CUNA economic and credit union forecast

July 8, 2020 | Samira Salem, PhD, Senior Policy Analyst, Credit Union National Association

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Economic overview

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The U.S. economy officially entered a recession in February due to the novel coronavirus (COVID-19), which has caused both widespread human suffering and severe economic disruption. Social distancing, event cancellation, school closures, and "stay at home" orders—all of which are critical to controlling the public health crisis—have dramatically reduced routine economic activity.

We expected that the coronavirus recession would be incredibly sharp and short lived. However, the economic recovery that began as states opened up in May and early June is stalling as a surge in COVID-19 cases is leading to slower economic activity and increasing the likelihood of a protracted recovery. Approximately 70% of states are reversing course on reopening while California, Florida, Texas, and Arizona—which employ 30% of the U.S. workforce—are experiencing an unprecedented increase in COVID-19 cases. This is occurring just as the fiscal stimulus from the Coronavirus Aid, Relief, and Economic Support (CARES) Act—aimed at providing a lifeline to tens of millions of unemployed Americans and businesses—is set to expire. While there is uncertainty around the exact shape and timing of any additional fiscal stimulus, Congress and the President have signaled a willingness to provide a second round of stimulus, albeit at a smaller level than the first round. Ultimately, uncertainty is extremely high and the range of potential scenarios for the economy is vast, with the majority of risk to the downside.

While no credit union is immune, those serving members on the frontlines, members employed by affected industries and members of the most vulnerable populations (especially women, low-income families and people of color)—as well as smaller credit unions with less diversified loan portfolios—will be most affected by the downturn. In general, credit unions should be prepared for a significant slowdown in economic growth, increased unemployment, significantly slower loan, and membership growth, a surge in deposit growth (especially in the second quarter), a deterioration in portfolio quality, an increase in loan loss provisions, and a reduction in earnings due to lower interest and non-interest income.

Most credit unions have strong balance sheets and are very well-capitalized. For many credit unions, the best course of action is to avoid overreacting and to let their capital do its work. If there was ever a need to allow capital ratios to fall to meet member needs, this is it.

Note: This forecast is a revised version of the forecast released on June 8th. Given the rapidly changing economic environment, CUNA economists will update our forecast on a more regular basis until the current crisis subsides.

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The most significant changes to our previous forecast from June 8th include:

- The unexpected recent surge in COVID-19 cases will put a damper on the pace of U.S. economic growth. We now forecast gross domestic product (GDP) to fall 5.3% in 2020, a more pessimistic forecast relative to our previous estimate of a 2.9% decline.
- We increased our 2020 annual credit union savings and asset growth forecasts from 14.0% and 12.0%, respectively, to 17.0% and 15.0%.
- Our 2020 annual loan growth forecast increased from 3.5% to 6.0%. Our membership rate growth forecast also increased slightly from 1.5% to 2.0%.
- We decreased our 2020 net charge-off rate forecast from 1.00% to 0.75%.

Key Assumptions: Our forecast is based on the following assumptions. Should the assumptions prove to be erroneous, then the risks to the economy and credit union operations are to the downside.

1. **Society will increasingly adapt to the new normal by social distancing, mask-wearing, and other preventative measures to slow the spread of the virus and this will encourage some level of economic activity, albeit muted.** We will learn to live and work with the virus, but a full economic recovery won't be in reach until a vaccine is widely available. That is not expected until 2021 at the earliest. That said, we assume that improvements in treatments will continue apace and help to keep death rates falling relative to cases.
2. **Congress and the Federal Reserve will continue to respond with fiscal and monetary policy as the situation warrants.** The Federal Reserve and Congress have responded with substantial fiscal and monetary policy to support the economy, including expanded unemployment benefits, small-business loans, direct payments to consumers, and actions to reduce short- and long-term interest rates. The Federal Reserve will continue to support the economy, and further Congressional action is likely by the end of July/beginning of August, although it is not expected to be as generous as the CARES Act.
3. **No other major events affect the economy**, such as significant natural disasters, new international conflicts, or increased trade barriers.

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	Actual results		Quarterly results/forecasts				Annual forecasts	
	5 Yr Avg	2019	2020:1	2020:2	2020:3	2020:4	2020	2021
Growth rates:								
Economic Growth (% chg GDP)*	2.43%	2.33%	-5.0%	-35.0%	15.0%	5.0%	-5.3%	4.0%
Inflation (% chg CPI)*	1.55%	1.81%	-0.2%	-1.0%	1.0%	1.0%	0.8%	1.5%
Unemployment Rate (BLS)	4.70%	3.50%	4.4%	11.1%	10.5%	10.0%	10.0%	8.0%
Unemployment Rate (Adjusted***)	NA	NA	NA	12.1%	11.0%	10.0%	10.0%	8.0%
Federal Funds Rate (effective)	1.18%	1.55%	0.08%	0.08%	0.10%	0.10%	0.10%	0.10%
10-Year Treasury Rate	2.35%	1.92%	0.70%	0.66%	0.70%	0.80%	0.80%	1.10%
10-Year-Fed Funds Spread	1.17%	0.37%	0.62%	0.58%	0.60%	0.70%	0.70%	1.00%

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*Percent change, annual rate. All other numbers are end-of-period values.
***Estimated unemployment rate reported by BLS if workers absent for work due to “other reasons” (e.g., COVID-19 related business closures) were classified as unemployed.

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- **Economic Growth**: The U.S. economy contracted at a 5.0% annualized pace in the first quarter of 2020 and, according to the National Bureau of Economic Research (NBER), officially entered a recession as of February. This ended the longest economic expansion since 1854. Given that most stay-at-home orders started in March and lasted through May or June, we expect a significantly larger contraction in the second quarter of -35.0% GDP growth (annualized). That would represent the steepest quarterly decline in GDP on record. The economic recovery that began as states opened up in May and early June is now stalled due to a recent upsurge in COVID-19 cases. As a result, we expect economic growth in the third quarter to register 15.0% instead of our previous estimate of 20.0%. Economic growth is likely to remain muted during the fall and winter months and into next year as we adjust to the new normal, which includes continued consumer caution when it comes to travel, tourism, restaurants, large events, and many other activities. In addition, the likelihood that children will return to school and childcare in the fall seems increasingly unlikely in many places. Economists estimate that approximately 10% of economic activity won't happen as long as child care and in-person school isn't available. As a result, third quarter growth is expected to be slower in the fourth quarter (5.0% annualized growth). Overall, we forecast a 5.3% *fall* in real GDP in 2020, followed by growth of 4.0% in 2021. This translates into negative economic growth over the two-year period from 2020 to 2021. We expect that it will take until 2022 for U.S. GDP to reach the same level as the fourth quarter of 2019.

- **Inflation:** As a result of the plummeting consumer and business demand coupled with the steep decline in oil prices, the economy experienced price deflation in the first quarter of 2020, which will continue in the second quarter as well. As economic activity resumes, inflation will reach 1.00% (annualized quarterly growth rate) in the third and fourth quarters, and 0.8% for the year. As economic growth stabilizes, expect annual inflation to average 1.50% in 2021.

- **Unemployment:** The current recession is marked by an unprecedentedly deep and rapid dislocation in the labor market concentrated in March and April. However, for the second month in a row The Bureau of Labor Statistics' (BLS') Employment Situation Summary report showed a *decrease* in the BLS unemployment rate. The June unemployment rate decreased from 13.3% to 11.1%, with total nonfarm payroll employment rising 4.8 million in June. Moreover, Compared to May, a smaller proportion of workers were incorrectly counted as absent from work due to "other reasons" instead of unemployed. The adjusted unemployment rate registered at 12.1%, or 1 percentage point higher than the reported unemployment rate. Despite the declining trend in unemployment, at 11.1% the unemployment rate is still more than three times the unemployment rate as of year-end 2019 and higher than the peak during the Great Recession (10.0%). Based on previous recessions, we expect to see elevated levels of unemployment long after economic growth returns to pre-pandemic levels. Expect the BLS unemployment rate to fall slightly to 10.0% by the end of 2020 as the economy experiences some growth.

- **Interest Rates:** The Federal Reserve will not increase the Federal Funds Rate by the end of 2021. The 10-Year Treasury rate will also stay relatively low as investors seek safe investments and the Federal Reserve does everything in its power to keep long-term rates low, including additional quantitative easing. As the economic outlook improves in the latter half of the year, the 10-year Treasury rate will increase slightly to 0.8% in 2020 and 1.1% in 2021.

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	Actual results		Quarterly results/forecasts				Annual forecasts	
	5 Yr Avg	2019	2020:1	2020:2	2020:3	2020:4	2020	2021
Growth rates:								
Savings growth	6.8%	8.1%	4.3%	8.5%	2.1%	2.1%	17.0%	8.0%
Loan growth	9.3%	6.5%	0.8%	1.6%	2.0%	1.6%	6.0%	5.0%
Asset growth	6.9%	7.7%	4.6%	7.4%	1.5%	1.5%	15.0%	7.0%
Membership growth	3.9%	3.6%	0.8%	0.4%	0.5%	0.3%	2.0%	2.0%
Liquidity:								
Loan-to-share ratio**	82.1%	84.4%	81.1%	76.3%	76.3%	76.0%	76.0%	73.9%
Asset quality:								
Delinquency rate**	0.77%	0.70%	0.63%	0.75%	1.00%	1.50%	1.50%	1.25%
Net charge-off rate*	0.55%	0.56%	0.58%	0.65%	0.75%	1.00%	0.75%	0.90%
Earnings:								
Return on average assets (ROA)*	0.83%	0.93%	0.53%	0.40%	0.30%	0.15%	0.35%	0.10%
Capital adequacy:								
Net worth ratio**	11.1%	11.4%	11.0%	10.2%	10.1%	10.0%	10.0%	9.5%

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

Note: Data for the first quarter of 2020 is from CUNA's Monthly Credit Union Estimates survey data given that NCUA data was not yet available.

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- **Loan & Membership Growth**: CUNA's Monthly Credit Union Estimates (MCUE) survey data show loan growth rising 2.0% year-to-date through May. In this low interest rate environment, people are buying and refinancing homes, creating a boom in mortgages. Fixed-rate mortgages rose an incredible 12.9% (through May), and we expect continued mortgage lending to support modest credit union loan and membership growth in the immediate future. However, besides used auto loans, which grew slightly (0.9%), all other loan categories fell during the first five months of 2020 according to CUNA monthly estimates, including credit cards (-9.2%), new auto loans (-3.0%), adjustable-rate mortgages (-3.0%), HELOCs (-1.7%) and other/commercial loans (-2.3%). New auto loans and memberships may see a boost in the third quarter as the new model year cars are released and historically low interest rates encourages spending on such big-ticket items. As economic growth resumes in the second half of the year, loan growth will increase slightly and end the year up 6.0%, just below the annual long-term loan growth rate of roughly 7.0%. Next year loan growth will taper slightly to 5.0% as demand for refinances declines and unemployment remains elevated. Membership growth is likely to follow a similar pattern: according to the MCUEs, credit union memberships grew just 0.6% as of May 2020. Annual membership growth will grow 2.0% in 2020 and 2.0% in 2021.

- **Savings Growth**: The MCUEs show exceptionally fast growth in credit union savings balances: year-to-date through May credit union deposits grew 12.0%. However, this rapid growth is largely due to the government stimulus checks that greatly magnified normal seasonal savings inflows (e.g., deposits due to tax refunds). This is also evidenced by the fact that a high percentage of all savings growth (84%) was in the relatively liquid share drafts and regular shares. However, as is common during recessions, consumers also tend to increase cautionary savings and pull back on borrowing and spending. Due to these factors, expect exceptionally high savings growth of 8.5% in the second quarter of 2020, before slower growth in the second half of the year, as is common during the fall and winter months. A second round of stimulus checks may boost third-quarter savings, but not to the degree of the first round given that it is likely to be smaller and more targeted. Overall, we forecast savings growth of 17.0% in 2020 and 8.0% in 2021, with asset growth following a similar trend.

- **Asset quality**: As a result of the economic slowdown and increased unemployment, we anticipate an increase in credit union delinquencies and charge-offs in 2020 and 2021. Delinquency and charge-off rates will increase to 1.50% and 0.75%, respectively, in 2020, before falling slightly to 1.25% and 0.90% in 2021. Portfolio quality will not deteriorate to the extent that it did during the Great Recession for several reasons: First, many credit unions are allowing skip pays, debt restructuring, forbearance, and other means to provide repayment flexibility. Recent NCUA guidance makes it clear that many of these activities will not result in credit unions automatically categorizing loan modifications as troubled debt restructurings (TDRs) and that will help to keep both delinquency and net charge-offs rates, lower than they would otherwise be. Buttressed by very low interest rates, mortgage and housing markets will also remain relatively strong, preventing significant deterioration in mortgage portfolios. Moreover, significant fiscal stimulus—including checks for consumers, expanded unemployment benefits, and loans to small businesses—has helped members remain current on their bills. We expect continued fiscal support for households through the end of the year, albeit at lower levels than earlier stimulus. If further government assistance is not forthcoming, credit unions may experience a significantly greater deterioration in portfolio quality than what is predicted here.

- **ROA:** The combination of near-zero market interest rates and a shift to fast growth in low-yielding investments has translated into a decline in net interest income to 0.53%, according to NCUA's first-quarter credit union results. Additional ROA pressures include rising provisions for loan losses and decreased interchange income. Moreover, anecdotally, many credit unions are waiving fees and offering emergency loans with significantly reduced interest rates which, while laudable, also decrease earnings. However, earnings will be buttressed slightly by strong mortgage refinancing and an increase in fees from mortgage sales to the secondary market. Our forecast shows ROA falling to 0.35% for 2020, a significant decline from 0.93% ROA in 2019 but well above the Great Recession low of 0.18% in 2009. In 2021, earnings will fall even further to 0.10% as losses mount and interest rate margins remain extremely tight, limiting returns on loan portfolios and investments.

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