Economic & Credit Union Update

January 2023

If you have any questions or comments, please contact:
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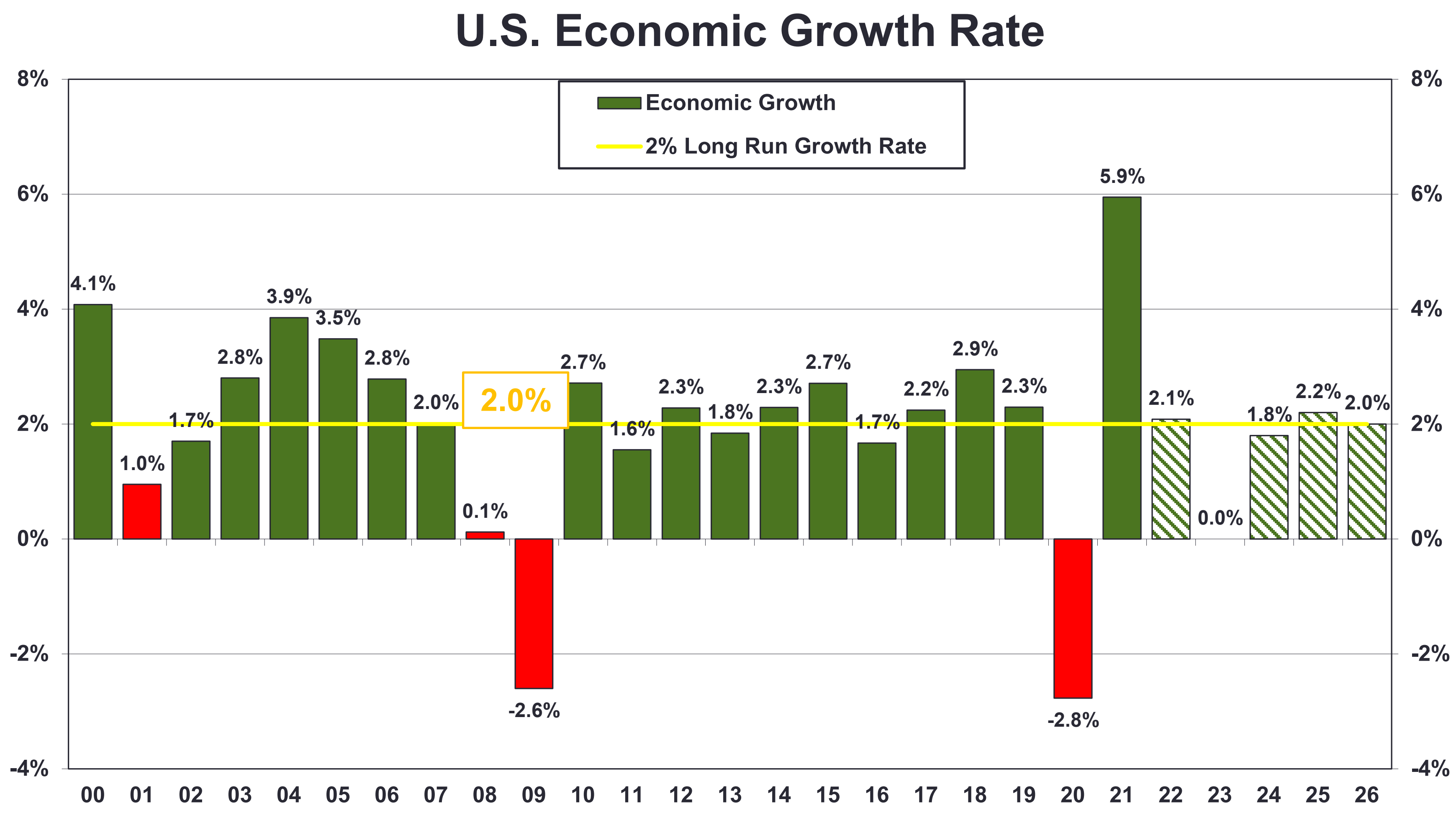
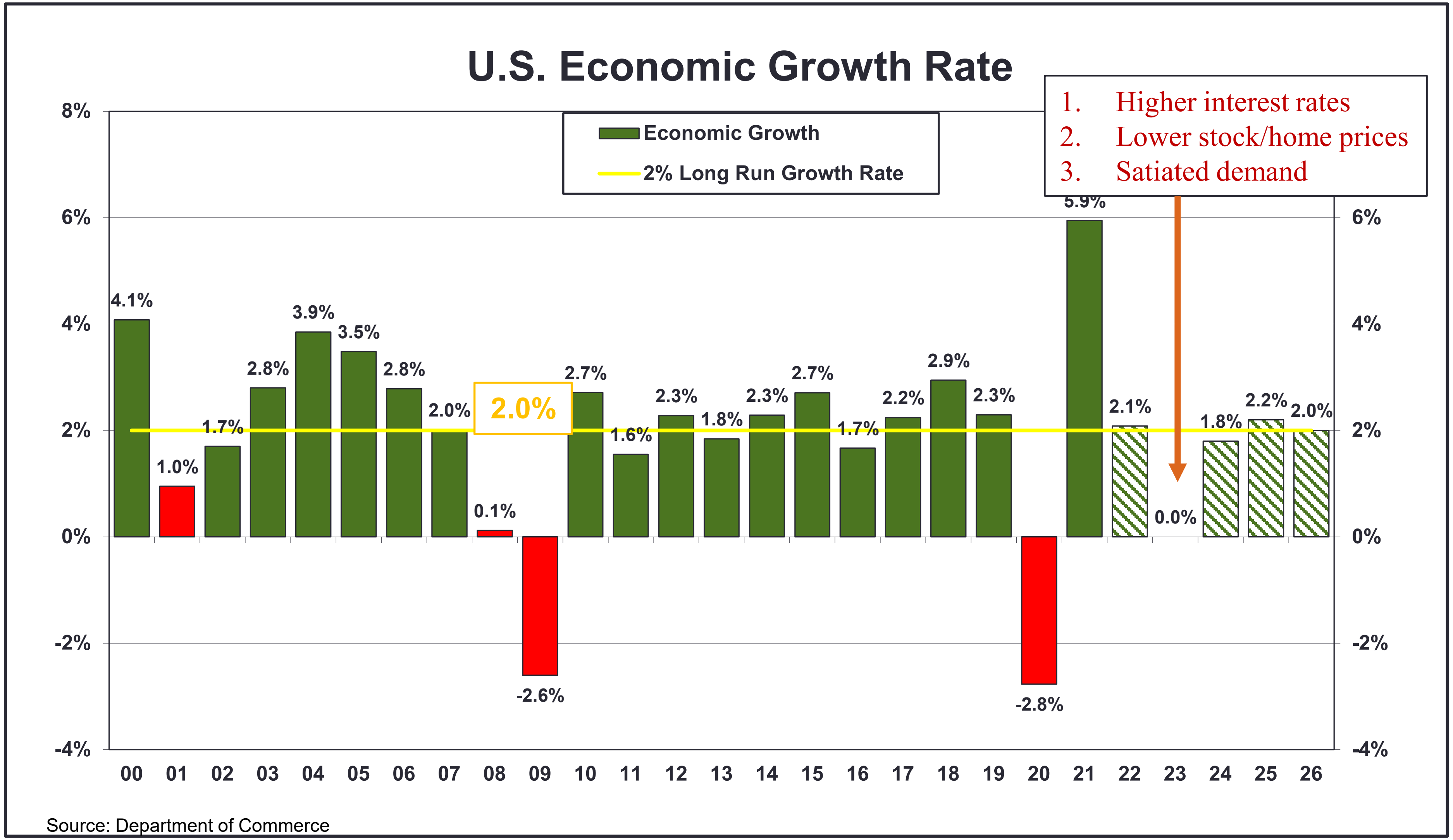
Weak Economic Growth for Next 2 Years

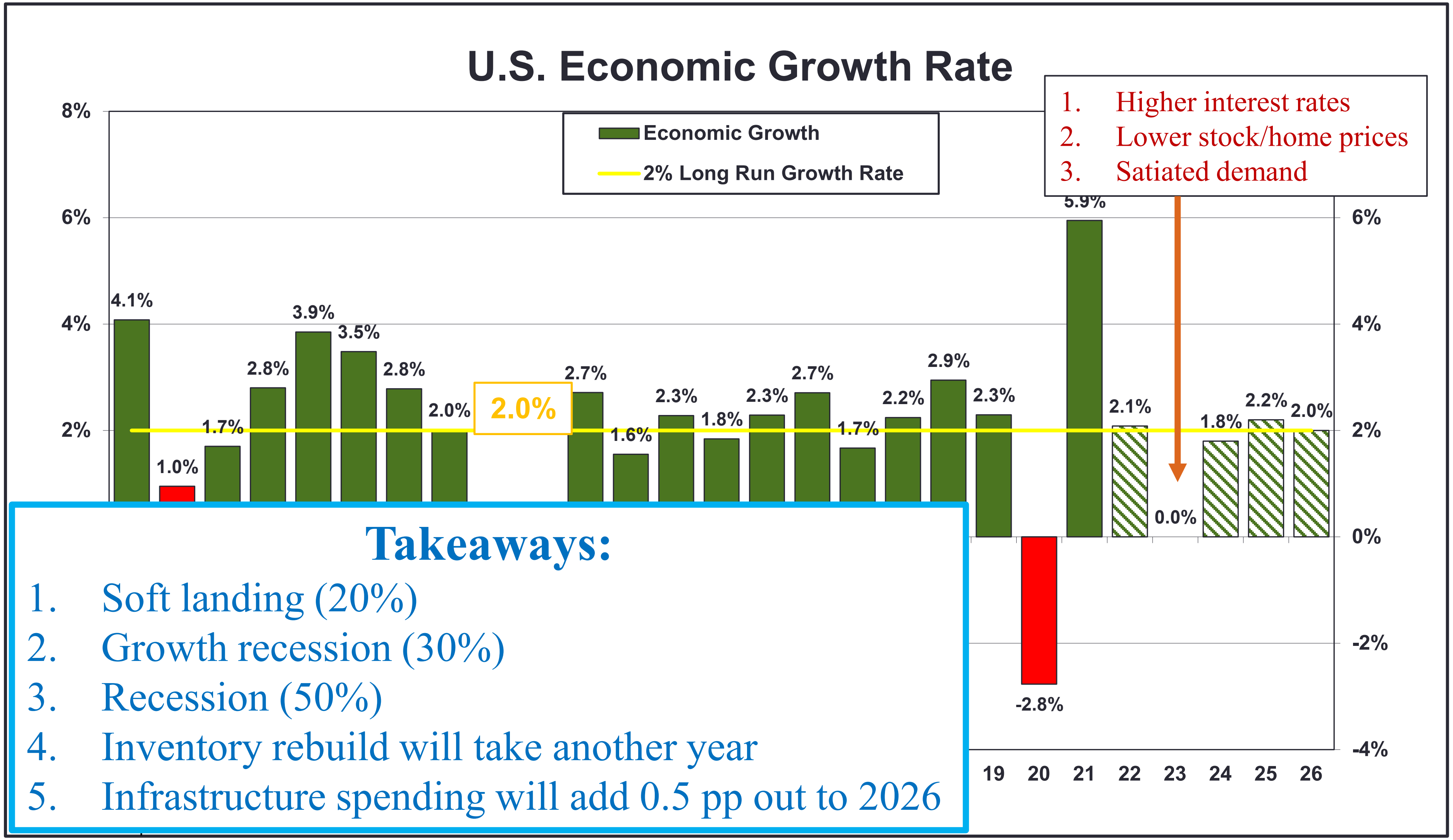


Source: Department of Commerce

Weak Economic Growth for Next 2 Years



Weak Economic Growth for Next 2 Years



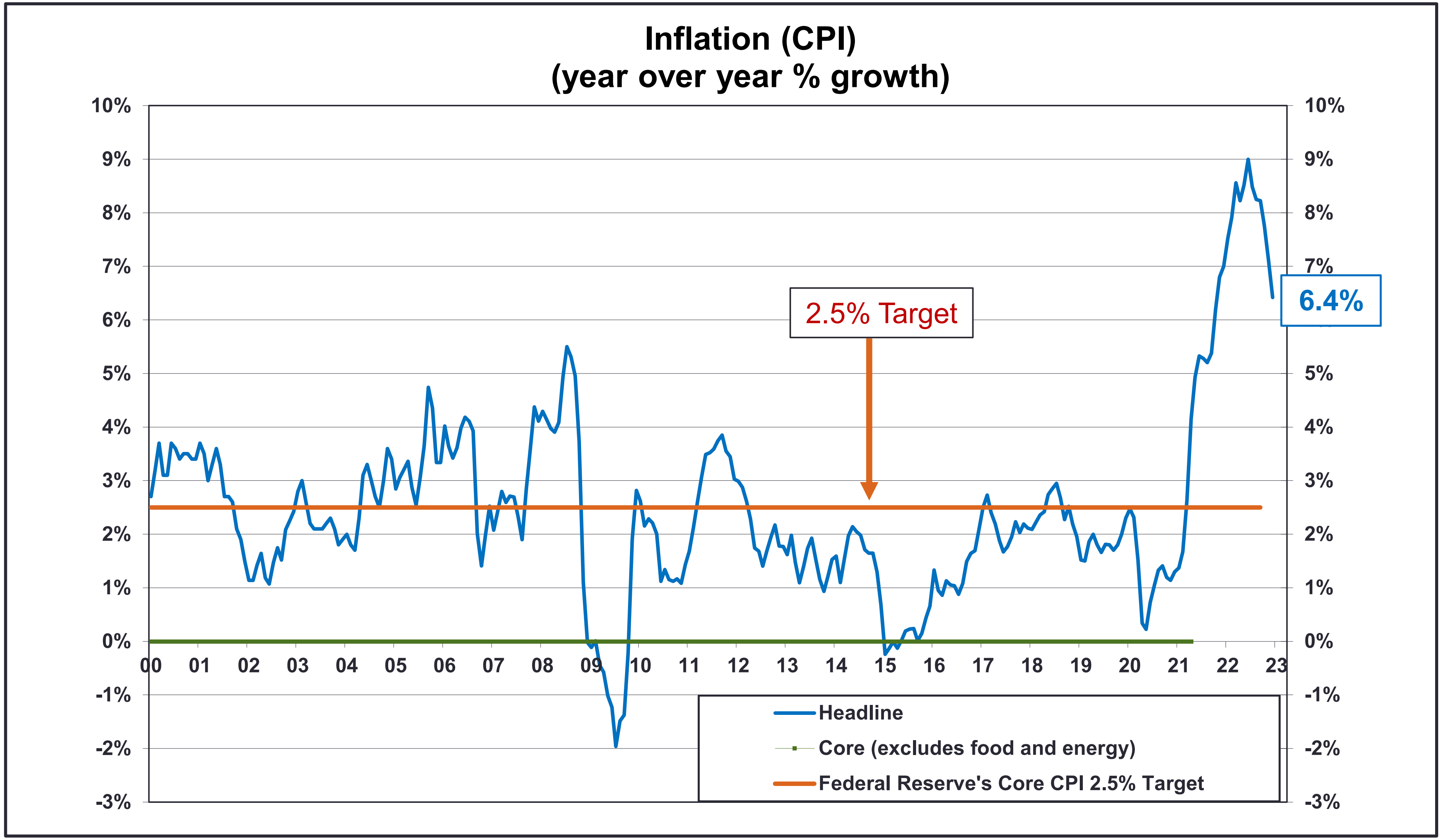
Takeaways:

1. Soft landing (20%)
2. Growth recession (30%)
3. Recession (50%)
4. Inventory rebuild will take another year
5. Infrastructure spending will add 0.5 pp out to 2026

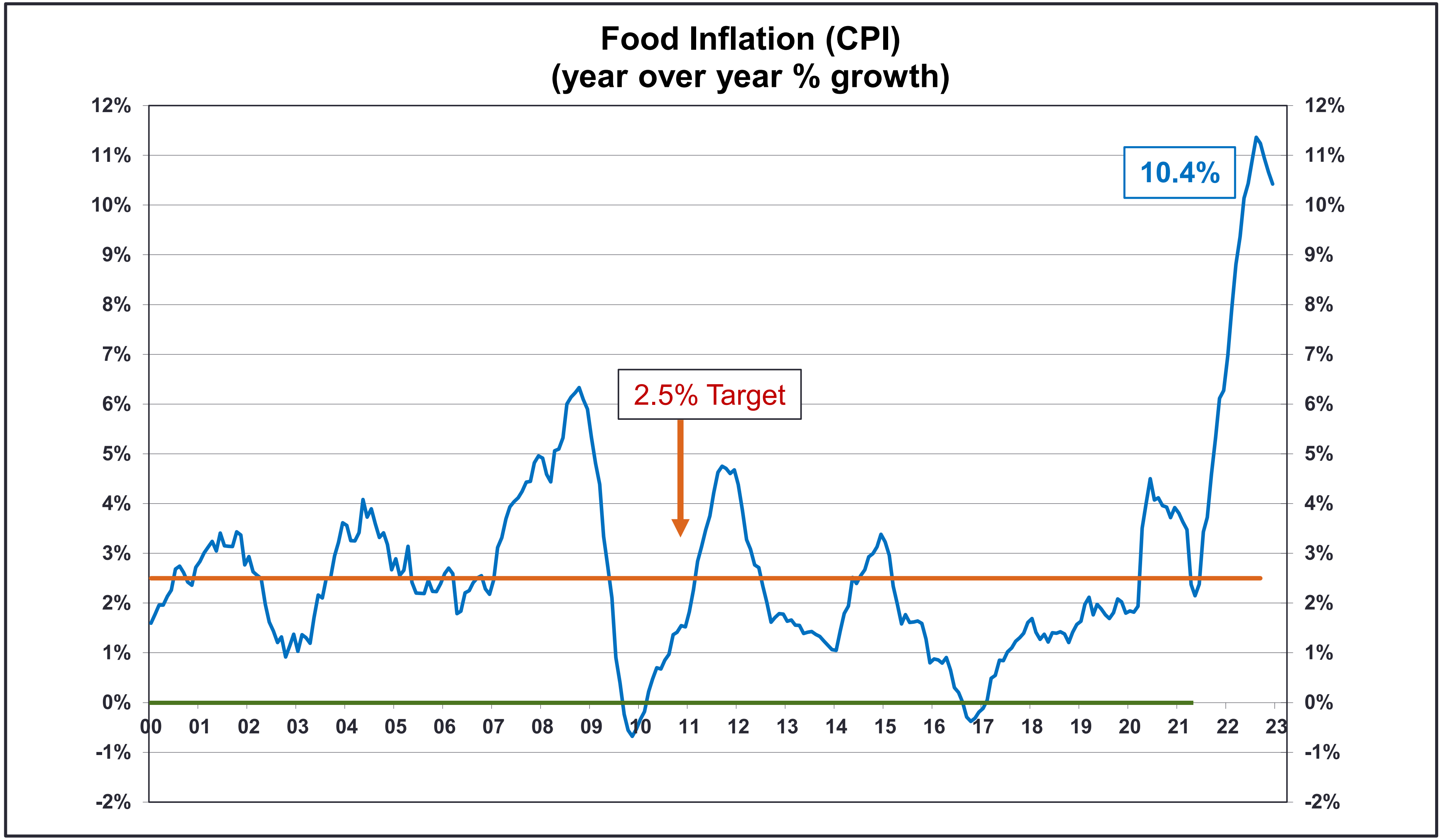
The Big Question

Inflation or Deflation
tell me if you can
will we be Zimbabwe
or will we be Japan?

High Inflation for the Next Year

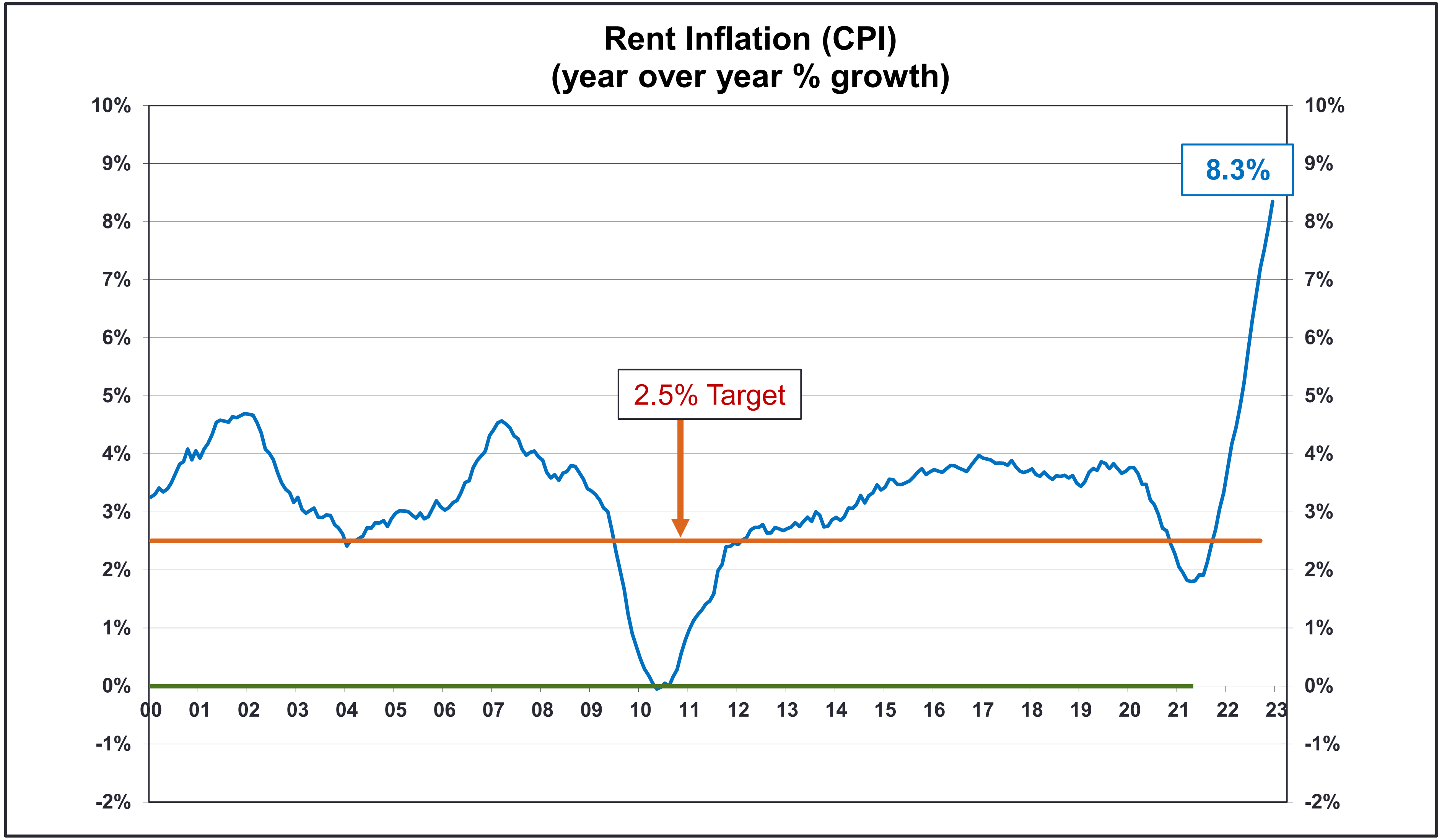


Food Prices

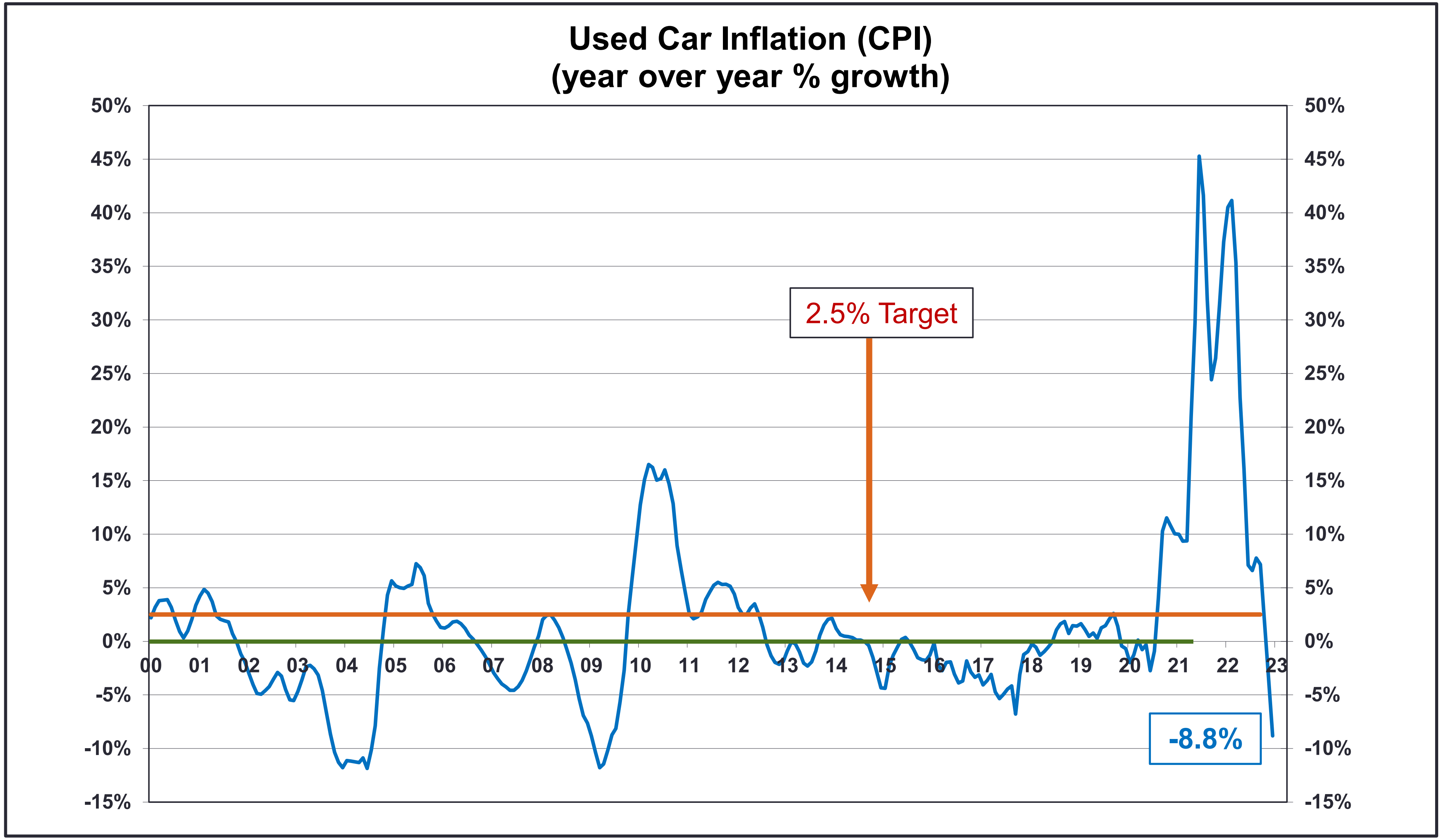


Food Inflation (CPI)
(year over year % growth)
12%
11%
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
-1%
-2%
00
01
02
03
04
05
06
07
08
09
10
11
12
13
14
15
16
17
18
19
20
21
22
23
10.4%
2.5% Target

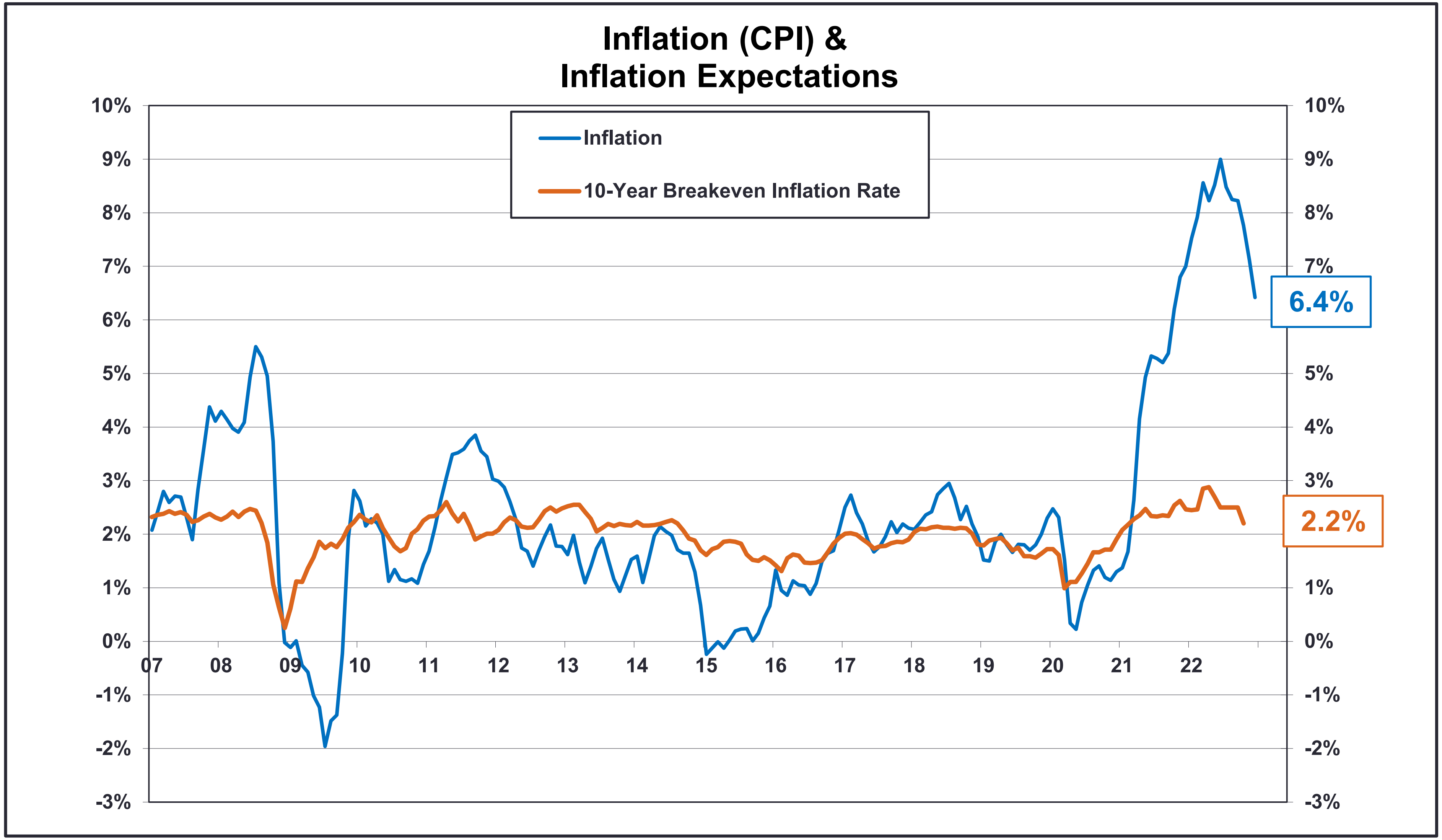
Rent of Primary Residence



Used Car Prices



High Inflation for the Next Year



The Inflation Debate:

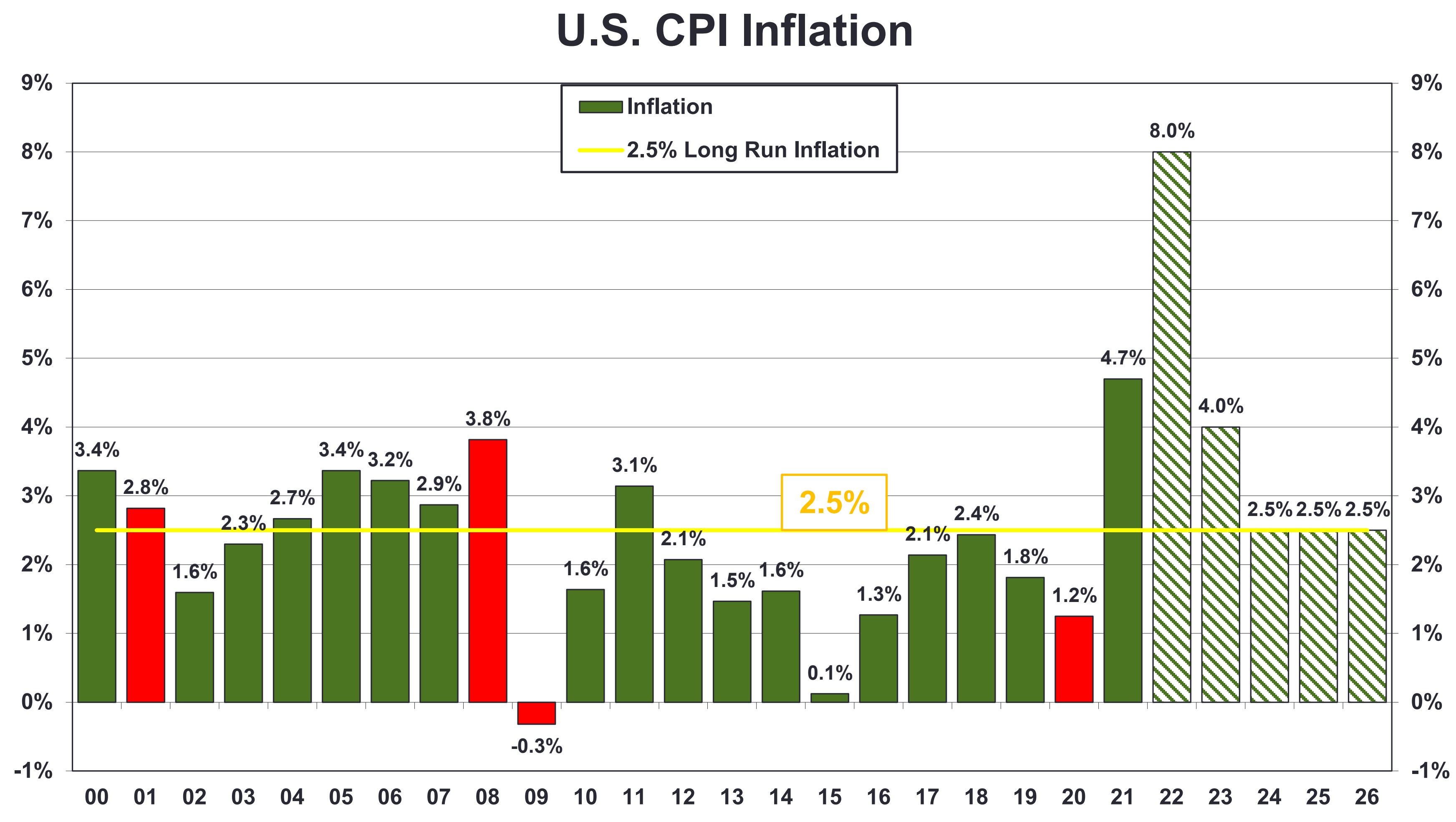
Higher Inflation Factors:

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:

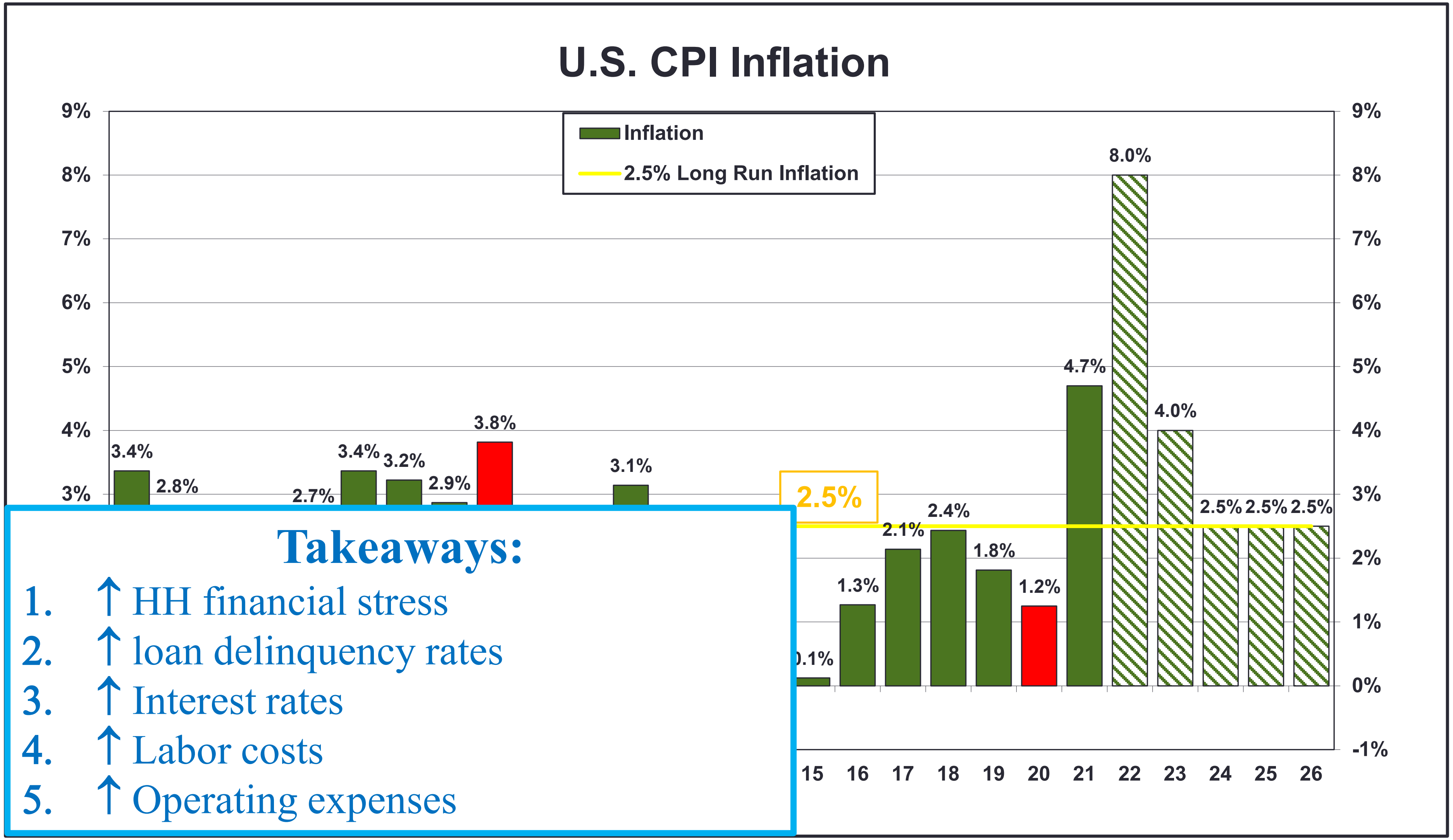
1. eCommerce is a powerful deflationary force
2. Rising competition from globalization
3. Rising productivity => falling costs per unit
4. Low population growth
5. Negative output gap and excess production capacity
6. Excess supply of labor

Inflation Above Target Until 2024



Source: Department of Commerce

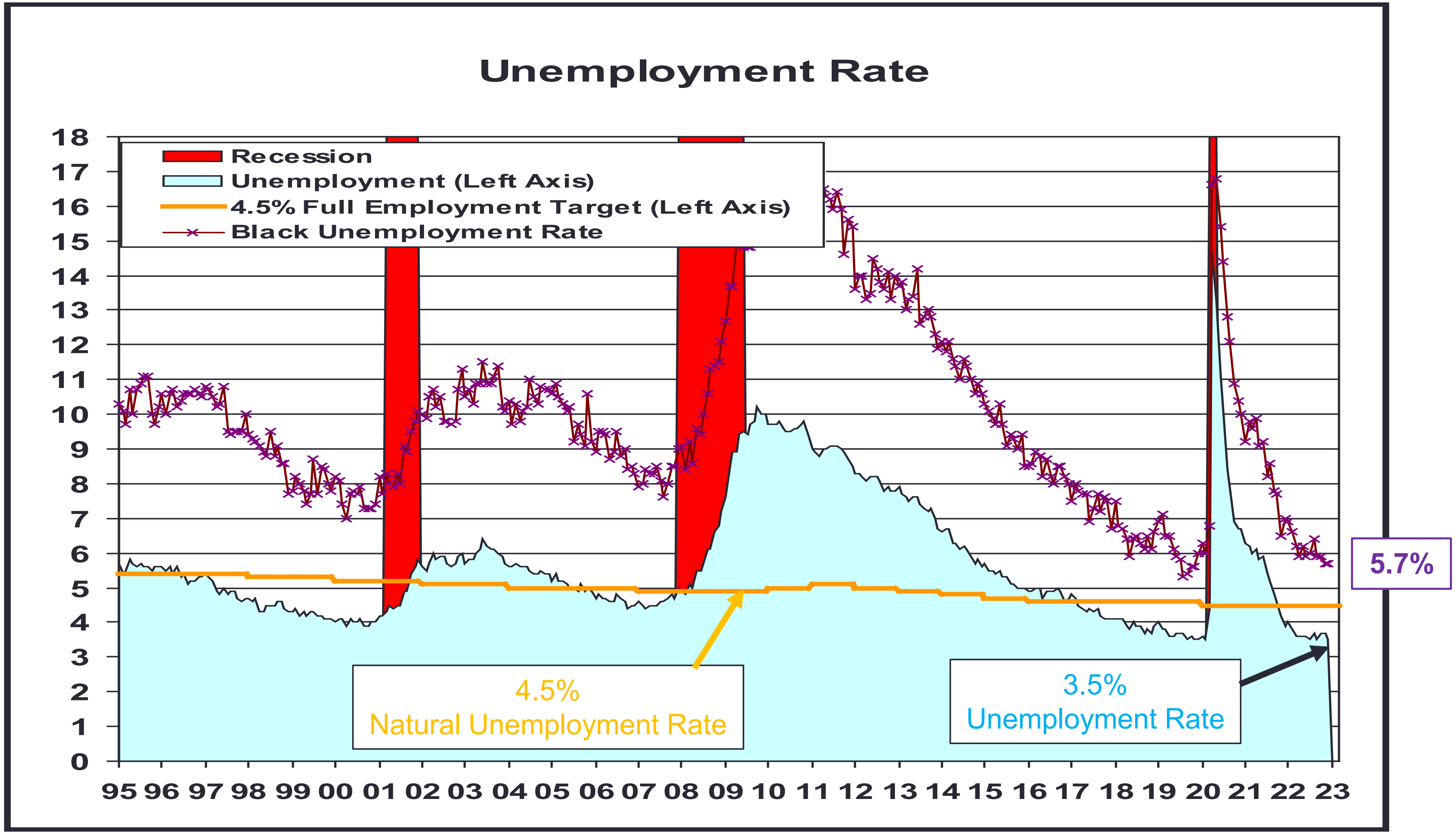
Inflation Above Target Until 2024



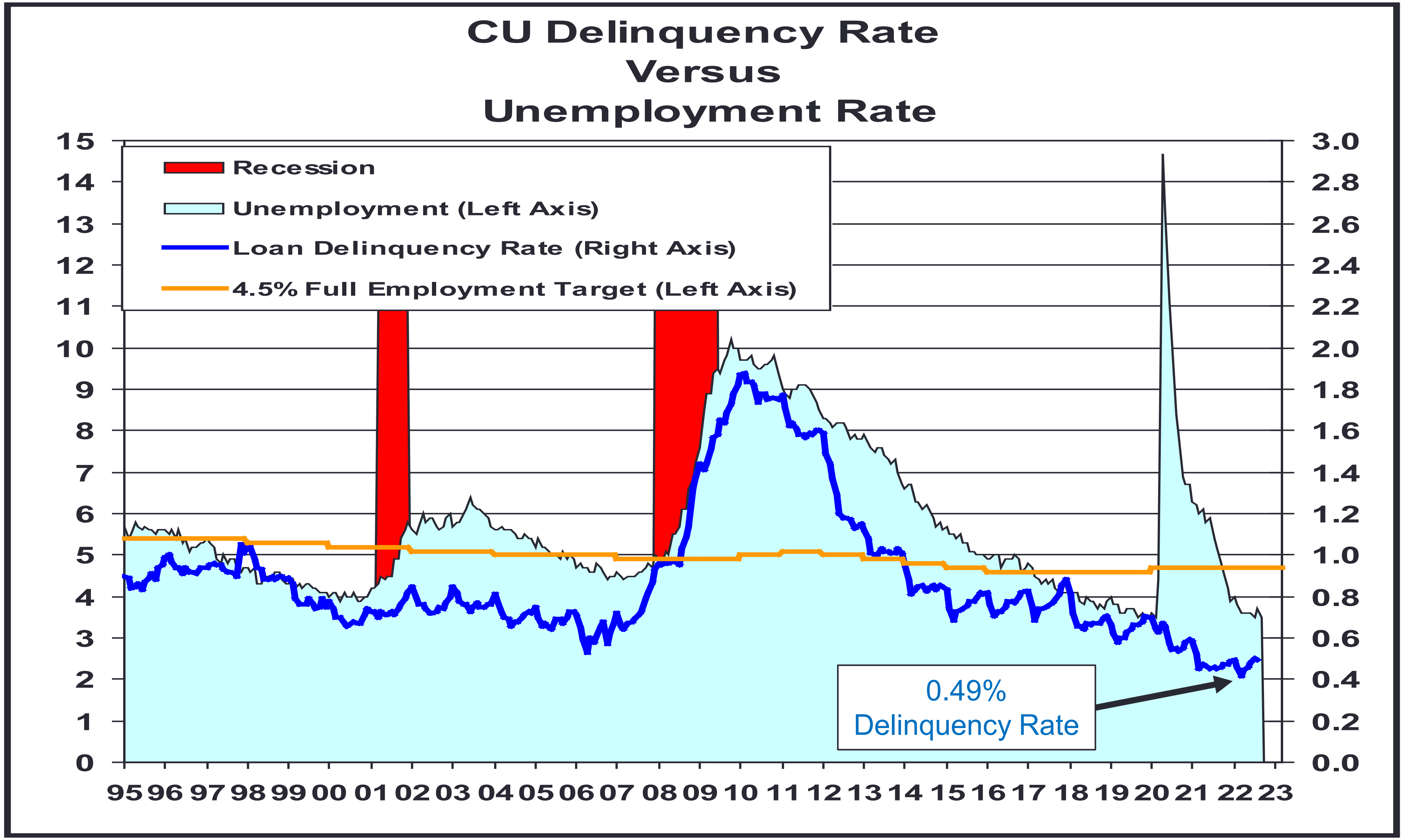
Takeaways:

1. ↑ HH financial stress
2. ↑ loan delinquency rates
3. ↑ Interest rates
4. ↑ Labor costs
5. ↑ Operating expenses

Unemployment Rate Below Natural Unemployment Rate



CU Loan Delinquency Rates are Low but Heading Up



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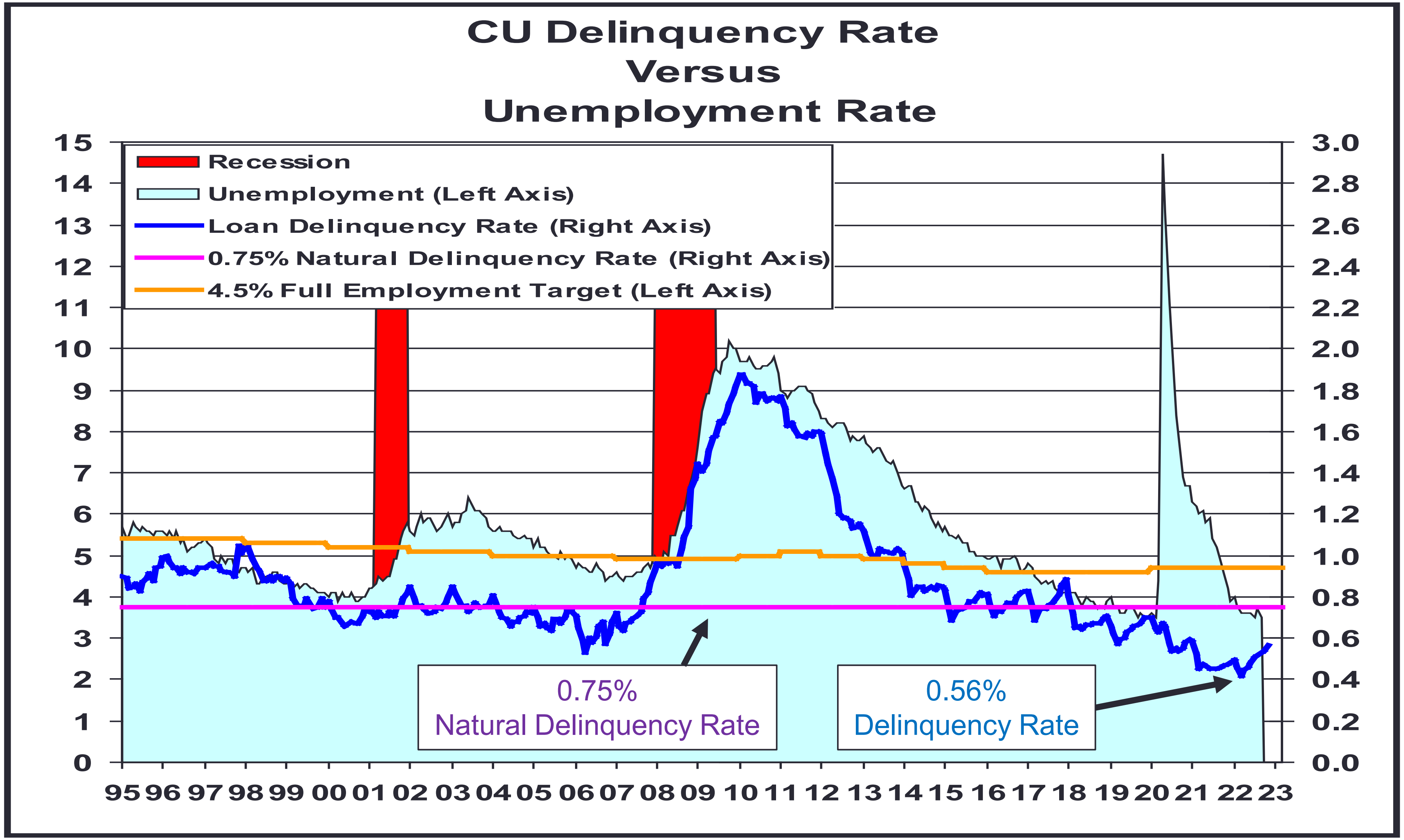


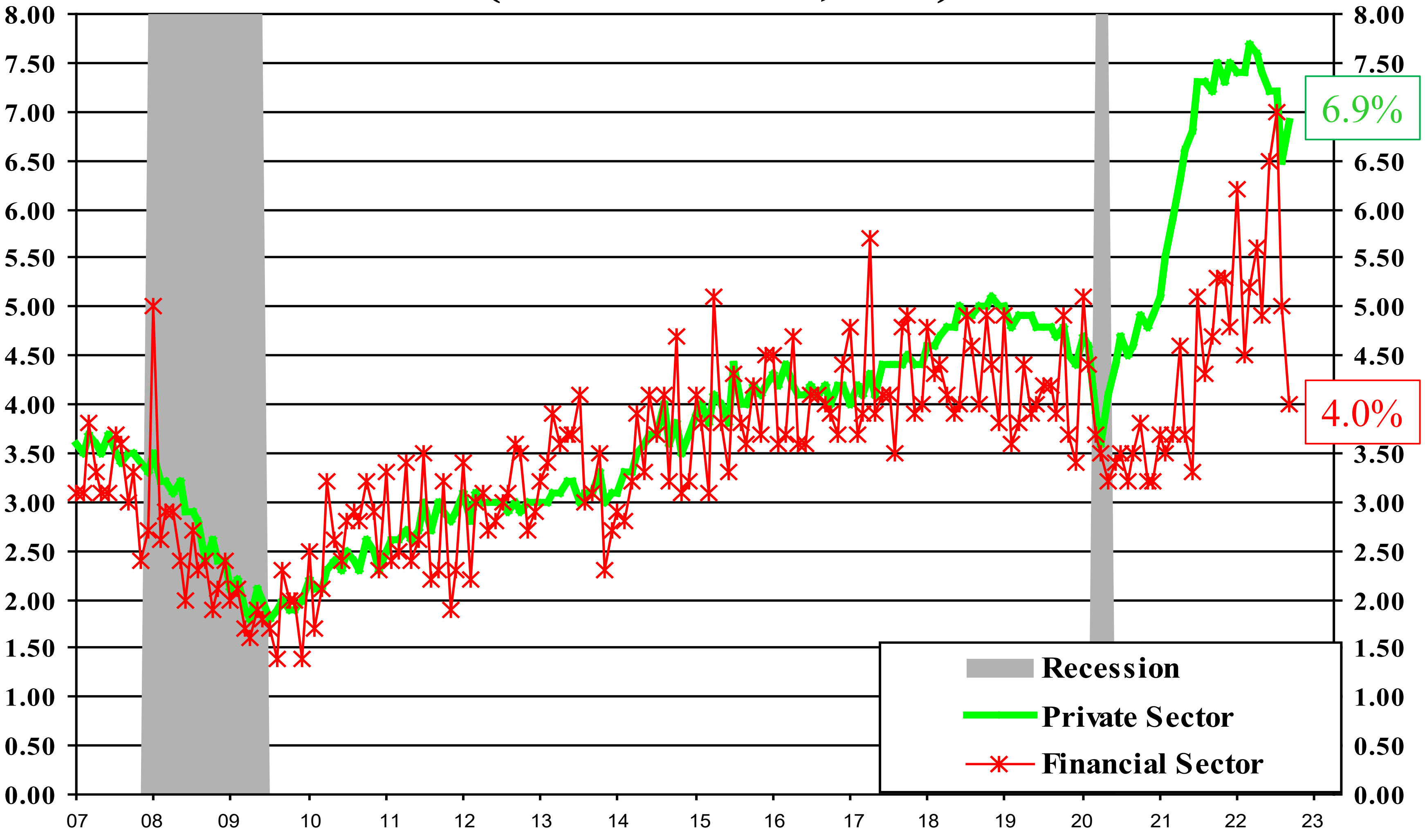
Job Openings Rate is the number of job openings on the last business day of the month as a percent of total employment plus job openings.

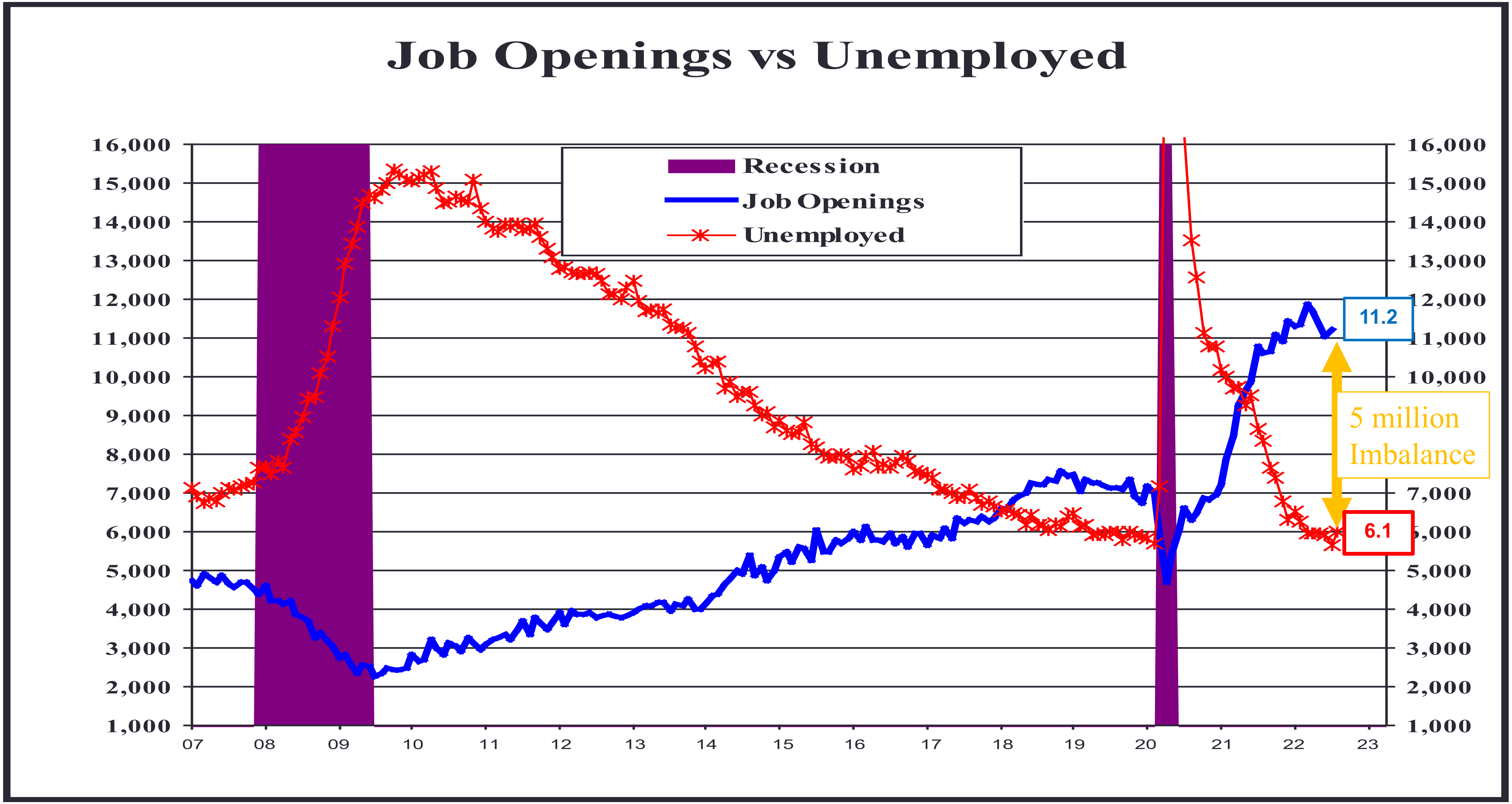
Job Openings Rate VS Quit Rate

Quit Rate is the number of voluntary separations by employees as a percent of total employment

Job Openings Rate is the number of job openings on the last business day of the month as a percent of total employment plus job openings.

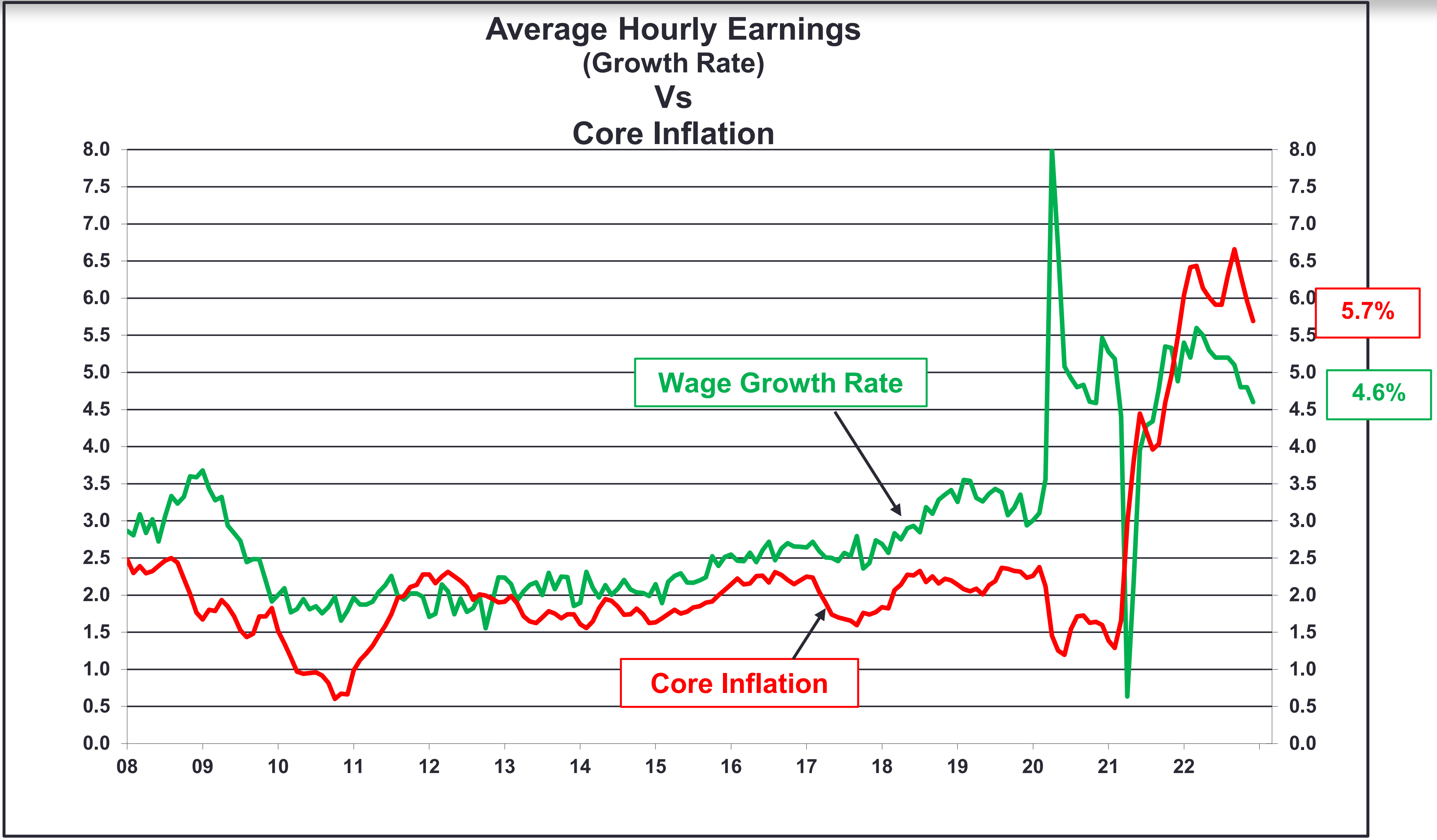
Job Openings Rate (Thousands, SA)



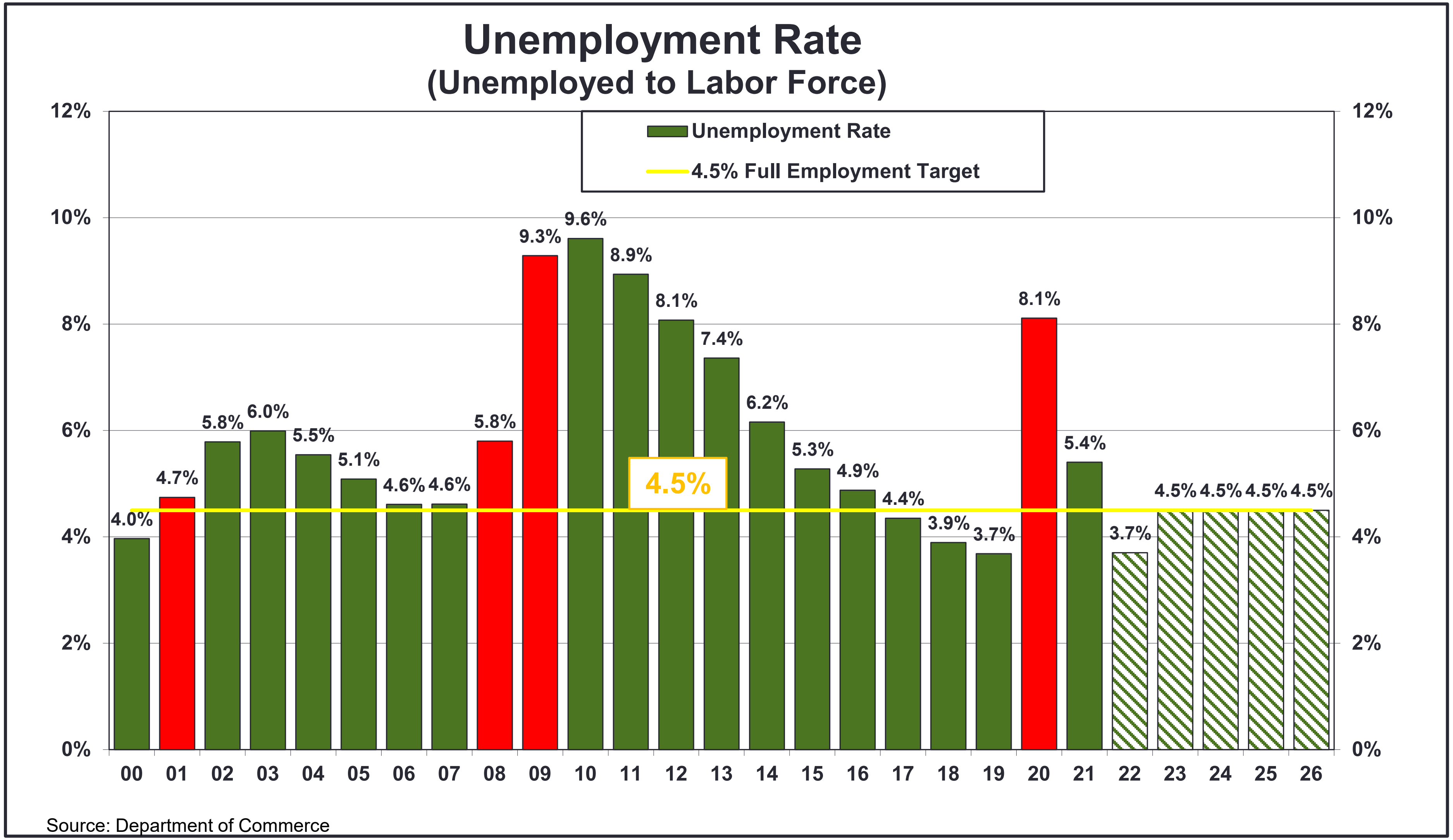


Job Openings vs Unemployed
Recession
Job Openings
Unemployed
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
07
08
09
10
11
12
13
14
15
16
17
18
19
20
21
22
23
11.2
5 million Imbalance
6.1

Wage Growth Exceeds 4.6%
Since December 2021



Unemployment Rate Below Normal for Next 2 Years



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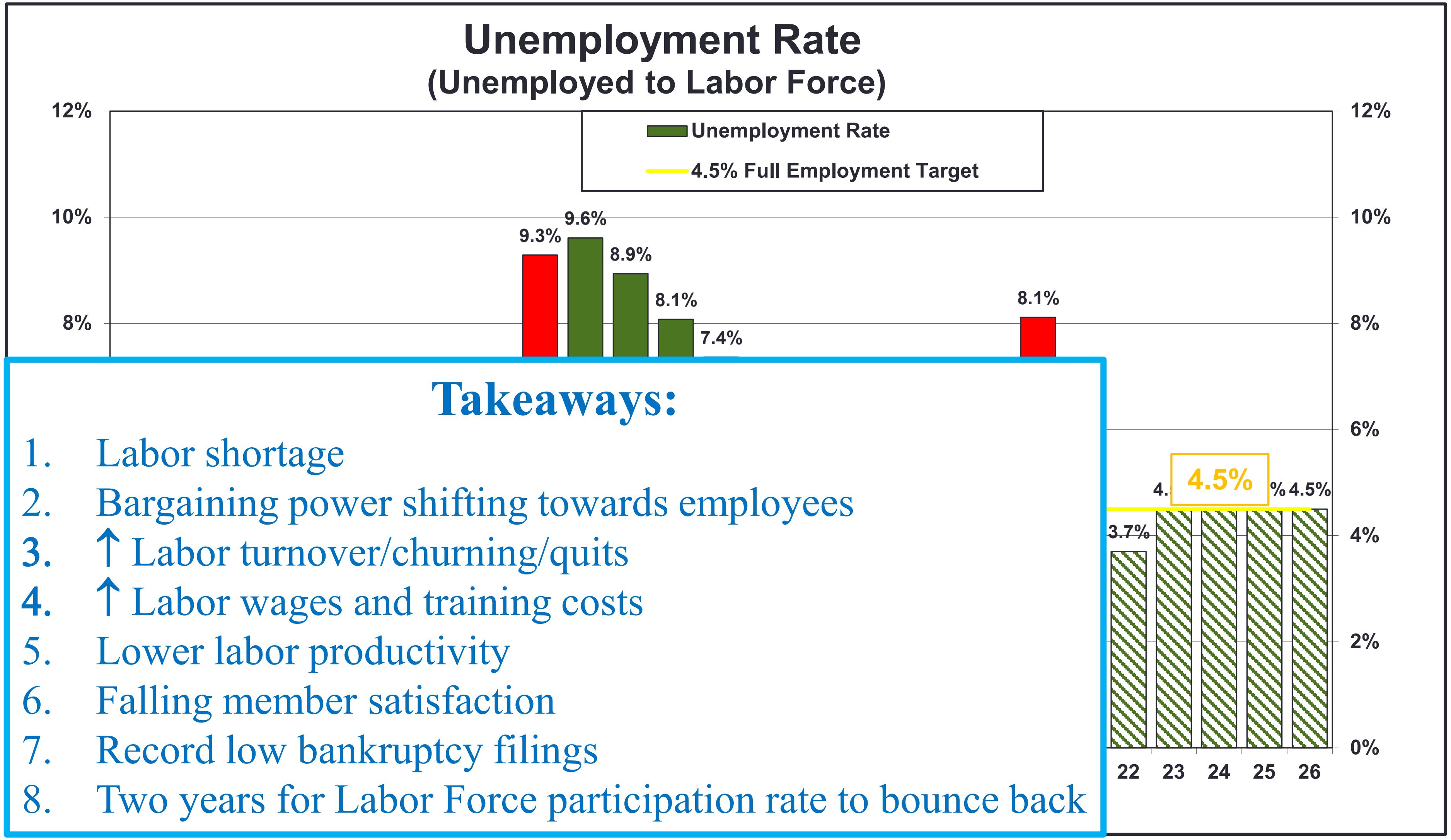


Takeaways:

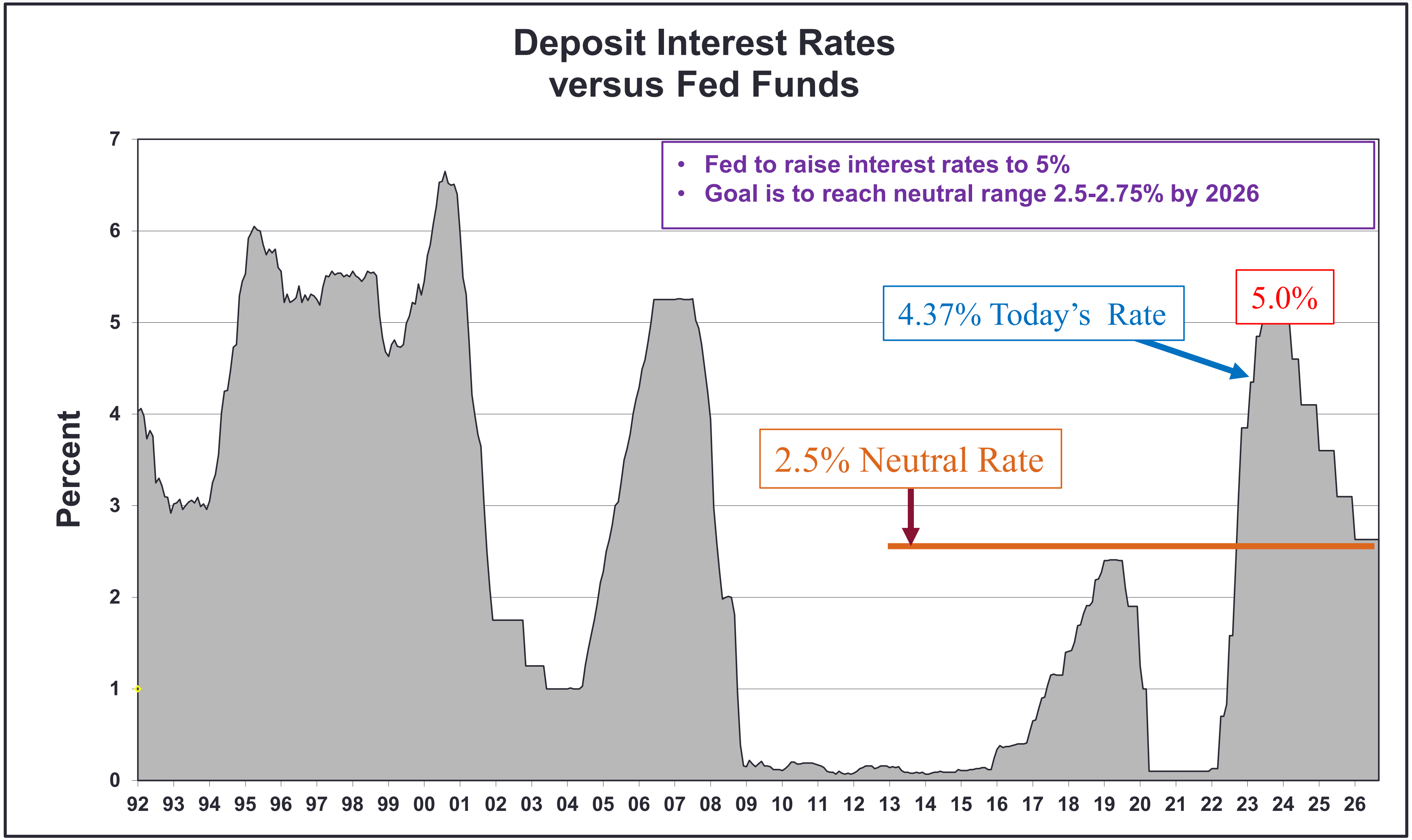
1. Labor shortage
2. Bargaining power shifting towards employees
3. ↑ Labor turnover/churning/quits
4. ↑ Labor wages and training costs
5. Lower labor productivity
6. Falling member satisfaction
7. Record low bankruptcy filings
8. Two years for Labor Force participation rate to bounce back

What is the most important price in any economy?

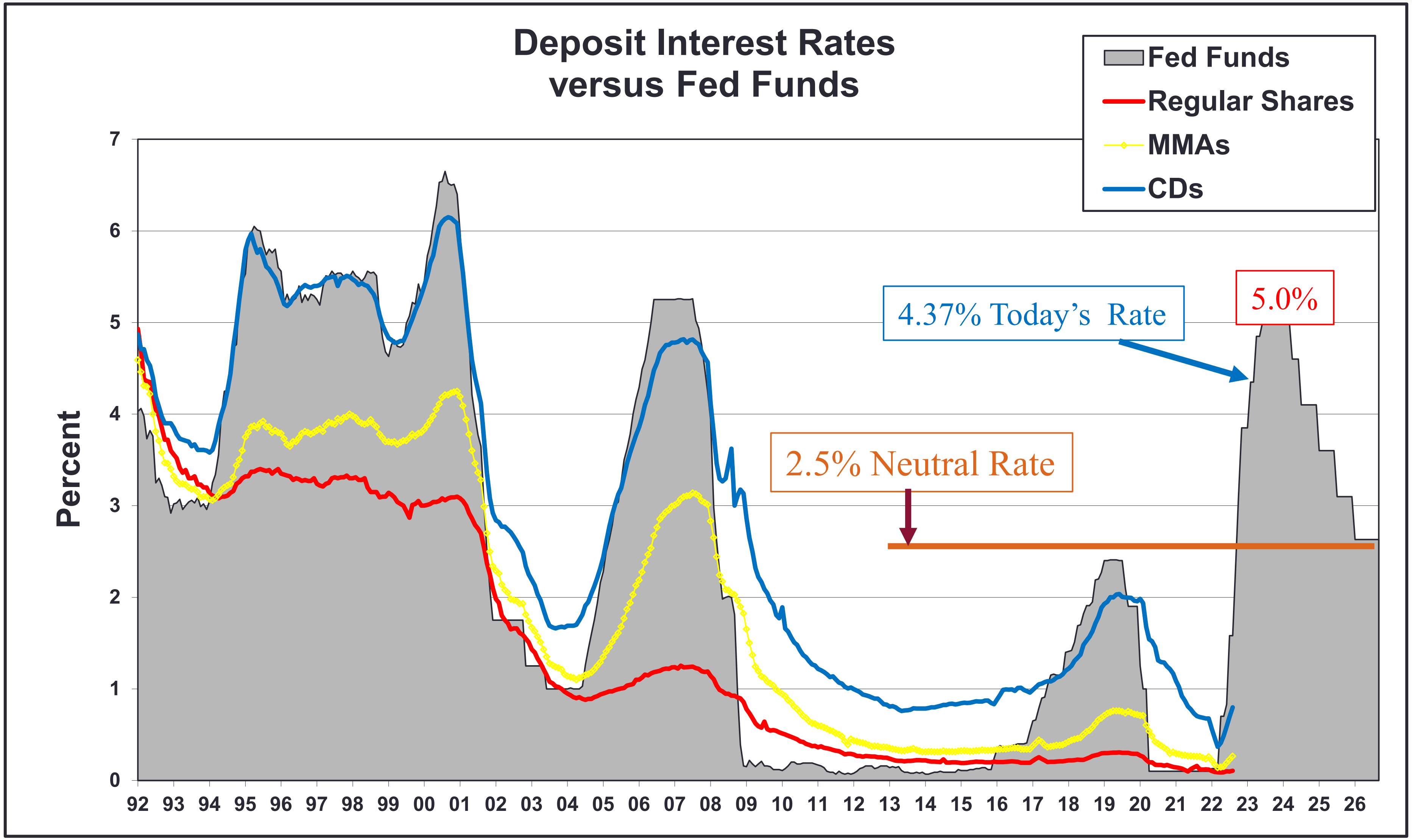
The Price of Money

Interest Rates

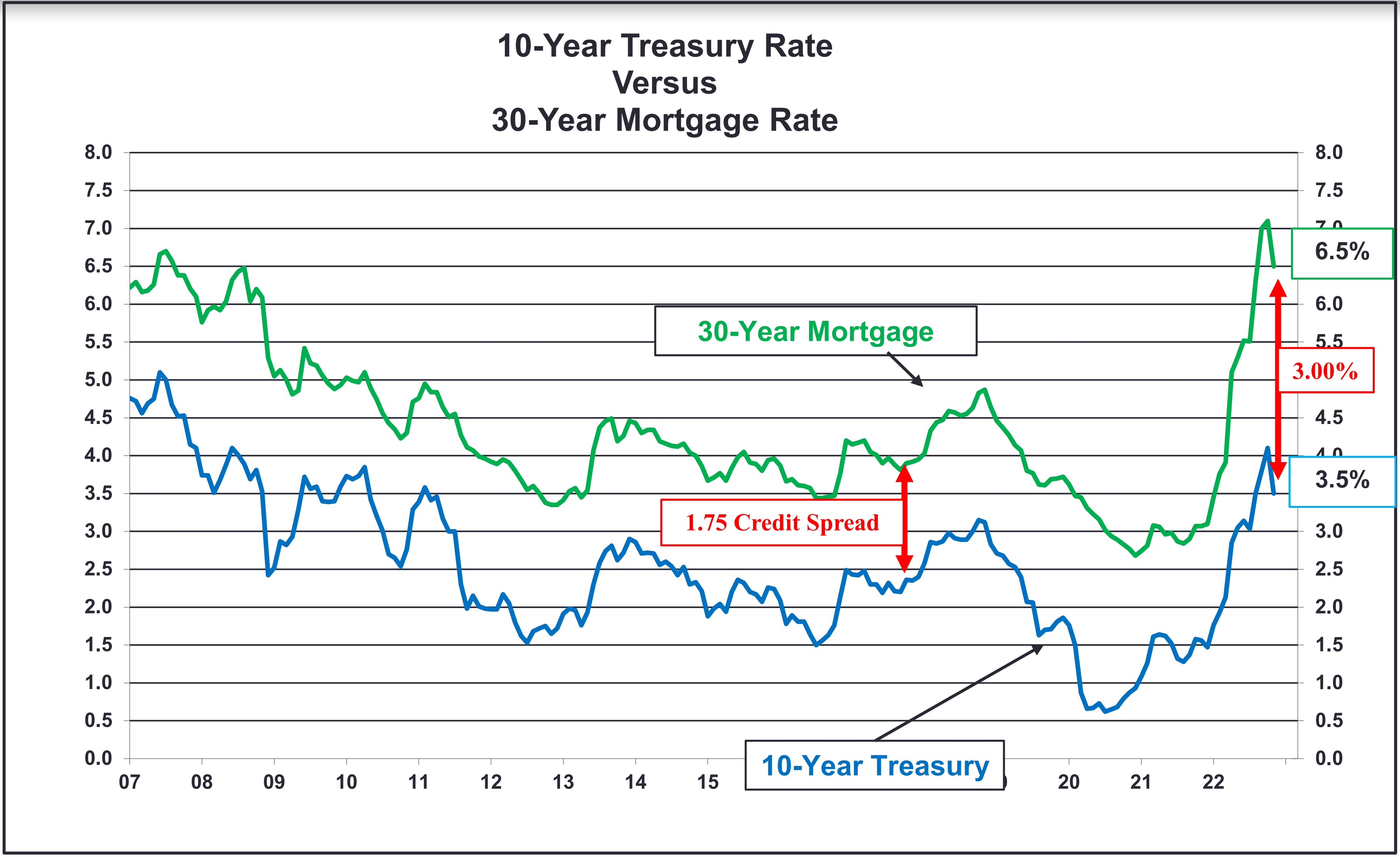
Rising Fed Funds Interest Rate and Deposit Pricing

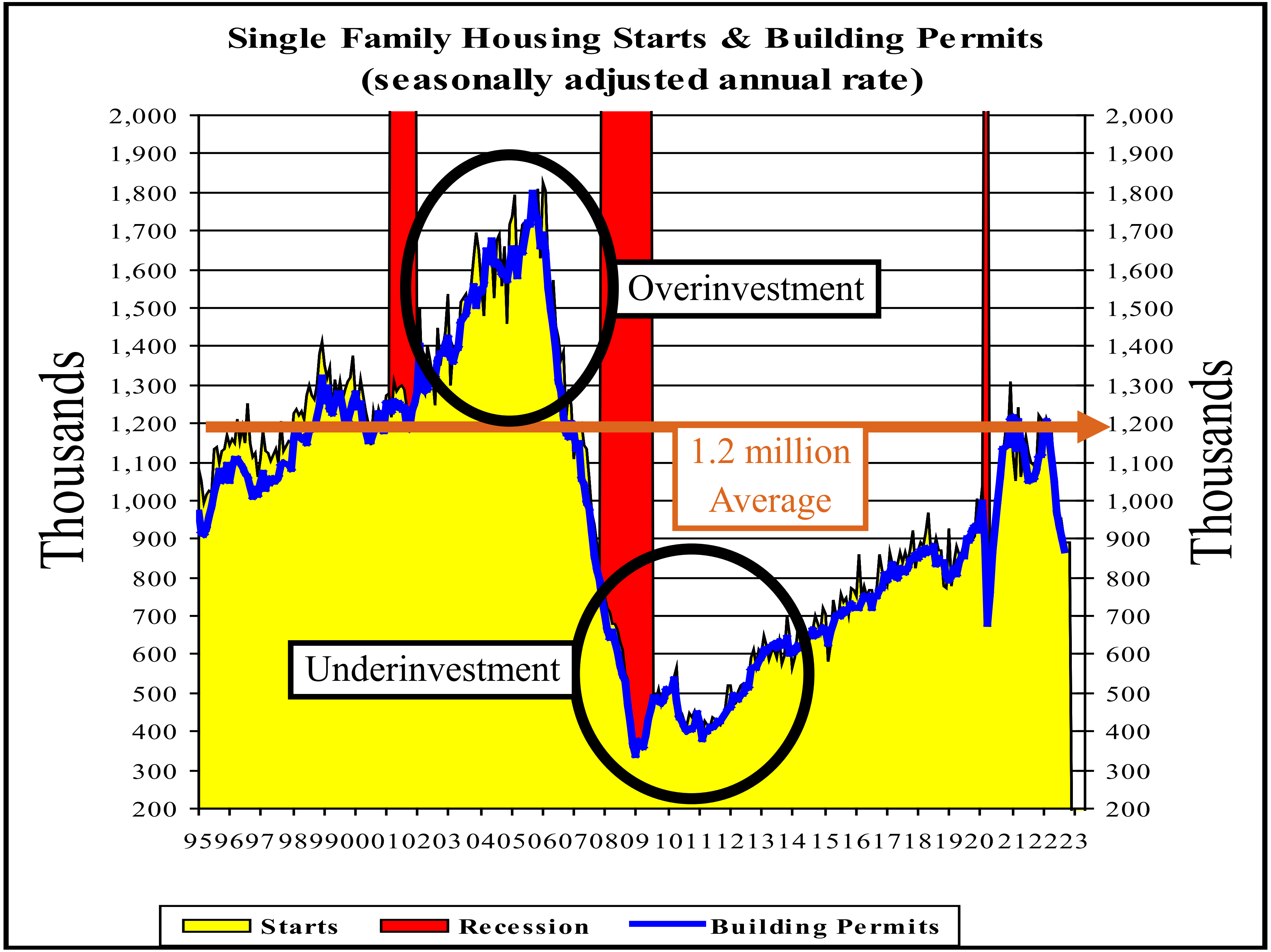


Rising Fed Funds Interest Rate and Deposit Pricing



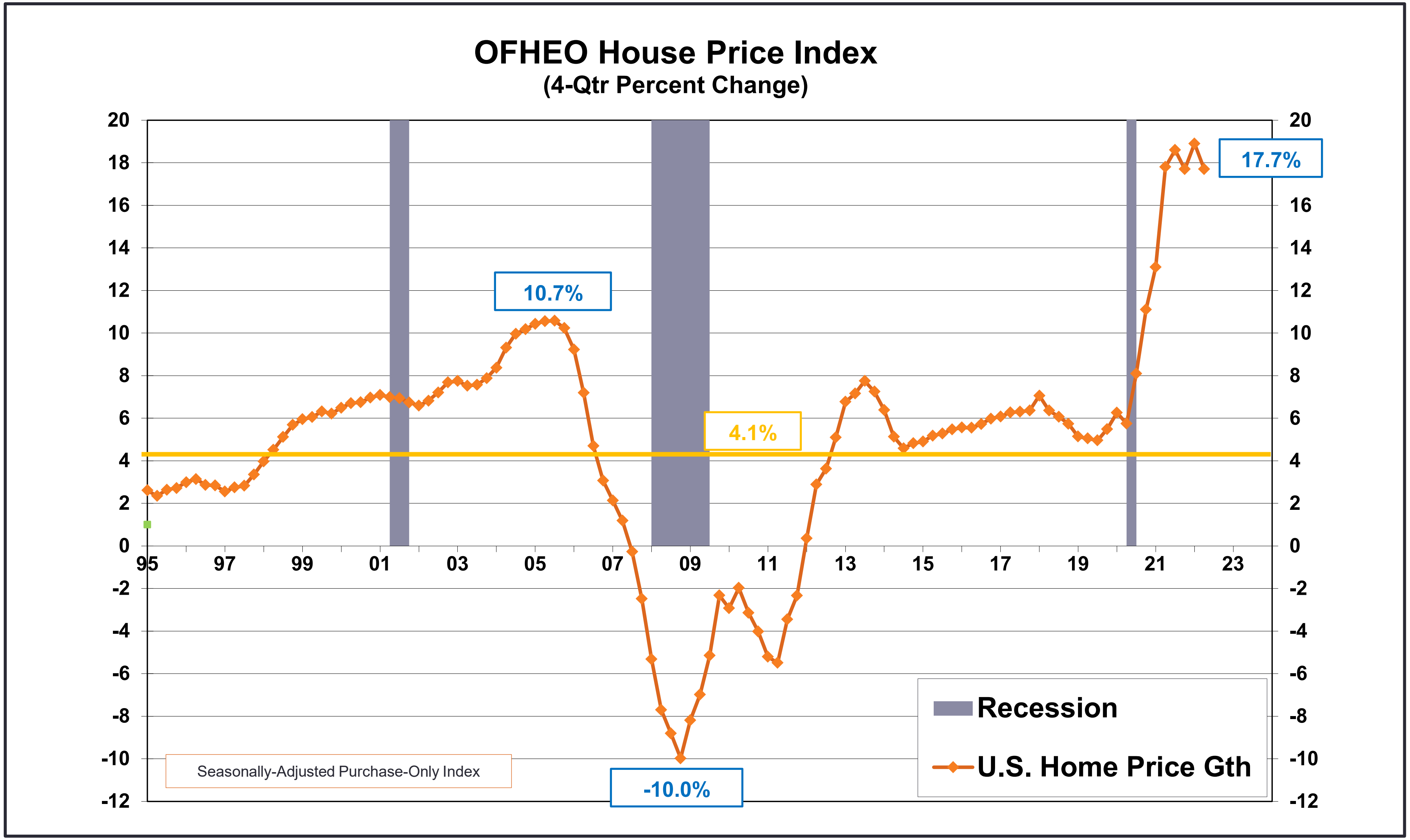
Rising Real Interest Rates, and Rising Inflation Expectations will Push Up Nominal Interest Rates



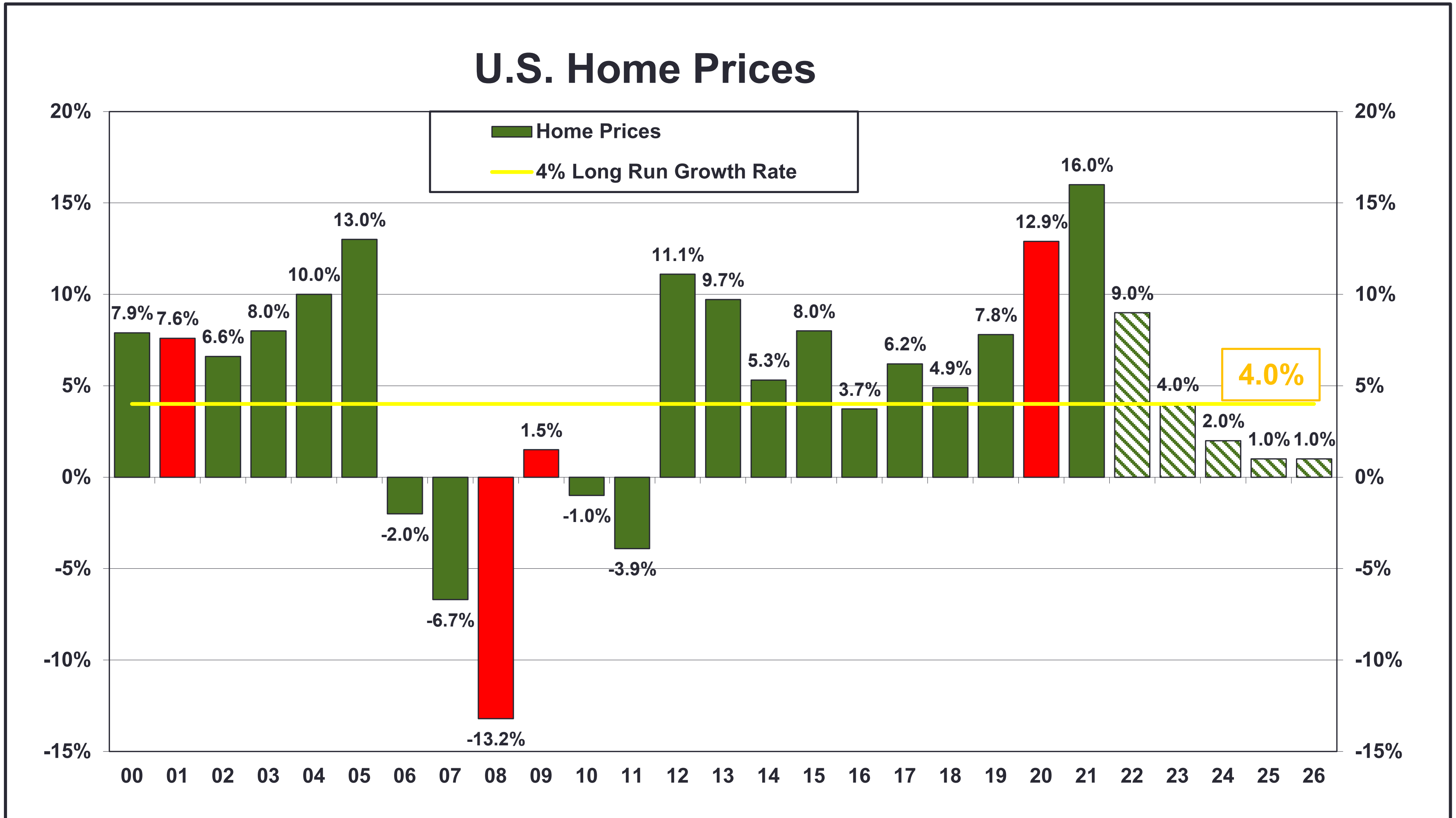


Single Family Housing Starts & Building Permits
(seasonally adjusted annual rate)
Thousands
Thousands
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23
Overinvestment
Underinvestment
1.2 million Average
Starts
Recession
Building Permits

Home Price Appreciation are at Record Levels

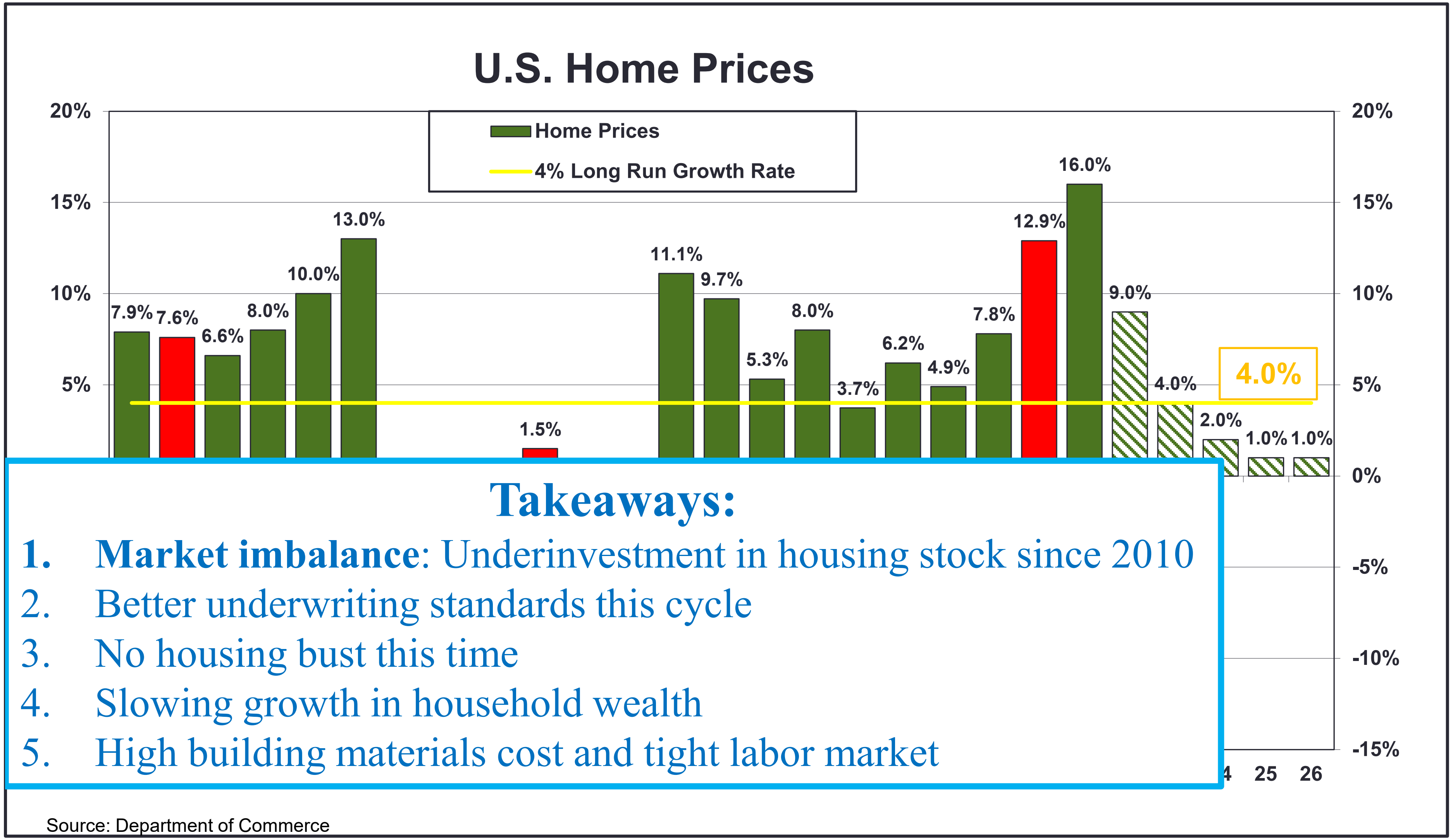


Home Price Growth Rate Slowing



Source: Department of Commerce

Home Price Growth Rate Slowing

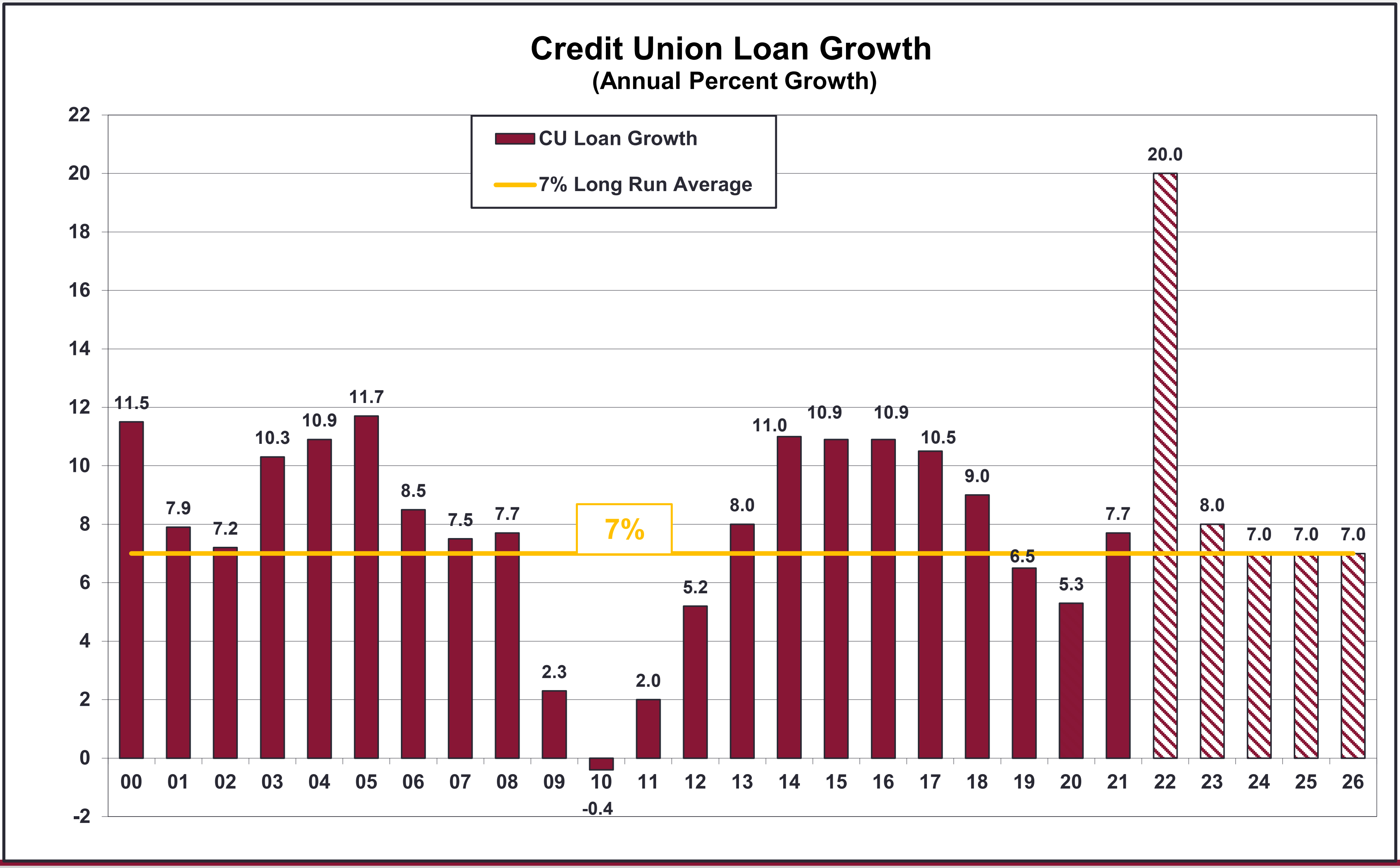


Takeaways:

1. **Market imbalance**: Underinvestment in housing stock since 2010
2. Better underwriting standards this cycle
3. No housing bust this time
4. Slowing growth in household wealth
5. High building materials cost and tight labor market

Source: Department of Commerce

Above Trend Credit Union Loan Growth



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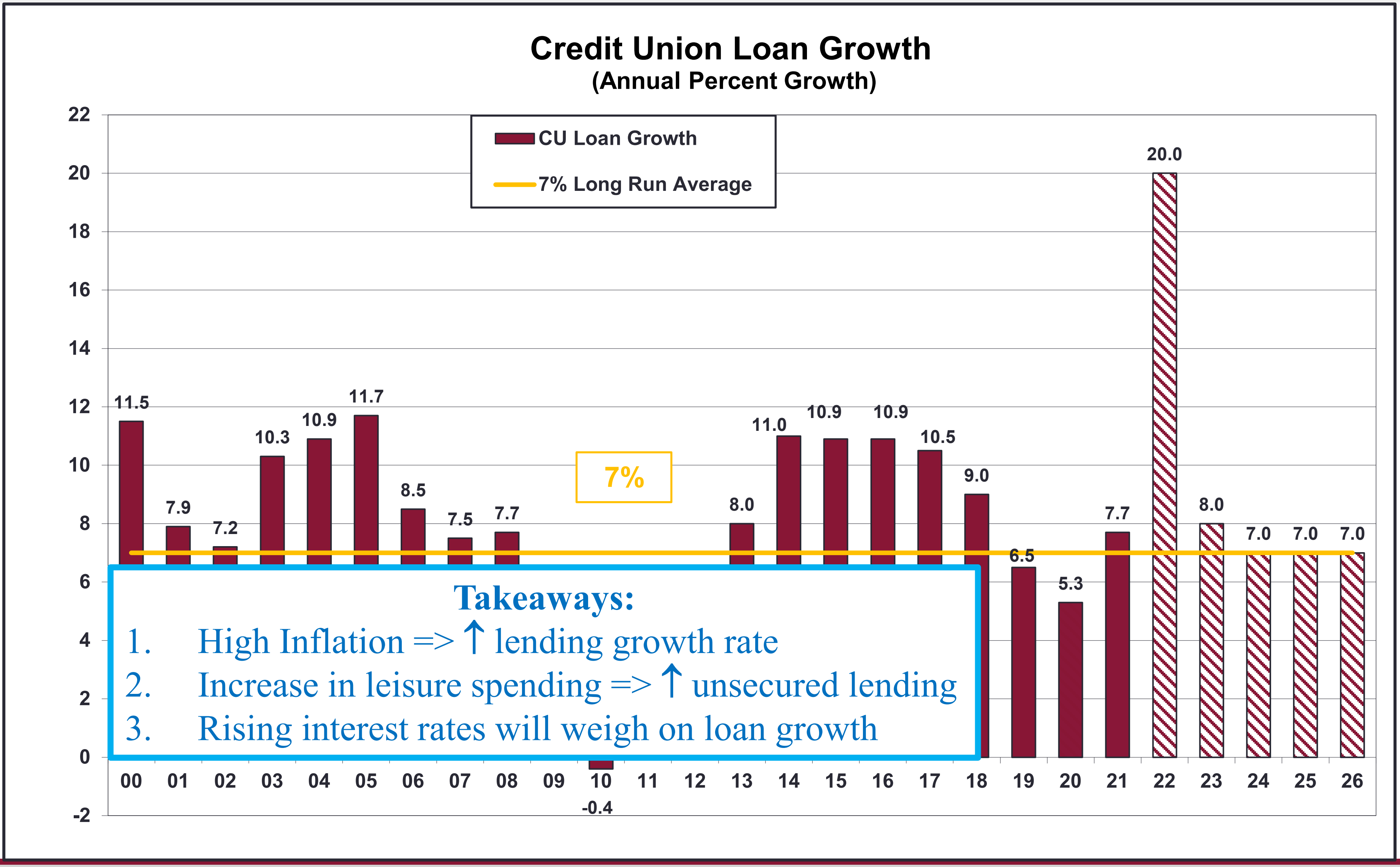
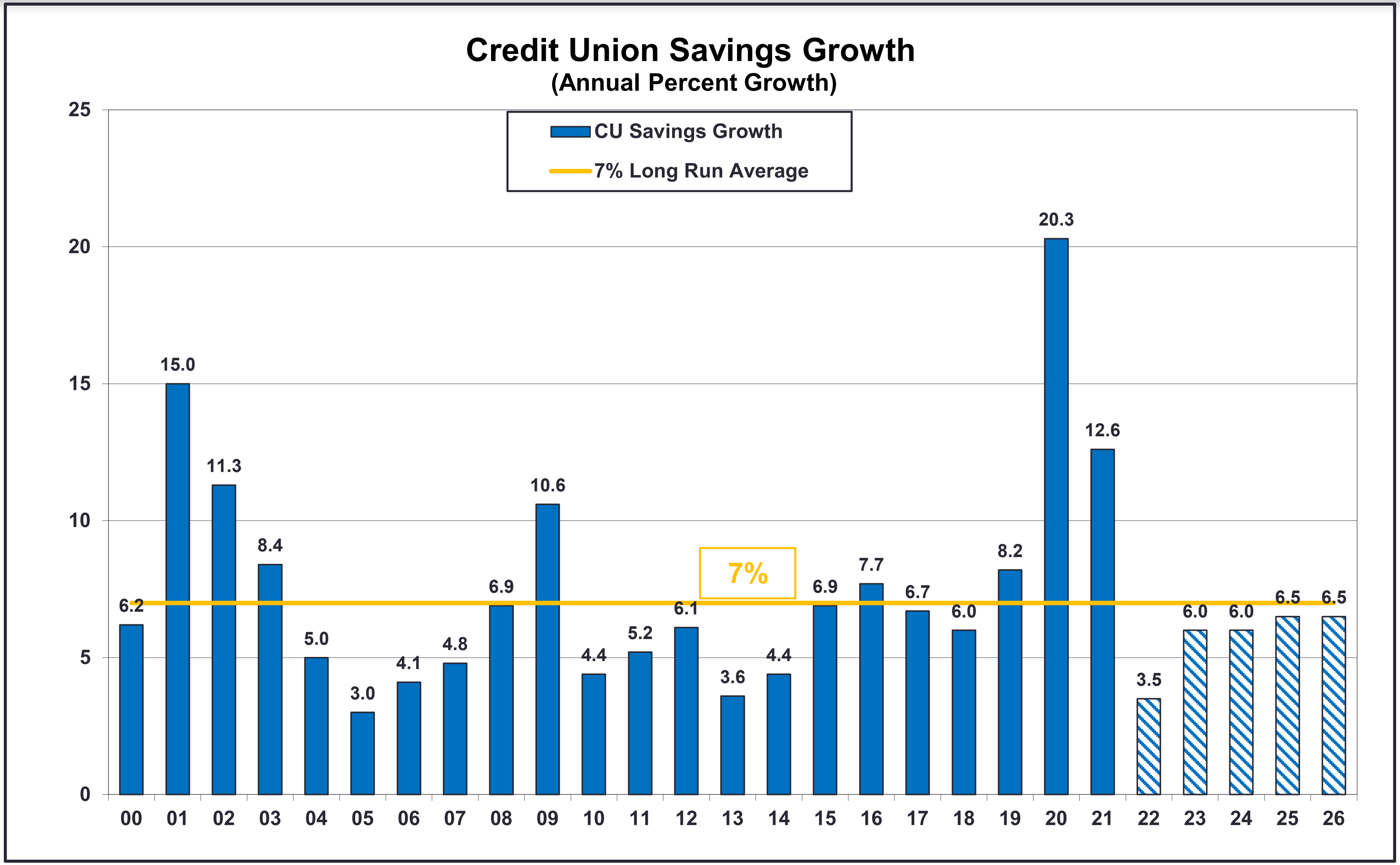
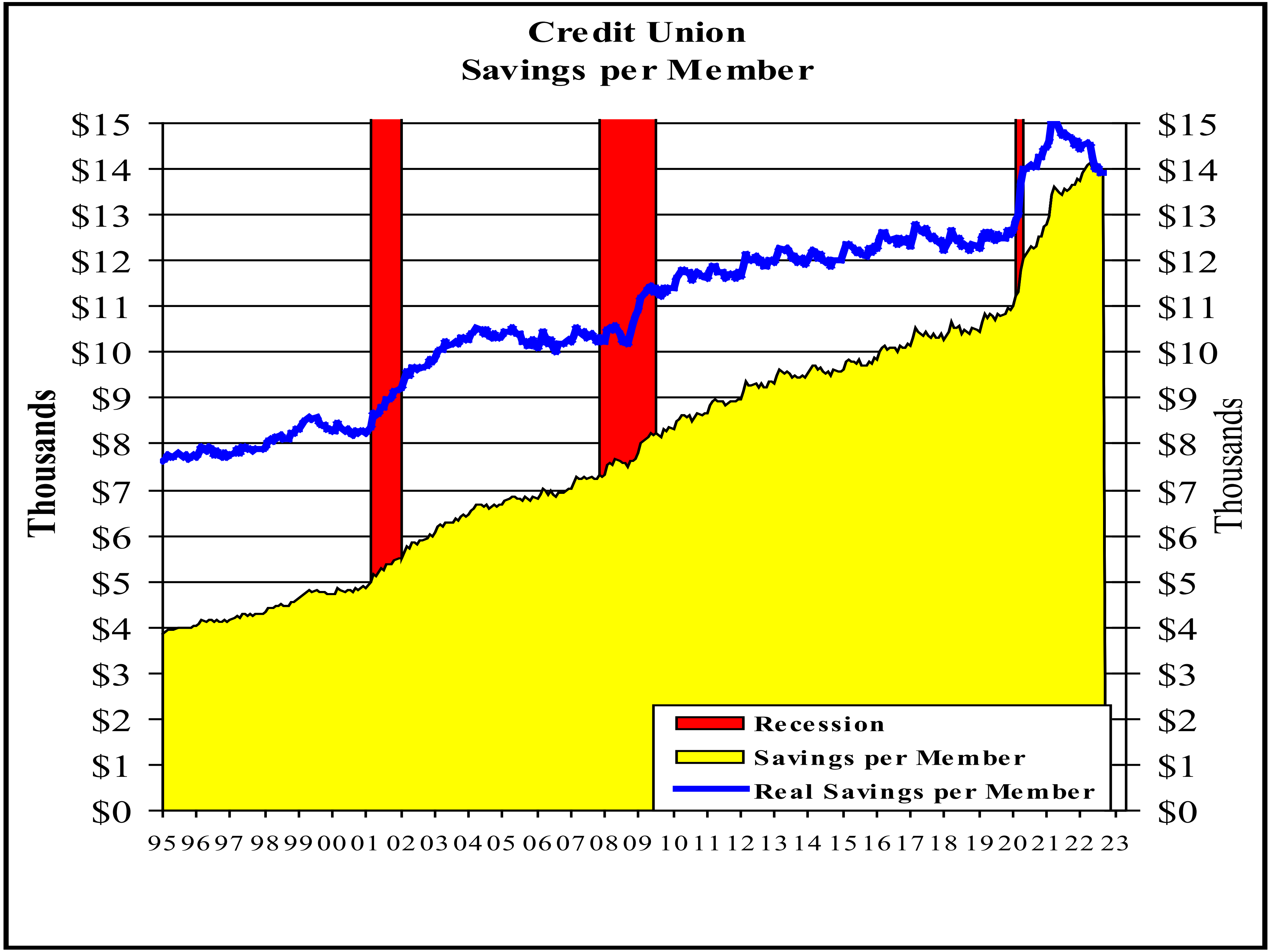


Takeaways:

1. High Inflation => ↑ lending growth rate
2. Increase in leisure spending => ↑ unsecured lending
3. Rising interest rates will weigh on loan growth

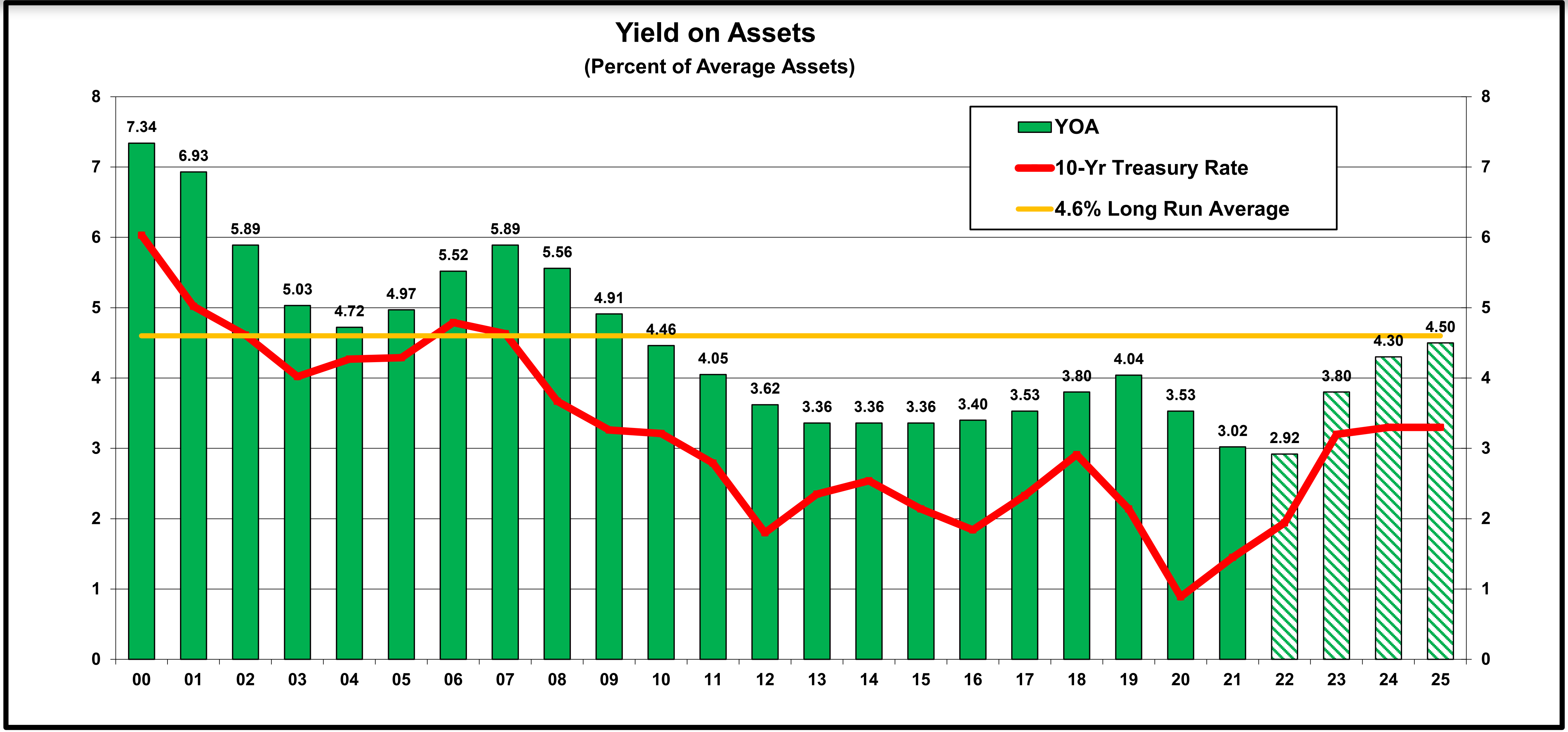
Below Trend Credit Union Saving Growth in 2023



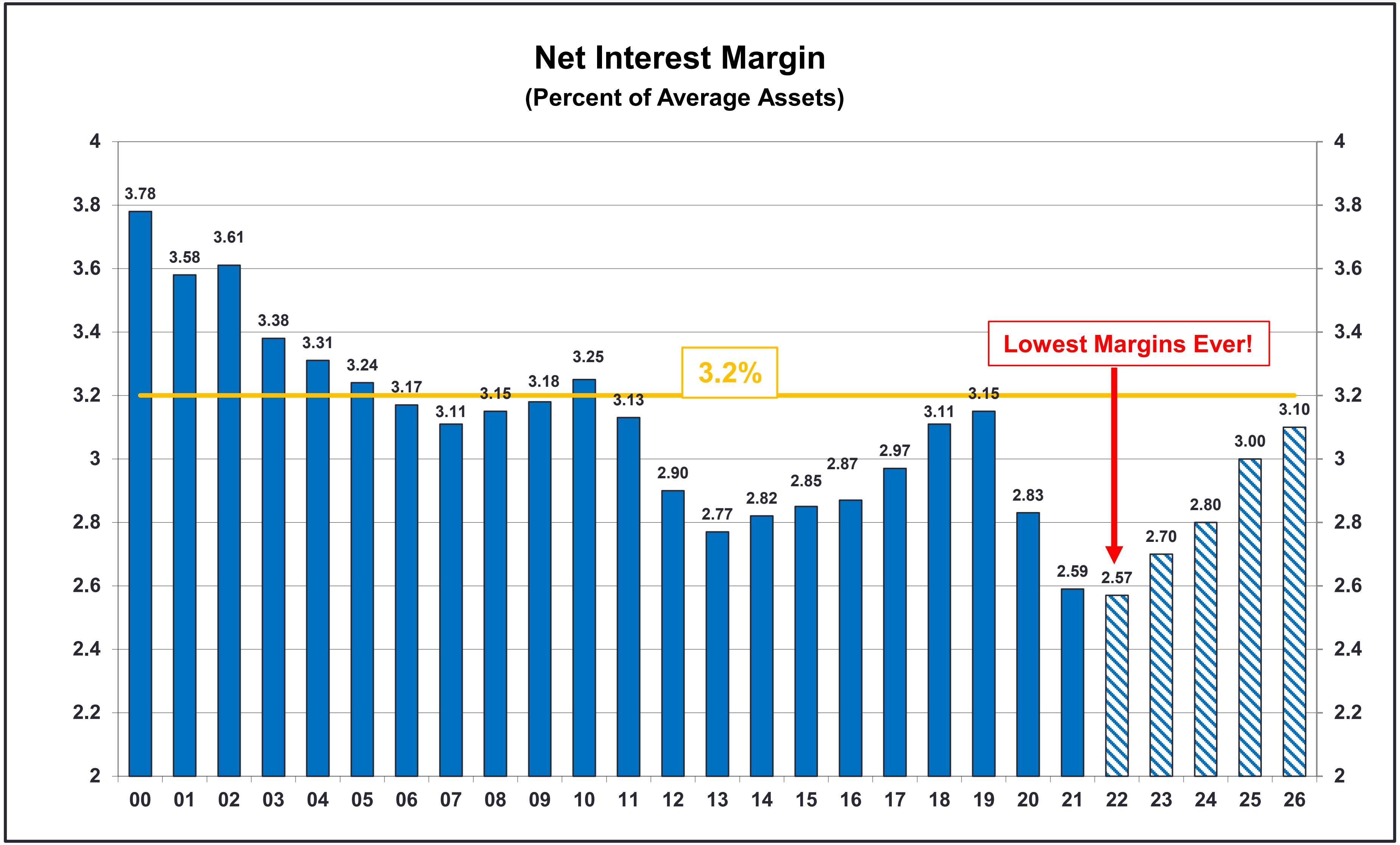


Credit Union
Savings per Member
$15
$14
$13
$12
$11
$10
$9
$8
$7
$6
$5
$4
$3
$2
$1
$0
Thousands
Recession
Savings per Member
Real Savings per Member
95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23

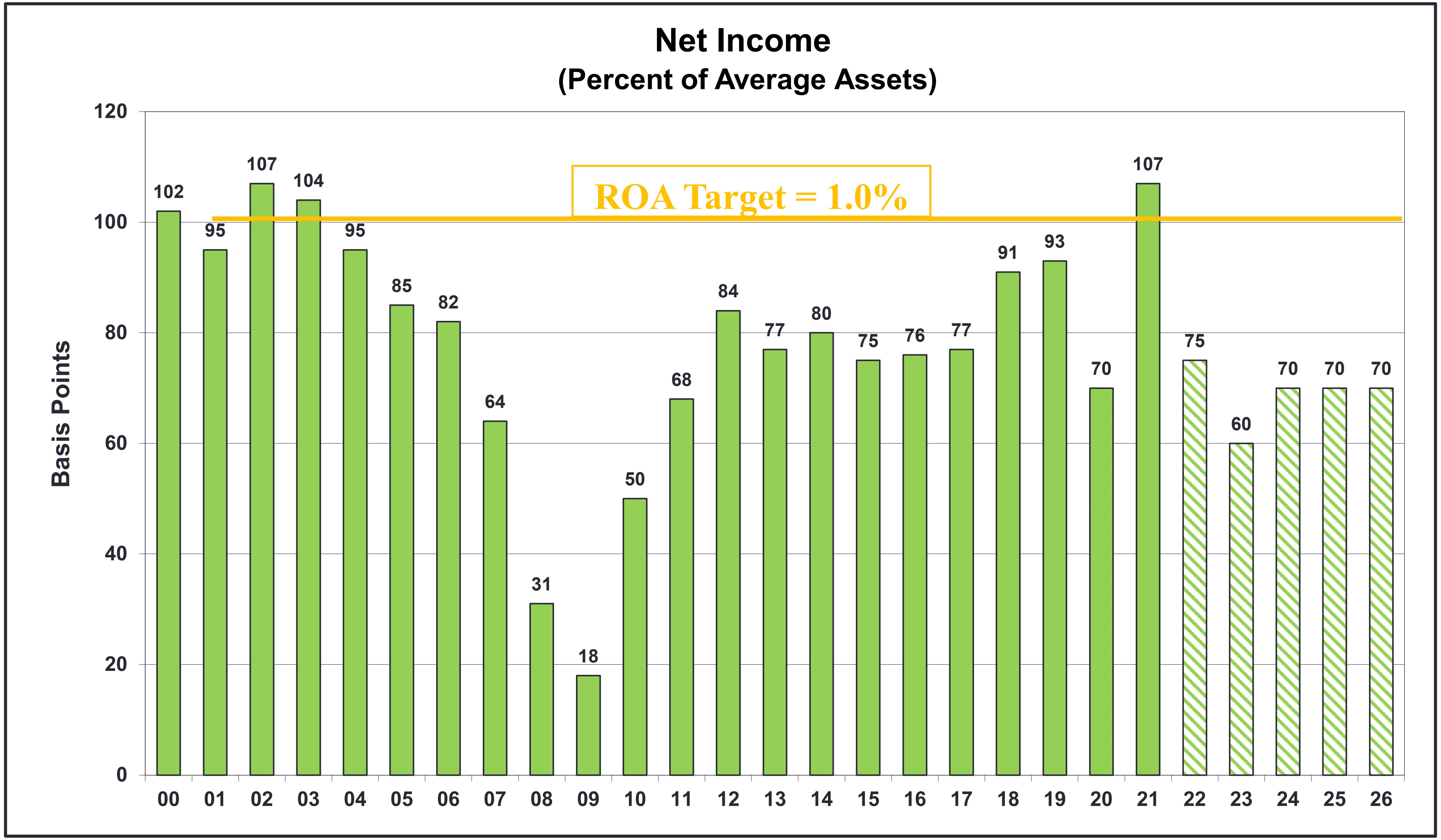
Rising Yield-on-Asset Ratios



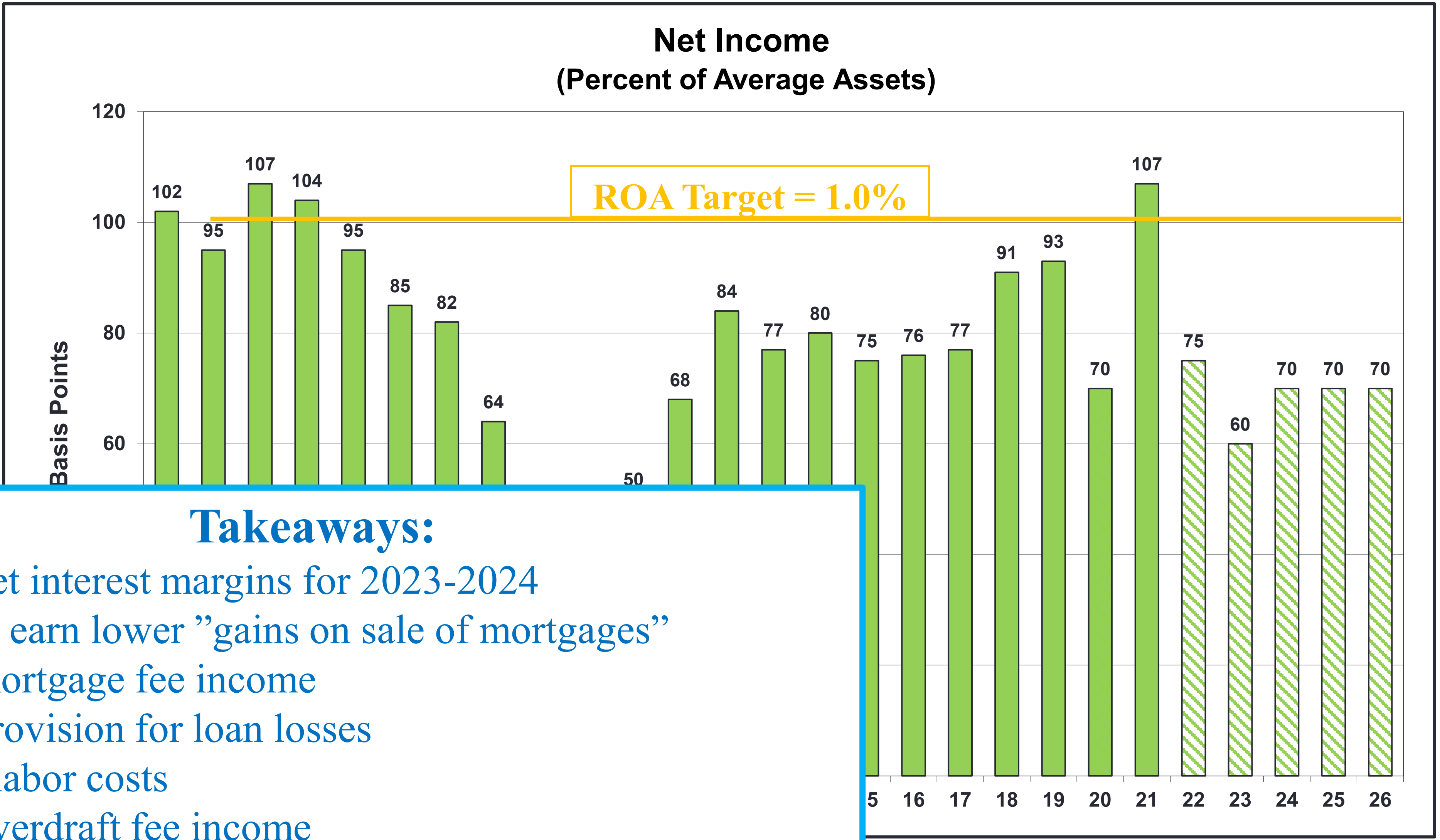
Net Interest Margins will Rise in 2023



Credit Union Earnings Below Trend in 2023



Credit Union Earnings Below Trend in 2023



Takeaways:

1. Rising net interest margins for 2023-2024
2. CUs will earn lower "gains on sale of mortgages"
3. Lower mortgage fee income
4. Rising provision for loan losses
5. Surging labor costs
6. Lower overdraft fee income

Economic Update Summary For 2023

1. Slow economic growth for the next 2 years
2. Falling inflation rate during the next 2 years
3. Unemployment rate below normal for next 2 years
4. Long-term interest rates rising to 3.5% over the next 2 years
5. Credit union loan growth slowing in 2023
6. Rising net interest margins in 2023
7. Credit union mortgage originations falling 40-45% over next 2 years

Economic forecast

October 2022

	Past results		Quarterly results/forecasts				Annual forecasts	
	Previous 10 Yr. Avg	2021	2022:1	2022:2	2022:3	2022:4	2022	2023
Growth rates:								
Economic Growth (% chg GDP)*	2.1%	5.7%	-1.6%	-0.6%	2.5%	1.0%	0.3%	0.0%
Inflation (CPI, 12 mth % chg)	2.1%	7.1%	8.6%	9.0%	8.2%	7.5%	7.5%	4.0%
Unemployment Rate (BLS)	5.2%	3.9%	3.6%	3.6%	3.5%	3.7%	3.7%	4.5%
Federal Funds Rate (effective)	0.64%	0.07%	0.33%	1.58%	3.08%	4.35%	4.35%	4.60%
10-Year Treasury Rate	2.12%	1.52%	2.34%	2.98%	3.83%	4.00%	4.00%	4.00%
10-Year-Fed Funds Spread	1.48%	1.45%	2.01%	1.40%	0.75%	-0.35%	-0.35%	-0.60%

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

Economic Forecast
October 2022

Economic Growth. GDP fell by 1.6% in the first quarter and 0.6% in the second. Two consecutive declines in GDP meet a popular definition of a recession, but not the National Bureau of Economic Research's official definition: a significant, widespread and persistent decline in economic activity. During the first half of the year, the unemployment rate was hovering just above 3.5%, payrolls were increasing by an average of 450 thousand jobs a month, industrial production was rising, and consumer spending was strong: all signs of a booming economy. It was fluctuations in inventory growth and the international trade balance that caused GDP to decline despite this strength. GDP growth resumed in the third quarter at a 2.6% annual rate, and we expect moderate growth in the fourth quarter. Next year, the substantial rise in interest rates that has occurred this year will slow interest sensitive sectors of the economy (housing is already slowing) enough to qualify as a real recession. A troubling sign is that the yield on two-year Treasury securities has exceeded the yield on ten-year Treasuries since July, by 30bp to 40bp for most of that time. Every time the yield curve has inverted as much as that during the past 50 years, a recession has followed about six to twelve months later.

Inflation. Headline (all items) inflation moderated in the third quarter to an annual rate of only 1.9%, from 10.6% in the second. But this was deceiving. After soaring in the previous year, gasoline prices tumbled during the quarter, pulling down the all-items average. The core inflation rate (all items less food and energy) remained elevated during the second quarter at 5.9%. This suggests a substantial decline in the headline inflation rate is not imminent. Service and shelter costs increases will persist for some time. Looking further ahead, the COVID related causes of the recent bout of inflation (supply chain problems, restricted labor supply, pent up demand) are abating, and interest rate increases will further slow demand. As a result, consumer price inflation should fall from 7.5% this year to 4% next year and to around 2.5% in 2024.

Unemployment. The labor market remains strong. All signs point to full employment: strong job growth, an unemployment rate below 4%, a working age labor force participation rate of 82.3%, more job openings than job seekers. Monthly job growth moderated slightly in the third quarter to 370,000 a month, and was declining during the quarter, but is still very strong. However, we expect the Fed's tightening to eventually soften the labor market with rising unemployment rates and several months of job losses next year.

Interest Rates. Since March, the Fed Fund's target range has risen by a whopping 3 percentage points. Longer term interest rates have also risen, but by less so that the yield curve has inverted. Expect the Fund's rate to rise another 100bp this year, and 25bp to 50bp more next year for a high for this cycle of between 4.5% and 5%. With the unemployment rate rising next year we might normally expect the Fed to reverse course quickly and lower the Fed Funds rate as it has several times over the past few decades. However, the inflation rate is now well above what it was during those episodes, so unless the recession is much worse than expected, the Fed is unlikely to lower the Funds rate until inflation is below 4% and falling. That will be toward the end of 2023 or later.

Credit union forecast

October 2022

	Past results		Quarterly results/forecasts				Annual forecasts	
	10 Yr Avg	2021	2022:1	2022:2	2022:3	2022:4	2022	2023
Growth rates:								
Savings growth	8.1%	12.6%	3.5%	0.2%	0.0%	-0.2%	3.5%	6.%
Loan growth	8.2%	7.7%	3.7%	6.6%	4.7%	3.0%	18.0%	7.0%
Asset growth	9.8%	11.7%	2.8%	0.8%	0.5%	0.4%	4.5%	6.25%
Membership growth	3.5%	4.2%	1.1%	1.3%	0.3%	0.3%	3.0%	2.5%
Liquidity:								
Loan-to-share ratio**	77.0%	70.7%	70.2%	74.7%	78.9%	81.4%	81.4%	82.2%
Asset quality:								
Delinquency rate**	0.79%	0.48%	0.42%	0.48%	0.50%	0.55%	0.55%	0.65%
Net charge-off rate*	0.53%	0.26%	0.28%	0.29%	0.30%	0.35%	0.31%	0.45%
Earnings:								
Return on average assets (ROA)*	0.83%	1.07%	0.87%	0.84%	0.70%	0.65%	0.77%	0.60%
Capital adequacy:								
Net worth ratio**	10.6%	10.3%	10.5%	10.7%	10.3%	10.4%	10.4%	10.6%

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

Credit Union Forecast
October 2022

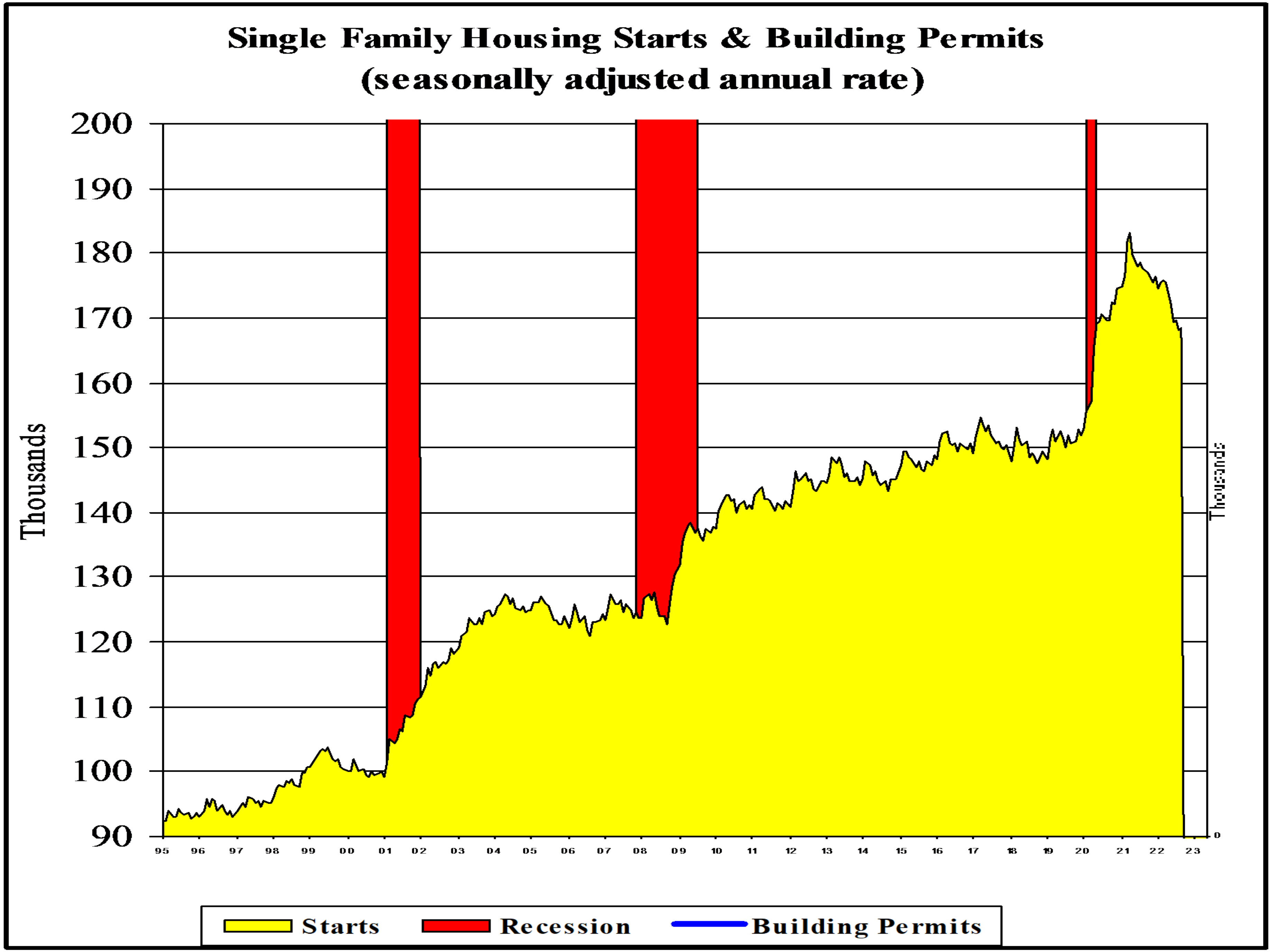
Savings (Deposit) and Asset Growth. After COVID caused about the fastest two-year growth rates in history in 2020 and 2021, savings growth at our forecasted 3.5% in 2022 will be among the slowest rates of the past forty years: a remarkable reversal. And with an inflation rate over 7%, real (inflation adjusted) savings growth will be negative for the year. This weak growth is due in part to members spending down the excess savings they built up during the worst of the COVID shutdowns. More recently, members with larger deposits are likely finding interest rates at internet banks, money market mutual funds, and even on Treasury bills attractive: cross- and dis-intermediation. Slower spending next year will restore some growth, but the pull of relatively high short-term market interest rates from competing short-term deposits and investments will persist for much of the year.

Loan Growth. Credit union lending has been on a tear so far this year, and the 18% increase in loan outstanding we expect by the end of the year will be the strongest calendar year growth in over 35 years. This is likely due a surge in pent up consumer demand as the effects of COVID recede, coupled with the higher prices of products members are financing. Slowing prepayments on mortgage loans due to higher interest rates and the fact that credit unions have so far been slow to raise consumer loan interest rates are likely also playing a role. With higher interest rates on loans and a slowing economy, next year loan growth will slow to around 7%.

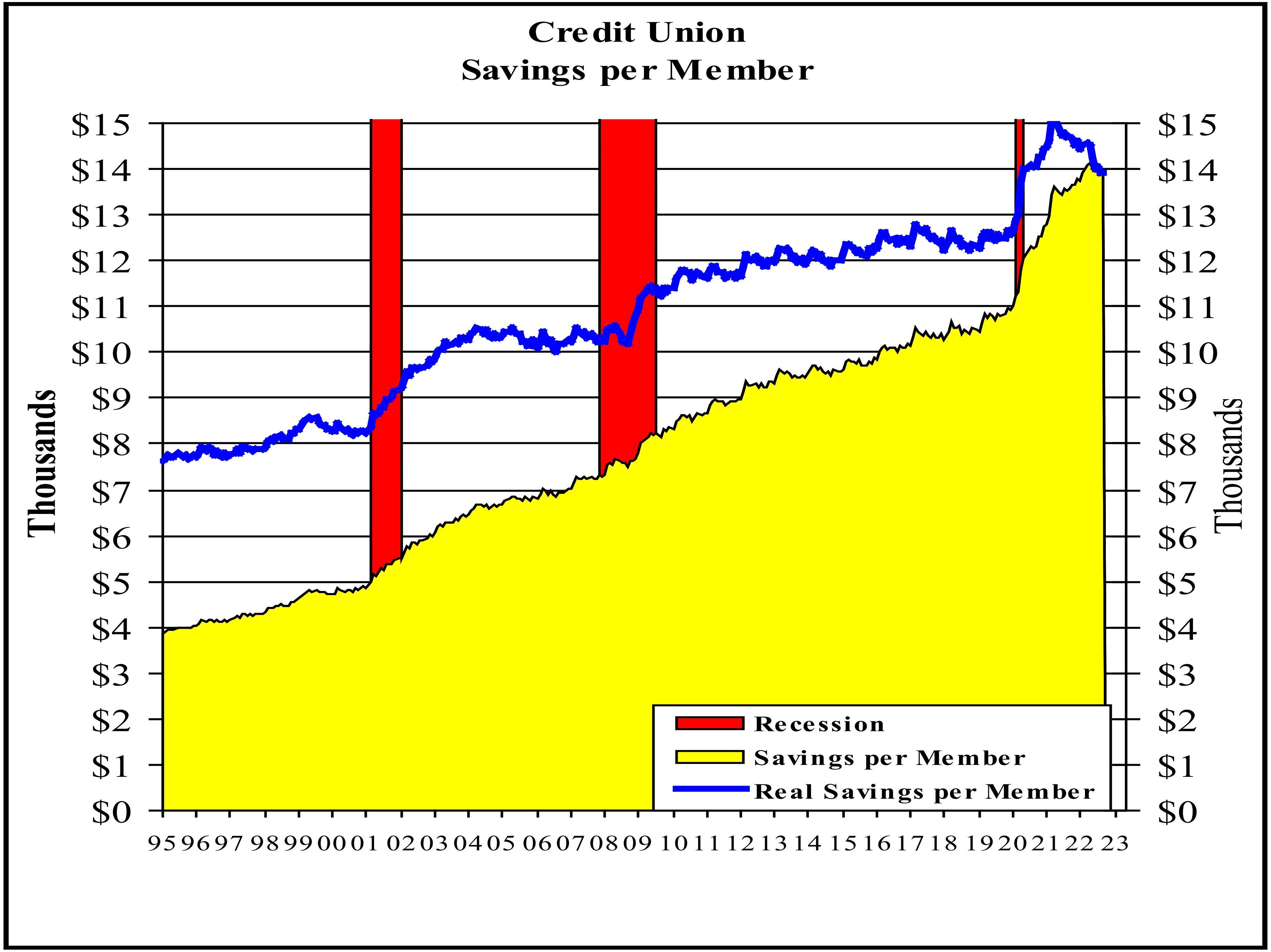
Liquidity. Not surprisingly, with unusually slow deposit growth and strong loan growth, credit union liquidity has fallen dramatically this year. The average loan-to-savings ratio will rise by more than ten points during the year, from 70.7% to 81.4%. With the national average over 80%, many credit unions are now likely fully “loaned up” and facing significant liquidity challenges. With our loan and savings growth forecasts, we don’t expect liquidity to tighten much more next year, with the loan-to-savings rising only by about a point during the year,

Asset Quality. By the end of 2022, average credit union delinquency and charge-offs rates will rise slightly but will still be well below long-term averages. These low readings are likely the result of very low unemployment and the fact that many members’ balance sheets improved substantially (unexpected savings accumulation and reduced borrowing for big ticket durables) as a result of COVID. Members’ healthy financial condition is one of the most important reasons why if indeed there is a recession next year, its impacts on credit unions will be much less severe than during the recession of 2008 to 2009.

Earnings. After last year’s strong 1.07% return on assets (ROA), the first half of 2022 came in lower at 85 basis points, and we expect it to continue to fall to about 70 bp in the second half and to 60 bp for all of next year. The headwinds for earnings next year are numerous. With evidence of a recession, credit unions will increase loan loss provisions. Interest rate increases would normally boost credit union earnings, but the inversion of the yield curve may increase deposit costs more than loan yields, especially for those credit union faced with disintermediation. Operating expenses will rise due to general inflation. Slower household spending will reduce interchange income growth. Finally, with 30-year mortgage rates over 6% after several years below that rate, income from mortgage refinancing will remain very low.



Single Family Housing Starts & Building Permits
(seasonally adjusted annual rate)
Thousands
200
190
180
170
160
150
140
130
120
110
100
90
95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23
Thousands
0
Starts
Recession
Building Permits



Credit Union
Savings per Member
$15
$14
$13
$12
$11
$10
$9
$8
$7
$6
$5
$4
$3
$2
$1
$0
Thousands
95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23
Recession
Savings per Member
Real Savings per Member