Economic and Credit Union Forecast

America’s Credit Unions Forecast Group

July 2024

Forecast Overview

July 2024

Despite an unexpectedly strong second quarter, America's Credit Unions' forecast group continues to expect cooling economic growth in full-year 2024 and continuing into 2025. Even so, optimism for a soft landing remains high with the group's consensus odds of recession over the forecast horizon holding steady – for the fifth consecutive quarter - at 33%.

Our third-quarter baseline economic forecast reflects the following (relatively small) changes:

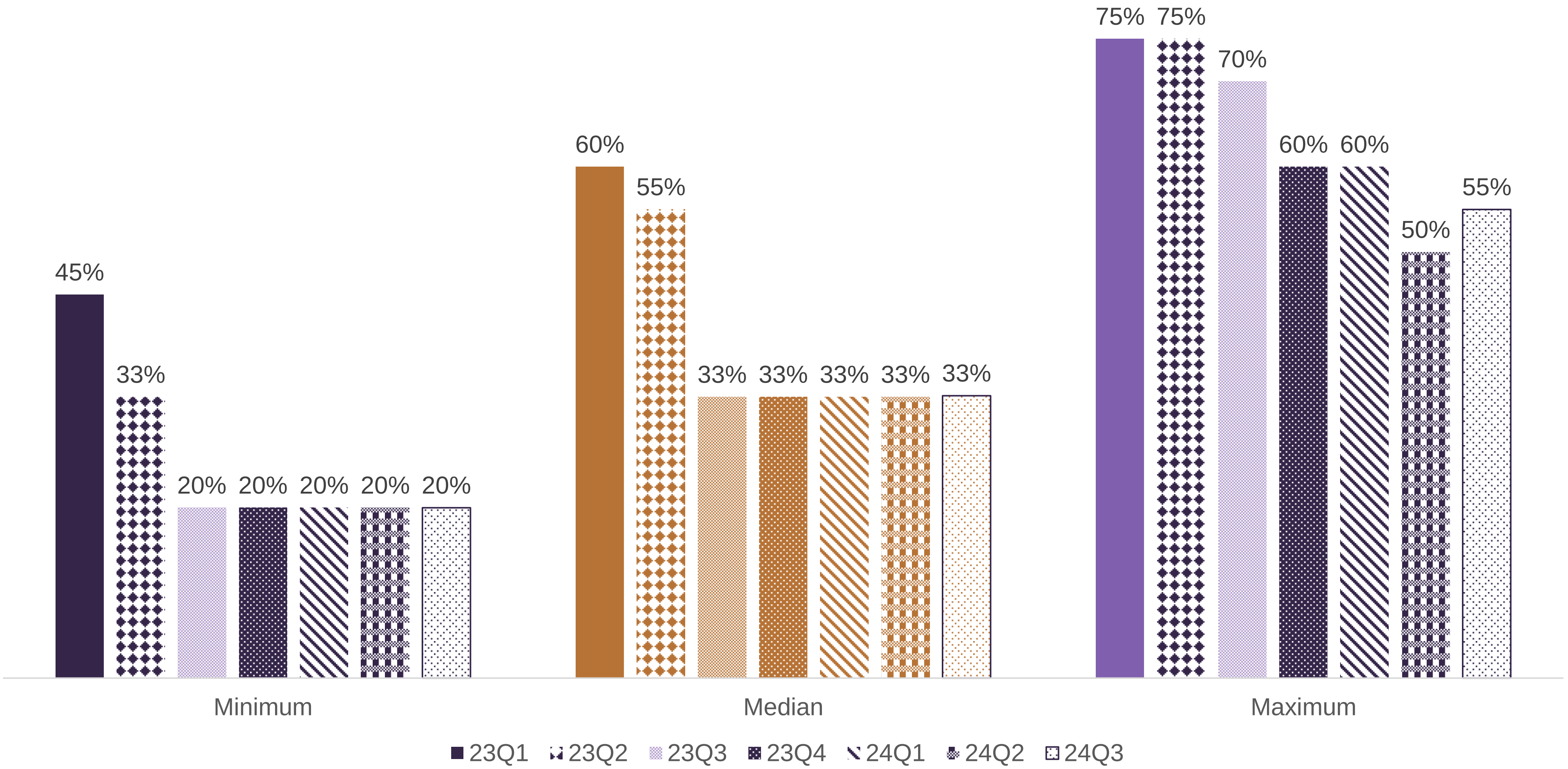
- We increased our year-end 2024 baseline unemployment rate outlook from 4.0% to 4.3%. We've likewise become a bit more pessimistic for the year ahead, nudging the year-end 2025 unemployment rate up from 4.3% to 4.5%.
- We lowered our outlook for over-the-year headline inflation in 2024 – from 3.0% previously to 2.8% in the current forecast.
- We added an additional quarter-point cut to our short-rate outlook next year – which takes the baseline Fed Funds rate down to 3.9% by year-end 2025. We expect 10-year Treasury yields to follow – lowering our year-end 2025 long-rate forecast by 0.20% (to 3.8%).

Our view of credit union operating results also changed modestly:

- We bumped our savings growth forecast up by two full percentage points in 2024 and by one point in 2025 – putting the current-year increase at 5.0% and next-year's advance at 6.0%.
- We lowered our outlook for annual membership growth – shaving a point off both 2024 and 2025 expectations. A 1.5% increase in the current year, followed by a 1.8% advance in 2025 now seems likely. That deceleration will almost certainly lead to slower loan growth than previously anticipated – especially in the near term. Accordingly, we've lowered our full-year 2024 loan growth outlook from 4% in the previous forecast to 3% currently.
- From a risk profile perspective, the above adjustments to growth suggest credit union loan-to-savings ratios will be lower than expected in the prior forecast. The year-end 2024 loan-to-savings ratio forecast is now 83.5% and the 2025 forecast is 82.3%. These represent declines of 2.9 percentage points and 3.7 percentage points respectively. We increased both 2024 and 2025 net chargeoff rates from 0.70% to 0.75%.
- We bumped up 2024 credit union earnings expectations a bit – from 0.50% to 0.60%. Those higher earnings resulted in a more favorable outlook for the movements year-end net worth ratio, which should now settle in at 10.8% (0.10% higher than expected in our previous forecast.

Odds of Recession Over Forecast Horizon

America's Credit Unions Forecast Group



Economic Forecast
July 2024

The Federal Reserve once again seems on track to deliver on the promise of a soft landing.

Year-over-year inflation as measured by CPI has dropped by two-thirds since peaking at 9% in 2022. And while progress clearly reversed during the first quarter, more recent developments reflect a resumption of the cooling Fed policy makers are aiming for: Year-over-year headline inflation (measured by the CPI) declined each month in the second quarter – ending June at 3.0% A distinct slowing in shelter cost increases in June were an especially helpful (and hopeful) sign that the path to the Fed's 2.0% inflation target is in sight. In addition, the Federal Reserve's preferred inflation measure – based on personal consumption expenditures – also declined each month in the second quarter – and ended June at 2.5%.

Labor markets are showing signs of stress. While the unemployment rate remains low it has increased by nearly one-half percentage point since the beginning of the year. Hiring has been on a broad declining trend and job losses are accelerating. The number of unemployed workers has increased by 815,000 in the year ending June 2024 and nearly two-thirds of that increase (525,000) has occurred since the start of the year. Hours worked in the non-farm business sector are nearly flat compared to year-ago readings – a harbinger of economic decline historically. While we don't foresee significant job market deterioration over the forecast horizon we do expect more obvious weakness – including a modest increase in the unemployment rate.

June's slower inflation data combined with broadly cooling labor markets suggests our original forecast for two quarter-point declines in the Federal Funds target in 2024 is on track. While Fed rate cuts were imperiled by first quarter developments, we now believe the recent lower inflation data makes two rate cuts in 2024 much more likely. In fact, much of our recent conversation revolved around whether the Federal Reserve is now risking unnecessarily severe labor market impacts due to inaction.

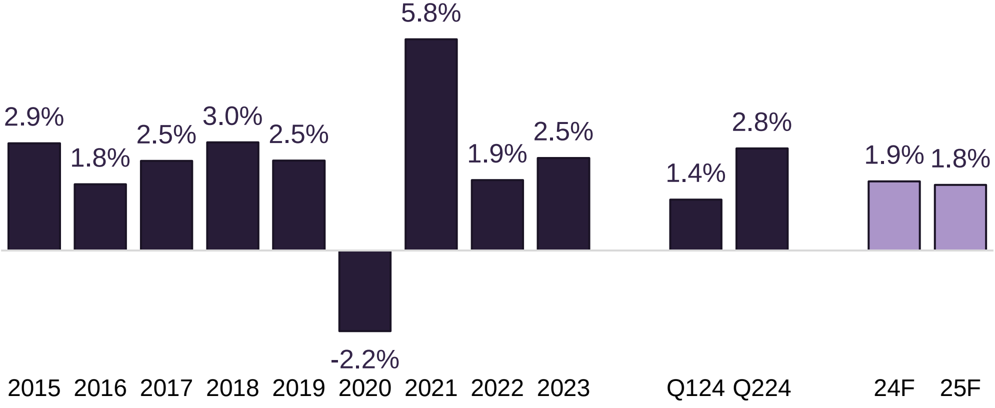
Long-term rates have been volatile lately, but we see upside and downside risks as being relatively balanced. In that context, if inflation behaves as we expect, Ten-year Treasury yields should stay close to 4% over the forecast horizon. Importantly, we expect the yield curve to remain inverted (though increasingly less so) through the end of our year-end 2025 forecast horizon.

Finally, we note high interest in the outcome of the upcoming election(s) among credit union professionals but stress that our forecast group does not evaluate economic impacts of the wide variety of possible outcomes. We presume political divisiveness will continue. And we acknowledge that the current political environment is characterized by high levels of uncertainty that have economic consequences: anxiety about the future tends to make consumers, investors and businesses more cautious than otherwise.

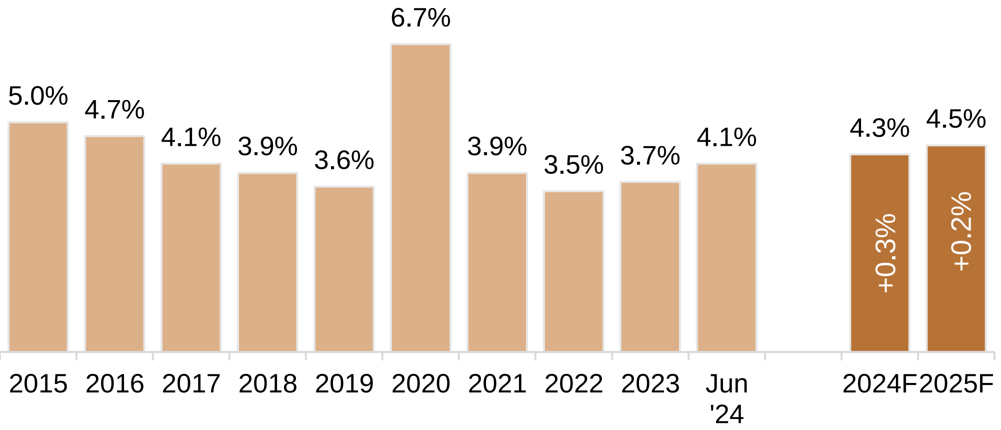
Real GDP growth has been strong in recent quarters, but we see the expansion getting "a little long in the tooth". The economy is already operating above potential - and in that context it becomes more difficult to assume consistent growth above 2%.   We anticipate a gradual downshift over the third and fourth quarters in 2024 with tepid growth continuing into 2025.

Economic Results and Outlook

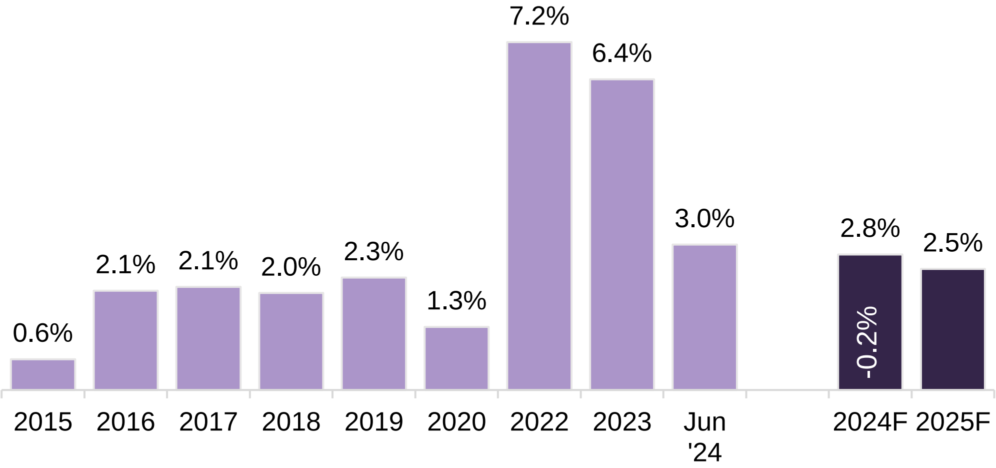
Economic Growth: Fed Delivers on Soft Landing
But Overall Modest Increases in GDP
30-Year Average = 2.5% // Source: BEA and America's Credit Unions



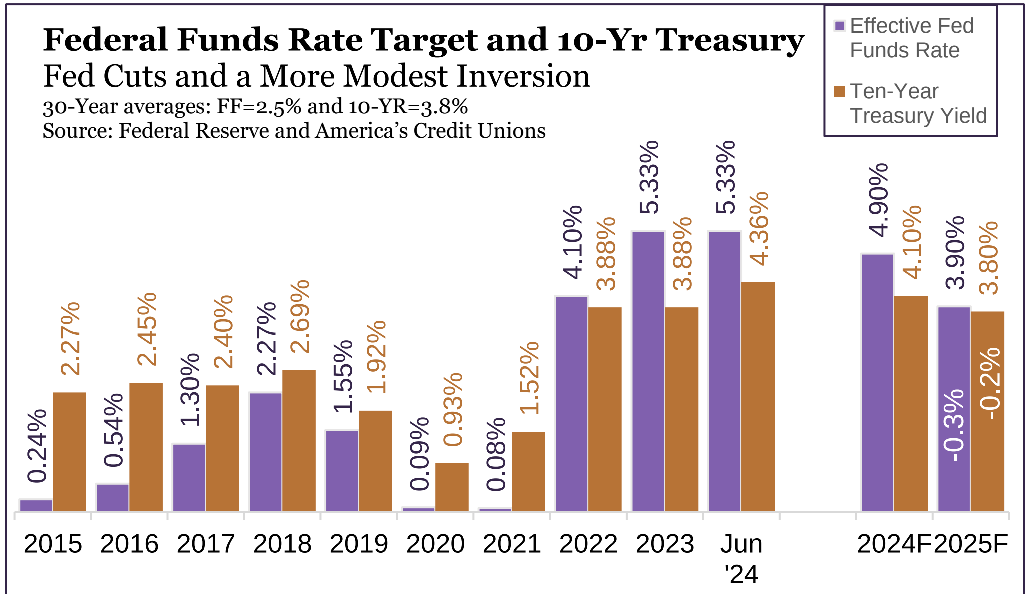
Unemployment Rate Drifting Up
30-yr avg 5.5% // Source: BLS and America's Credit Unions



Inflation Falling Close to Fed's 2.0% Target
12-month change in Consumer Price Index //
30-Year Average = 2.5% // Source: BLS and America's Credit Unions



Federal Funds Rate Target and 10-Yr Treasury
Fed Cuts and a More Modest Inversion
30-Year averages: FF=2.5% and 10-YR=3.8%
Source: Federal Reserve and America's Credit Unions



Economic Forecast

July 2024

	Past results		Actual/Forecasts					
	Previous 10 Yr. Avg	2023	2024 Q1	2024 Q2	2024 Q3	2024Q4	2024	2025
Growth rates:								
Economic Growth (% chg GDP)*	2.3%	2.5%	1.4%	2.8%	2.1%	2.0%	1.9%	1.8%
Inflation (CPI, 12 mth % chg)	2.8%	3.3%	3.5%	3.0%	2.9%	2.8%	2.8%	2.5%
Unemployment Rate (BLS)	4.5%	3.7%	3.8%	4.1%	4.2%	4.3%	4.3%	4.5%
Federal Funds Rate (effective)	1.45%	5.33%	5.33%	5.33%	5.10%	4.90%	4.90%	3.90%
10-Year Treasury Rate	2.41%	3.88%	4.20%	4.36%	4.10%	4.10%	4.10%	3.80%
10-Year-Fed Funds Spread	0.96%	-1.45%	-1.13%	-0.97%	-1.00%	-0.80%	-0.80%	-0.10%

*Percent change, annualized rate for quarterly and Q4-to-Q4 change for annual. All other numbers are end-of-period values.

Credit Union Forecast

July 2024

Our outlook for credit union operations has improved modestly this quarter but we continue to believe the movement will experience challenges – most especially with loan growth, credit quality and earnings results. On the other hand, this quarter's outlook reflects less pronounced liquidity issues with faster savings growth and slower loan growth than we expected last quarter.

Deposit growth has surprised on the upside and will likely continue to be strong – for several reasons. Credit unions continue to pay-up for deposits with one-year certificate accounts yields now averaging 3.45% nationally - 166 basis points above the comparable bank yield according to Datatrac. Average one-year yields at credit unions have been hovering around that lofty level since early in the fourth quarter 2023. Rate chasing activity seems to have slowed somewhat – reflected in significant declines in money market mutual fund growth over the past several quarters. Looking forward, Fed easing also should help to turn the tide. We make no attempt to forecast the stock market – but note any correction in overvalued equity markets would almost certainly also motivate inflows into insured shares.

On the other side of the balance sheet, we expect relatively slow loan growth over the forecast horizon – with continued weak growth in both first mortgages (36% of credit union loans) and auto loans (31% of credit union loans) based primarily on the outlooks of prognosticators who track these industries closely. Recent forecast revisions by economists at the Mortgage Bankers Association and at Cox Automotive suggest slower growth than previously anticipated. Bright spots include unsecured loans and home equity/2nd mortgage loans – expected to maintain momentum with near-double-digit increases in the near term. While loan growth will be relatively low over the forecast horizon, declining market interest rates will help to nudge overall loan growth higher in 2025.

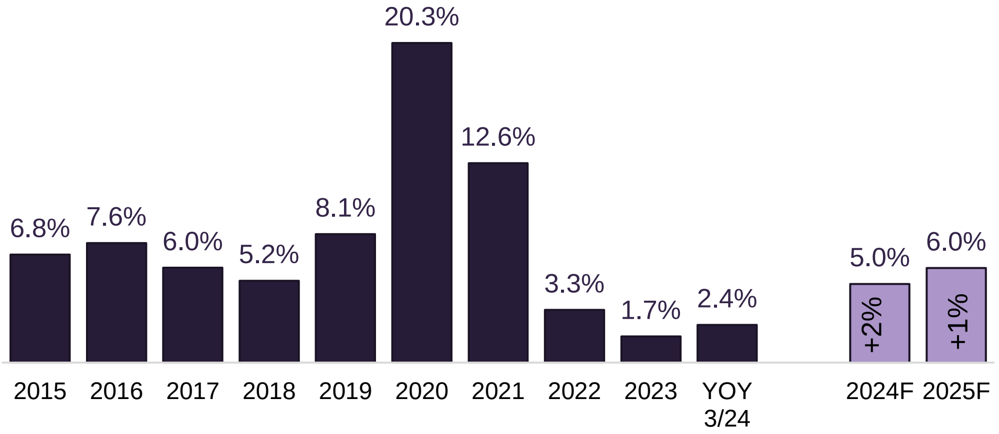
Our new third quarter forecast reflects a rather pronounced downward revision to membership growth – which is primarily a reflection of lower demand for indirect auto loans. Even so, the lower membership growth we anticipate is roughly three times higher than U.S. population growth.

Growing financial challenges in the household sector will keep credit quality concerns front-and-center for many. Credit score inflation (generally) and high-priced automobiles (specifically) during the COVID Crisis appear to be playing a big role in the increases in both delinquencies and net chargeoffs. In addition, lowish loan growth means the denominator effect is unlikely to help offset recent trends in a significant way.

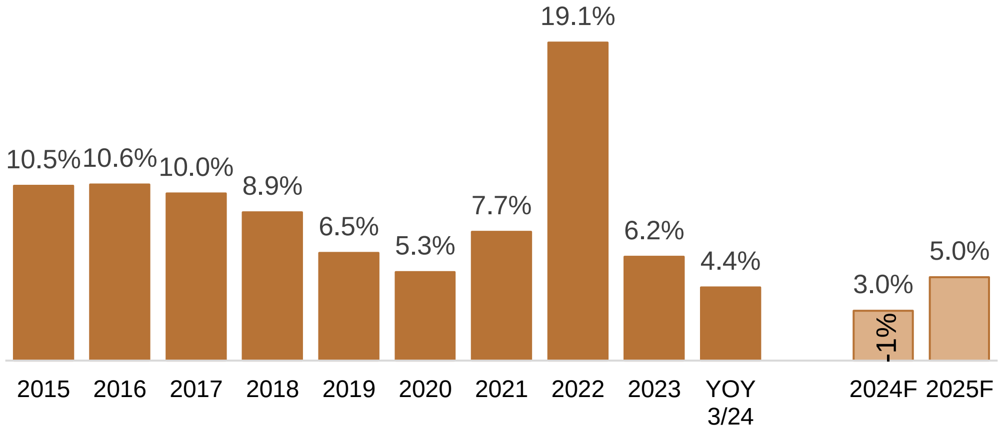
With low loan growth, lower consumer spending (hence interchange income that is under pressure), operating expense pressures and a supervisory focus on fees, credit union earnings will decline a bit in 2024 before bouncing back closer to long-run norms. Capital-to-asset ratios will hold steady at very healthy levels.

Growth Trends and Outlook

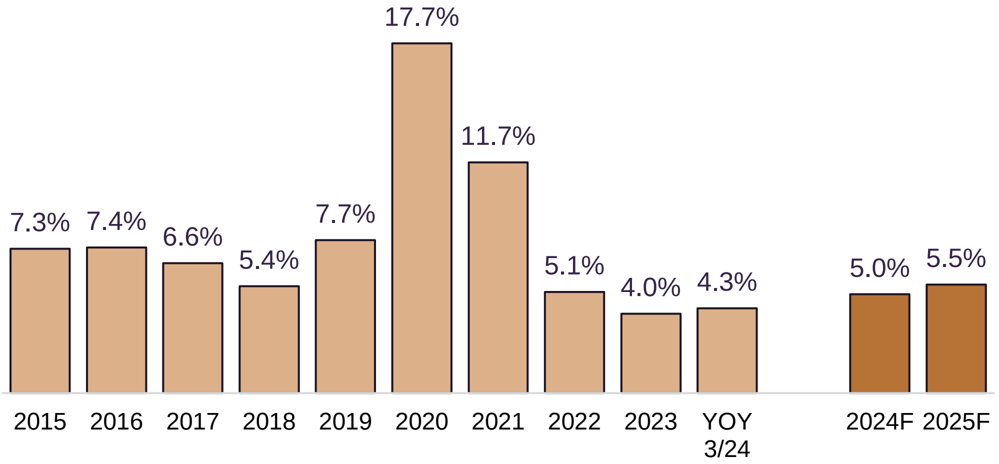
Stronger Savings Growth
And Trending to "Normal"
30-Year Average = 7.0% // Source: NCUA and America's Credit Unions



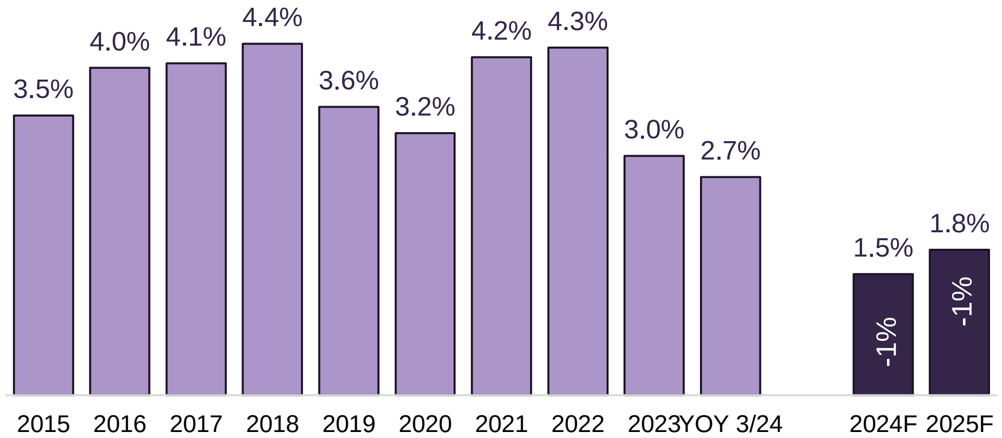
Weak Loan Growth
And Trailing Savings Growth
30-Year Average = 8.2% // Source: NCUA and America's Credit Unions



Asset Growth Shift
Reflecting Less Reliance on Borrowings
30-Year Average = 7.3% // Source: NCUA and America's Credit Unions

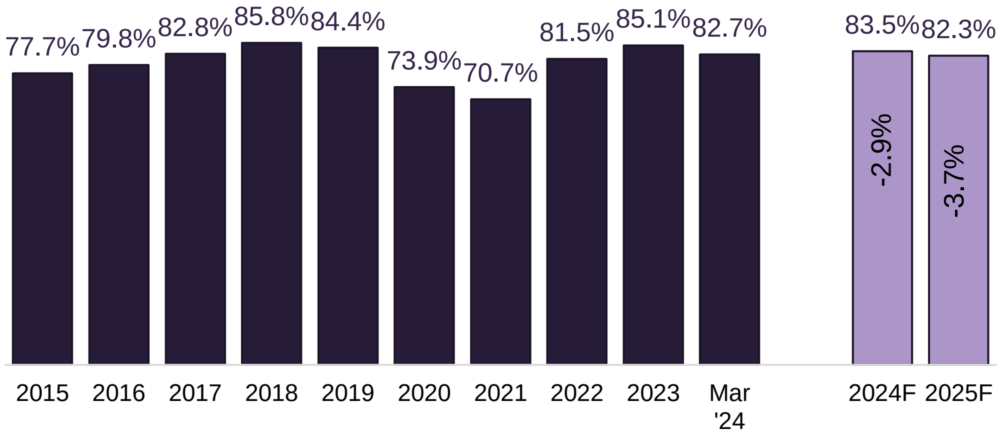


Slowing Membership Growth
Due to Low Indirect Auto Loan Growth
30-Year Average = 2.7% // Source: NCUA and America's Credit Unions

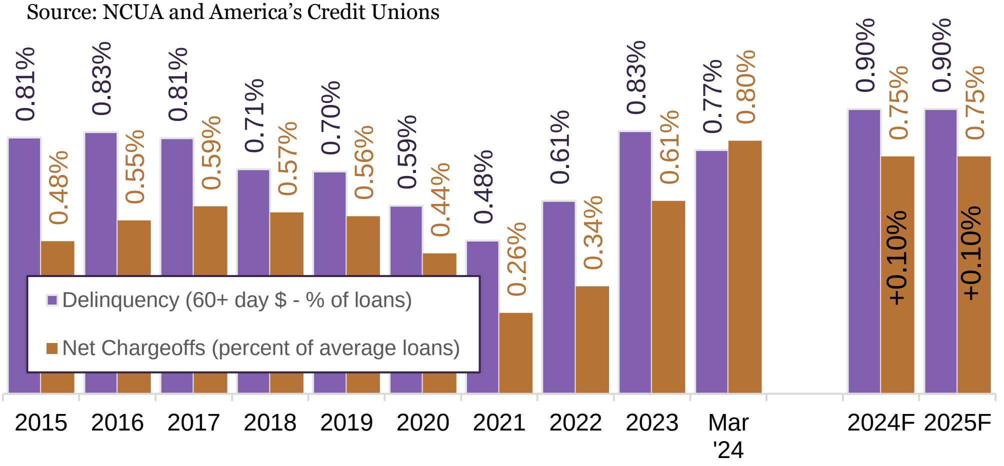


Risk Profile and Outlook

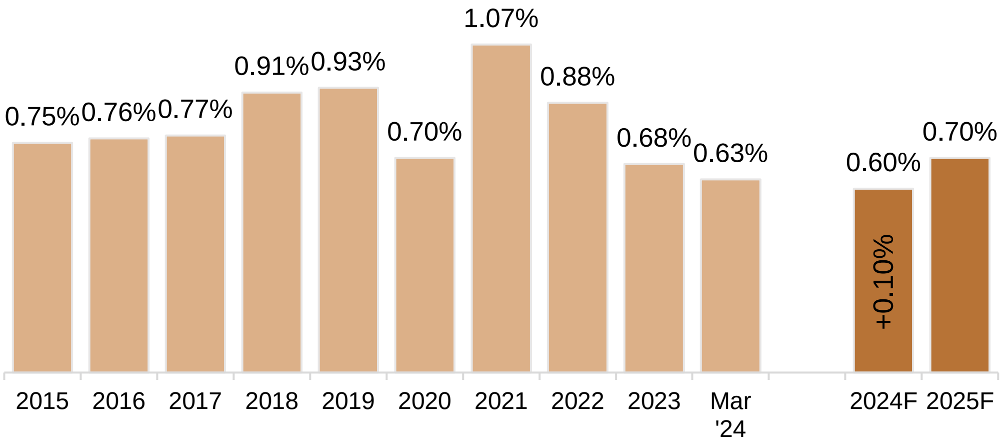
Liquidity Challenges Easing
Loan-to-Savings Ratio
30-Year Average = 75.6% // Source: NCUA and America's Credit Unions



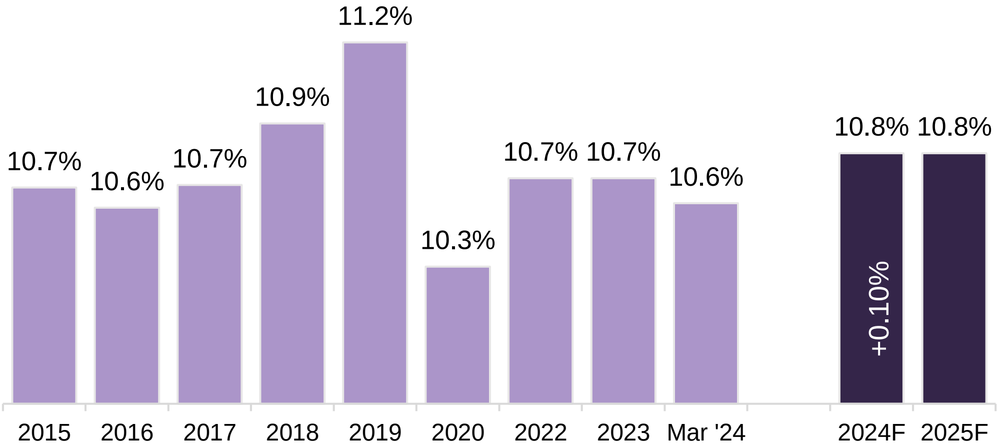
Credit Quality Concerns Peaking
Big Increases from COVID's Historical Lows
30-Year averages: Delinquency = 0.94% NCO- 0.54%
Source: NCUA and America's Credit Unions



Obvious Earnings Pressures
With ROA at Cyclical Lows
30-yr avg 0.88% // Source: NCUA and America's Credit Unions



Favorable Solvency Trends
98% of Credit Unions are Well Capitalized
Net Worth as a % of Assets // Source: NCUA and America's Credit Unions



Credit Union Forecast

July 2024

	Past Results		Actual/forecasts				Annual forecasts	
	10 Yr Average	2023	2024 Q1	2024 Q2	2024 Q3	2024 Q4	2024	2025
Growth rates:								
Savings growth	7.6%	1.6%	3.0%	1.0%	0.5%	0.5%	5.0%	6.0%
Loan growth	9.5%	6.2%	0.0%	0.5%	1.0%	1.5%	3.0%	5.0%
Asset growth	7.9%	4.0%	2.3%	0.7%	1.0%	1.0%	5.0%	5.5%
Membership growth	3.7%	2.9%	1.0%	-0.5%	0.5%	0.5%	1.5%	1.8%
Liquidity:								
Loan-to-share ratio**	79.7%	85.1%	82.7%	82.2%	82.6%	83.5%	83.5%	82.3%
Asset quality:								
Delinquency rate**	0.72%	0.83%	0.77%	0.85%	0.87%	0.90%	0.90%	0.90%
Net charge-off rate*	0.49%	0.61%	0.80%	0.63%	0.65%	0.67%	0.75%	0.75%
Earnings:								
Return on average assets (ROA)*	0.83%	0.68%	0.66%	0.55%	0.57%	0.60%	0.60%	0.70%
Capital adequacy:								
Net worth ratio**	10.9%	10.7%	10.6%	10.7%	10.7%	10.8%	10.8%	10.8%

*Quarterly data, annualized. **End of period ratio. Net worth forecast does not account for CECL Provision