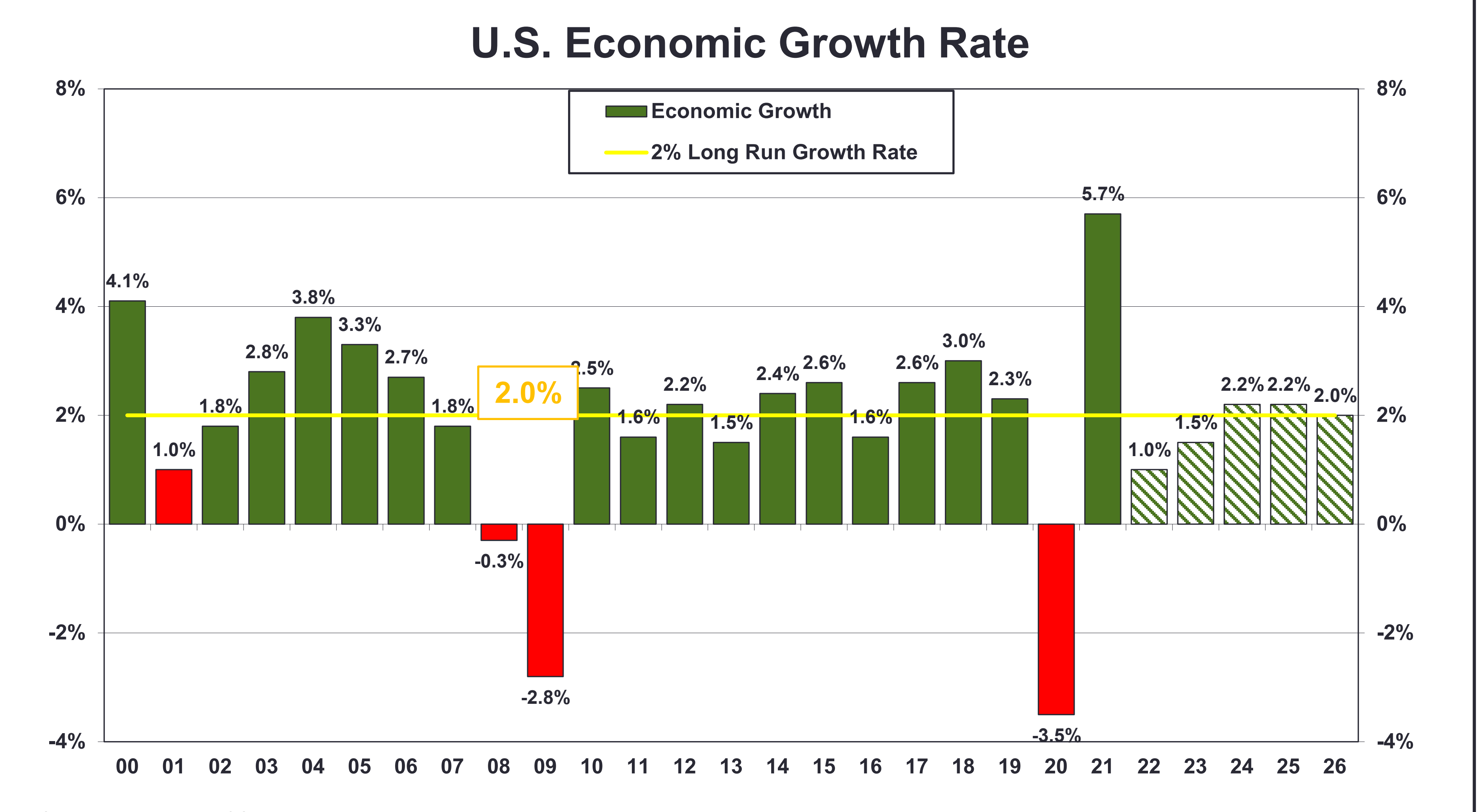
Economic & Credit Union Update

October 2022

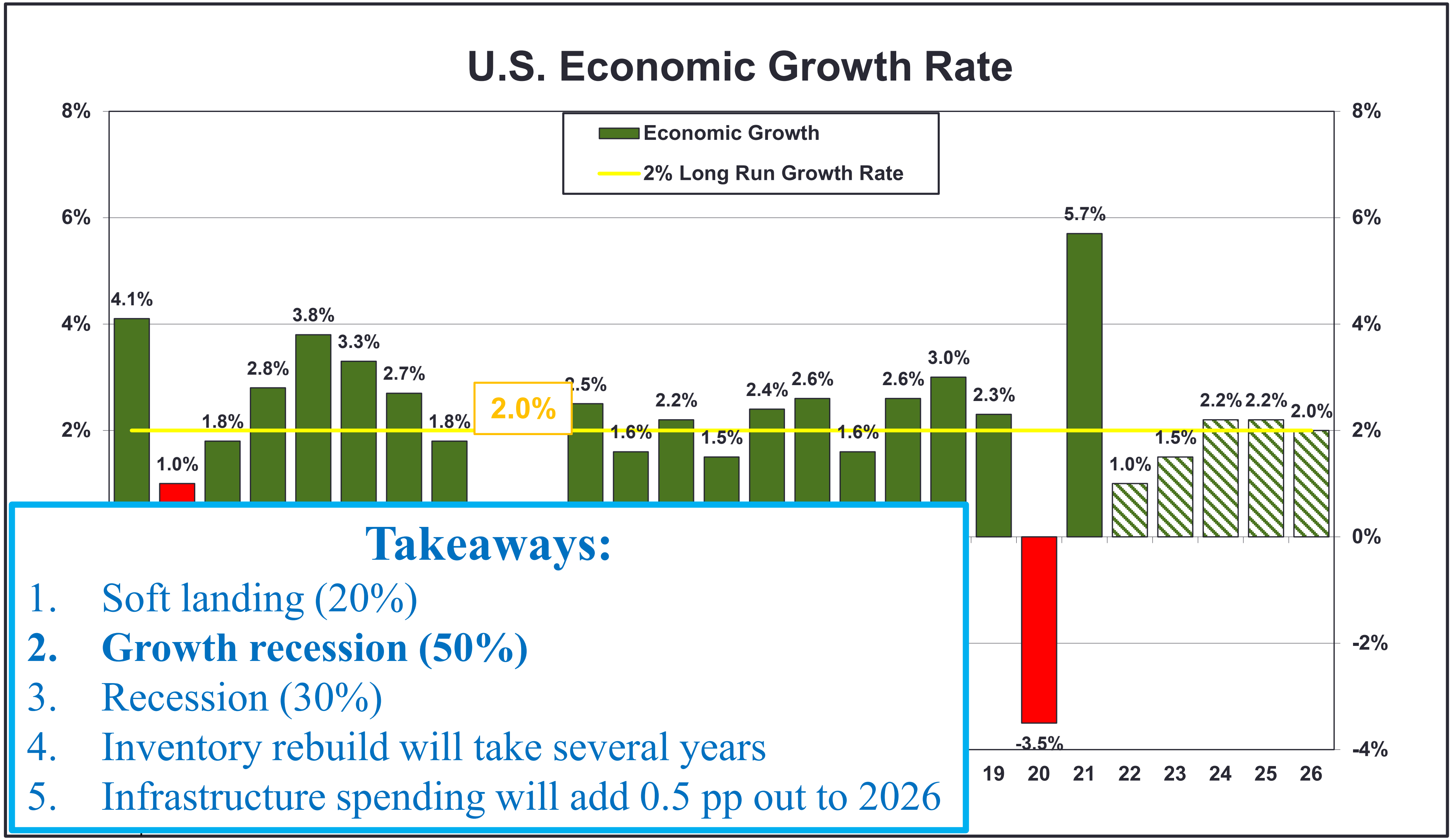
If you have any questions or comments, please contact:
Steven Rick, Chief Economist
CUNA Mutual Group – Economics
800.356.2644, Ext. 665.5454
Steve.rick@cunamutual.com

Moderate Economic Growth for Next 5 Years



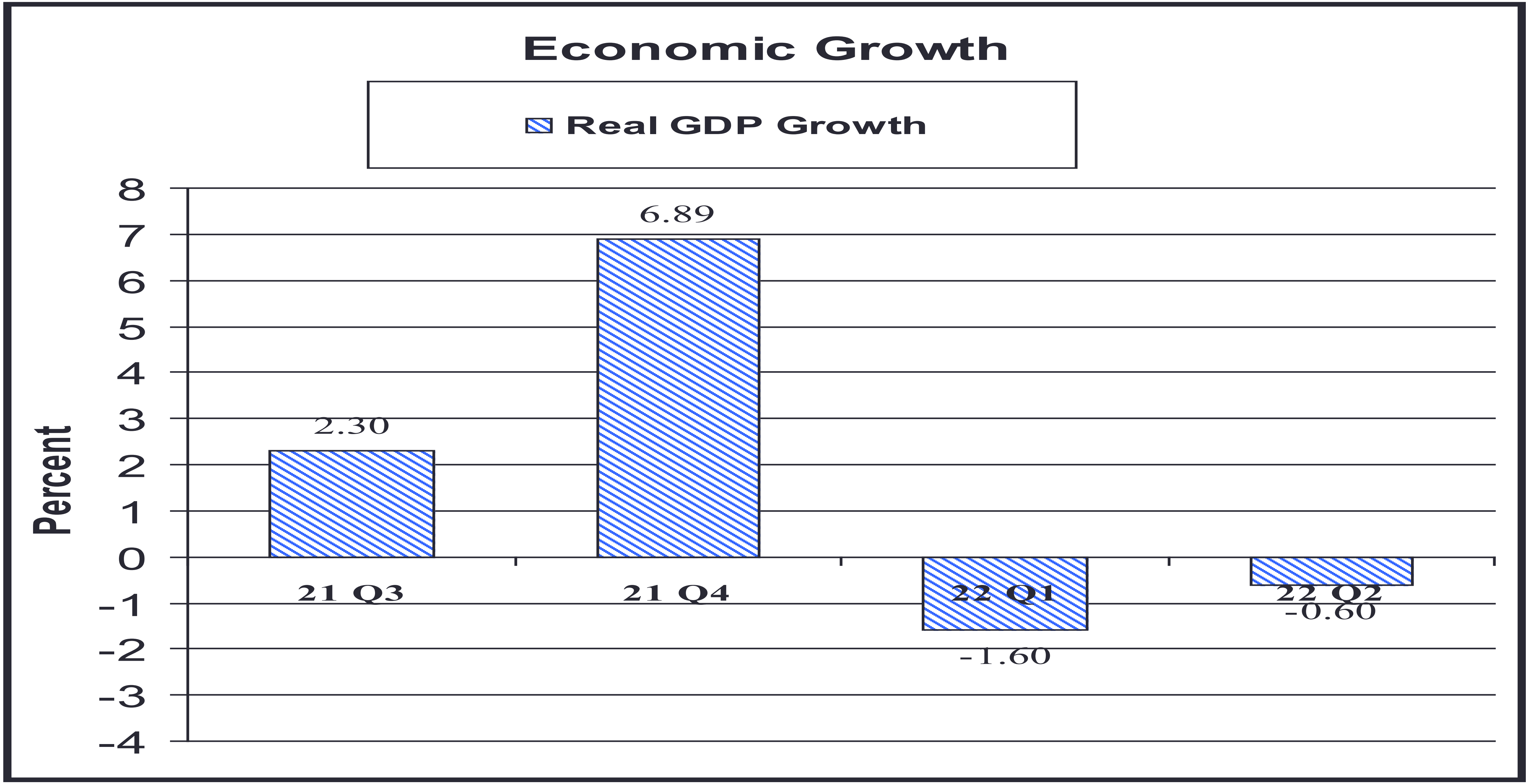
Source: Department of Commerce

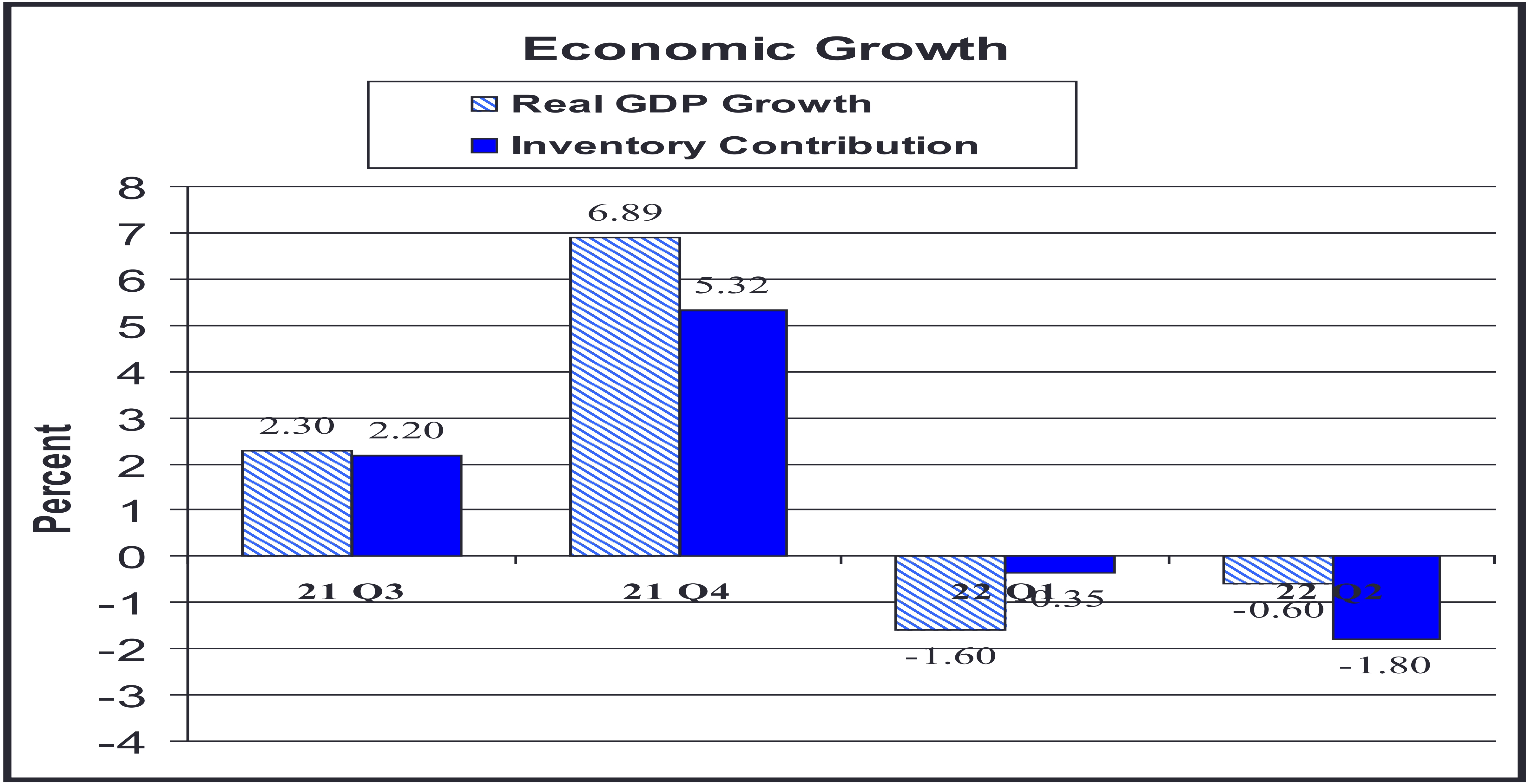
Above Trend Economic Growth for Next 5 Years



Takeaways:

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


Economic Growth
Real GDP Growth
Percent
8
7
6
5
4
3
2
1
0
-1
-2
-3
-4
2.30
6.89
-1.60
-0.60
21 Q3
21 Q4
22 Q1
22 Q2

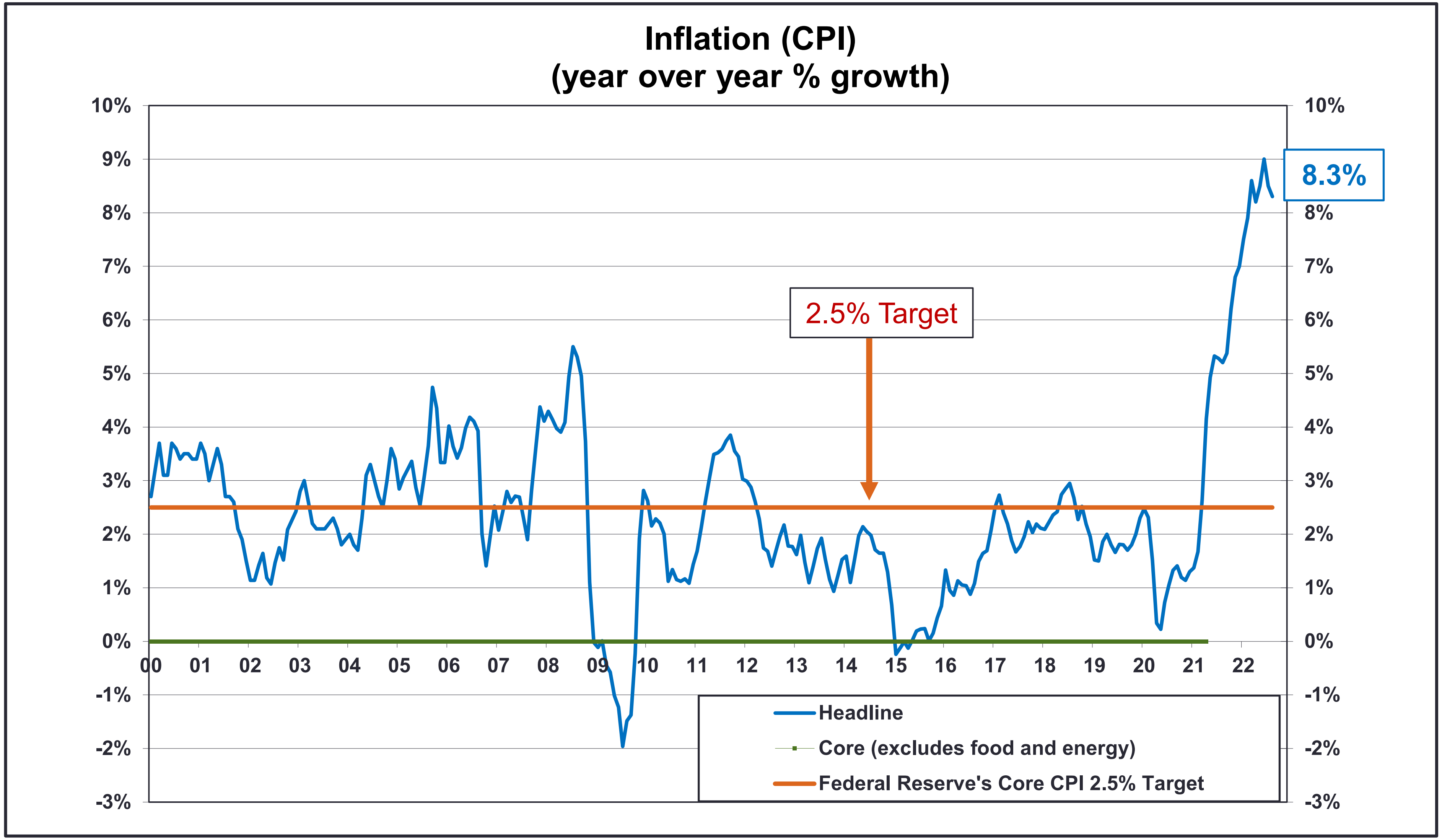

Economic Growth
Real GDP Growth
Inventory Contribution
Percent
8
7
6
5
4
3
2
1
0
-1
-2
-3
-4
2.30
2.20
6.89
5.32
-1.60
-0.35
-0.60
-1.80
21 Q3
21 Q4
22 Q1
22 Q2

The Big Question

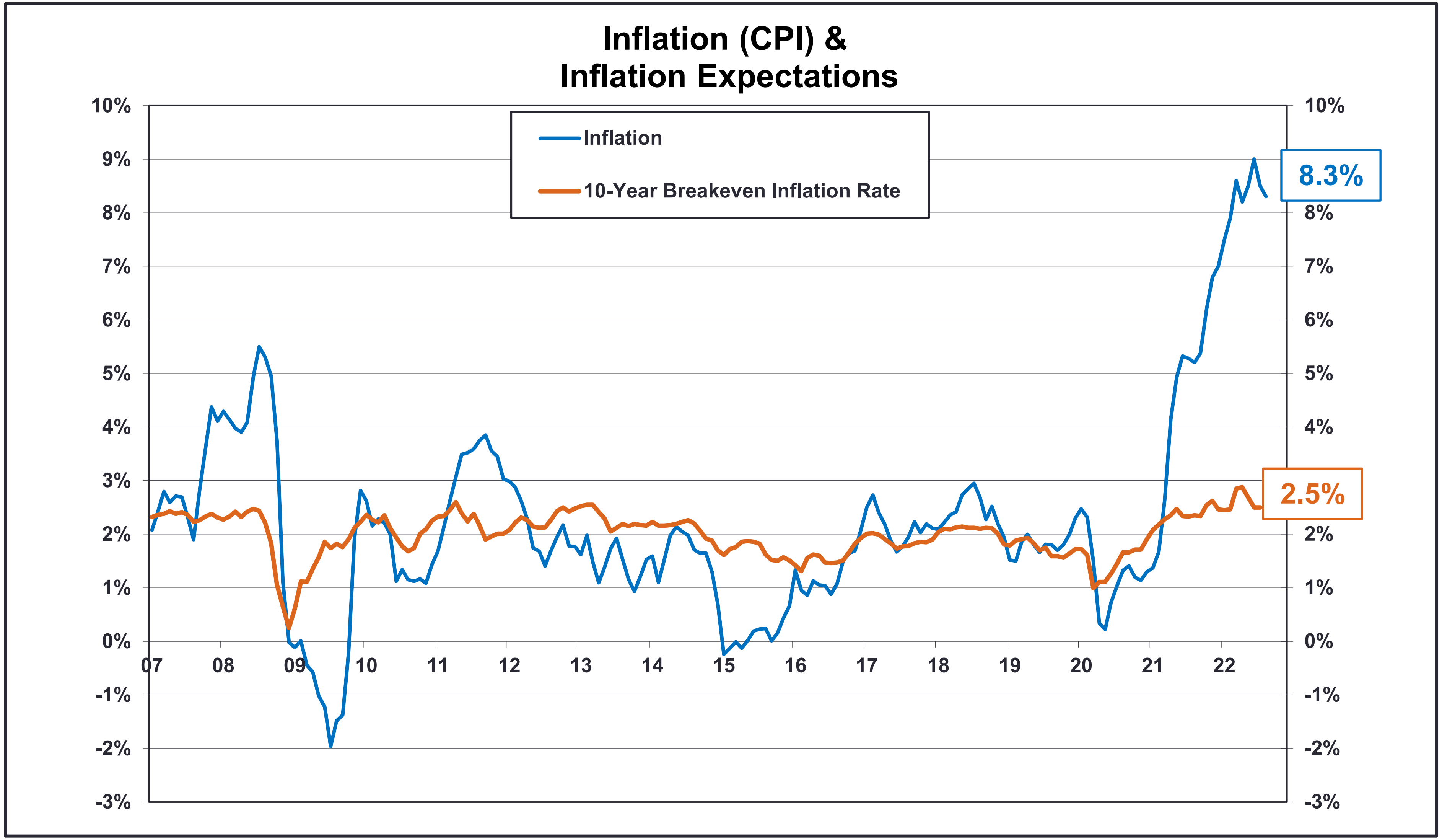
The Big Question

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

High Inflation for the Next Year



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

The Inflation Debate:

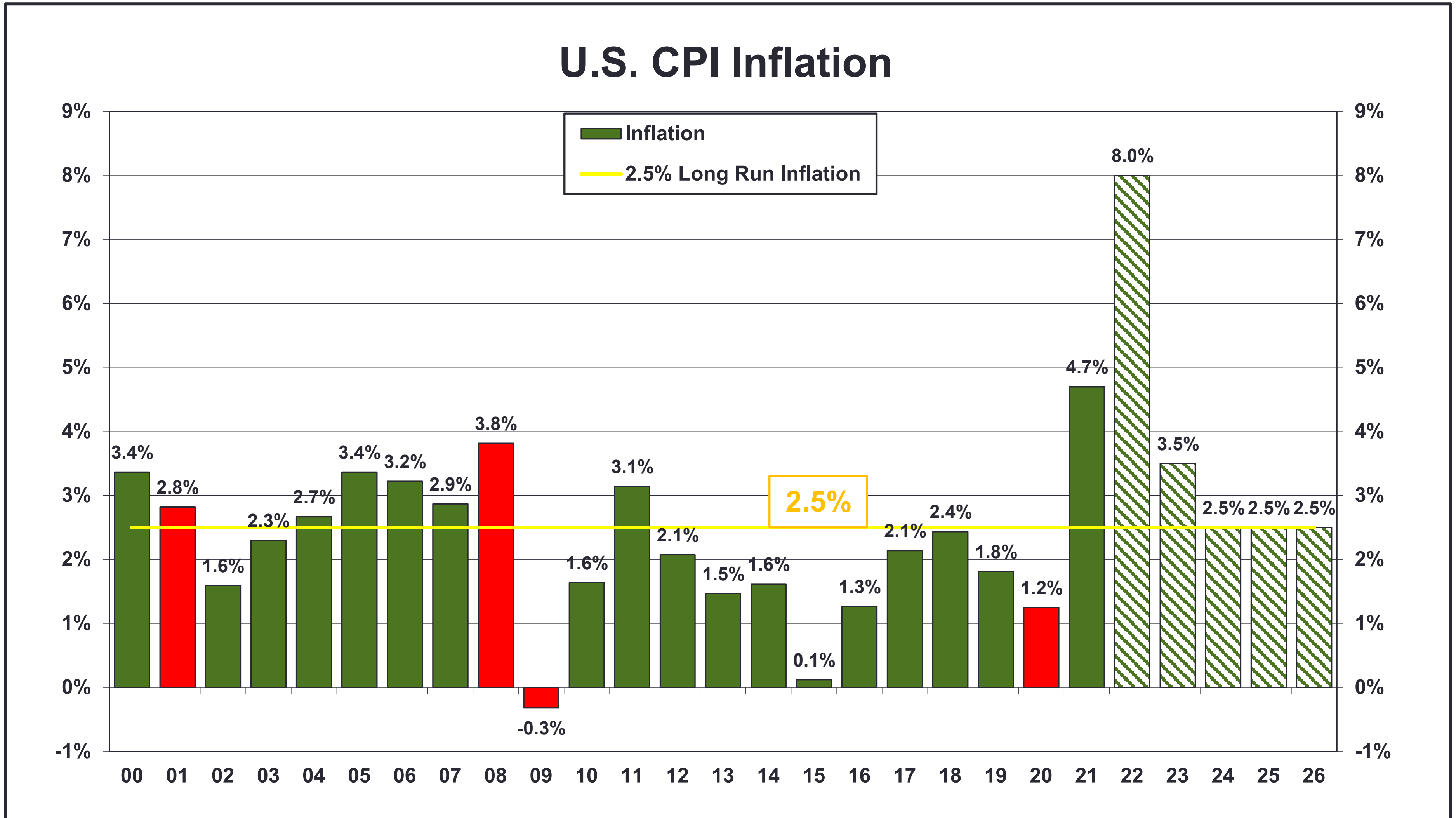
Higher Inflation Factors:

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:

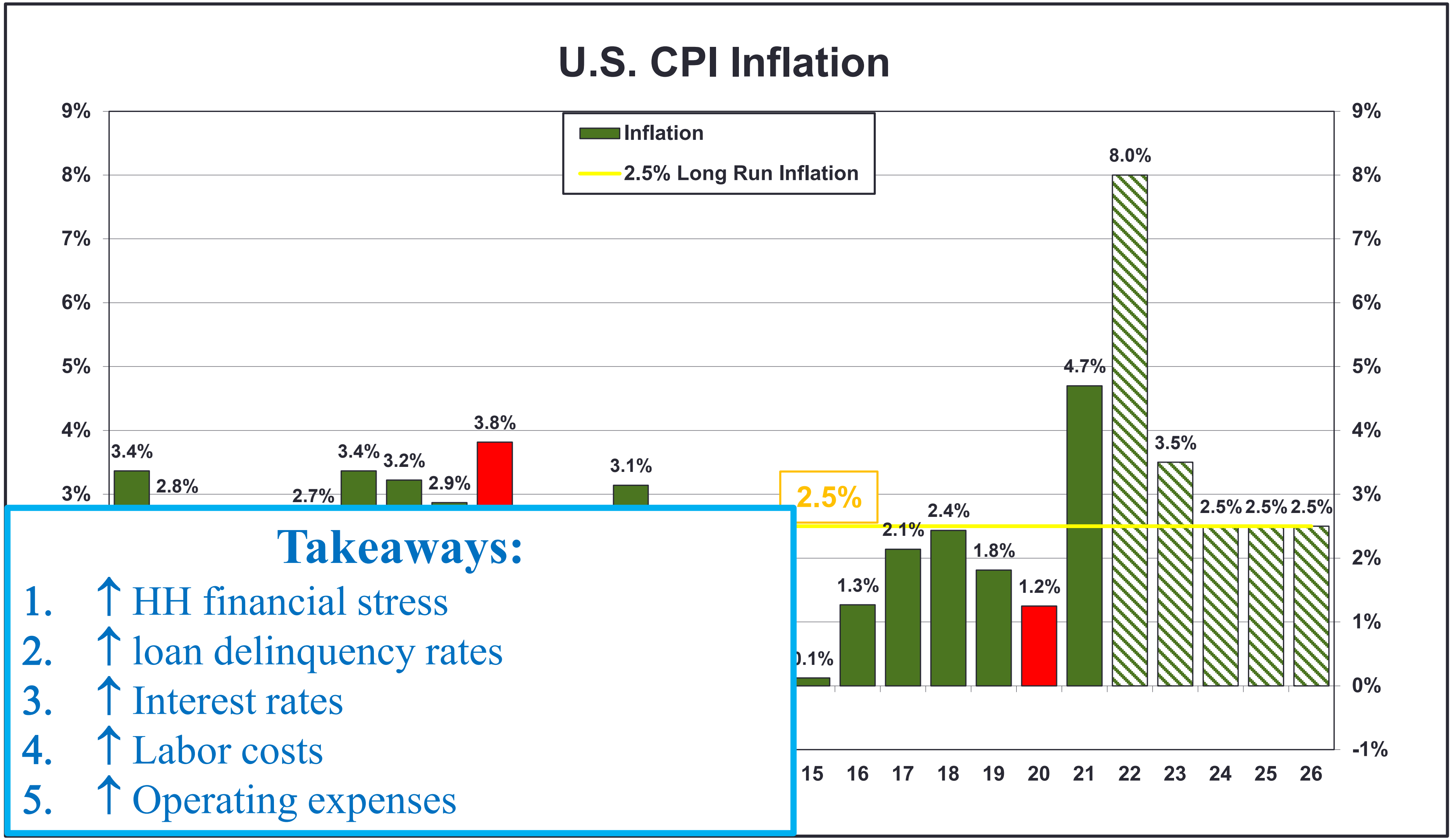
1. eCommerce is a powerful deflationary force
2. Rising competition from globalization
3. Rising productivity => falling costs per unit
4. Low population growth
5. Negative output gap and excess production capacity
6. Excess supply of labor

Inflation Above Target Until 2024



Source: Department of Commerce

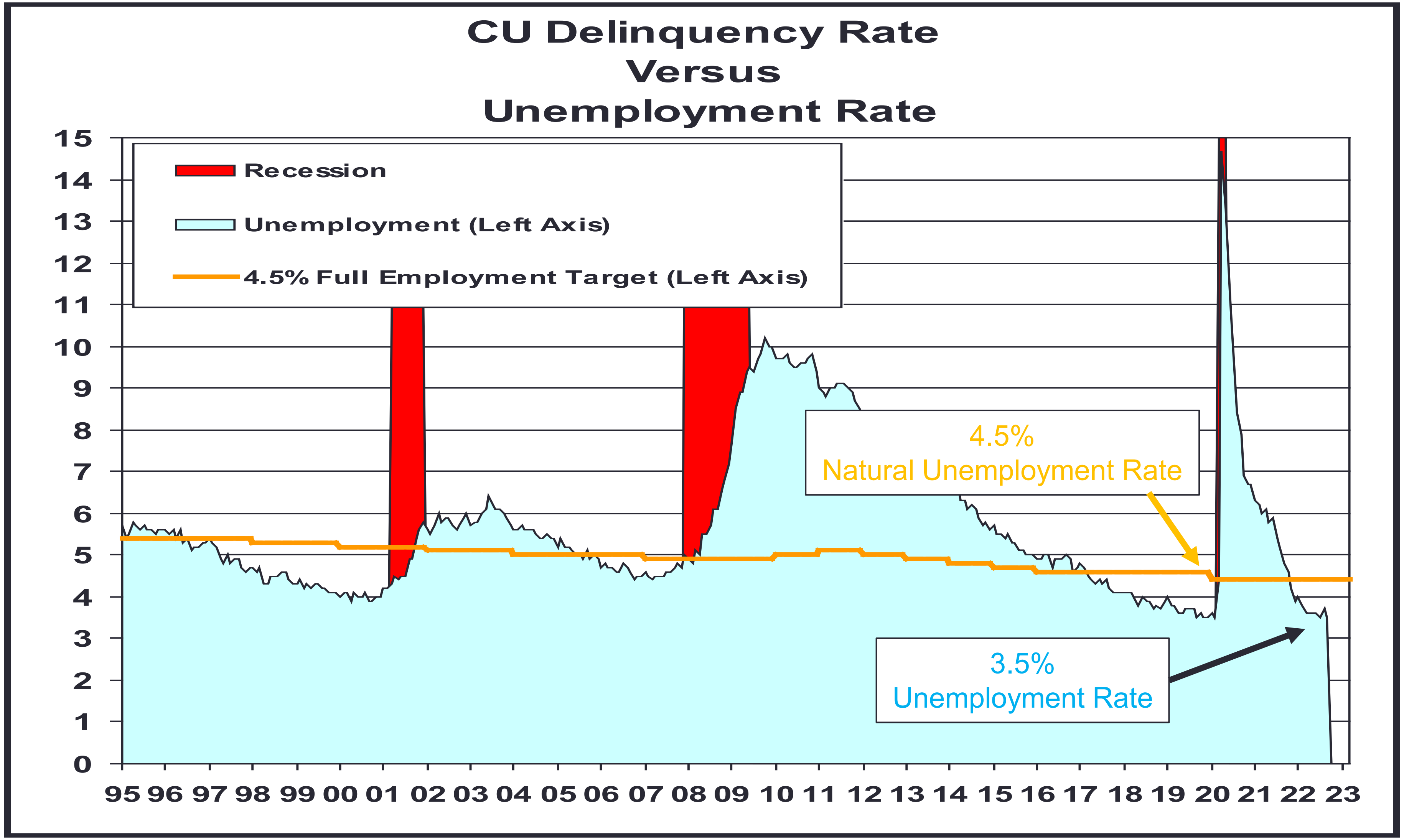
Inflation Above Target Until 2024



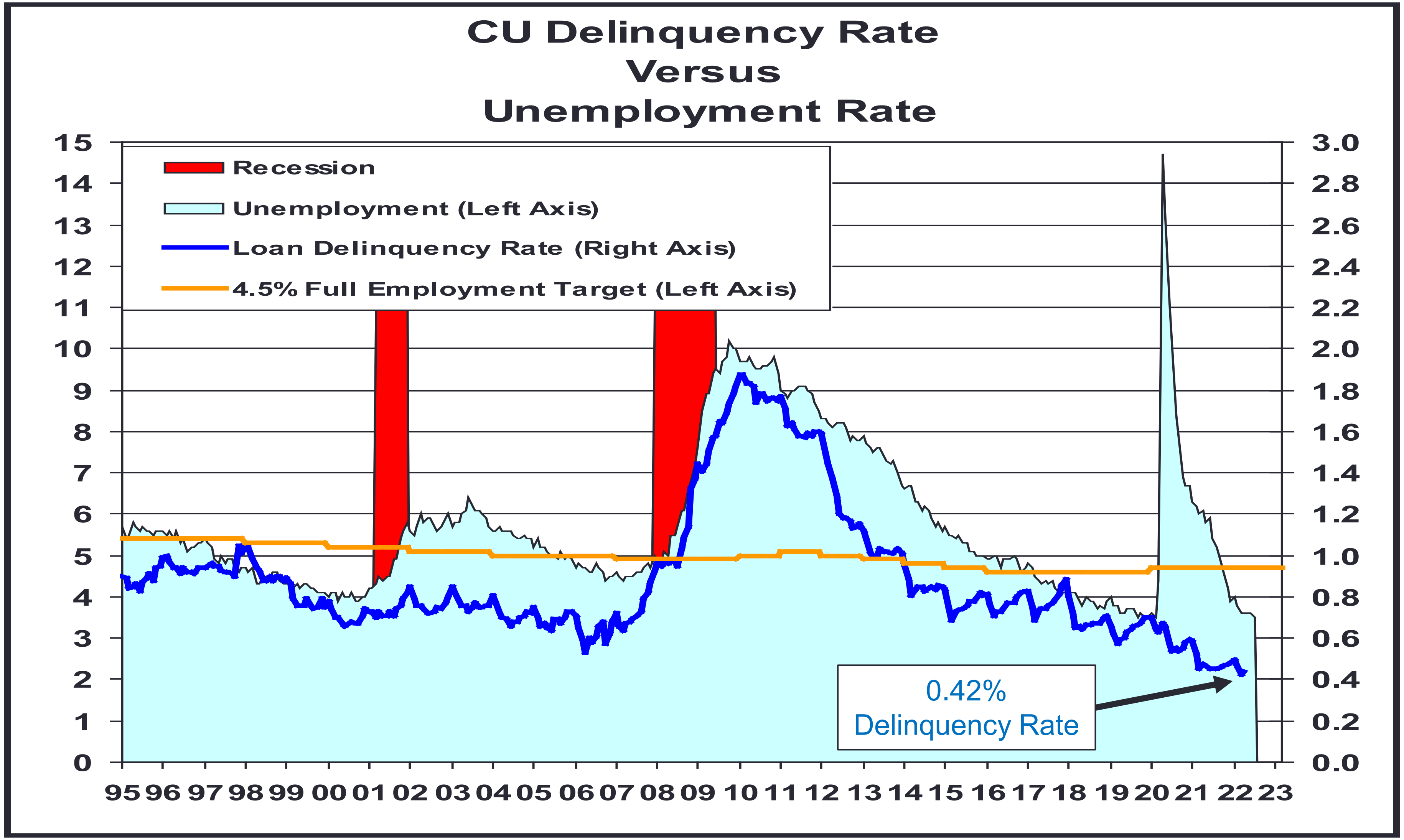
Takeaways:

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

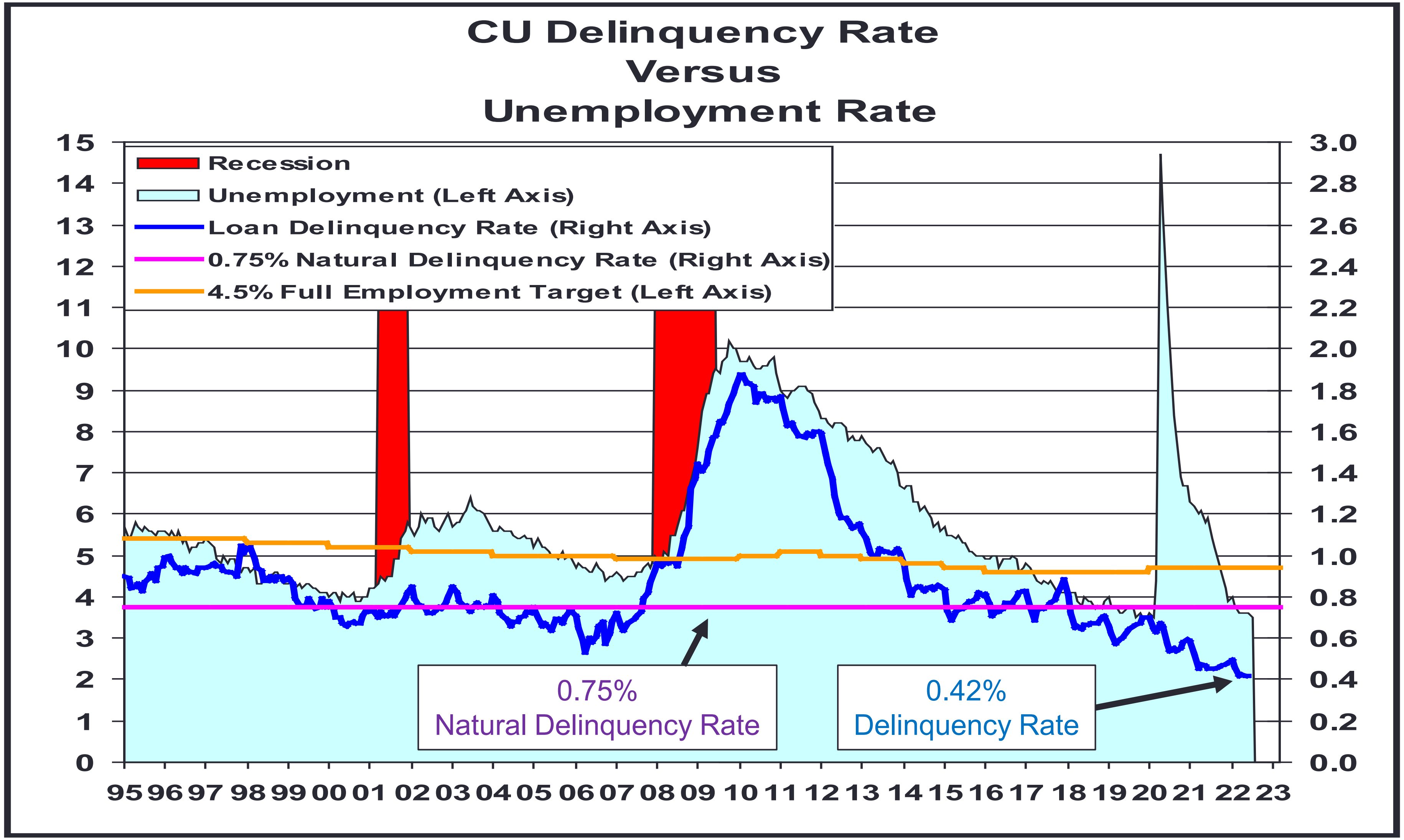
Unemployment Rate Below Natural Unemployment Rate



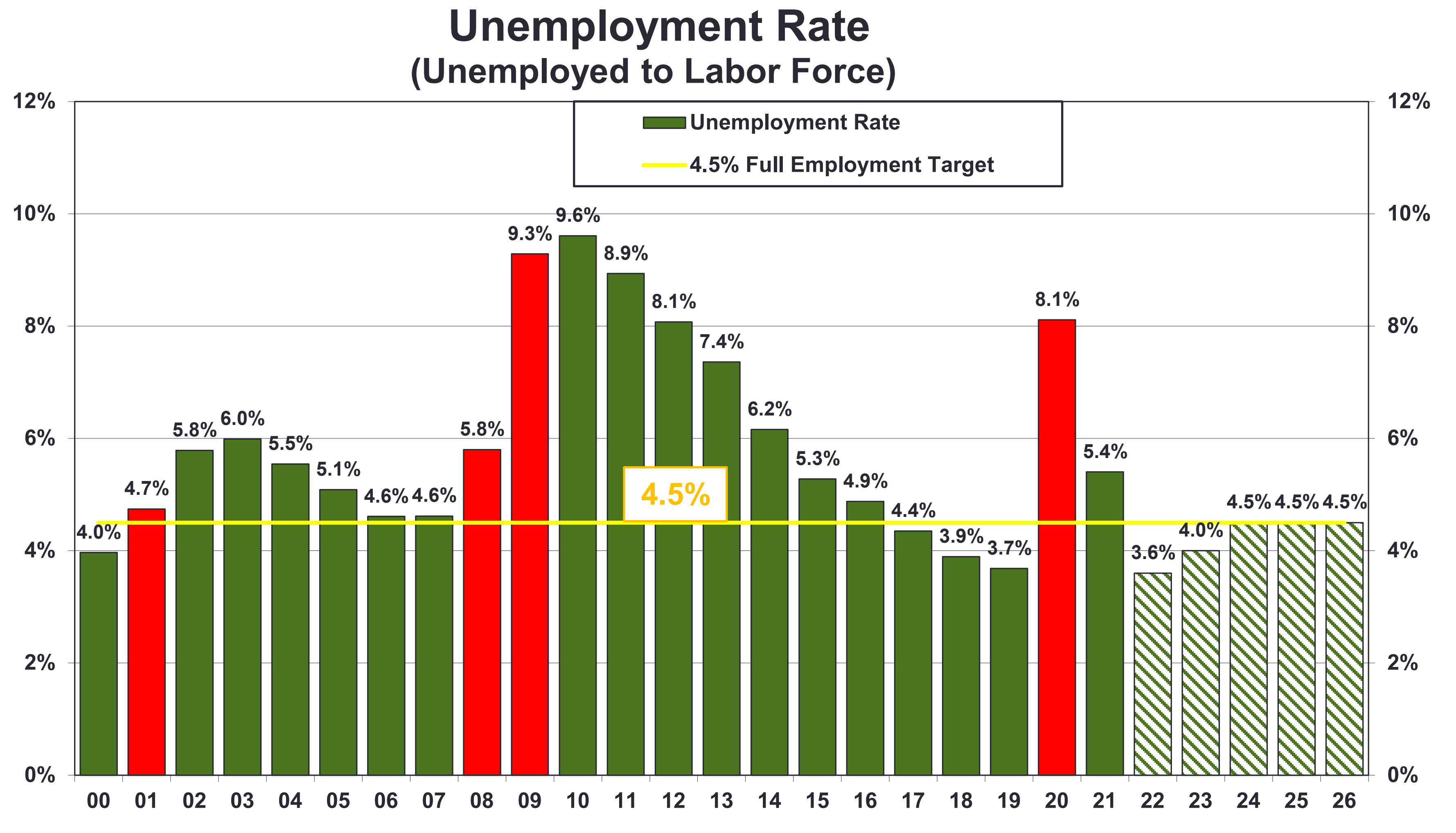
CU Loan Delinquency Rates are Low but Heading Up



CU Loan Delinquency Rates are Low but Heading Up

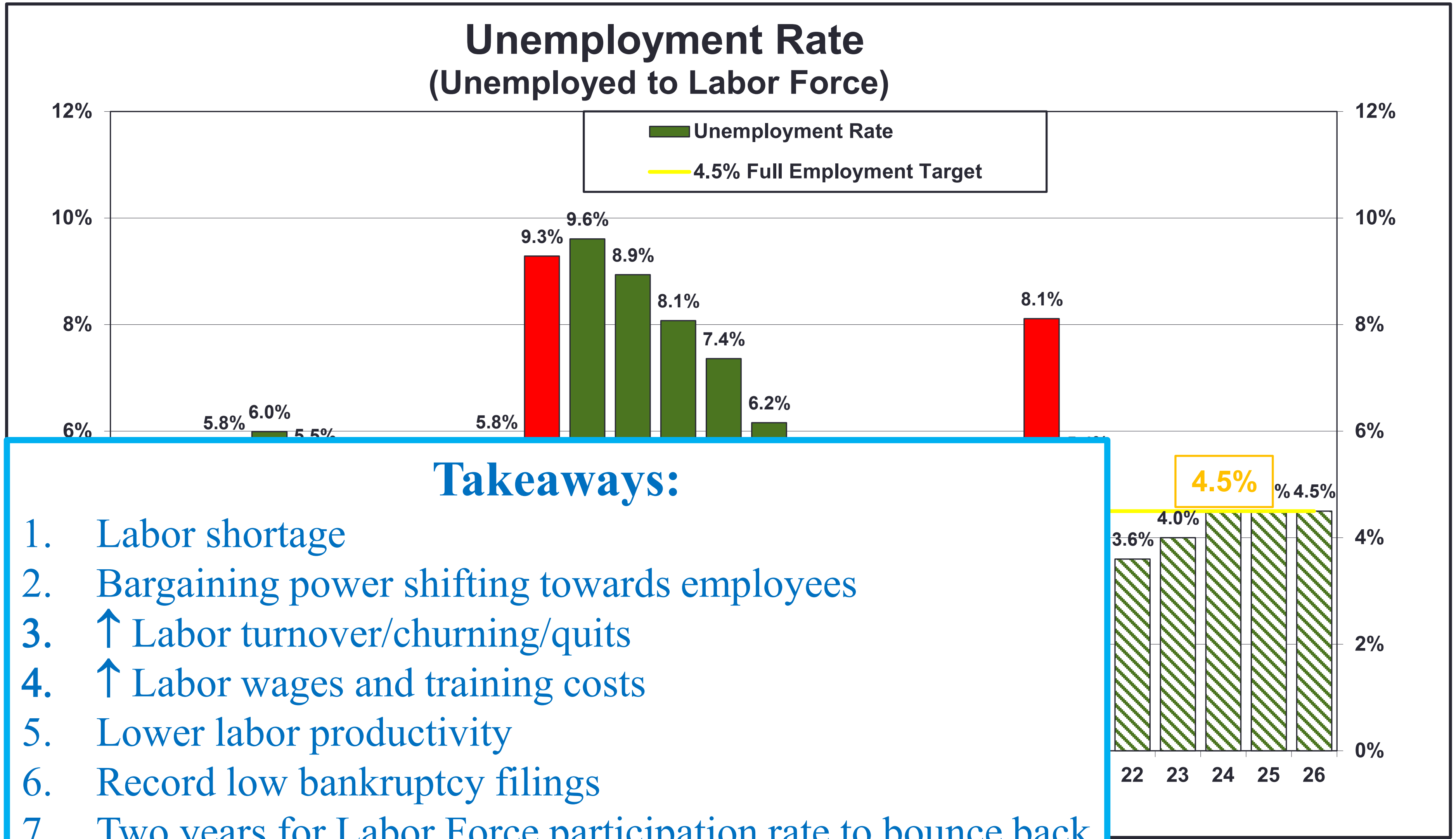


Unemployment Rate Below Normal for Next 2 Years



Source: Department of Commerce

Unemployment Rate Below Normal for Next 2 Years



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. Record low bankruptcy filings
7. Two years for Labor Force participation rate to bounce back

What is the most important price in any economy?

What is the most important price in any economy?

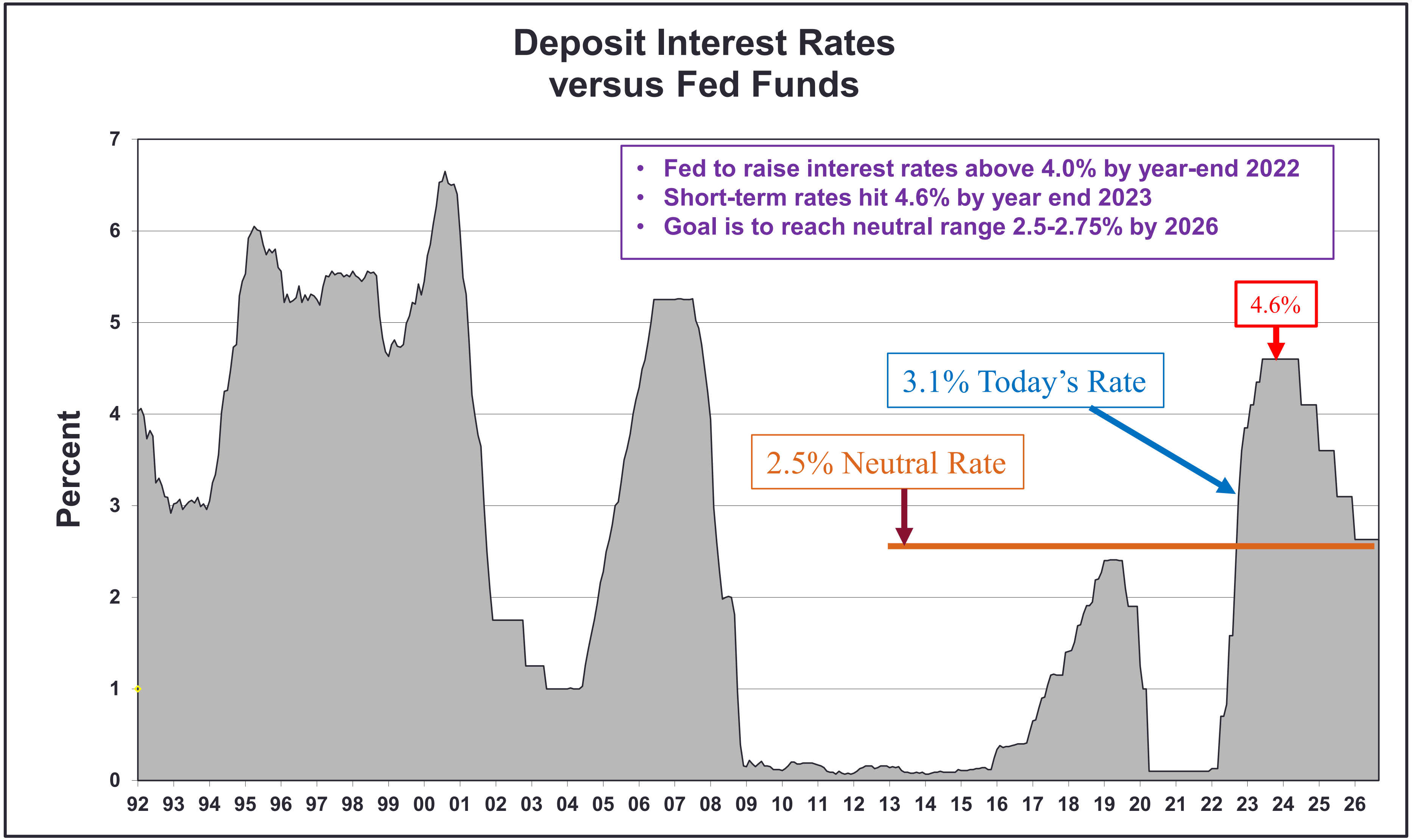
The Price of Money

What is the most important price in any economy?

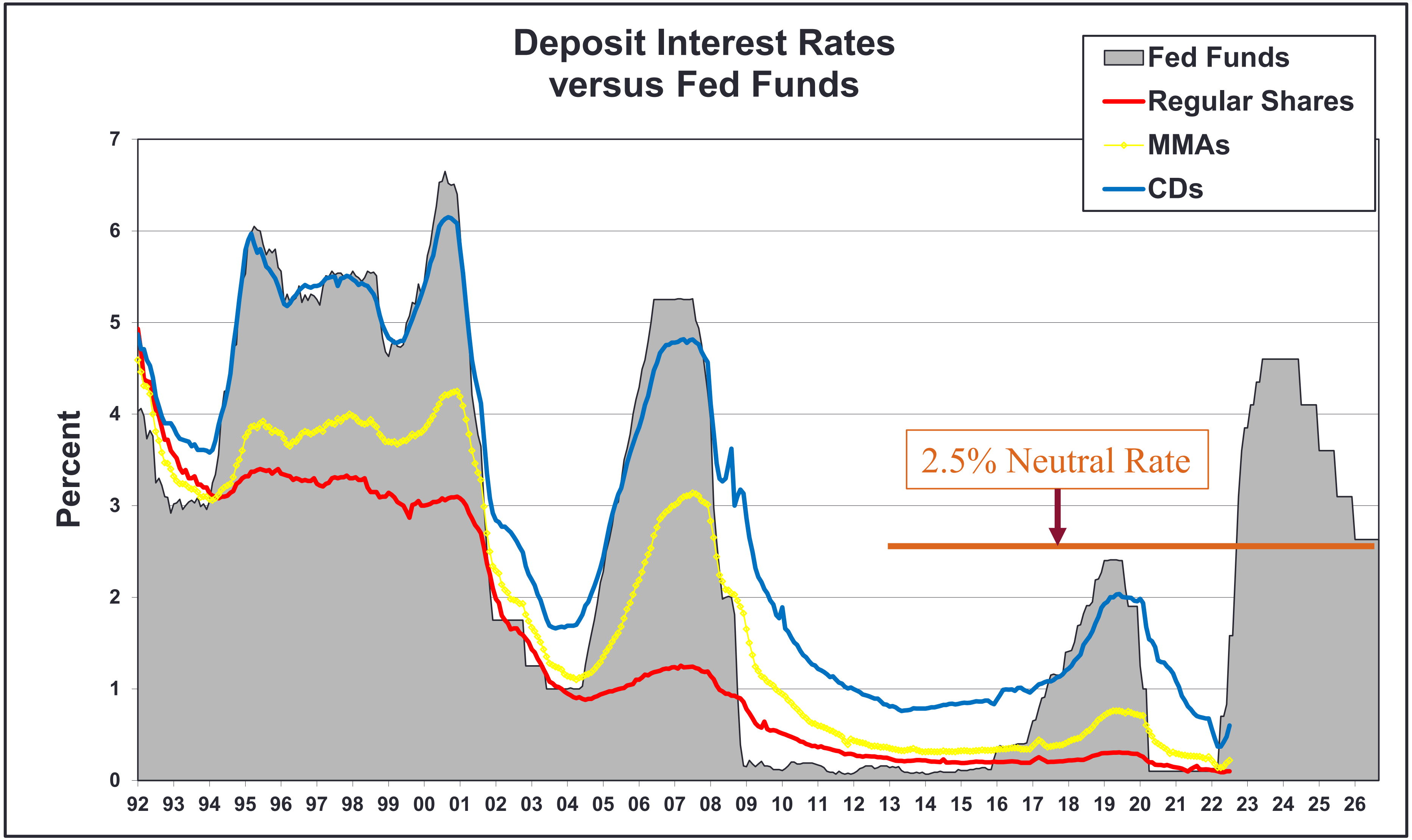
The Price of Money

Interest Rates

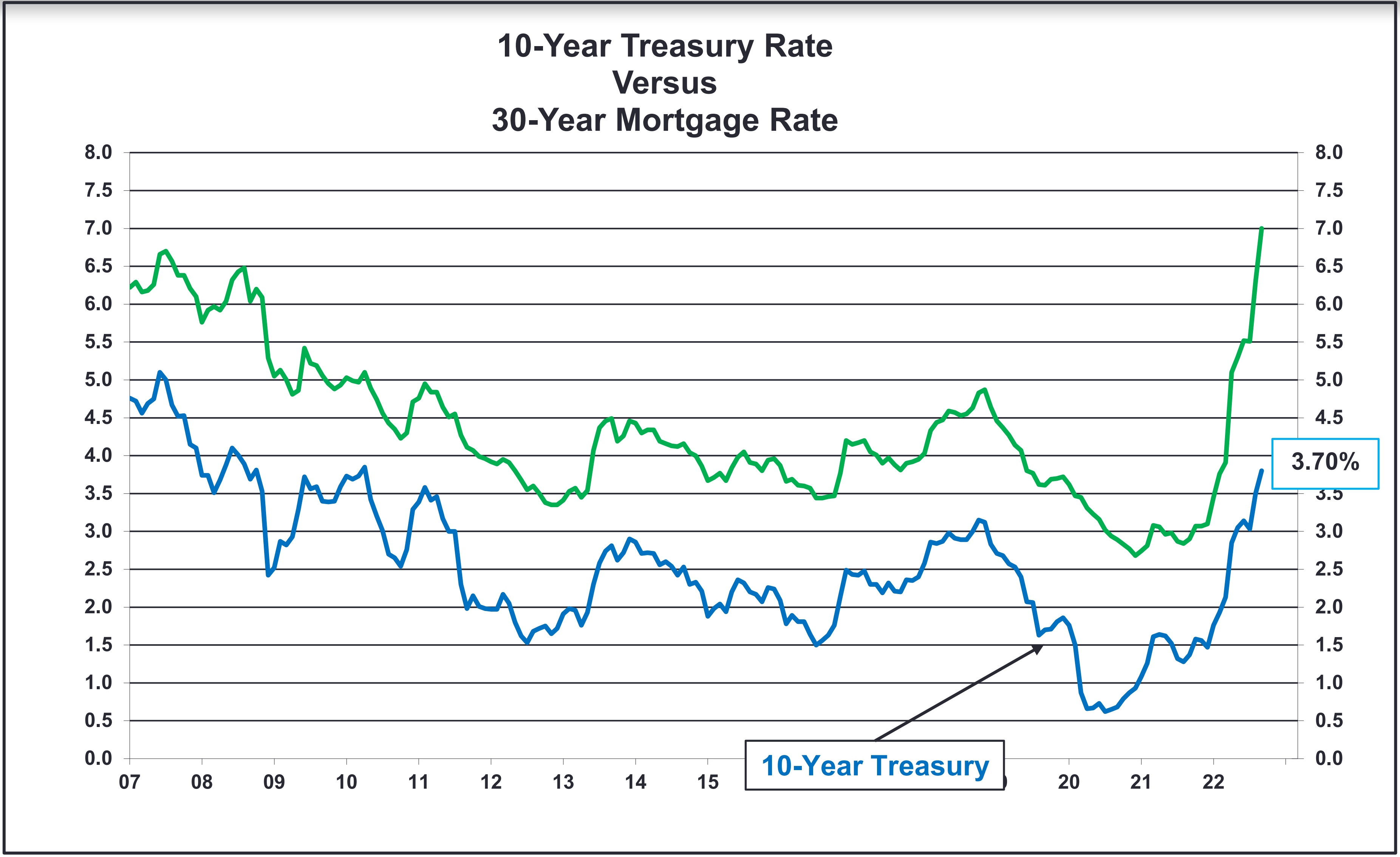
Rising Fed Funds Interest Rate and Deposit Pricing



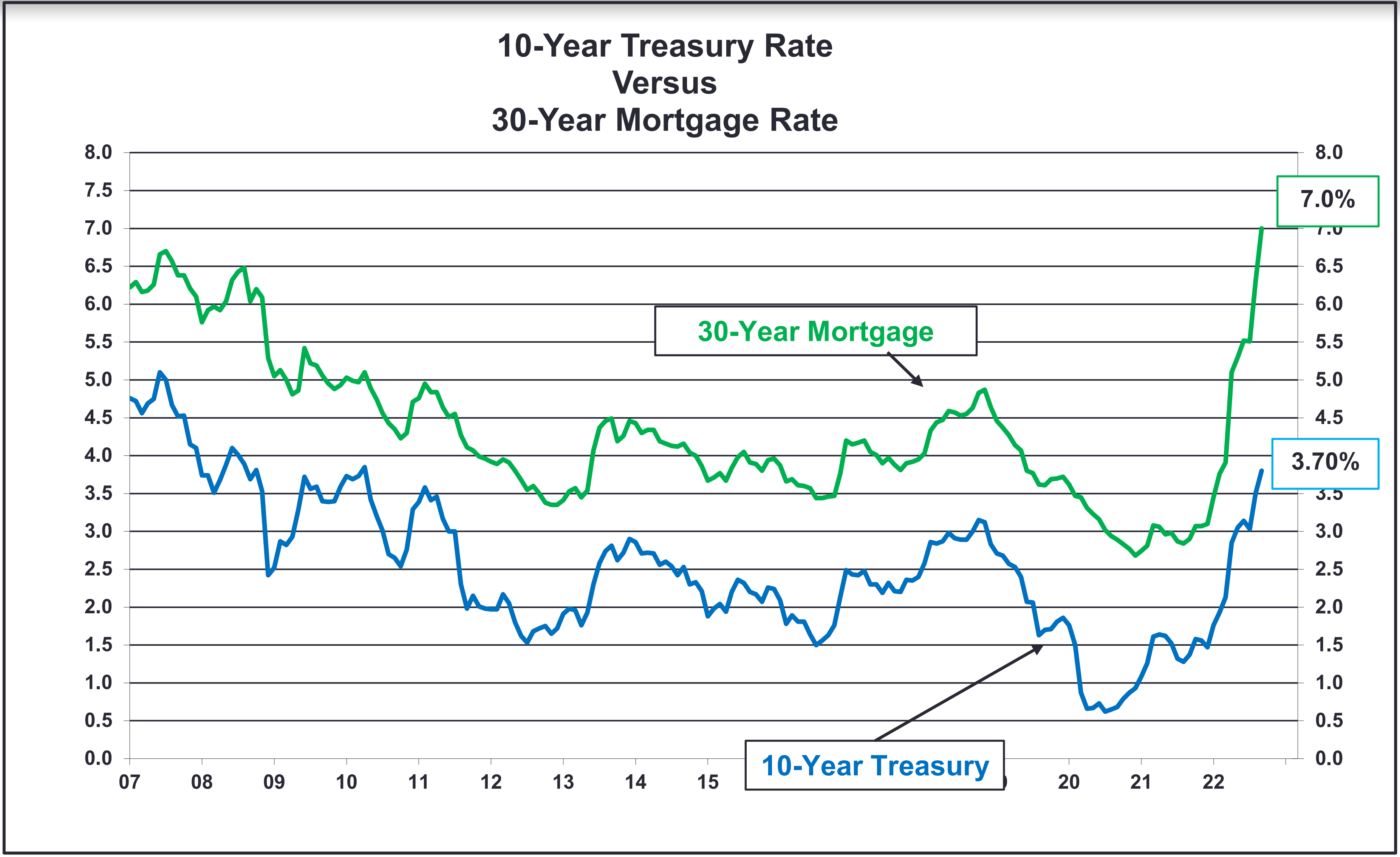
Rising Fed Funds Interest Rate and Deposit Pricing



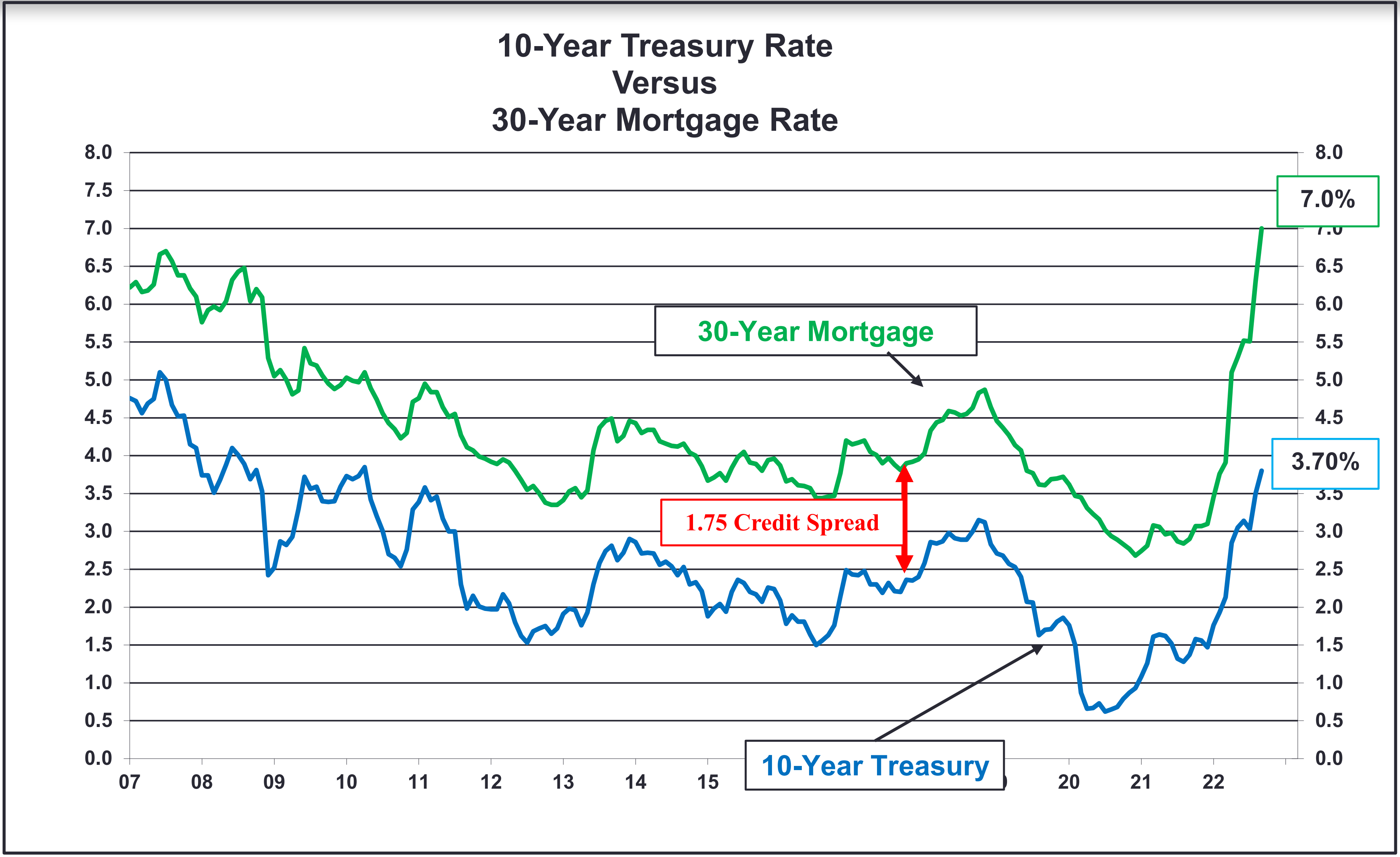
Rising Real Interest Rates, and Rising Inflation Expectations will Push Up Nominal Interest Rates



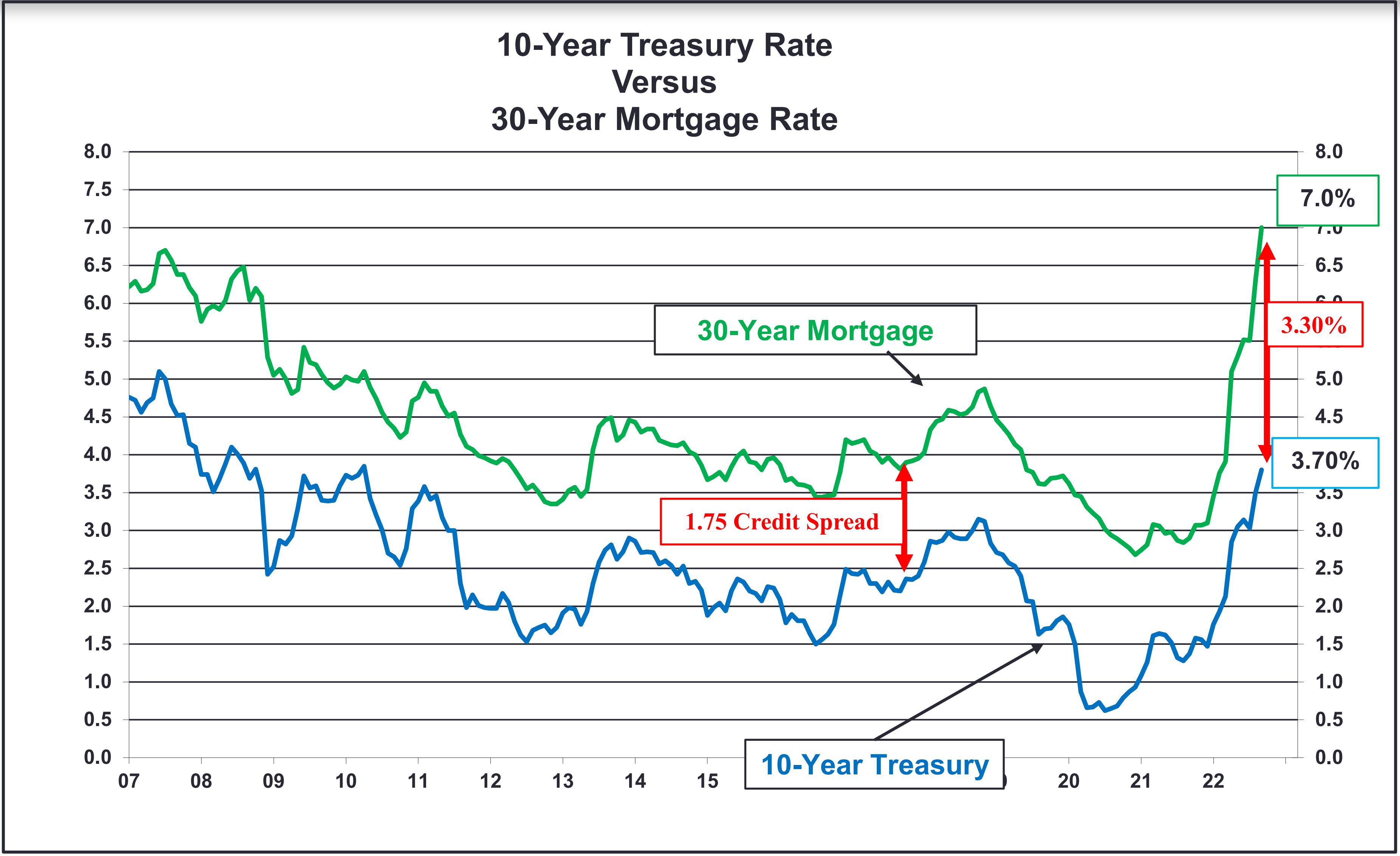
Rising Real Interest Rates, and Rising Inflation Expectations will Push Up Nominal Interest Rates



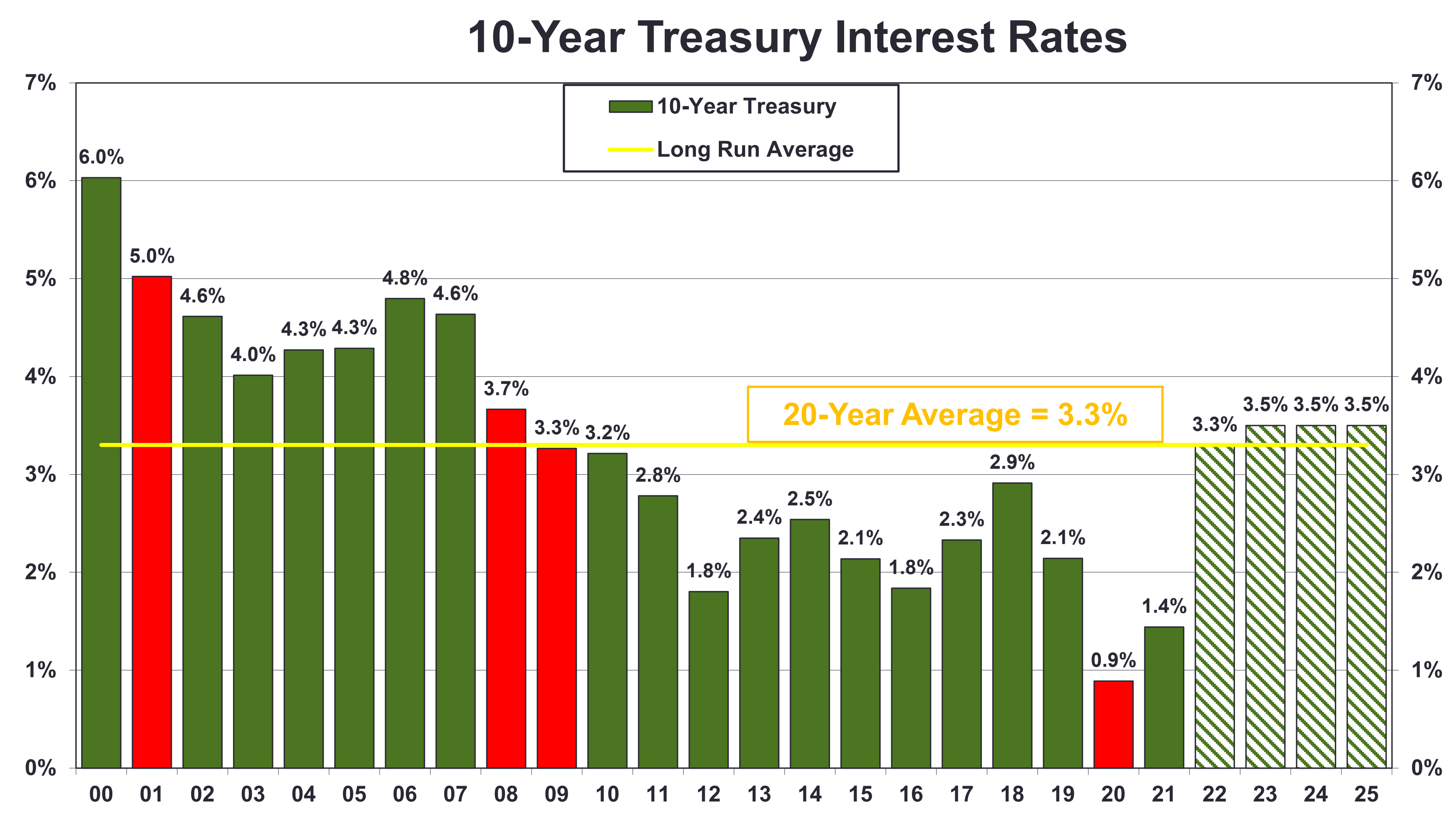
Rising Real Interest Rates, and Rising Inflation Expectations will Push Up Nominal Interest Rates



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

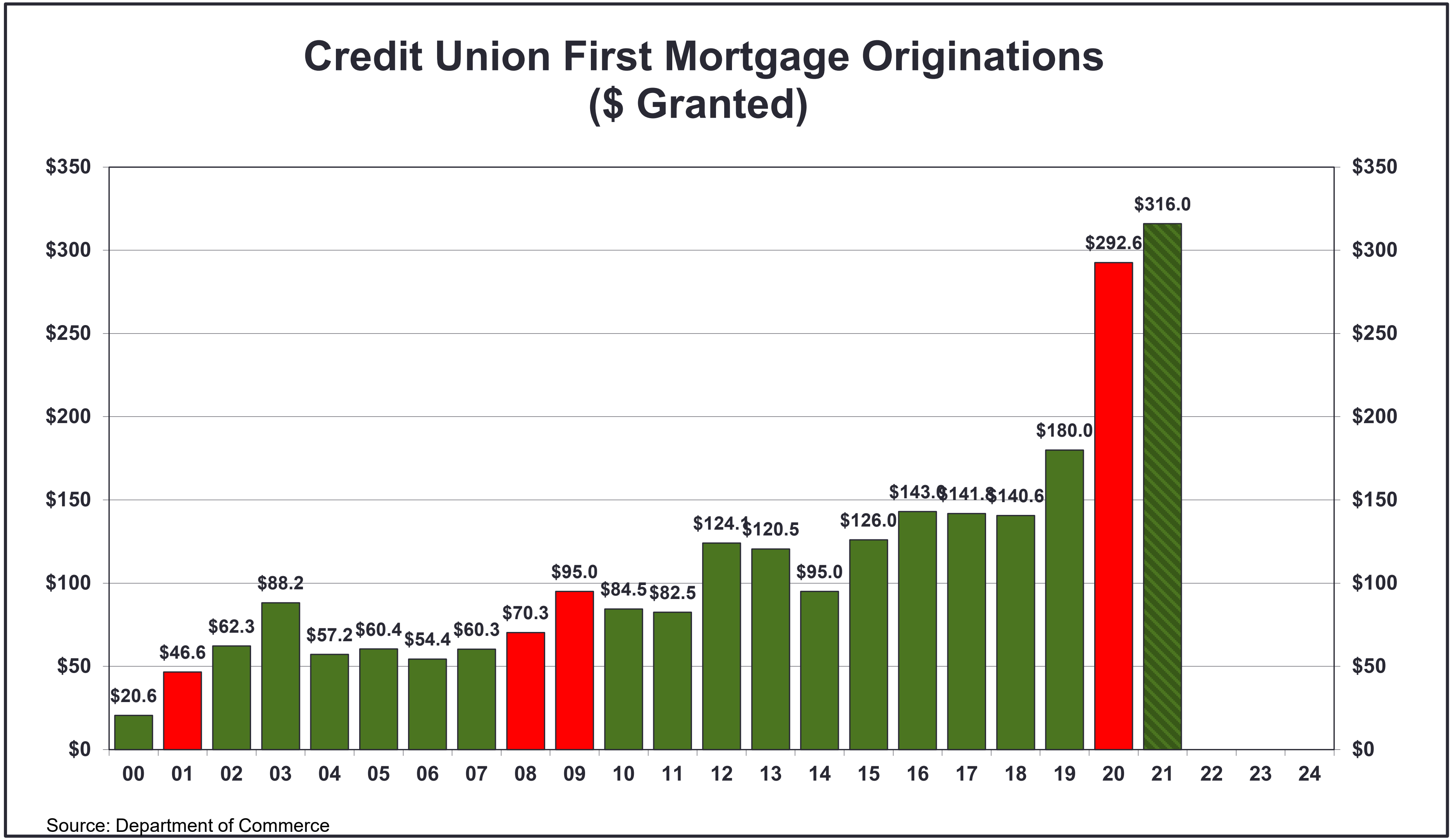


Rising Long-term Interest Rates



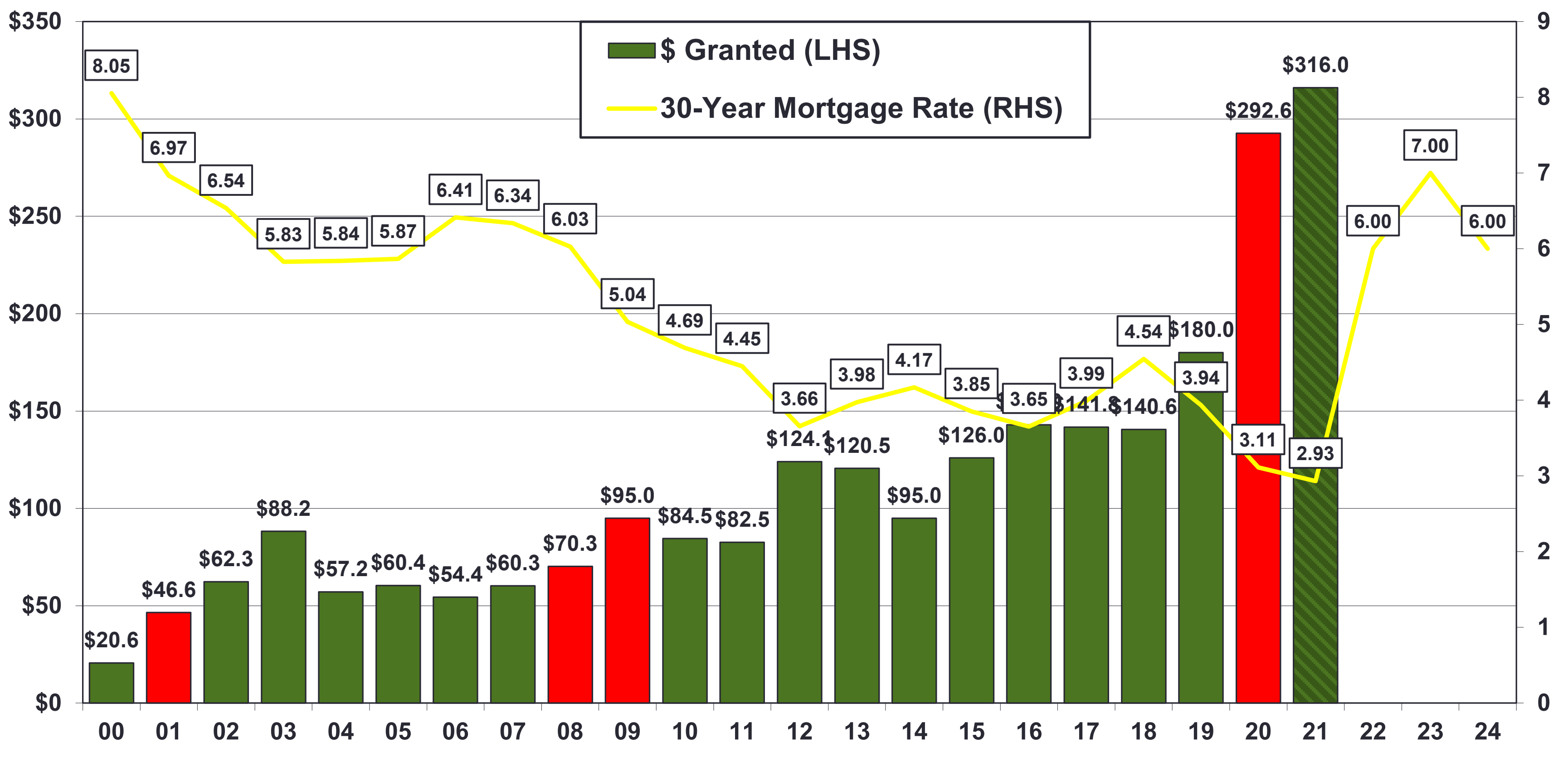
Source: Department of Commerce

First Mortgage Originations



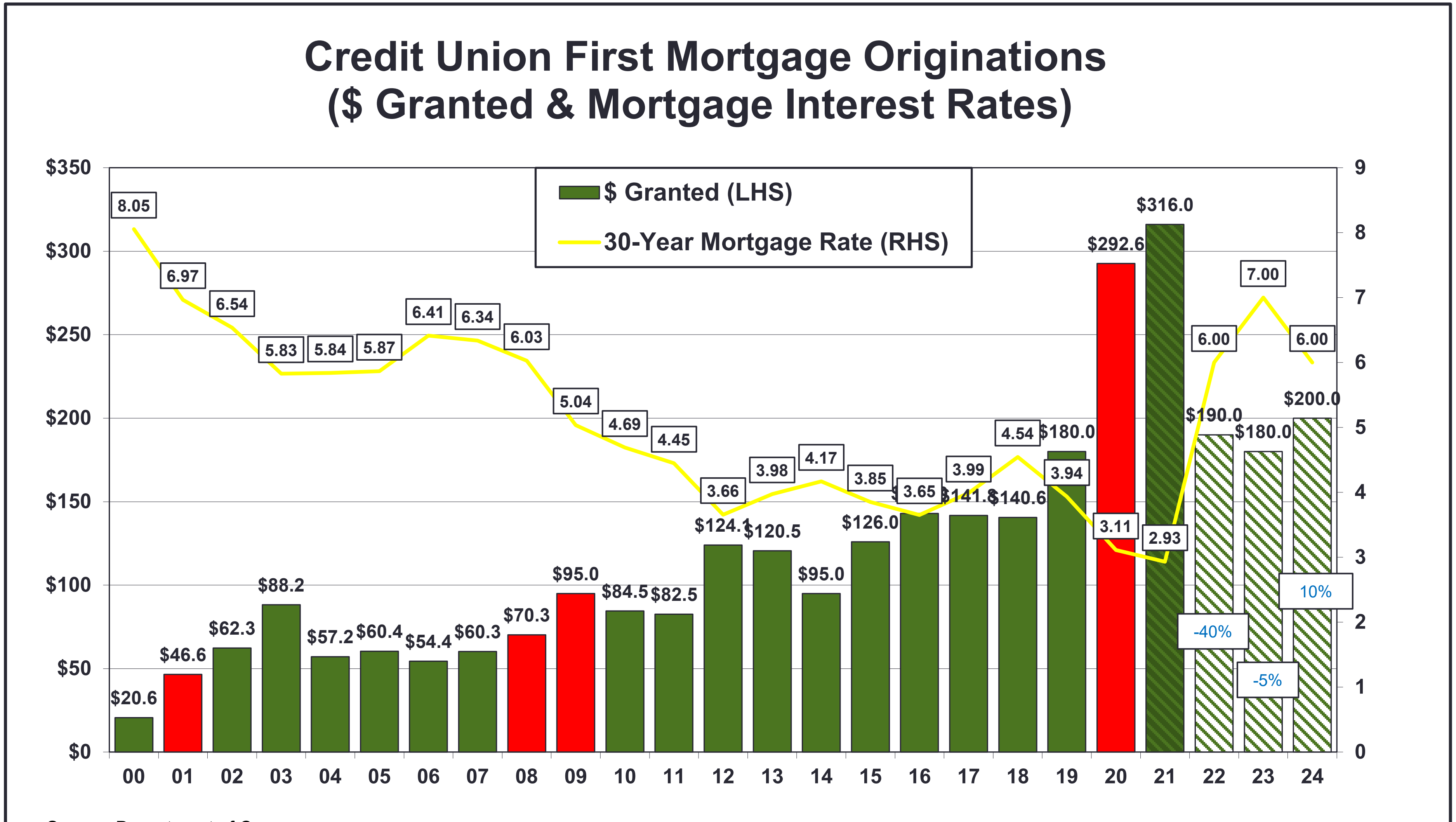
First Mortgage Originations

Credit Union First Mortgage Originations
($ Granted & Mortgage Interest Rates)

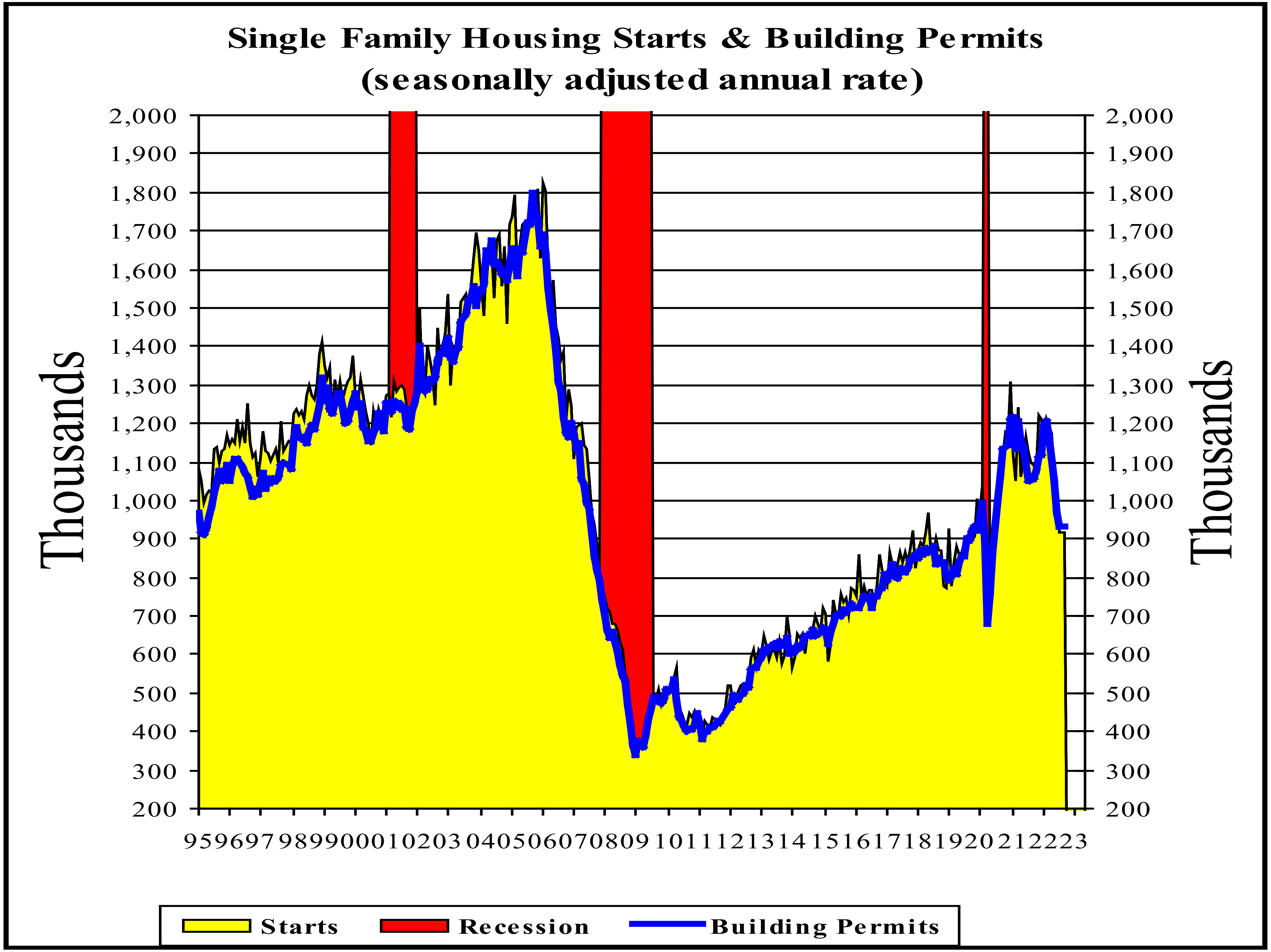


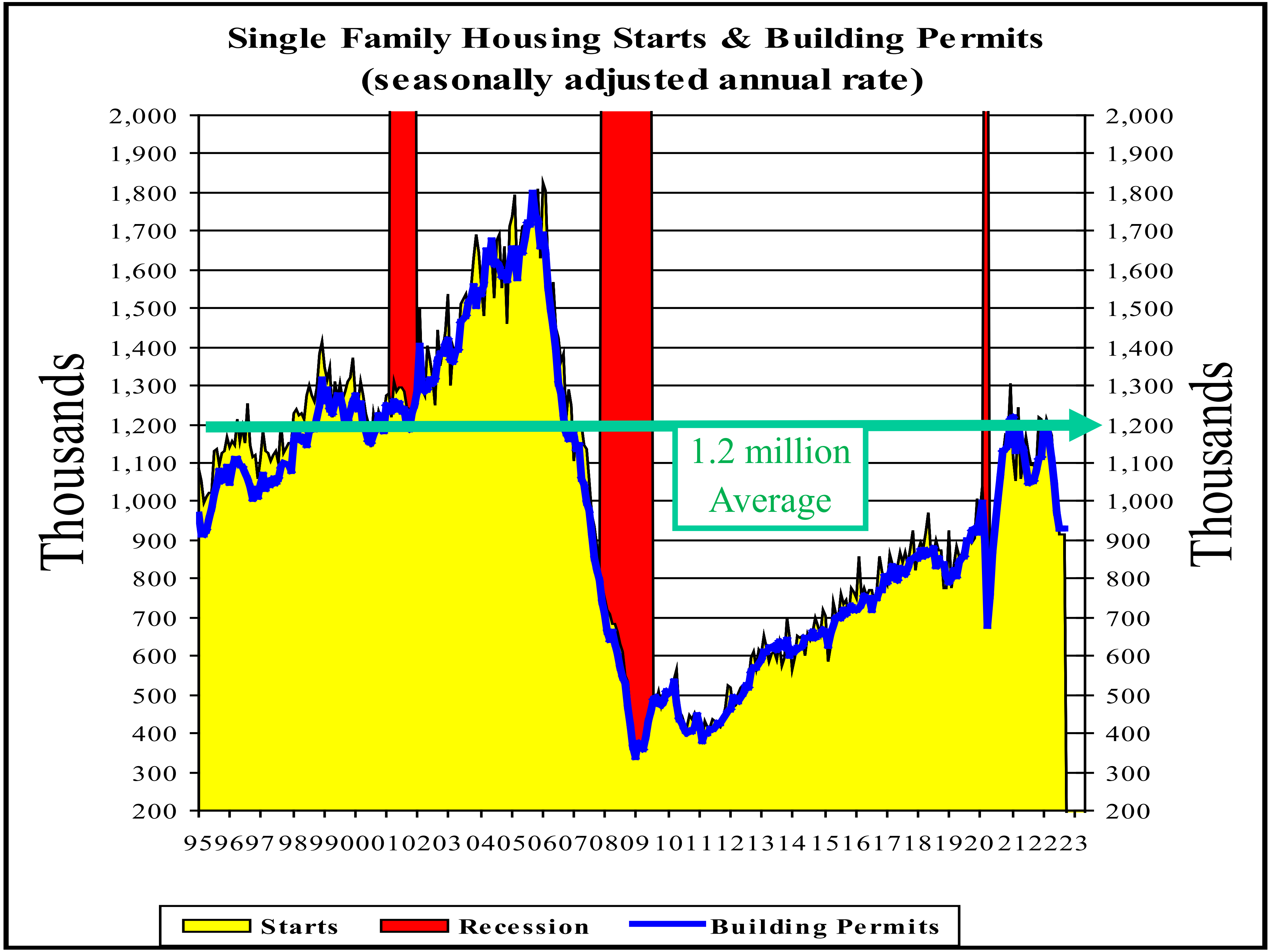
Source: Department of Commerce

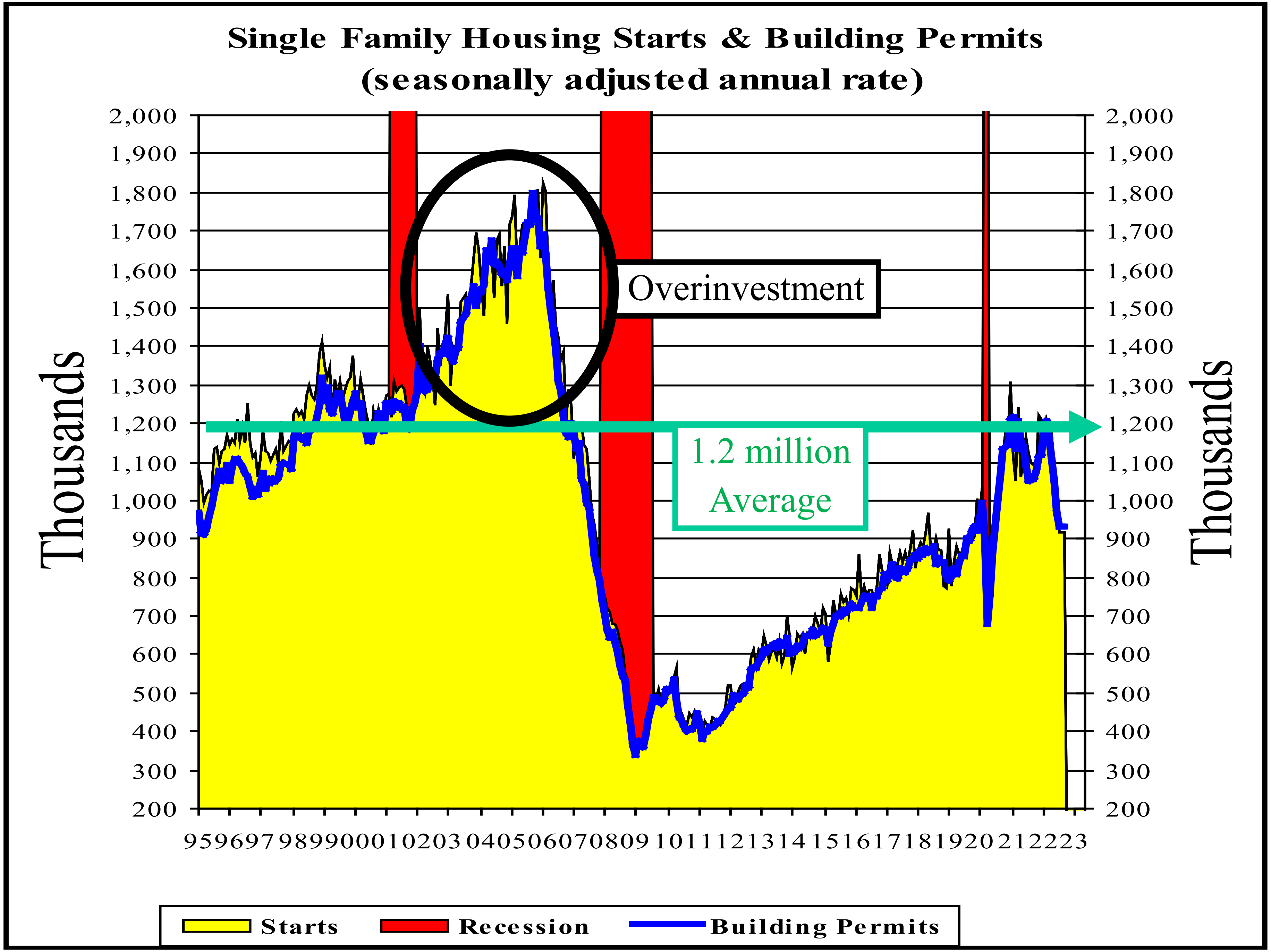
First Mortgage Originations



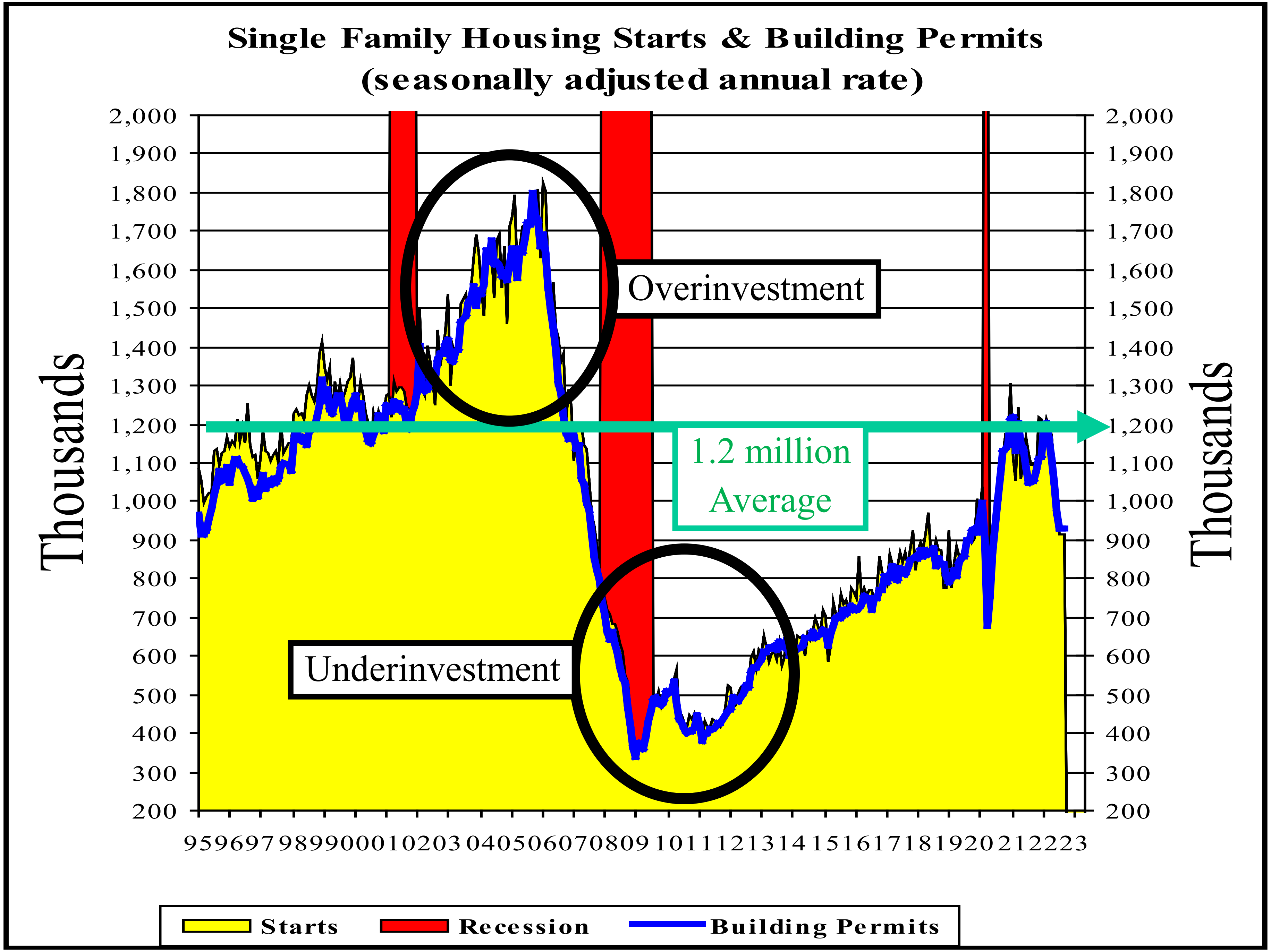
Source: Department of Commerce


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
Starts
Recession
Building Permits


Single Family Housing Starts & Building Permits
(seasonally adjusted annual rate)
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
Thousands
1.2 million
Average
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
Starts
Recession
Building Permits

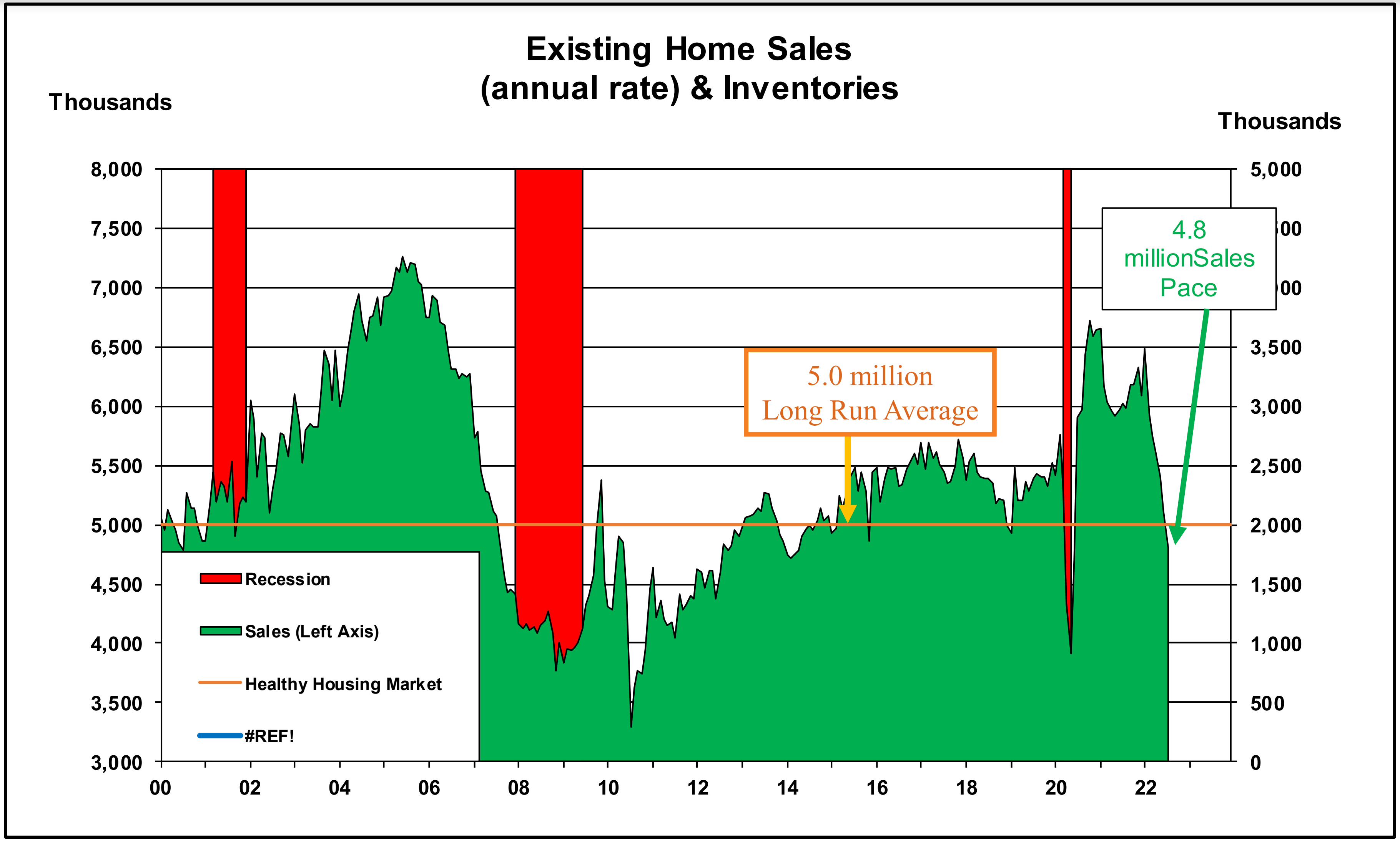


Single Family Housing Starts & Building Permits
(seasonally adjusted annual rate)
Thousands
Thousands
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
Overinvestment
1.2 million
Average
95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16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

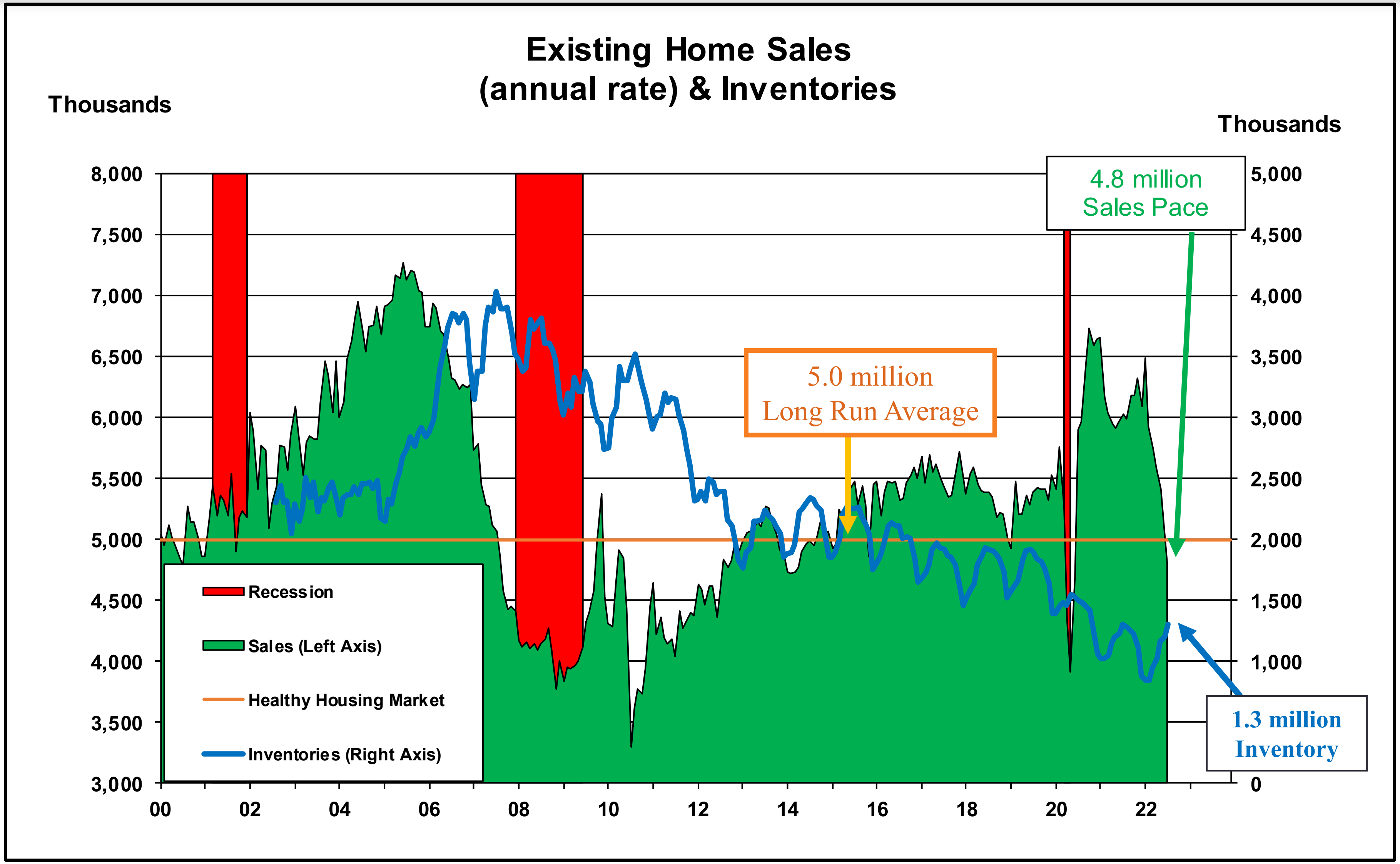


Single Family Housing Starts & Building Permits
(seasonally adjusted annual rate)
Thousands
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
Overinvestment
Underinvestment
1.2 million
Average
95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14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

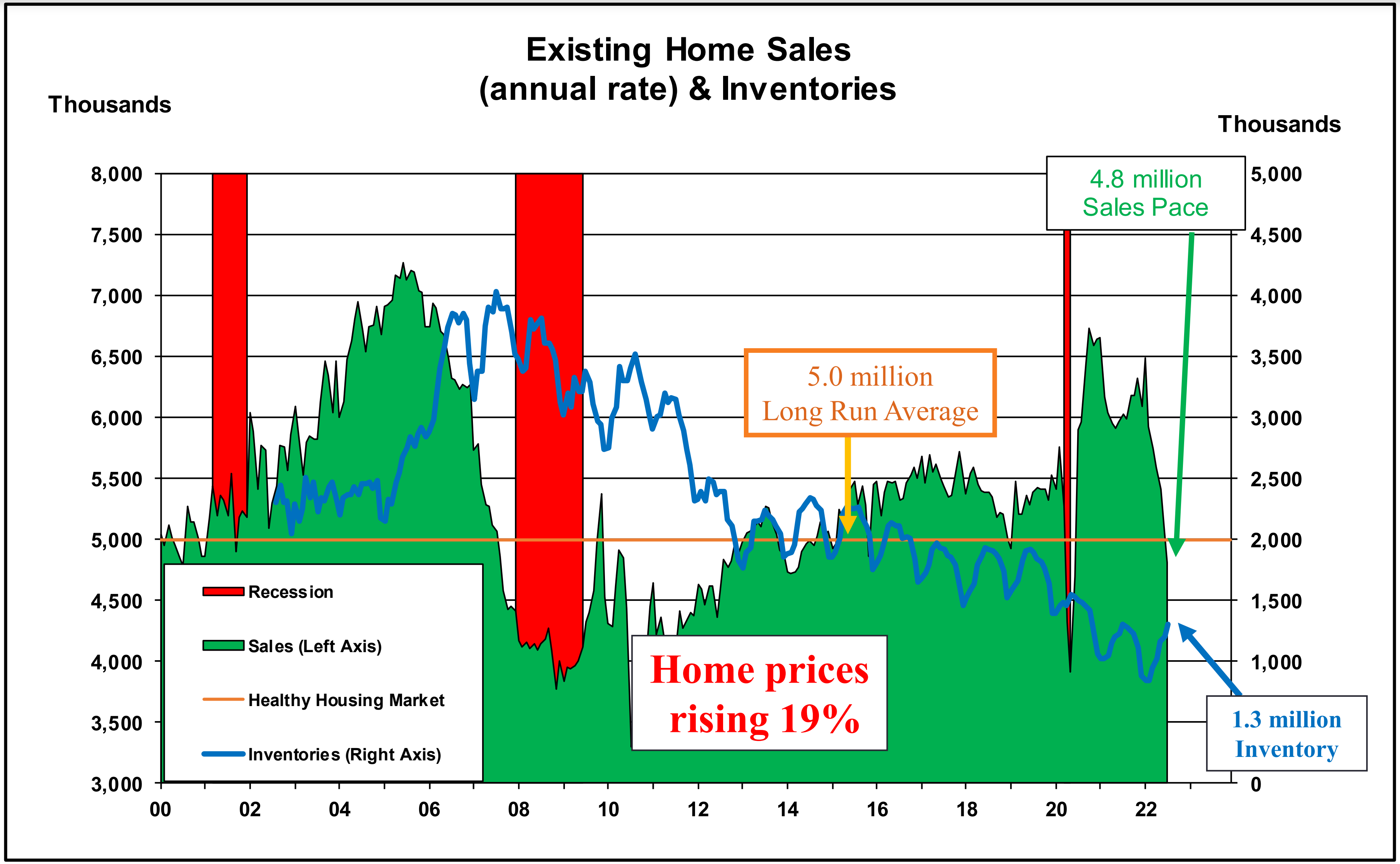
Home Sales are Strong, but Inventories are Low



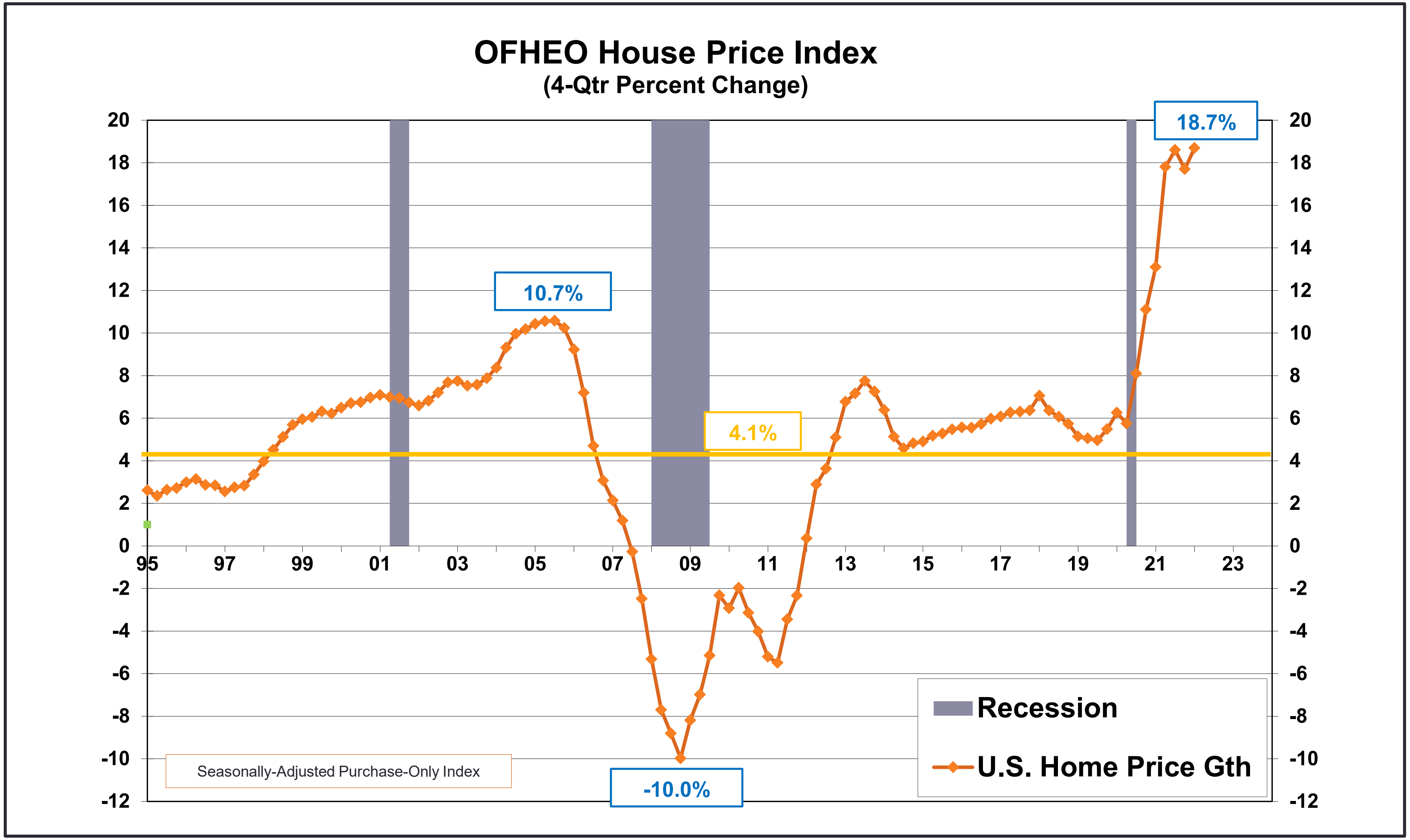
Home Sales are Strong, but Inventories are Low



Home Sales are Strong, but Inventories are Low

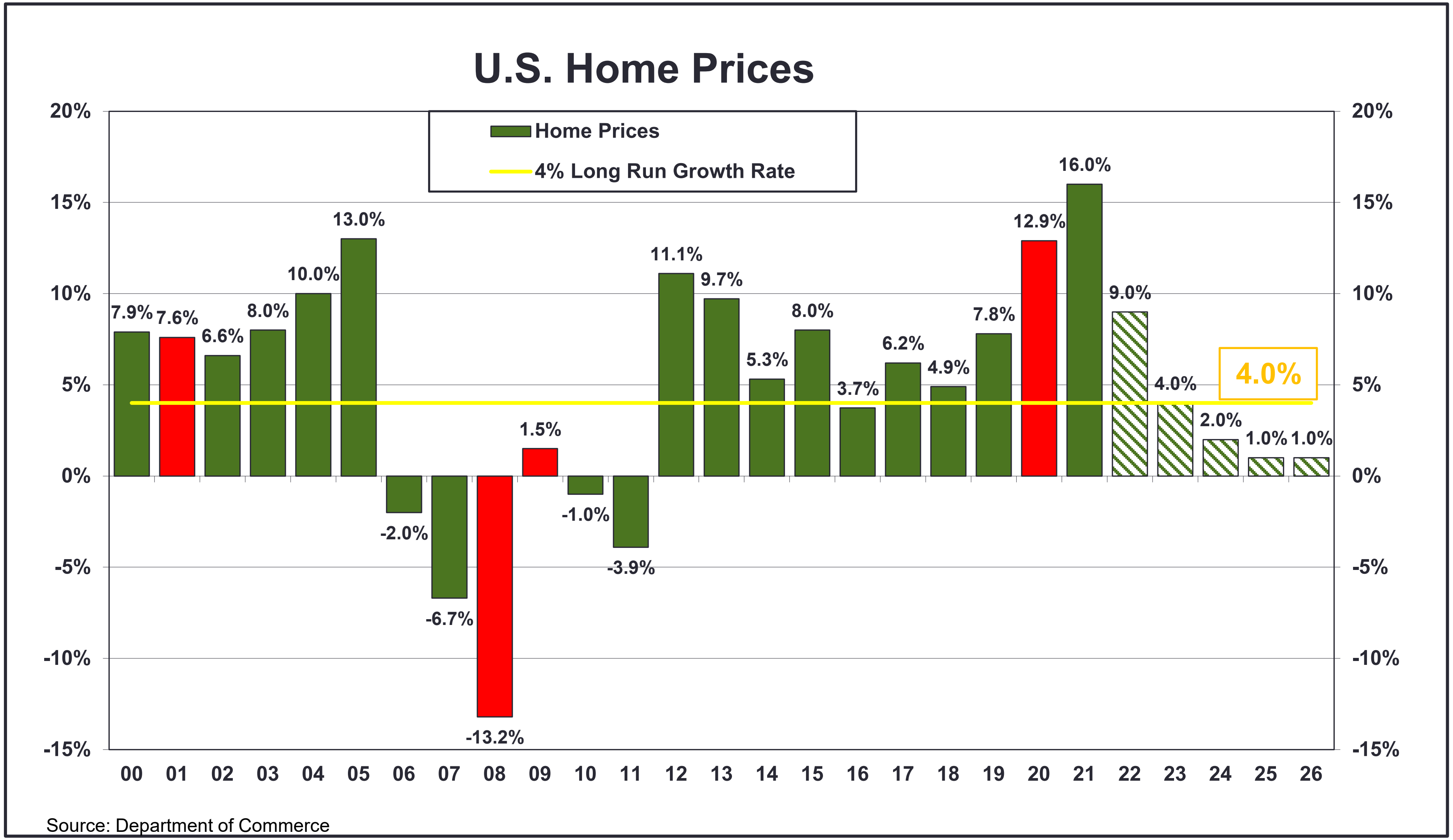


Home Price Appreciation are at Record Levels

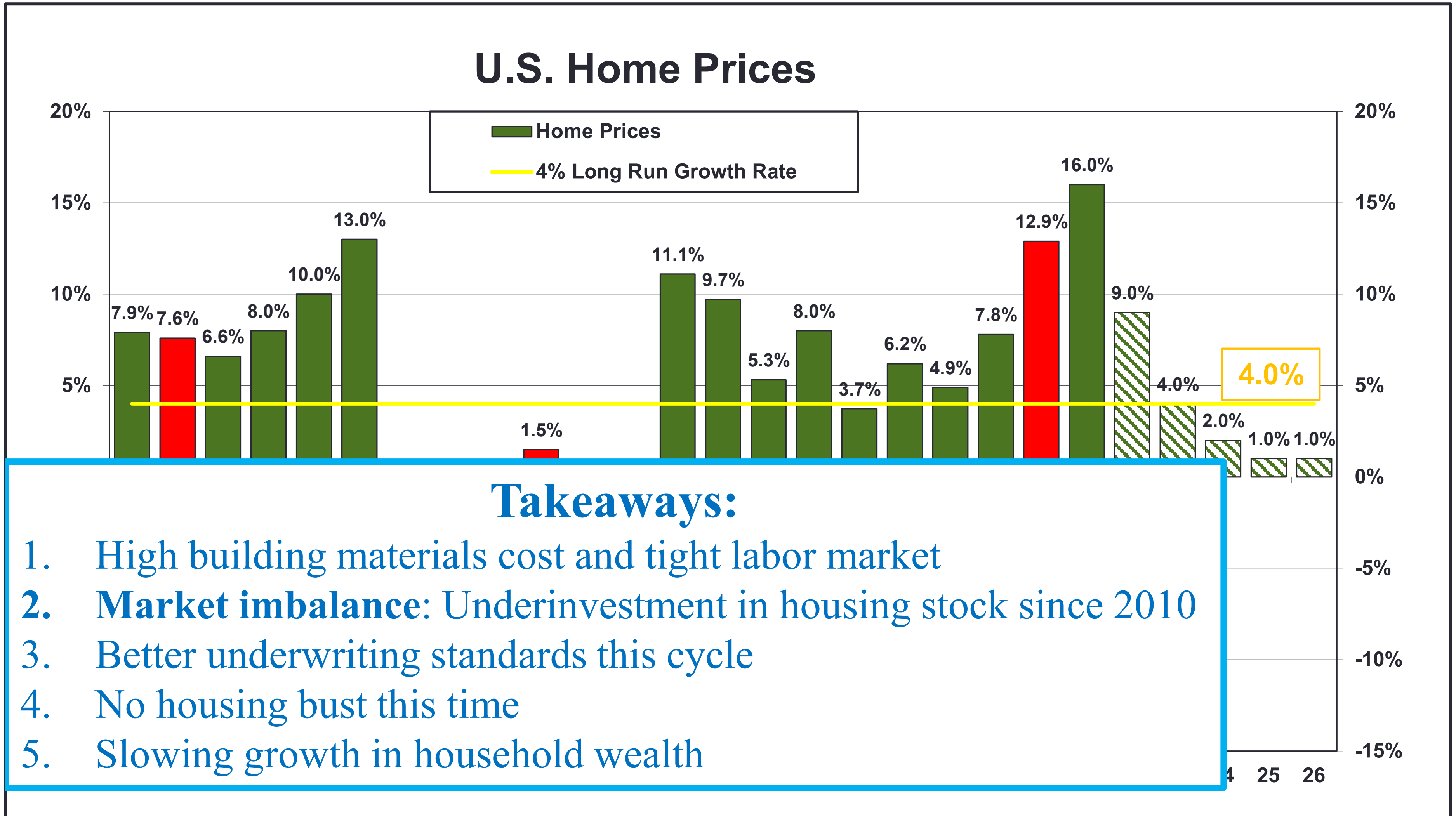


CUNA MUTUAL GROUP

Home Price Growth Rate Slowing



Home Price Growth Rate Slowing

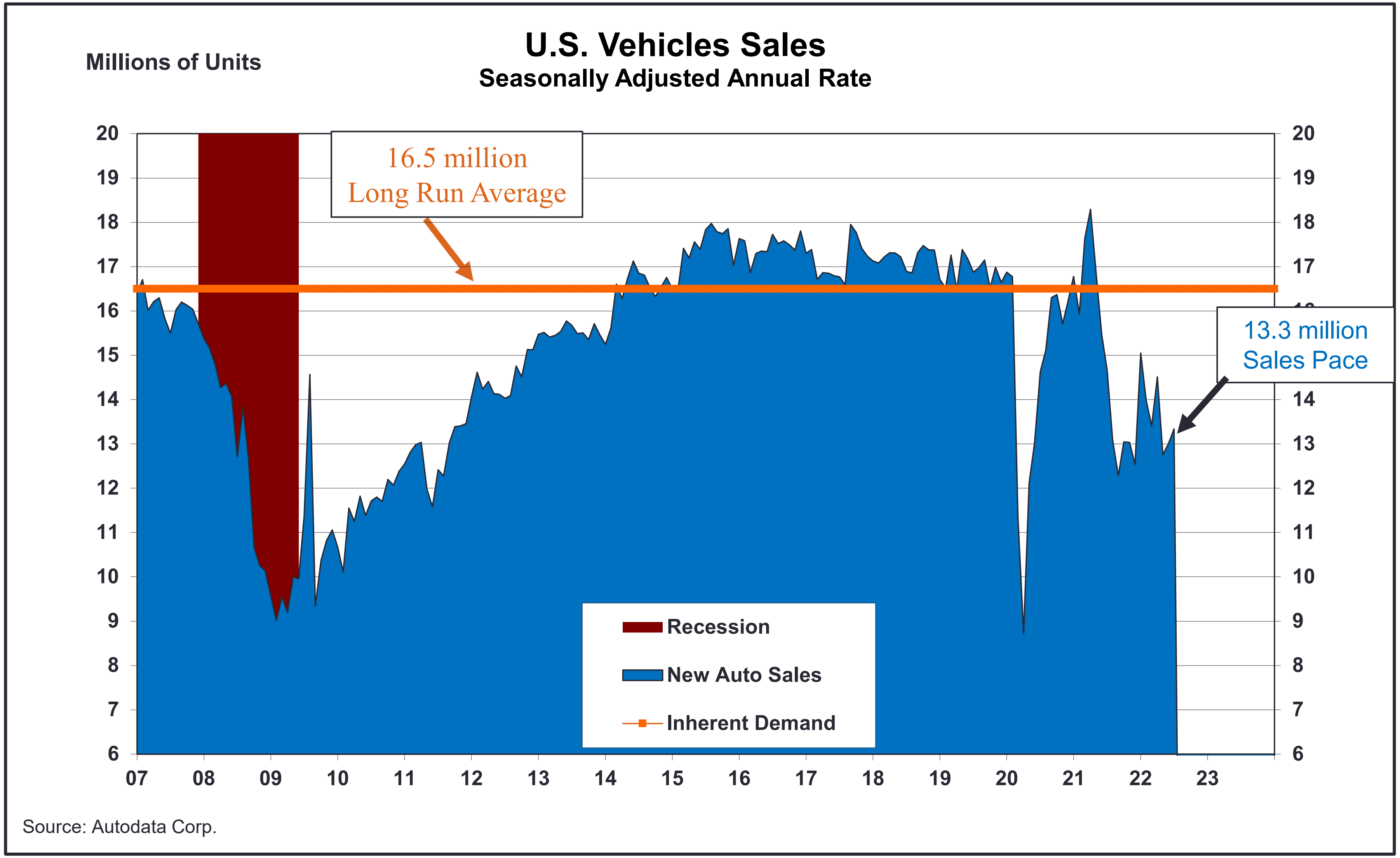


Takeaways:

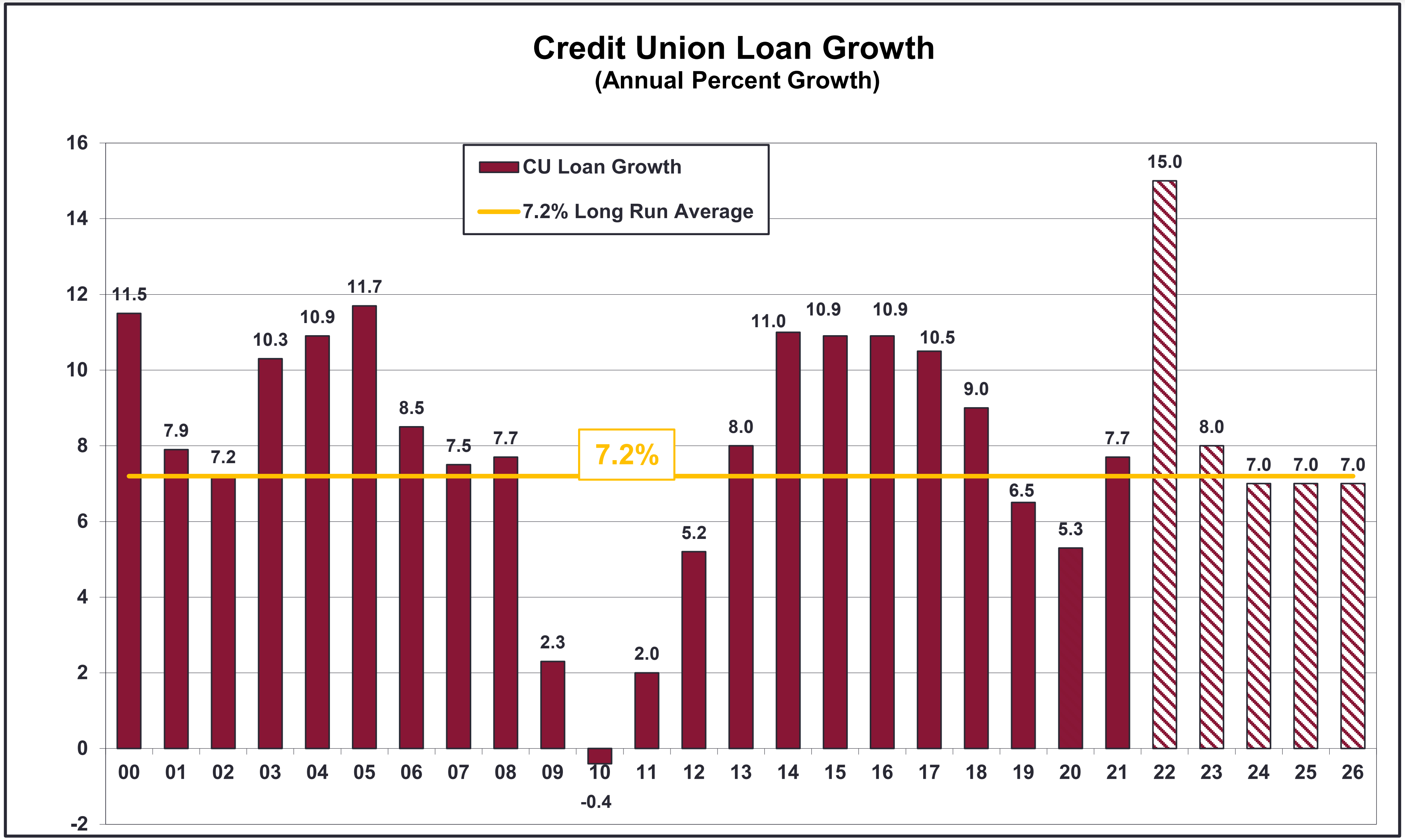
1. High building materials cost and tight labor market
2. **Market imbalance**: Underinvestment in housing stock since 2010
3. Better underwriting standards this cycle
4. No housing bust this time
5. Slowing growth in household wealth

Source: Department of Commerce

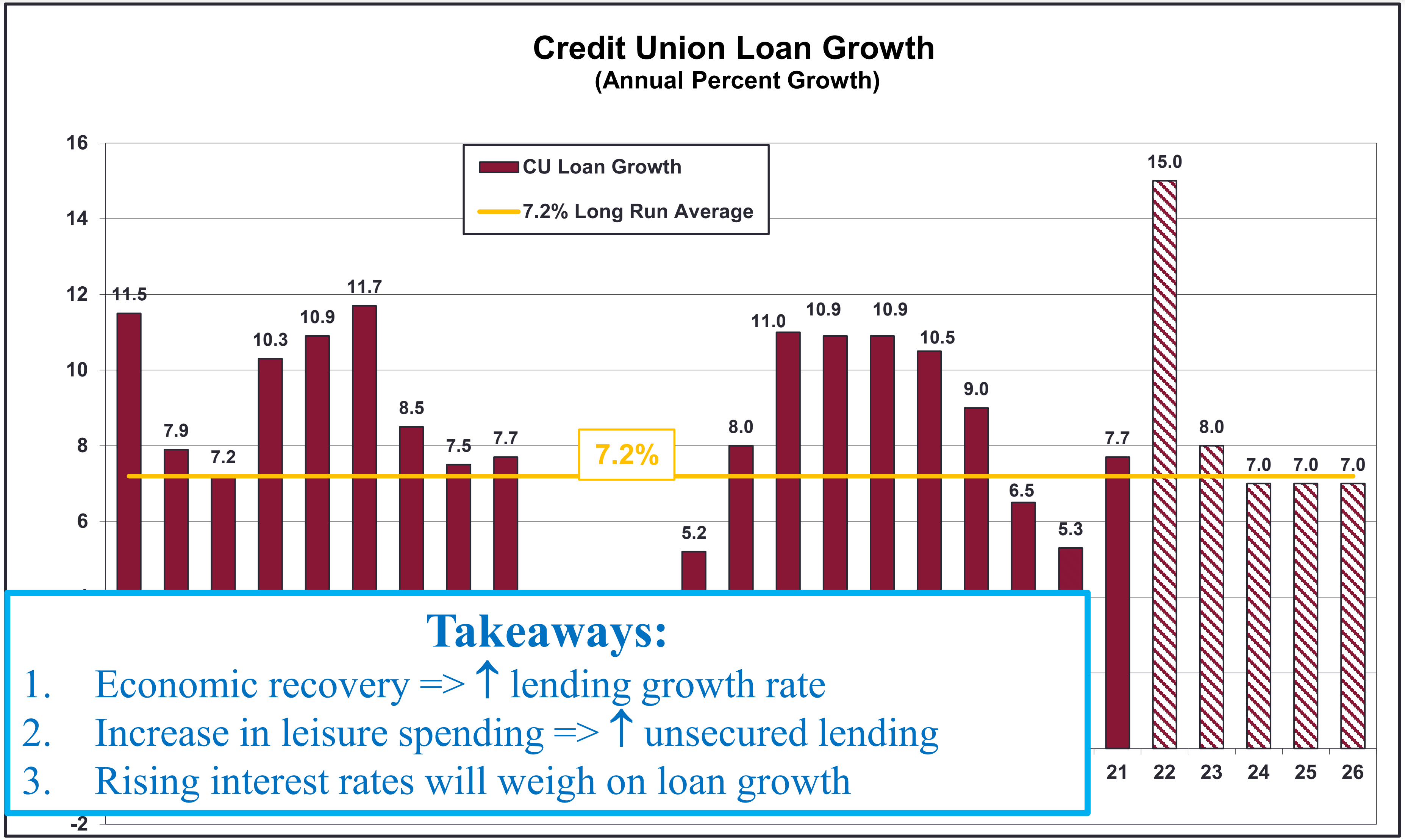
Low Auto Sales Below Long-term Trend



Above Trend Credit Union Loan Growth in 2023



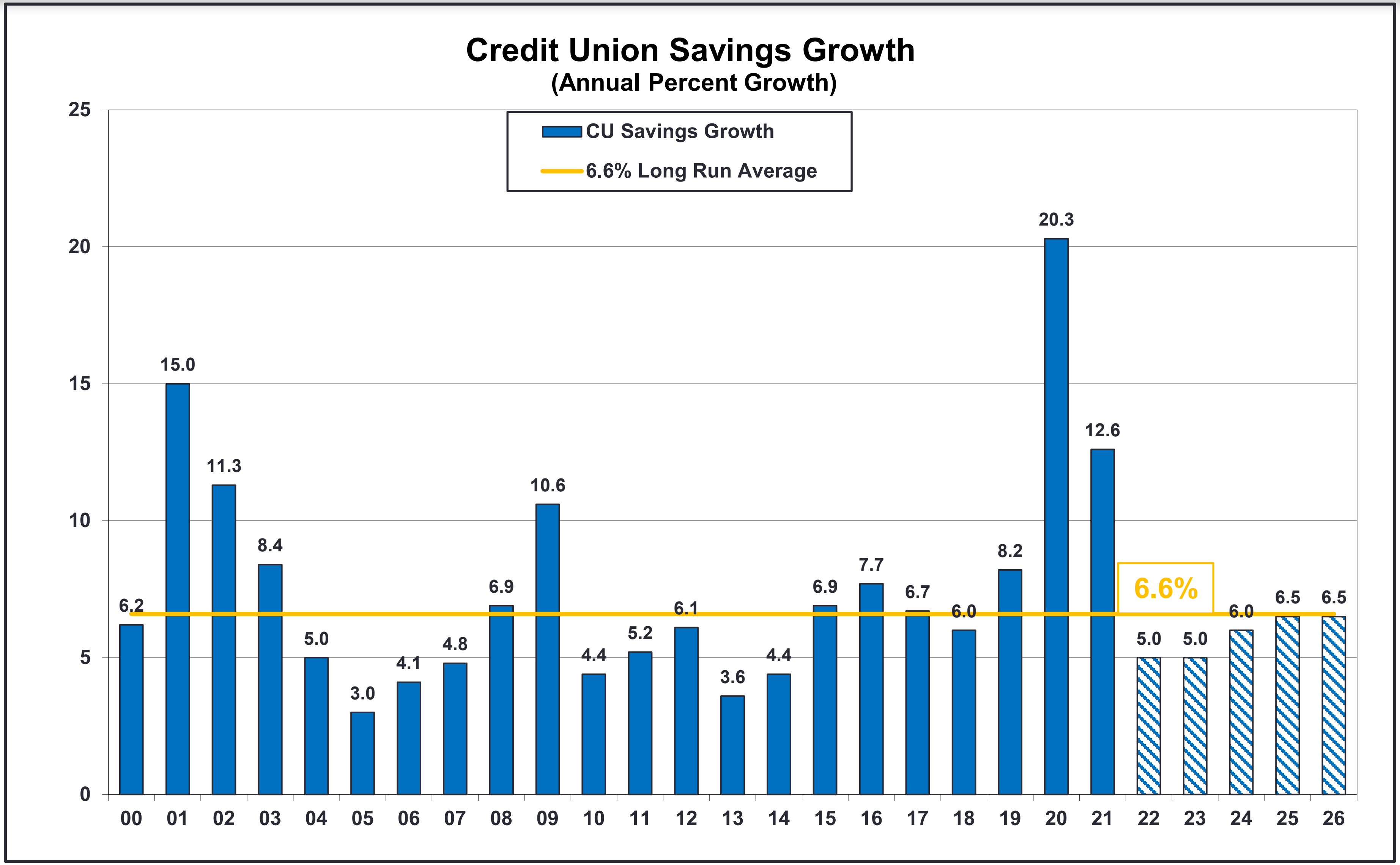
Above Trend Credit Union Loan Growth in 2023



Takeaways:

1. Economic recovery => ↑ 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



Economic Truism

"Economics is the study of the confusion between stocks and flows"

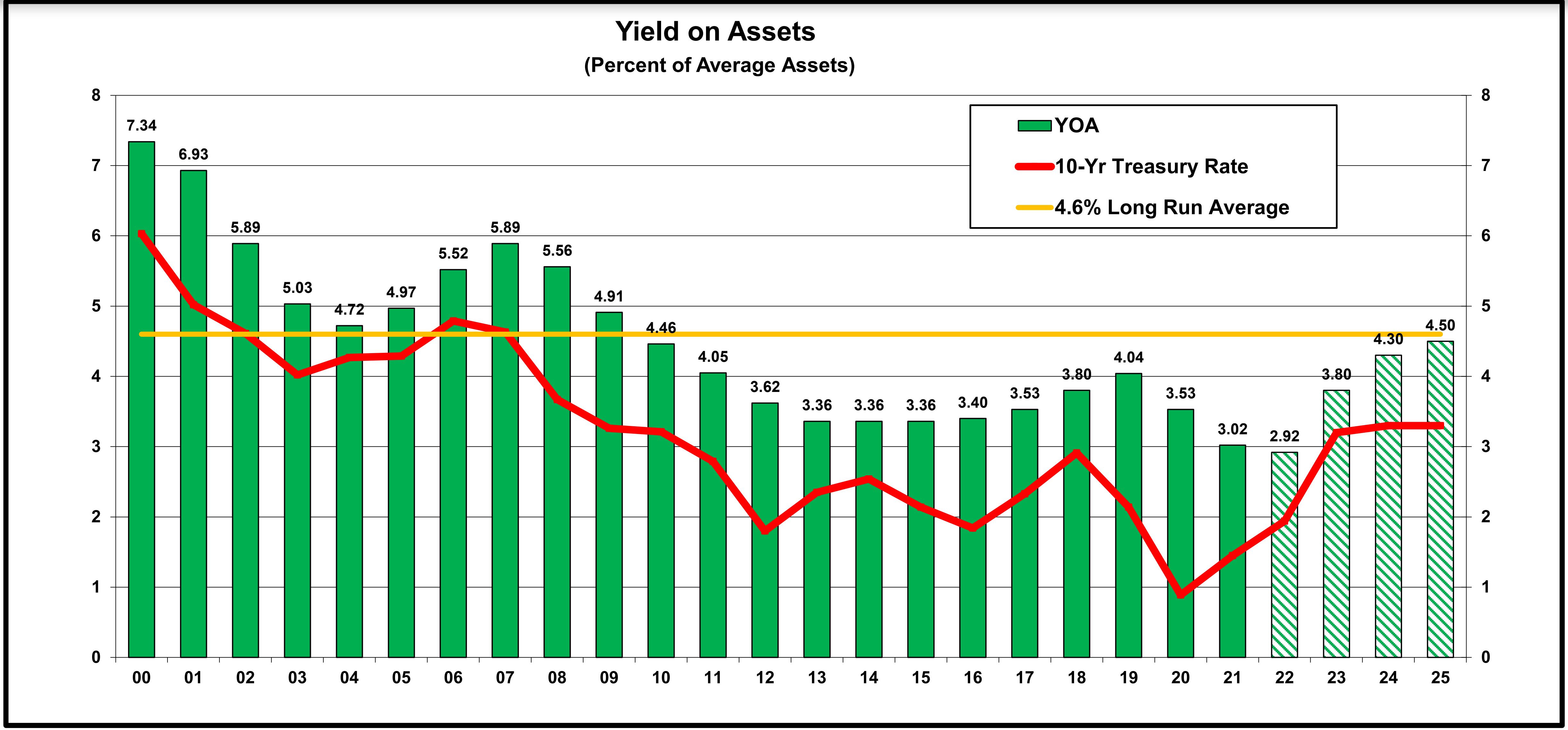
Economic Truism

"Economics is the study of the confusion between stocks and flows"

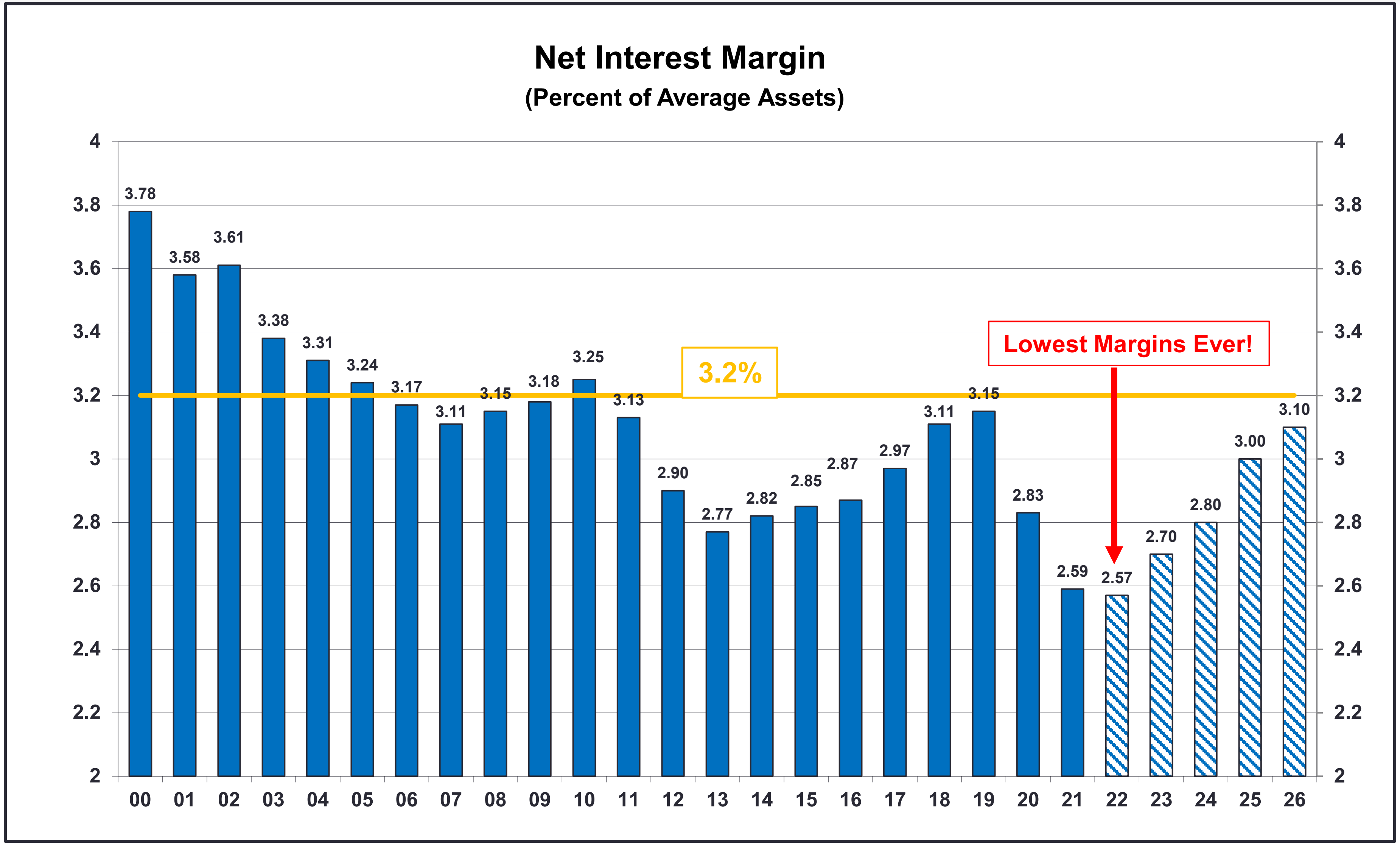
Balance Sheets

Income Statements

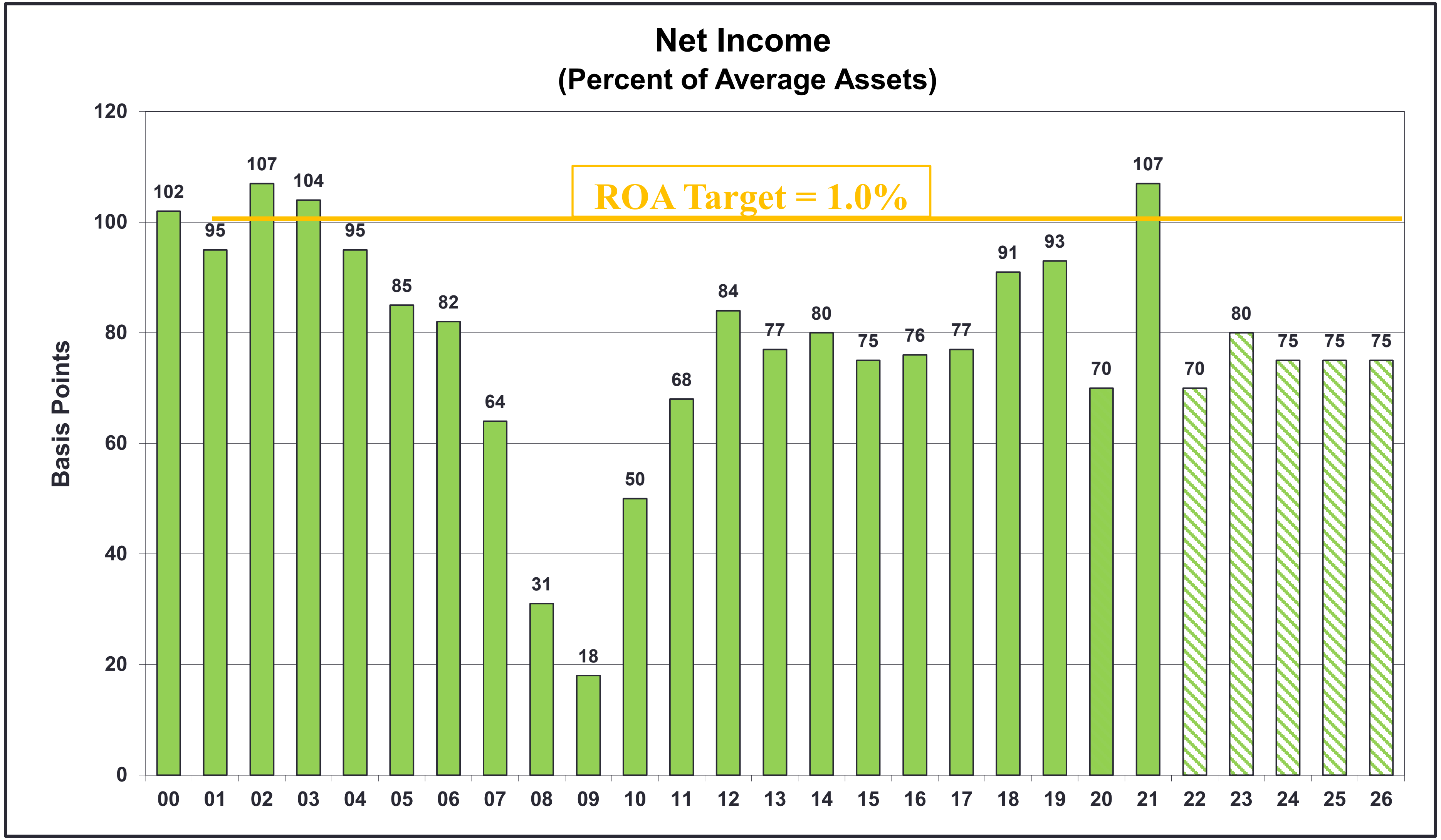
Rising Yield-on-Asset Ratios



Net Interest Margins will Rise in 2023



Credit Union Earnings Below Trend in 2023



Economic Update Summary For 2023

Economic Update Summary For 2023

1. Slowing economic growth for the next 2 years

Economic Update Summary For 2023

1. Slowing economic growth for the next 2 years
2. Falling inflation rate during the next 2 years

Economic Update Summary For 2023

1. Slowing 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

Economic Update Summary For 2023

1. Slowing 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% over the next 2 years

Economic Update Summary For 2023

1. Slowing 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% over the next 2 years
5. Credit union loan growth slowing in 2023

Economic Update Summary For 2023

1. Slowing 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% over the next 2 years
5. Credit union loan growth slowing in 2023
6. Rising net interest margins in 2023

Economic Update Summary For 2023

1. Slowing 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% 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

Economic Growth. After falling at an annual rate of 1.6% in the first quarter, GDP is likely to decline again in the second quarter. However, this weakness is due to changes in inventories and a rise in net imports. Consumer demand remains strong. According to a popular notion of a recession as two consecutive quarters of negative GDP growth, the media will refer to this as a recession. However, the National Bureau of Economic Research's official definition requires a significant, widespread and persistent decline in economic activity, defined by a number of economic variables including consumer spending and the level of employment. With the current strength in the labor market, we expect GDP growth to rebound in the second half, but a more significant slowdown, or even a recession is quite possible next year if the Fed's tightening overshoots.

Inflation. Inflation continues to defy expectations that it will moderate. The current bout of inflation is more "cost-push" (supply shocks) than the traditional "demand-pull" (overly stimulative fiscal and/or monetary policy). A variety of supply shocks began with COVID, and new ones emerged with the war in Ukraine. The effects of COVID are receding, but the war rages on. The two major fiscal stimulus packages enacted during COVID occurred when the economy was very weak and thus were not likely inflationary (although the early 2021 package was perhaps a bit oversized). Likewise, while the economy was operating well below capacity, low interest rates and quantitative easing were not inflationary. However, accommodative monetary policy in the second half of last year and the first few months of this year, as the economy was strengthening, has exacerbated inflation. We remain convinced that inflation will moderate over the coming months so long as COVID continues to fade. In addition, monetary policy is transitioning from being very to only slightly accommodative, and will soon be quite restrictive.

Unemployment. The labor market remains very strong. Even as GDP appeared to stagnate over the first half of the year, the economy added an average of 450,000 jobs a month. That's well over twice the average monthly jobs gained during the long expansion following the Great Recession. Although job growth will slow, we expect the unemployment rate to remain around 3.6% for the rest of the year before rising next year.

Interest Rates. So far, the Fed has stuck to the policy Chair Powell recently announced of being serious about choking off inflation by aggressively increasing interest rates. The likely 150 basis point increase in the Fed Funds target range over just two FOMC meetings is a far cry from the more traditional 25 bp per meeting increases that we've seen in previous tightening episodes. Given our forecast that inflation will only slow to 7% by year's end, the Fed will continue to tighten, and the Funds rate will be over 3% by December. Given the high probability of a growth slowdown next year, we do not expect longer term interest rates to rise nearly as much as short term rates do. As a result, the yield curve is likely to remain flat, or even negative over the rest of 2022.

Economic Forecast – July 2022

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5 Year Average	2020	2022:1	2022:2	2022:3	2022:4	2022	2023
Growth Rates:								
Economic Growth (% Change GDP)*	2.1%	5.7%	-1.6%	0.0%	3.0%	2.5%	1.0%	1.5%
Inflation (% Change CPI)*	2.1%	7.1%	8.6%	9.0%	8.0%	7.0%	7.0%	3.5%
Unemployment Rate	5.2%	3.9%	3.6%	3.6%	3.6%	3.6%	3.6%	4.0%
Federal Funds Rate (effective)	0.64%	0.07%	0.33%	1.58%	2.65%	3.15%	3.15%	3.25%
10-Year Treasury Rate	2.12%	1.52%	2.34%	2.98%	3.00%	3.25%	3.25%	3.50%
10-Year-Fed Funds Spread	1.48%	1.45%	2.01%	1.40%	0.35%	0.10%	0.10%	0.25%

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

Credit Union Forecast

Savings (Deposit) and Asset Growth. Credit union members have been on a spending spree so far in 2022. Savings growth in the first five months of the year is the weakest it's been in five years, at only 3%. Since the bulk of savings growth usually occurs in the first half of the year, we project full year 2022 growth at only 5%, down from over 12% last year, and an average of 8% over the preceding decade. Although consumer spending may slow in the second half, competition from money market mutual funds may cause disintermediation. As asset growth is largely determined by savings growth, expect total credit union assets to grow by 4% this year and 5% next year.

Loan Growth. Credit union lending has been on a tear so far this year, rising by 8.1% (not annualized) through May. That's the strongest percentage increase in loans outstanding in the first five months of a year going back to at least 1993. It's almost double the previous high for the period of 4.2% in 2000. This is likely due a surge in pent up consumer demand as the effects of COVID are reduced, coupled with the higher prices of products members are financing. Slowing prepayments on some loan categories due to higher interest rates are likely also playing a role. Expect full year loan growth in 2022 to be 12%, up from 7.7% last year.

Liquidity. With loan and savings growth moving in opposite directions, the average credit union loan-to-savings ratio will rise to 74.7% by December. That's a sharp increase from its 70.7% level at the beginning of the year, but it is still below the 77% average of the previous decade. The increase in the loan to savings ratio will slow next year as we expect loan growth to decelerate and savings growth to accelerate slightly.

Asset Quality. So far in 2022, the average credit union delinquency rate has continued to decline, falling from a then-record low of 0.48% last December to a new record of 0.42% as of March and May. These incredibly 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. Look for a gradual return to a more normal delinquency rate by the end of next year as the economy slows.

Earnings. After last year's strong 1.07% return on assets (ROA), the first quarter came in lower at 87 basis points. We expect the net income ratio to fall further this year to 70 bp for the full year, and the same next year. Credit union loan loss allowance accounts are finally back to their long-run average of between 80 and 90 basis points, so provision expenses will resume at a modest rate. Interest rate increases would normally boost credit union earnings, but the flattening and inversion of the yield curve may increase deposit costs more than loan yields, especially for those credit unions faced with disintermediation. Strong household spending will support interchange income, at least for the next several months, but with 30-year mortgage rates over 5%, income from mortgage refinancing will fall sharply this year compared to last year.

Credit Union Forecast – July 2022

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	10 Year Average	2021	2022:1	2022:2	2022:3	2022:4	2022	2023
Growth Rates:								
Savings Growth	8.1%	12.6%	3.5%	0.7%	0.4%	0.4%	5.0%	6.0%
Loan Growth	8.2%	7.7%	3.7%	4.2%	2.3%	1.8%	12.0%	8.0%
Asset Growth	9.8%	11.7%	2.8%	0.3%	0.5%	0.2%	4.0%	5.0%
Membership Growth	3.5%	4.2%	1.1%	1.0%	0.9%	0.5%	3.5%	3.5%
Liquidity:								
Loan-to-Share Ratio**	77.0%	70.7%	70.6%	73.3%	74.7%	75.7%	75.7%	76.4%
Asset Quality:								
Delinquency Rate**	0.79%	0.48%	0.42%	0.50%	0.50%	0.55%	0.55%	0.70%
Net Charge-off Rate*	0.53%	0.26%	0.28%	0.35%	0.35%	0.40%	0.40%	0.50%
Earnings:								
Return on Average Assets (ROA)*	0.83%	1.07%	0.87%	0.80%	0.70%	0.60%	0.70%	0.80%
Capital Adequacy:								
Net Worth Ratio**	10.6%	10.3%	10.5%	10.3%	10.4%	10.5%	10.5%	10.8%

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

PRESENTER

STEVEN RICK
Chief Economist
CUNA Mutual Group
Steve.rick@cunamutual.com
800-356-2644, Ext. 665-5454

CUNA MUTUAL GROUP

www.cunamutual.com