Economic & Credit Union Update

April 2022

If you have any questions or comments, please contact:
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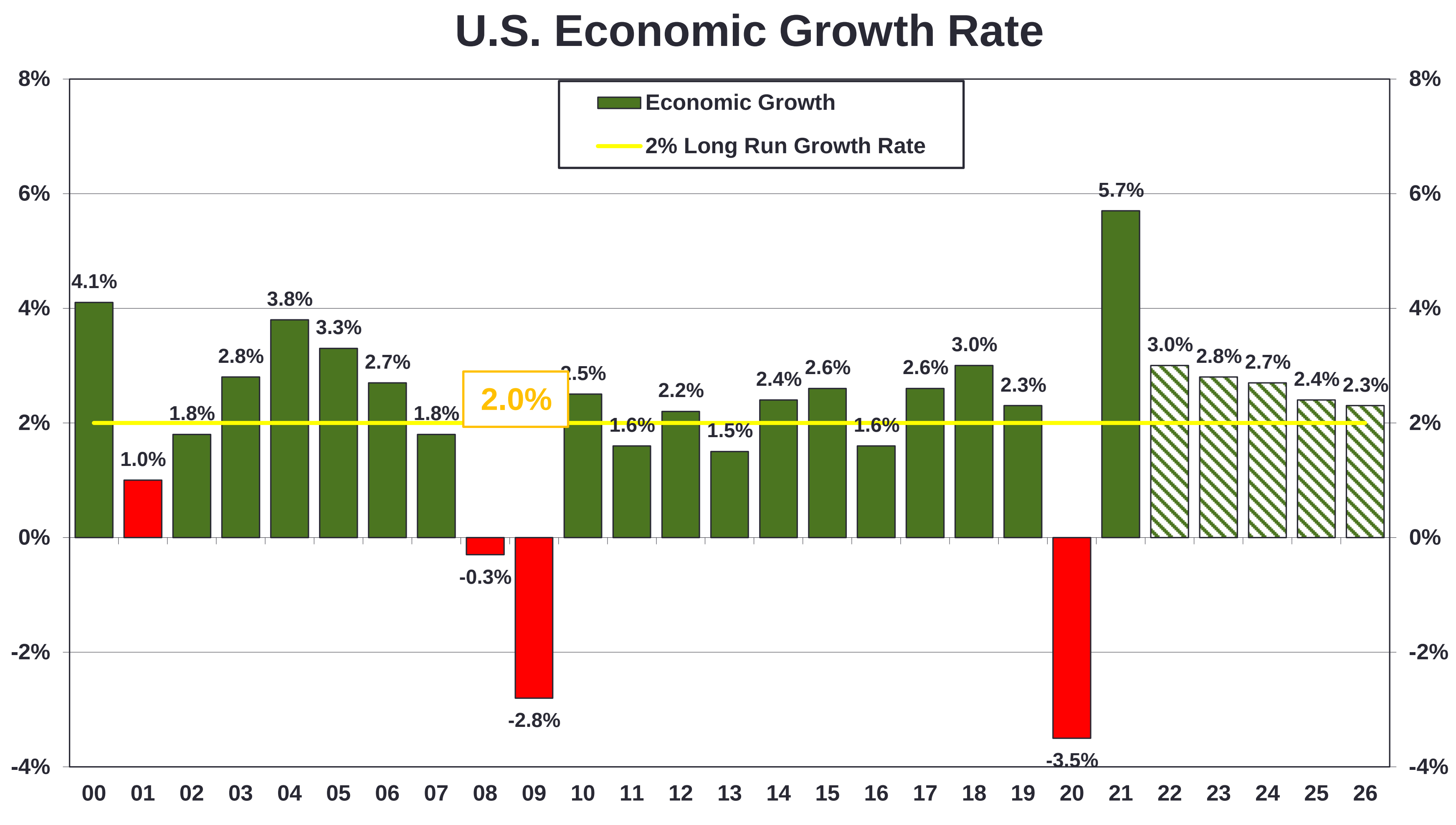
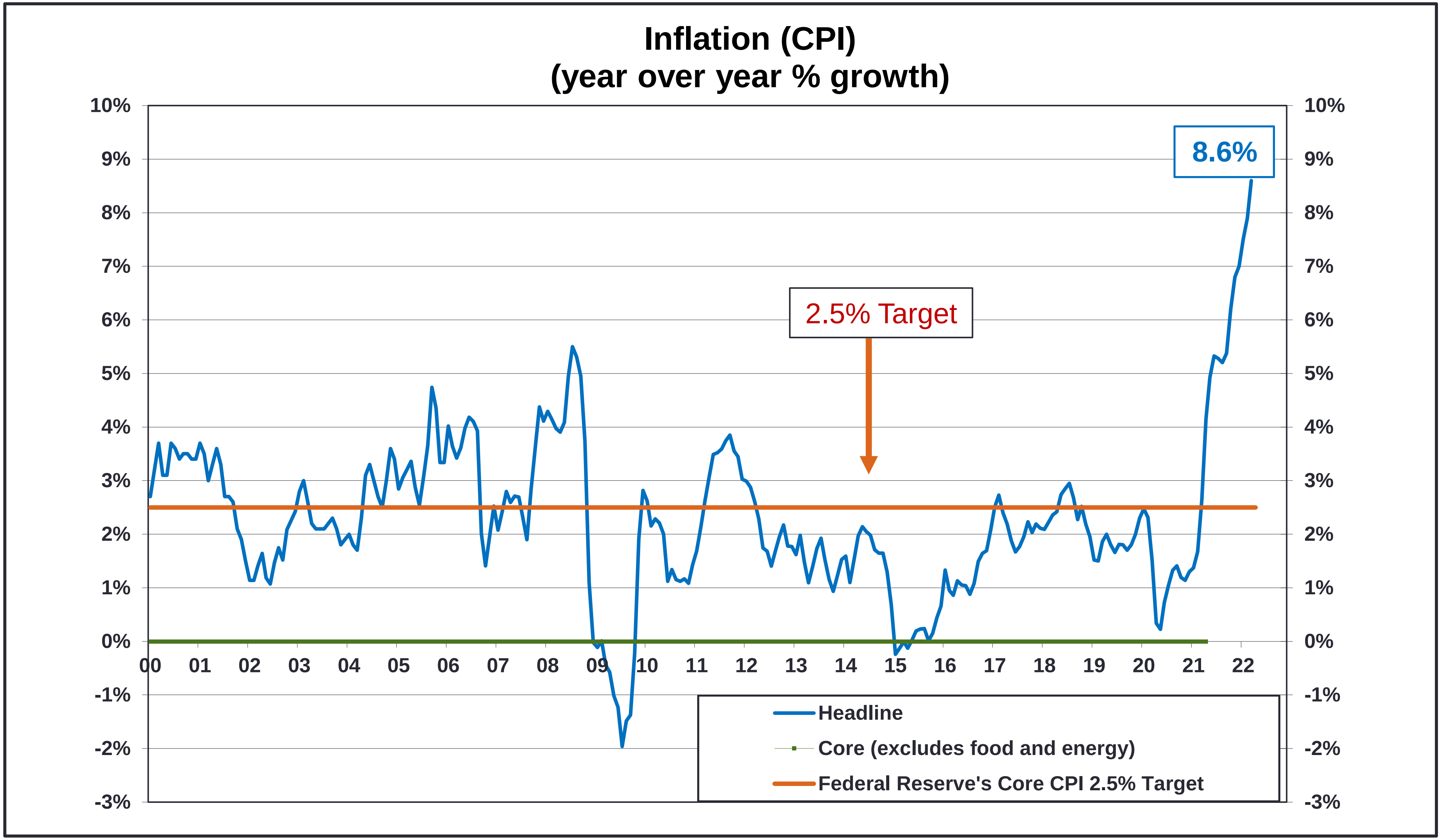
Above Trend Economic Growth for Next 5 Years

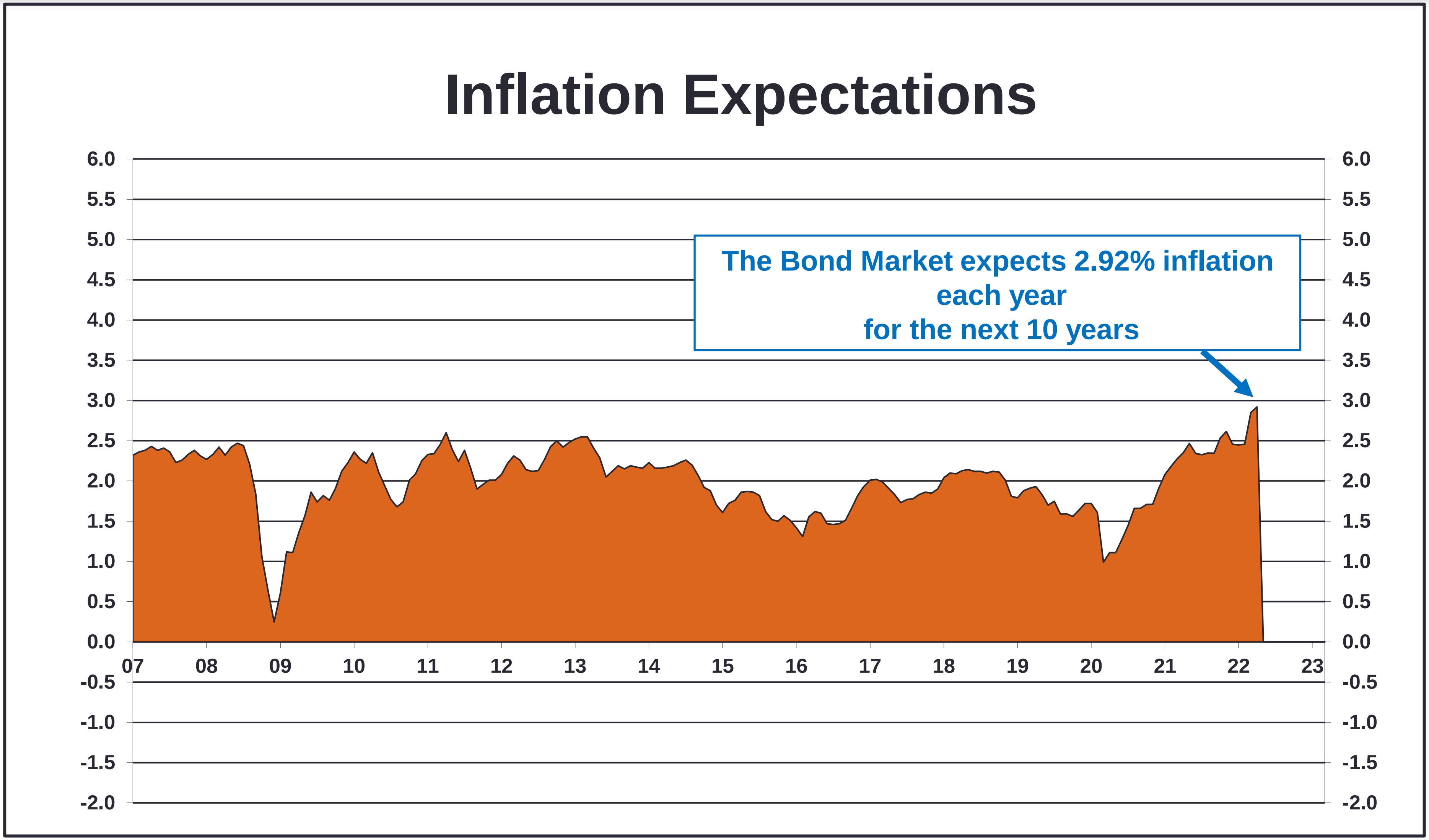


Source: Department of Commerce

High Inflation for the Next Year



Inflation Expectations are Anchored Below 3.0%

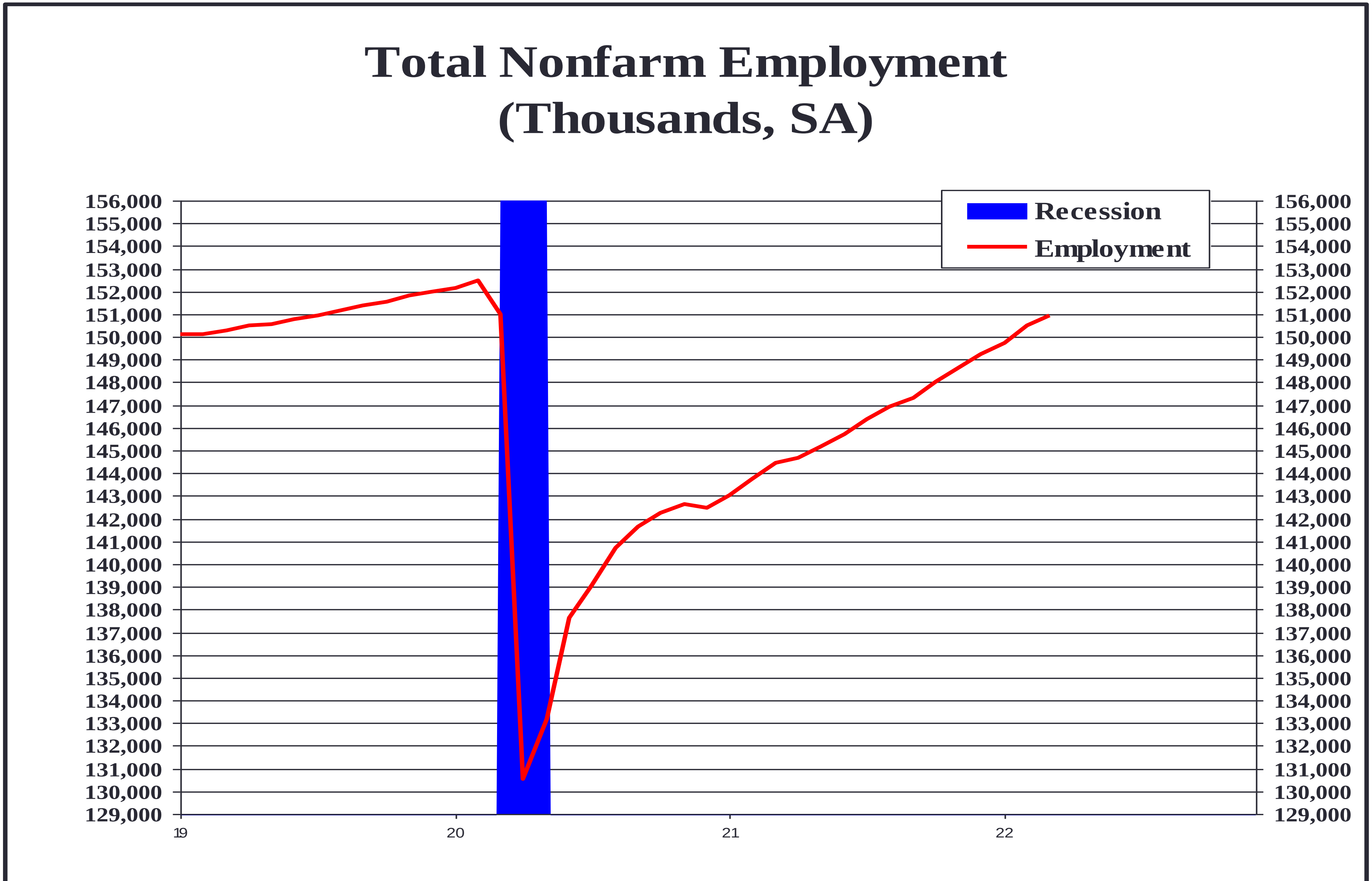


The Inflation Debate:

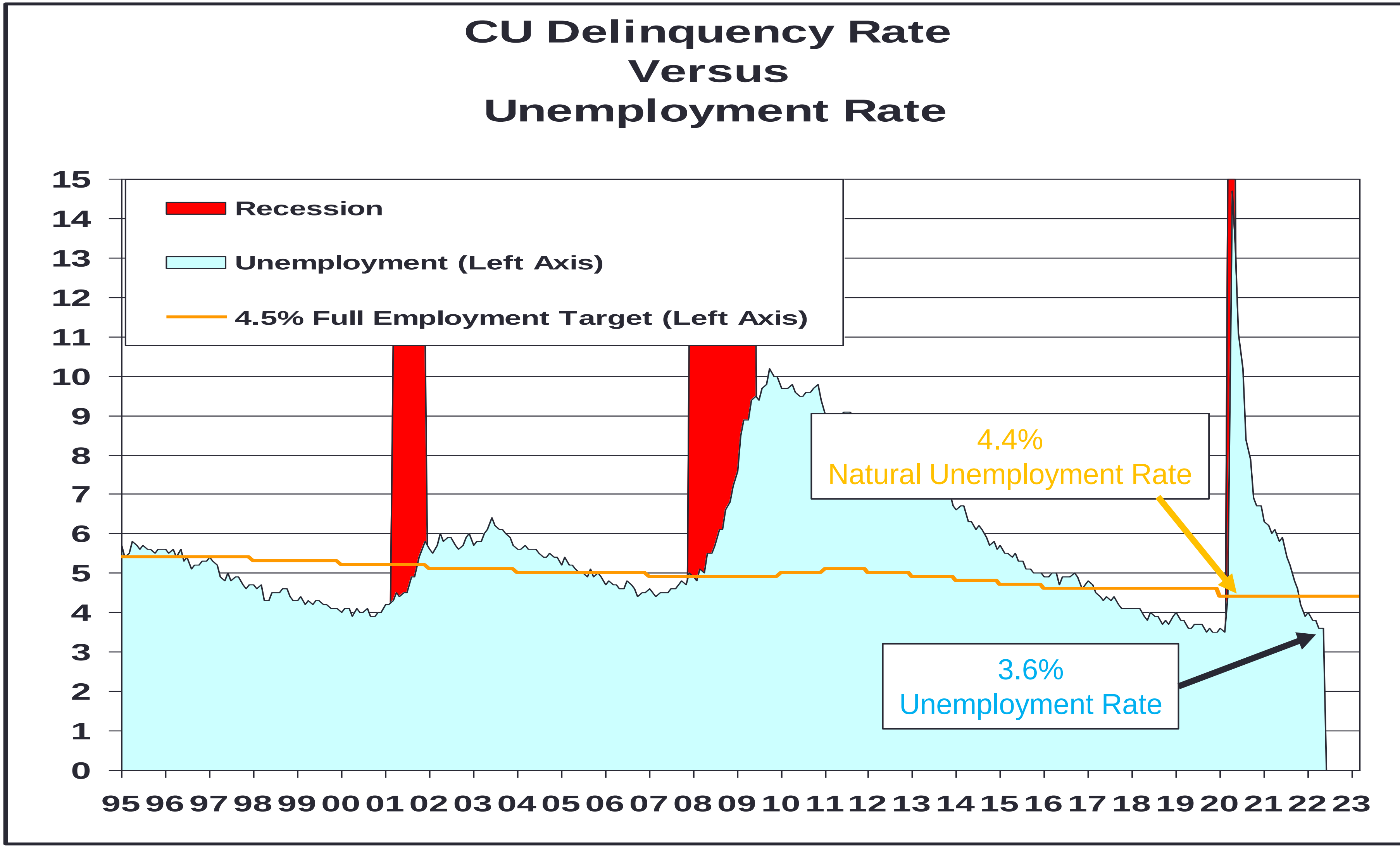
Higher Inflation Factors:
1. Pent up demand for goods and services
2. Supply chain disruptions reducing inventories
3. Rising energy & commodity prices
4. Massive monetary and fiscal stimulus
5. Lower dollar exchange rate => import prices
6. Rising housing and medical care costs

Lower Inflation Factors:
1. eCommerce is a powerful deflationary force
2. Rising competition from globalization
3. Rising productivity => falling costs per unit
4. Low population growth
5. Negative output gap and excess production capacity
6. Excess supply of labor

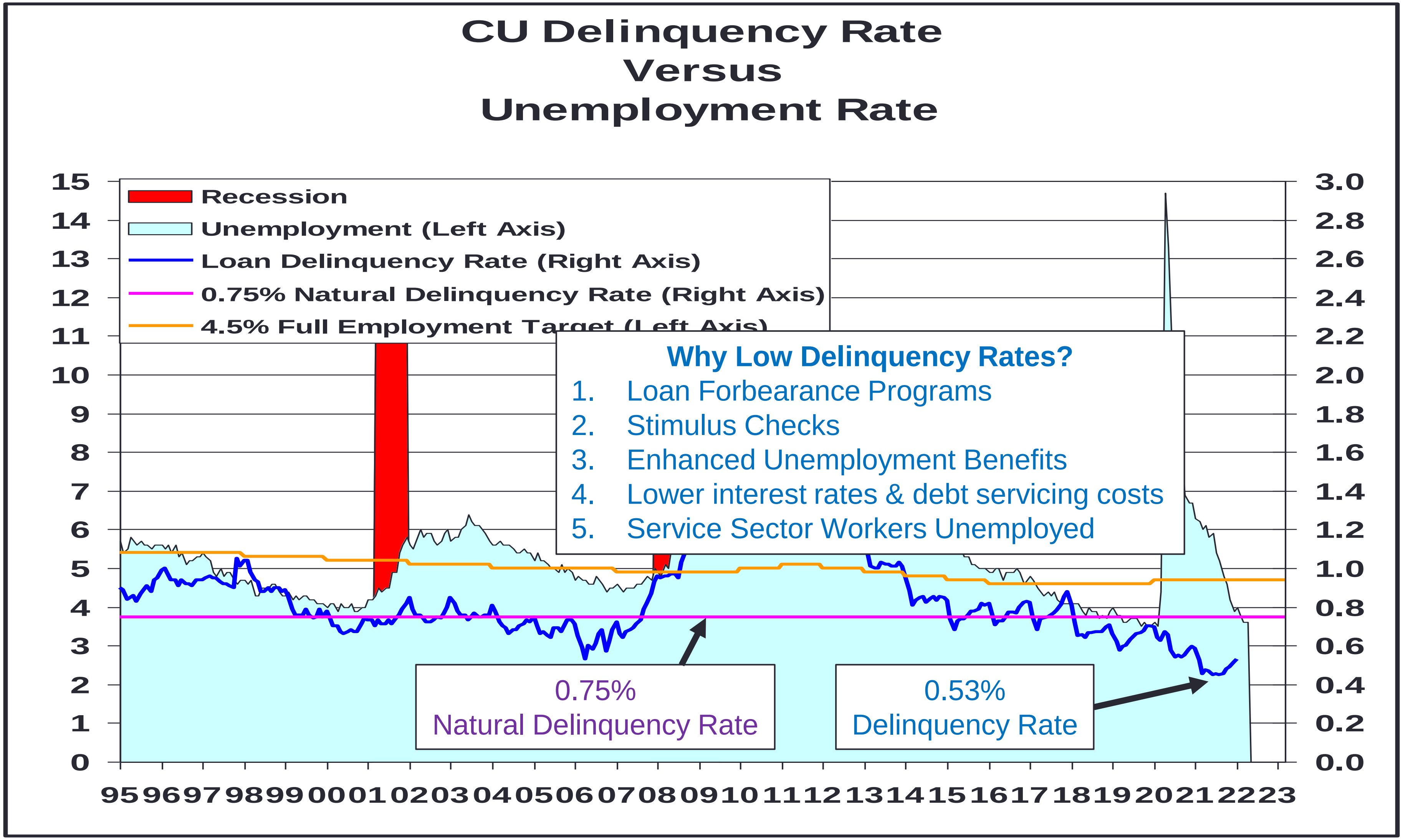
1.5 million Few Americans Working Today Compared to February 2020's 152.5 million



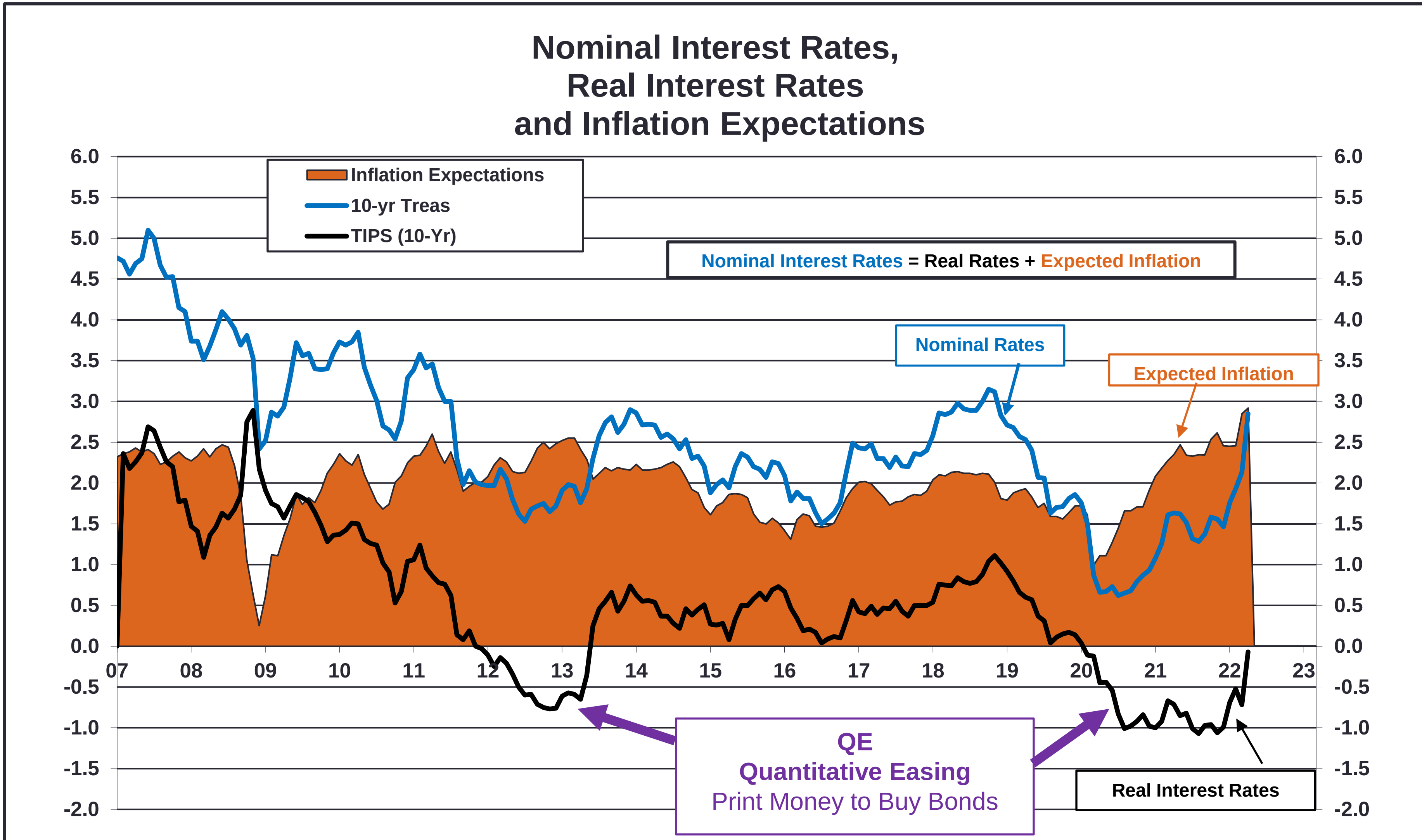
Unemployment Rate Below Natural Unemployment Rate



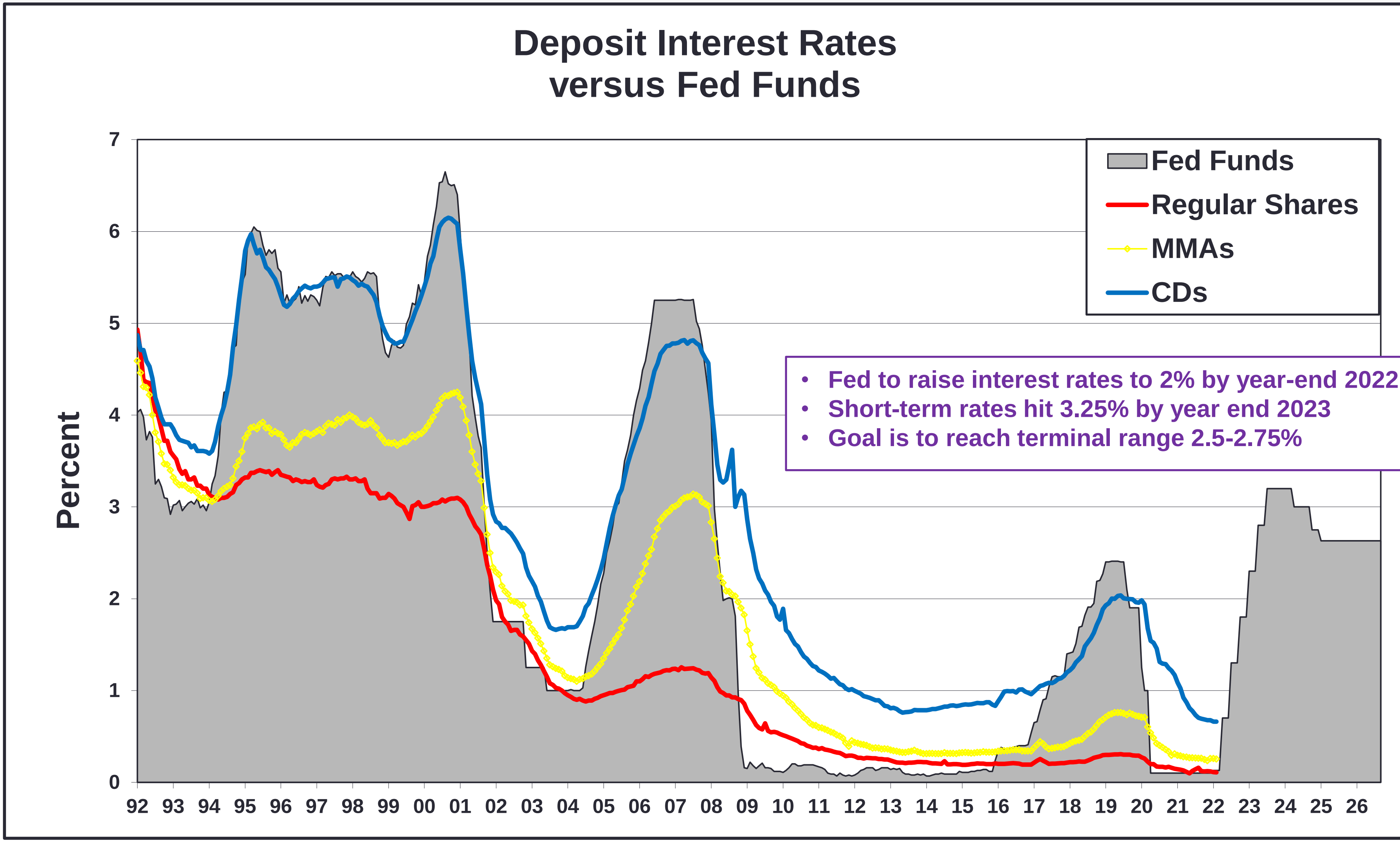
CU Loan Delinquency Rates are Low but Heading Up



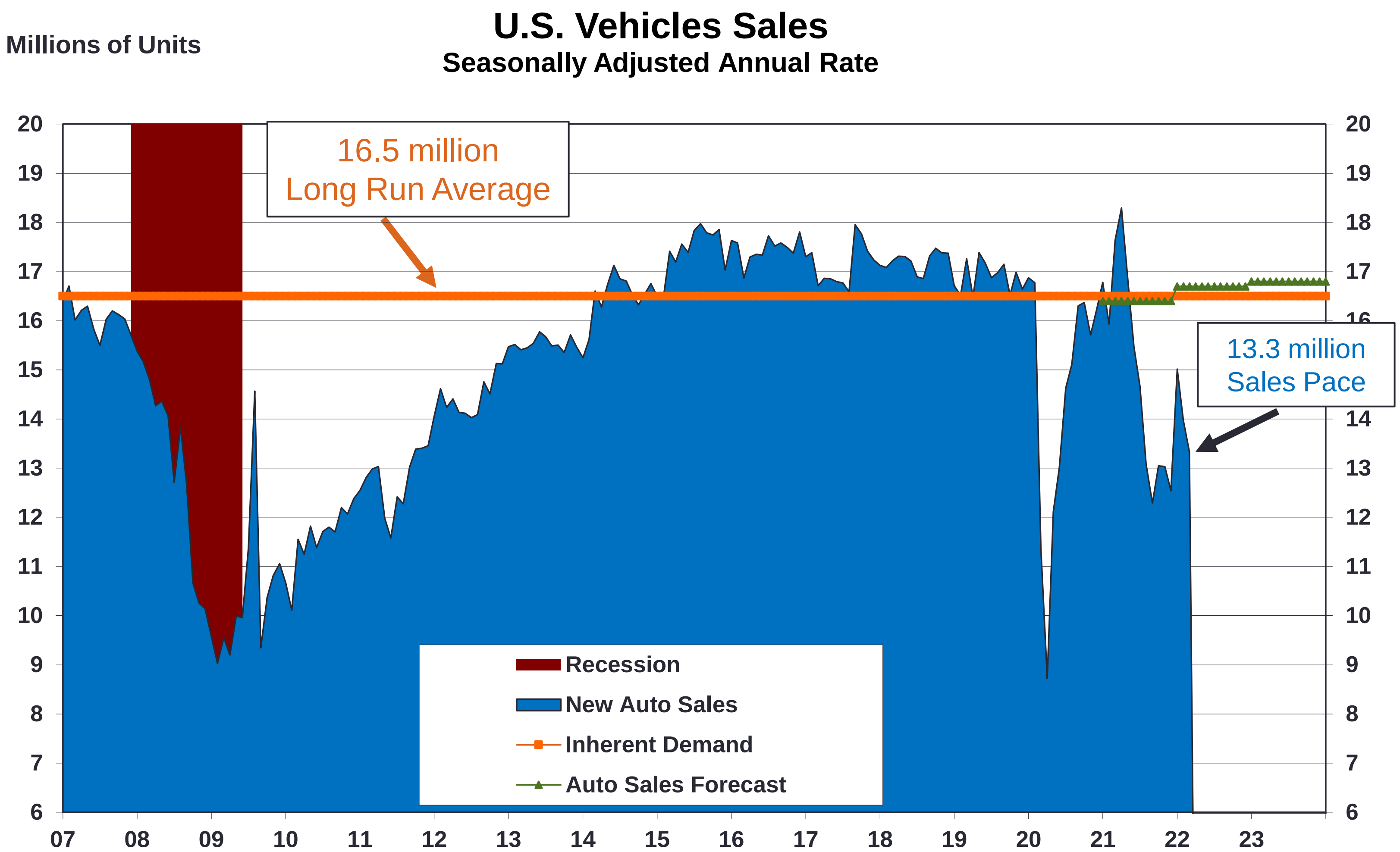
Rising Real Interest Rates, and Rising Inflation Expectations are Pushing Up Nominal Interest Rates



Rising Fed Funds Interest Rate and Deposit Pricing

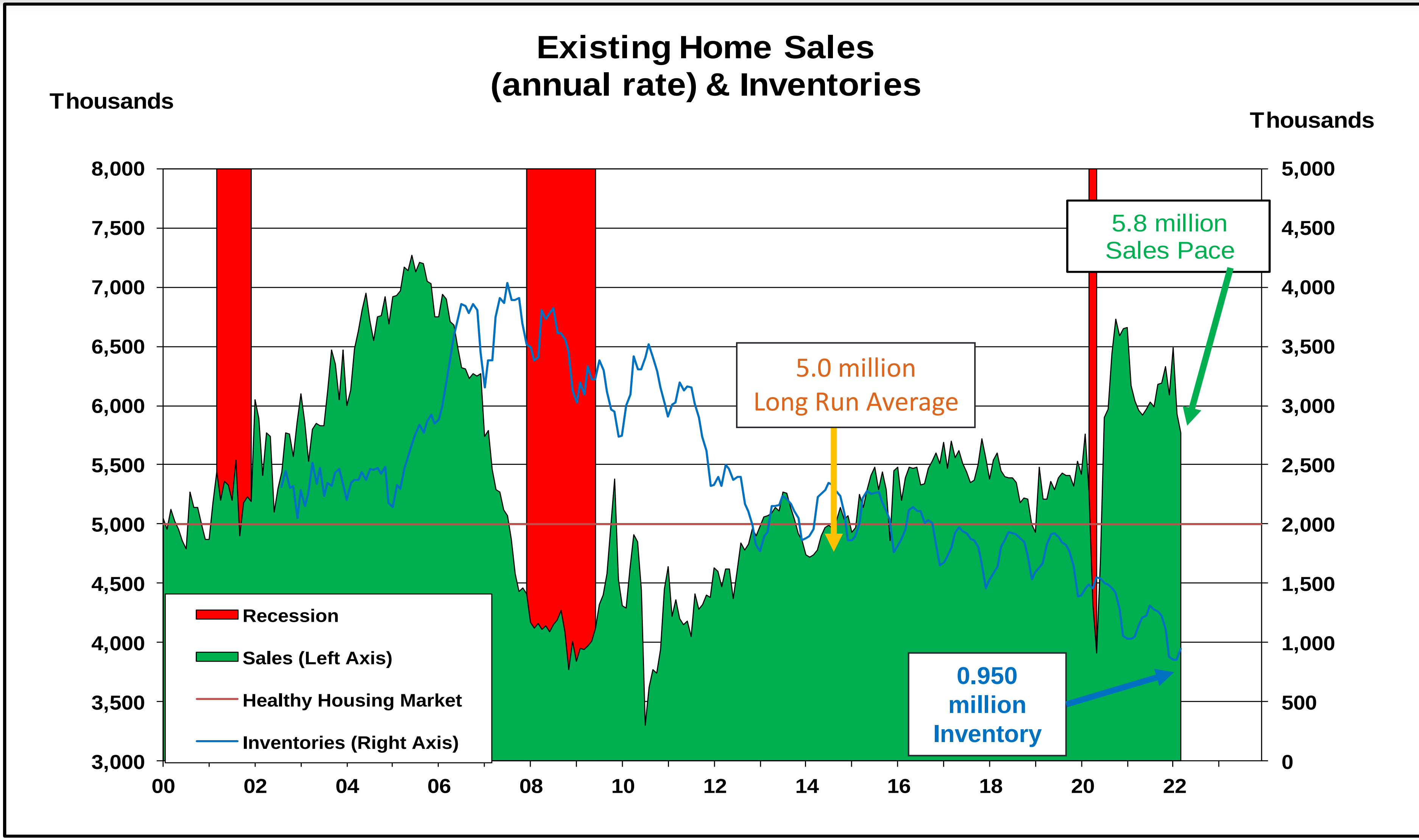


Low Auto Sales Below Long-term Trend

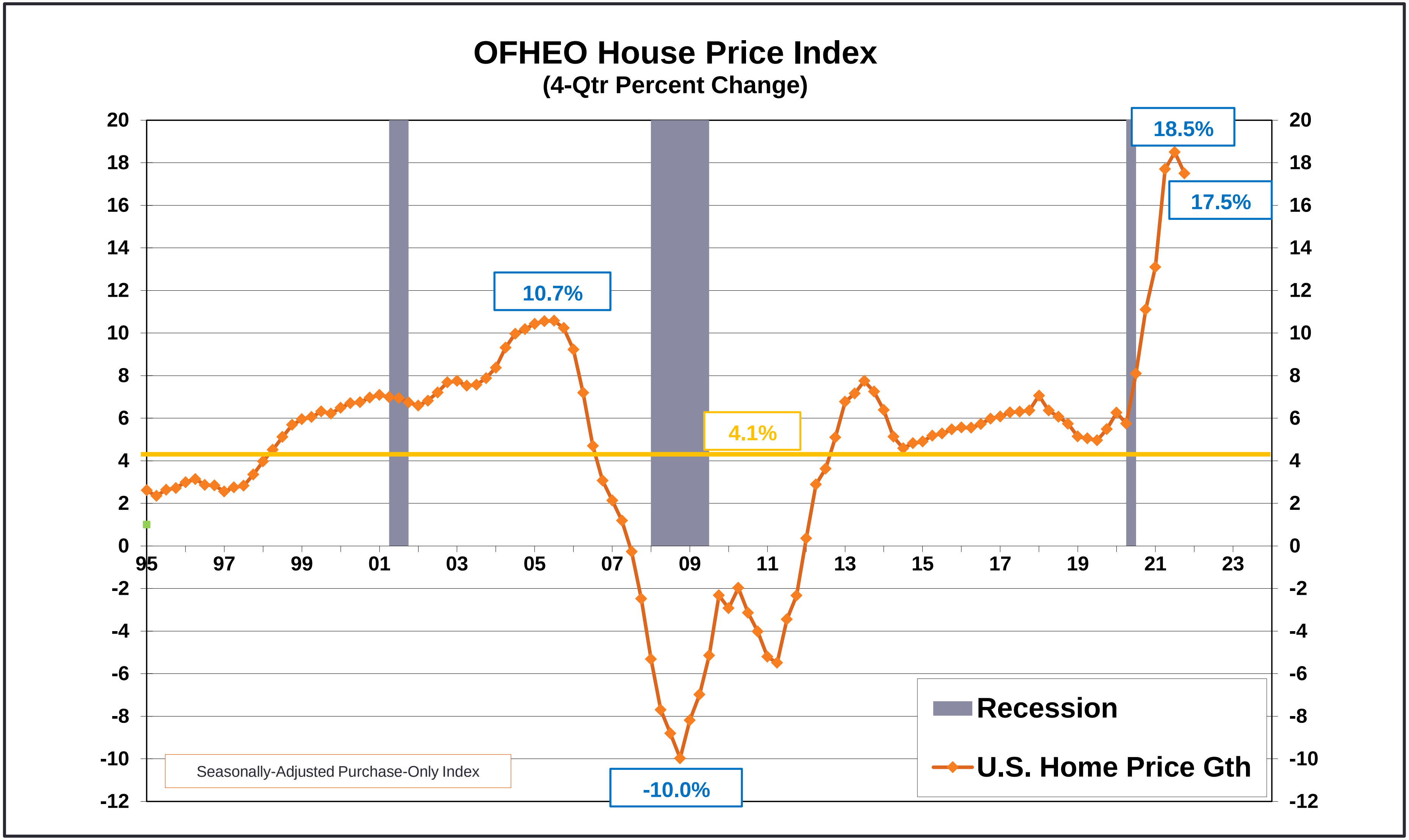


Source: Autodata Corp.

Home Sales are Strong, but Inventories are Low

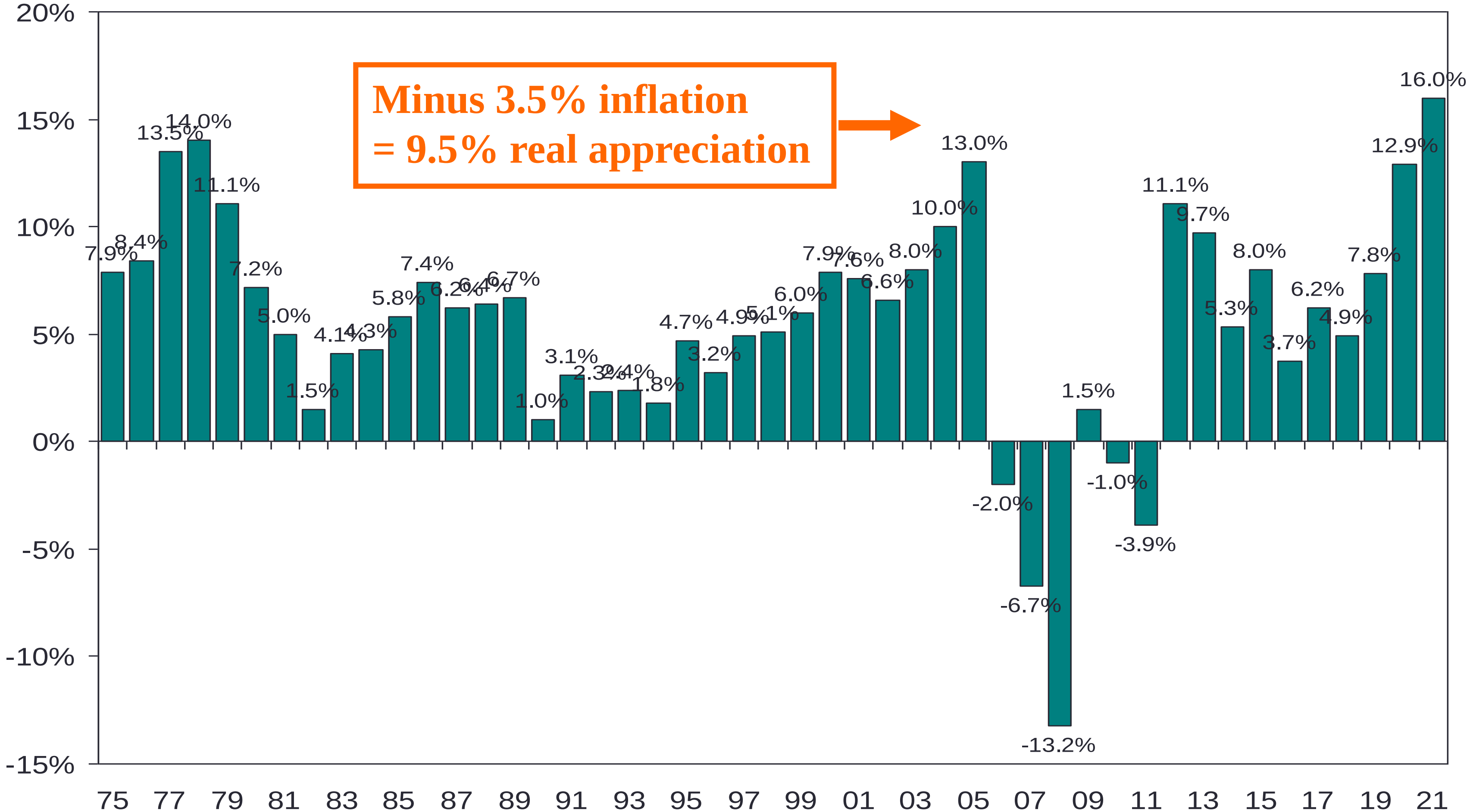


But we are seeing Record Inflation in Asset Prices
(Home Prices and Stock Prices are at Record Levels)



Median Existing Home Prices

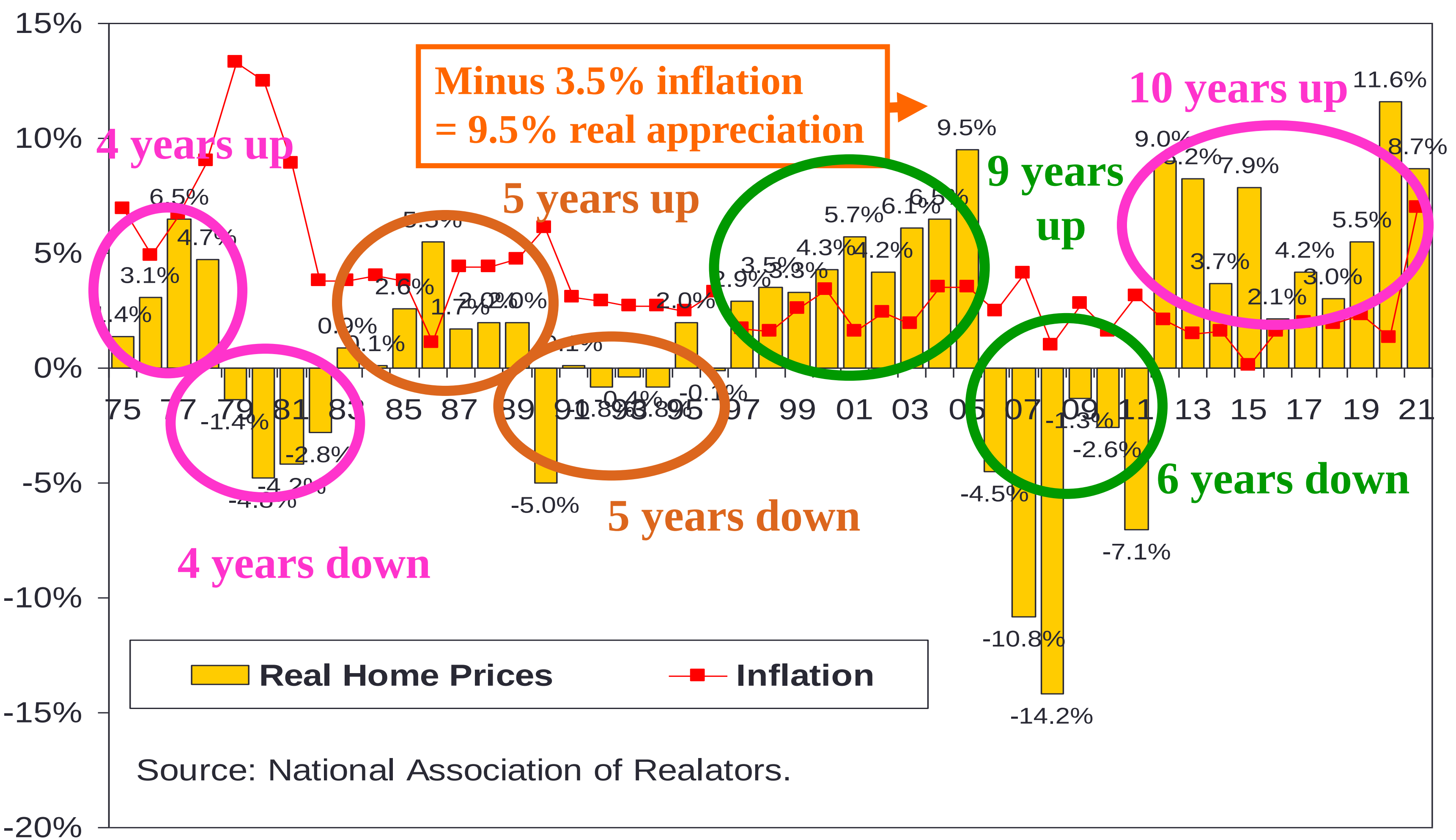
(Nominal Annual Home Price Increases)



Source: National Association of Realators.

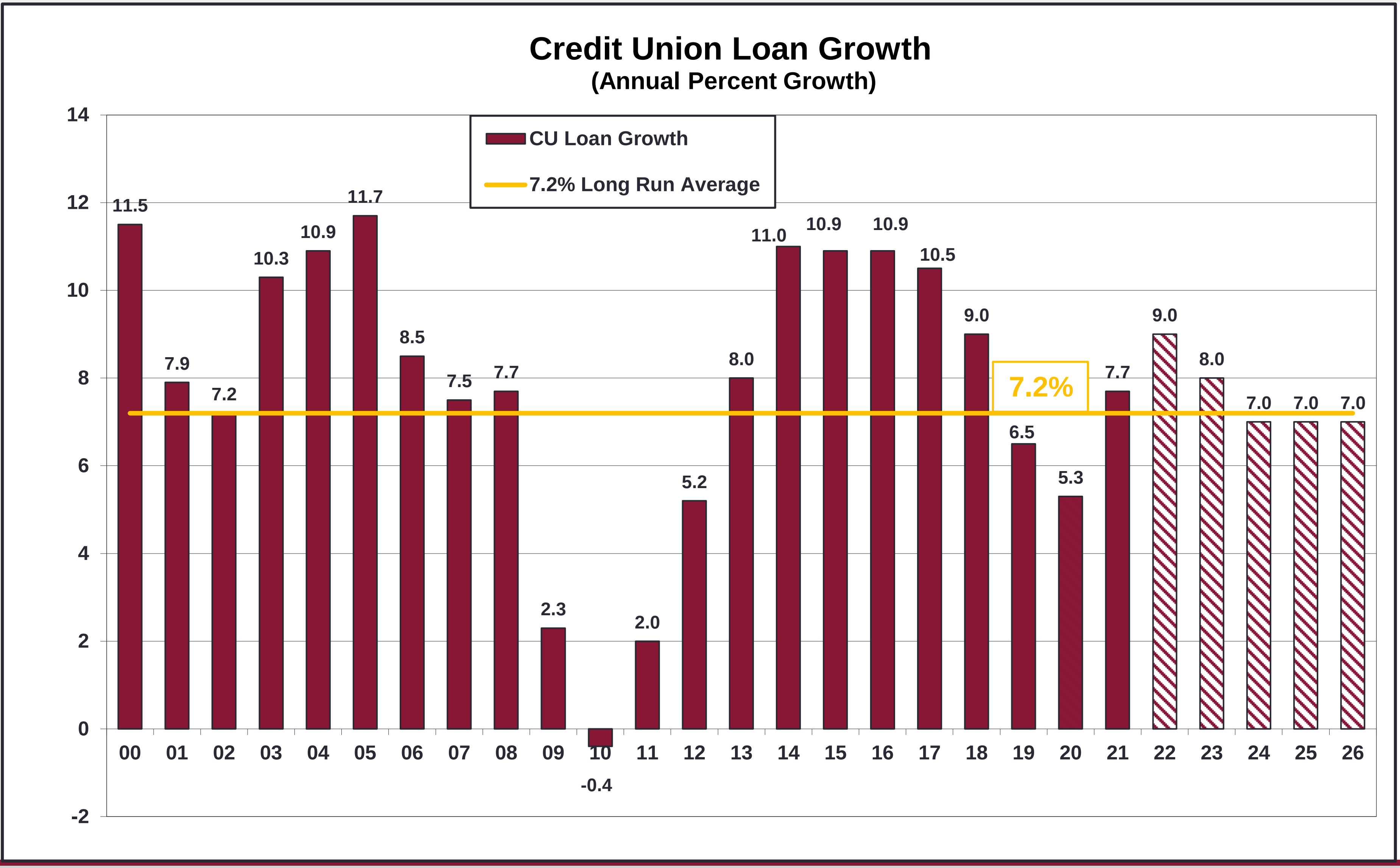
The Housing Cycle

(Inflation-Adjusted Annual Home Price Increases)



Source: National Association of Realators.

Above Trend Credit Union Loan Growth



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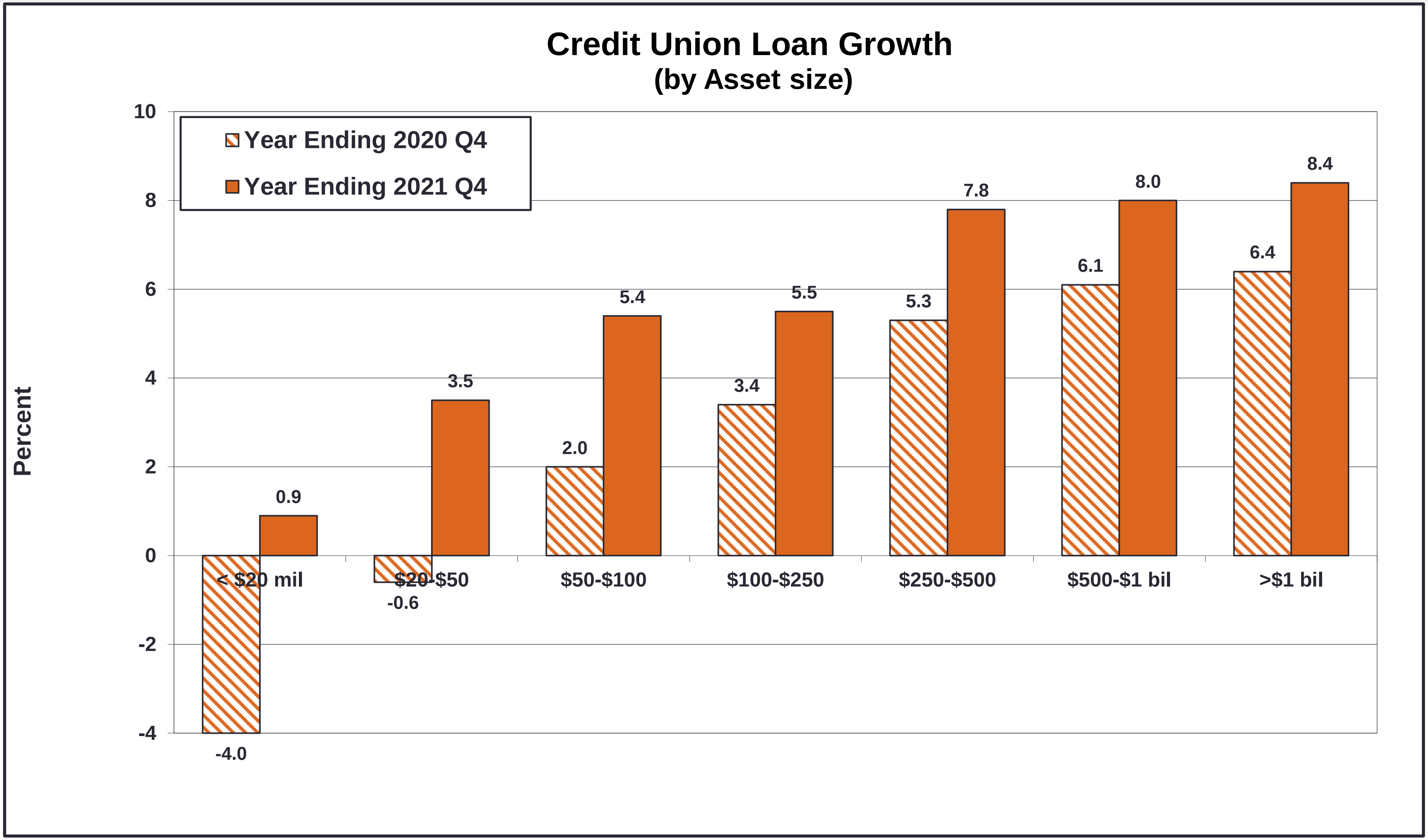
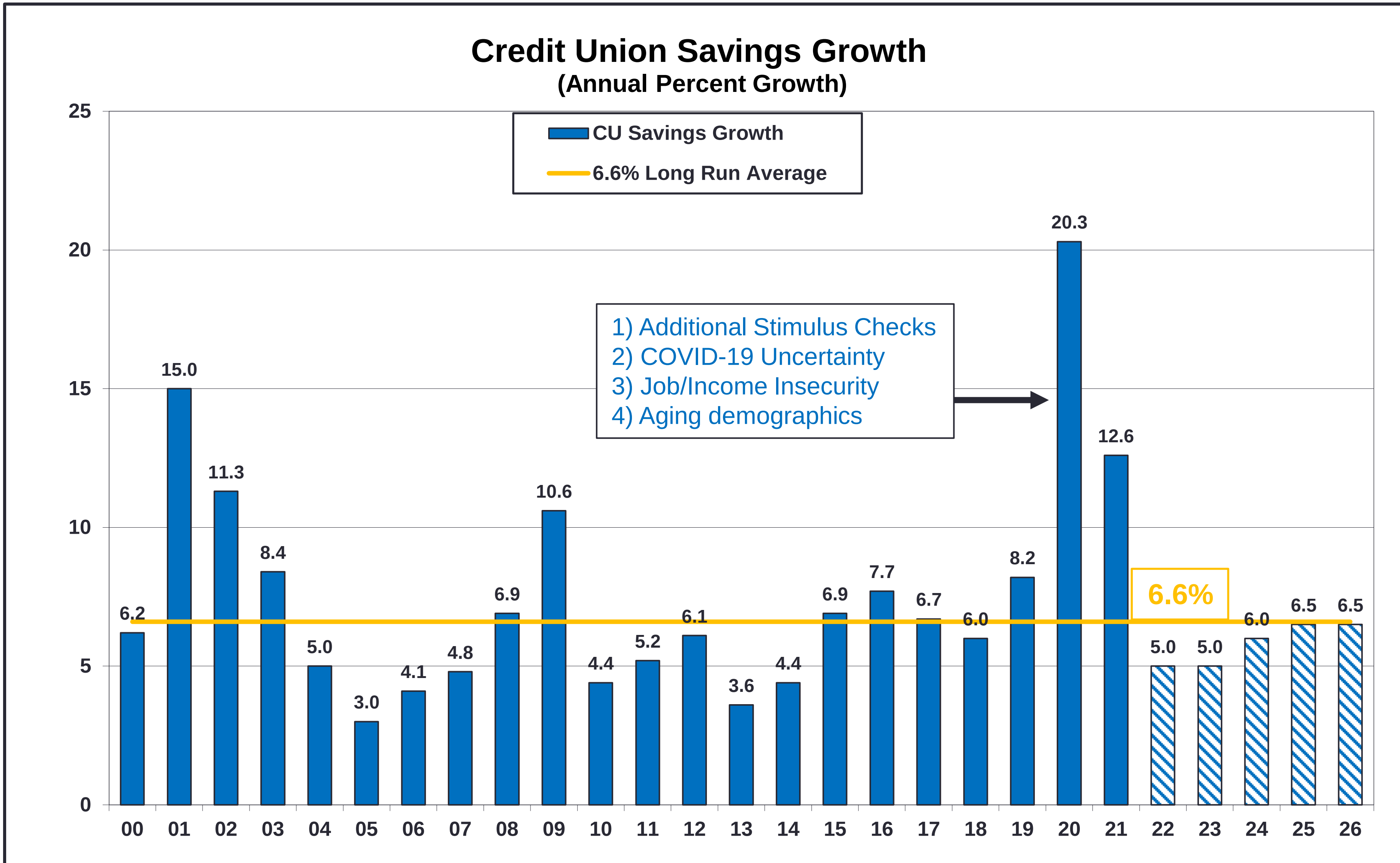
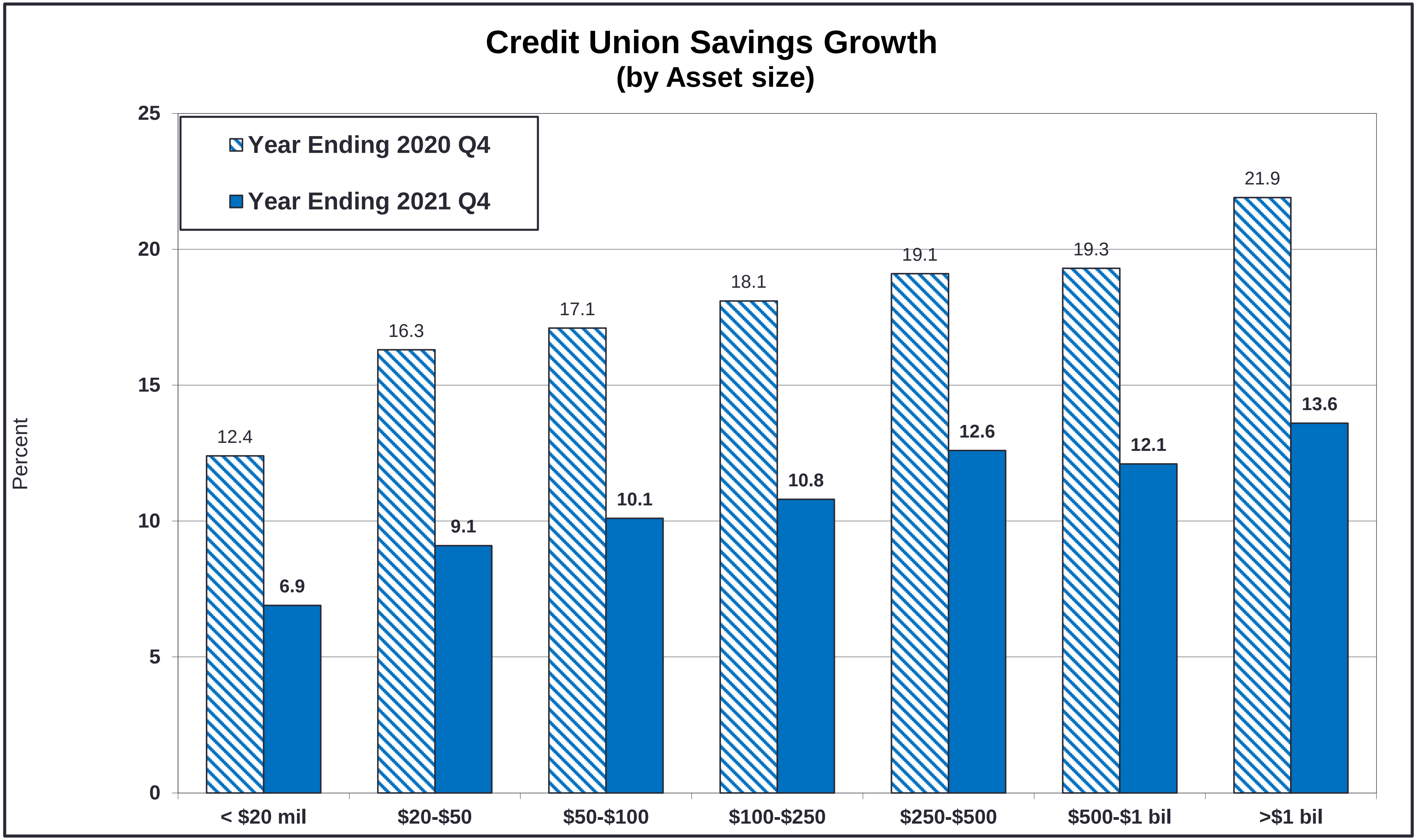
9% Credit Union Loan Growth in 2022



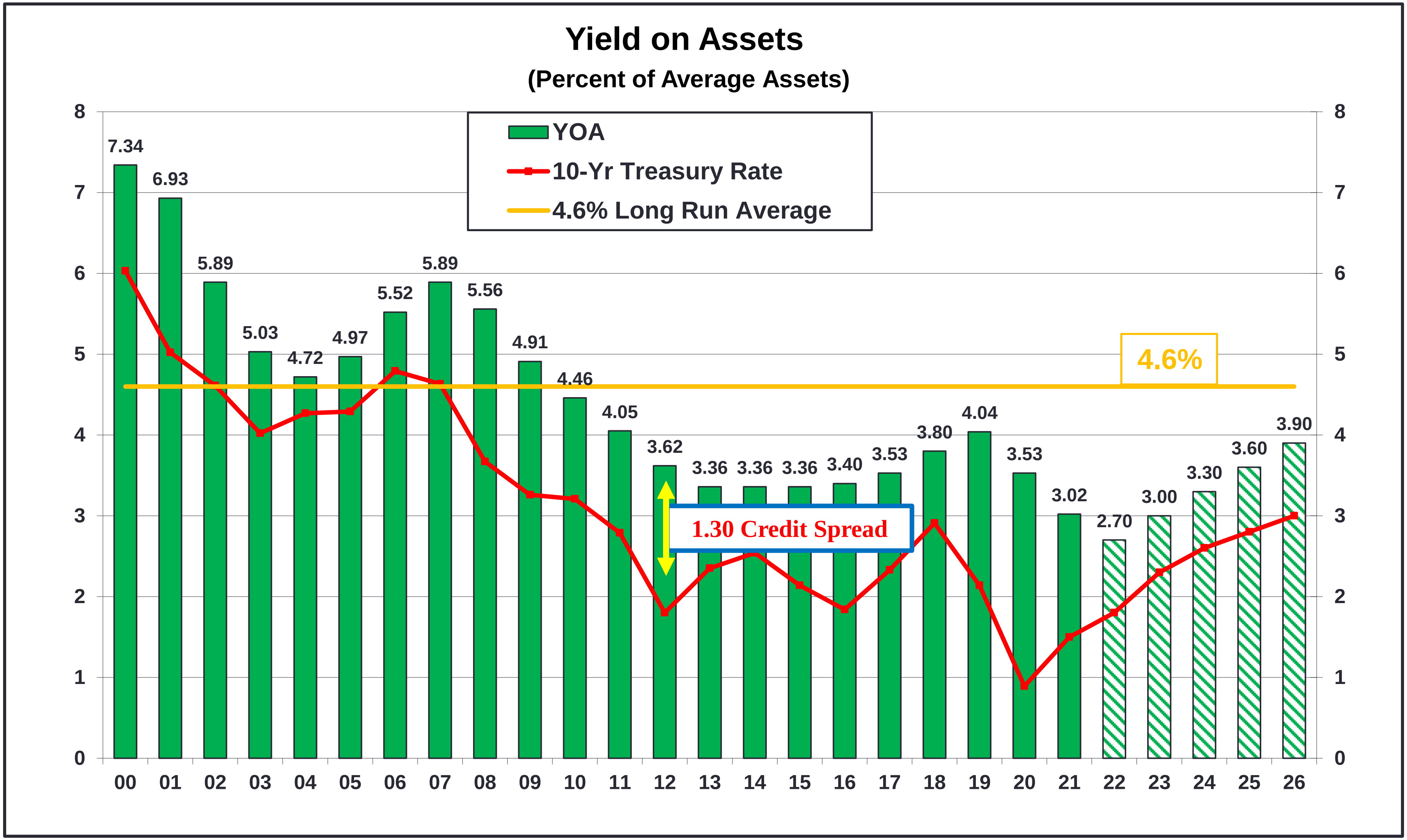
Below Trend Credit Union Saving Growth in 2022



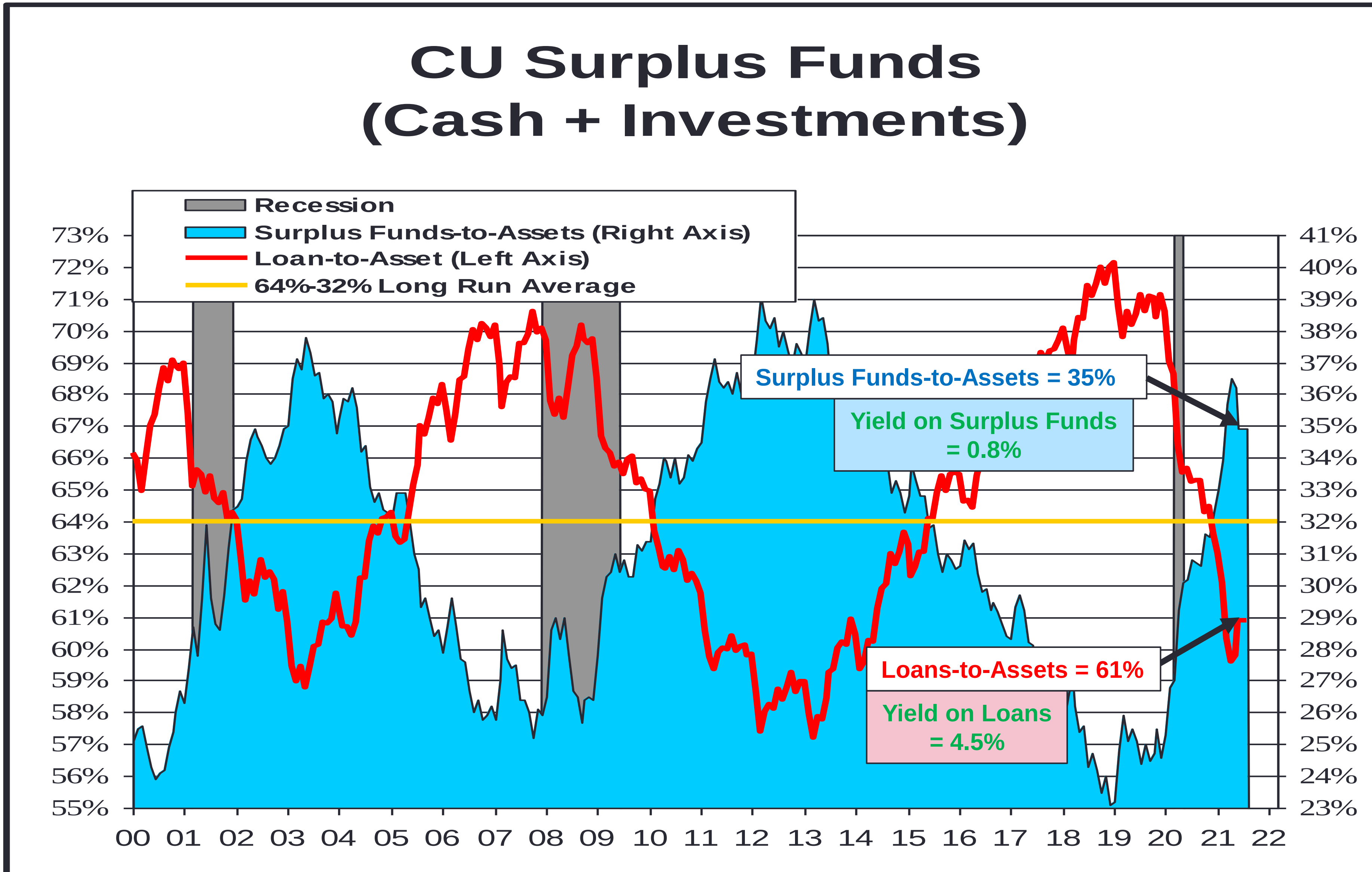
5% Credit Union Saving Growth in 2022



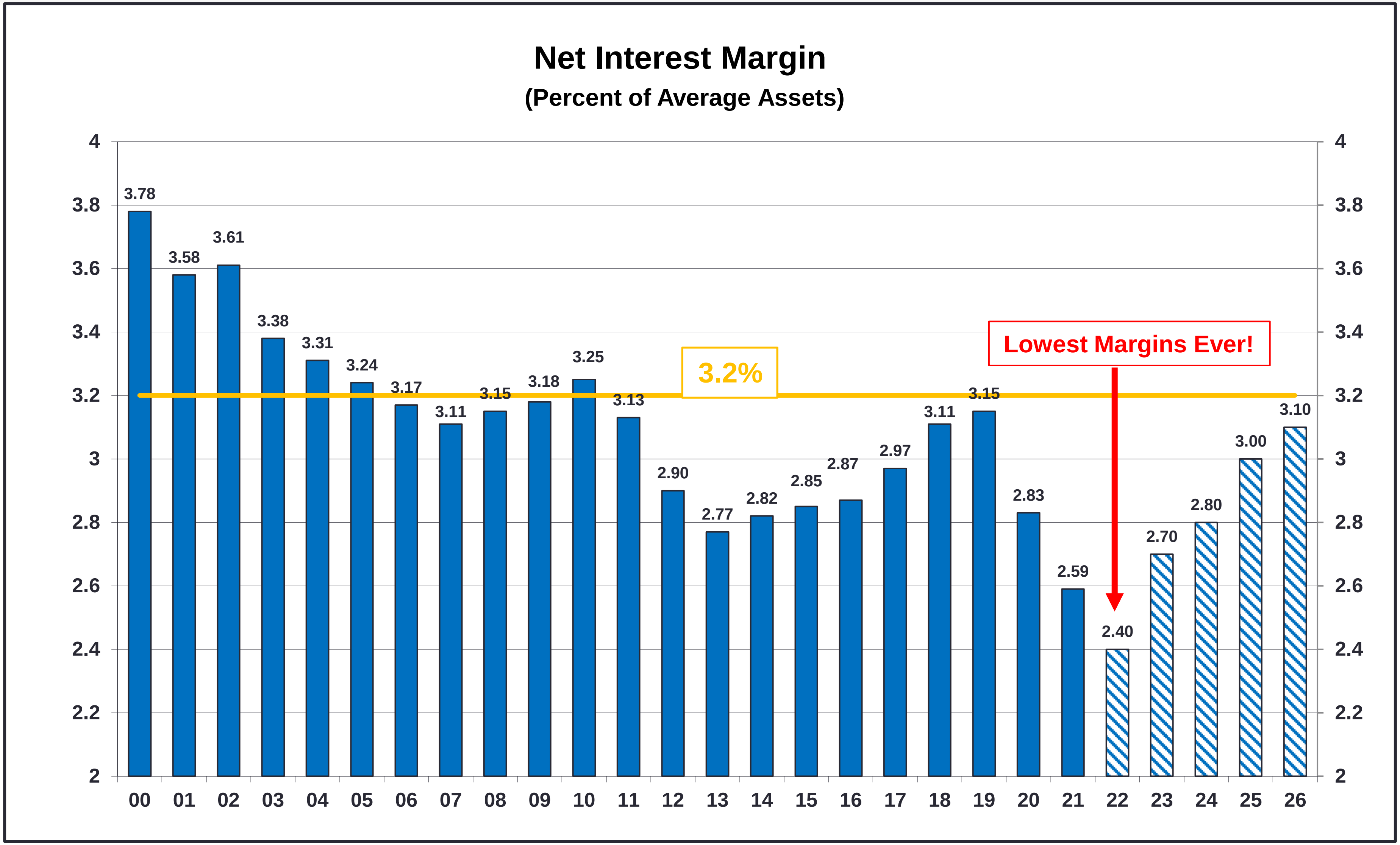
Yield-on-Assets Falling to Record Lows in 2022



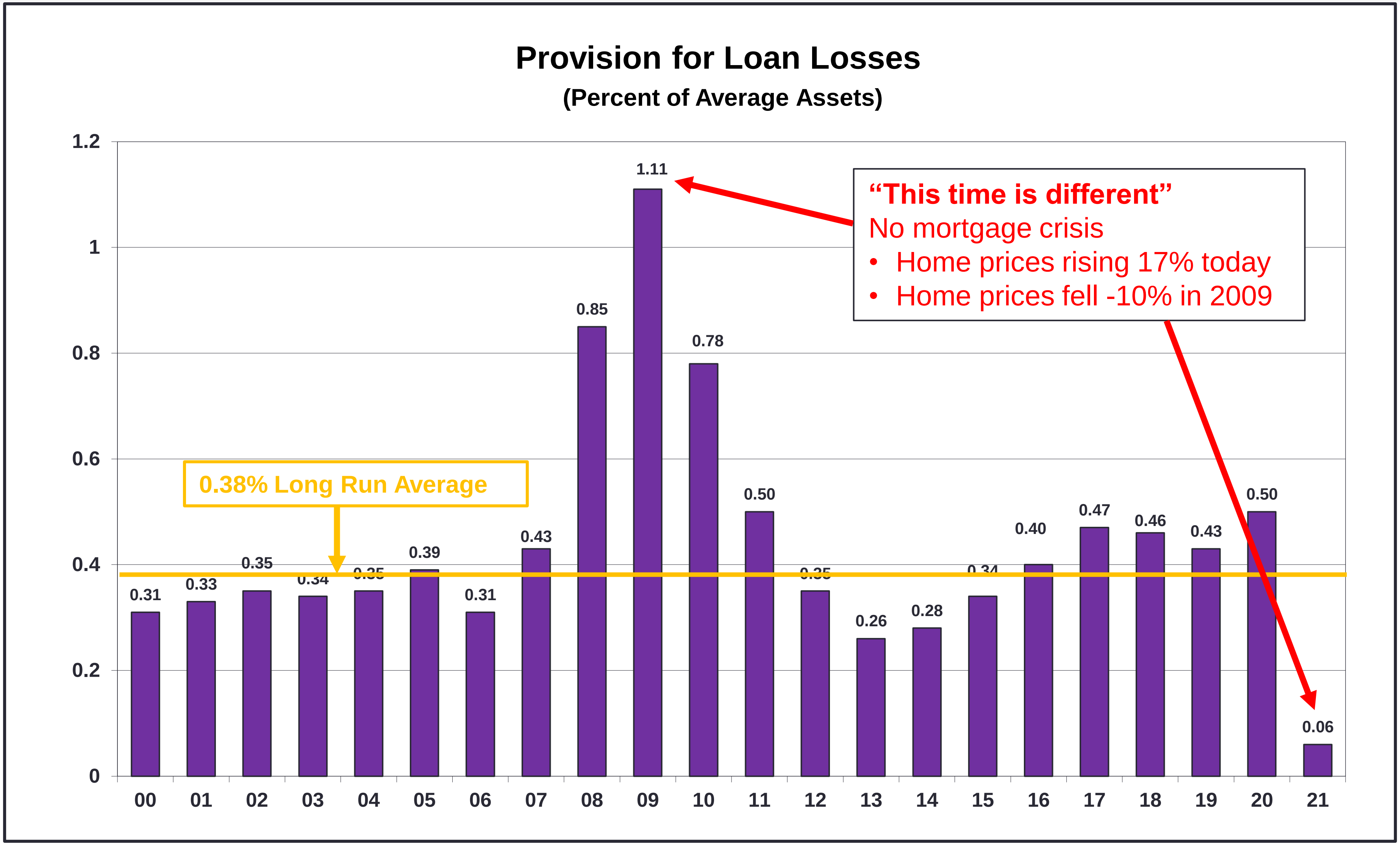
Investments Are Rising and Yields Are Falling



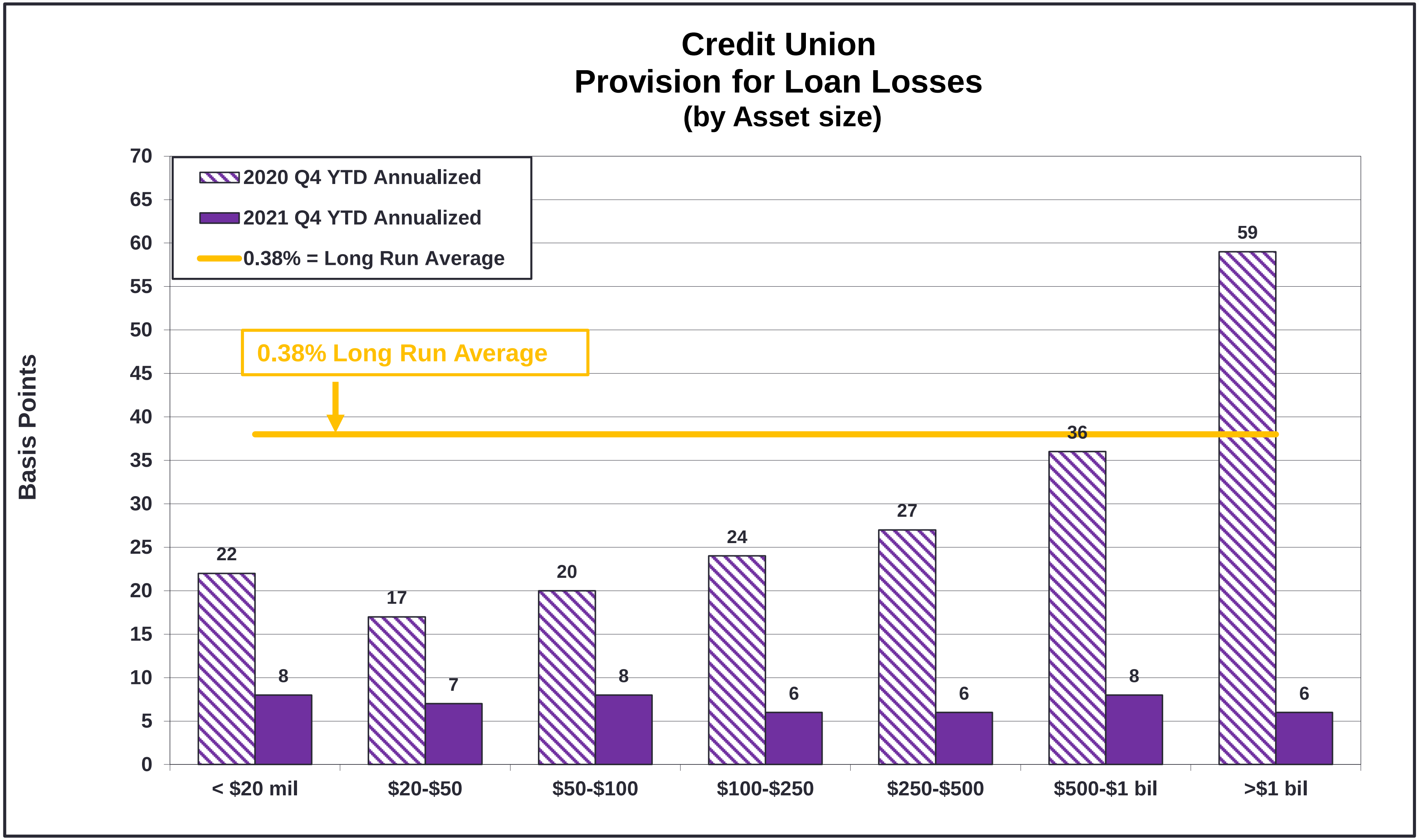
Net Interest Margins will Fall to Record Lows in 2022



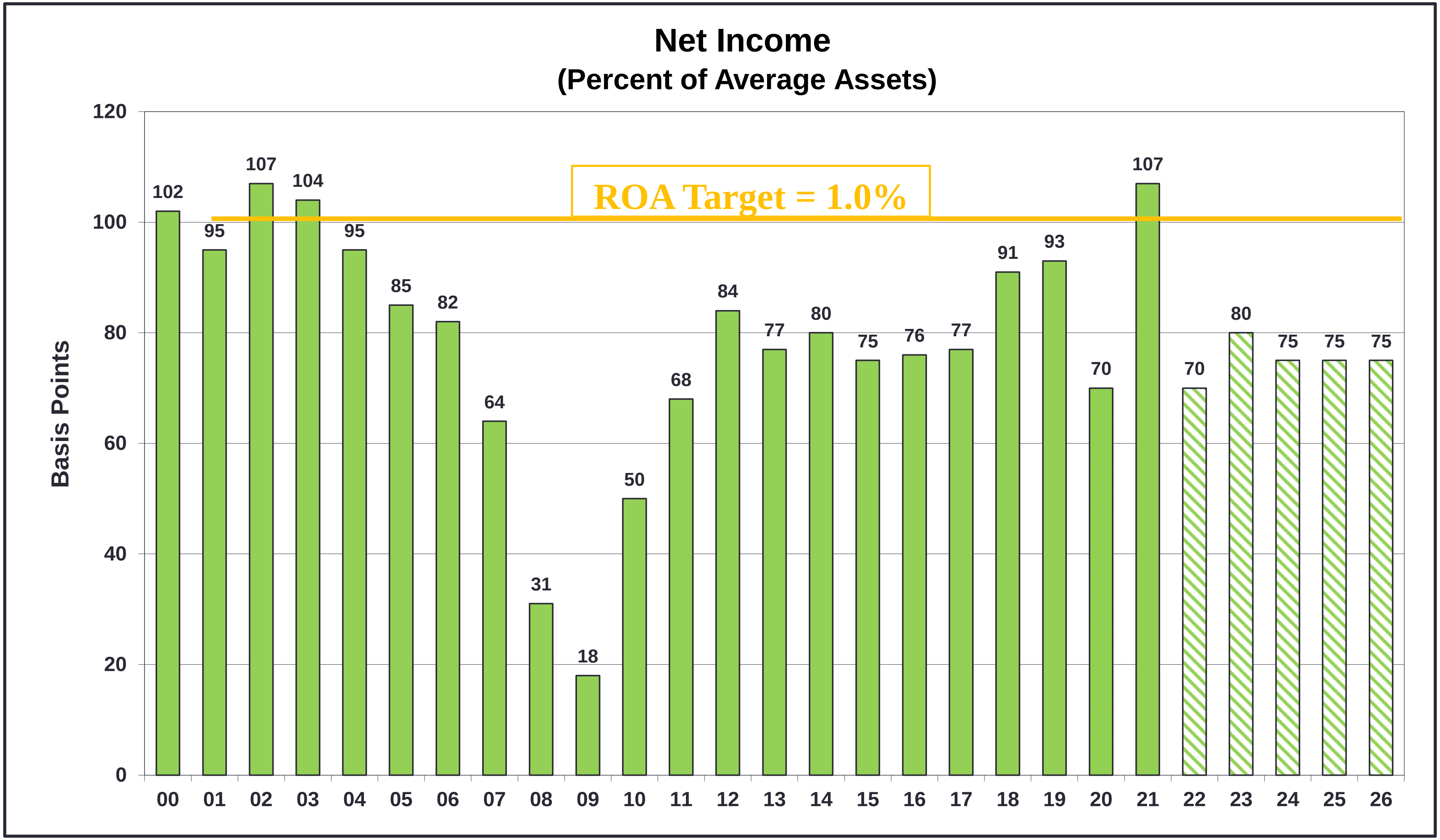
Falling Provisions for Loan Loss Ratios



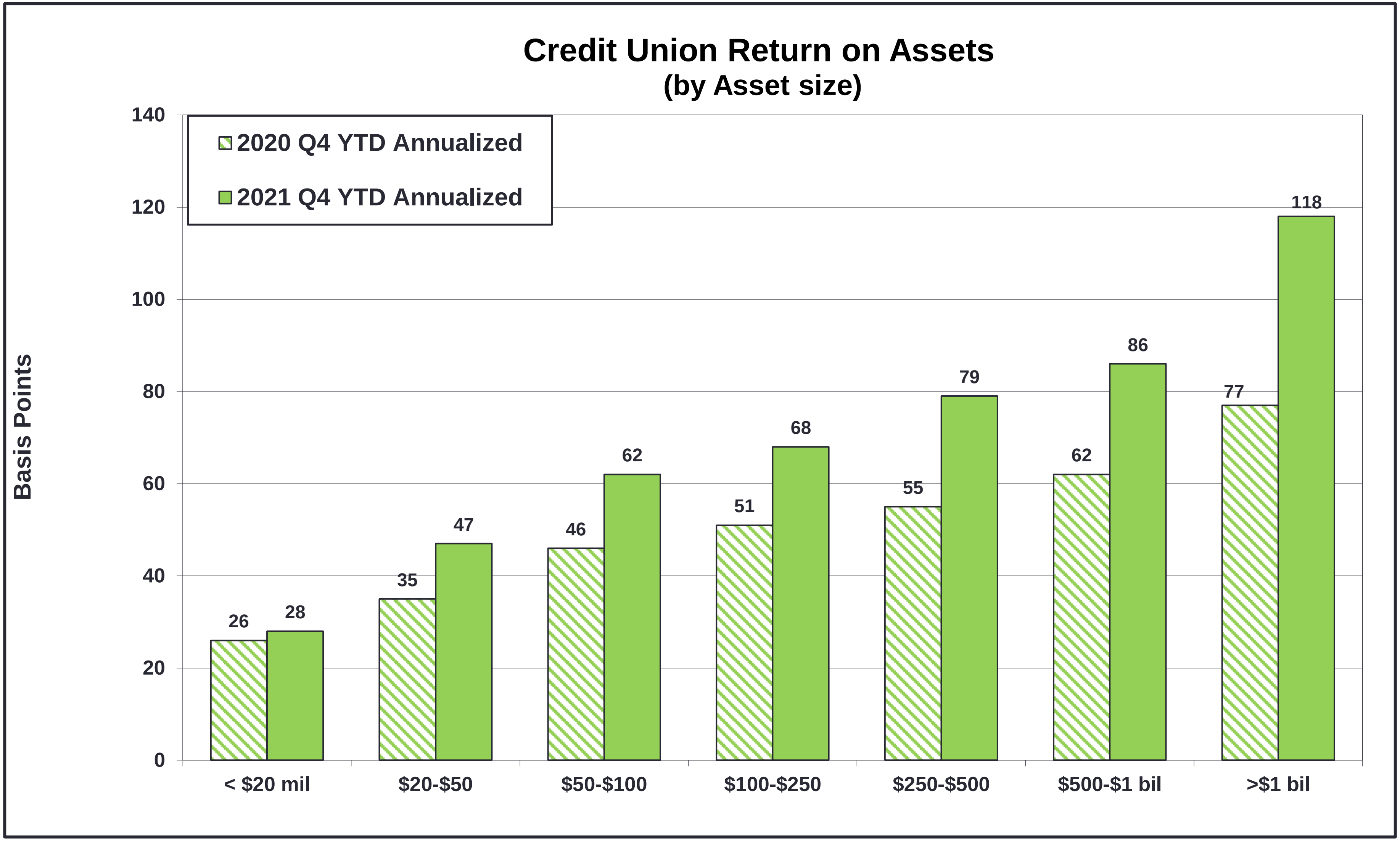
Falling Provisions for Loan Loss Ratios



Credit Union Earnings Below Trend in 2022



Rising Return-on-Asset Ratios



Economic Update Summary 2022

1. Very strong economic growth for the next 2 years
2. Long-term interest rates rising 1 percentage point over the next 2 years
3. Unemployment rate below normal for the next few years
4. Credit union loan growth rebounding in 2022
5. Record low net interest margins in 2022

Top 10 CU Issues For 2022

1. Record low net interest margins will lead to expense containment
2. Monitor employee stress and morale during pandemic
3. Update business activity expectations and reallocate staff
4. The new economic environment will create new path for profitability
5. Opportunities for prime real estate purchases and future branching
6. Adopt COVID-19 related design changes for old and new buildings
7. Excess liquidity will intensify search for higher yielding assets
8. Monitor closely the drop in capital-to-asset ratios
9. Focus on serving financially stressed members will build brand loyalty
10. 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				
Consumers Saving More of their Income				
Rising Health Insurance Costs and Premiums				
COVID-19 Building Design Changes				
More Remote & Less Onsite Staffing				
Loss of Tax-Exempt Status				
Market Expansion/Membership Growth				

Economic Forecast

Economic Growth. GDP growth slowed in the first quarter of 2022 largely due to inventory drawdowns and a rise in net imports. Expect growth to regain some momentum in the second quarter as inventories stabilize. Over the coming year, positives for growth include households spending down some of the substantial savings built up during COVID (which of course becomes a negative if a highly lethal COVID variant emerges), and strong job growth and rising labor force participation boosting household income, Negative for growth are fallout from the war in Ukraine, and the economy's reaction to rising interest rates. We believe these forces will, on net, cause GDP growth to slow starting in the second half, and to rise by only 2% in 2023. This is essentially the "soft landing" scenario where the Fed raises interest rates just enough to slow inflation without precipitating a recession. Such soft landings are rare, and the risks are to the downside, i.e., an even slower economy in 2023 or possibly even a recession.

Inflation. Most economists (us included) have underestimated the level and persistence of inflation. The pandemic created the primary drivers of last year's rise in inflation: surging demand after much supply had been destroyed, supply chain bottlenecks, reduced labor supply due to worker health concerns and school closings, and stimulative fiscal and monetary policies. Although most of these forces are abating or reversing, the war in Ukraine is driving up commodity prices and creating new problems for some supply chains. However, we still believe inflation will slow in the second half and into 2023 as the inflationary effects of COVID continue to abate and slower growth in the US and much slower growth in European economies reduce price pressures.

Unemployment. The US job market is hot. Over the twelve months to March, the unemployment rate has dropped from 6.0% to 3.6% and the economy has added 6.4 million jobs (normal over the past decade is a bit over 2 million a year). There are about 1.8 job openings per unemployed worker, and businesses report difficulty hiring. The percentage of the prime working population with jobs is nearing is pre-pandemic level, so there is only so much room for employment to increase. We expect the unemployment rate to settle around 3.5% for the remainder of the forecast period.

Interest Rates. The highest inflation rate in the US in four decades is forcing the Fed to react by raising the Fed Funds target rate and shrinking its balance sheet which will push longer term rates up. Don't expect rates to rise to the levels reached the last time the Fed had to tame surging inflation in the early 1980s, when the Fed Funds rate reached 19% and the 10-year Treasury Note rate touched 15% (yes, really)! Nevertheless, we now expect the Fed Funds rate to reach 2.5% by year-end, its highest rate since 2007, and to rise further next year to 3.25%. Although notoriously difficult to forecast (for us especially), expect the 10-year Treasury rate to rise to 3% by December and to 3.5% next year. If the Fed turns out to have been particularly skillful and lucky, these rate movements will slow the economy enough to cool inflation without causing a recession. However, the risks are that the monetary tightening could cause a mild recession in 2023 or 2024.

Economic Forecast – April 2022

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5 Year Average	2021	2022:1	2022:2	2022:3	2022:4	2022	2023
Growth Rates:								
Economic Growth (% Change GDP)*	2.1%	5.7%	1.5%	4.0%	3.5%	3.0%	3.0%	2.0%
Inflation (% Change CPI)*	2.1%	7.1%	8.5%	5.0%	4.0%	3.5%	5.0%	3.0%
Unemployment Rate	5.2%	3.9%	3.6%	3.5%	3.5%	3.5%	3.5%	3.5%
Federal Funds Rate (effective)	0.64%	0.07%	0.33%	1.33%	2.00%	2.50%	2.50%	3.25%
10-Year Treasury Rate	2.12%	1.52%	2.34%	2.50%	2.75%	3.00%	3.00%	3.50%
10-Year-Fed Funds Spread	1.48%	1.45%	2.01%	1.17%	0.75%	0.50%	0.50%	0.25%

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

Credit Union Forecast

Savings and Asset Growth. Look for credit union savings growth to slow to 5% in both 2022 and 2023, below the long-term average. This is largely payback for the torrid deposit growth of the past two years, fueled by COVID's impact on consumer spending. There is also the possibility that members holding high-balance non-maturity shares and deposits (particularly money market accounts) might find yields on money market mutual funds attractive as the year progresses. As credit union asset growth is principally determined by savings growth, expect asset growth to also slow, to 4.5% in 2022 and 2023.

Loan and Membership Growth. Loan growth is likely to hold at 8% this year, close to last year's rate, before declining slightly in 2023. Auto loan volume will pick up as semiconductor shortages ease and the the supply of new vehicles recovers. Substantially higher mortgage interest rates will dramatically slow new mortgage originations, particularly refinances, but reduced refis will also slow the runoff from existing portfolios. With healthy auto loan activity, membership growth will hold at around 3.5% through 2023.

Liquidity. With loans outstanding outpacing savings growth, the average credit union loan-to-savings ratio will drift up from 70.7% last December to 72.8% this year and 74.2% by the end of 2023. That will still be well below the 86% level reached in 2018, and represents a substantial amount of credit union liquidity.

Asset Quality. Credit union credit quality metrics broke modern records in 2021. The year-end average delinquency rate was only 0.48% and full-year net charge-offs were just 0.26% of loans outstanding. We expect a gradual reversion to long-term averages, with delinquency rising to 0,6% by the end of 2022 and 0.7% next year. Similarly, look for net charge-offs to rise to 0.4% in 2022 and 0.5% in 2023.

Earnings. After recoding a very strong 1.07% return on assets (ROA) last year, we expect earnings to moderate to around 70 basis points in 2022 and 2023. Changes in earnings will vary considerably across credit unions depending on how rising interest rates affect net interest income (NII). Average credit union NII fell to a modern record low of only 259 bp in 2021, due to very low interest rates across the board. That suggests that rising interest rates should boost NII, unless the yield curve inverts, pushing up shorter rates (deposit costs) more than loan rates. However, the timing of changes in deposit costs and asset yields may be problematic, and for some credit unions deposit costs could rise by more than average asset earnings. Other determinants of ROA face headwinds in 2022 and 2023 compared to last year. Loan loss provisions fell to an unheard of 6 bp of assets last year with low charge-offs and as credit unions drew down the loan loss allowances built up in the uncertainty of the first year of the pandemic. This year, provisions should return toward a more normal 30 bp to 40 bp of assets. With the interest-rate-induced slowdown in mortgage refinancing, revenues related to that activity (gain on sales) will fall sharply. Inflation will put upward pressure on operating expenses, and overdraft revenues will be curtailed by low unemployment and growing competitive pressures. The only bright spot (except for the many credit unions that will benefit from rising interest rates) is interchange revenue which will be boosted by members returning to face-to-face experiences (travel, eating out, etc).

Credit Union Forecast – April 2022

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5 Year Average	2021	2022:1	2022:2	2022:3	2022:4	2022	2023
Growth Rates:								
Savings Growth	8.1%	12.6%	3.0%	0.7%	0.4%	0.9%	5.0%	5.0%
Loan Growth	8.2%	7.7%	0.5%	2.9%	2.8%	1.8%	8.0%	7.0%
Asset Growth	9.8%	11.7%	0.5%	2.5%	1.0%	0.5%	4.5%	4.5%
Membership Growth	3.5%	4.2%	1.0%	1.0%	1.0%	0.5%	3.5%	3.5%
Liquidity:								
Loan-to-Share Ratio**	77.0%	70.7%	69.0%	70.5%	72.2%	72.8%	72.8%	74.2%
Asset Quality:								
Delinquency Rate**	0.79%	0.48%	0.50%	0.55%	0.60%	0.60%	0.60%	0.70%
Net Charge-off Rate*	0.53%	0.26%	0.30%	0.35%	0.35%	0.40%	0.40%	0.50%
Earnings:								
Return on Average Assets (ROA)*	0.83%	1.07%	0.90%	0.80%	0.70%	0.60%	0.70%	0.70%
Capital Adequacy:								
Net Worth Ratio**	10.6%	10.3%	10.3%	10.3%	10.4%	10.5%	10.5%	10.8%

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

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