Credit Union National Association

CUNA economic and credit union forecast

June 14, 2021 | Jordan van Rijn, PhD, Senior Economist, Credit Union National Association

Economic overview

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After the pandemic-induced recession, the U.S. economy continues its strong recovery. COVID vaccinations, warmer weather and reduced COVID restrictions in most states have led to increased consumer optimism and spending. As of June 14th, 43.9% of the U.S. population was fully vaccinated and over half had received at least one dose. Nonetheless, the pace of vaccination has stalled considerably, and vaccine hesitancy and more contagious variants have caused scientists to doubt whether the U.S. can achieve full herd immunity. Moreover, back-to-back months of disappointing jobs reports have highlighted challenges in the labor market, as workers remain sidelined due to various factors including childcare responsibilities, health concerns and competition with expanded unemployment benefits. Furthermore, a spike in inflation has raised concerns about the Federal Reserve's plan for interest rates and its ability to maintain the recovery into the future. Meanwhile, first quarter call report data shows that credit unions have continued to perform well throughout the pandemic, with historically low delinquency and charge-off rates, solid membership growth, soaring deposits, and earnings over 1.0%. Overall, there were only minor changes to our previous forecast in April.

The most significant changes to our April forecast include:

- The economy is estimated to grow 6.5% in 2021 and 4.5% in 2022, up from our previous forecasts of 6.0% and 4.0%, respectively.
- After a strong first quarter, credit union ROA is expected to reach 0.85% in 2020 and 2021, up from our previous forecast of 0.60% in both years.

Key Assumptions: With the pace of COVID vaccination slowing considerably, we do not expect the U.S. to reach herd immunity in 2022. The biggest risk to the economy is the continuing rise in new COVID variants that are more contagious and likely to become the dominating strains around the world. Widespread vaccinations will lead to a more open economy and evidence suggests that the vaccines are highly effective against new COVID variants that currently exist; however, it is unclear whether vaccines will be effective against new variants that may emerge in the future. We assume that the virus will continue to wane, which will lead to further reopening of the economy, particularly in the fall when schools resume in-person instruction. Moreover, we expect passage of an infrastructure bill sometime in the second half of 2021, in the range of $1 trillion to $1.5 trillion. Nonetheless, most of the benefits to the economy will accrue in 2022 and beyond, as infrastructure spending takes time to trickle through the economy and create efficiency gains. Finally, as President Biden has stated, extended unemployment benefits will end in September and there will be no further stimulus related to the pandemic.

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	Actual results		Quarterly results/forecasts				Annual forecasts	
	5 Yr Avg	2020	2021:1	2021:2	2021:3	2021:4	2021	2022
Growth rates:								
Economic Growth (% chg GDP)*	1.1%	-3.5%	6.4%	8.0%	6.5%	5.0%	6.5%	4.5%
Inflation (% chg CPI)*	1.9%	1.3%	4.9%	2.5%	2.3%	2.3%	3.0%	2.5%
Unemployment Rate (BLS)	4.6%	6.7%	6.0%	5.7%	5.3%	5.0%	5.0%	4.0%
Federal Funds Rate (effective)	1.18%	0.09%	0.07%	0.10%	0.10%	0.10%	0.10%	0.10%
10-Year Treasury Rate	2.08%	0.93%	1.74%	1.80%	1.90%	2.00%	2.00%	2.50%
10-Year-Fed Funds Spread	0.90%	0.84%	1.67%	1.70%	1.80%	1.90%	1.90%	2.40%

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

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Economic Growth: The Bureau of Economic Analysis (BEA) reported that real gross domestic product increased at an annual rate of 6.4% in the first quarter, one of the strongest quarters of economic growth in recent history. Government stimulus—including direct payments to households and extended unemployment benefits—have combined with rising vaccination rates to make consumers feel more optimistic about the future. Consumer spending makes up approximately two-thirds of the economy, and the University of Michigan's Index of Consumer Sentiment rose to 88.3 in April, the highest since March 2020. CUNA economists now expect the U.S. economy to grow around 6.5% in 2021. This would represent the fastest pace of growth since the 1980s.

Unemployment: After forecasters anticipated growth of roughly 1 million new jobs per month, the Bureau of Labor Statistics (BLS) reported relatively weak job creation in both April and May. Total nonfarm payroll employment grew only 278,000 in April followed by a more robust but still underwhelming figure of 559,000 in May. Several factors appear to be restraining job creation, including fear of contracting COVID-19, a dearth of in-person childcare options, supply chain challenges, generous unemployment benefits, and structural changes to the economy as many shuttered businesses fail to reopen and new technology- and mobile-based firms struggle to find qualified workers. Nonetheless, the unemployment rate fell to 5.8% in May and is likely to continue to fall as vaccinations continue and schools resume in-person instruction in the fall. However, given the lower labor force participation rate, the true unemployment rate is likely one to two percentage points above this figure. We expect the official unemployment rate to fall to 5.0% by year-end 2021 and 4.0% by the end of 2022, which would bring the economy close to full employment.

Inflation: Inflation has spiked in recent months as the economy reopens and consumer spending rebounds. The BLS reports that the Consumer Price Index (CPI) increased 0.6% in May after rising 0.8% in April. Over the last 12 months the index rose 5.0%. This represents the steepest rise in prices since 2008 and is well above the Federal Reserve's 2.0% target. Federal Reserve Chairman Jerome Powell argues that inflation is temporary and due to a rebounding economy and transitory spike in prices relative to a year ago when prices were significantly deflated due to the pandemic. Nonetheless, expected inflation has also risen considerably in recent months and fears are mounting that this could lead to an unsustainable spiral in which higher prices lead workers to demand higher wages, which in turns feeds further increases in prices. Such a situation occurred in the 1970s and can typically only be remedied by a sharp increase in interest rates which leads to significantly reduced loan demand and consumer spending, and often ends in a recession. CUNA economists expect headline CPI to temporarily rise to 3.0% in 2021 before falling to 2.5% in 2022—not far from the Fed's 2.0% target range—which is in line with inferred inflation expectations from bond market activity. Nonetheless, credit unions should keep an eye on both inflation and inflation expectations, and how the Fed plans to respond.

Interest Rates: Although it has fallen slightly in recent months, the 10-year Treasury yield has risen considerably since the beginning of the year. On January 4th the rate was 0.93% compared with 1.51% as of June 15th. As the economy continues to rebound and inflation expectations rise, credit unions should anticipate rising long-term interest rates. CUNA economists expect the 10-year Treasury yield to reach 2.0% by year-end 2021 and 2.5% by the end of 2022. Federal Reserve Chairman Jerome Powell had previously stated that he expects the Fed to maintain short-term rates near zero through at least 2023 in order to help lower-income households that have been particularly impacted by the pandemic; however, the strong economic growth and rise in inflation could portend a policy shift towards raising rates sooner. Credit unions should monitor this situation closely, but for the time-being CUNA economists expect the Fed Funds rate to remain near zero for the foreseeable future.

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	Actual results		Quarterly results/forecasts				Annual forecasts	
	5 Yr Avg	2020	2021:1	2021:2	2021:3	2021:4	2021	2022
Growth rates:								
Savings growth	9.6%	20.3%	6.8%	5.2%	1.5%	1.5%	15.0%	5.0%
Loan growth	8.4%	5.3%	0.3%	1.0%	2.0%	1.6%	5.0%	9.0%
Asset growth	9.1%	17.7%	5.7%	4.3%	2.0%	1.5%	13.5%	4.5%
Membership growth	3.7%	3.2%	1.2%	0.7%	0.6%	0.5%	3.0%	3.5%
Liquidity:								
Loan-to-share ratio**	80.4%	73.9%	69.4%	66.7%	67.0%	67.1%	67.1%	69.6%
Asset quality:								
Delinquency rate**	0.74%	0.59%	0.45%	0.58%	0.60%	0.65%	0.65%	0.60%
Net charge-off rate*	0.53%	0.44%	0.31%	0.40%	0.50%	0.60%	0.45%	0.45%
Earnings:								
Return on average assets (ROA)*	0.79%	0.70%	1.04%	0.80%	0.80%	0.70%	0.85%	0.85%
Capital adequacy:								
Net worth ratio**	10.9%	10.3%	10.0%	9.6%	9.5%	9.6%	9.6%	9.9%

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

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Loan & Membership Growth: First quarter NCUA data shows that credit union loan portfolios grew a tepid 0.3%—not atypical for the first three months of the year which often witnesses slower loan growth—and memberships rose a strong 1.2%. The reopening economy, increased consumer confidence and pent-up demand will lead to stronger loan and membership growth of 5.0% and 3.0%, respectively, in 2021. Next year, credit unions can expect these figures to revert closer to long-run averages of 9.0% and 3.5% as the pandemic recedes and the economy continues to expand. Moreover, as government stimulus ends, consumers will have less excess liquidity to pay down loan balances, such as credit cards. Nonetheless, the mortgage boom is expected to cool off slightly as the supply of mortgages that are in-the-money wanes, interest rates rise, consumers shift to spending on services (like restaurants and vacations), and vaccinated workers return to apartments in urban areas.

Savings & Asset Growth: The last round of government stimulus checks led to another quarter of substantial savings and asset growth at credit unions. Overall, credit union deposits grew 6.8% in the first quarter of 2021 and assets rose 5.7%. Savings and asset growth should remain strong in the second quarter as well as households receive their tax refunds. Moreover, deposits of child tax credits are scheduled to begin in July which will create another inflow of savings at credit unions. On the other hand, the opening economy and pent-up demand mean that people are relatively more likely to spend their stimulus funds and even draw down on savings compared with last year (such as by taking long-delayed vacations). Overall, credit unions should expect strong savings and asset growth of 15.0% and 13.5%, respectively, this year, before experiencing a return to longer-run averages in 2022. At this point, CUNA economists do not anticipate a decline in savings balances in the foreseeable future, as negative annual deposit growth is extremely rare for the credit union industry.

Asset quality: Credit union asset quality remains very healthy: The first-quarter delinquency and net charge-off rates fell to near historic lows of 0.45% and 0.31%, respectively. This trend is being driven by deleveraging (which is magnified by refinancing activity), continued forbearance activity, significant government stimulus and a recovering economy. However, several of these factors will recede in the coming months: households are unlikely to receive further direct stimulus payments related to COVID-19 and extended unemployment benefits are set to expire in September. Therefore, credit unions should expect a slight deterioration in portfolio quality figures, but not to any great extent. CUNA economists forecast delinquency and net charge-off rates of 0.65% and 0.45% in 2021, slightly above last year but below long-run averages.

ROA: Credit union earnings received a large boost in the first quarter of 2021 as credit unions pulled back loan loss allowances set aside during the pandemic and benefited from sales on mortgages and Payment Protection Program (PPP) loans. However, this was mainly driven by larger credit unions: The median large credit union with over $1 billion in assets experienced ROA of 1.18% in the first quarter versus just 0.13% at the smallest credit unions with under $20 million in assets. Overall, ROA for the industry reached 1.04%, well above last year's figure of 0.70%. Going forward, earnings will be hindered somewhat by rising interest rates and tight interest margins, supply chain challenges in the auto sector, and a slowing housing market; nonetheless, credit unions should expect relatively robust ROA of 0.85% in 2021 and 2022—slightly above the five-year average—as the economic recovery continues and consumers become more confident spending and borrowing.

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