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CUNA Economic and Credit Union Forecast

April 3rd, 2020

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CUNA Economic and Credit Union Forecast

April 3rd, 2020 Overview

The U.S. economy has suddenly and unexpectedly entered a recession as a result of 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.

Given current projections, we expect that the economic effects of the COVID-19 crisis will be substantial but mostly concentrated in the second quarter of 2020. We predict that the economy will slowly begin to recover in the second half of 2020. We also expect fiscal stimulus and monetary policy to mitigate some of the effects of the crisis and help accelerate the economic recovery. However, if the virus does not recede by the end of the second quarter or if it returns later in the year, then a longer recession and slower recovery is possible.

While no credit union is immune, those serving members on the frontlines, members employed by affected industries and members of the most vulnerable populations—and smaller credit unions with less diversified 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, and a reduction in earnings due to lower interest and non-interest income, and an increase in loan loss provisions.

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 in order to meet member needs and preserve the credit union, this is it.

Note: This forecast is a revised version of the forecast released on March 24th. 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 March 24th include:

- We decreased our economic growth forecast for 2020 from -2.25% to -3.75%.
- We now expect the unemployment rate to peak out at 15.0% in the second quarter of 2020, before settling in at 10.00% by year-end 2020.
- We decreased our credit union loan growth forecast from 3.5% to 2.0% in 2020.
- We expect membership growth will reach just 1.0% in 2020, down from the 1.5% membership growth rate we previously forecasted.
- We increased our delinquency rate forecast from 1.00% to 1.25% in 2020.
- Our previous forecast had credit union ROA at 0.50% in 2020; we now expect it to fall to 0.40% in 2020.

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) **Social distancing, "stay at home" orders and other measures will slow the spread of the virus, which will peak in the second quarter of 2020, gradually recede and not return to any significant degree later in the year (or next year).** We assume the epidemiological path of the virus in the U.S. lies somewhere between South Korea—which has been successful at containing new cases and flattening the epidemic curve—and Italy, where the number of new cases increased at a fast rate, causing many deaths and significant isolation measures.
2) **Congress and the Federal Reserve will rapidly respond with aggressive fiscal and monetary policy.** The Federal Open Market Committee (FOMC) has already reduced the federal funds target rate to a range of 0.00% to 0.25%, and the Federal Reserve announced it will purchase hundreds of billions of dollars in government debt and mortgage-backed securities. We expect the Federal Reserve to continue these and other measures to support the economy. In parallel, Congress recently passed (and the President signed) a massive fiscal stimulus that includes a provision requiring paid sick leave for workers affected by COVID-19, increased unemployment benefits, payments to individuals, support for hard-hit sectors, and loans to businesses, among other provisions. Expect further Congressional action to buttress the economy in the near future
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%	-5.00%	-20.00%	5.00%	5.00%	-3.75%	3.00%
Inflation (% chg CPI)*	1.55%	1.81%	1.00%	-5.00%	0.00%	1.50%	-0.63%	1.70%
Unemployment Rate	4.70%	3.50%	4.40%	15.00%	12.50%	10.00%	10.00%	7.50%
Federal Funds Rate (effective)	1.18%	1.55%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%
10-Year Treasury Rate	2.35%	1.92%	0.70%	0.70%	0.80%	0.90%	0.90%	1.50%
10-Year-Fed Funds Spread	1.17%	0.37%	0.55%	0.55%	0.65%	0.75%	0.75%	1.35%

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

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- **Economic Growth:** The COVID-19 pandemic has resulted in a severe and rapid slowdown in economic activity. While economic growth in the first quarter of 2020 started on solid footing, it quickly deteriorated as the effects of the COVID-19 virus intensified. The most immediately-affected industries—recreation, transportation, and food services and accommodation—add up to $2.1 trillion in annual spending (14% of total consumption spending). This consumption is likely to dry up almost completely for several months, with the effects reverberating throughout other sectors as well. As a result, we expect a contraction in GDP in the first quarter (-5.00%, annualized quarterly growth rate) followed by a significantly larger contraction in the second quarter (-20.00%, annualized quarterly growth rate). Assuming we pass the peak of the virus by mid- to late summer, we expect economic growth to bounce back slightly in the third and fourth quarters (5.00%, annualized quarterly growth rate). But growth will remain muted as supply chains rebuild, many businesses are forced to close indefinitely, and consumers remain cautious. We anticipate GDP to decline 3.75% in 2020 before rebounding to an increase of 3.00% in 2021.
- **Inflation:** As a result of the plummeting consumer and business demand coupled with the steep decline in oil prices, we forecast significant price deflation this year, particularly in the second quarter (-5.00%, annualized quarterly growth rate). As demand and economic growth rebound in the latter half of the year, we expect inflation to reach 1.50% (annualized quarterly growth rate) in the fourth quarter and -0.63% for the year. As the economic recovery proceeds and the economy moves back toward the long-run equilibrium growth path, we expect annual inflation to average 1.70% in 2021.
- **Unemployment:** A record 10 million people filed for unemployment claims during the last two weeks of March, suggesting that the near cessation of economic activity as a result of the COVID-19 response will have a significant impact on employment across a wide range of sectors. Workers in the service sector (e.g., hospitality, travel, leisure, food service, retail, and transportation) are experiencing job loss and reduced hours due to collapsing consumer demand. Moreover, supply side disruptions indicate that jobs in the manufacturing sector (e.g., auto manufacturers) are also at risk. By the end of the second quarter, we expect the unemployment rate to increase to 15.00% in the second quarter. As economic activity resumes towards the end of 2020, we expect unemployment to fall slightly but remain elevated at 10.00%. We expect the unemployment rate to fall further but remain elevated in 2021 as the economic recovery gradually extends throughout the economy.
- **Fed funds Rate:** To boost household and business confidence, the Federal Reserve's Federal Open Market Committee (FOMC) cut the federal funds target rate twice in March resulting in a target range of 0.00% to 0.25%. CUNA economists expect the federal funds target rate to remain unchanged for 2020 and 2021.
- **10-Year Treasury:** We expect the 10-Year Treasury rate to 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 likely increase slightly but remain below 1.0%.

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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%	5.3%	3.9%	1.2%	1.6%	12.0%	8.0%
Loan growth	9.3%	6.5%	0.5%	0.3%	0.5%	0.7%	2.0%	3.5%
Asset growth	6.9%	7.7%	4.5%	3.0%	1.0%	1.5%	10.0%	7.0%
Membership growth	3.9%	3.6%	0.5%	0.0%	0.0%	0.5%	1.0%	1.5%
Liquidity:								
Loan-to-share ratio**	82.1%	84.4%	80.6%	77.8%	77.2%	76.6%	76.6%	73.4%
Asset quality:								
Delinquency rate**	0.77%	0.70%	0.75%	1.25%	1.50%	1.25%	1.25%	1.10%
Net charge-off rate*	0.55%	0.56%	0.58%	0.90%	1.00%	1.00%	0.87%	0.75%
Earnings:								
Return on average assets (ROA)*	0.83%	0.93%	0.80%	0.25%	0.25%	0.25%	0.40%	0.60%
Capital adequacy:								
Net worth ratio**	11.1%	11.4%	10.9%	10.7%	10.6%	10.5%	10.5%	10.4%

*Quarterly data, annualized. **End of period ratio. Additional information and updates available on our website https://www.cuna.org/economics/

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- **Loan Growth:** Economic contraction, increased uncertainty, and heightened consumer caution will depress credit union lending despite historically low interest rates. We expect a significant slowdown in consumer loan growth, particularly auto loans. However, very low interest rates are likely to stimulate mortgage lending, particularly refinances, which will help support some credit unions. Lower long-term rates are also likely to induce credit unions to sell more mortgages and other long-term loans to the secondary market. We also expect members to utilize existing lines of credit—such as credit cards and home equity loans—to cover short-term and emergency expenses. Finally, normal commercial lending activity is likely to stall but many credit unions will utilize the Small Business Administration's Paycheck Protection Program (PPP) and those loans will undoubtedly help to buoy results. However, overall credit union loan growth will be down significantly in 2020 and into 2021, to 2.0% and 3.5%, respectively. Credit union membership growth will follow a similar trend.

- **Savings Growth:** We expect exceptionally strong savings growth at most credit unions discretionary spending declines, and the volatile stock market makes investments less attractive. Moreover, members will receive government stimulus checks starting in mid-April which will further boost deposits. Nonetheless, although overall savings growth will be high, the most significant deposit gains will be concentrated in credit unions that have a high proportion of members with salaried jobs. Credit unions that serve a high proportion of hourly or service workers—many of whom will face layoffs and reduced hours—may in fact face lower savings growth as payroll deposits fall.

- **Asset quality:** As a result of the economic slowdown we anticipate a significant increase in unemployment and underemployment. This will make it difficult for many to pay their bills on time. As a result, we expect delinquency rates to increase substantially, reaching 1.25% in 2020. We similarly expect charge-off rates to increase, peaking in the third and fourth quarters at 1.00% (quarterly annualized) and settling in at 0.87% for 2020. However, we do not expect portfolio quality to 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 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. Also, fiscal stimulus—including checks for consumers and loans to small businesses—should help members remain current on many of their bills. However, again, credit unions that have a higher proportion of hourly and service workers are likely to experience higher delinquency and charge-offs rates than credit unions that serve salaried workers.

- **ROA:** The combination of near-zero market interest rates and a shift to fast growth in low-yielding investments will translate to a decline in net interest income. Additional ROA pressures include rising provisions for loan losses and decreasing 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 coming in at 0.40% for 2020, a significant decline from 0.93% ROA in 2019 but well above the Great Recession low of 0.18% in 2009.

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