

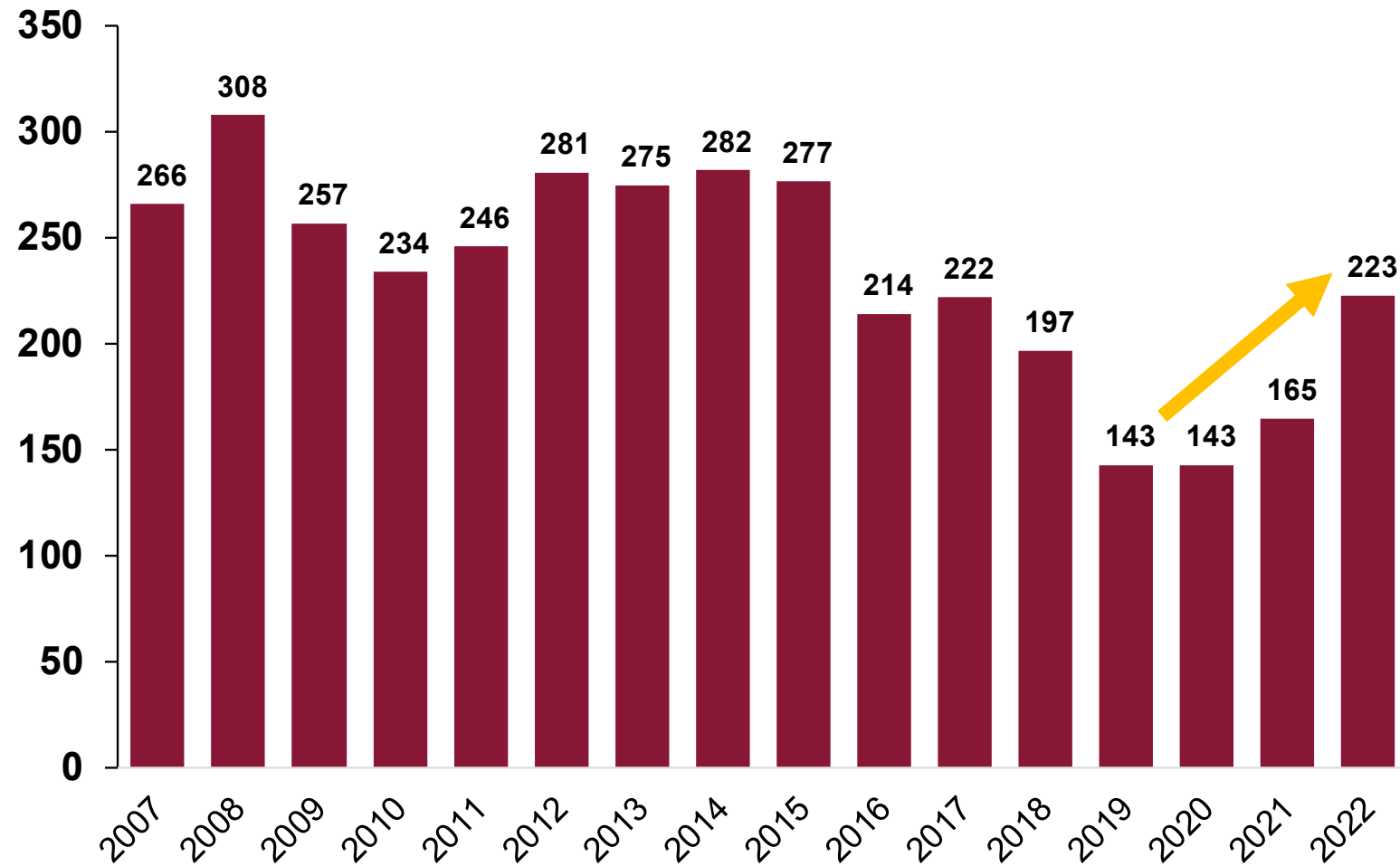
Economic and Credit Union Update

October 2023

If you have any questions or
comments, please contact:
Steven Rick, Chief Economist
TruStage - Economics
800.356.2644, Ext. 665.5454
Steve.rick@TruStage.com

Annual Net Decline in Number of CUs

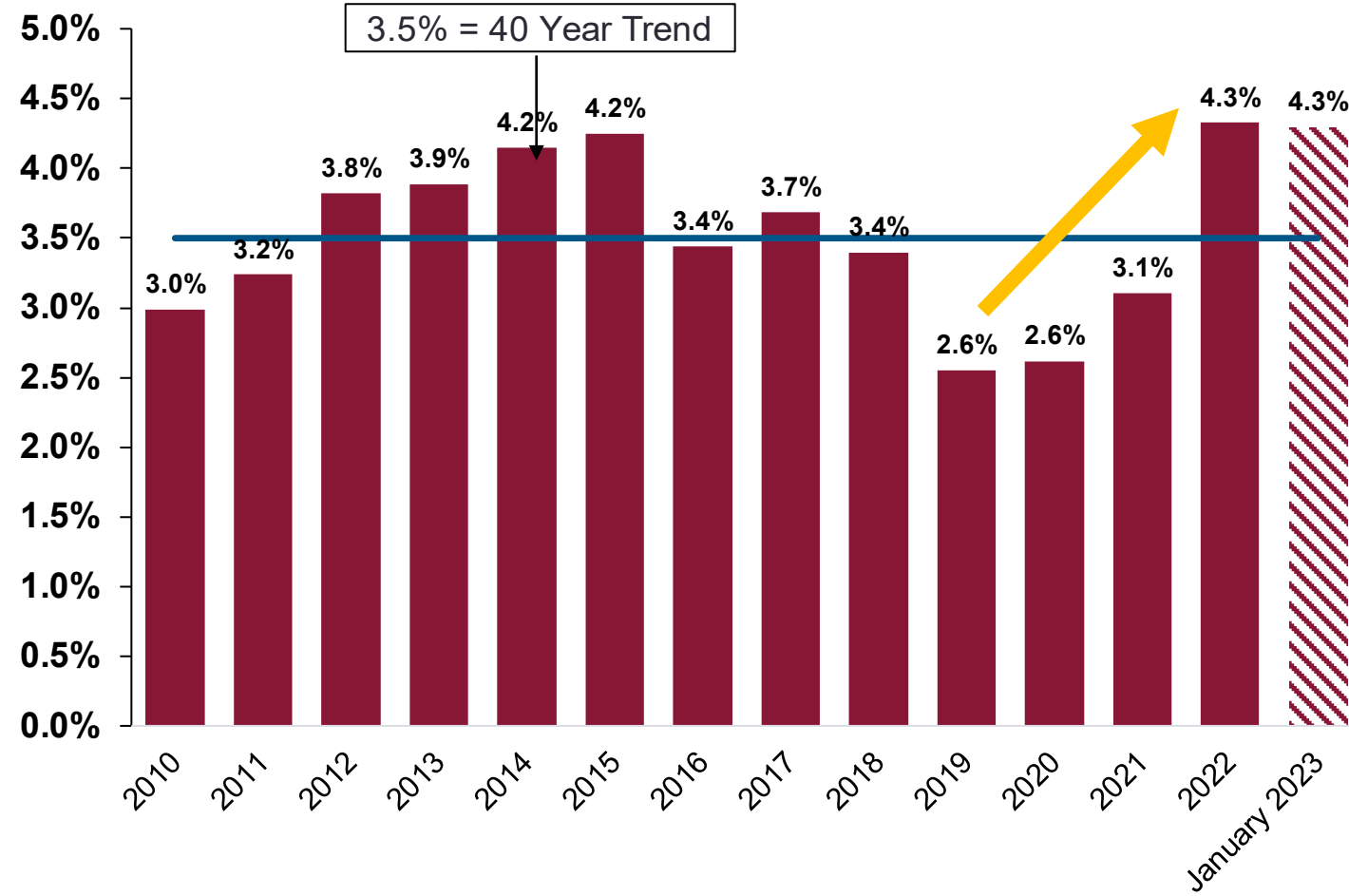
Number of CUs



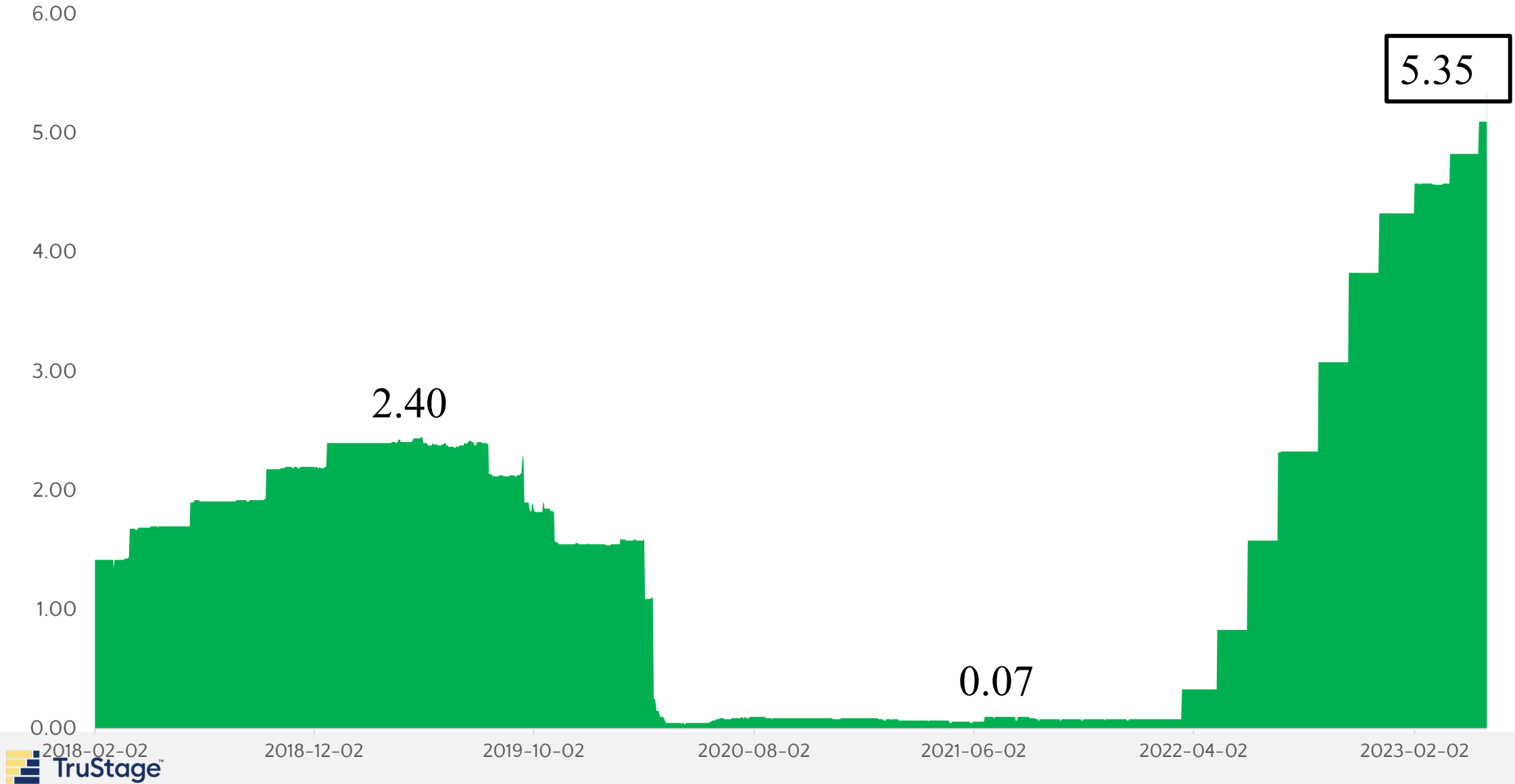
Annual Contraction Rate in CU Marketplace

January 2023

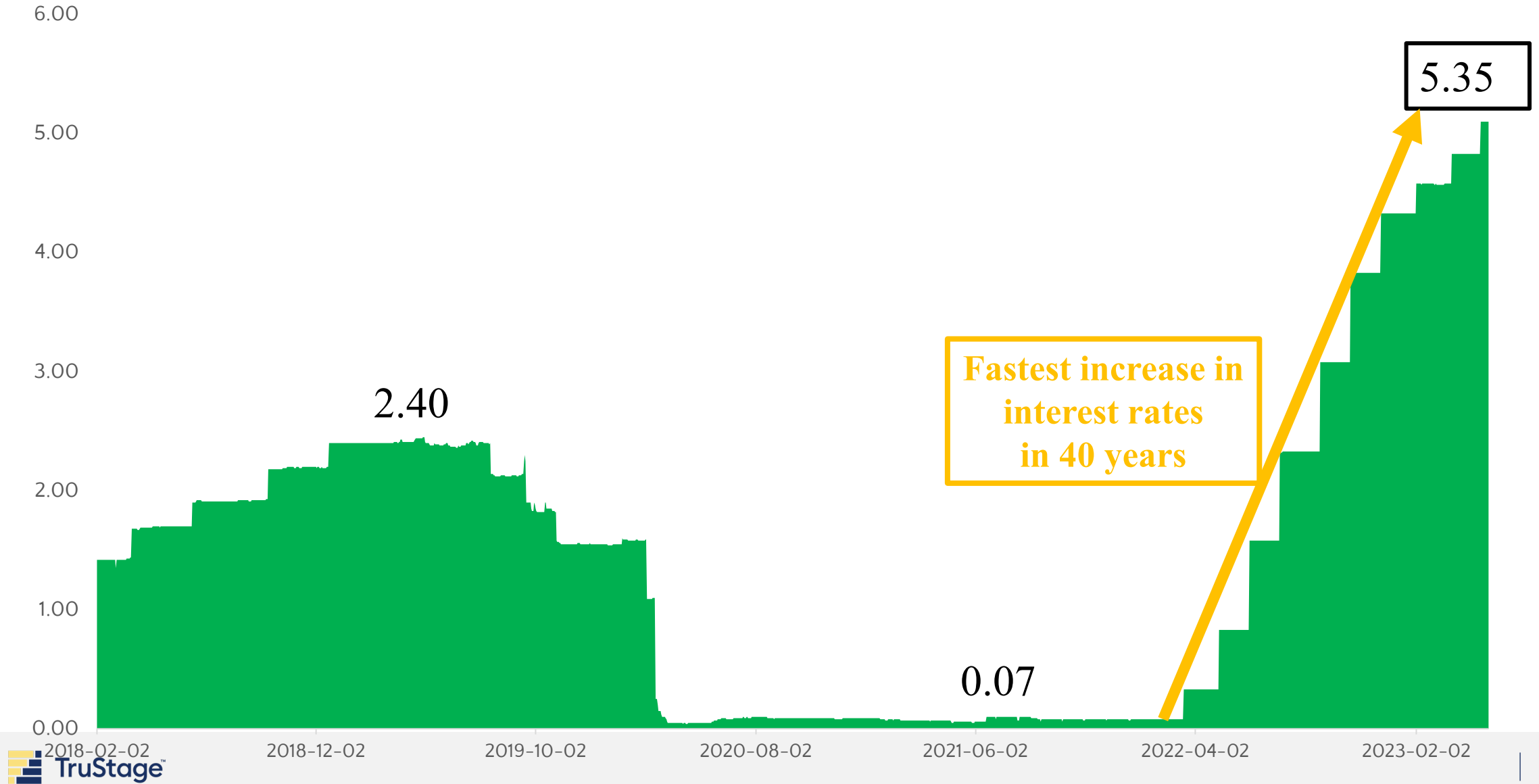
January 2022 - January 2023 Decline = 221 CUs



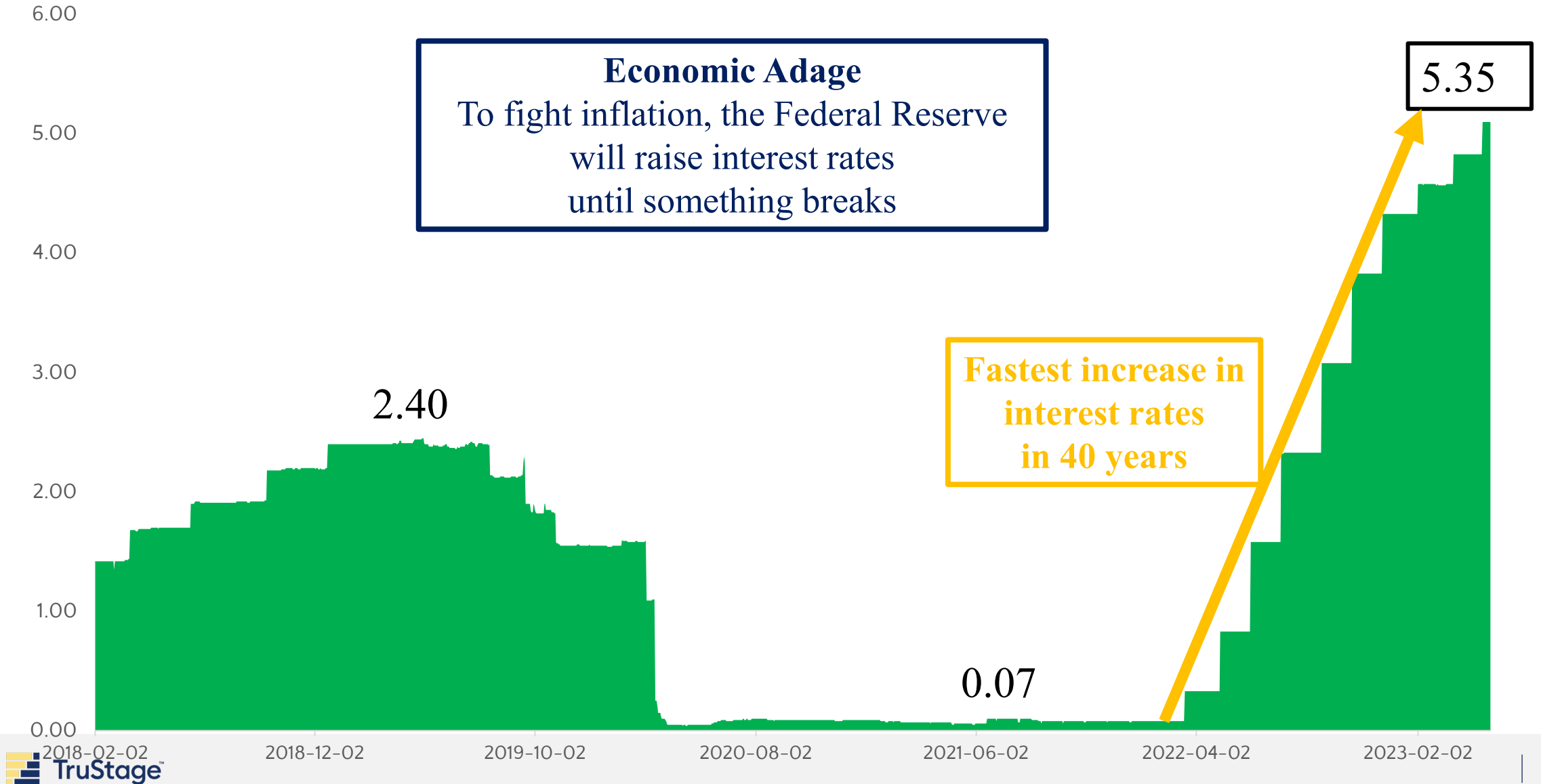
Federal Funds Rate, 2018 - 2023



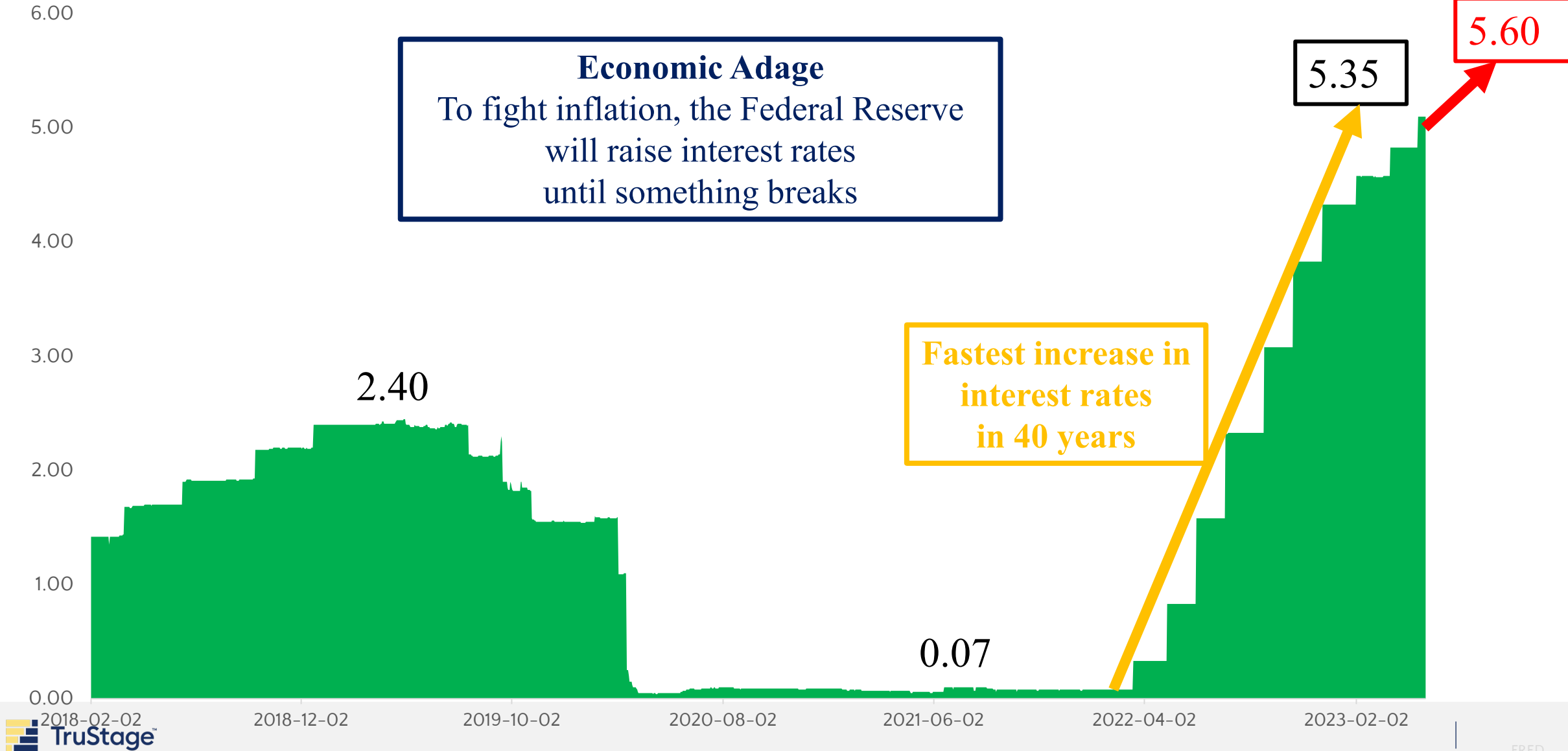
Federal Funds Rate, 2018 - 2023



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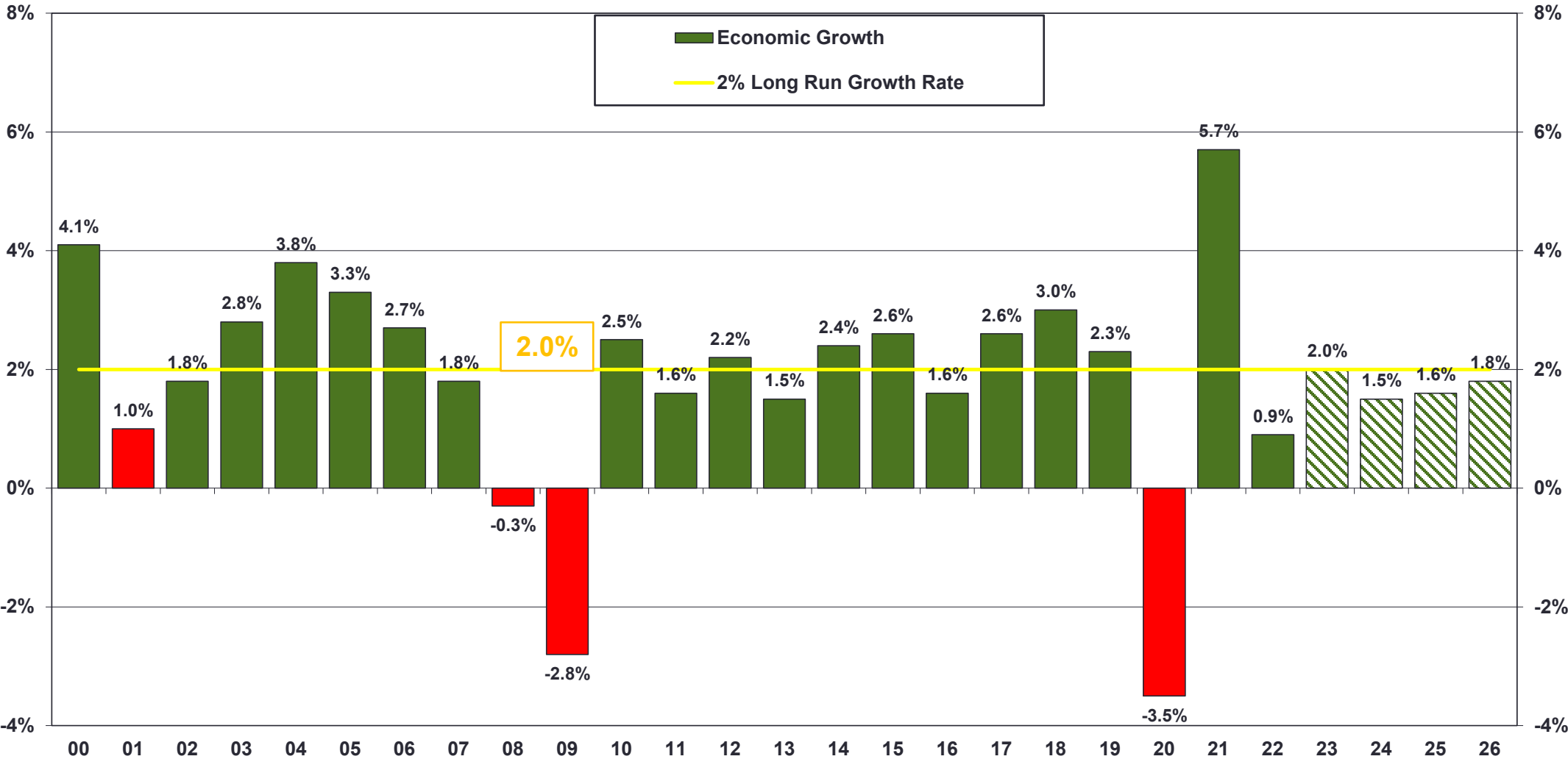


Federal Funds Rate, 2018 - 2023

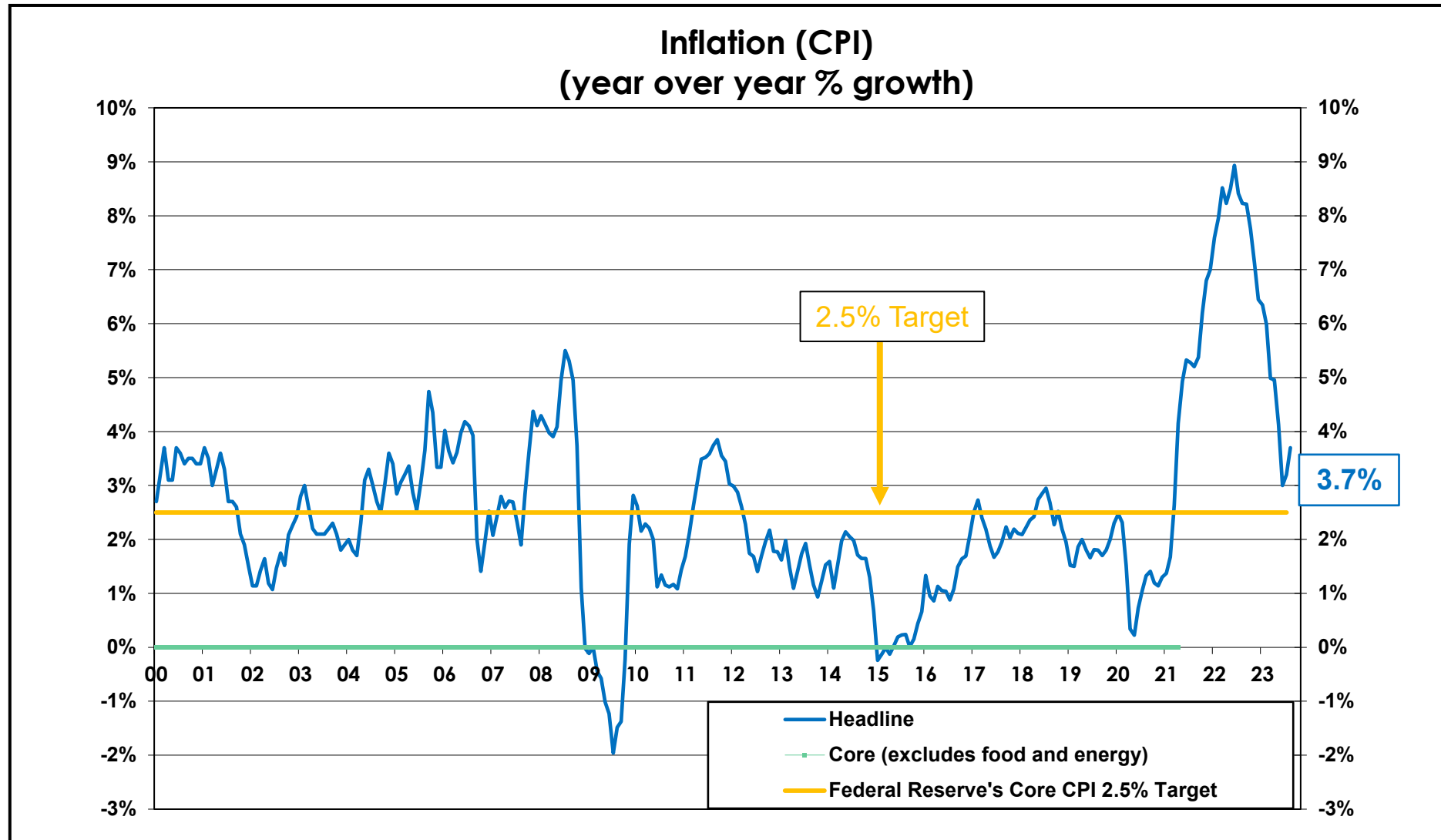


Weak Economic Growth for Next 2 Years

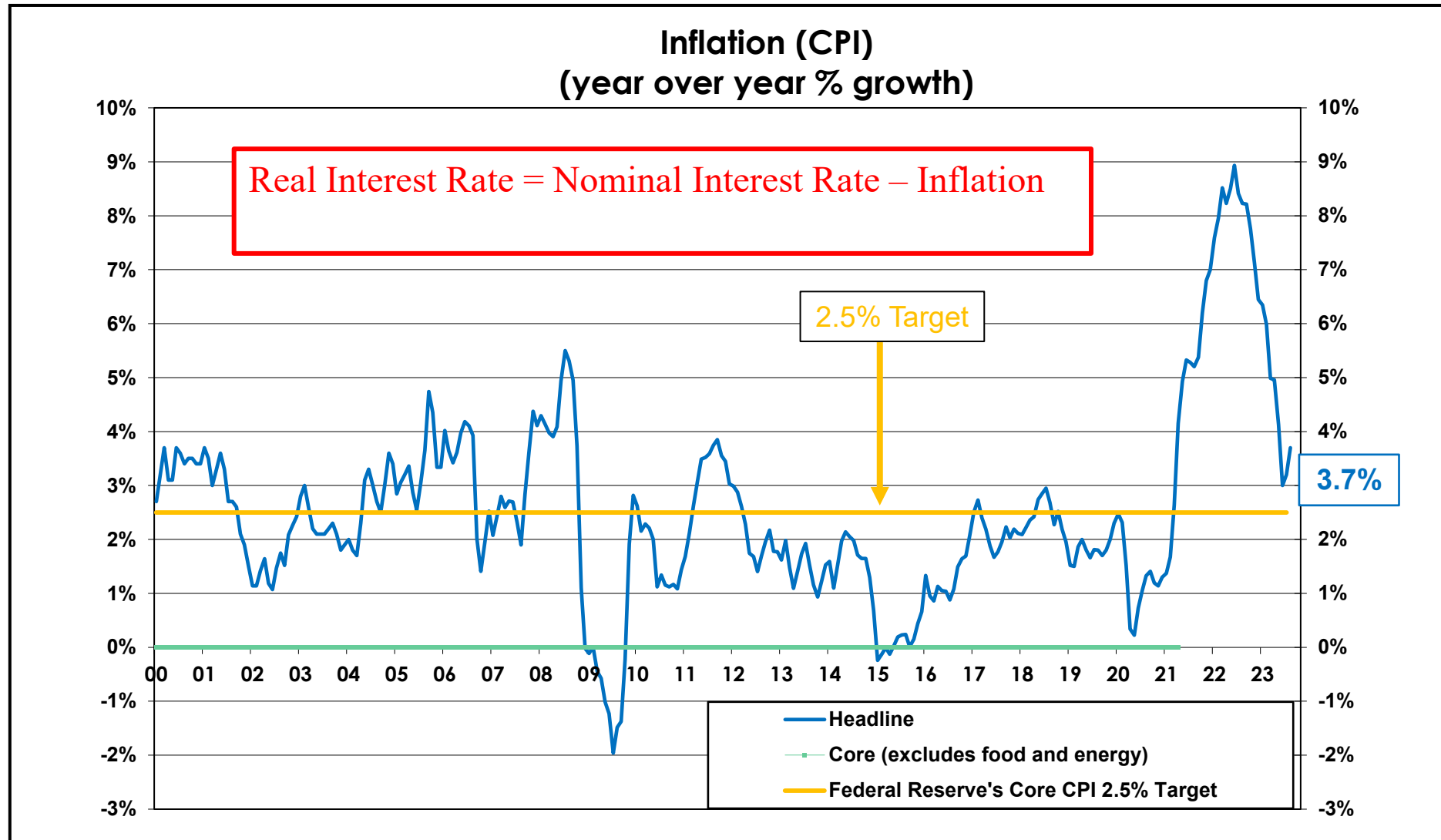
U.S. Economic Growth Rate



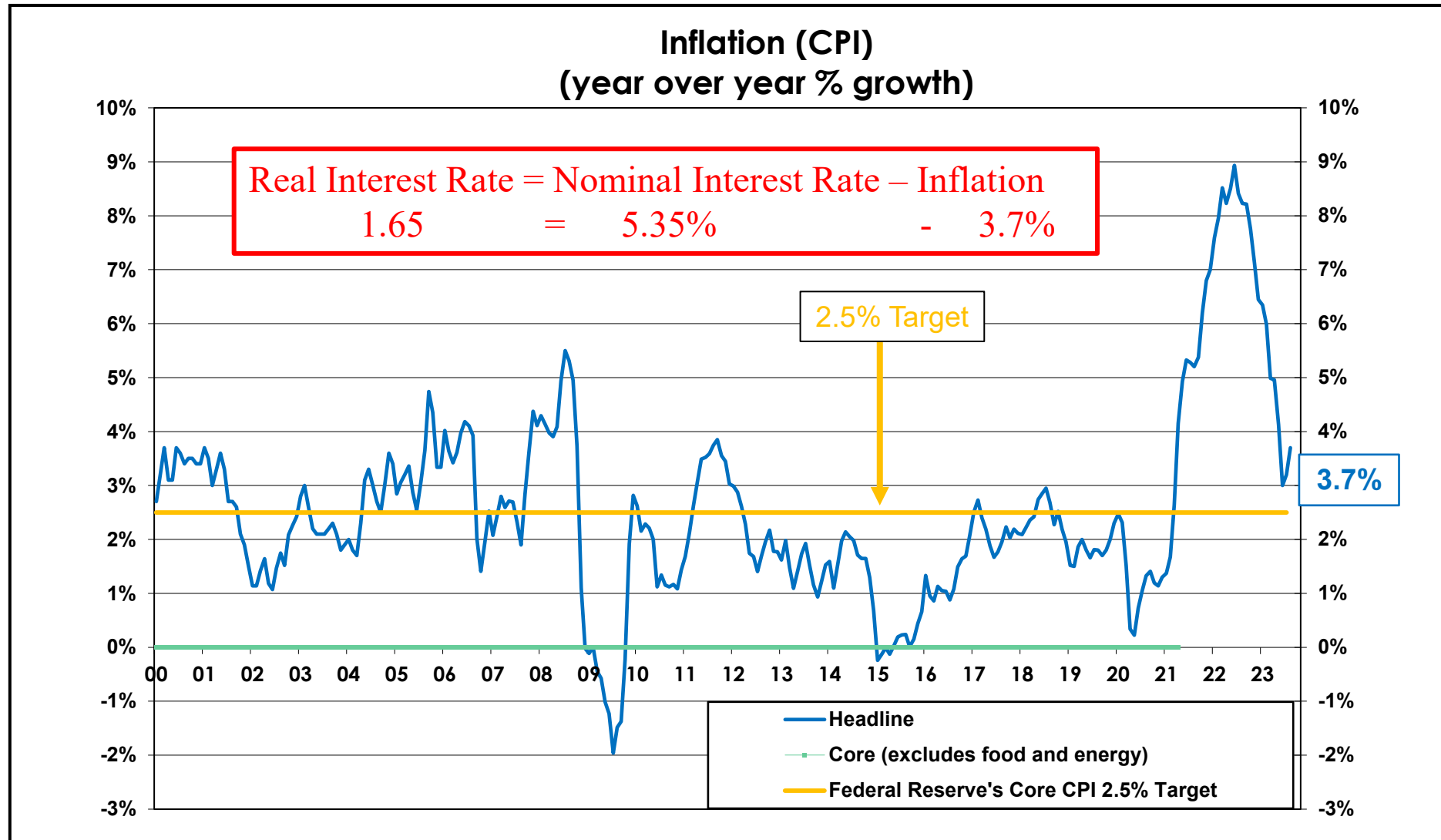
High Inflation for the Next Year



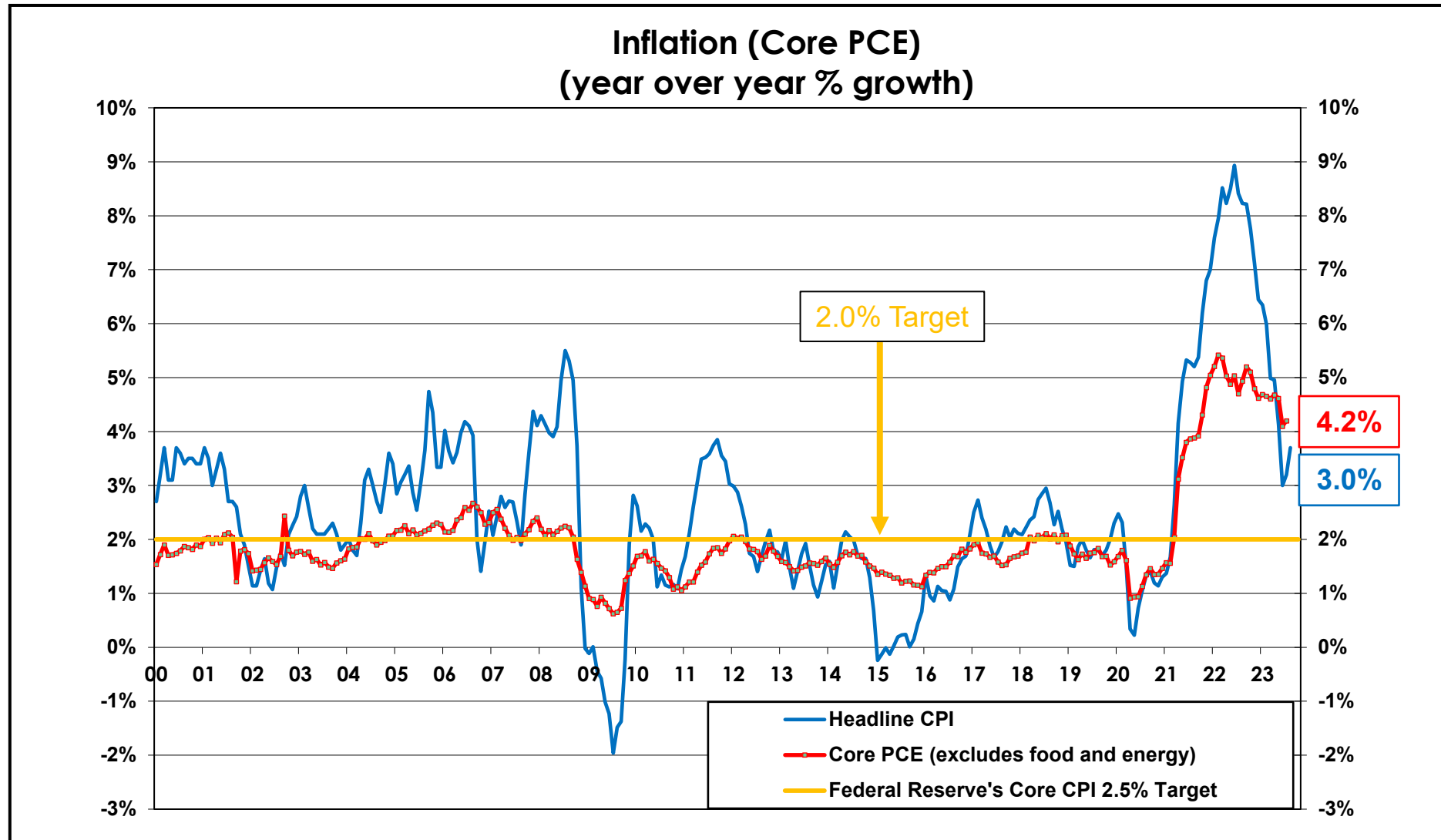
High Inflation for the Next Year



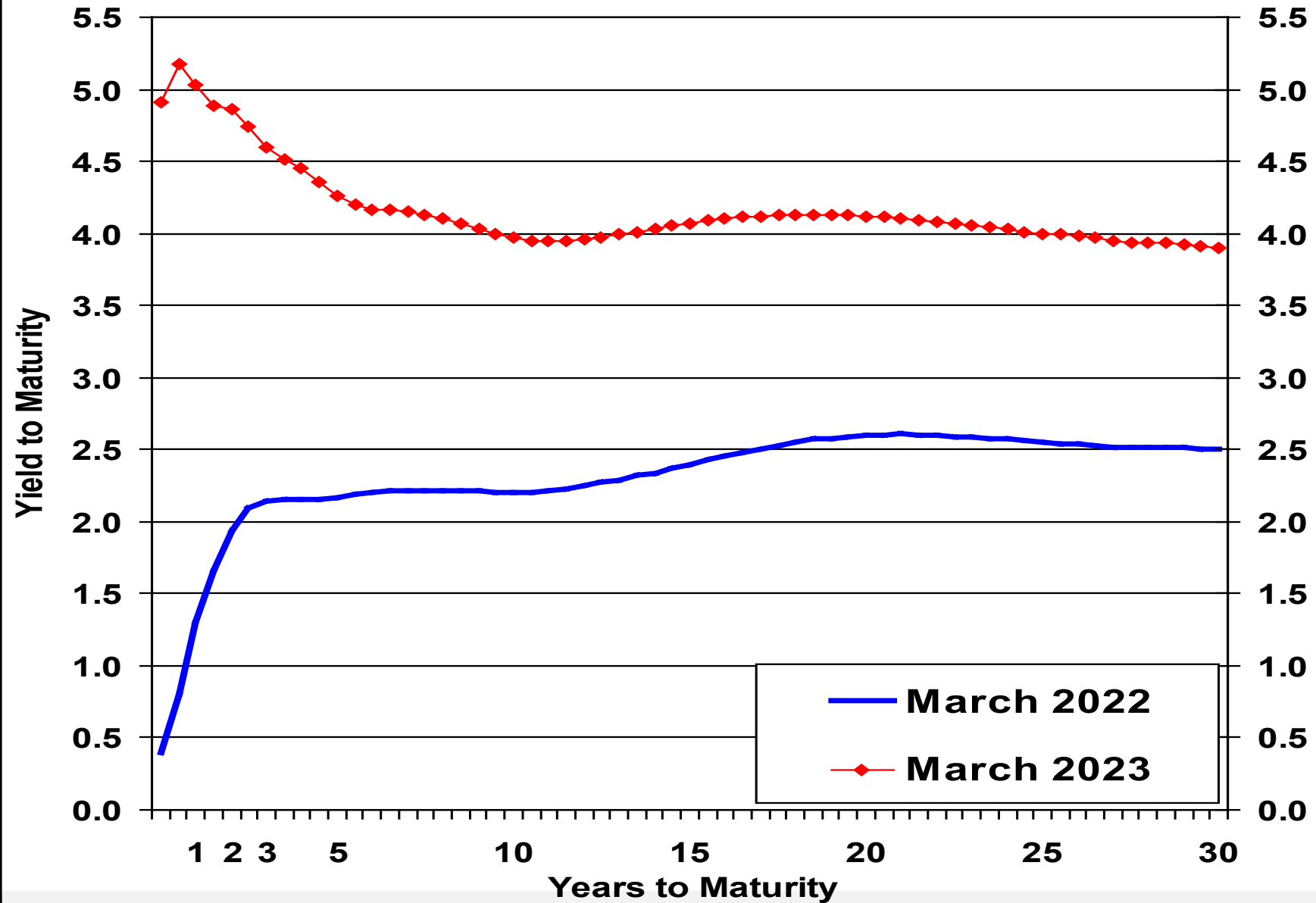
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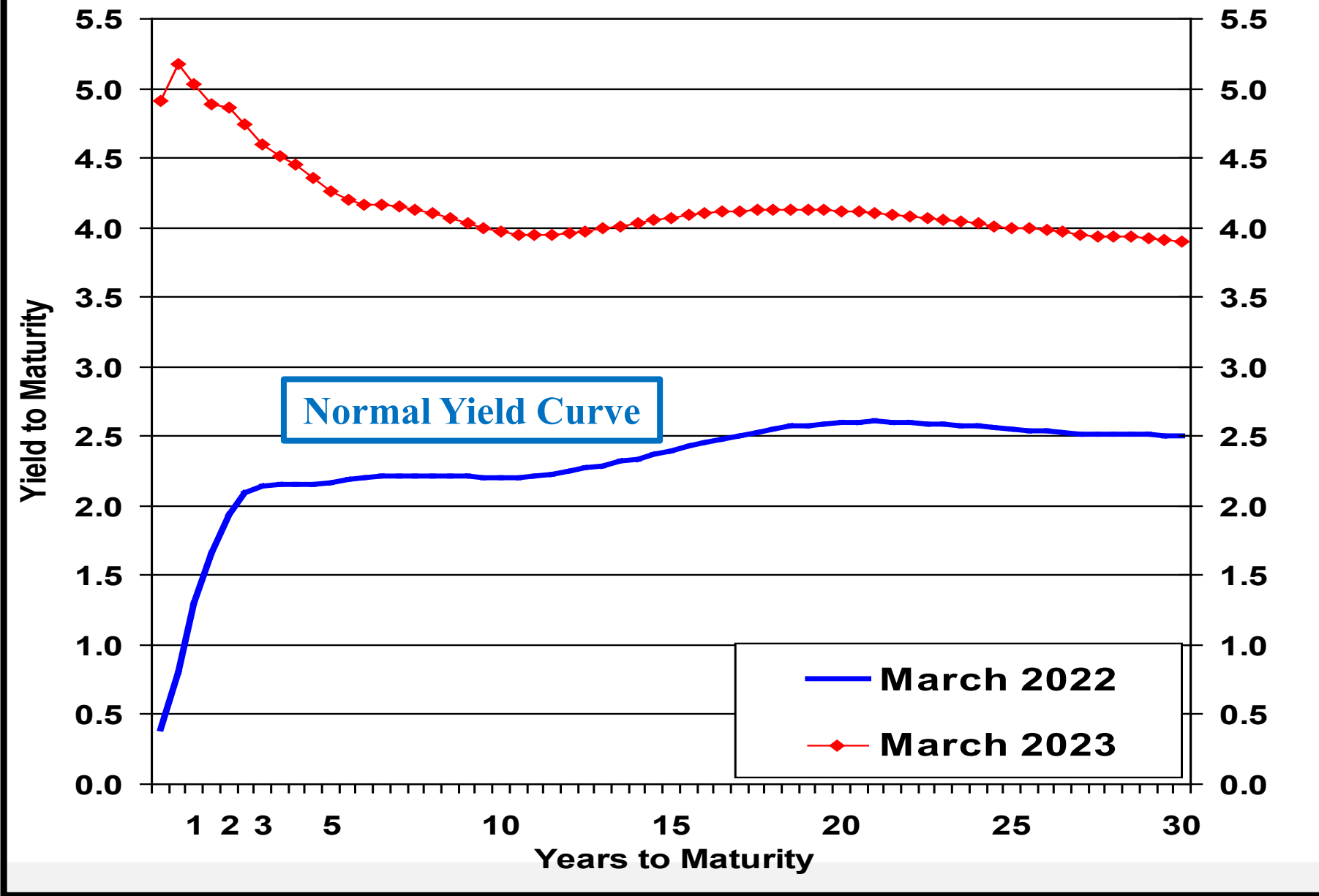
High Inflation for the Next Year



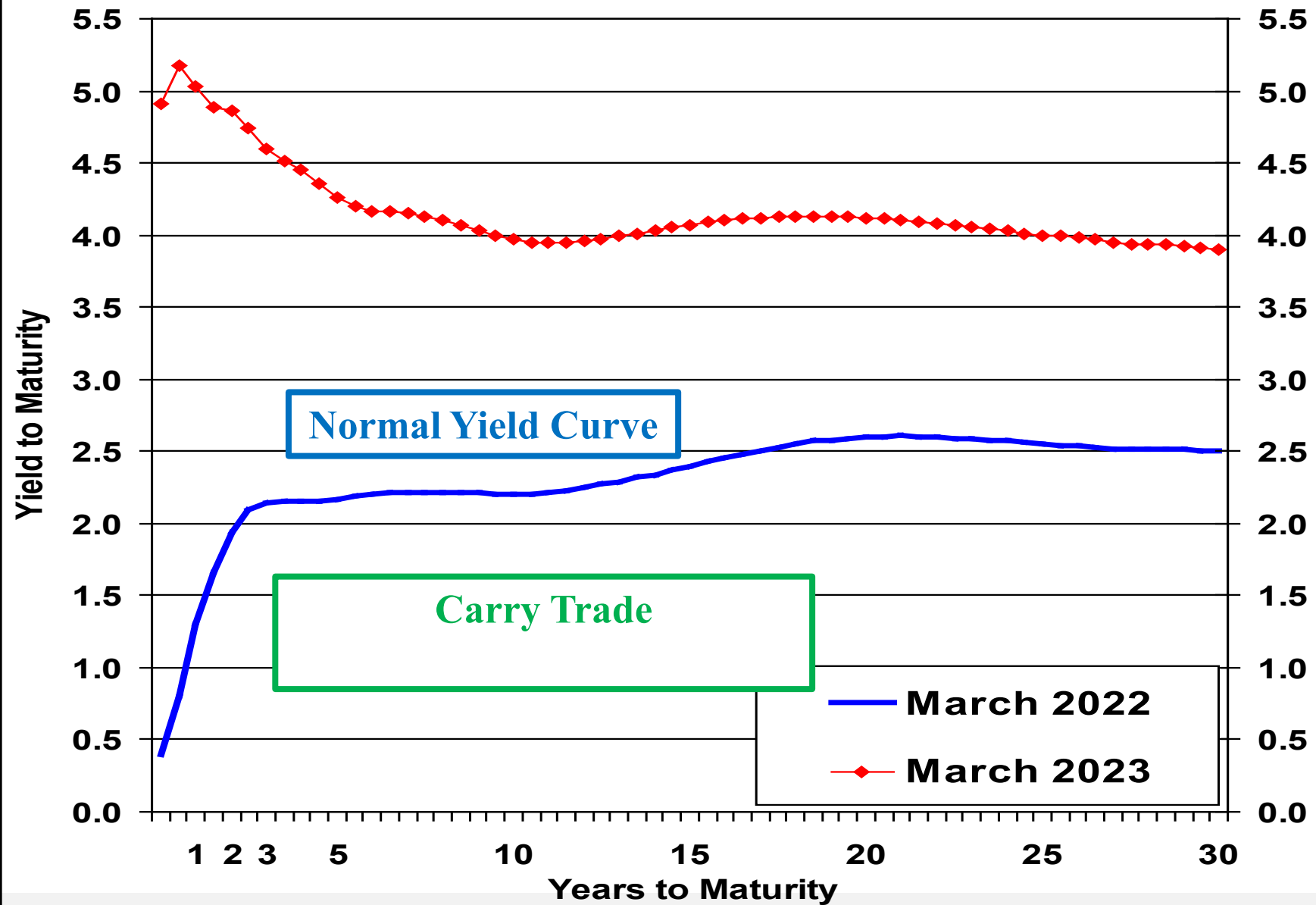
Treasury Yield Curves



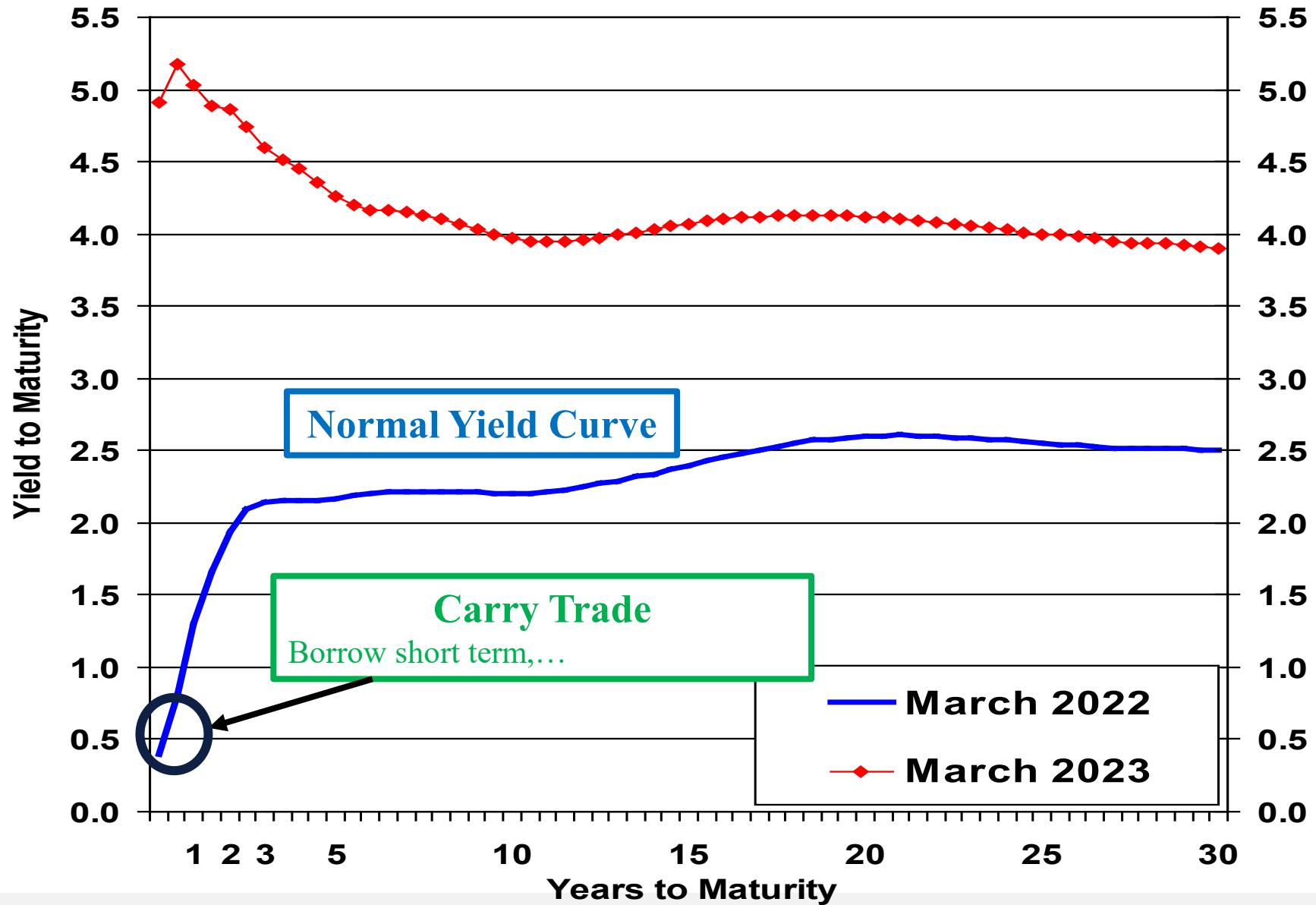
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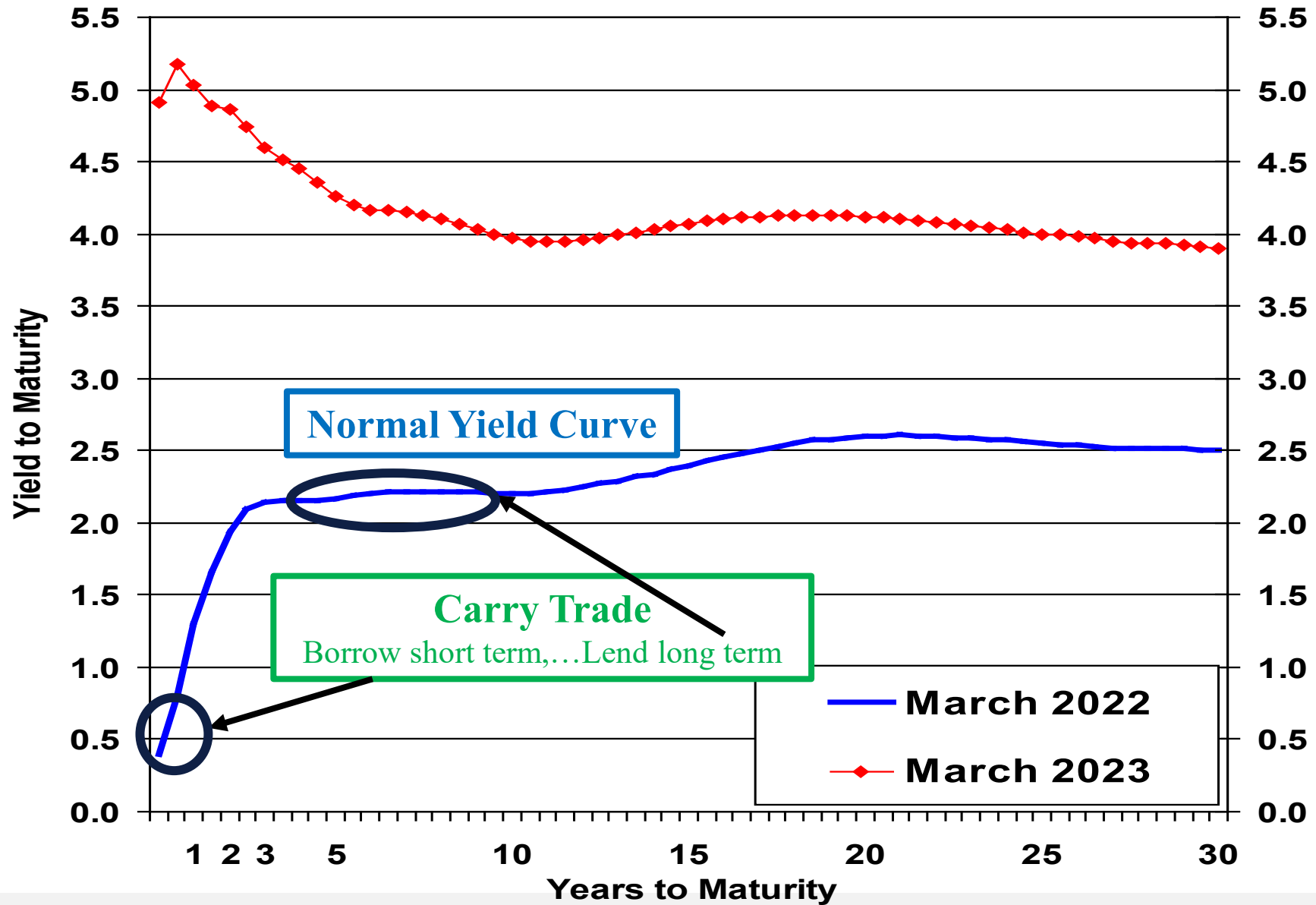
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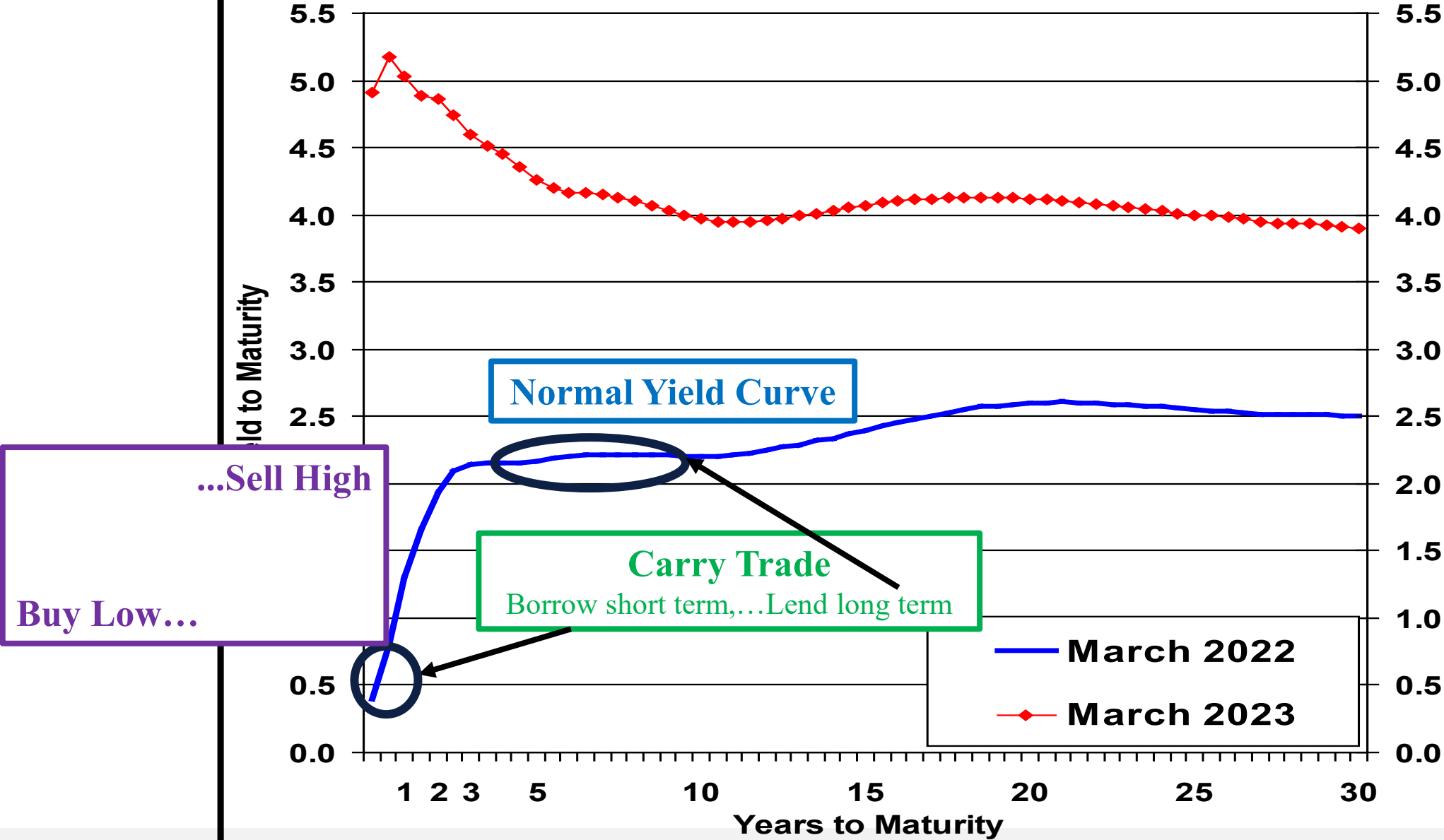
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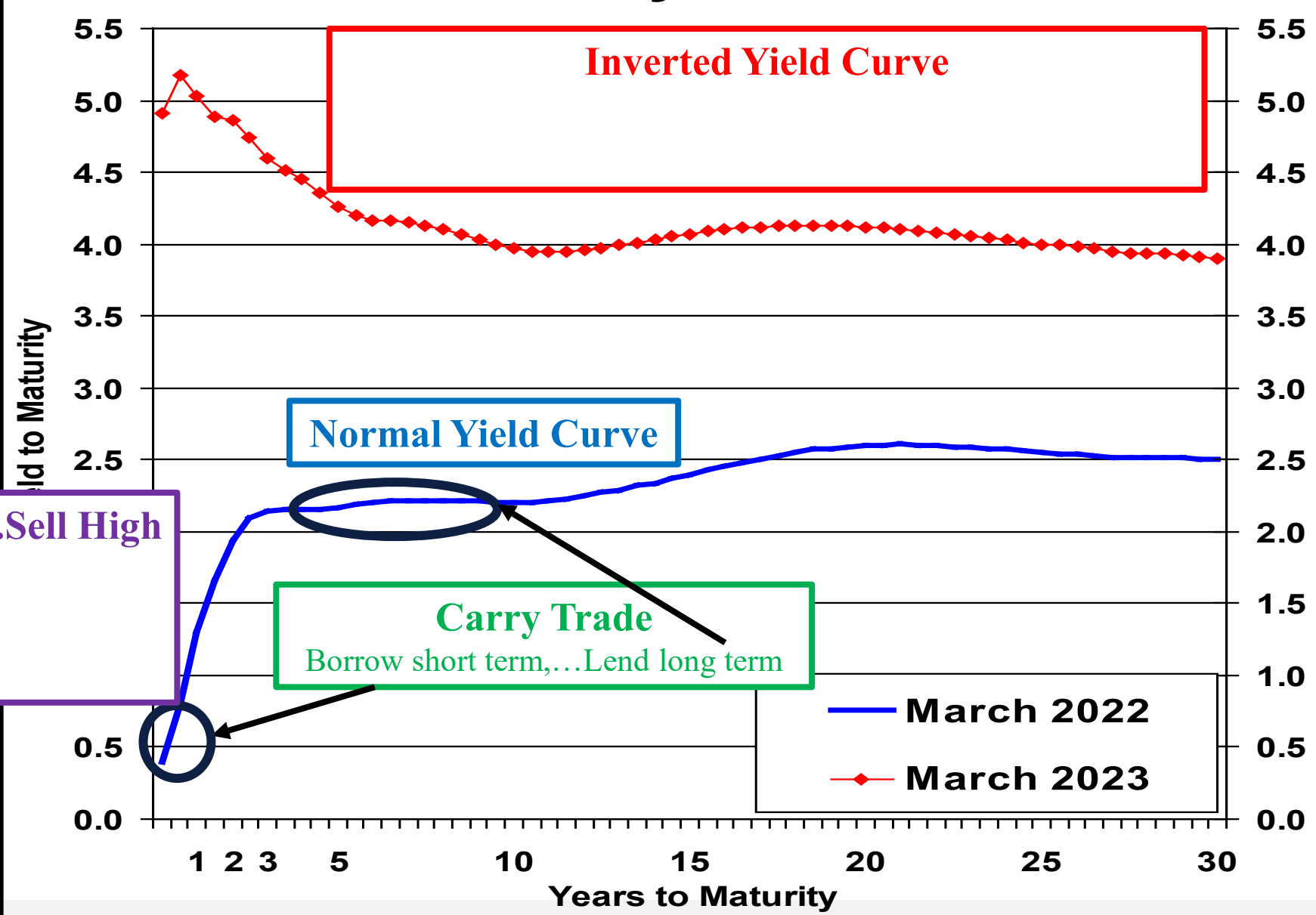
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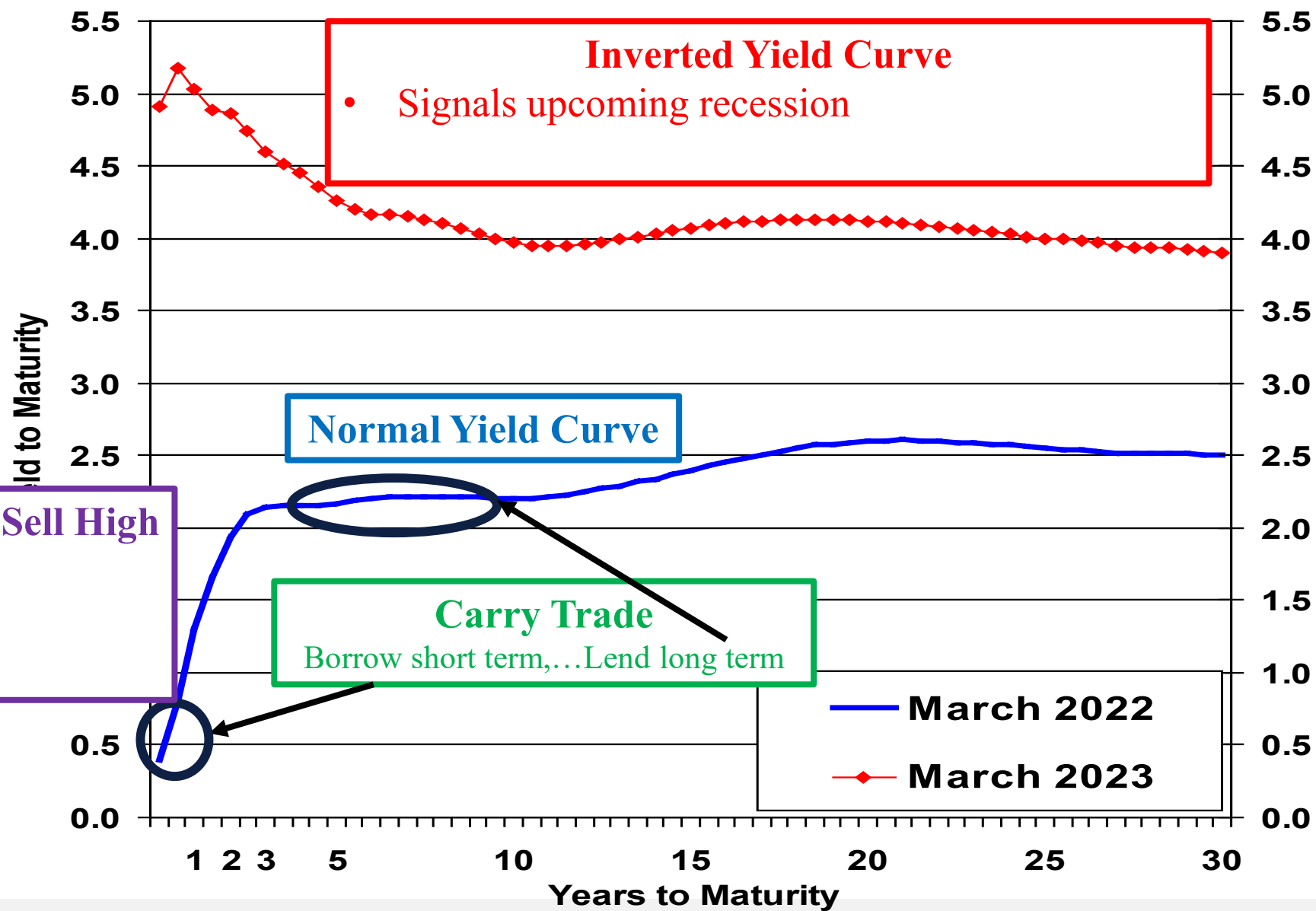
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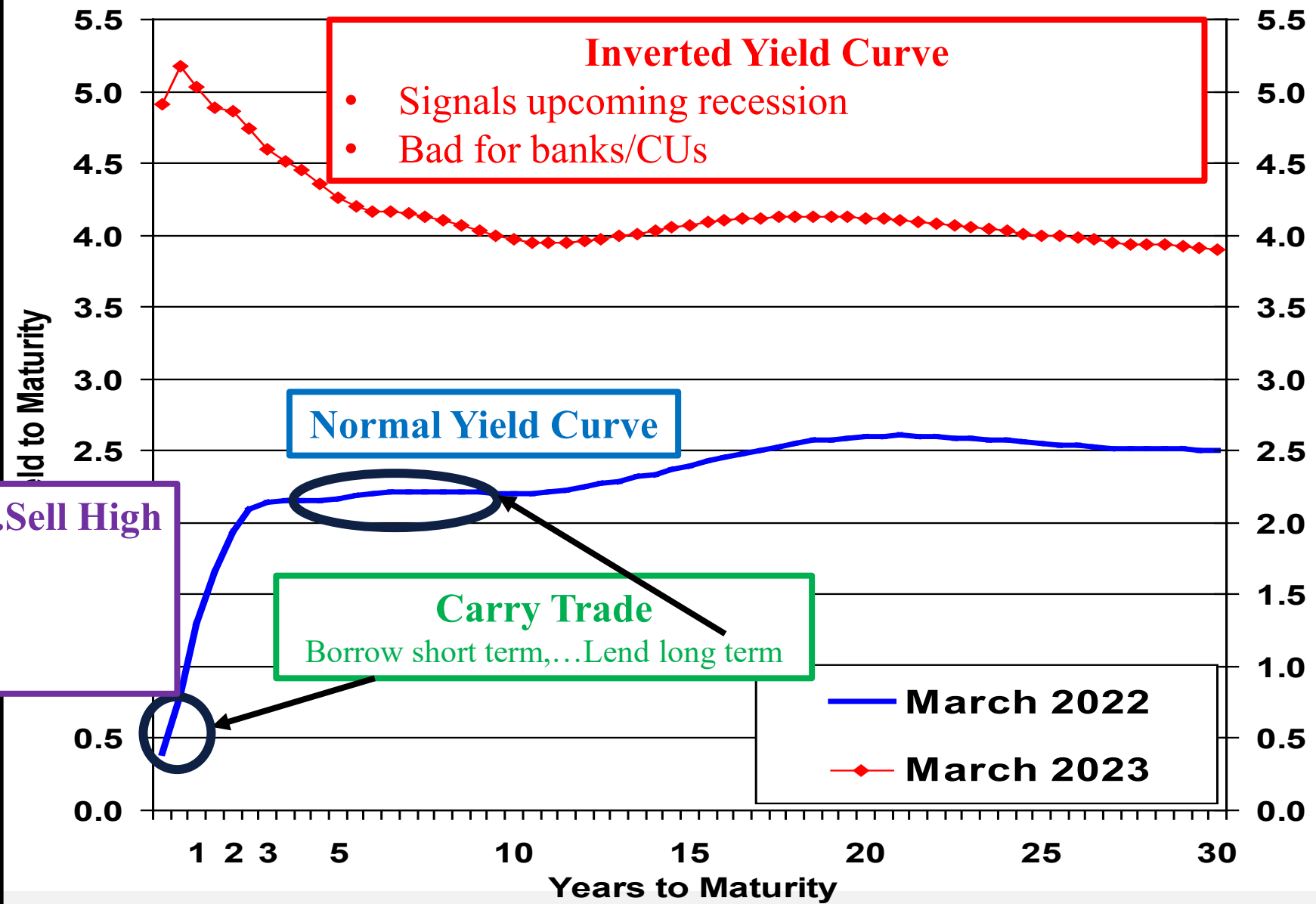
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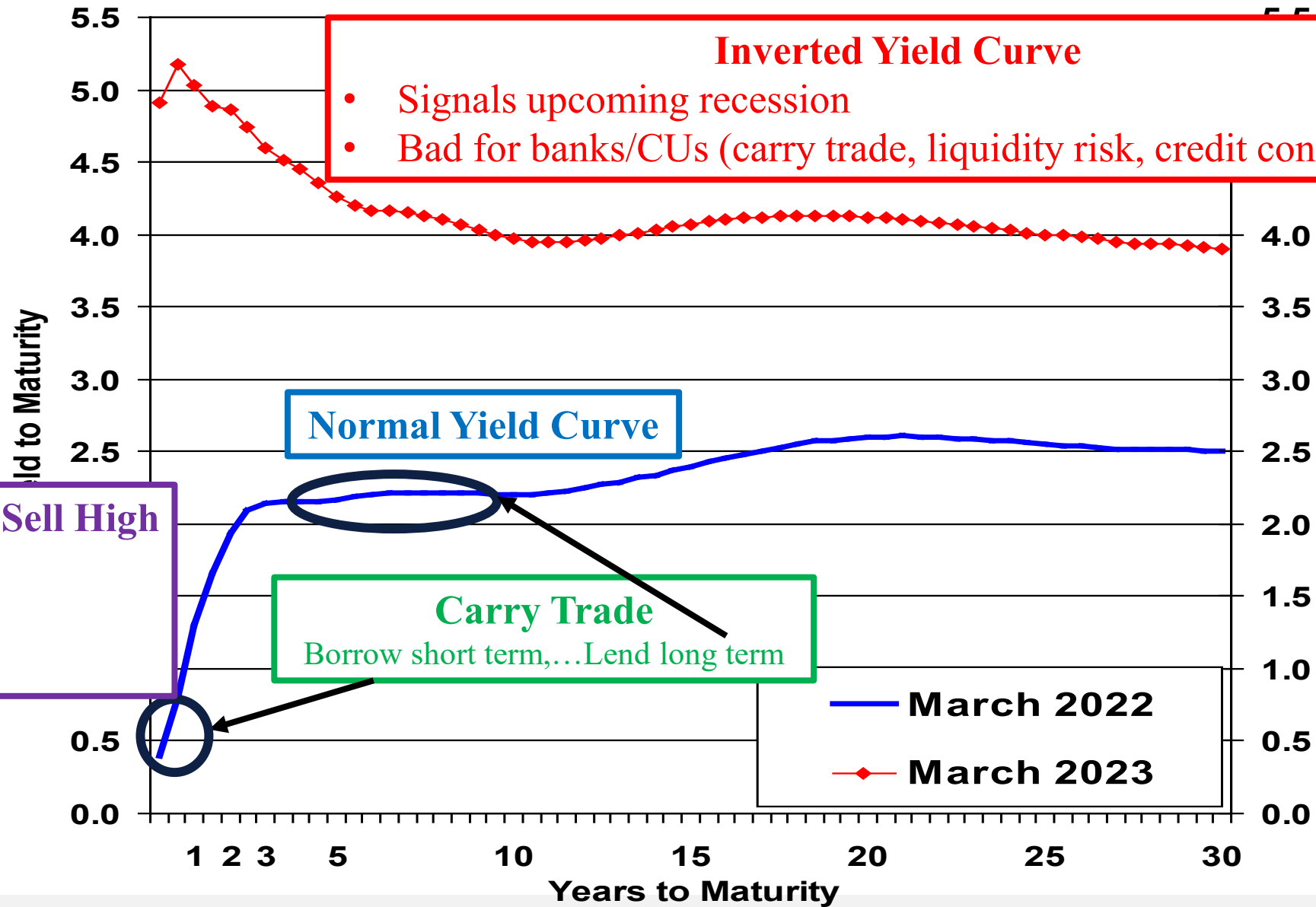
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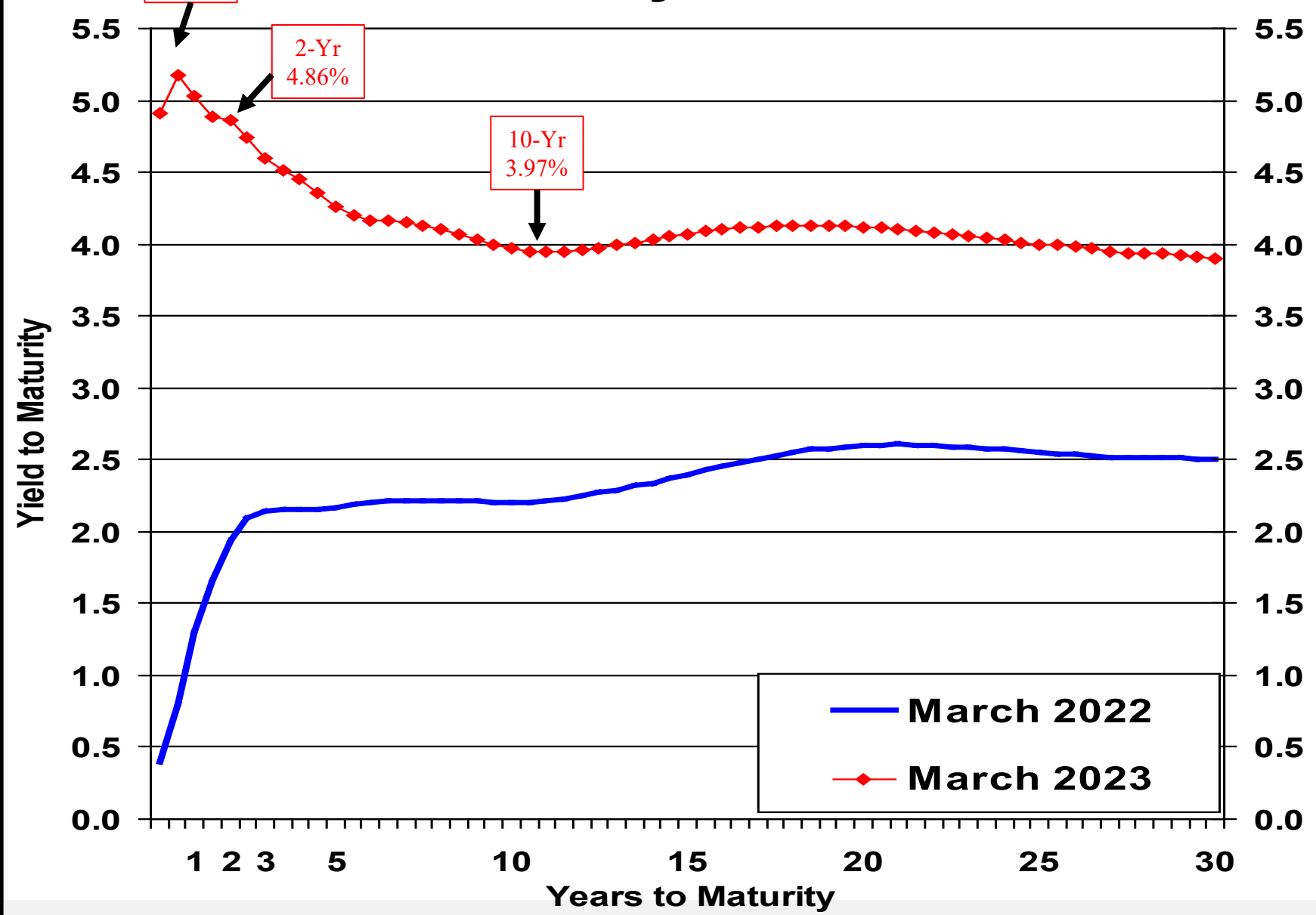
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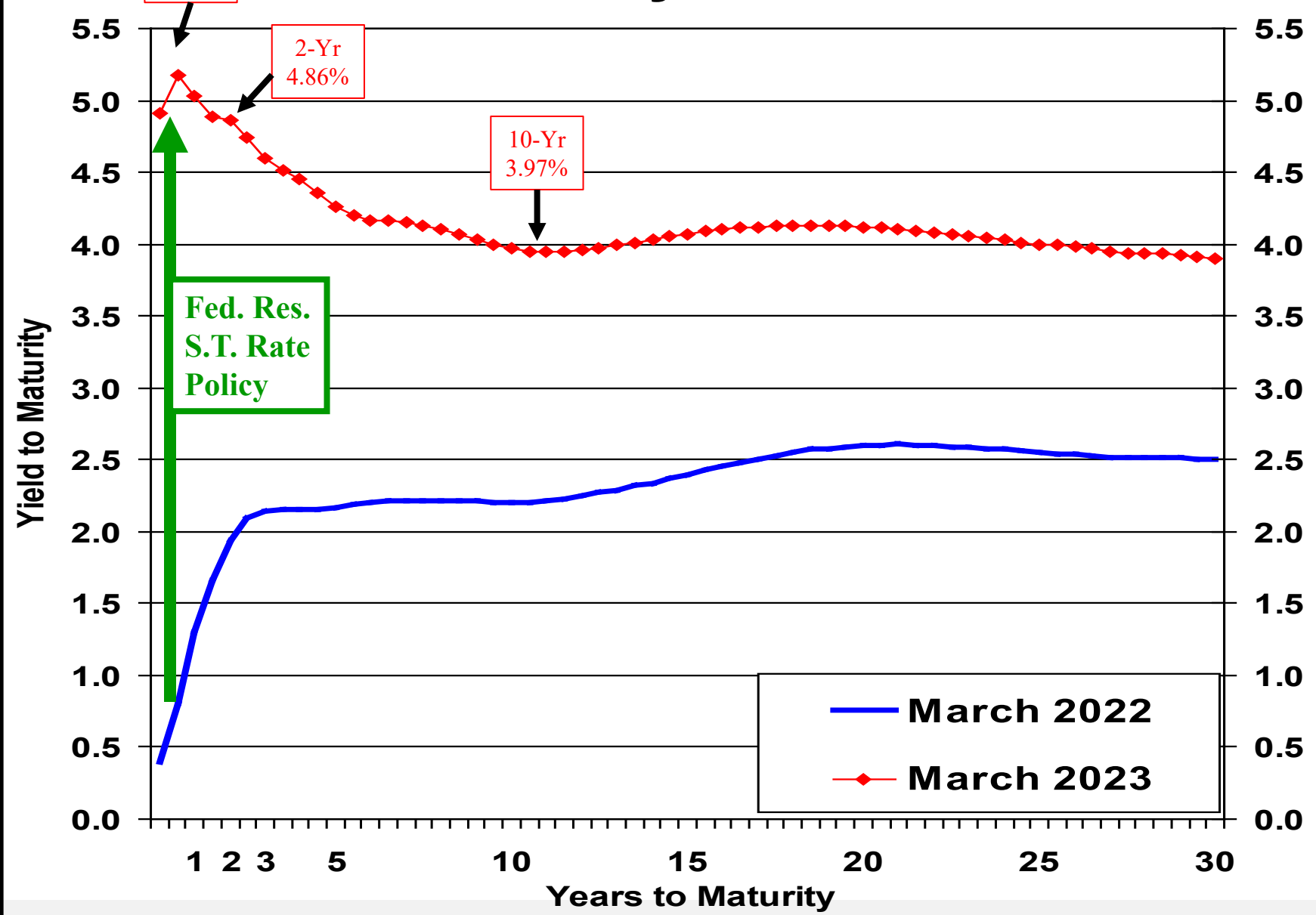
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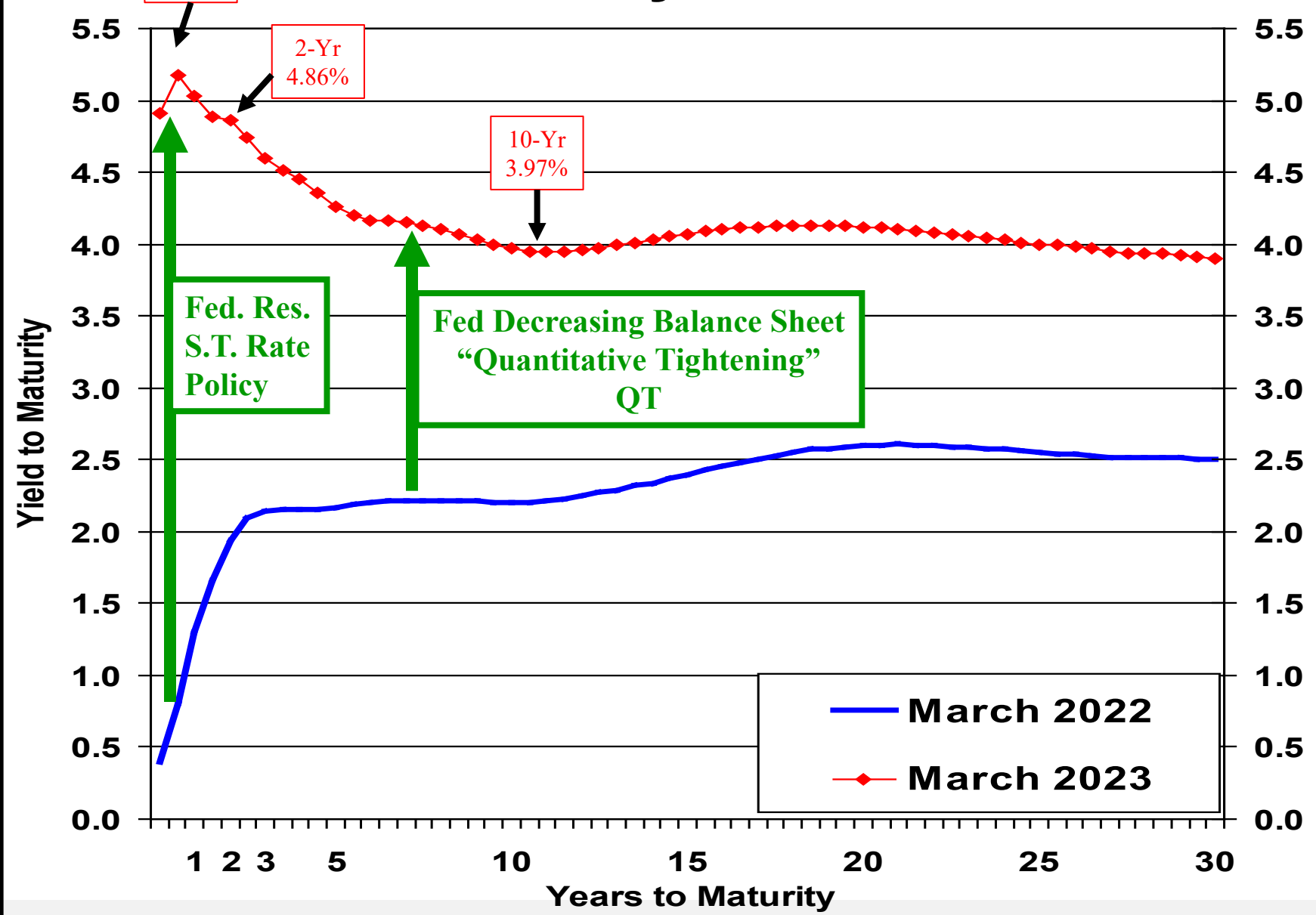
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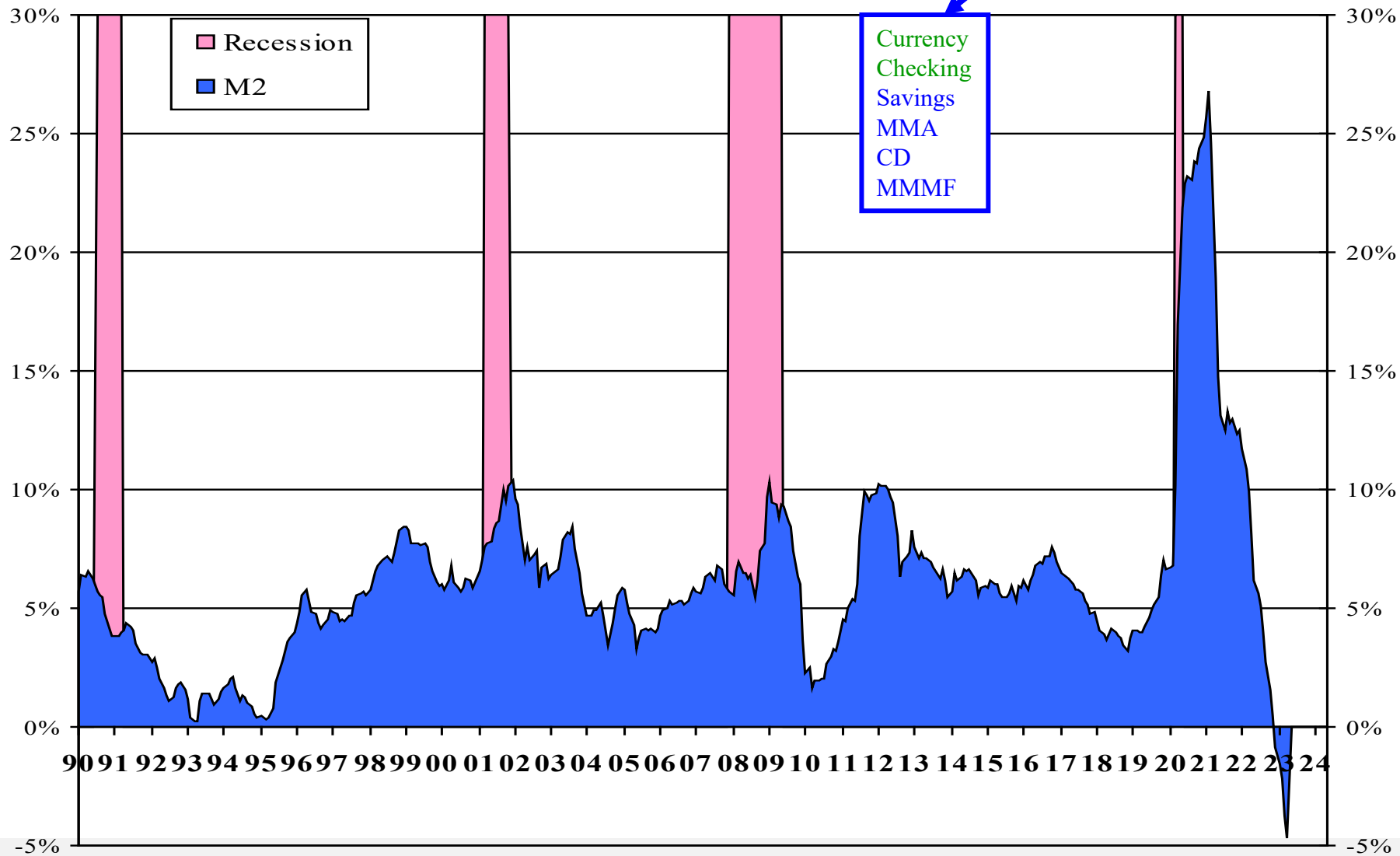
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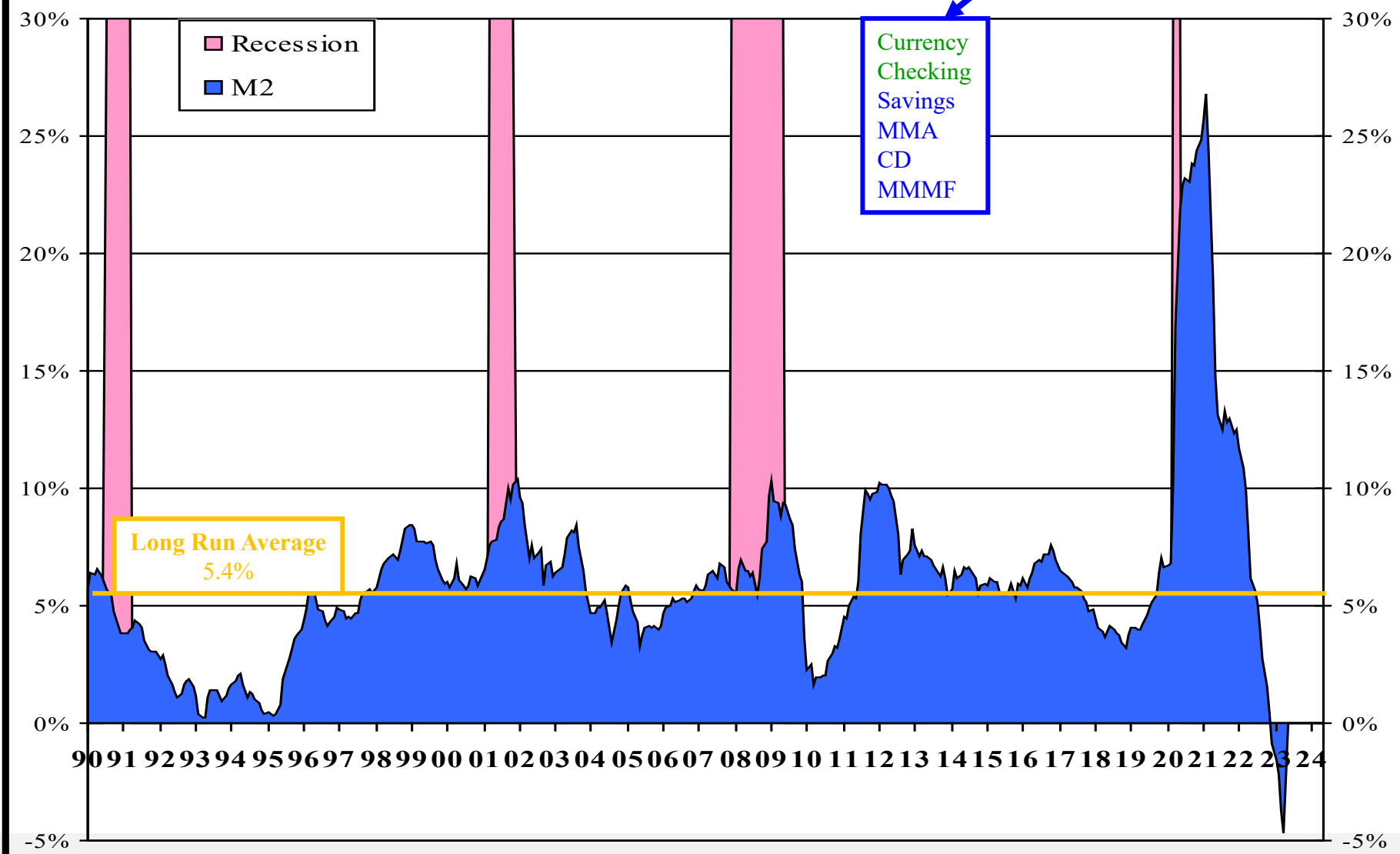
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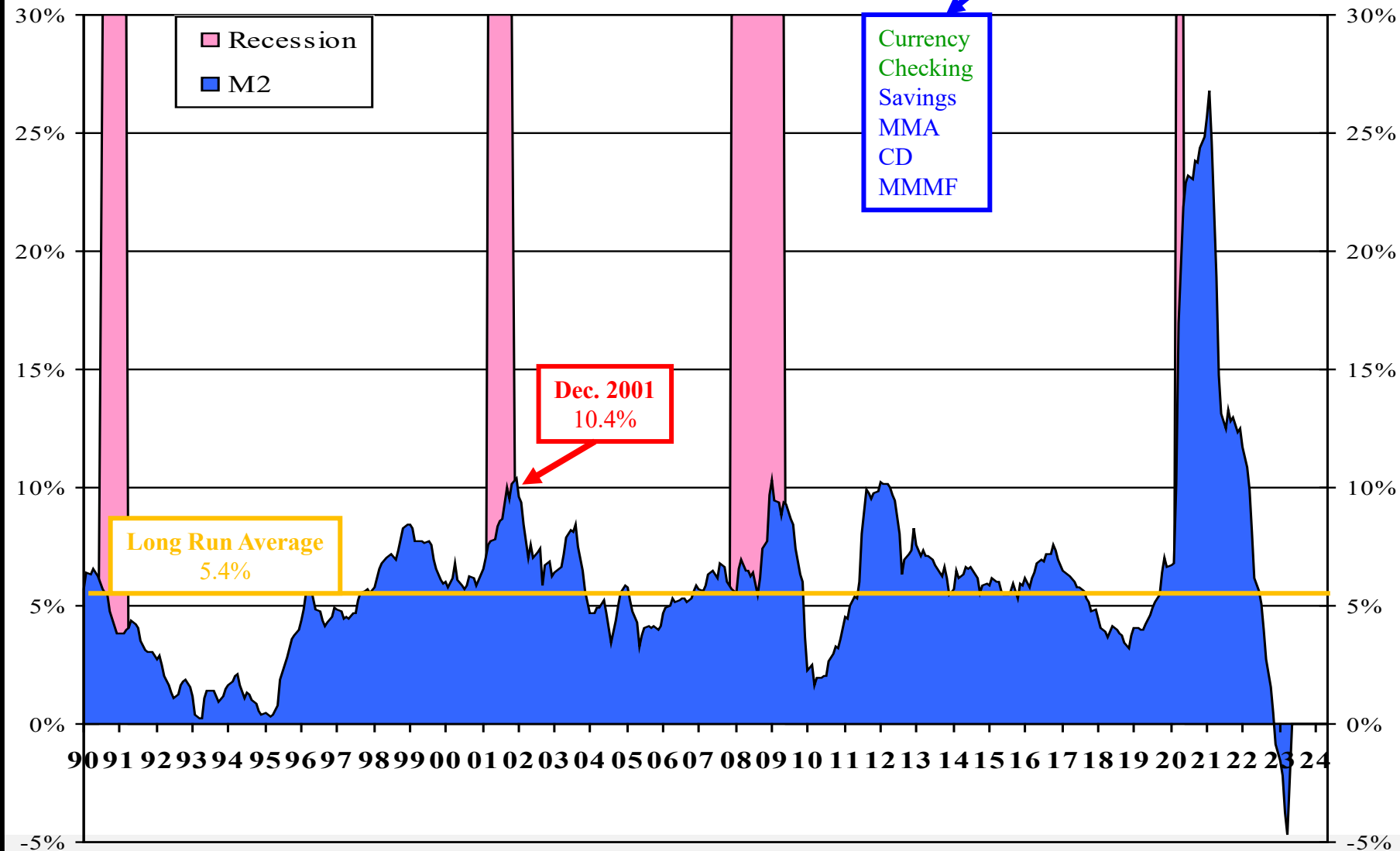
Money Supply Growth, M2



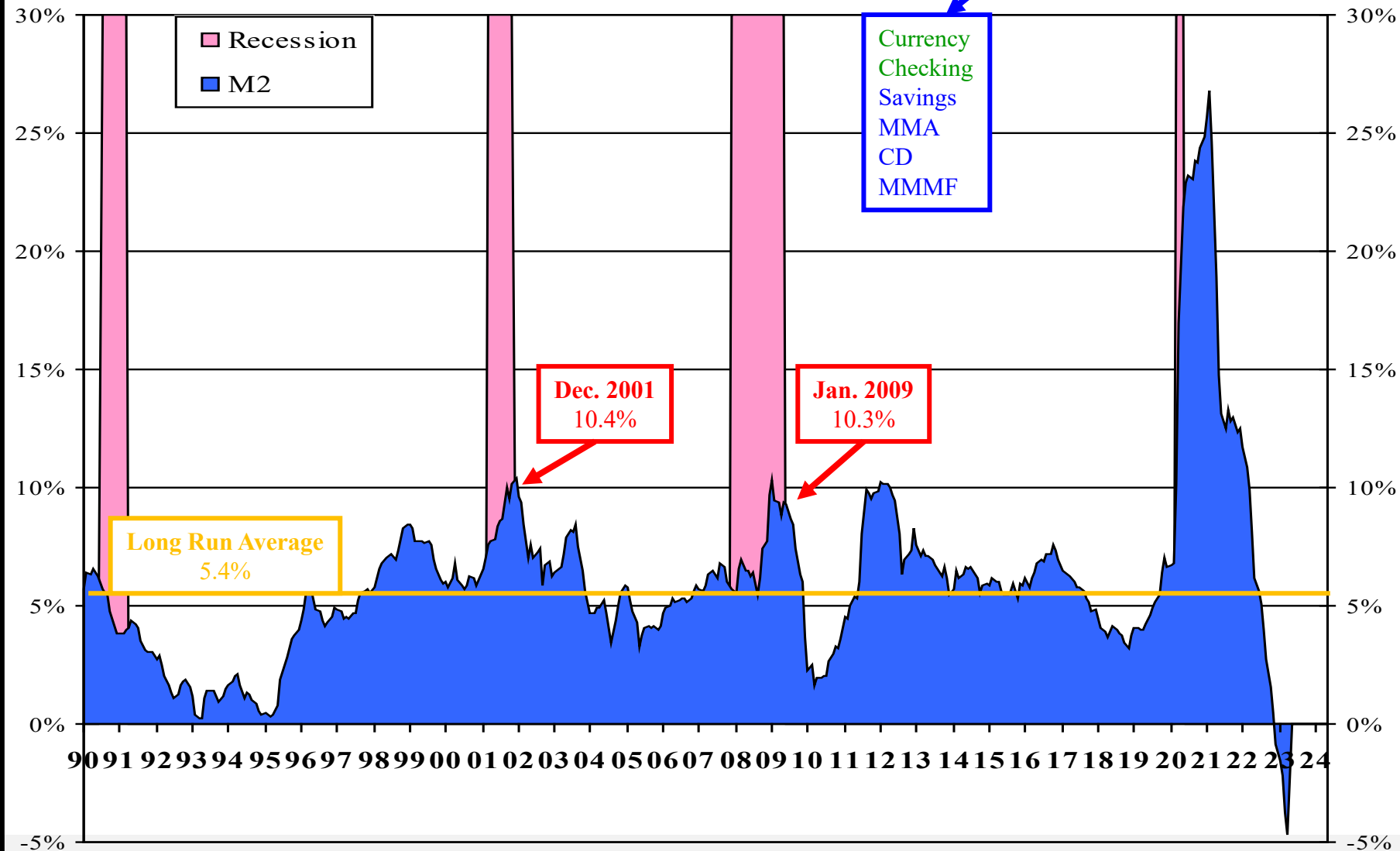
Money Supply Growth, M2



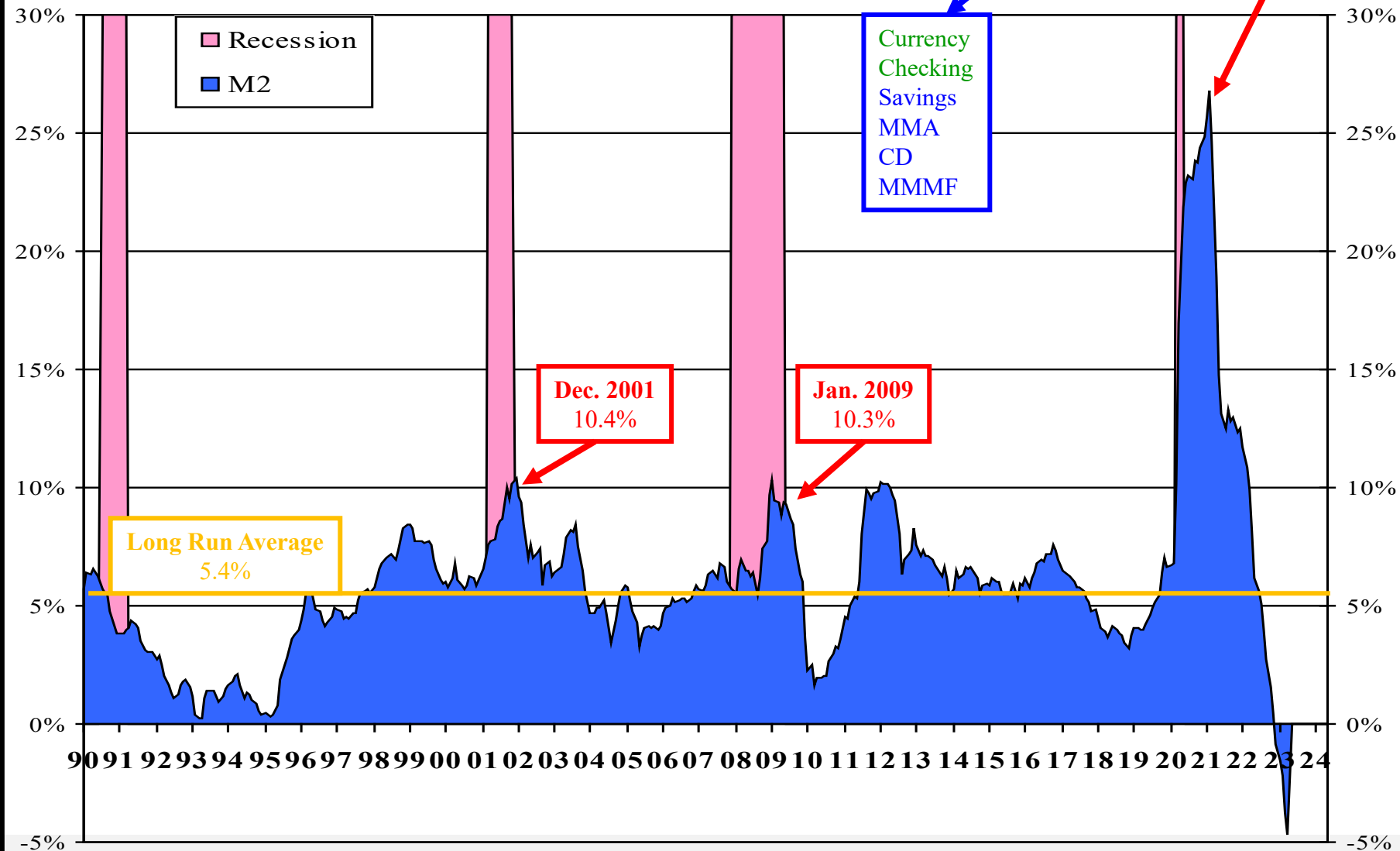
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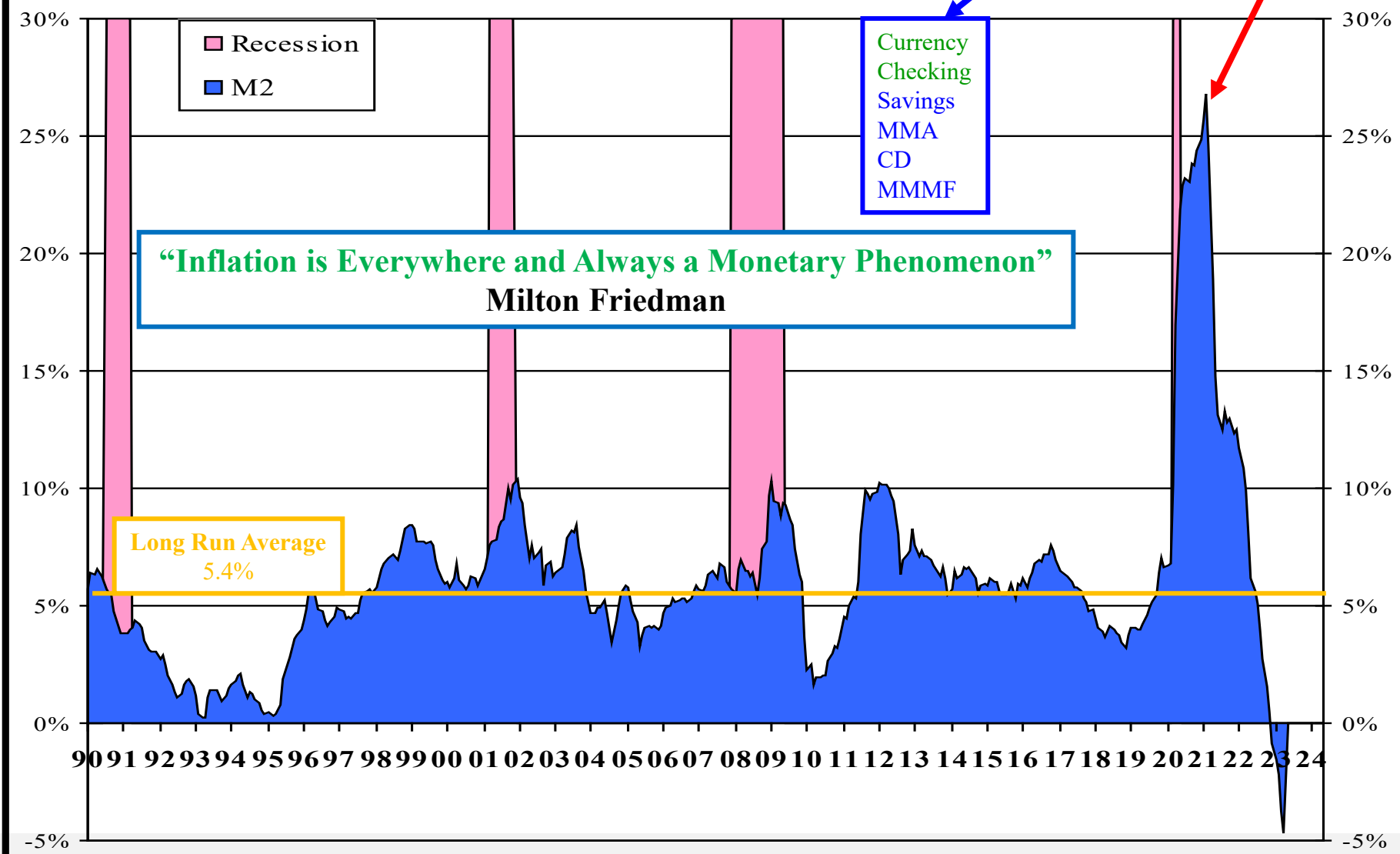
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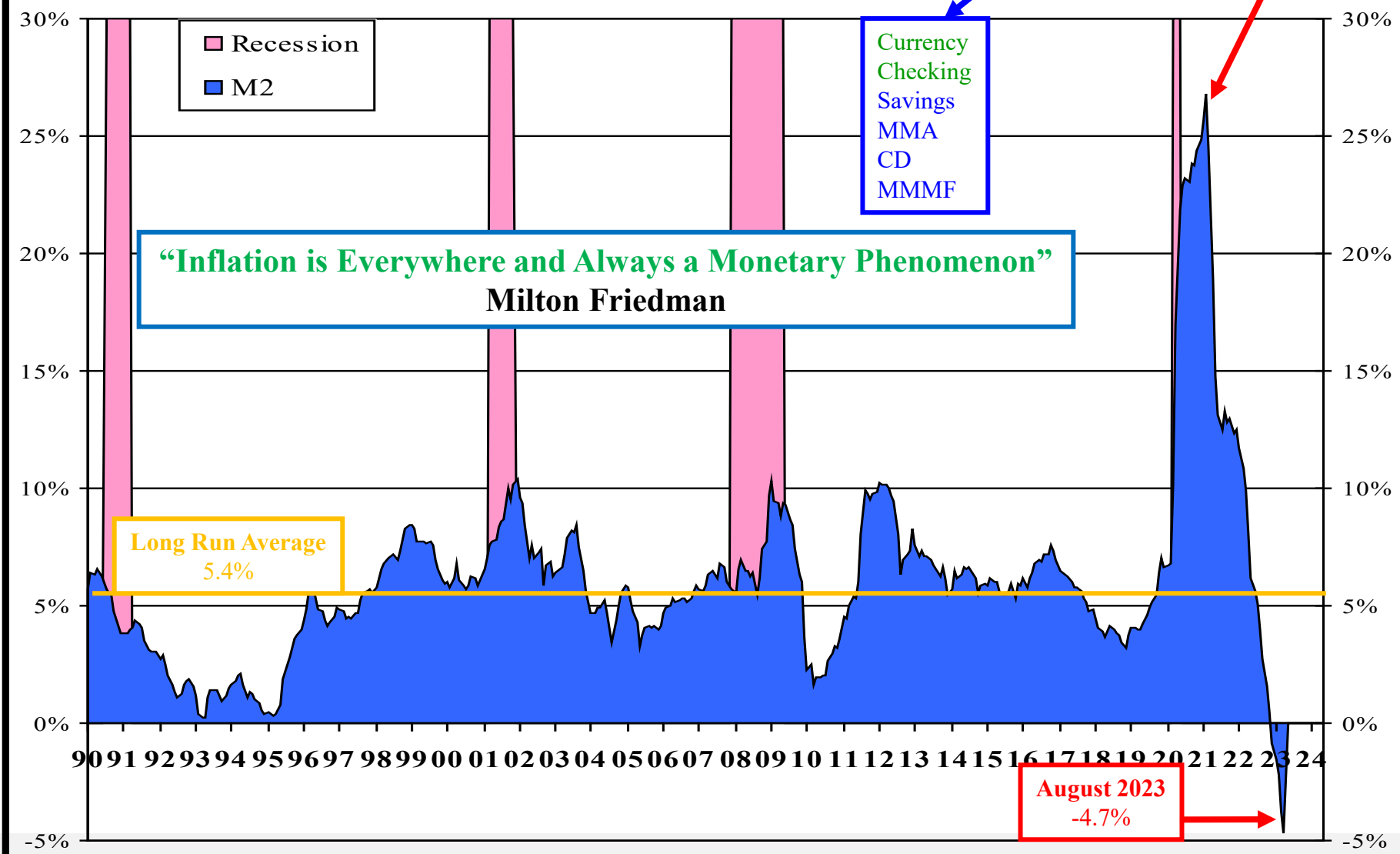
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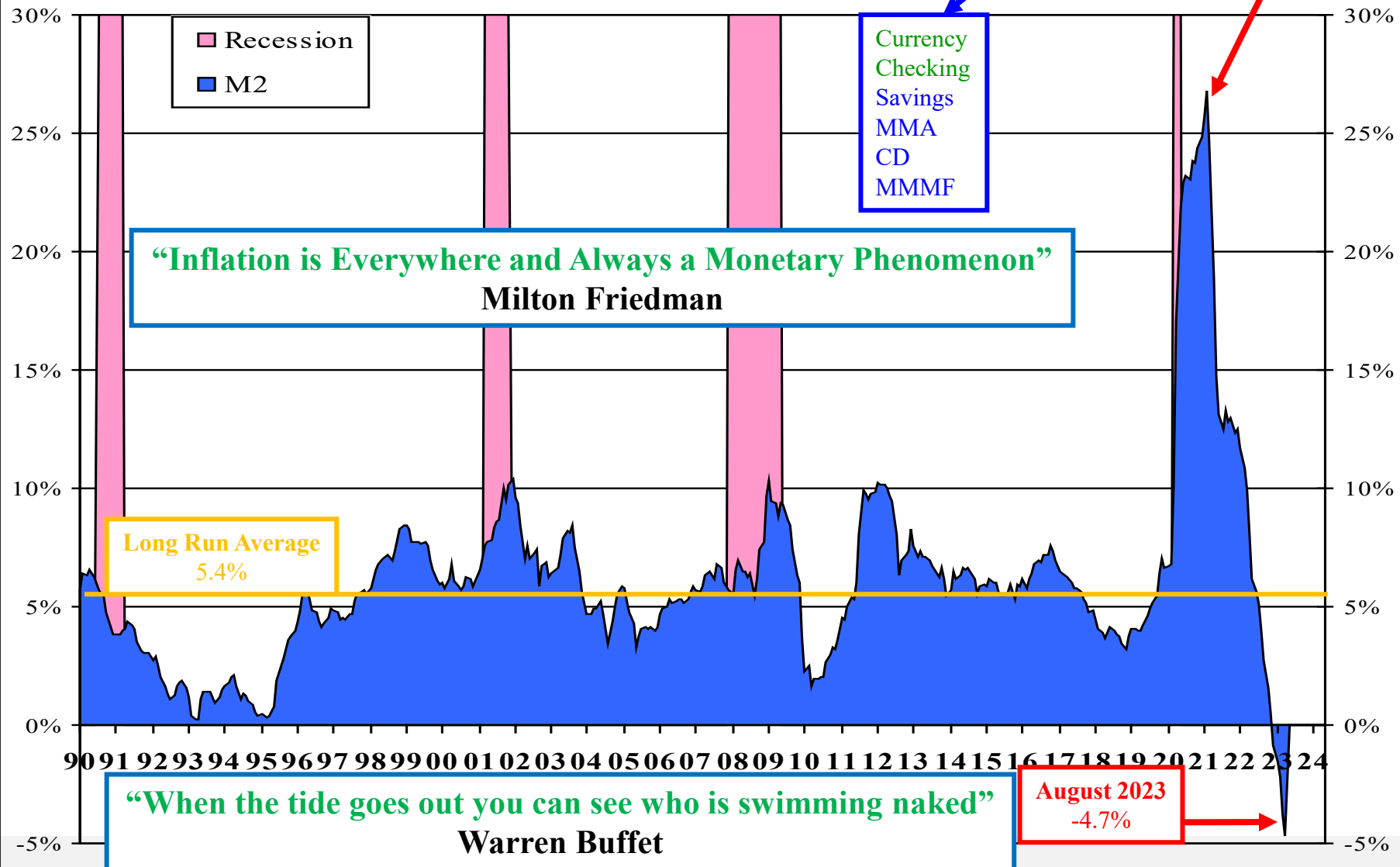
Money Supply Growth, M2



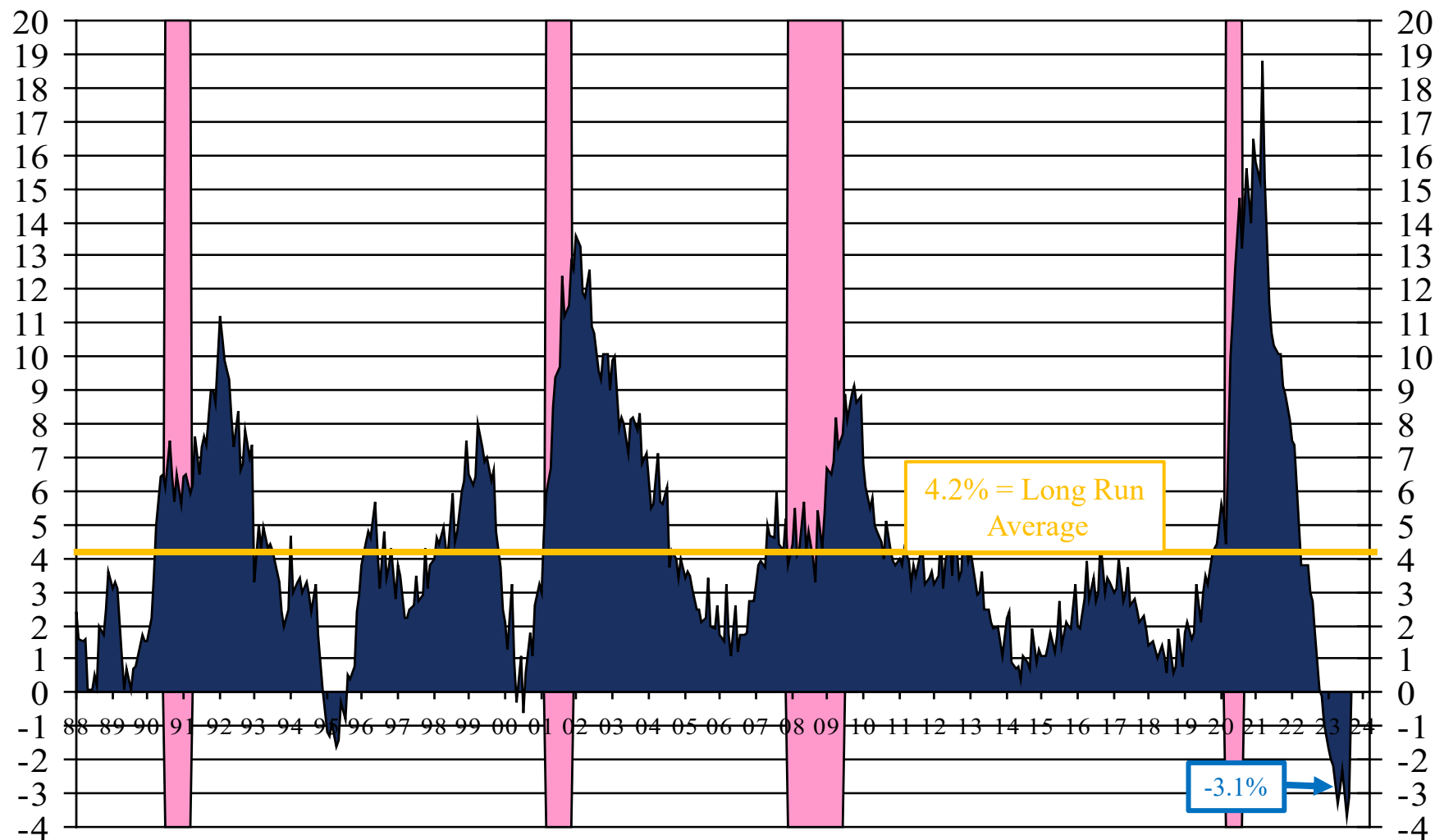
Money Supply Growth, M2



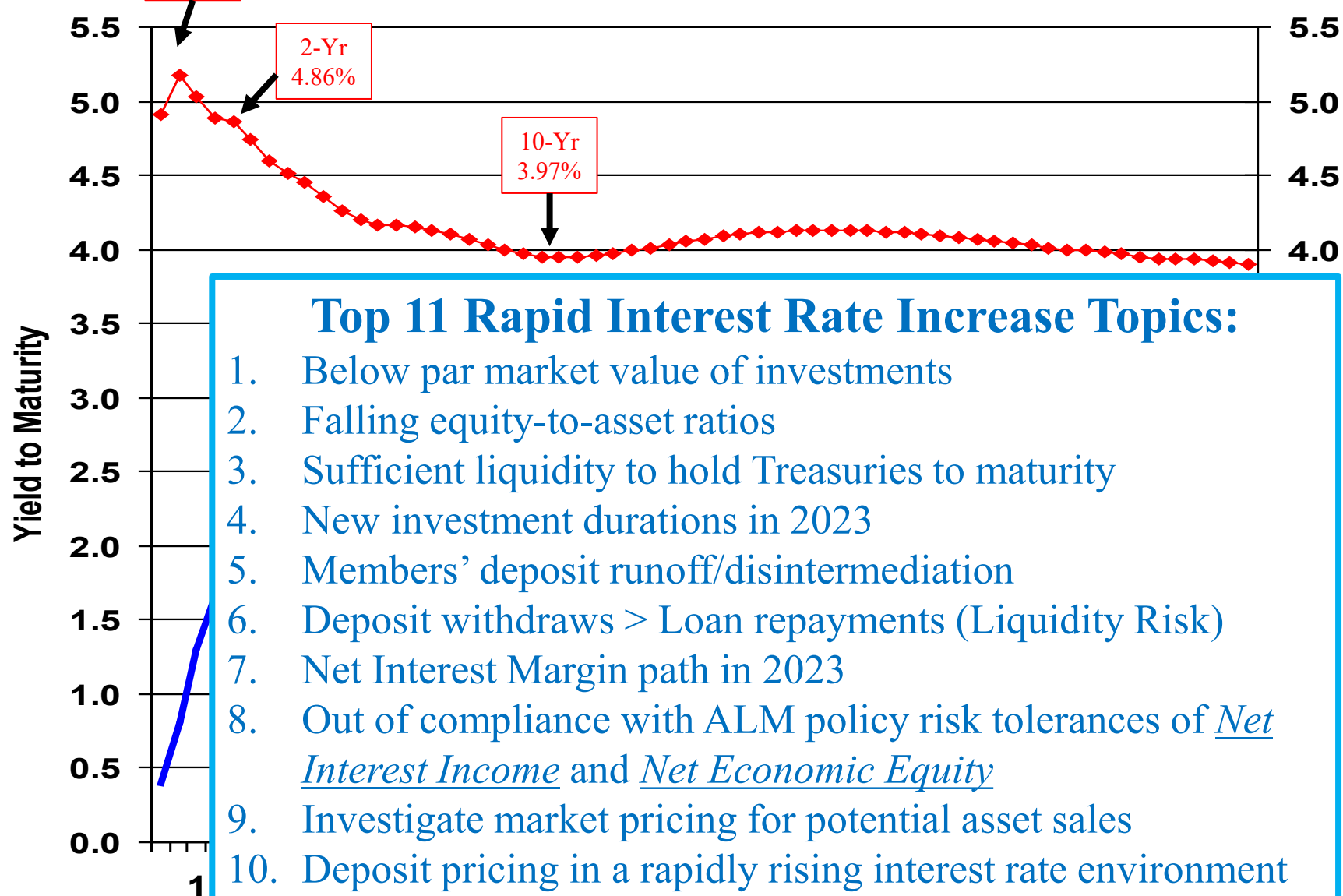
Money Supply Growth, M2



Savings per Member Growth Rate



Treasury Yield Curves



Top 11 Rapid Interest Rate Increase Topics:

1. Below par market value of investments
2. Falling equity-to-asset ratios
3. Sufficient liquidity to hold Treasuries to maturity
4. New investment durations in 2023
5. Members' deposit runoff/disintermediation
6. Deposit withdraws > Loan repayments (Liquidity Risk)
7. Net Interest Margin path in 2023
8. Out of compliance with ALM policy risk tolerances of Net Interest Income and Net Economic Equity
9. Investigate market pricing for potential asset sales
10. Deposit pricing in a rapidly rising interest rate environment
11. Rely on wholesale borrowings to maintain sufficient liquidity

Credit Union Balance Sheet

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Credit Union Balance Sheet

Assets

Credit Union Balance Sheet

Assets

Liabilities + Capital

Credit Union Balance Sheet

Assets

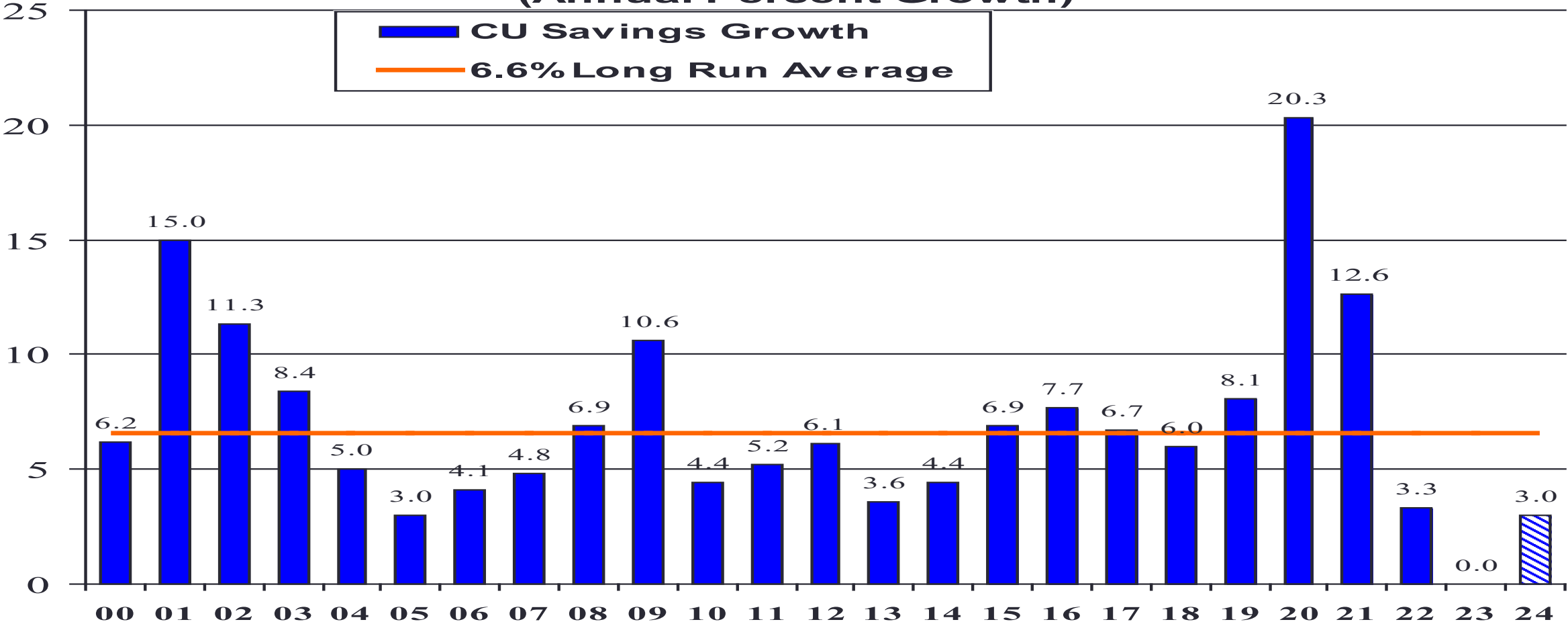
Liabilities + Capital

Deposits

- Checking Accounts
- Savings
- Money Market Deposits
- Certificates of Deposits

Slowing Credit Union Savings Growth

Credit Union Savings Growth (Annual Percent Growth)



Credit Union Balance Sheet

Assets

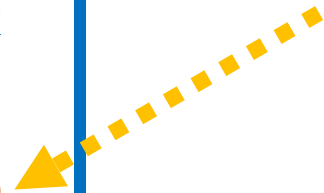
Liabilities + Capital

Deposits

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Borrowings

- Federal Home Loan Bank
- Corporate Line of Credit
- Fed Funds Purchased
- Bank Term Funding Program



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Liabilities + Capital

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Equity (Net Capital)

1. Undivided Earnings
2. Regular Reserves
3. Gains (losses) on Available For Sale (AFS) Securities

Credit Union Balance Sheet

Assets

Liabilities + Capital

Cash (Reserves)

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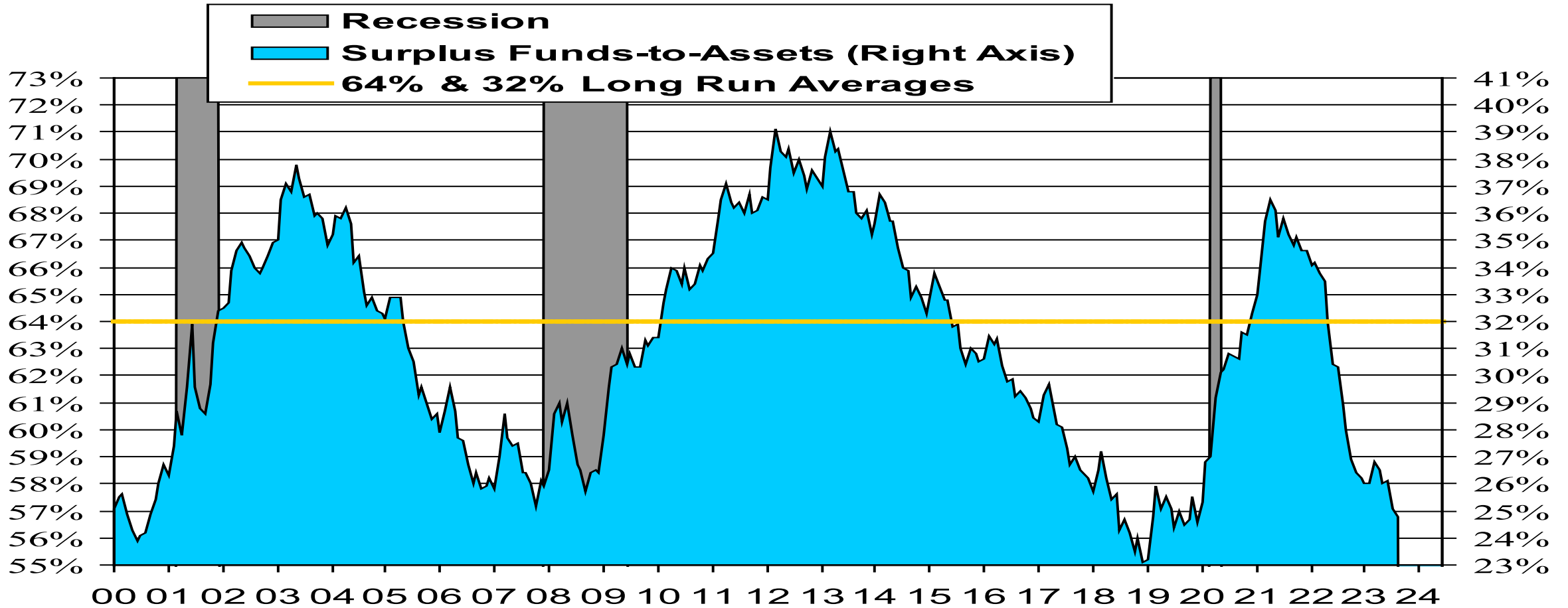
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Investments Are Falling and Yields Are Rising

CU Surplus Funds (Cash + Investments)



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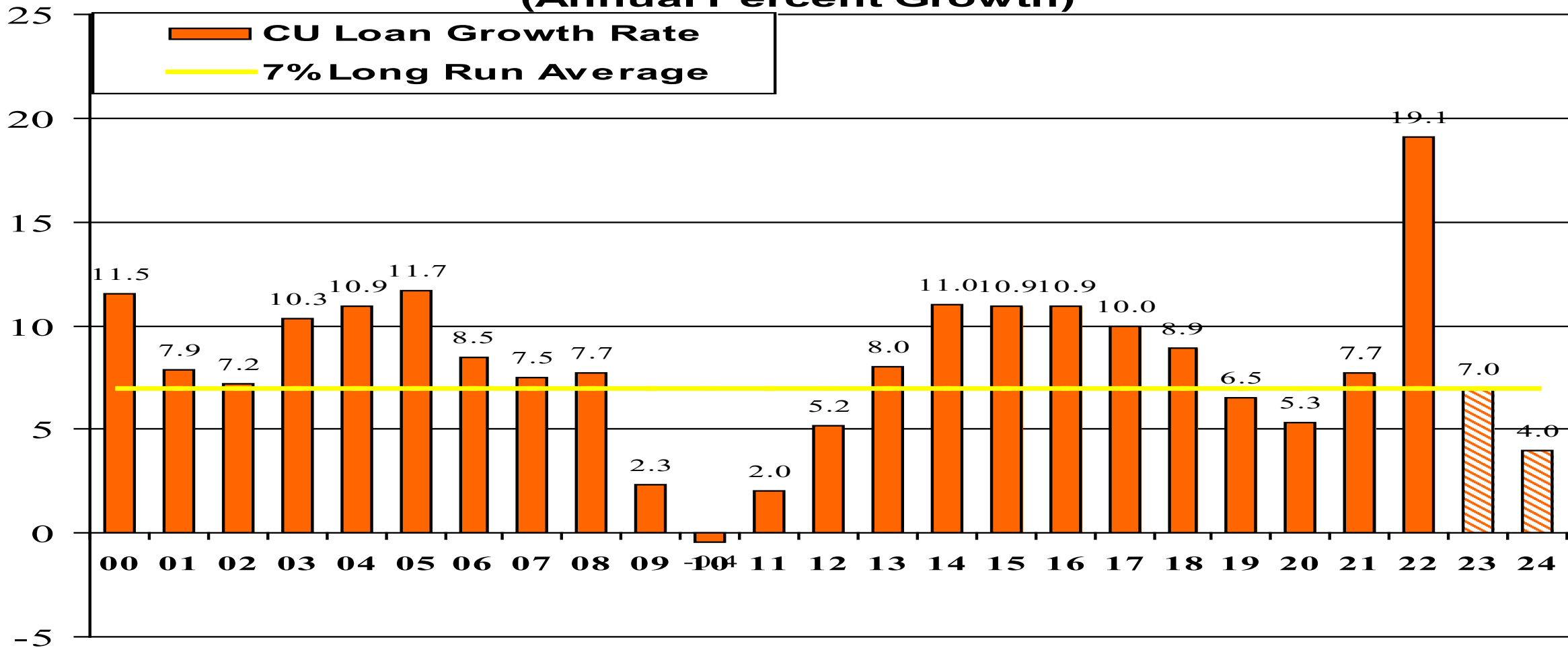
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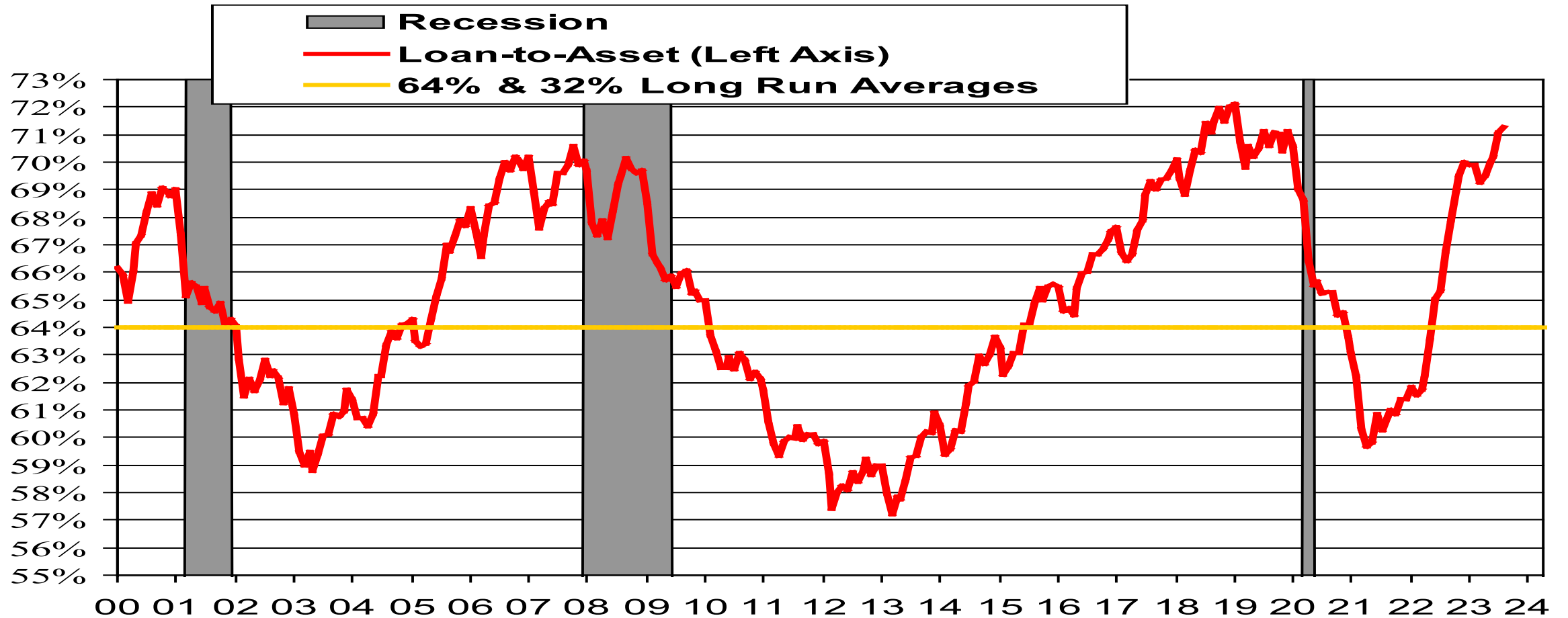
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Slowing Credit Union Loan Growth

Credit Union Loan Growth (Annual Percent Growth)



CU Loan to Asset Ratio



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“Non progredi est regredi”

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To not go forward is to go backward

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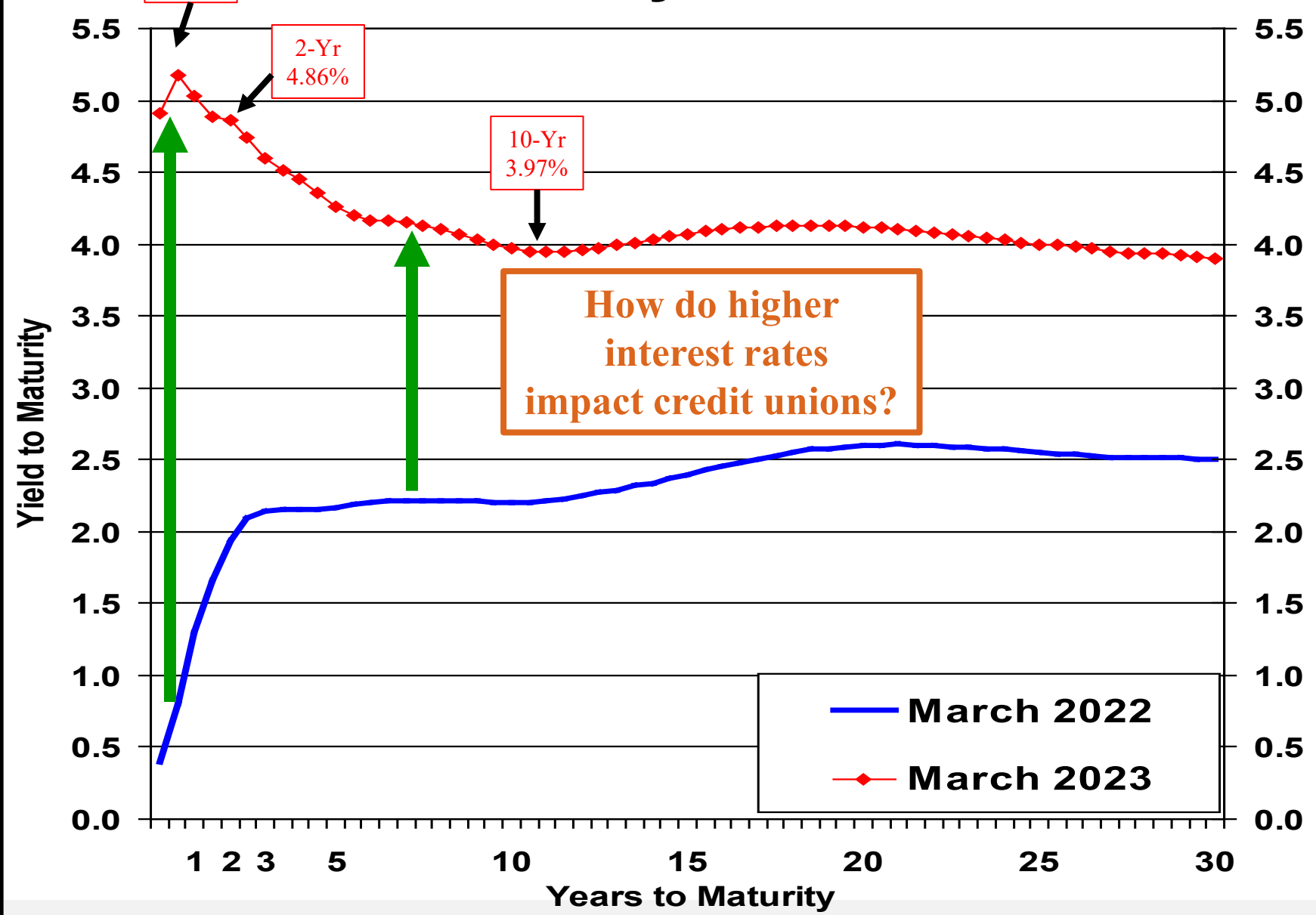
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If you're not growing, you're dying

Treasury Yield Curves



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How do higher
interest rates
impact credit unions?

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↑ interest rates => ↓ Bond Prices

1. Below par market value of investments

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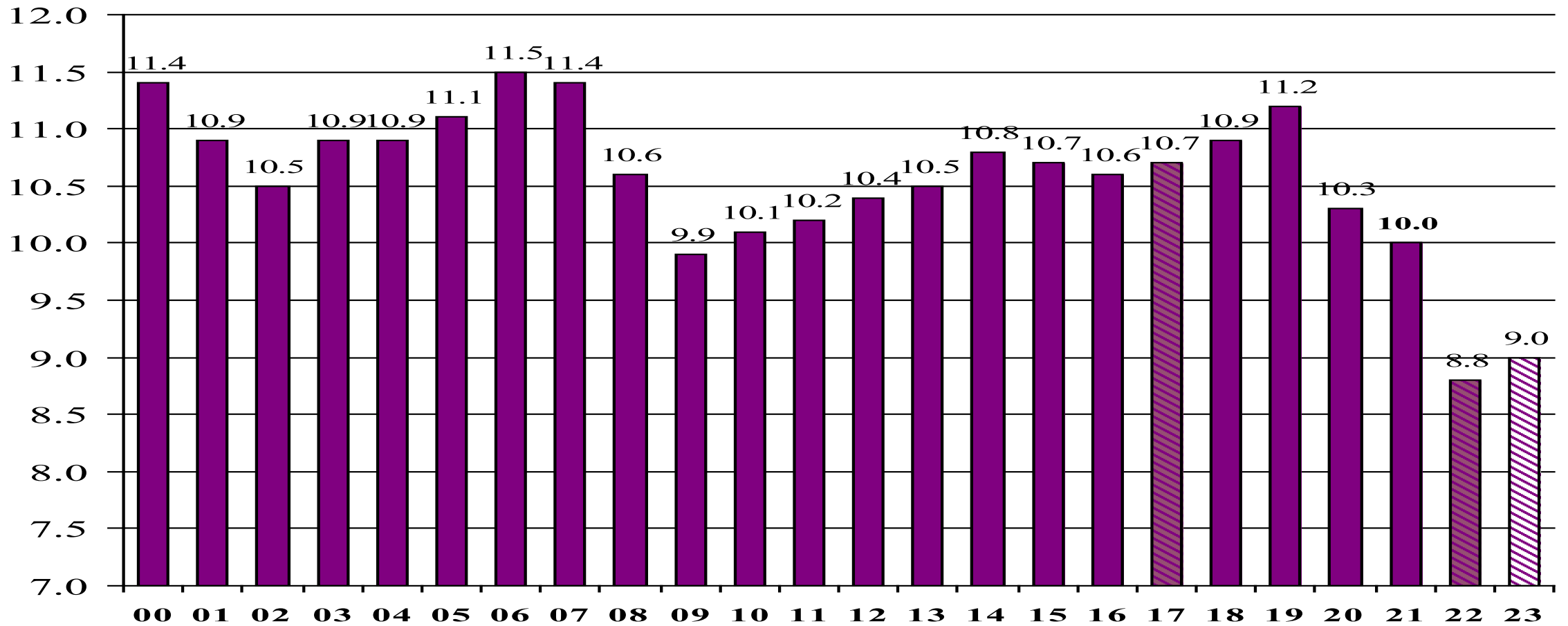
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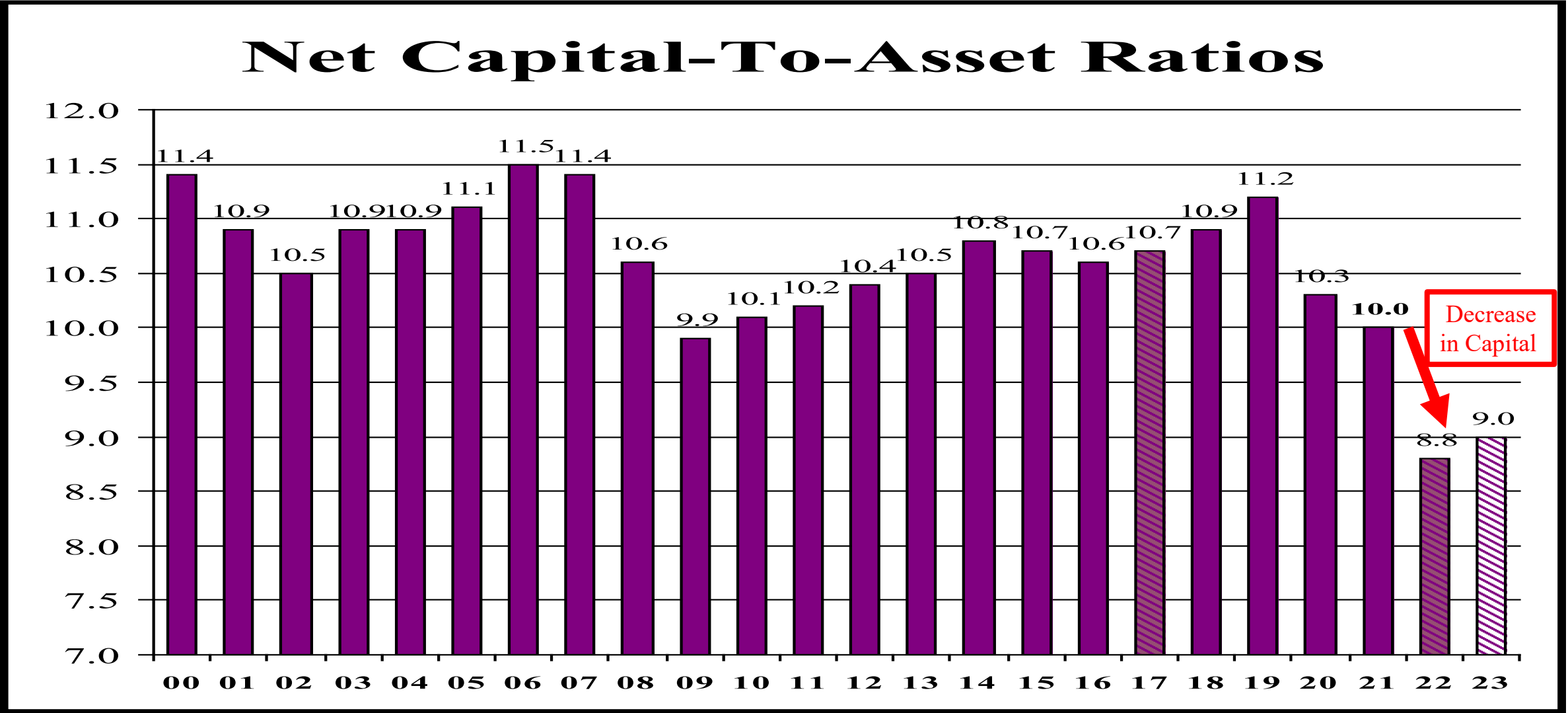
2. Falling equity-to-asset ratios

Falling Net Capital Ratios

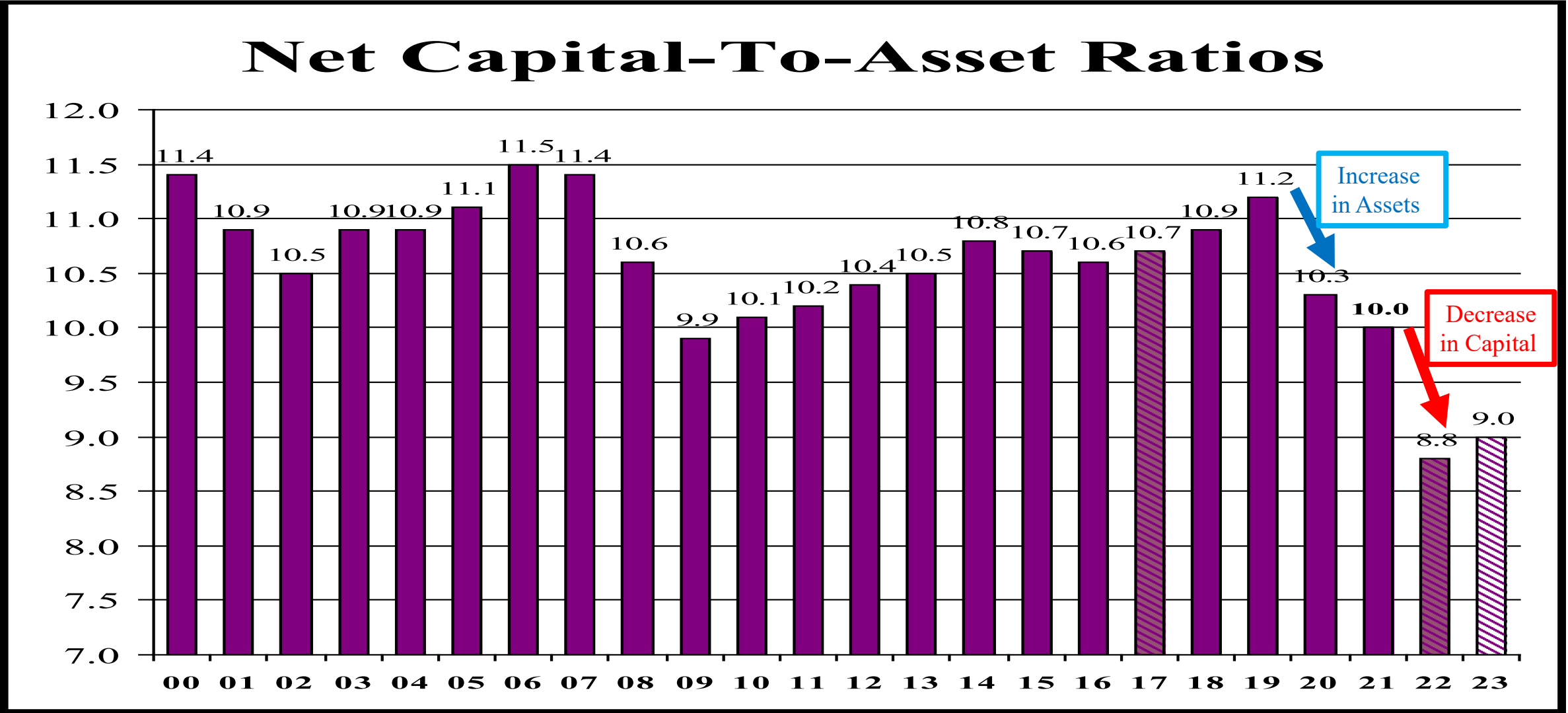
Net Capital-To-Asset Ratios



Falling Net Capital Ratios



Falling Net Capital Ratios



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1. Below par market value of investments

3. Sufficient liquidity to hold Treasuries to maturity

2. Falling equity-to-asset ratios

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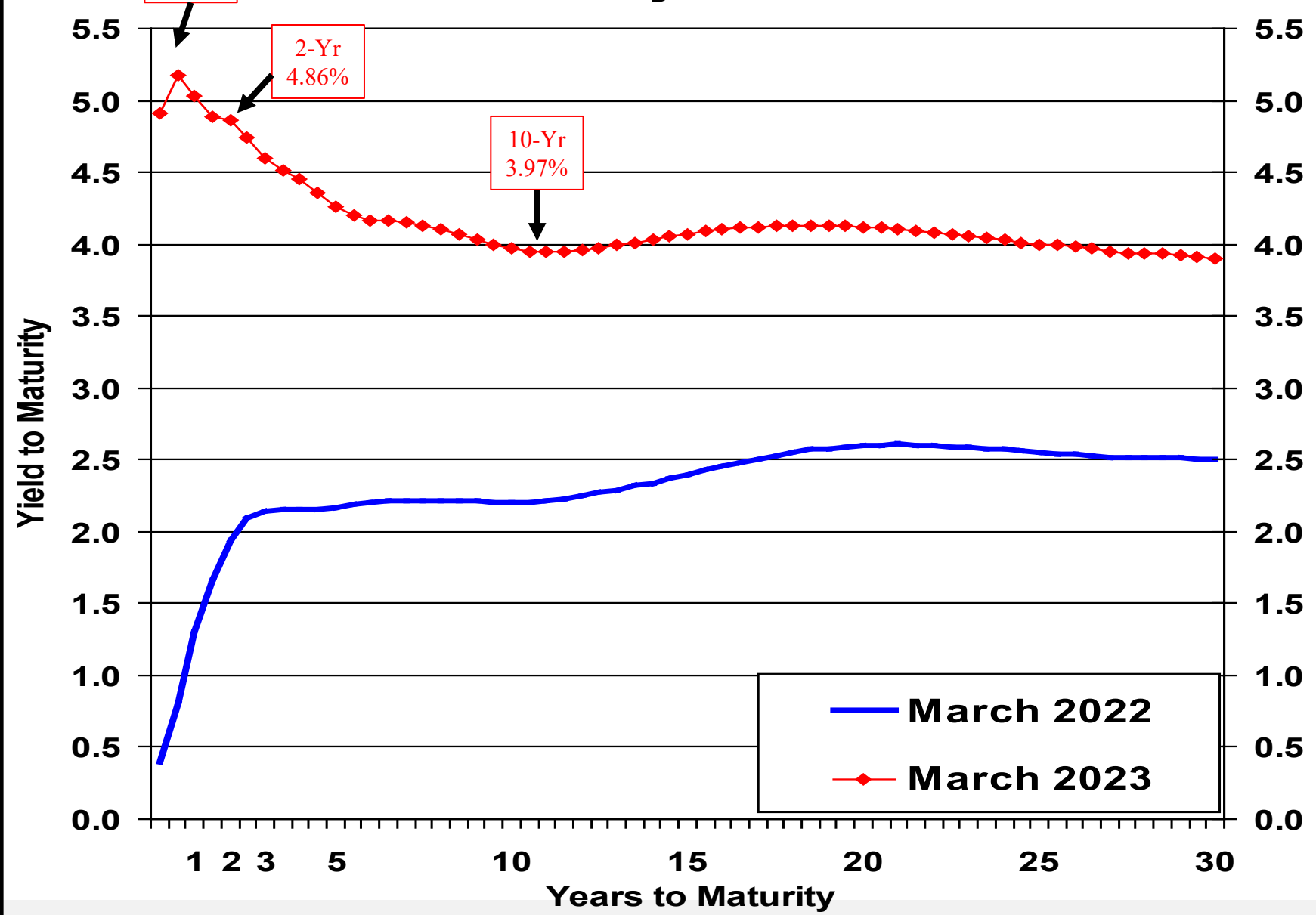
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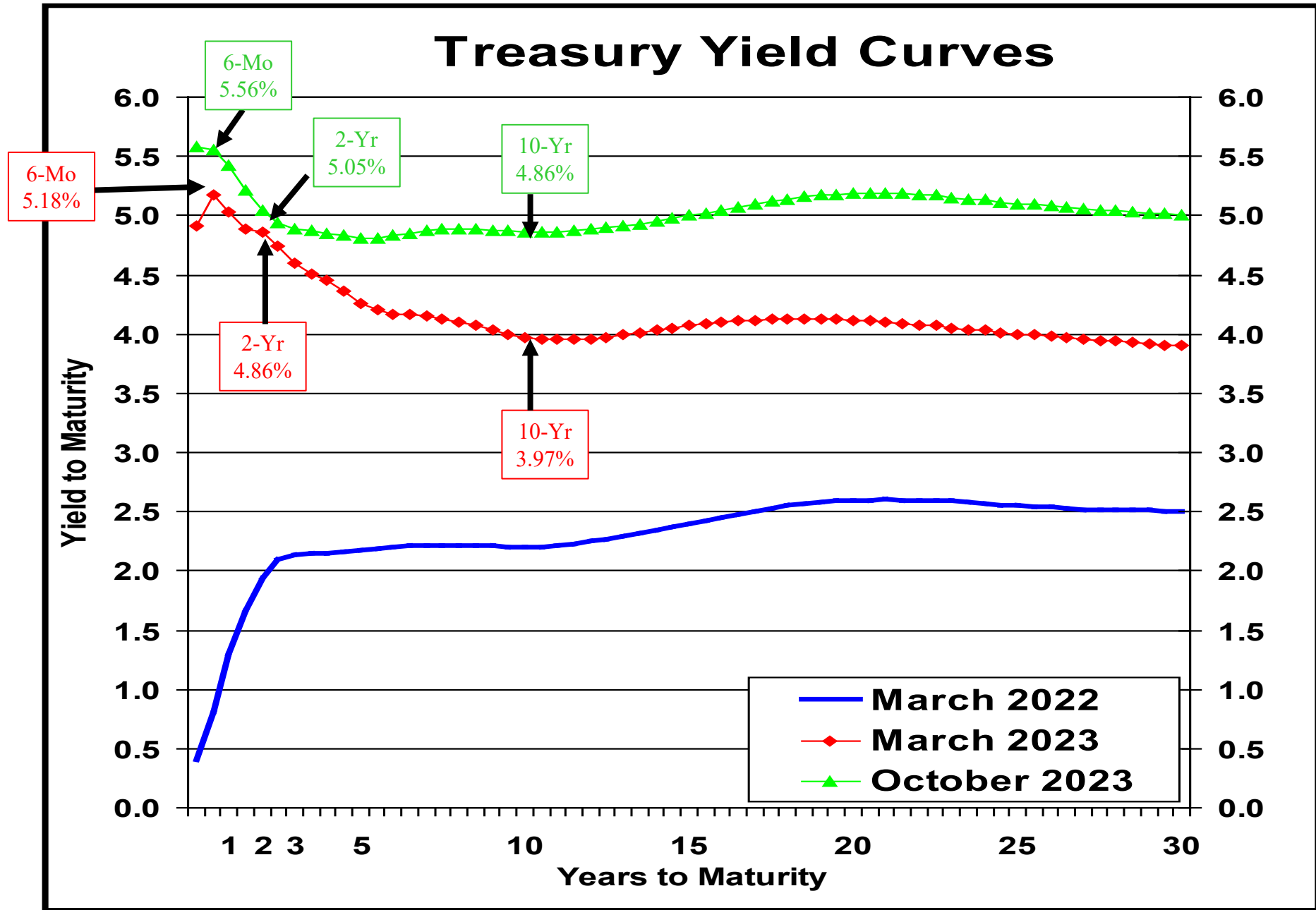
1. Below par market value of investments

4. New investment maturities in 2023

2. Falling equity-to-asset ratios

Treasury Yield Curves





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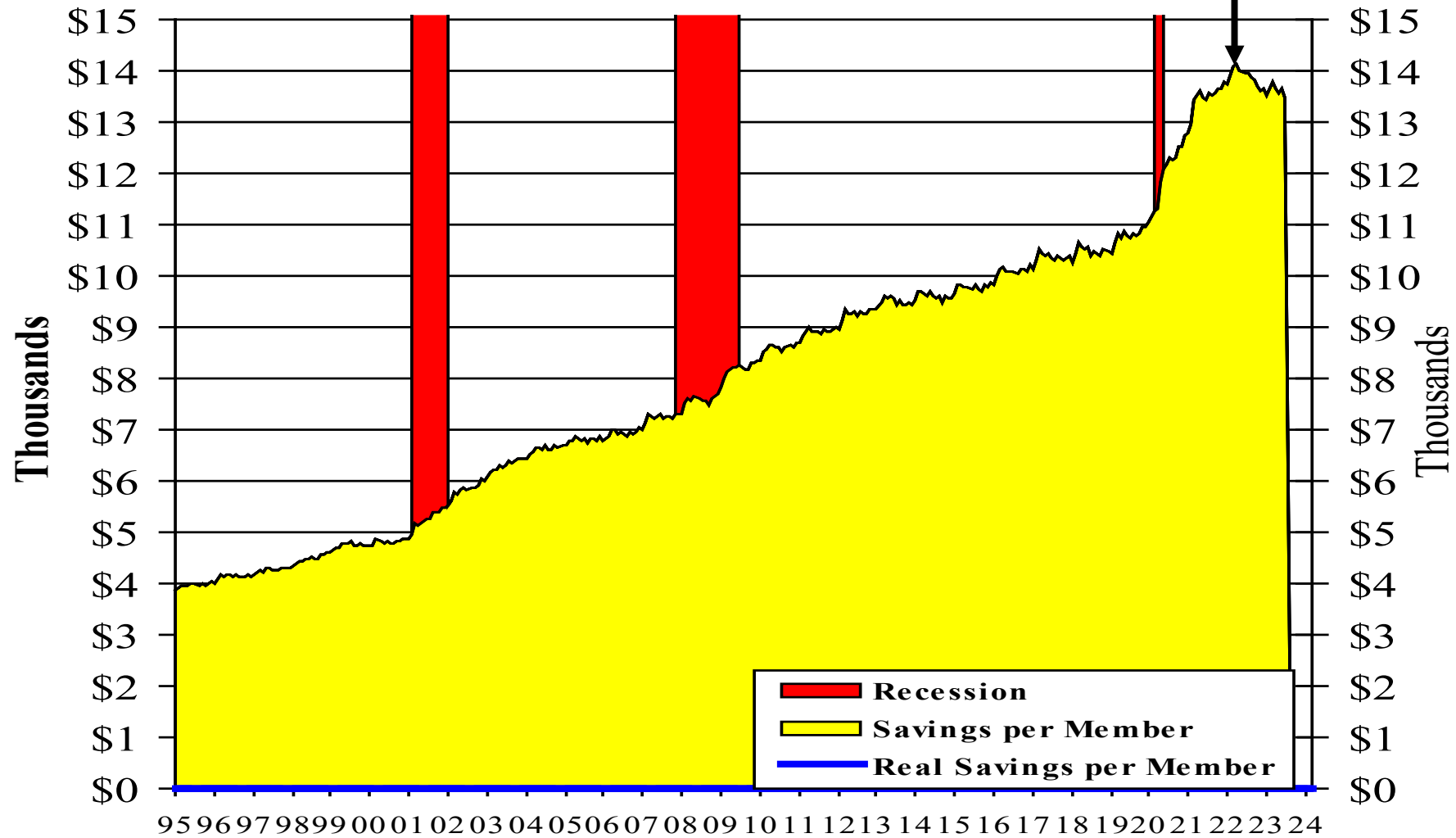
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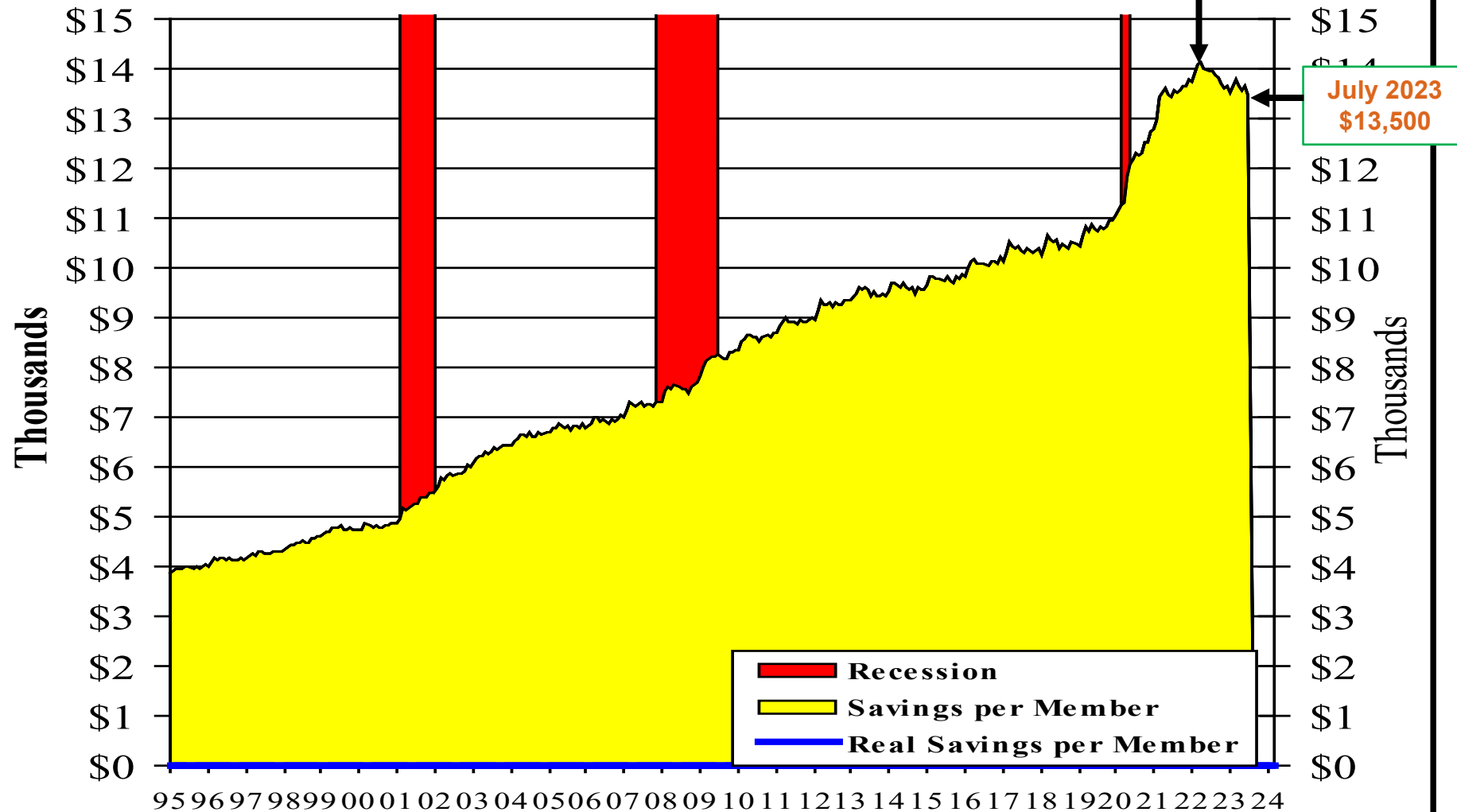
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2. Falling equity-to-asset ratios

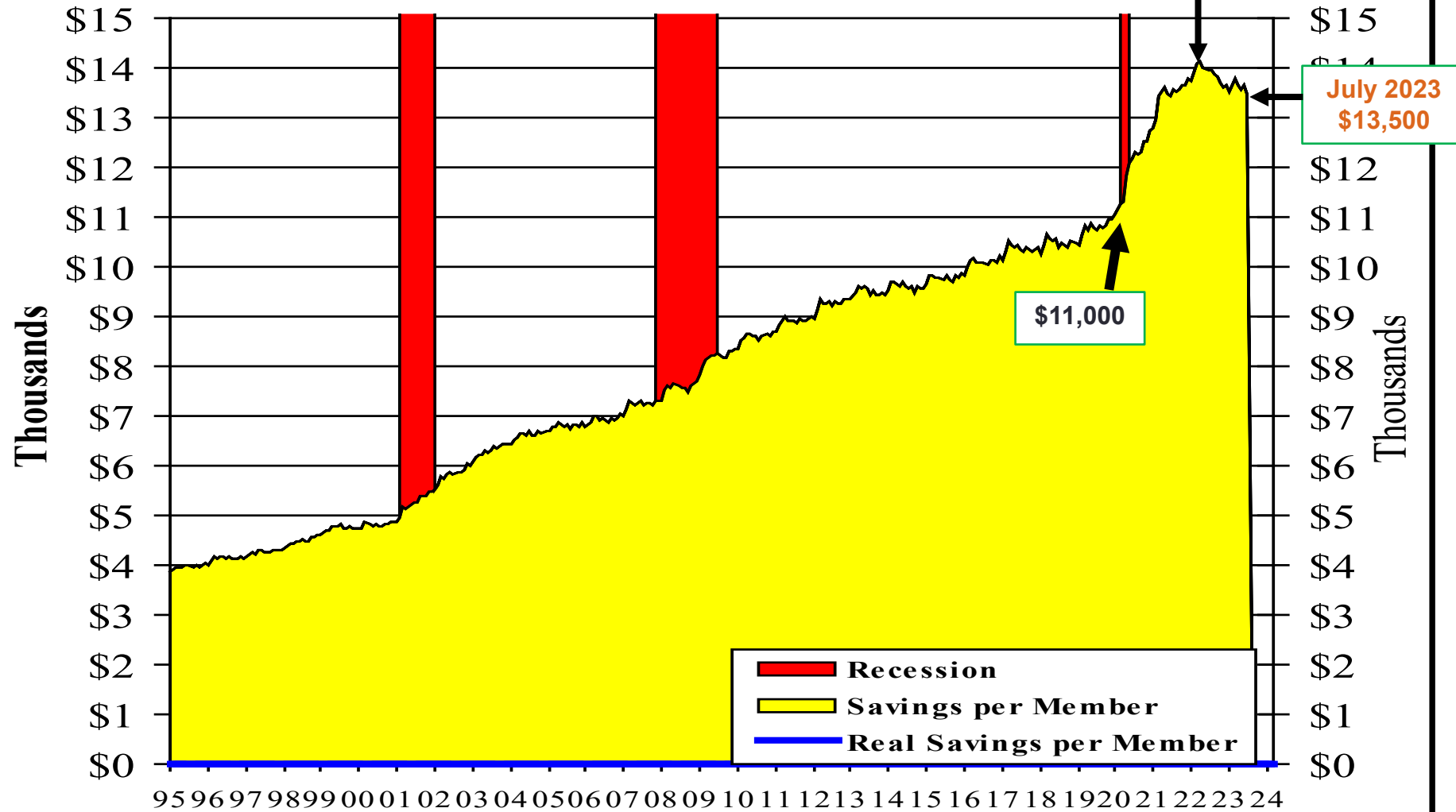
Credit Union Savings per Member



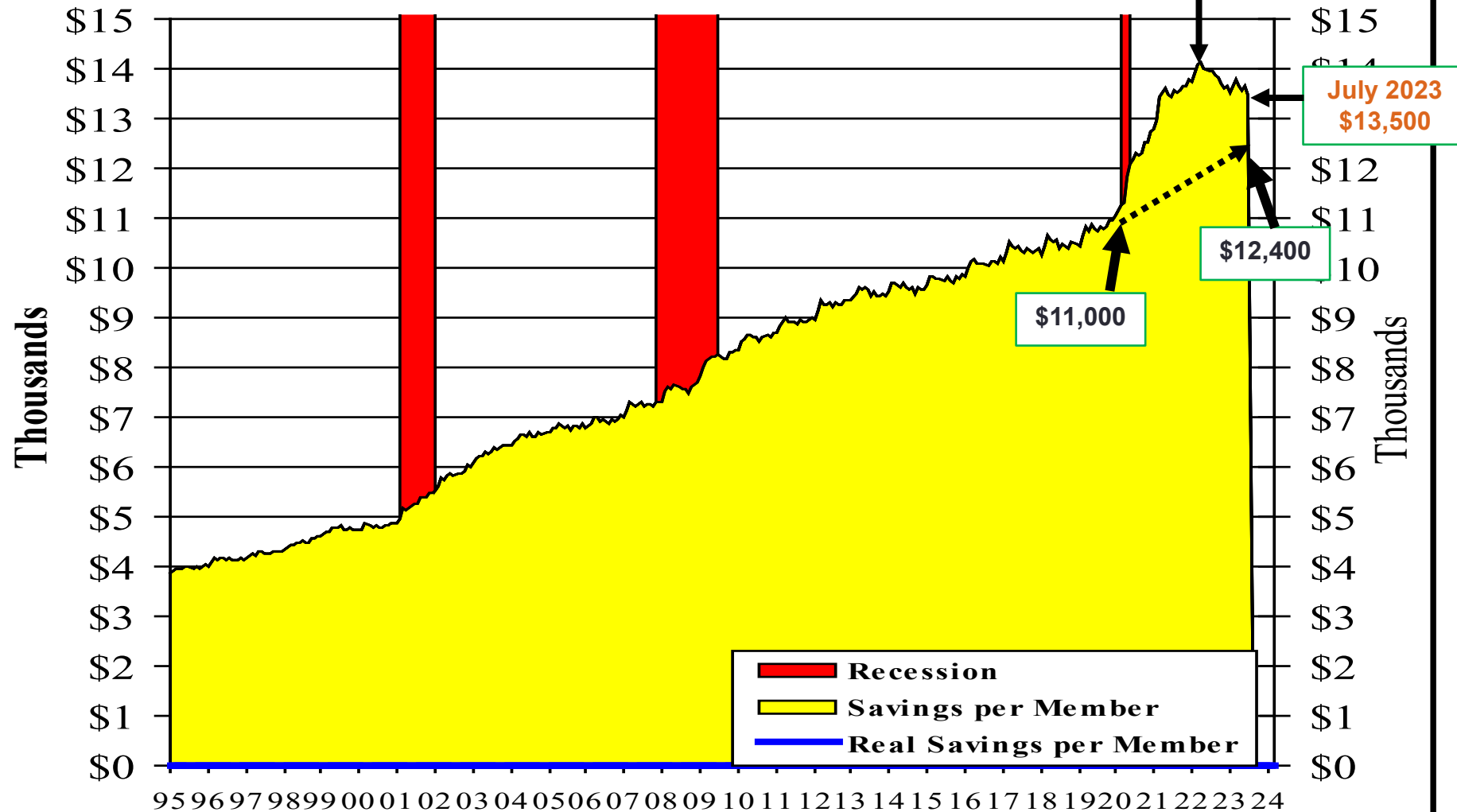
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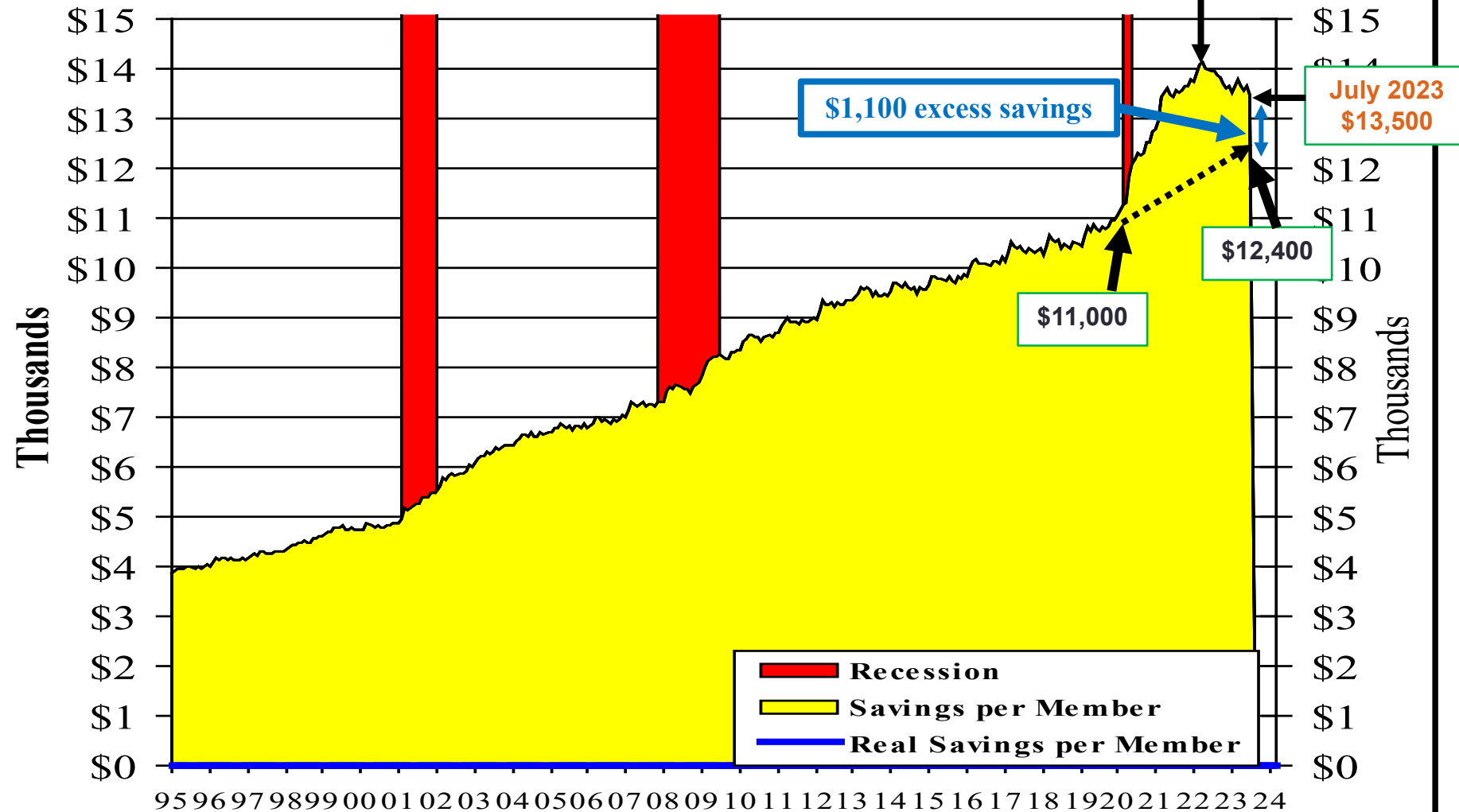
Credit Union Savings per Member



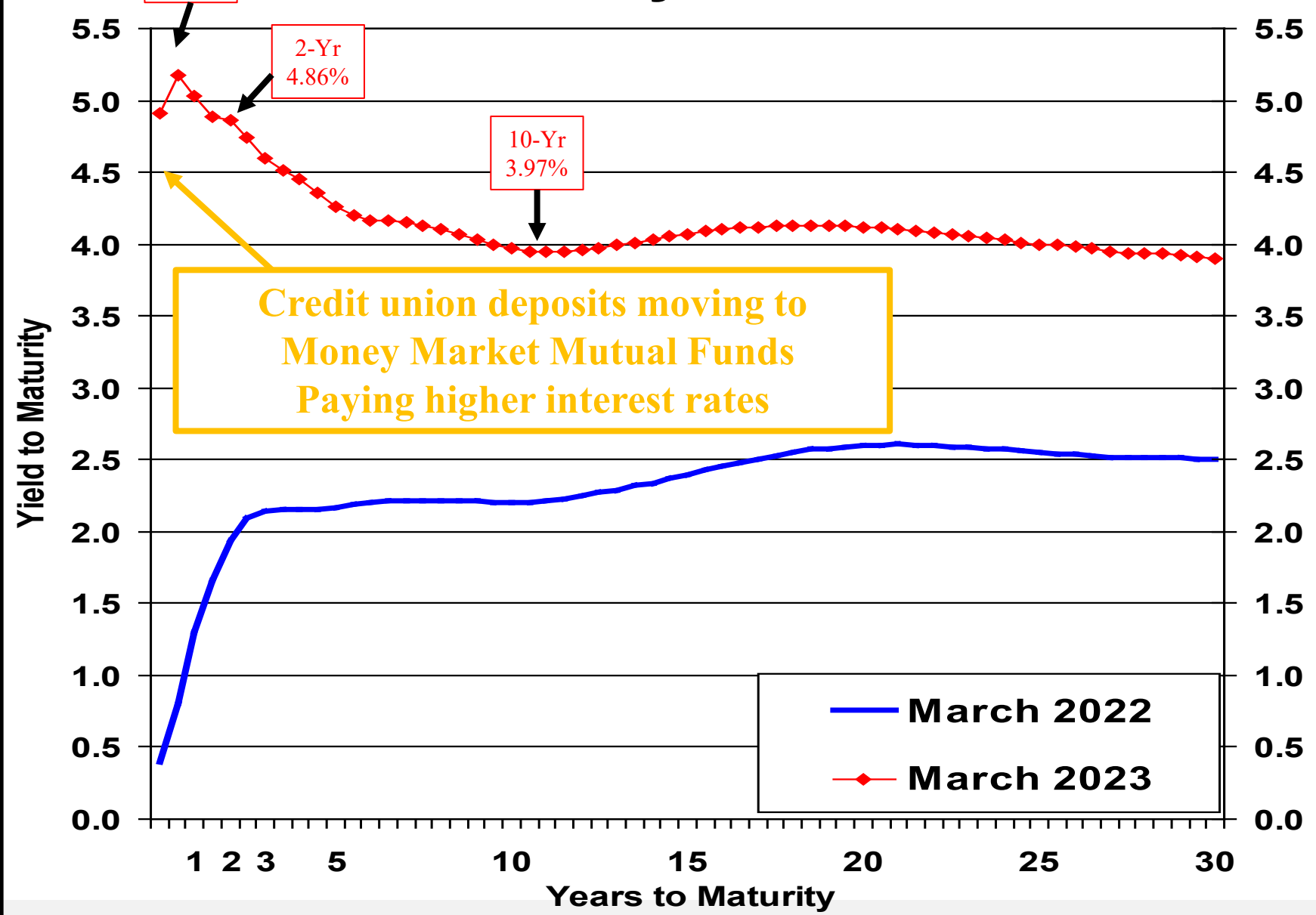
Credit Union Savings per Member



Credit Union Savings per Member



Treasury Yield Curves



Credit Union Balance Sheet

Assets

Liabilities + Capital

Cash (Reserves)

Fixed Assets

- Land
- Building
- Equipment

Investments

- < 1-year maturity
- 1–3-year maturity
- > 3-year maturity

Loans

- Commercial
- Auto
- Home
- Credit Card

Allowance for Loan Loss

Deposits

- Checking Accounts
- Savings
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Borrowings

- Federal Home Loan Bank
- Corporate Line of Credit
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Equity (Net Capital)

1. Undivided Earnings
2. Regular Reserves
3. Gains (losses) on Available For Sale (AFS) Securities

1. Below par market value of investments

4. New investment Maturities in 2023

6. Deposit withdraws > Loan repayments
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(the 4th dimension)

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Short Run vs Long Run

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Short Run vs Long Run

How long it takes for financial instrument interest rates to reprice to current market rates

2. Falling equity-to-asset ratios

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8. Out of compliance with ALM policy risk tolerances of *Net Interest Income* and *Net Economic Equity*

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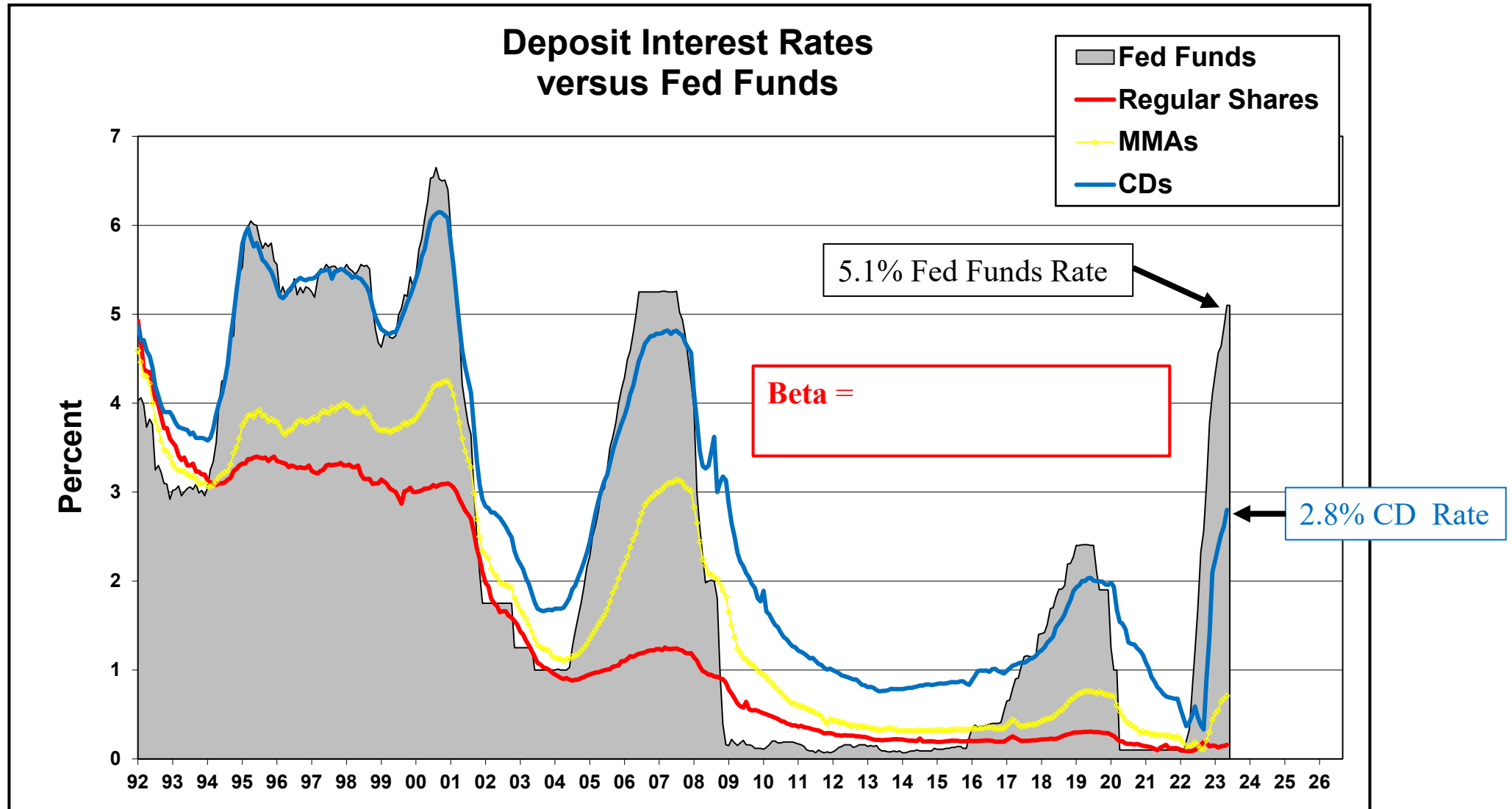
5. Members' deposit runoff/disintermediation

10. Deposit pricing in a rapidly rising interest rate environment

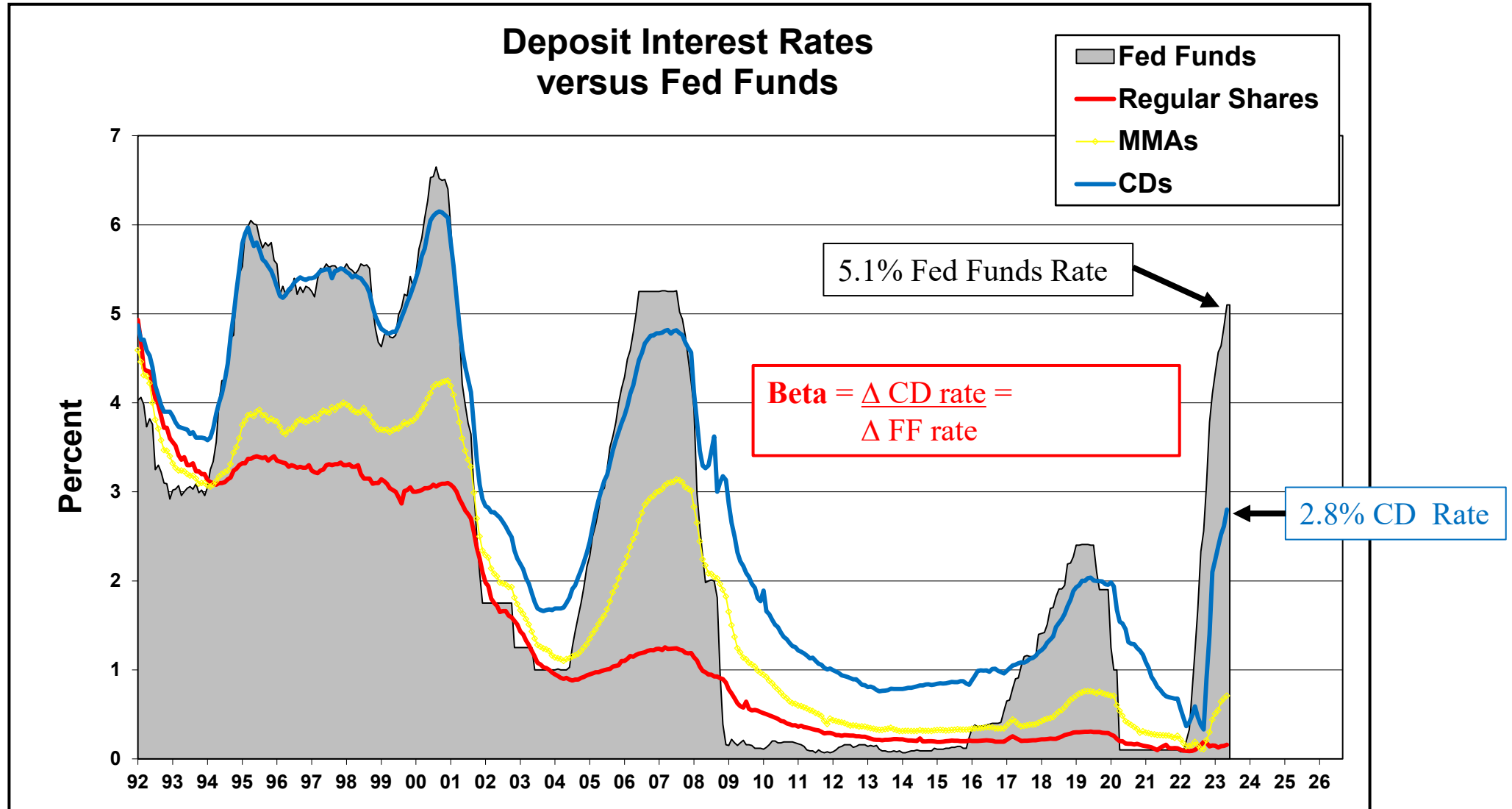
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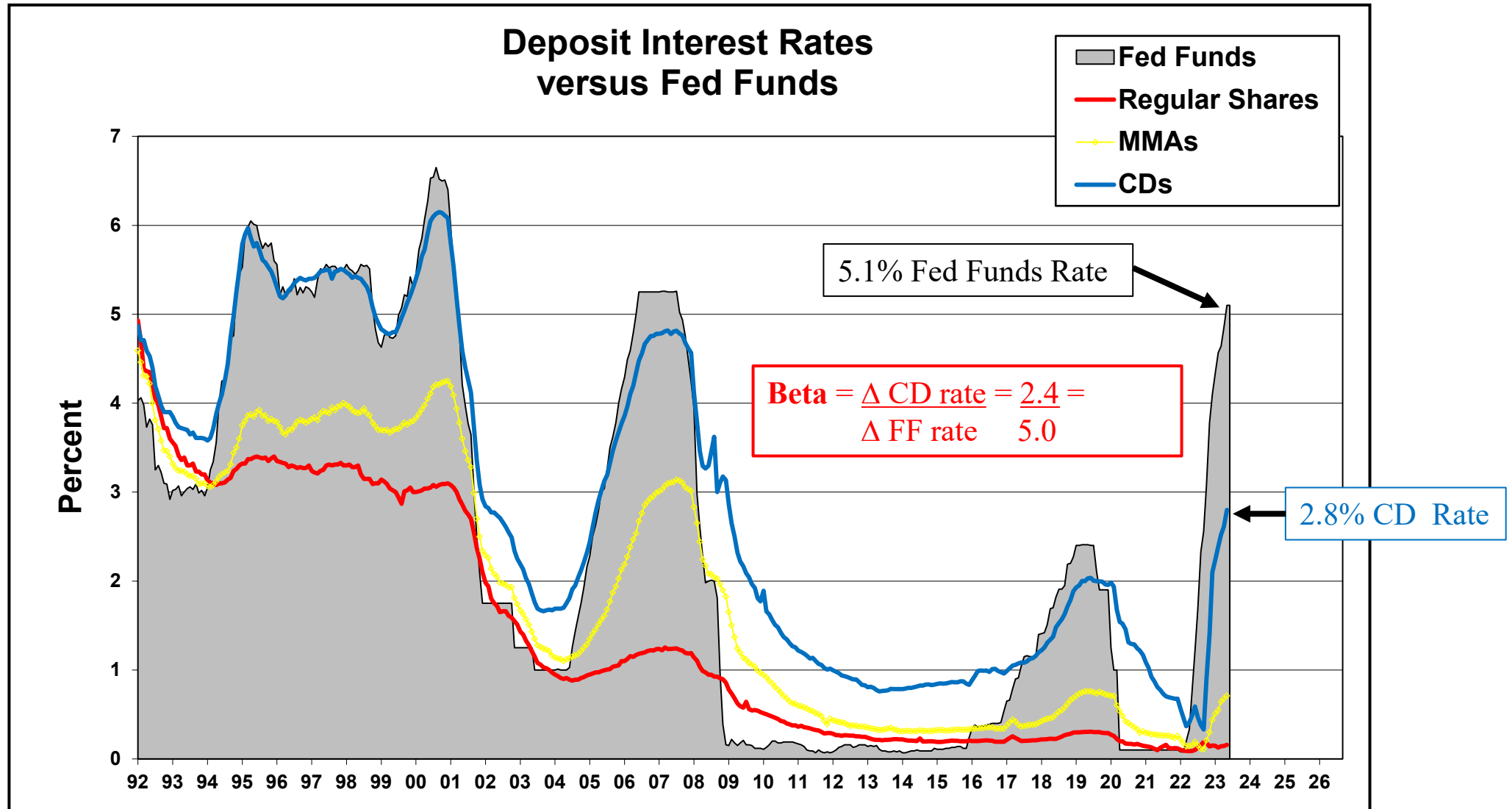
Rising Fed Funds Interest Rate and Deposit Pricing



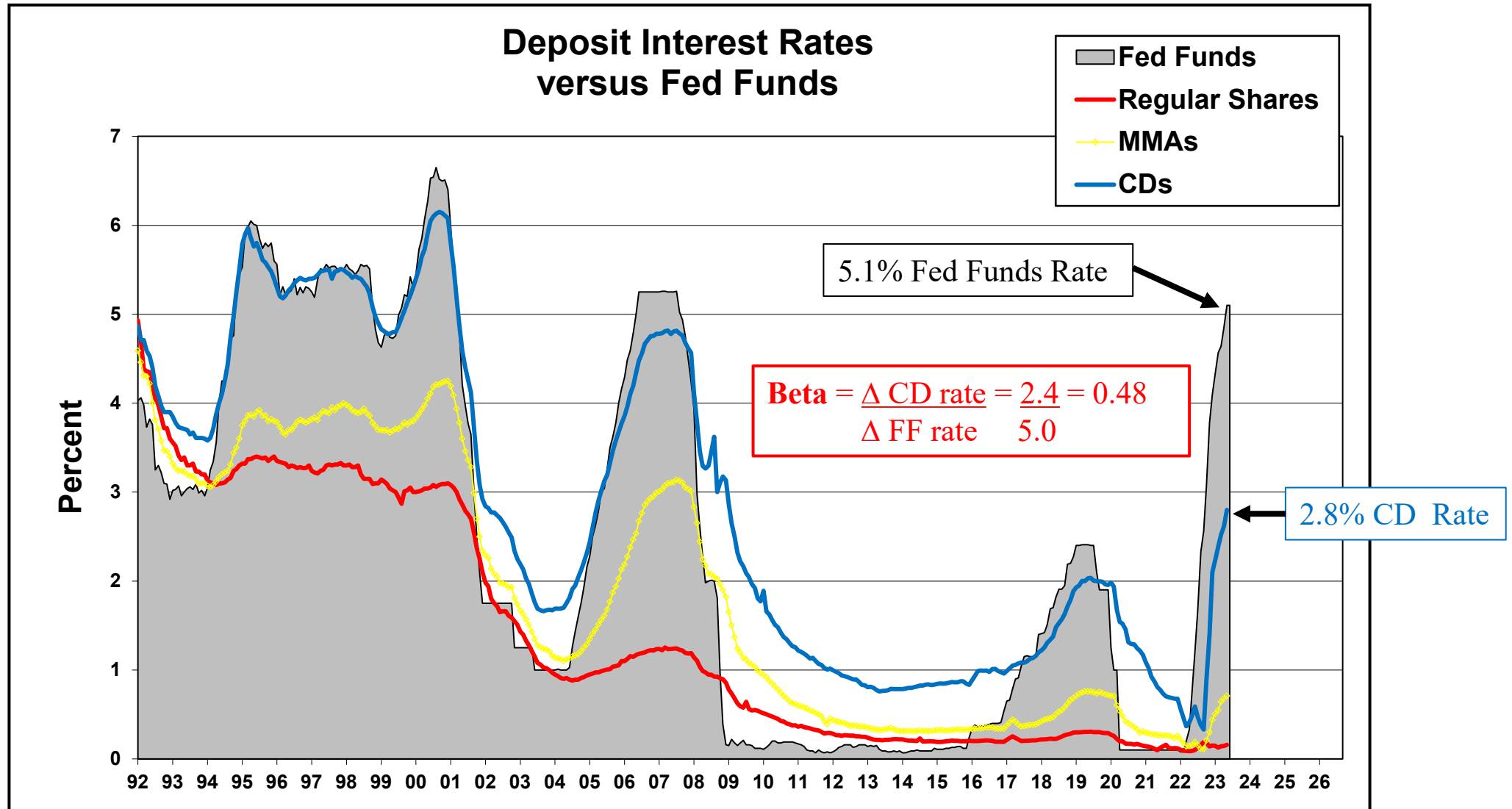
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11. Rely on wholesale borrowings to maintain sufficient liquidity

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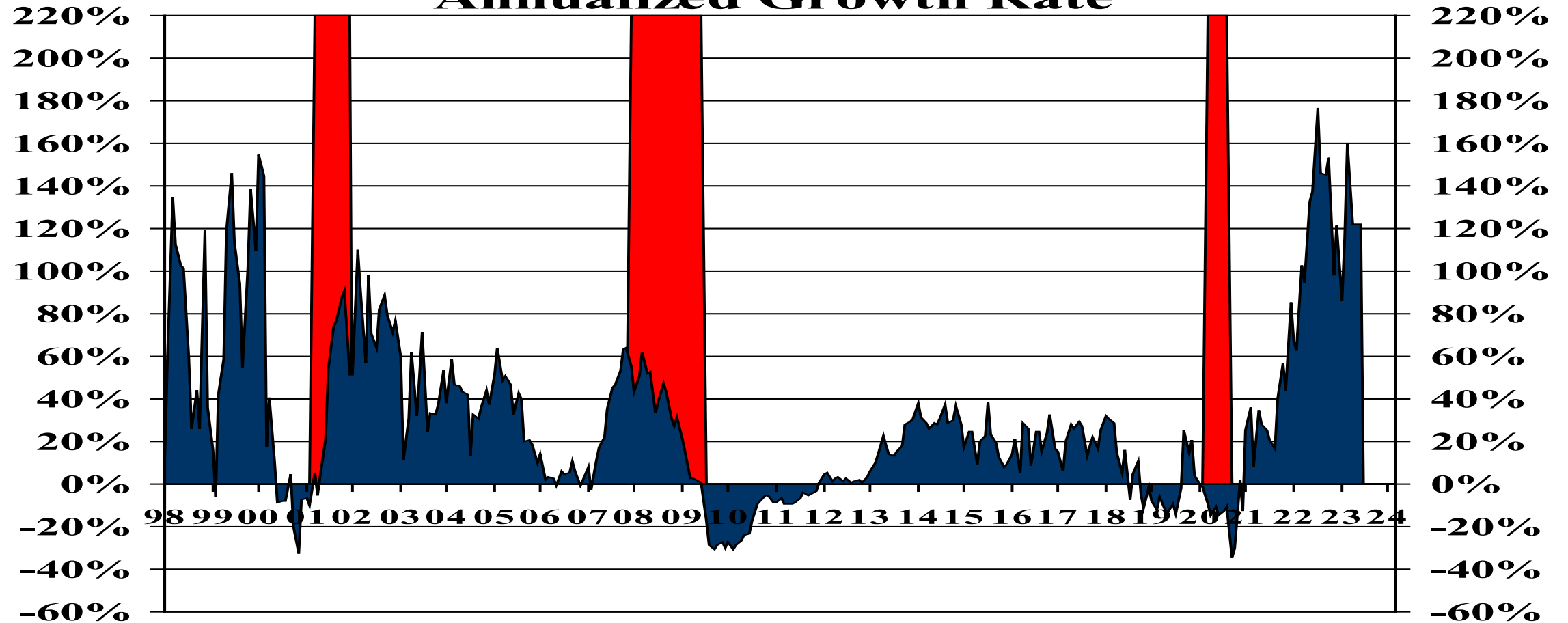
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Resurgent Borrowings

CU Borrowings Growth Seasonally Adjusted Annualized Growth Rate



Limerick of the Day

There once was a credit union that had quite a scare

Limerick of the Day

There once was a credit union that had quite a scare
For their liquidity seemed quite rare

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There once was a credit union that had quite a scare
For their liquidity seemed quite rare
But with some quick loans

Limerick of the Day

There once was a credit union that had quite a scare
For their liquidity seemed quite rare
But with some quick loans
And more cash in their bones

Limerick of the Day

There once was a credit union that had quite a scare
For their liquidity seemed quite rare
But with some quick loans
And more cash in their bones
They managed to keep their head above the despair.

Economic Update Summary For 2023

1. Slow economic growth for the next year

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2. Falling inflation rate during the next 2 years

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2. Falling inflation rate during the next 2 years
3. Unemployment rate rising to natural rate in 2024
4. Short-term interest rates above long-term interest rates into 2024
5. Credit union loan growth slowing in 2024
6. Falling net interest margins in 2024

Economic forecast

Aug 2023

	Past results		Forecasts					
	Previous 10 Yr. Avg	2022	2023 Q1	2023 Q2	2023 Q3	2023Q4	2023	2024
Growth rates:								
Economic Growth (% chg GDP)*	2.1%	2.1%	2.0%	2.4%	1.0%	0.5%	2.0%	1.5%
Inflation (CPI, 12 mth % chg)	2.2%	6.5%	5.0%	3.1%	4.0%	3.5%	3.0%	2.5%
Unemployment Rate (BLS)	6.0%	3.5%	3.5%	3.6%	4.0%	4.0%	3.9%	4.2%
Federal Funds Rate (effective)	0.58%	4.33%	4.83%	5.08%	5.33%	5.60%	5.60%	4.60%
10-Year Treasury Rate	2.11%	3.88%	3.48%	3.81%	4.00%	4.00%	4.00%	3.75%
10-Year-Fed Funds Spread	1.53%	-0.45%	-1.35%	-1.27%	-1.33%	-1.60%	-1.60%	-0.85%

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

Economic Forecast

Aug 2023

We now expect the U.S. economy to expand by 2.0% this year (up from 1.0% in our previous forecast) and by 1.5% in 2024 (unchanged compared to our previous forecast.)

The surprisingly strong labor market is a key reason the economy has performed well in the face of the Fed's aggressive interest rate increases. We expect continued resilience in the job sector – and if that assumption holds it will bode well for both personal consumption activity and overall economic performance.

The just-announced July unemployment rate dipped marginally – to 3.5% (equal to the pre-COVID crisis reading and well below its 5.7% long-run average rate). We see the unemployment rate rising only modestly to 3.9% at year-end 2023 and 4.2% at the end of 2024.

We believe the Fed has likely concluded its rate-hike regime because inflation (variously measured) has eased significantly, and we expect that trend to continue going forward. On a year-over-year basis the June Consumer Price Index is up 3.1% - well below the 8.9% cyclical high (in June 2022) and close to the Fed's 2.0% target. Fewer and less pronounced supply chain disruptions and declines in prices of energy and agricultural commodities have helped to push headline inflation down. We see price increases generally continuing to moderate (though not in a straight line) as lagged effects of the Fed's interest rate increases work their way through the economy. We now believe the CPI will increase 2.5% during calendar year 2024.

With that in mind it seems reasonable to expect the Fed to hold off on rate cuts until after mid-year 2024.

We acknowledge the possibility of significant economic disruption if the federal budget fight turns into a bare-knuckled affair – but assume policy makers will “play nice”. Election season is quickly approaching, and the public has little appetite for the trauma of that self-inflicted wound. If that view is incorrect the odds of recession will undoubtedly rise.

Credit union forecast

Aug 2023

	Past Results		Quarterly results/forecasts				Annual forecasts	
	10 Yr Average	2022	2023 Q1	2023 Q2	2023 Q4	2023 Q4	2023	2024
Growth rates:								
Savings growth	7.7%	3.3%	2.3%	-1.2%	-0.6%	-0.5%	0.0%	3.0%
Loan growth	9.20%	19.10%	1.7%	2.0%	2.0%	1.3%	7.0%	4.0%
Asset growth	7.70%	5.10%	2.0%	0.4%	0.4%	0.2%	3.0%	3.5%
Membership growth	3.55%	4.30%	1.2%	0.6%	0.8%	0.4%	3.0%	2.5%
Liquidity:								
Loan-to-share ratio**	79.5%	81.5%	80.9%	83.7%	85.9%	87.4%	87.4%	88.1%
Asset quality:								
Delinquency rate**	0.66%	0.61%	0.52%	0.70%	0.75%	0.80%	0.80%	1.00%
Net charge-off rate*	0.48%	0.34%	0.52%	0.55%	0.60%	0.65%	0.60%	0.70%
Earnings:								
Return on average assets (ROA)*	0.88%	0.88%	0.81%	0.75%	0.70%	0.65%	0.65%	0.65%
Capital adequacy:								
Net worth ratio**	10.9%	10.7%	10.8%	10.9%	11.1%	11.0%	11.0%	11.2%

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

Credit Union Forecast

Aug 2023

Against the backdrop of our new economic outlook, we anticipate more obvious financial and operational challenges on the horizon for credit unions.

As noted, the yield curve is steeply inverted – and will remain so over the near term. This means (on the margin) credit unions will continue to pay high prices for funding (i.e., high interest rates on deposits and borrowings - which tend to have short terms) and will continue to asset yields (i.e., those associated with longer-term loans and investments) trail or only modestly exceed those funding costs.

CUNA's forecast group anticipates very weak savings growth over the forecast horizon with total credit union savings balances essentially unchanged in 2023 and rising by only 3.0% in 2024. Competition with money market fund yields and with other depositories will be fierce. On the other side of the balance sheet loans will grow by 7.0% in 2024, but by only 4.0% in 2023. First mortgage and automobile lending will lag, while stronger increases in variable-rate home equity lines and unsecured loans (personal loans and credit card balances) should be obvious.

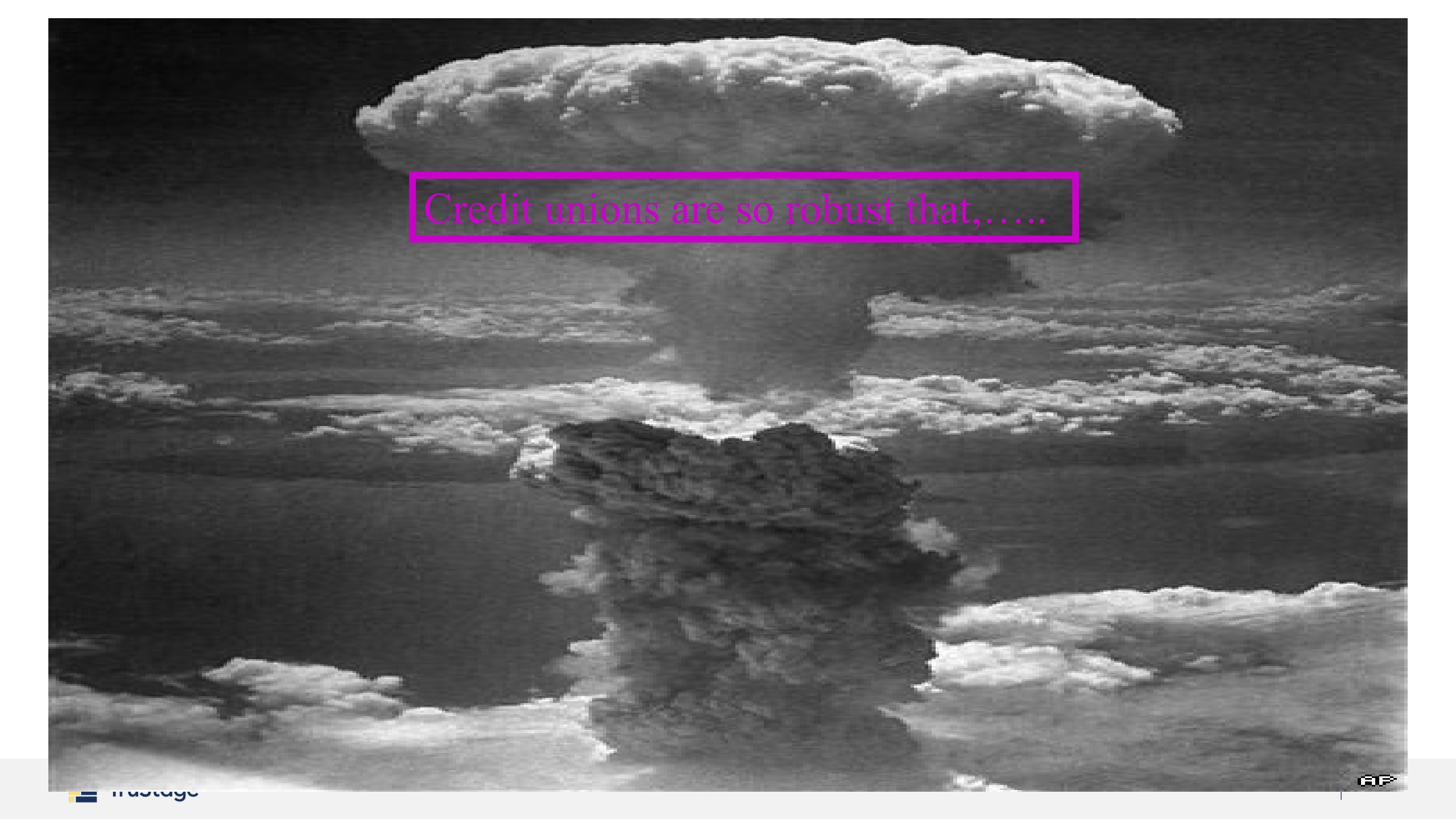
With loan growth outpacing savings growth loan-to-savings ratios will continue to rise. That means liquidity will continue to be a big issue for many credit unions – driving up funding costs (as noted) and continuing to garner considerable supervisory scrutiny. Our year-end 2024 system-wide loan-to-savings ratio in this forecast comes in at a lofty 88.1%. The pre-COVID crisis reading was 84.4%.

Modest increases in the U.S. unemployment rate virtually guarantee declining credit union asset quality. Several other factors also are likely to come into play: First, we're apt to see a significant seasoning effect related to the massive number of loans credit unions originated in 2022; Second, loan growth is slowing so the "denominator effect" on both the delinquency and net-chargeoff ratios will be obvious; and third, a significant volume of student loans will come off COVID-19 forbearance in October. The resumption in payments could affect both student loans and other forms of credit as households adjust to this new reality. Delinquencies and net chargeoffs finished 2022 at 0.61% and 0.34% respectively – with each very close to all-time lows. However, our baseline forecast now has delinquencies increasing to 0.80% by year-end 2023 and to 1.00% by year-end 2024. Net chargeoff rates will be up from 0.34% in 2022 to 0.60% in 2023 and 0.70% in 2024. That would put both ratios near long-run average rates.

Bottom-line results will be influenced by net interest margin compression, low noninterest margins and increased loss provisions. Noninterest margins pressures will continue most significantly in substantially lower mortgage originations (and associated gains on secondary market sales) but will be experienced in other ways as well (e.g., Visa's recent decision to lower interchange rates). Loan loss provisions will almost certainly be increasing modestly. ROA which totaled 0.88% of average assets in 2022 is apt to drift down to 0.65% in both 2023 and 2024.

Substantially slower asset growth and healthy (though lower) earnings should combine to boost the aggregate credit union net worth ratio above 11.0% - which should put that KPI very close to pre-COVID crisis levels.

Credit unions are so robust that,.....

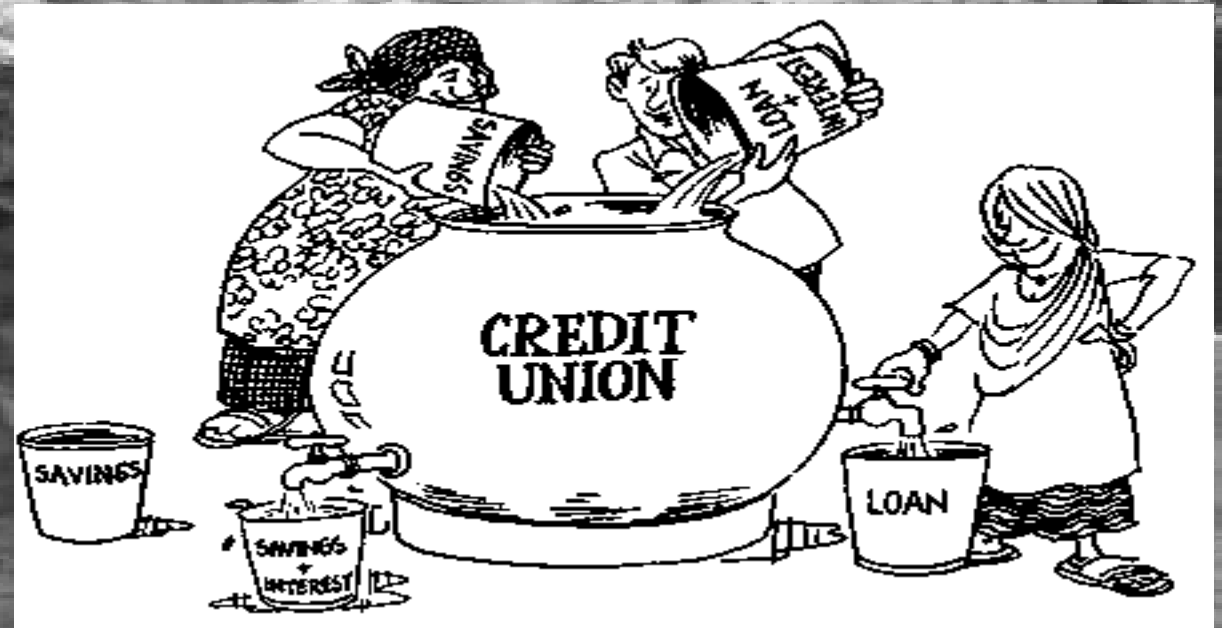
A black and white photograph of a nuclear explosion's mushroom cloud. The cloud has a large, billowing, white top that spreads out like a mushroom cap, with a dark, dense column rising from the center. The background is a dark, cloudy sky.

Credit unions are so robust that,.....

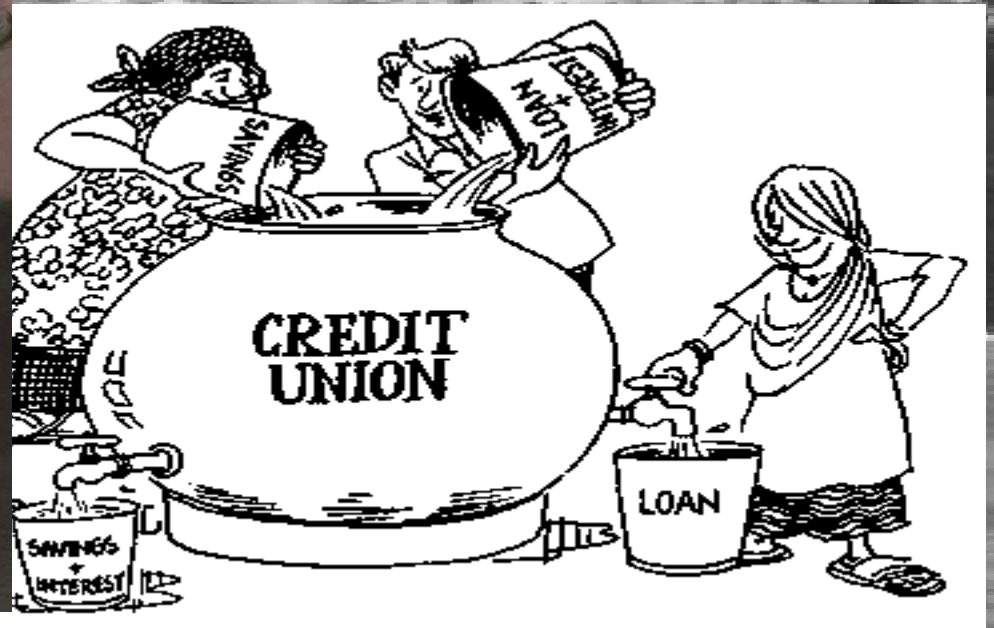
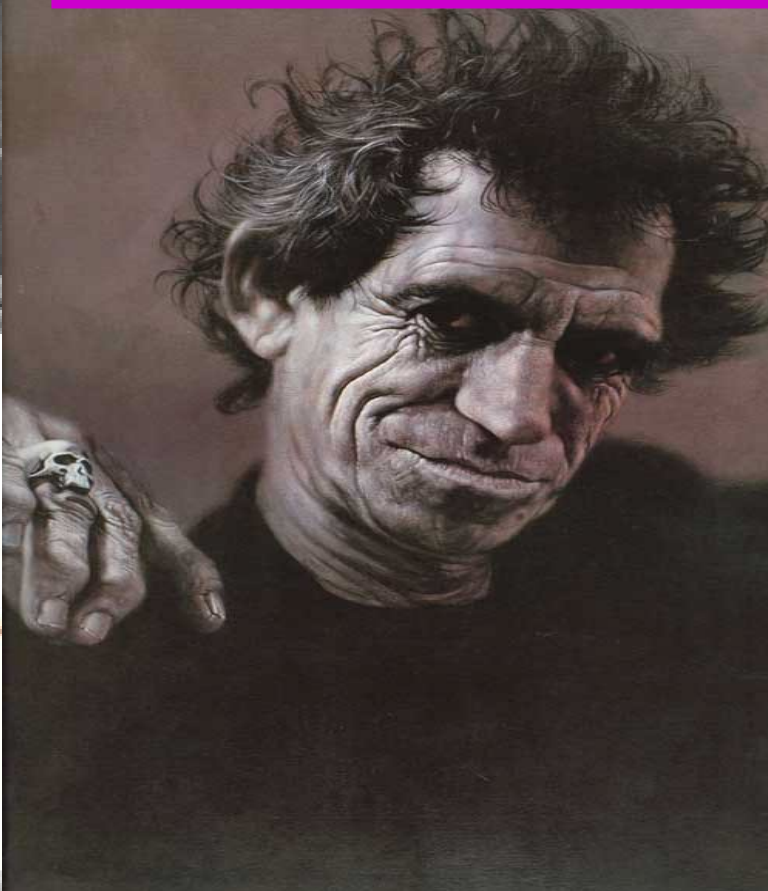
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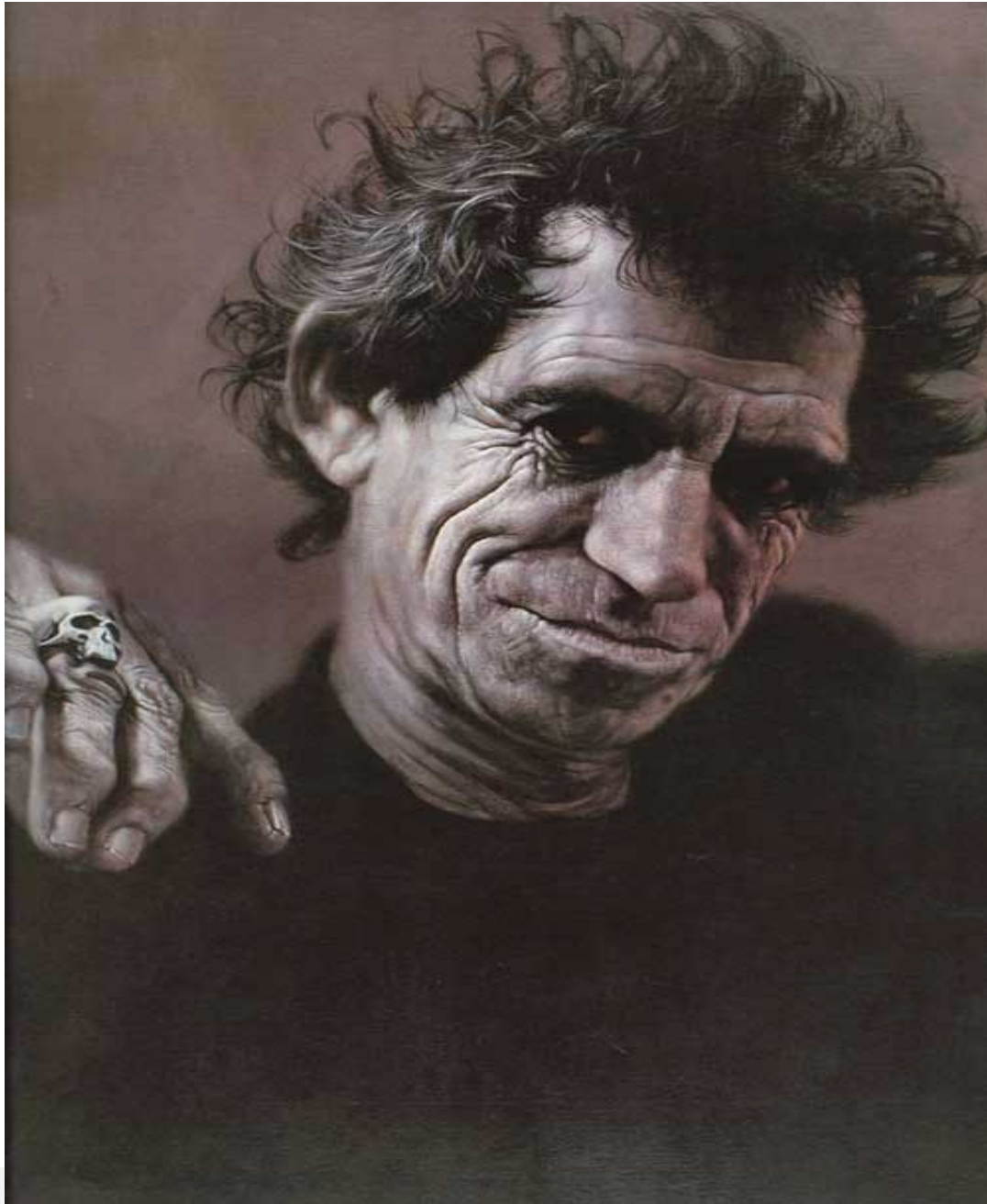


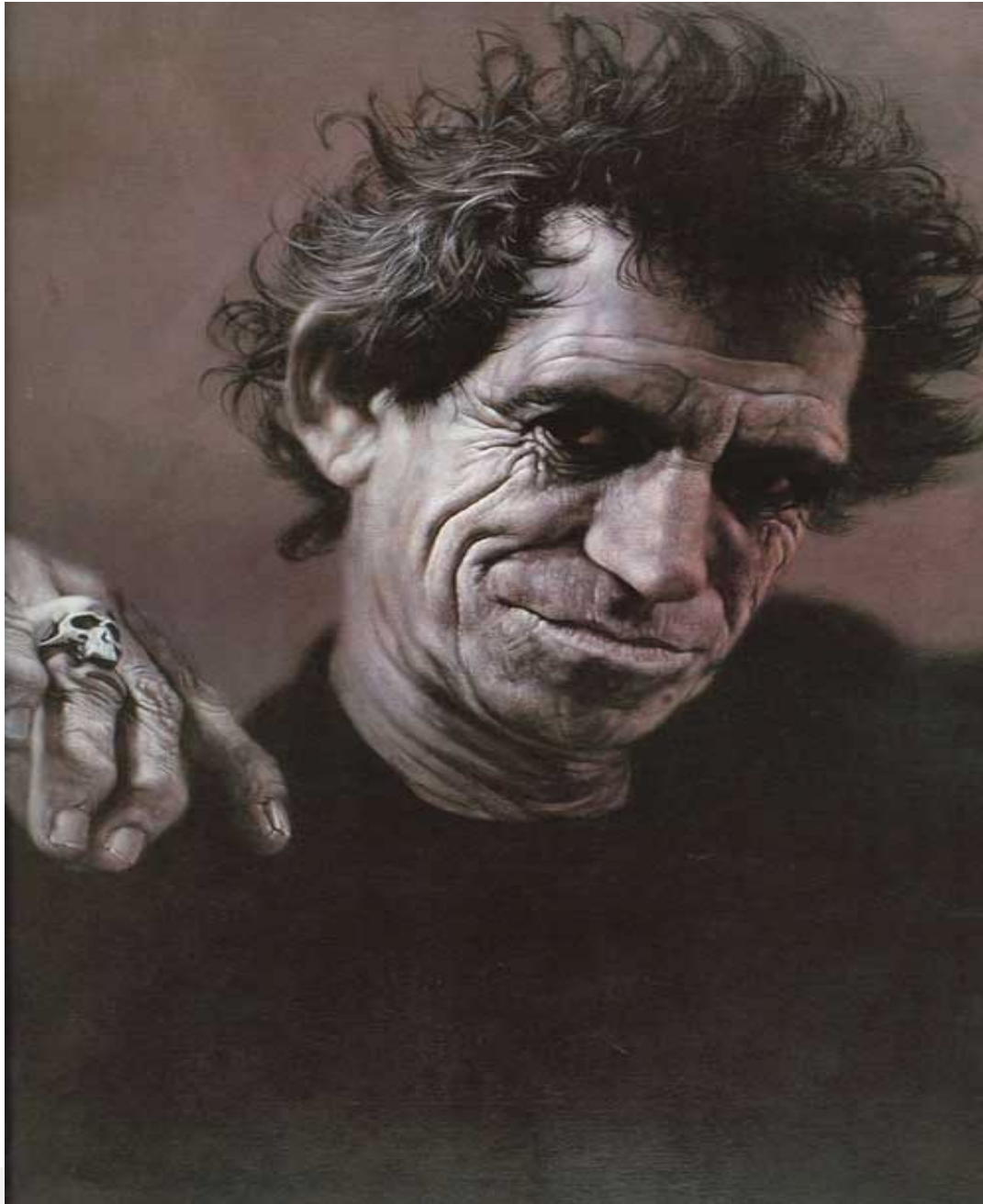
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Carpe Diem
“Seize the day”

Questions?