CUNA Economic and CU Forecast

September 2016

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September 2016 Change Highlights

CUNA's economists recently updated their economic and credit union outlook. Compared to the previous forecast, this update reflects a modest reduction in economic growth prospects across the fifteen-month forecast horizon. Our outlook for credit union financial operations is more robust; we expect savings and loan balances, assets, and membership to grow a bit faster than previously forecast. Further, the revised outlook reflects continued moderate economic growth, continued (though less dramatic) labor market improvement and only small increases in the Fed's interest rate target. As was the case in the previously-published forecast, we continue to expect strong credit union loan growth and healthy, but marginally lower, credit union earnings. The most significant changes include:

- We lowered our forecast for GDP growth by 0.45% for 2016 and 0.10% for 2017 – putting expectations at 1.80% and 2.40%, respectively.
- We still expect one rate hike this year with the Fed bumping the Fed Funds interest rate to 0.60% at the December FOMC meeting, but now expect only three (not four) rate hikes next year.
- We lowered our forecast for 10-year Treasury rate to 1.90% at year-end 2016 and 2.25% at the end of 2017.
- Our forecast for credit union savings growth is revised up from 6.5% to 7.0% this year and from 5.0% to 6.0% in 2017.
- We increased our forecast for credit union loan growth to 10.0% in 2016. Our forecast for credit union loan growth in 2017 is unchanged at 9.0%.
- Our forecast for credit union asset growth is revised up from 6.4% to 7.5% this year, and from 4.5% to 6.5% next year.
- We now expect membership growth at 3.8% in 2016 and 3.3% in 2017 – higher than our previous forecast by 0.30% and 0.50%, respectively.

CUNA Economic Forecast

- **We now expect the U.S. economy to grow by 1.80% in 2016 and 2.40% in 2017**. Robust domestic demand in the household and business sectors will continue to spur growth in 2016 and 2017. Pressures of the rising U.S. dollar on manufacturing and exports are easing and will boost GDP growth. Changing economic conditions will continue to have spillover effects on the U.S. economy. Although the U.S. remains resilient given its limited exposure to weaker aggregate demand from the rest of world, effects of a weak global economy will impact U.S. financial markets.

- **Headline and core (excluding food and energy prices) inflation will be 2.0% in 2016. In 2017 headline inflation will increase to 2.25% equal to core inflation.** The uptick in headline inflation will be driven by higher energy prices against the backdrop of an economy fast approaching full employment. U.S. economic expansion without inflation will be a thing of the past. Consumer benefits from lower petroleum prices and the strong U.S. dollar will further diminish.

- **The unemployment rate will finish 2016 at 4.8% and at 4.6% in 2017**. Monthly job gains will continue to nudge the unemployment rate lower. The quality of jobs created continues to shift from lower-paying entry-level to higher-paying professional and construction jobs. Unemployment resulting from lower commodity prices such as job losses in oil and gas will begin to dissipate as oil and energy prices start to increase. Re-entry of discouraged workers into the job market will mean unemployment rate declines will not be as dramatic as those in the recent past. However, overall job growth should remain strong, reaching full employment no later than the end of next year.

- **The Federal Funds interest rate will increase to 0.60% in December and will rise to 1.40% by the end of 2017.** Federal Reserve actions will remain data driven. Rising output, tighter labor markets, and higher inflation in 2016 will cause the FOMC to continue monetary policy normalization. We now expect one quarter-point rate hike this year and three next year.

- **The 10-year Treasury interest rate will increase modestly to 1.90% by December 2016.** That is still about 1.5 percentage points below what we might expect given the condition of the U.S. economy. But geopolitical uncertainty will continue to overrule domestic financial considerations. We expect the 10-year Treasury rate to reach 2.25% by December 2017.

- **The Treasury yield curve will flatten in 2016 as short-term interest rates rise faster than long-term interest rates.**

CUNA Economic Forecast

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	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5Yr Avg	2015	2016:1	2016:2	2016:3	2016:4	2016	2017
Growth rates:								
Economic Growth (% chg GDP)*	2.00%	2.40%	0.80%	1.40%	2.50%	2.50%	1.80%	2.40%
Inflation (% chg CPI)*	1.55%	0.67%					2.00%	2.25%
Core Inflation (ex. food & energy)*	1.92%	2.09%					2.25%	2.25%
Unemployment Rate	5.16%	5.00%	5.00%	4.90%	4.80%	4.80%	4.80%	4.60%
Federal Funds Rate	0.17%	0.24%	0.36%	0.38%	0.36%	0.60%	0.60%	1.40%
10-Year Treasury Rate	2.21%	2.24%	1.89%	1.64%	1.60%	1.90%	1.90%	2.25%
10-Year-Fed Funds Spread	2.04%	2.00%	1.53%	1.26%	1.24%	1.30%	1.30%	0.85%

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

CUNA Credit Union Forecast

- **Credit union savings balances will grow by 7.0% in 2016 and 6.0% in 2017.** As the Federal Reserve continues raising short-term interest rates this year and the next, we expect the anticipated transfer of funds to money market mutual funds will finally materialize. With inflation in the offing and the windfall from lower oil prices disappearing, cautiously optimistic members will seek higher returns.

- **Memberships will increase in 2016 by 3.8%** due to more indirect auto lending and more recognition of the positive credit union value proposition. We expect membership growth next year to be slightly lower, at 3.3%, as the auto lending boom begins to slow and indirect borrower memberships decline.

- **Credit union loan balances will increase by 10.0% in 2016 and 9.0% in 2017**. Loan growth this year will be only marginally lower than the impressive 10.5% loan growth of 2015. As the economy continues to expand, we expect households to continue to release pent up demand for autos, furniture and appliances over 2016; and a slightly slower pace in 2017 year. New auto loans, credit card loans and purchase mortgage loans will remain strong growth areas.

- **Credit quality will remain healthy in 2016 and 2017**. The improving job market and fast loan growth (the denominator of the loan quality rations) will keep the delinquency ratio down to 0.75% in 2016 and 2017. Net charge-offs will likewise decline to 0.50% in 2016 and in 2017.

- **Credit union return on assets will increase to 0.76% in 2016 and 0.65% in 2017**. Interest margins will be helped by strong loan growth in 2016 but hurt by the flattening yield curve. Mortgage refinancing and its resulting revenue will decline in 2016. The effect of overfunded loan loss allowance accounts, which kept loan loss provision expenses very low for the past few years, will dissipate in 2016 and 2017. Higher funding costs, higher operating expenses due to a tighter labor market, and lower fee income from overdrafts and NSFs will also contribute to lower return on assets in 2016 and 2017.

- **Net worth ratios will stay at 10.7% in 2016 and 2017**. Even with the expected slight decline in earnings, capital ratios will continue to rise this year and next as soft savings inflows provide for only modest asset growth.

CUNA Credit Union Forecast

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	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5Yr Avg	2015	2016:1	2016:2	2016:3	2016:4	2016	2017
Growth rates:								
Savings growth	5.2%	6.8%	3.6%	0.9%	1.5%	1.0%	7.0%	6.0%
Loan growth	6.8%	10.5%	1.7%	3.1%	3.2%	2.0%	10.0%	9.0%
Asset growth	5.6%	7.3%	3.0%	1.1%	1.7%	1.6%	7.5%	6.5%
Membership growth	2.5%	3.5%	1.1%	1.3%	1.0%	0.5%	3.8%	3.3%
Liquidity:								
Loan-to-share ratio**	72.4%	77.7%	76.0%	77.7%	79.0%	79.8%	79.8%	82.0%
Asset quality:								
Delinquency rate**	1.08%	0.81%	0.70%	0.75%	0.75%	0.75%	0.75%	0.75%
Net charge-off rate*	0.64%	0.48%	0.52%	0.51%	0.50%	0.50%	0.50%	0.50%
Earnings:								
Return on average assets (ROA)*	0.77%	0.75%	0.75%	0.79%	0.75%	0.75%	0.76%	0.65%
Capital adequacy:								
Net worth ratio**	10.7%	10.9%	10.8%	10.7%	10.7%	10.7%	10.7%	10.7%

*Annualized Quarterly Data. **End of period ratio. Additional information and updates available on our MCUE website.

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