CUNA Economic and Credit Union Forecast

January 2019

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January 2019 Change Highlights

The U.S. economy continues to grow at a strong pace; however, recent steep declines in the stock market and U.S. Treasury yields highlight numerous downside risks, including further increases of the federal funds rate, Brexit and slowing global growth, the trade dispute with China, political gridlock and the government shutdown, and longer-term challenges such as low productivity growth, a growing federal budget deficit, and an aging U.S. population. On the other hand, at present, economic fundamentals remain strong, with consumer confidence high, unemployment low, and the economy continuing to create jobs at a very strong pace. Credit unions will continue to benefit from the relatively strong economy in 2019; however, we expect credit union performance to revert toward longer-term trends in coming months, as the economy gradually slows to a more sustainable rate of growth and interest rates continue to rise.

Below are the most significant changes to our previous forecast:

- We lowered our 2018 inflation (CPI) forecast from 2.80% to 2.10%.
- Our 2019 forecast for the 10-Year Treasury yield fell from 3.50% to 3.00%.
- We increased our outlook for 2018 annual membership growth from 4.1% to 4.4%.
- Our 2018 and 2019 delinquency rate forecasts were lowered from 0.75% and 0.85%, respectively, to 0.65% and 0.75%.
- We increased our forecast for credit union ROA in 2018 and 2019 from 0.85% and 0.75%, respectively, to 0.95% and 0.85%.

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- **Headline inflation (CPI) fell to just below 2.0% the past two quarters, and we expect 2018 CPI inflation to reach 2.10% for the year and 2.25% in 2019.** While inflation remains near the Fed's 2.0% target rate, it has slowed in recent quarters, mostly due to falling energy prices. The last quarter of 2017 and first quarter of 2018 witnessed annualized quarterly CPI growth of approximately 2.50%, but it has since fallen to 2.24% in the second quarter of 2018 and 1.81% in the third quarter. We expect overall 2018 inflation to reach 2.10% and 2.25% in 2019, as low unemployment and strong consumer spending continue to drive up prices.
- **The yield on the 10-year U.S. Treasury fell from a high of 3.24% to 2.69% by the end of 2018. We expect the 10-year Treasury rate to rise to 3.00% by the end of 2019.** Slowing global economic growth, poor stock market performance, uncertainty regarding tariffs, and the potential for a prolonged government shutdown have all put significant downward pressure on Treasury yields. This uncertainty will continue in 2019, but we expect more clarity throughout the year. We do not expect the stock market to perform as poorly in 2019 as in 2018, and the strong labor market, increased household wealth, and steady increases in inflation should bring 10-year Treasury yields back to a more sustainable level of approximately 3.00% by the end of 2019. For perspective, the average 10-year Treasury yield between the recession of 2001 and financial crisis of 2007 – 2009 was approximately 4.50%, and yields in the 1990s frequently rose above 6.0%.

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	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5 Yr Avg	2017	2018:3	2018:4	2019:1	2019:2	2018	2019
Growth rates:								
Economic Growth (% chg GDP)*	2.37%	2.20%	3.40%	2.50%	1.75%	2.50%	3.10%	2.25%
Inflation (% chg CPI)*	1.30%	2.10%	1.81%	1.50%	1.75%	2.25%	2.10%	2.25%
Unemployment Rate	5.60%	4.10%	3.70%	3.90%	3.80%	3.80%	3.90%	3.80%
Federal Funds Rate (effective)	0.36%	1.33%	2.20%	2.40%	2.40%	2.65%	2.40%	2.90%
10-Year Treasury Rate	2.26%	2.40%	3.05%	2.69%	2.75%	2.80%	2.69%	3.00%
10-Year-Fed Funds Spread	1.90%	1.07%	1.10%	0.29%	0.35%	0.15%	0.29%	0.10%

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

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- **Credit union memberships will end 2018 up 4.4%, but membership growth will slow to 3.5% in 2019.** Credit unions have experienced the fastest membership growth in decades over the past few years with 2018 on track to grow faster than any year since 1986. This has been driven by a number of factors, including a particularly strong economy and protracted economic recovery, very low interest rates, and credit unions' superior customer service and pricing relative to banks. As the Fed continues to raise interest rates, the economy decelerates and indirect auto loans mature and are paid off, we expect membership growth to slow slightly to 3.5% in 2019.
- **Credit union delinquency rates will reach 0.65% in 2018 and 0.75% by the end of 2019.** The strong economy and low unemployment has increased household wealth to record levels, contributing to very healthy loan portfolios at credit unions. Credit union delinquency rates will end 2018 near 0.65%, which would be the lowest delinquency rate since at least 1980, the oldest year we have on record. However, as interest rates rise and borrowers get longer into their loan terms, we expect delinquencies to rise slightly to 0.75% by the end of 2019. Nonetheless, the robust labor market should help maintain relatively healthy portfolio quality into the near future.
- **Credit union ROA will finish 2018 at 0.95%, but fall to 0.85% by the end of 2019.** Credit unions are on track to experience their best year of earnings since 2003, well before the financial crisis. Returns have been bolstered by the robust economy, share insurance fund equity distribution, and rising interest rates, which have contributed to higher investment yields and larger interest rate spreads between loan yields and deposit rates. While earnings are likely to remain strong in 2019, we expect a slight decrease in ROA as credit unions are pressured to increase deposit rates faster than loan yields in order to compete for deposits, increasing their cost of funds. Moreover, while the NCUA mentioned the possibility of another share insurance fund distribution in 2019, it would likely be much smaller than the 2018 distribution, which contributed about 0.05 percentage point to 2018 earnings.

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	5 Yr Avg	2017	2018:3	2018:4	2019:1	2019:2	2018	2019
Growth rates:								
Savings growth	5.7%	6.0%	0.2%	1.5%	4.1%	1.1%	6.0%	7.0%
Loan growth	9.8%	10.0%	2.6%	2.1%	0.5%	2.9%	9.5%	8.0%
Asset growth	6.2%	6.6%	0.7%	2.2%	4.4%	1.1%	6.5%	7.5%
Membership growth	3.5%	4.1%	1.3%	0.4%	1.1%	1.0%	4.4%	3.5%
Liquidity:								
Loan-to-share ratio**	77.3%	82.8%	85.2%	85.7%	82.7%	84.4%	85.7%	86.5%
Asset quality:								
Delinquency rate**	0.86%	0.81%	0.67%	0.65%	0.60%	0.65%	0.65%	0.75%
Net charge-off rate*	0.54%	0.59%	0.55%	0.60%	0.55%	0.60%	0.60%	0.65%
Earnings:								
Return on average assets (ROA)*	0.77%	0.77%	1.02%	1.00%	0.95%	0.90%	0.95%	0.85%
Capital adequacy:								
Net worth ratio**	10.9%	11.0%	11.2%	11.2%	11.0%	11.1%	11.2%	10.9%

*Quarterly data, annualized. **End of period ratio. Additional information and updates available on our MCUE website.