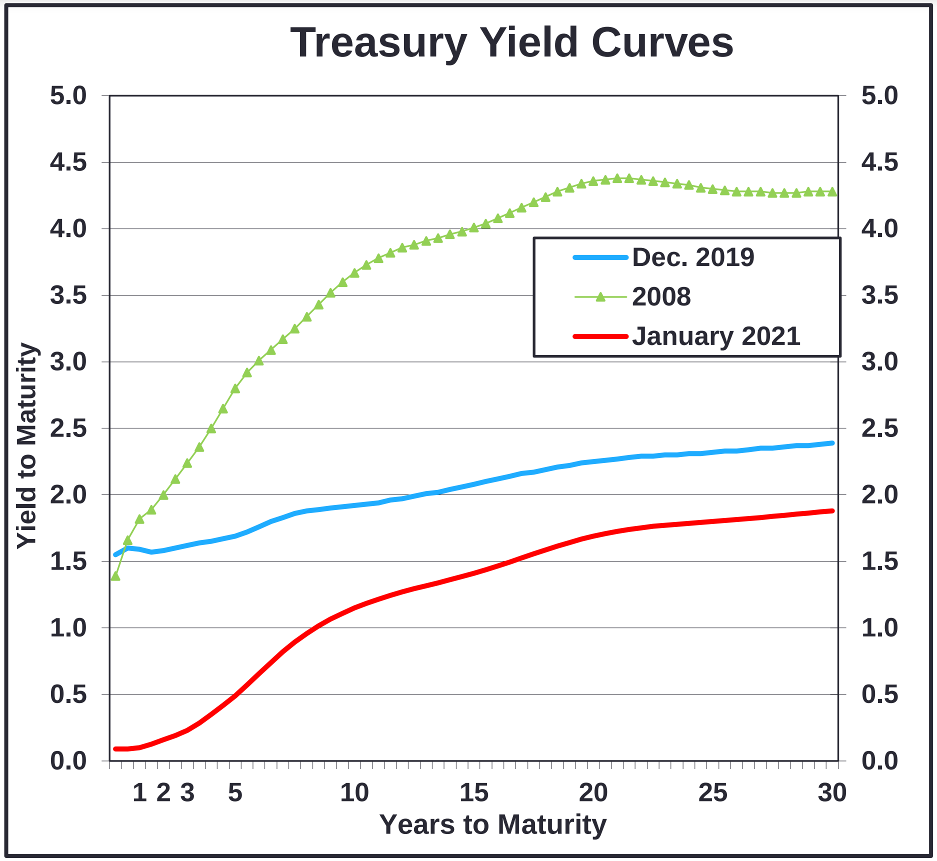
Seven Day Moving Averages, to February 21



Source: John Hopkins University

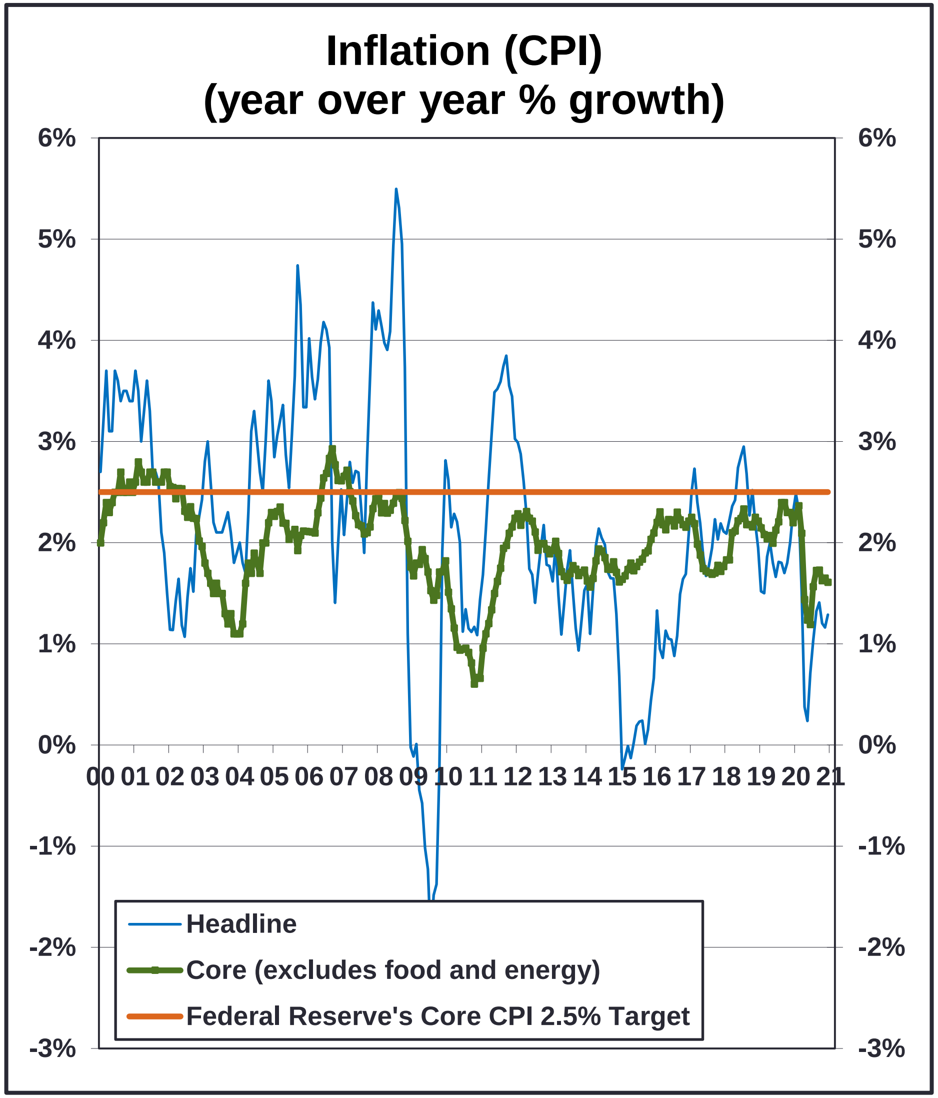
Record Low Interest Rates and Yield Curve Steepening

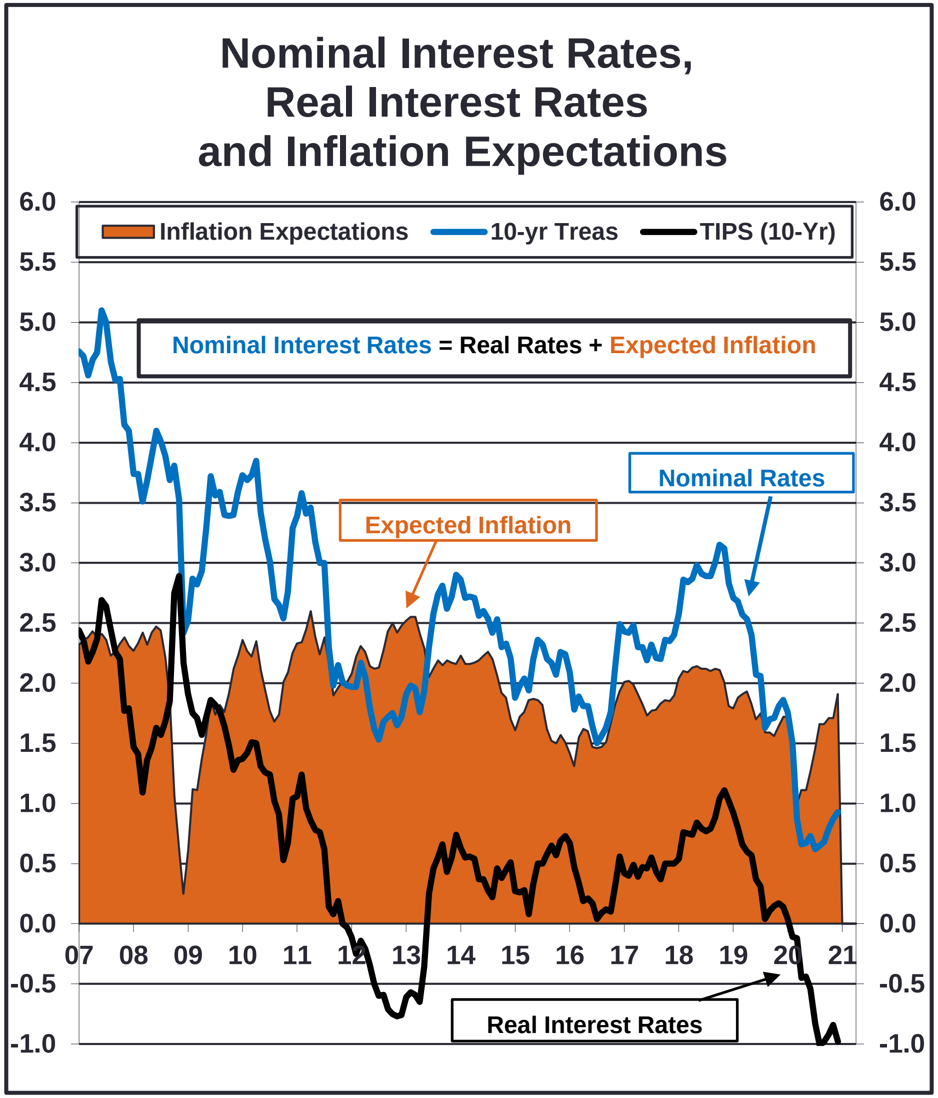




We expect the Fed to keep the fed funds rate at 0.1% through 2023. The Fed believes the new **neutral/equilibrium fed funds rate** is 2.5%, the rate which is neither accommodative or restrictive. Interest rates will "normalize" in 2021 at levels below previous plateaus due to lower real interest rates and lower expected inflation. The increase of the size of the Fed's balance sheet will lower the term premium on long-term bonds. Expect the 10-year Treasury bond interest rate to stay below 1.5% during 2021-2022. Expect the yield curve to steepen over the next two years, which typically buoys financial institutions' net interest margins.

Negative Real Interest Rates, Low Inflation Expectations are Pushing Nominal Interest Rates to Record Lows





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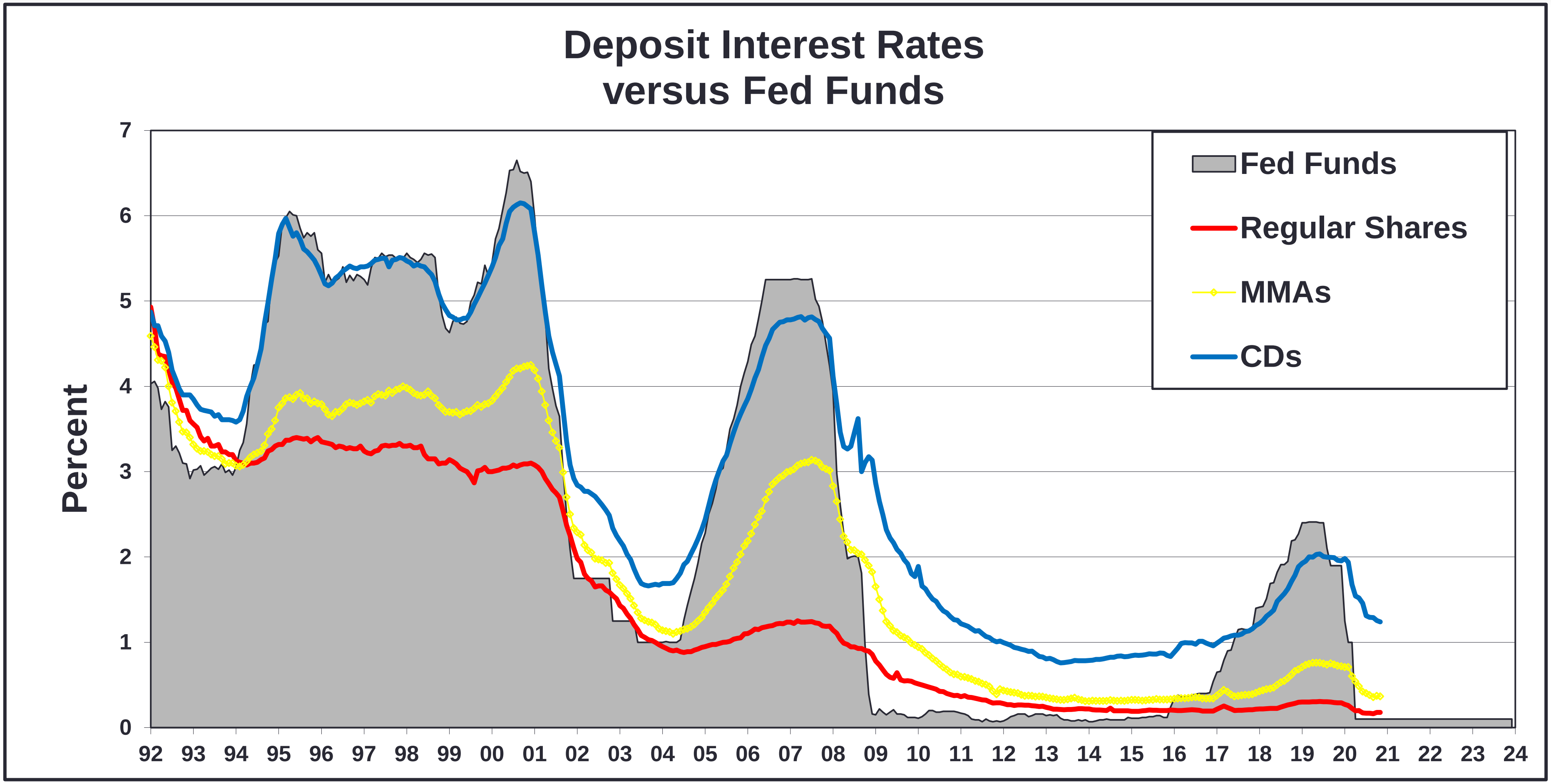
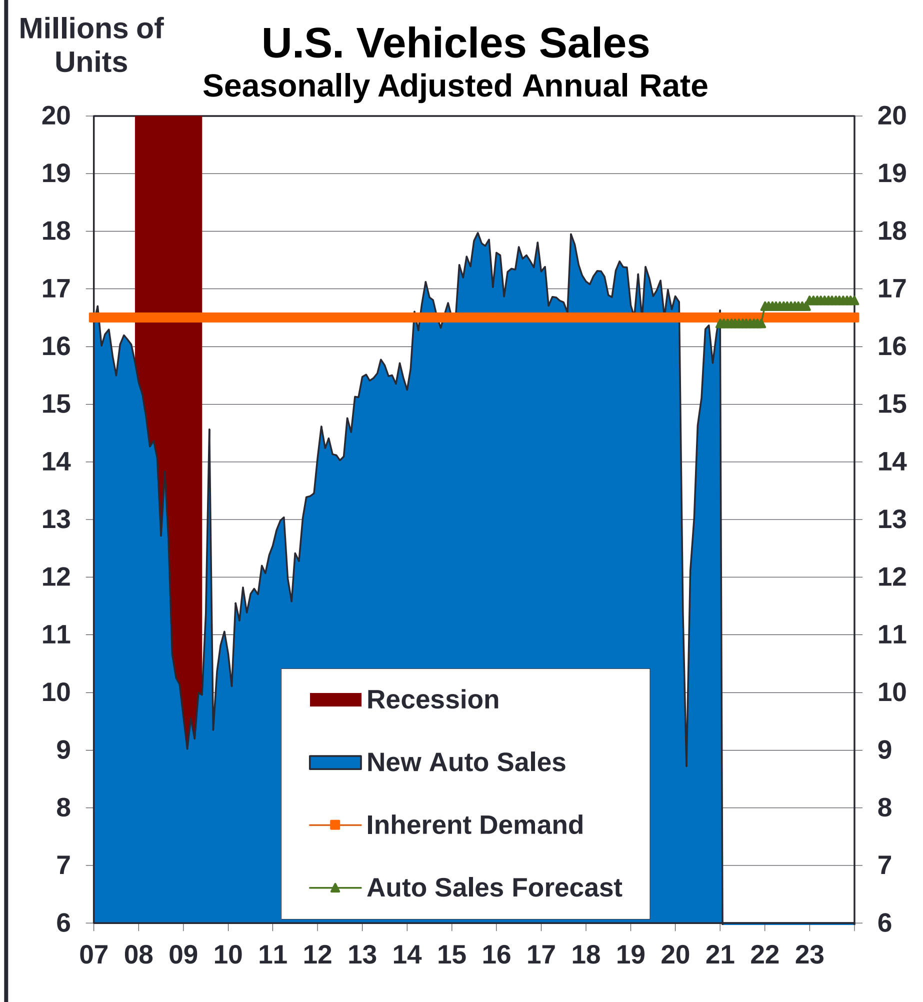
Falling Deposit Pricing and Lower Fed Funds Interest Rate

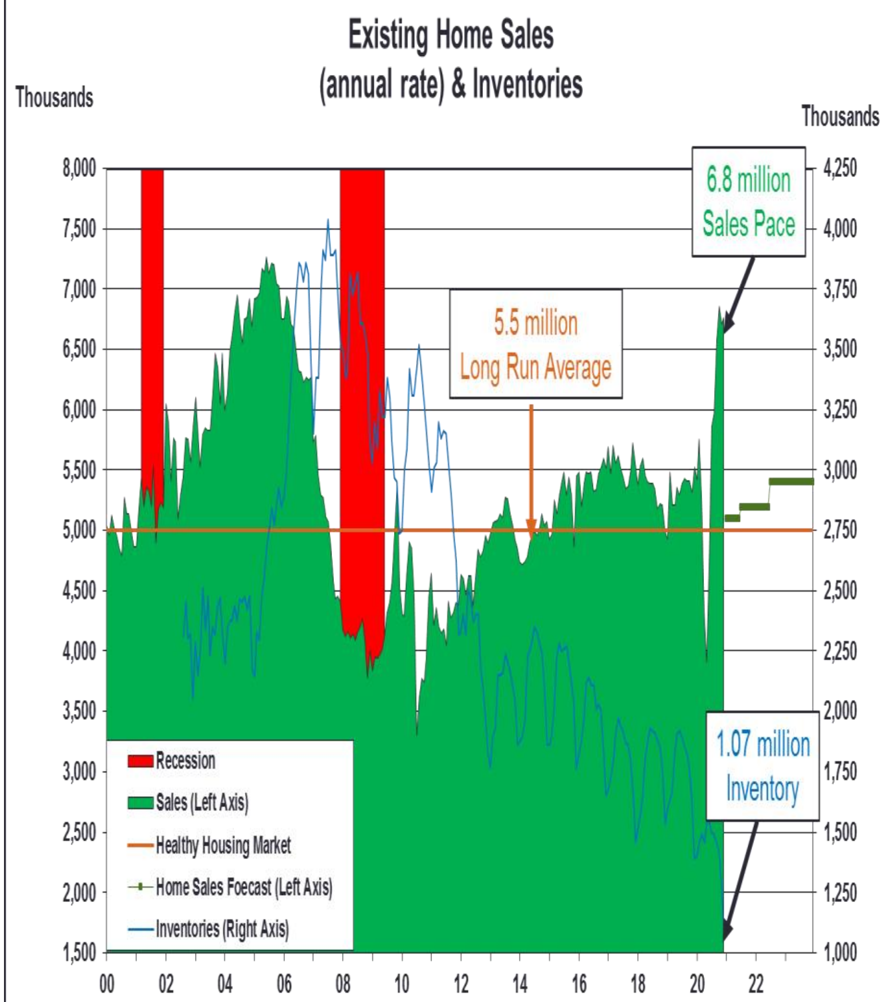


Credit union deposit interest rates will fall significantly in 2021 due to the Federal Reserve pushing the Fed Funds interest rates to around zero. Certificate of deposit rates will fall below 1% and MMDA interest rates will fall to 0.25%.
Expect the Federal Reserve to keep short-term interest rates around zero until late 2023.

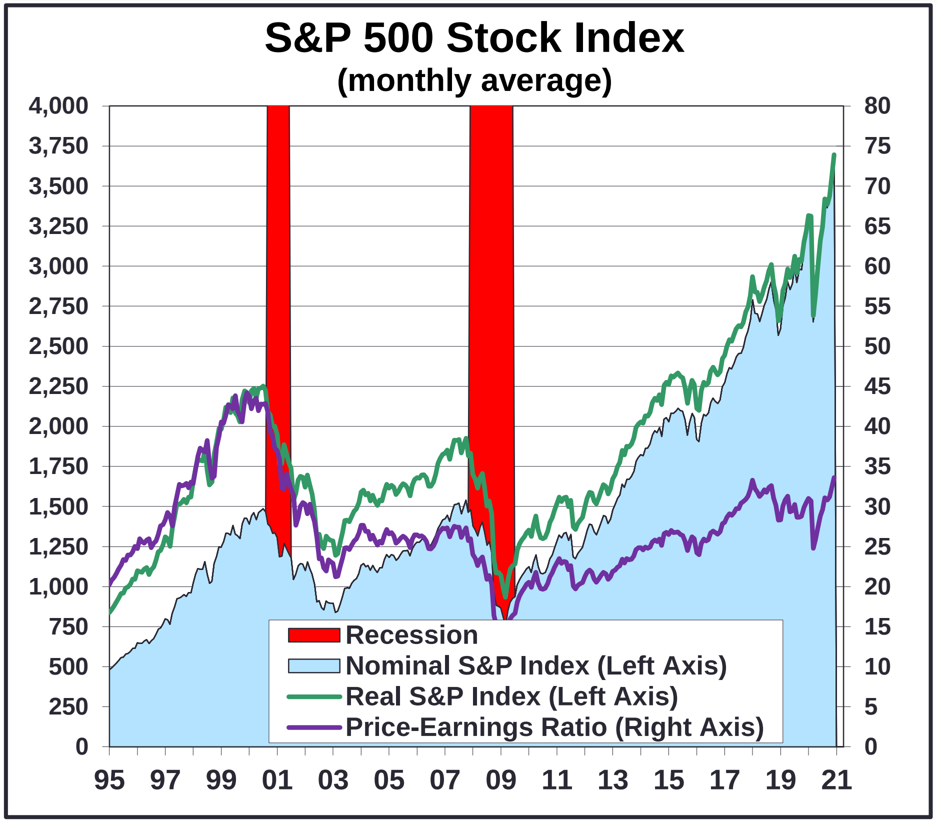
Auto Sales and Home Sales Bounced Back

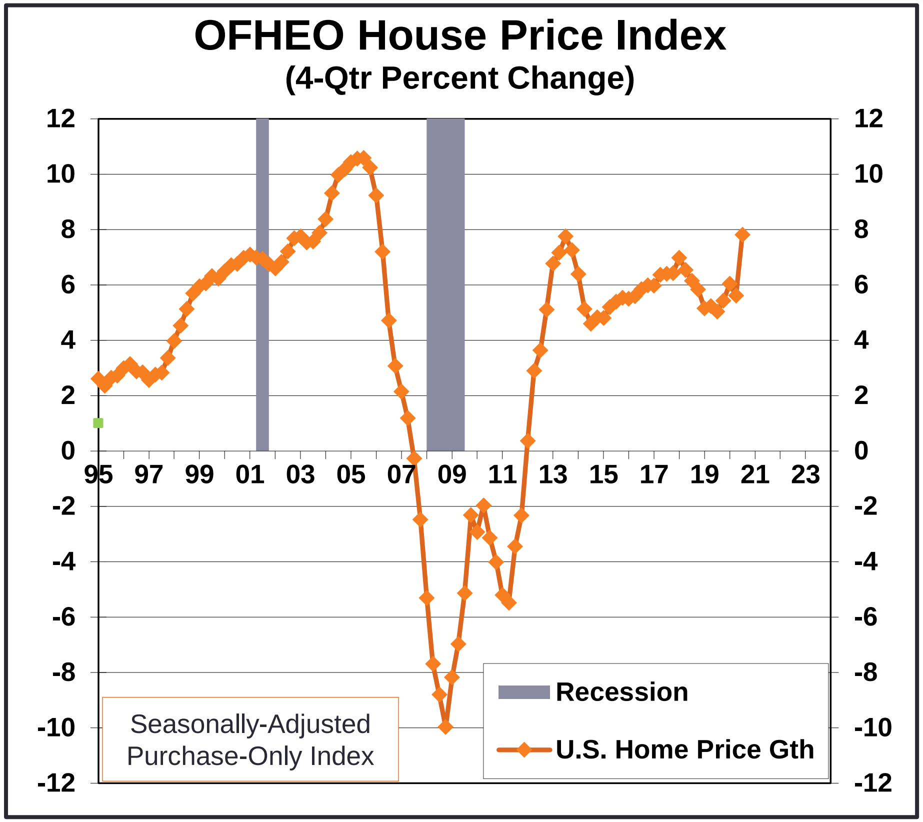


Source: Autodata Corp.



Higher Stock Prices and Faster Home Price Growth Rates will Boost Household Wealth and Consumer Spending



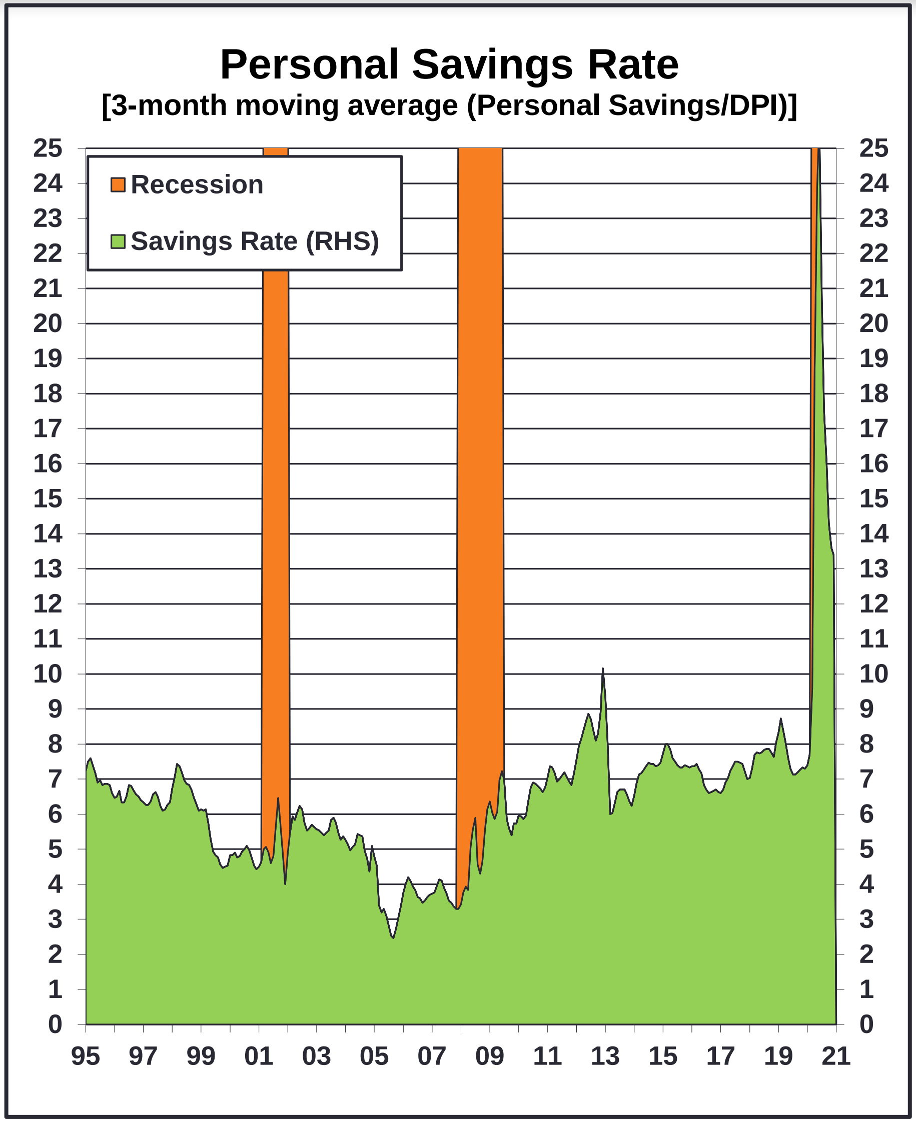


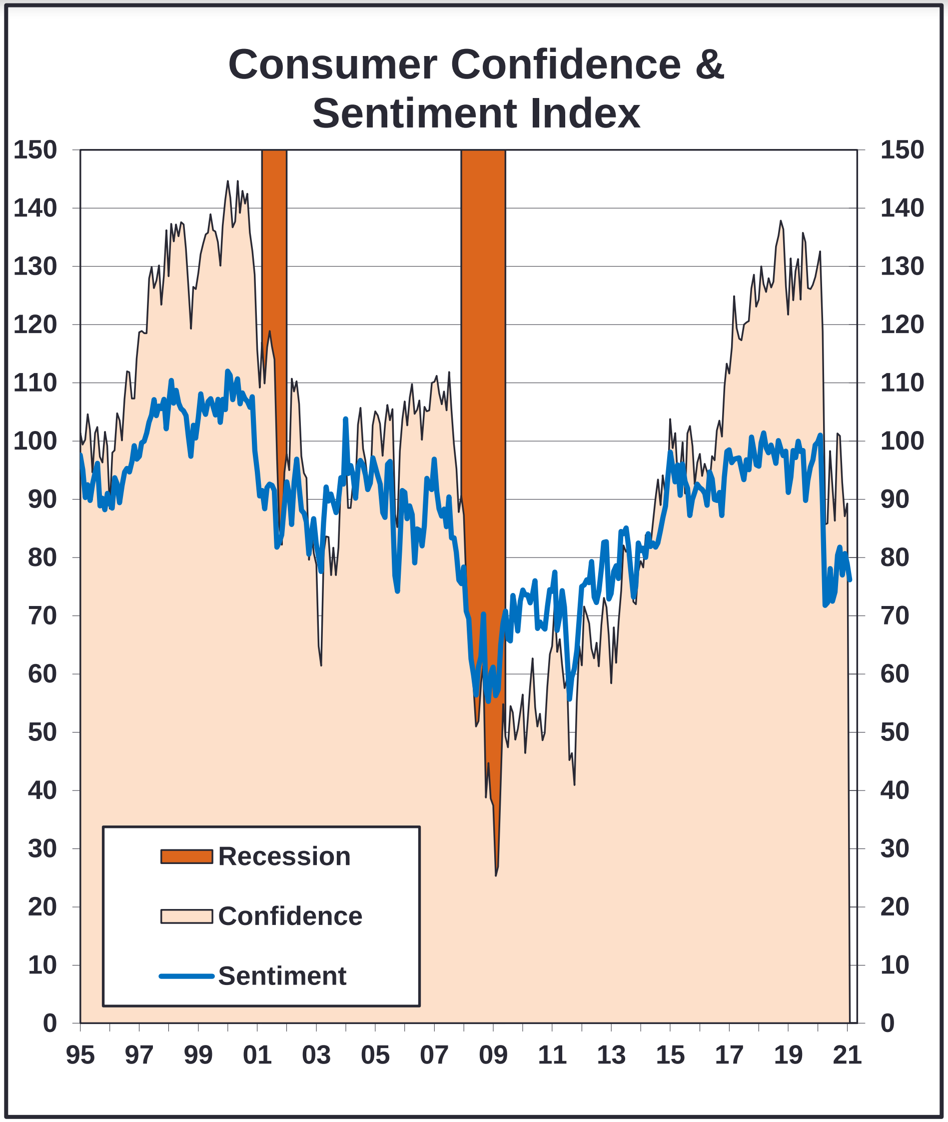
Household balance sheets have strengthened significantly as stock prices have risen to record territory. This will cause a positive wealth effect and increase spending on consumer durables.

The S&P 500 **Price-Earnings ratio fell** to 33.6 in December 2020, above the past 22-year average price-earnings ratio of 26.8 and above the average since 1950 of 19.1. This price-earnings ratio is the Shiller *Cyclically Adjusted Price-Earnings* ratio (CAPE) which is based on the average inflation-adjusted earnings from the previous 10 years.

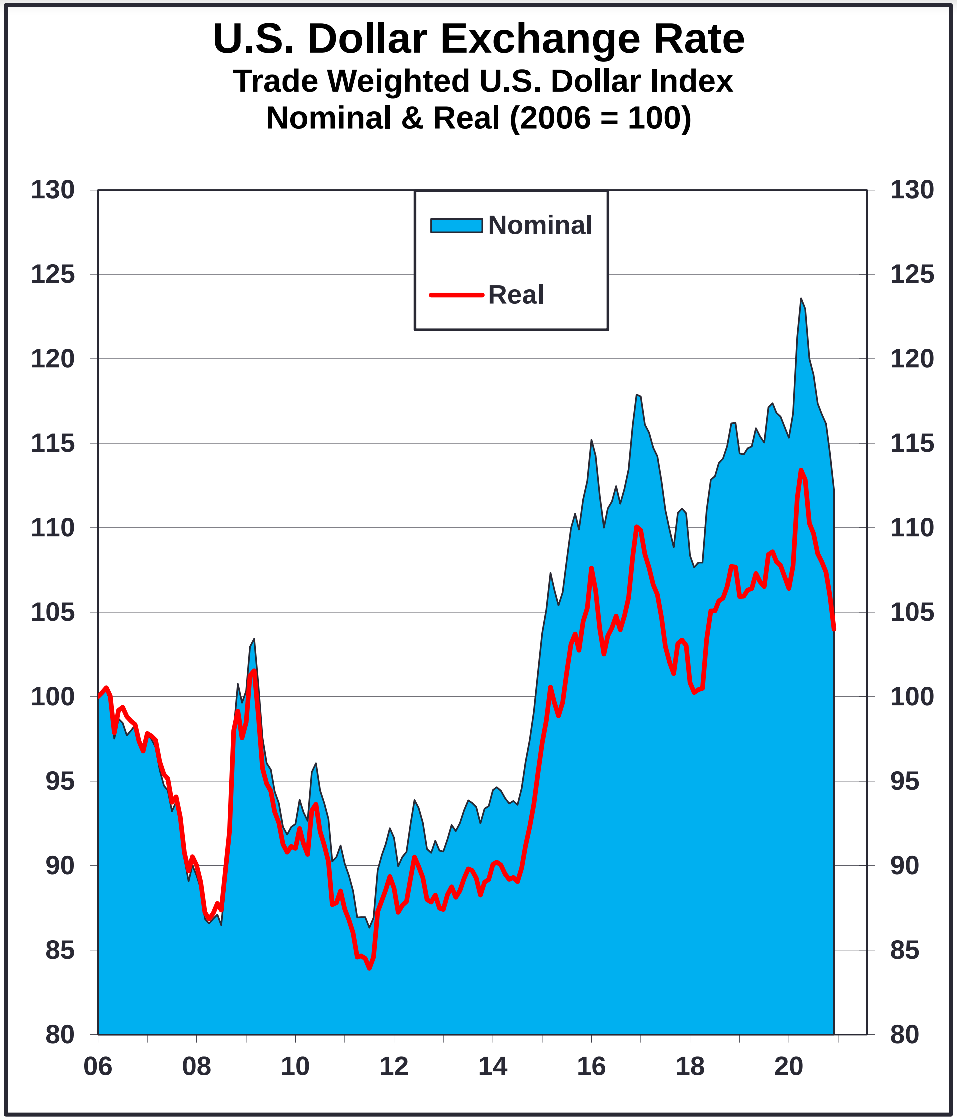
Home prices rose 8% over the last year, due to rising home demand colliding with a lack of housing inventory for sale. We expect home price growth to grow over 6-7% for the next year due to strong demand and low supply.

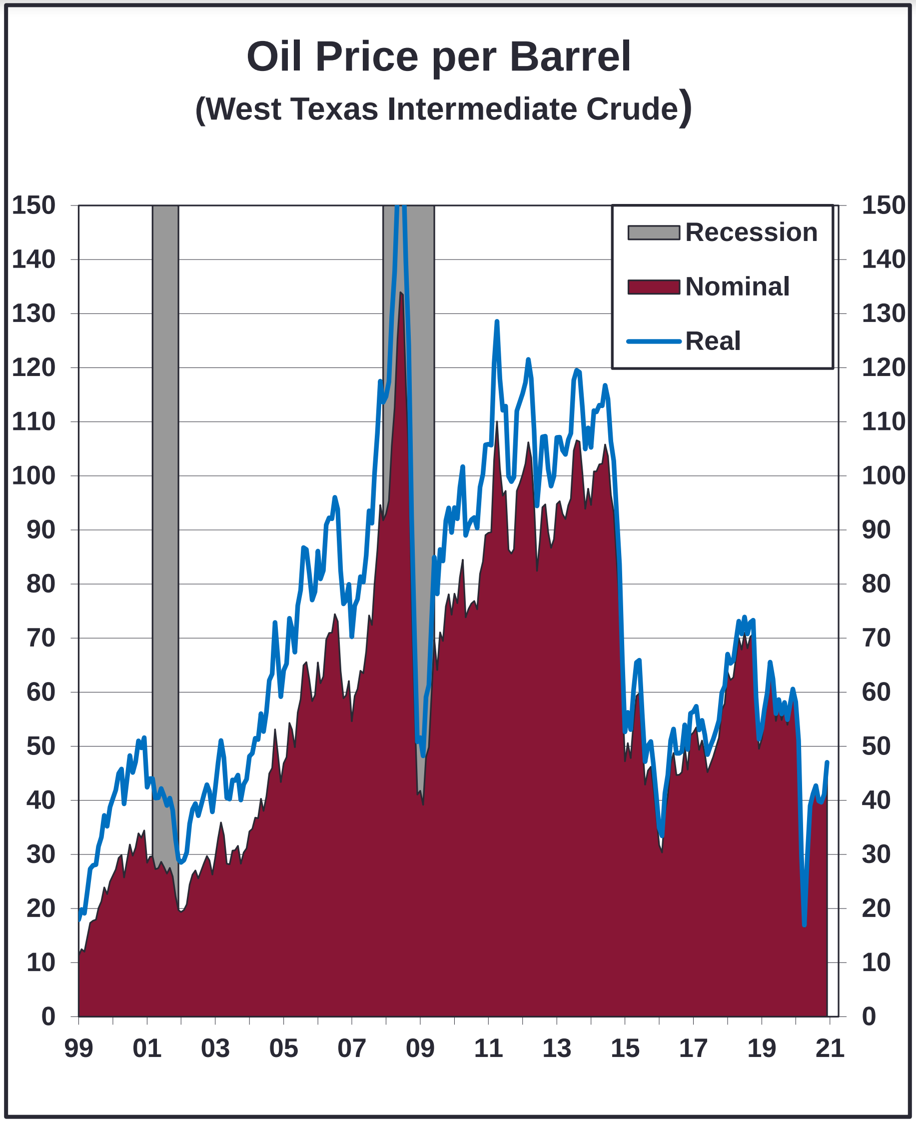
Consumers' Confidence Has Plummeted in 2020





The Dollar is Falling and Oil Prices Rising





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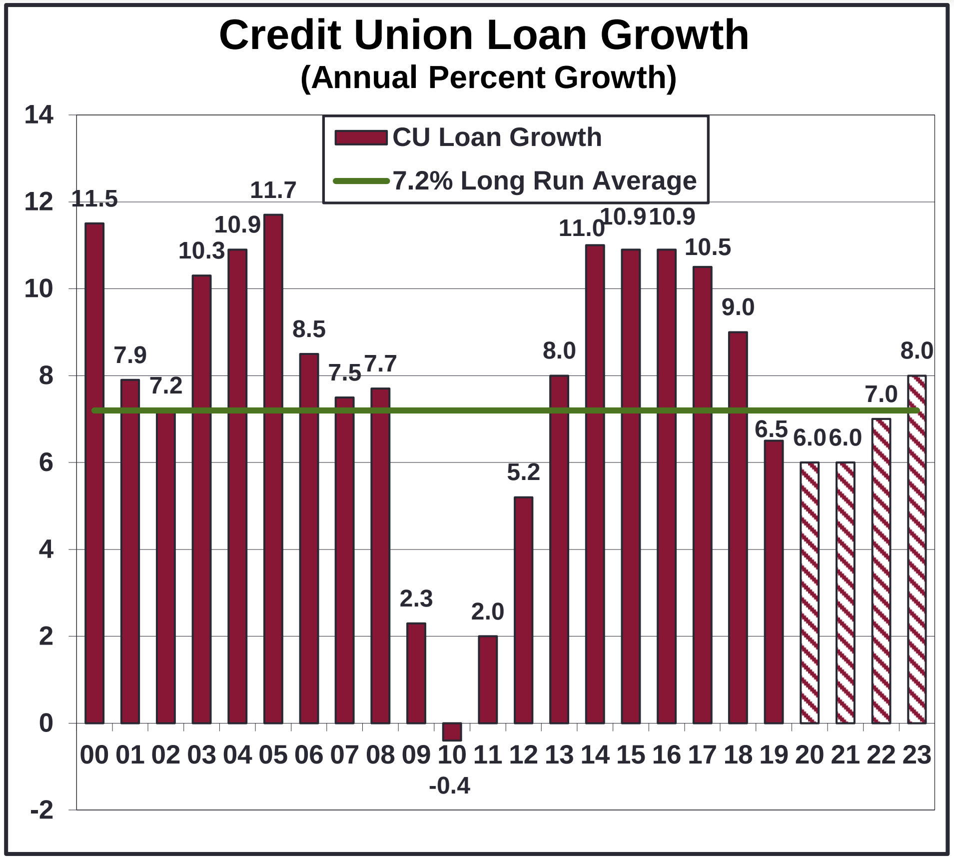
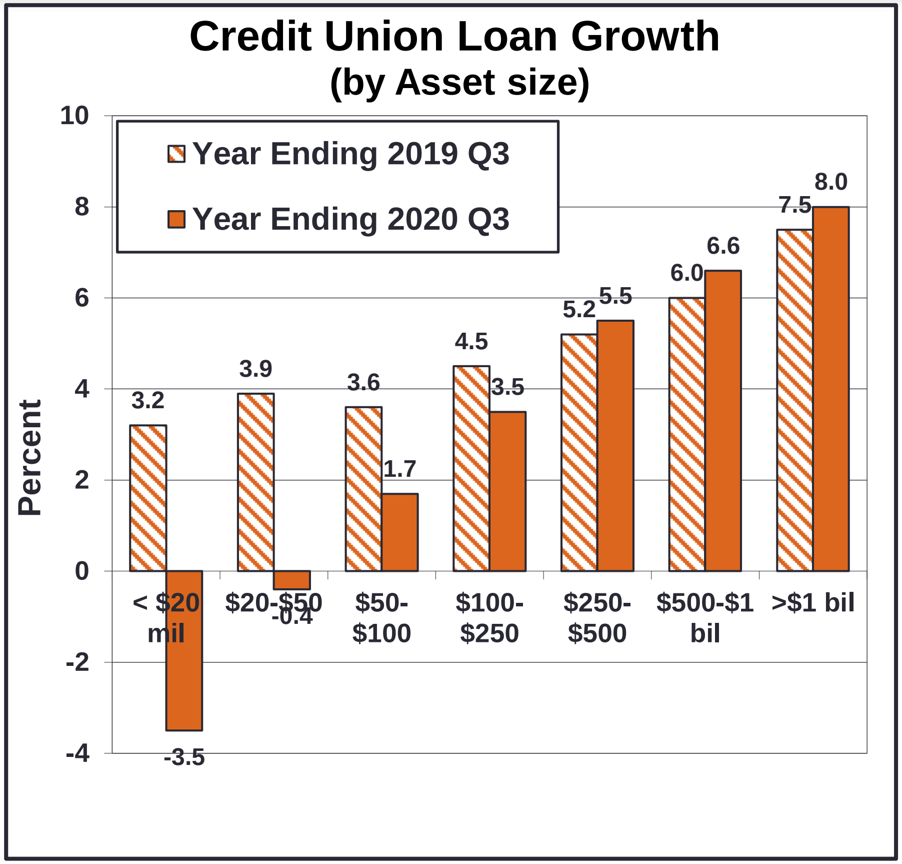
6% Credit Union Loan Growth in 2021

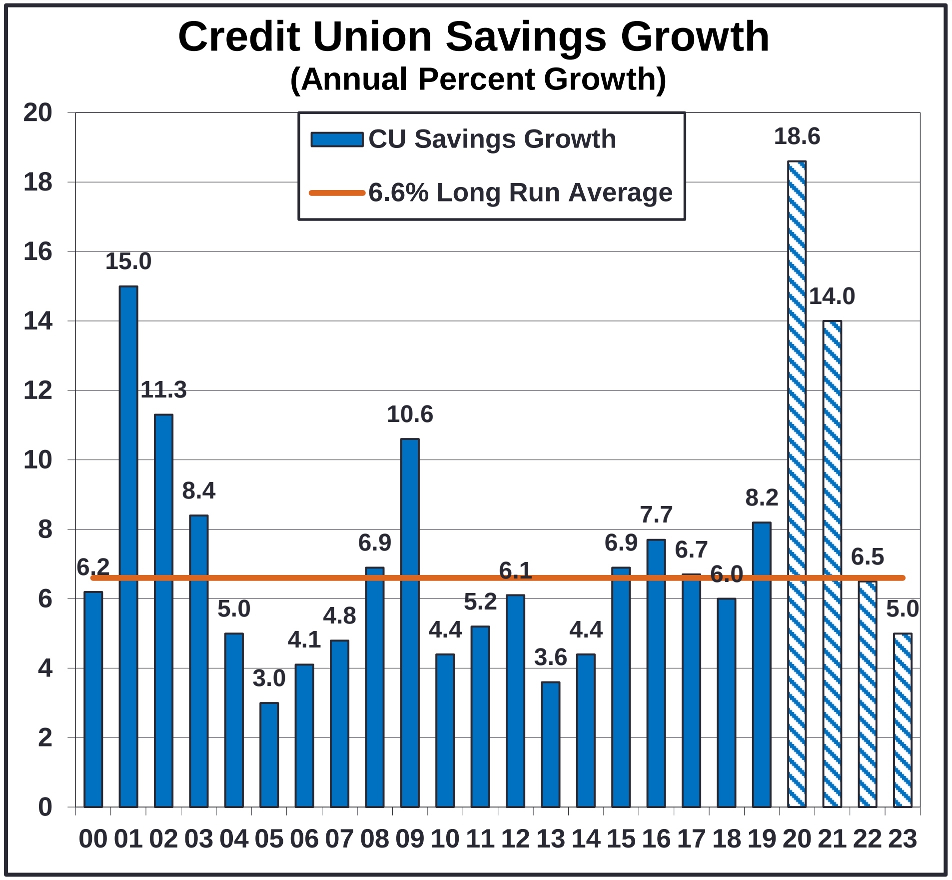


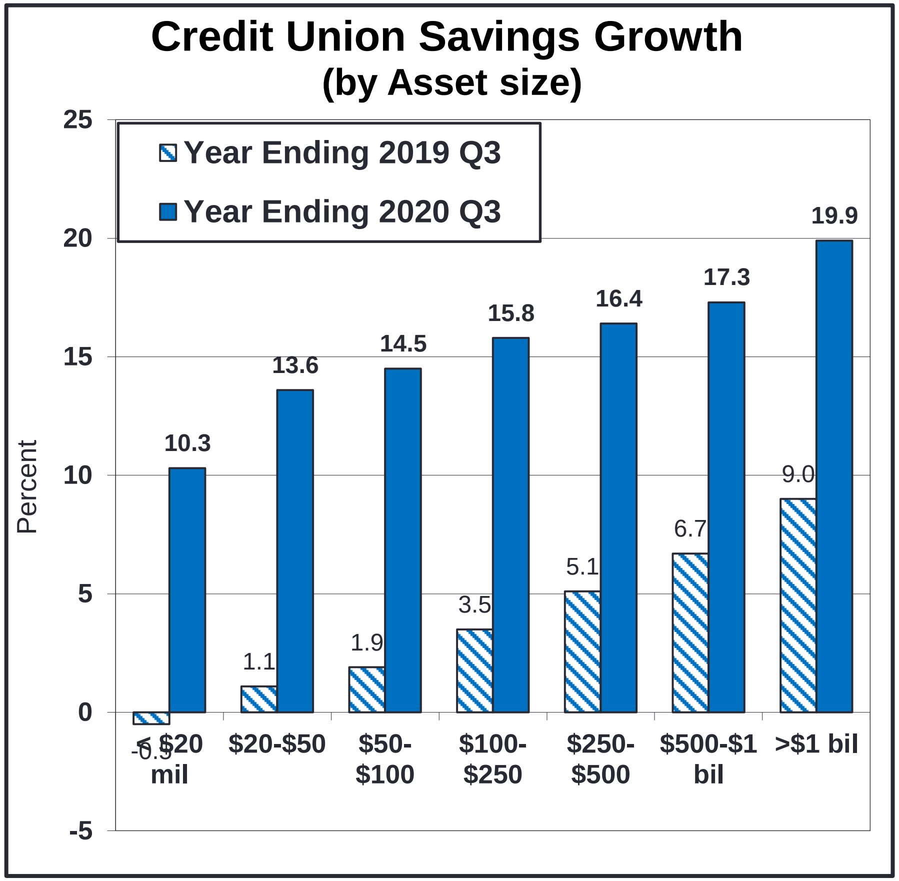


Expect loan balances to grow only 2% in 2020 as the economy enters a recession, consumer confidence falls and pent up demand for cars and appliances becomes satiated.

The COVID-19 pandemic will push the economy into recession and increase the unemployment to over 15%. Consumer will pay off existing debt and increase savings to prepare for potential layoffs. The government decreed shutdown has reduced consumer spending and therefore credit demand. Credit unions may tighten lending standards on credit card and auto loans as credit quality deteriorates. As the unemployment rate rises, delinquencies will rise and credit worthiness will fall dramatically.

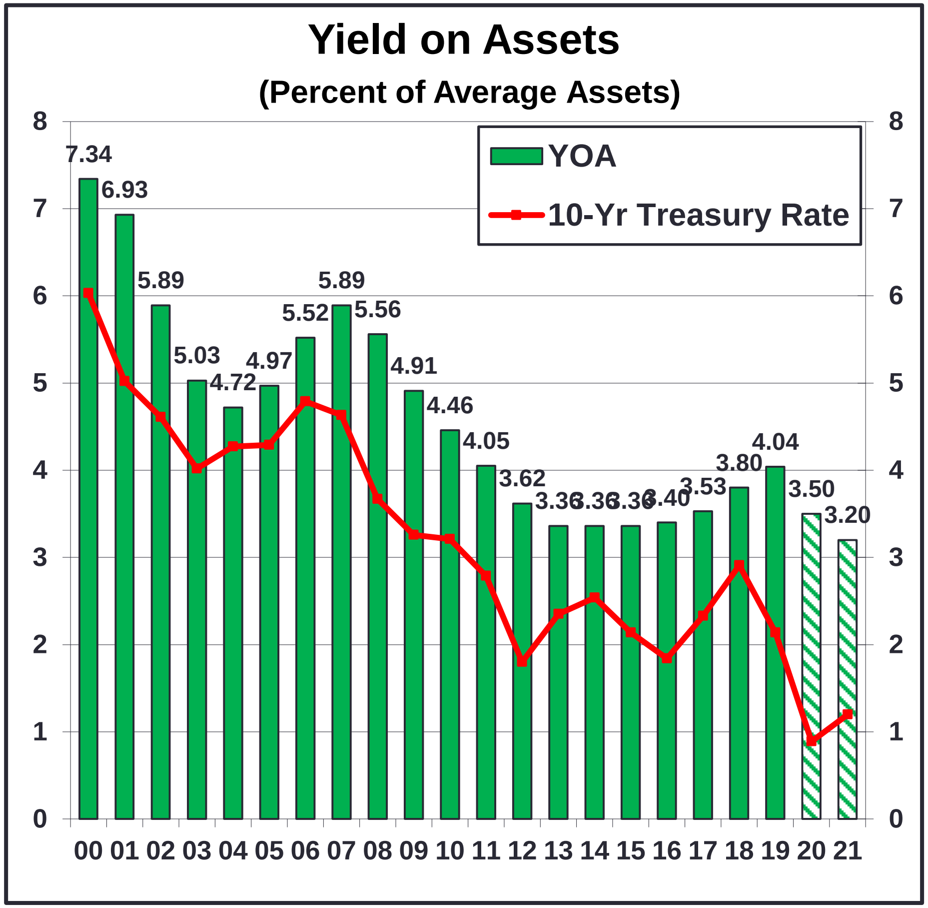
14% Credit Union Saving Growth in 2021

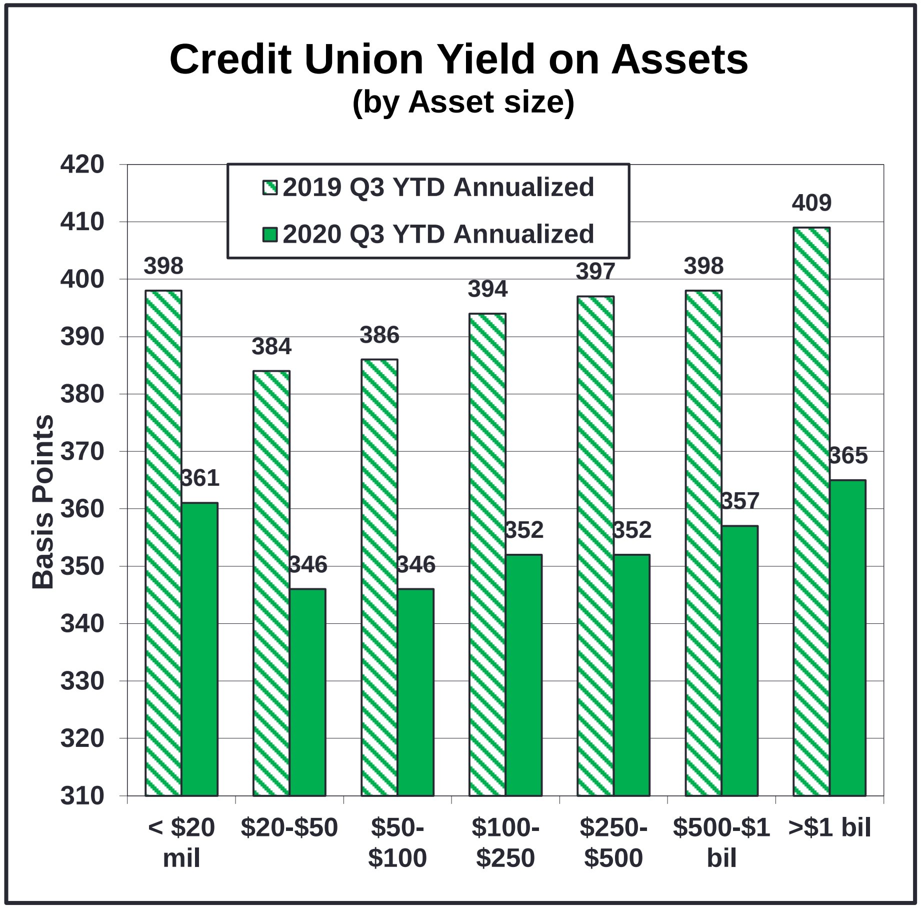




Savings balances are expected to rise 12% in 2020 due to fears of the COVID 19, savings at the gas pump, falling consumer confidence, and modest membership growth. Savings balances are driven by the following 9 factors: 1) ↑ Wealth/Income => ↓ Savings, 2) ↑ Interest Rates => ↑ Savings, 3)↑ Price Oil => ↓ Savings, 4) ↑ Income Growth Expectations => ↓ Savings Incentives, 5) ↑ Balance Sheet Repair => ↑ Savings, 6) ↑ Retirement Catchup (underfunded HHs near retirement) => ↑ Savings, 7) ↑ Risk/Uncertainty => ↑ Precautionary Savings, 8) ↑ Demographic Changes (fewer households in working age group) => ↓ Aggregate Savings, 9) ↑ Income Inequality => ↑ Savings of High Income Households.

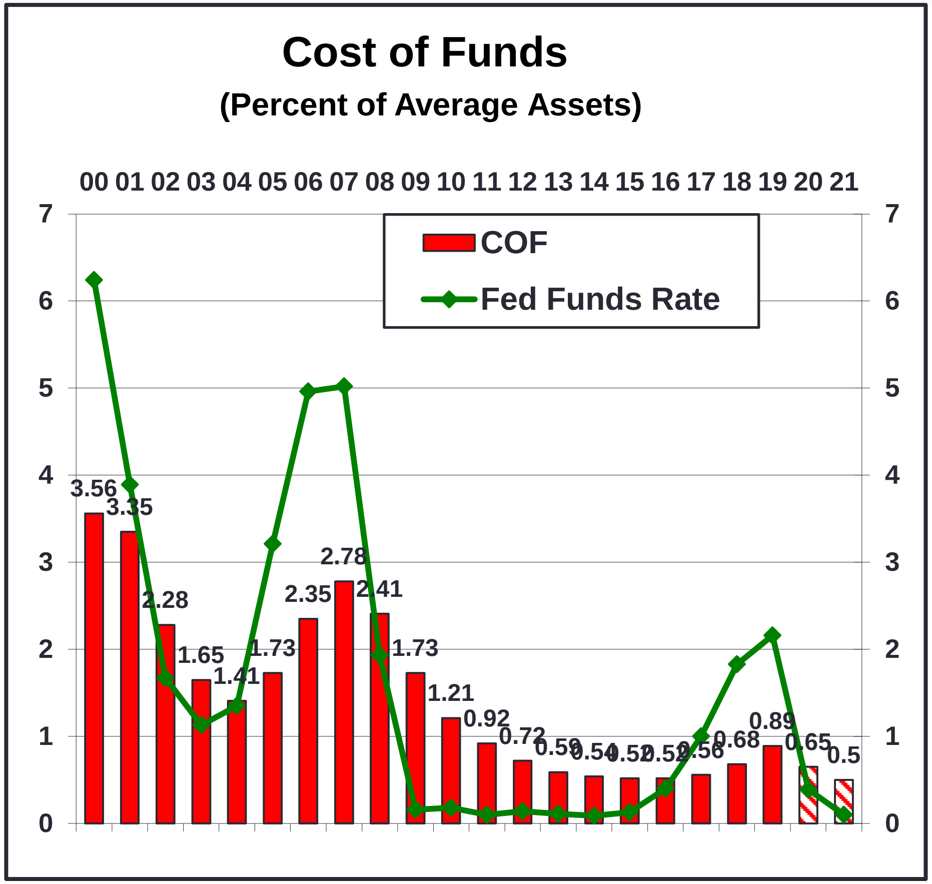
Yield-on-Assets Falling to Record Lows in 2021

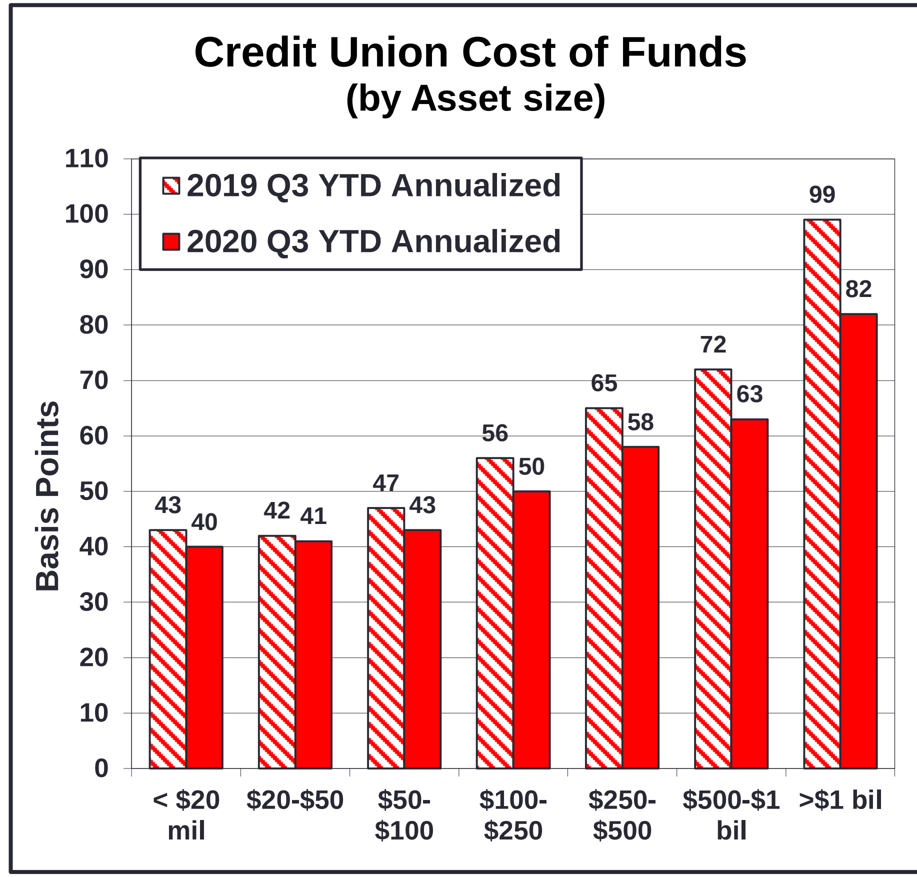




Expect yield-on-asset ratios to fall 64 basis points to a record low of 3.20% in 2021 due to record low interest rates and slow loan growth. Credit union loan growth of 6% in 2020 will shift assets toward low yielding investments and away from higher yielding auto and mortgage loans (mix effect). This will push credit union assets yields to 3.40% in 2020. The COVID-19 recession will keep the 10-year Treasury note interest rate around 1%. The Fed will keep the fed funds interest rate at 0.10% during 2020 and 2021 lowering the yields on short-term credit union investments (rate effect).

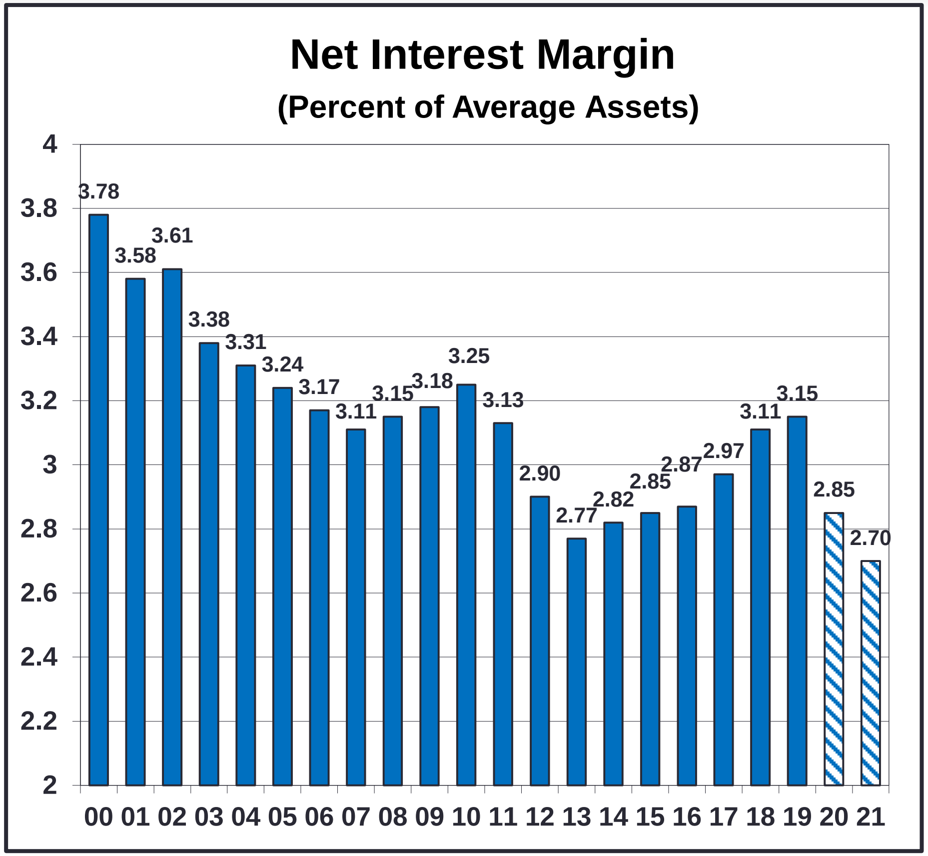
Cost of Funds will Decline as Market Rates Fall

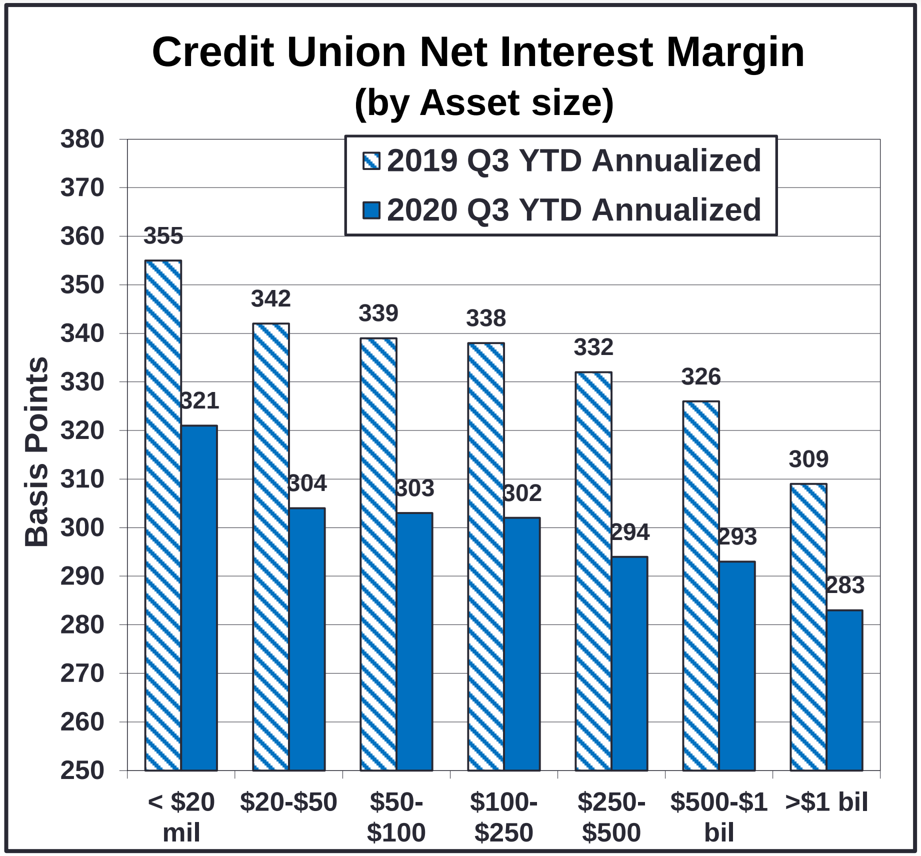




Falling short-term interest rates in 2020 will decrease credit union cost of funds to a record low of 0.50%. Surplus credit union liquidity will cause credit union deposit interest rates to fall quickly as market interest rates decrease. With certificate of deposits making up only 22% of total credit union savings balances today, down from 34% in 2007, falling market interest rates today will reduce cost of funds sooner than it did during the last falling interest rate cycle of 2008. Low market interest rates will encourage members to shift funds out of term certificate of deposits and into cheaper core deposits (share drafts, regular shares and MMDA), creating a **liability mix effect** which will also push down cost of funds.

Net Interest Margins will Fall to Record Lows in 2021

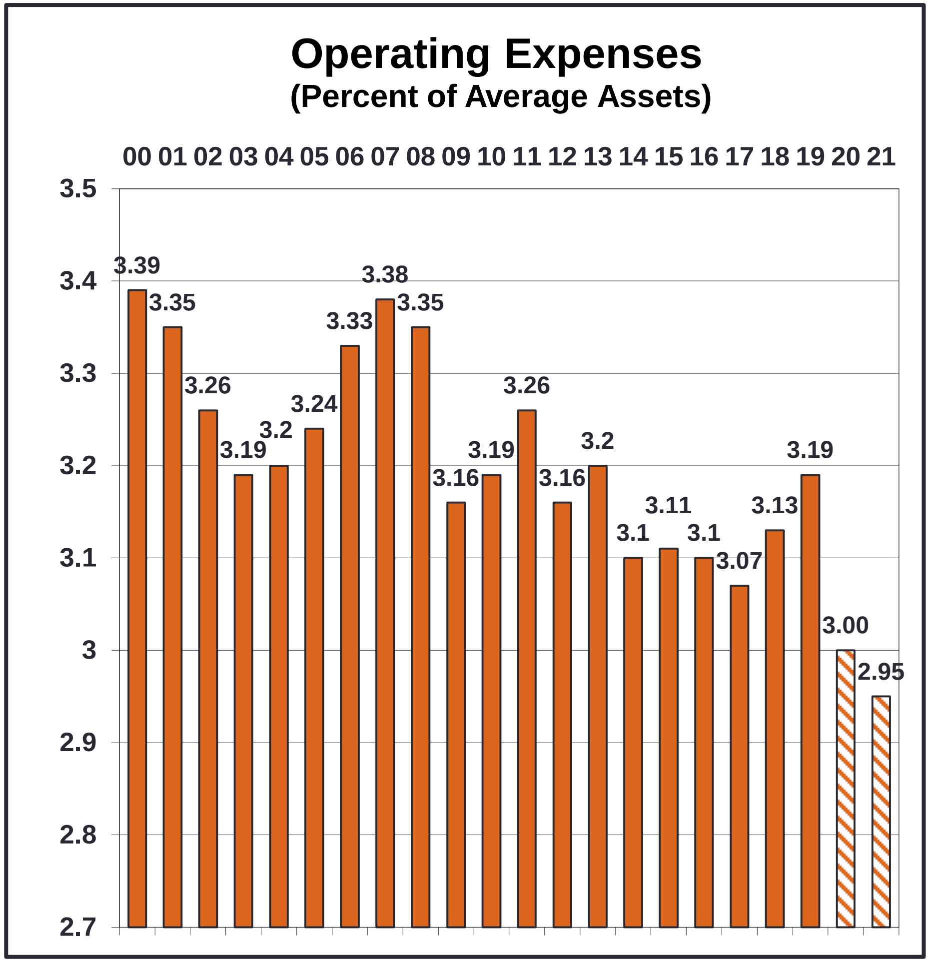


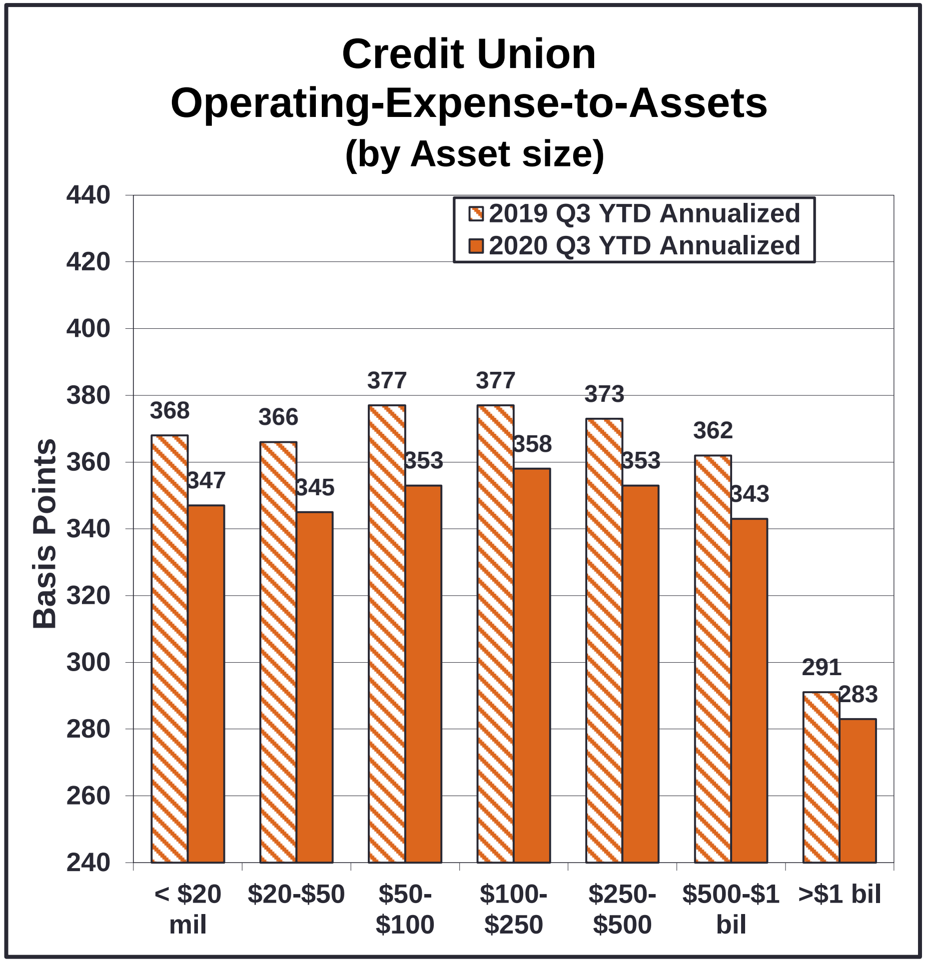


Net interest margins will decrease to record lows in 2021 as asset yields fall faster than cost of funds. Credit union net interest margins reached the lowest in history in 2013 due to historically low interest rates and excess liquidity. This will occur again in 2021 with net interest margins falling to 2.70%.

Deregulation over the last 30 years has increased competition in the financial services arena, resulting in lower net interest margins. For an individual CU, margins will also be determined by local market demographics: population growth, median household income, local industry, age trends. Tight margin are forcing CUs to increase the array of financial products and services offered while at the same time boosting efficiency and productivity.

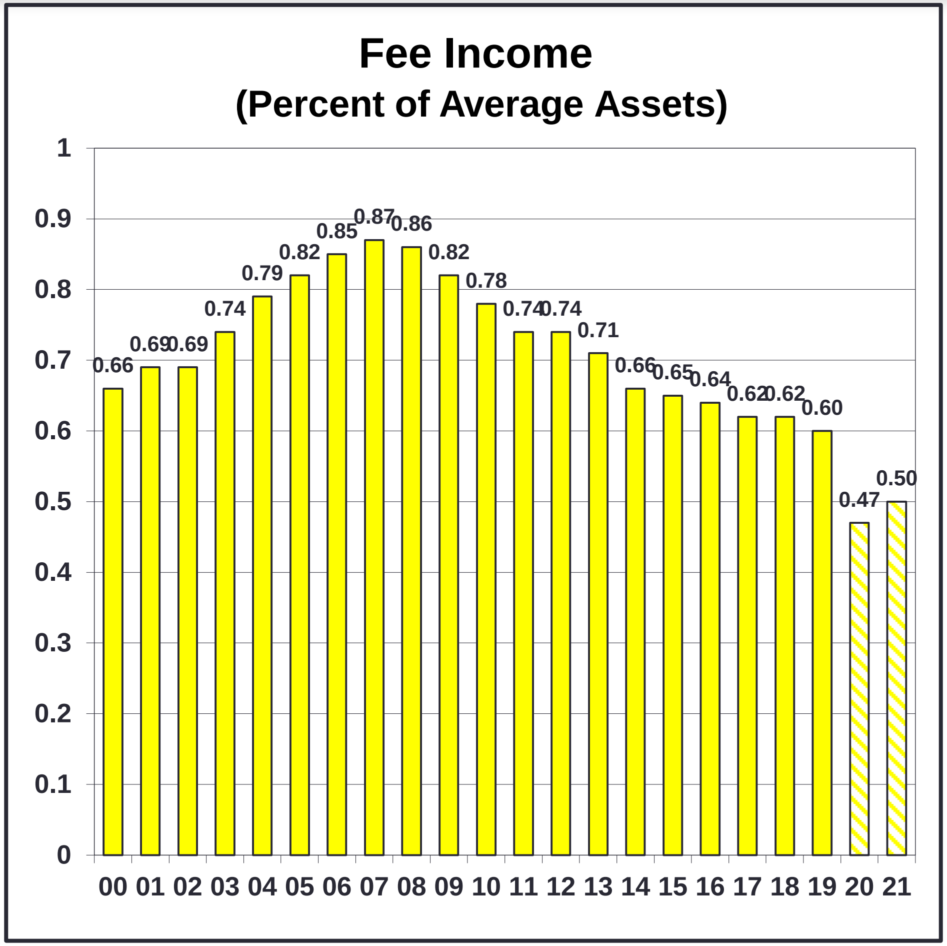
Falling Operating Expense Ratios

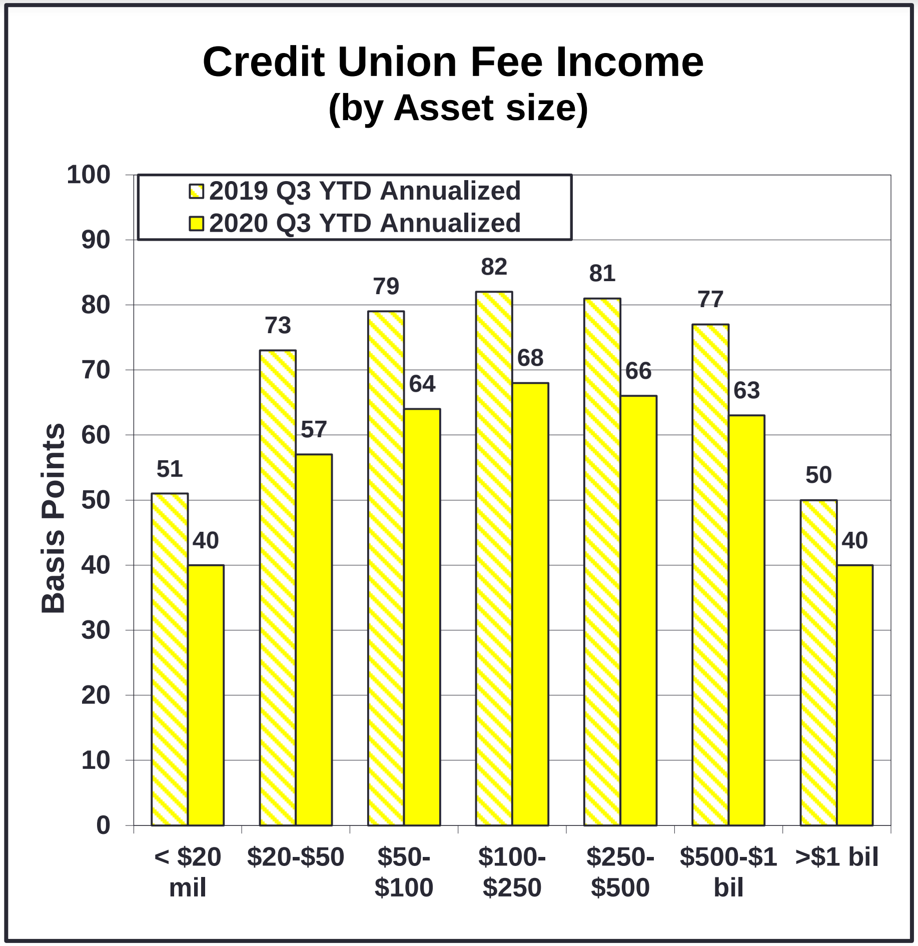




Operating expense ratios will decline over the next 2 years as the growth rate in assets exceed that of operating expenses. Credit unions will reduce new hiring and pull back on expense growth. Lower consumer loan processing costs due to decline in consumer lending. Decreased credit and debit card costs consistent with lower transaction costs.

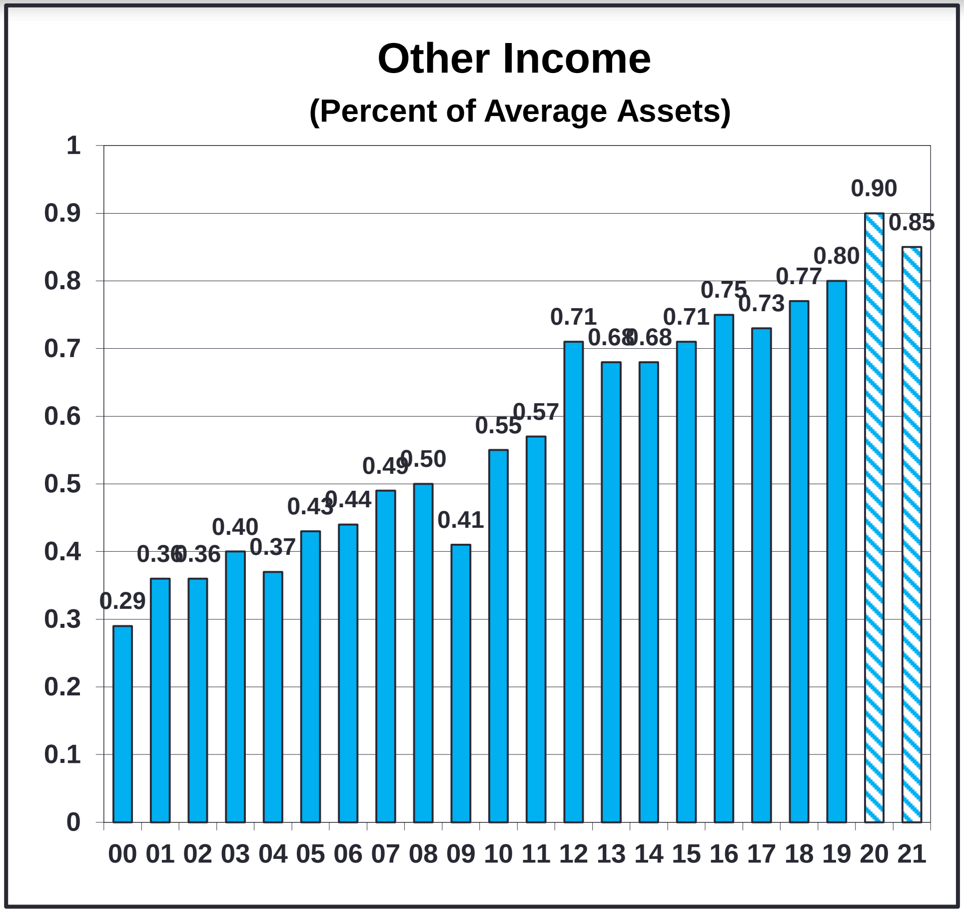
Falling Fee Income Ratios

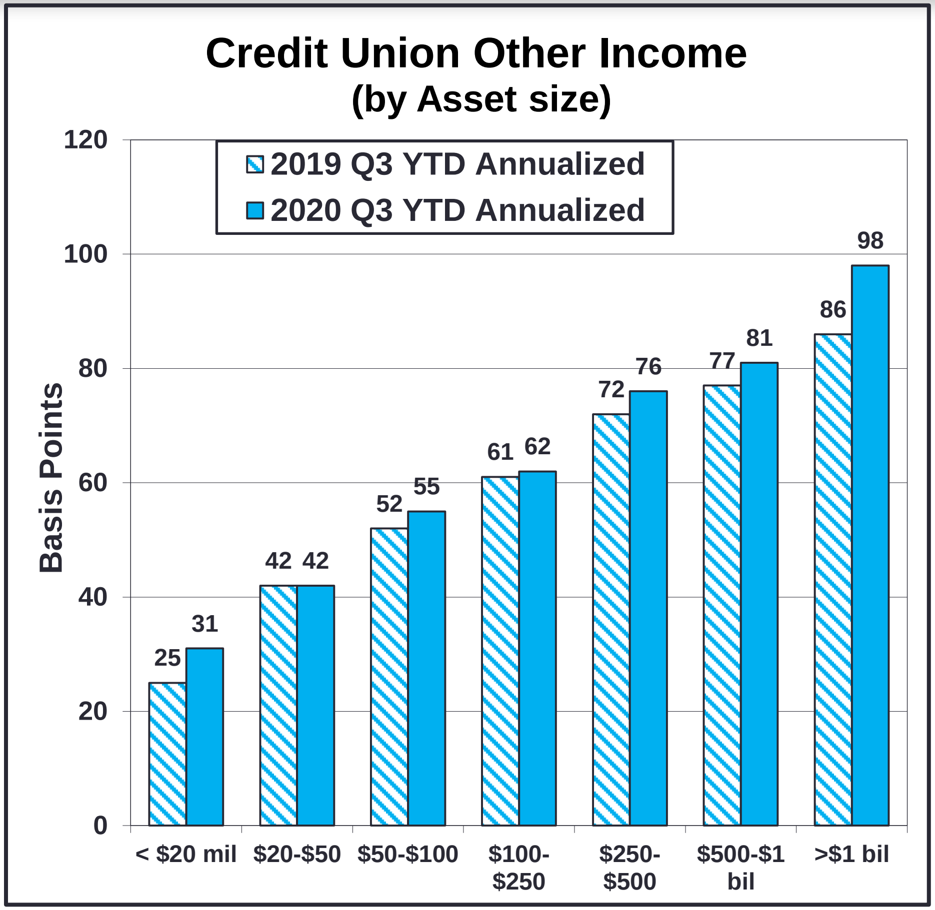




Fee income as a percent of average assets will continue its 12 year decline. The economic recession, however, may increase some penalty fee income. But web and mobile banking is providing members easier access to account balance information which reduces penalty fees. Fees from checking accounts serves as the single largest source of credit unions' fee income. The average percentage of fee income derived from nonsufficient funds (NSF), overdraft, and courtesy pay fell to 34% recently.

Falling "Other Income" Ratios

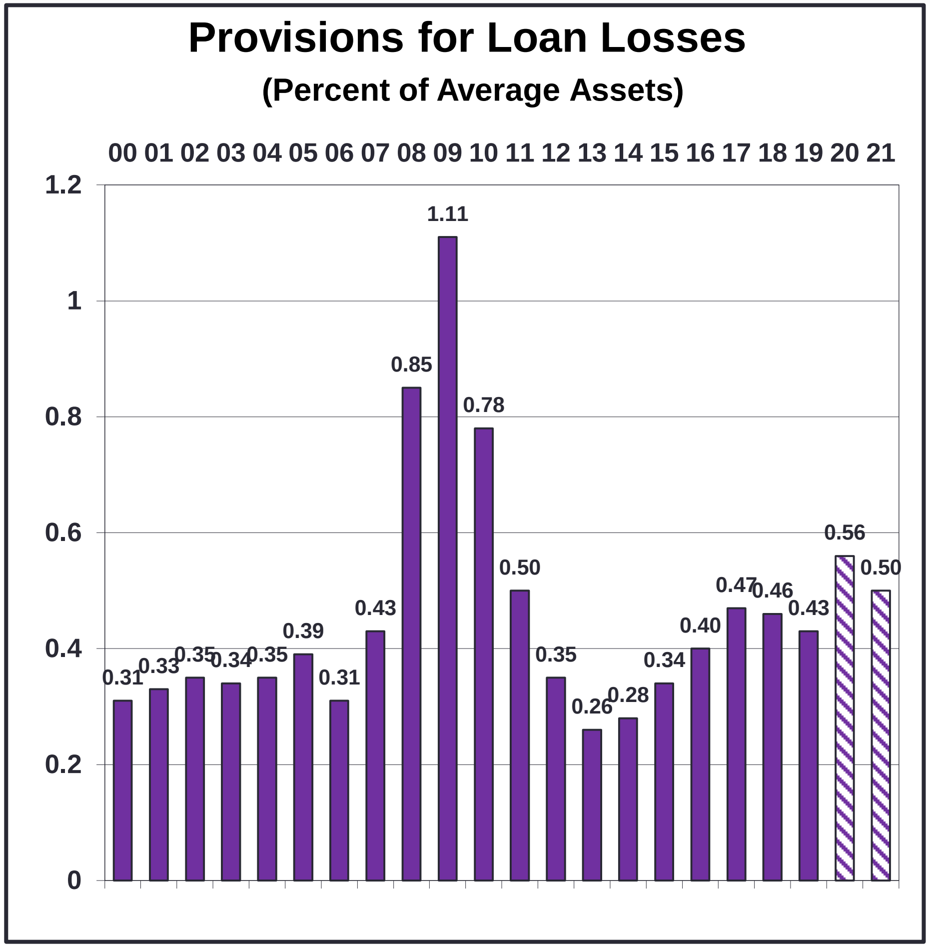


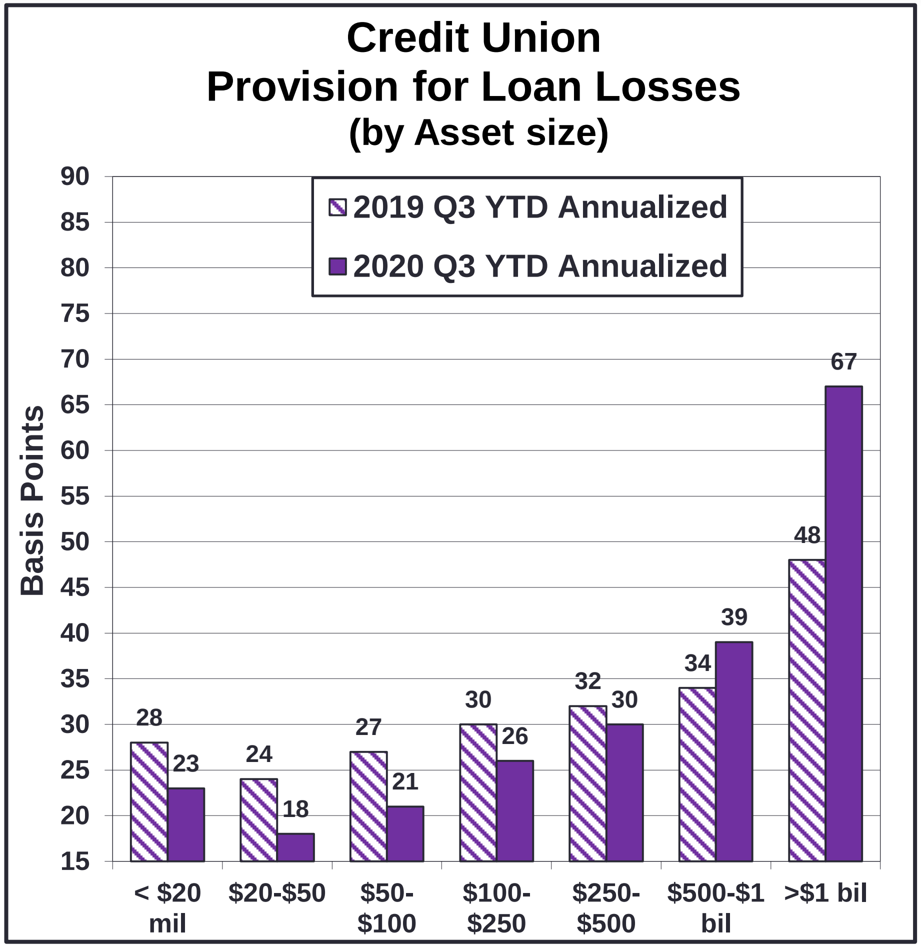


Interchange income will decline in 2020 as the number of debit card and credit card swipes fall 30-40% due to the stay-at-home orders and therefore a big drop in consumer spending. The mortgage refinance boom, however will boost **loan origination fees** and **"gains on sale"** of mortgages during the first half of 2020, therefore offsetting some of the loss in interchange income.

The ***interchange fee cap rule*** (October 1, 2011) capped the maximum fee charged per debit card transaction to 21 cents (plus an additional 2-3 cents for fraud prevention) for institutions greater than $10 billion.

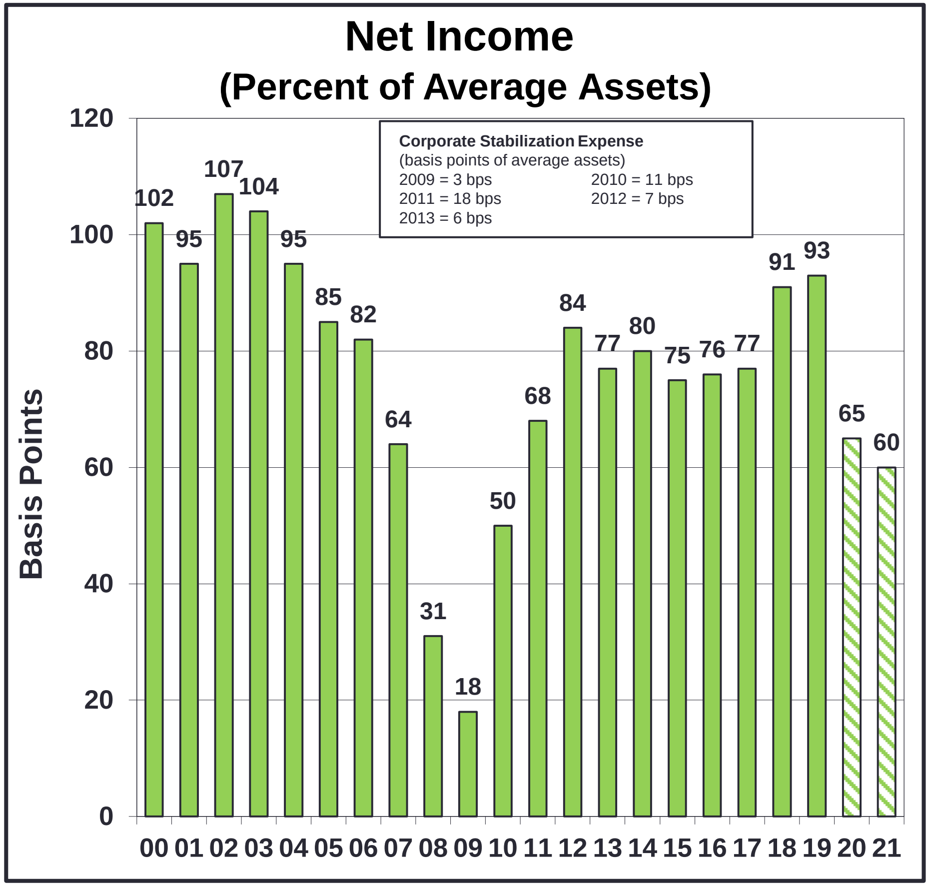
Rising Provisions for Loan Loss Ratios

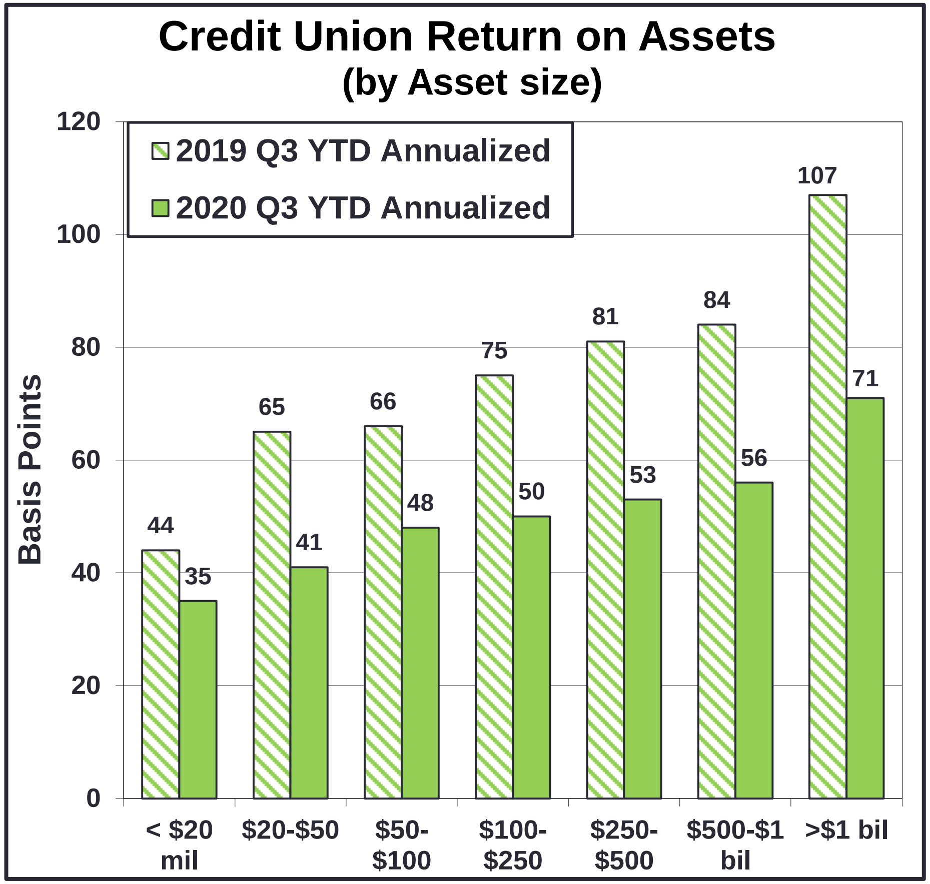




Provision for loan loss ratios will increase in 2020 due to rising loan delinquency and loan chargeoffs. Rising loan net charge-offs ratios (1.1%), a weaker labor market, and falling home prices will double loan loss provisions to 0.75% of average assets. This will be significantly above the historical average of 0.35%-0.45%. This will have a significant negative impact on earnings.

Falling Return-on-Asset Ratios





Credit union return-on-asset ratio will fall by 43 basis points in 2020. Falling asset yields – due to slower loan growth and lower market interest rates - will outpace lower funding costs. This will decrease net interest margins. Rising loan charge-offs will also increase provision for loan loss expense.

The disparity between large and small credit unions return-on-asset ratios remained large in Q1 2020. Credit unions with assets exceeding $1 billion reported ROA ratios of 0.57%, roughly twice that reported by credit unions with assets less than $20 million.

Top 12 CU Issues For 2021

1. Record low net interest margins will lead to expense containment
2. High unemployment rates will lead to larger collections departments and higher provisions for loan losses
3. Monitor employee stress and morale during pandemic
4. Invest in better technology for employees working at home
5. Update business activity expectations and reallocate staff
6. The new economic environment will create new path for profitability
7. Opportunities for prime real estate purchases and future branching
8. Adopt COVID-19 related design changes for old and new buildings
9. Excess liquidity will intensify search for higher yielding assets
10. Monitor closely the drop in capital-to-asset ratios
11. Focus on serving financially stressed members will build brand loyalty
12. Plan for post recession opportunities

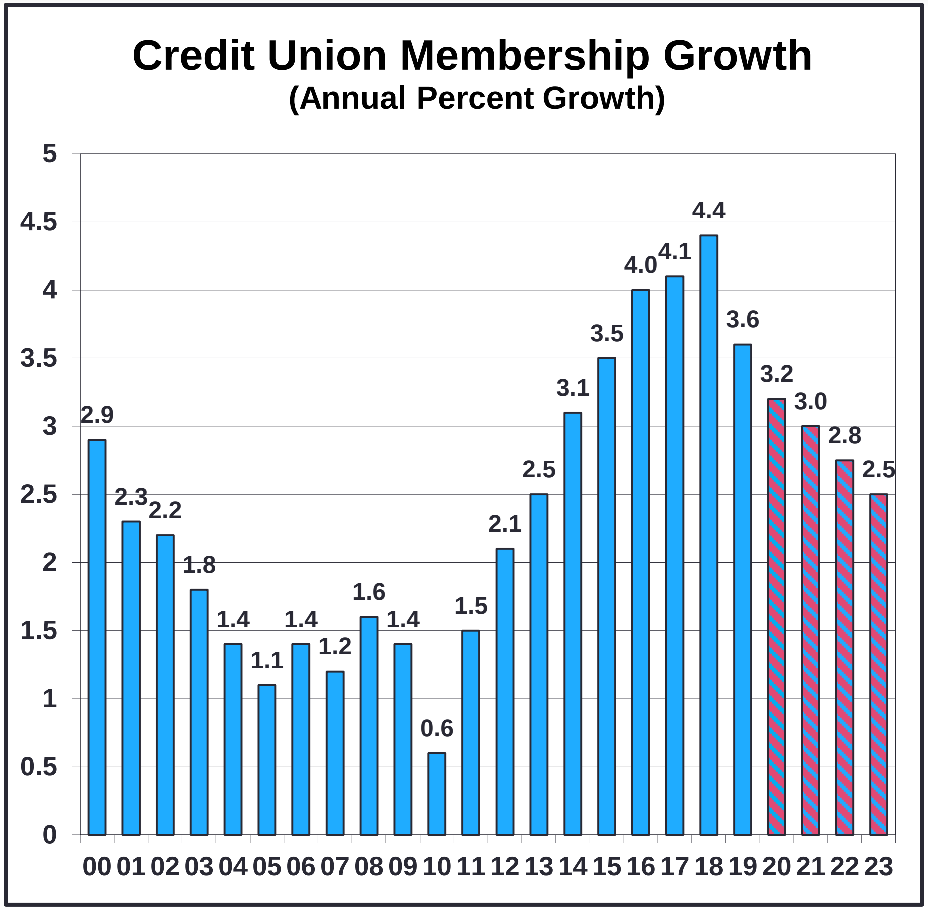
5-Year Strategic Plan Focus Areas
(How the Pandemic May Change Financial Institutions)

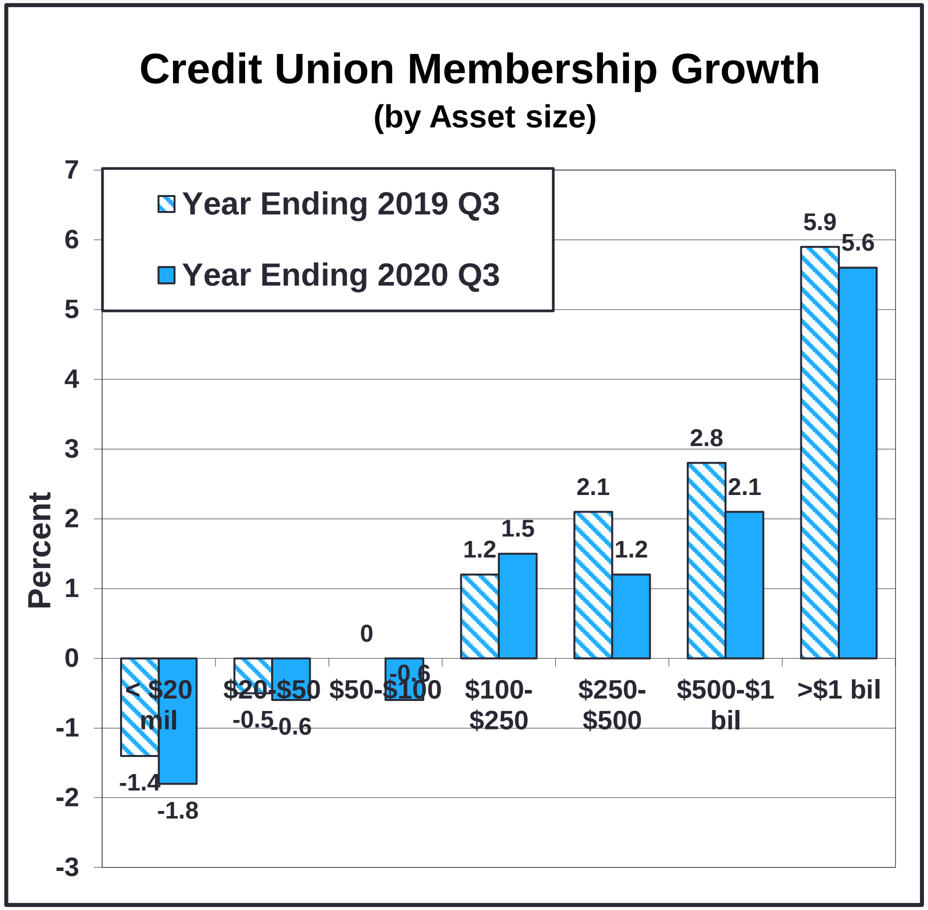
FOCUS AREAS	Temporary vs Permanent (1-3)	Impact to Credit Union (1-3)	Management Focus (1-3)	Freak-out Score (Multiply previous 3 numbers together)
Low Market Interest Rates				
Low Net Interest Margins				
Weaker Consumer Finances (higher loan chargeoffs & weaker loan demand)				
Digital Acceleration				
Less Face-to-Face Product Delivery and Less Branching				
Lower Capital Ratios				
Higher Consumer Savings Rates				
Rising Health Insurance Costs and Premiums				
COVID-19 Building Design Changes				
More Remote & Less Onsite Staffing				
Loss of Tax-Exempt Status				

Joe Biden’s Economic Plan

- Raise the top income tax rate to 39.6% from 37%.
- Apply Social Security payroll tax for those earning over $400,000 per year.
- Raise top corporate income tax rate to 28% from 21%.
- Forgive all undergraduate tuition-related federal student debt of those who make up to $125,000.
- Cancel immediately a minimum of $10,000 of federal student debt per person and forgiving the remainder of loans after 20 years with no tax burden.
- Supports making student loans dischargeable in personal bankruptcy.
- Supports making public colleges and universities free for families whose income is below $125,000.
- Protect and build on the Affordable Care Act. Does not support Medicare for all nor eliminating private health insurance.
- Supports lowering employees’ maximum contribution for health insurance coverage to 8.5%.
- Supports lowering Medicare eligibility age to 60 from 65.
- Supports raising the minimum wage to $15 per hour.
- Supports giving workers more bargaining power by getting rid of abusive non-compete clauses, removing rules in contracts that prevent employees from discussing pay with each other, and stopping companies from classifying low wage workers as managers to order to avoid paying them overtime.
- Supports spending $1.3 trillion over 10 years on infrastructure (roads, bridges, airports, broadband) and clean energy research.
- Supports the Green New Deal and will rejoin the Paris agreement. Wants the U.S. to reach net-zero emissions no later than 2050 and to ensure a carbon pollution-free power sector by 2035.

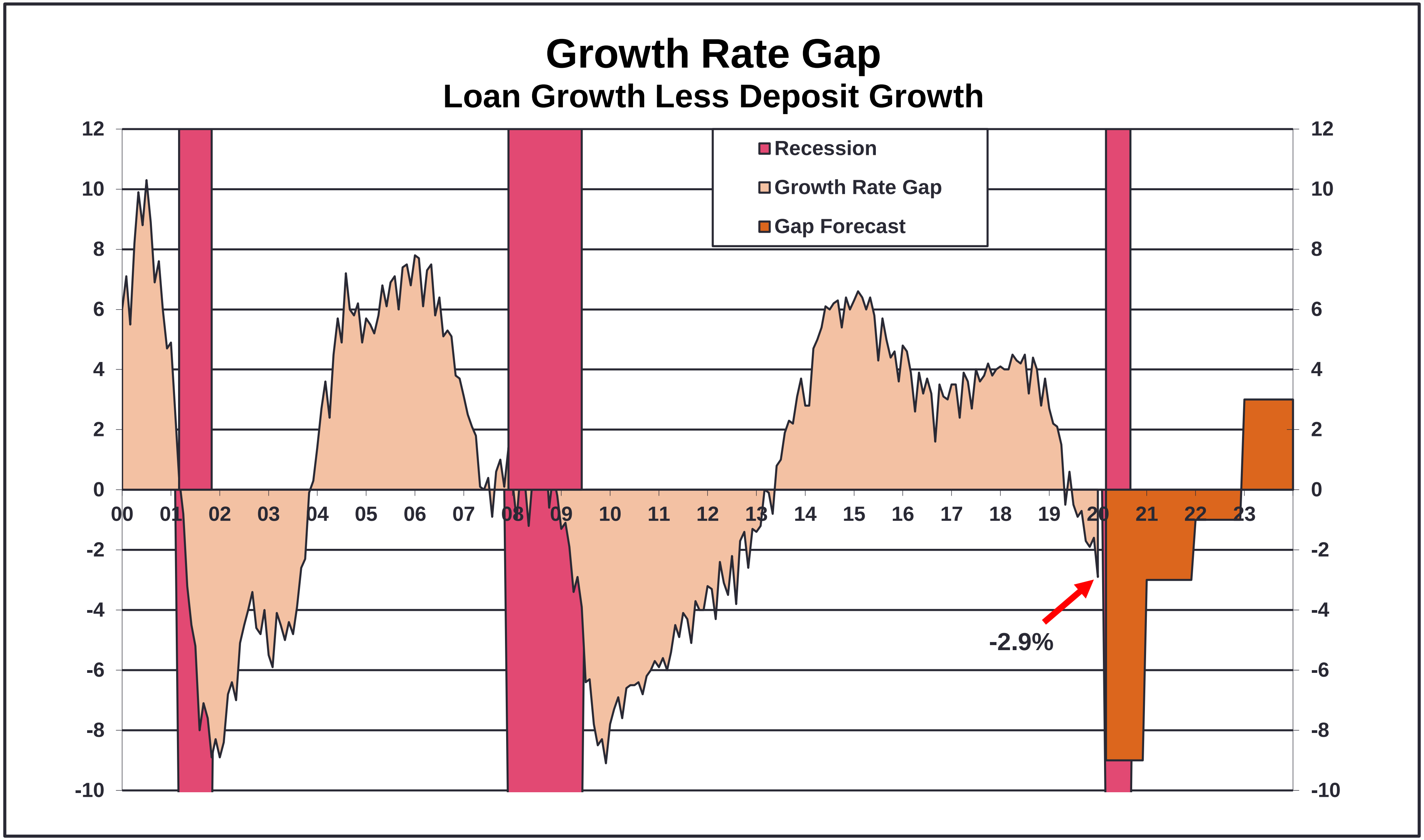
Membership Growth Slows





Credit unions should expect membership growth of 1.0% in 2020 due to slowing loan growth and weaker job growth. This will push the total number of credit union memberships to 125 million by year end 2020, which is equal to 33% of the total U.S. population. In the last 12 months ending in Q1 2020, credit union with assets over $1 billion reported 5.8% membership growth, compared with less than 1% for credit unions with assets less than $100 million. The 2,344 credit unions with assets less than $20 million reported a 1.8% decline in memberships.

The Short-Term Debt Cycle and Forecasting Recessions



Limerick of the Day

Credit Unions have always depended
On a rate of borrowing that is splendid
By consumers for whom
Their means to consume
May soon find them overextended

Economic Forecast

Economic Growth: As many predicted, the winter months have proven to be the darkest of the COVID-19 pandemic, with average daily deaths exceeding 3,000 and total deaths surpassing 400,000, more U.S. casualties than in all of World War II. Although secondary to the tremendous loss of life and human suffering, the effects of the pandemic on the economy have been similarly devastating: Real gross domestic product (GDP) fell 3.5% in 2020, the greatest annual decline in over 75 years. Nonetheless, there are reasons for optimism: multiple COVID-19 vaccines are shown to be 90% to 95% effective, more than 40 million doses of the COVID-19 vaccine have been administered as of late February 2021, and further government stimulus under the Biden Administration will provide a significant boost to the economy. Most economists now expect a strong rebound later in the year and into next year. CUNA economists expect that the economy will grow a strong 4.5% this year—mostly in the second half of the year—followed by more modest growth of 3.5% in 2022.

Inflation: The economic recovery and significant government stimulus will put upward pressure on prices and the Consumer Price Index (CPI) is expected to rise 2.1% this year and 2.3% next year, after sluggish growth of 1.3% in 2020. Nonetheless, given that inflation has remained well below the Federal Reserve's target of 2.0% over the past decade, this should not be a cause for concern. Moreover, the Fed's target is 2.0% growth in personal consumption expenditures, and Federal Reserve members do not expect this benchmark to reach the 2.0% target until 2023.

Unemployment: In April, the unemployment rate jumped to nearly 20% (the highest since the Great Depression), meaning that one in five people looking for work were unable to find a job. Fortunately, the U.S. labor market has improved dramatically since then, with the unemployment rate falling to 6.3% as of January 2021. Nonetheless, the unemployment rate is an imperfect measure of the labor market as it only considers those individuals who are actively working or looking for work; yet, millions of Americans have left the workforce altogether. In April, the overall labor force participation rate was just 60.2%, down from 63.4% in February, and the lowest since the early 1970s when far fewer women were in the workforce. Through January, the labor force participation rate has rebounded slightly to 61.4% but remains well below pre-pandemic levels. Moreover, the closure of schools and daycare centers have disproportionately affected women, both as teachers and parents, and women continue to lag men in returning to the work force. CUNA economists expect the unemployment rate to continue to fall to 5.5% in 2021 and 4.5% by year-end 2022; however, the pace will slow markedly as more people re-enter the labor force and look for work.

Interest Rates: When the pandemic began, the Federal Reserve reduced both short- and long-term interest rates. This dropped the effective federal funds rate to near zero and the 10-year Treasury rate to as low as 0.52% in August 2020. In parallel, the 30-year fixed mortgage rate fell to a record low of 2.65% in January 2021. Combined with an increase in demand for housing as individuals work from home and leave urban apartments, the low interest-rate environment has led to skyrocketing housing prices and a boom in first mortgage growth at credit unions (including refinances), which have grown 12.9% over the past 12 months through September 2020. Nonetheless, the 10-year Treasury rate has ticked up over the past month, reaching as high as 1.15% in mid-January 2021, the highest since February 2020. CUNA economists anticipate a modest increase in the 10-year Treasury rate to 1.40% by year-end 2021 and 1.65% by year-end 2022; however, short-term rates will remain low as Federal Reserve Chairman Jerome Powell has committed to maintaining low interest rates through at least 2023.

Economic Forecast – First Quarter, 2020

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5 Year Average	2020	2021:1	2021:2	2021:3	2021:4	2021	2022
Growth Rates:								
Economic Growth (% Change GDP)*	1.1%	-3.5%	3.0%	5.0%	5.5%	4.5%	4.5%	3.5%
Inflation (% Change CPI)*	1.9%	1.3%	1.5%	2.5%	3.0%	1.5%	2.1%	2.3%
Unemployment Rate	4.6%	6.7%	6.2%	5.9%	5.7%	5.5%	5.5%	4.5%
Federal Funds Rate (effective)	1.18%	0.09%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
10-Year Treasury Rate	2.08%	0.93%	1.20%	1.30%	1.40%	1.50%	1.50%	1.75%
10-Year-Fed Funds Spread	0.90%	0.84%	1.10%	1.20%	1.30%	1.40%	1.40%	1.65%

*Percent change, annual rate.
All other numbers are end of period values.

Credit Union Forecast

Loan & Membership Growth: Despite the pandemic, credit union loan portfolios grew 5.0% in 2020—and memberships rose 3.1%—according to CUNA's Monthly Credit Union Estimates. This represents relatively slow growth compared to long-run averages, but mortgage refinancing activity and sales into the secondary market were very strong. Overall, growth in loan portfolios was largely driven by first mortgage lending and Payment Protection Program (PPP) loans. Credit unions can expect relatively modest loan and membership growth of 5.0% and 3.0%, respectively, in 2021, and 8.0% and 3.5%, respectively, in 2022. The recovery will make consumers more confident to borrow and spend, particularly starting in the second half of 2021. We expect auto lending to recover and mortgage lending to remain strong. However, headwinds to faster growth include fewer PPP loans and households using stimulus funds and mortgage refinancing to pay down existing debt, such as credit cards.

Savings Growth: According to CUNA's Monthly Credit Union Estimates credit union savings grew an incredible 20.6% in 2020, largely due to the CARES Act and direct payments to consumers. In 2021, credit unions can expect similarly strong savings growth as $600 direct payments have already been sent to many households in January, and the Biden Administration hopes to send another $1,400 to qualifying individuals in its $1.9 trillion stimulus plan (which will likely pass in March or April). Moreover, under plans by both Republic Senator Mitt Romney and the Biden Administration, many couples with children will begin receiving payments of $250 to $350 per month per child starting in the summer. Overall, this stimulus will continue the strong deposit growth at credit unions and CUNA economists anticipate savings growth of 15.0% for 2021—mostly concentrated in the first and second quarters—before falling to 5.0% in 2022. The combination of fast savings growth and modest loan growth will continue to push down the credit union loan-to-share ratio, from 73.6% as of year-end 2020 to 65.6% by year-end 2021 and 64.4% by the end of 2022.

Asset quality: The combination of government stimulus and credit unions working with members to modify and defer loans has led to continued improvements in portfolio quality: CUNA's Monthly Credit Union Estimates show that the overall delinquency rate fell to just 0.61% as of year-end 2020, well below 2019's year-end figure of 0.70%. Given the substantial additional stimulus planned by the Biden Administration, portfolio quality will remain relatively healthy in 2021 and into 2022. However, there will be modest increases in the delinquency and net charge-off rates as the pandemic drags on and millions remain out of work. The delinquency rate will rise slightly to 0.80% by year-end 2021 before falling to 0.70% next year, and net charge-offs will settle at 0.50% in 2021 and 2022.

ROA: Credit unions should anticipate significant downward pressure on earnings in 2021 and 2022. Credit union ROA fell from 0.93% in 2019 to 0.65% in 2020, but the latter figure was propped up by fees from significant sales on mortgages and PPP loans. Overall, the very low interest rates and falling loan-to-share ratio means that credit unions will be forced to place funds in low-yielding investments, and newly disbursed loans will receive tiny interest margins. CUNA economists forecast ROA of 0.50% in 2021 and 2022. The combination of fast asset growth and tepid earnings will further reduce the industry's net worth ratio, from 10.3% in 2020 to 9.2% by year-end 2021 and 8.9% in 2022.

Credit Union Forecast – First Quarter, 2020

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5 Year Average	2020	2021:1	2021:2	2021:3	2021:4	2021	2022
Growth Rates:								
Savings Growth	9.6%	20.6%	4.0%	7.0%	2.0%	2.0%	15.0%	5.0%
Loan Growth	8.4%	5.0%	0.5%	1.0%	2.0%	1.5%	5.0%	8.0%
Asset Growth	9.1%	18.1%	3.5%	6.5%	2.0%	1.5%	13.5%	4.5%
Membership Growth	3.7%	3.1%	0.7%	0.7%	1.0%	0.6%	3.0%	3.5%
Liquidity:								
Loan-to-Share Ratio**	80.4%	73.6%	71.2%	67.1%	66.7%	65.6%	65.6%	64.4%
Asset Quality:								
Delinquency Rate**	0.74%	0.61%	0.65%	0.70%	0.75%	0.80%	0.80%	0.70%
Net Charge-off Rate*	0.53%	0.47%	0.50%	0.55%	0.65%	0.70%	0.60%	0.55%
Earnings:								
Return on Average Assets (ROA)*	0.79%	0.65%	0.60%	0.50%	0.45%	0.40%	0.50%	0.50%
Capital Adequacy:								
Net Worth Ratio**	10.9%	10.3%	9.9%	9.4%	9.3%	9.2%	9.2%	8.9%

CUNA MUTUAL GROUP

*Quarterly data, annualized.
**End of period ratio.

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