MCUL CUsolutions GROUP
MICHIGAN CREDIT UNION LEAGUE & AFFILIATES

U.S. Economic Outlook & Its Impact on Credit Unions

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Mock Federal Reserve Board Meeting

Future Path of Interest Rates

One and Done or Shallow Path of Rate Increases (2-3 rate moves in 2016)

Positive Economic News:

1. Strong job growth (210,000 monthly job growth average in 1st Quarter)
2. Unemployment rate at full employment 5%
3. Rising wages pressures (2.3% increase in last 12 months)
4. 5 million job openings
5. GDP grew 2.4% in 2015, expected to grow 2.5% in 2016
6. Low inflation increases real household incomes
7. Cars sales at record levels (17.4 million in 2015)
8. Pent up demand for durable goods
9. Housing investment is accelerating (9.4% growth expected in 2016)
10. Rising home prices (5.7% over last 12 months)
11. Low household debt and debt service ratios
12. Strong consumer credit growth
13. Rising consumer confidence, low Google searches of "recession"
14. Falling oil prices ($110 June 2014, to $38 in March 2016)
15. Rising manufacturing in Europe (53.5 ISM #) and Japan (52.5 ISM #)

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Future Path of Interest Rates

One and Done or Shallow Path of Rate Increases (2-3 rate moves in 2016)

Negative Economic News:

1. Falling oil prices ($110 in June 2014, to $38 in March 2016)
2. Falling energy investment (energy's share of capital expenditure:11% in 2012, 6% today)
3. Falling stock prices & rising volatility (S&P 500 down from 2,100 to 2,050)
4. Falling inflation expectations (1.5% annual inflation expected over next 10 years)
5. Falling 10-year treasury interest rates (1.7%)
6. Rising bond spreads in both investment grade and high yield
7. Excess inventories leading to an inventory correction
8. Falling commodity prices (20% decline over last 12 months)
9. Falling world trade
10. Rising value of the dollar (4.4% appreciation over last 12 months)
11. Manufacturing sector in recession and losing jobs (51.8 ISM #)
12. Commodity-linked emerging markets in recession (Brazil, Canada, etc.)
13. China's economy is slowing and they are devaluing Yuan
14. Commercial real estate bubble?
15. Falling corporate profits

Economic Forecast

- **We now expect the U.S. economy to grow by 2.50% in 2016 and 2.75% in 2017**. Robust domestic demand in the household and business sectors will continue to spur growth in 2016 and 2017. Pressures of the rising U.S. dollar on manufacturing and exports are easing and will boost GDP growth. Economic conditions in China, the Euro area, Japan and other emerging markets will continue to have spillover effects on the U.S. economy. However, the U.S. remains resilient given its limited exposure to weaker aggregate demand from the rest of world.

- **Headline and core (excluding food and energy prices) inflation will be 2.25% in 2016. In 2017 core inflation will stay at 2.25% but headline will overshoot core with a 2.50% increase**. The uptick in headline inflation will be driven by higher energy prices against the backdrop of an economy fast approaching full employment. U.S. economic expansion without inflation will be a thing of the past. Consumer benefits from lower petroleum prices and the strong U.S. dollar will start to diminish.

- **The unemployment rate will finish 2016 at 4.7% and at 4.5% in 2017**. Monthly job gains will continue to nudge the unemployment rate lower. The quality of jobs created continues to shift from lower-paying entry-level to higher-paying professional and construction jobs. Unemployment resulting from lower commodity prices such as job losses in oil and gas will begin to dissipate as oil and energy prices start to increase. Re-entry of discouraged workers into the job market will mean unemployment rate declines will not be as dramatic as those in the recent past. However, overall job growth should remain strong, reaching full employment no later than the end of next year.

- **The Federal Funds interest rate will increase to 0.90% by the end of 2016 and to 1.90% by the end of 2017.** Federal Reserve actions will remain data driven. Rising output, tighter labor markets, and higher inflation in 2016 will cause the FOMC to continue monetary policy normalization. We now expect two quarter-point rate hikes this year and four next year.

- **The 10-year Treasury interest rate will increase modestly to 2.50% by December 2016.** That is still about 1.5 percentage points below what we might expect given the condition of the U.S. economy, but geopolitical uncertainty will continue to overrule domestic financial considerations. We expect the 10-year Treasury rate to reach 3.0% by December 2017.

- **The Treasury yield curve will flatten in 2016 as short-term interest rates rise faster than long-term interest rates.**

Economic Forecast

March 2016

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5Yr Avg	2015	2016:1	2016:2	2016:3	2015:4	2016	2017
Growth rates:								
Economic Growth (% chg GDP)*	2.00%	2.40%	1.25%	3.00%	2.00%	1.75%	2.50%	2.75%
Inflation (% chg CPI)*	1.55%	0.67%					2.25%	2.50%
Core Inflation (ex. food & energy)*	1.92%	2.09%					2.25%	2.25%
Unemployment Rate	5.16%	5.00%	4.80%	4.70%	4.68%	4.60%	4.70%	4.50%
Federal Funds Rate	0.17%	0.24%	0.40%	0.60%	0.63%	0.90%	0.90%	1.90%
10-Year Treasury Rate	2.21%	2.24%	2.25%	2.45%	2.55%	2.75%	2.50%	3.00%
10-Year-Fed Funds Spread	2.04%	2.00%	1.85%	1.85%	1.92%	1.85%	1.60%	1.10%

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

Credit Union Forecast

- **Credit union savings balances will grow by 5.0% in 2016 and 4.0% in 2017.** As the Federal Reserve continues raising short-term interest rates this year, we expect the anticipated transfer of funds to money market mutual funds will finally materialize. With inflation in the offing and the windfall from lower oil prices disappearing, cautiously optimistic members will seek higher returns.

- **Membership growth will continue to increase in 2016 by 3.0%** due to more indirect auto lending and spreading word of the positive credit union value proposition. We expect membership growth next year to be slightly lower, at 2.75%, as the auto lending boom begins to slow and indirect borrower memberships decline.

- **Credit union loan balances will increase by 10.0% in 2016 and 9.0% in 2017**. Loan growth this year will be only marginally lower than the impressive loan growth of last year. As the economy continues to expand, we expect households to continue to release pent up demand for autos, furniture and appliances over 2016, and a slightly slower pace in 2017 year. New auto loans, credit card loans and purchase mortgage loans will remain to be strong growth areas.

- **Credit quality will remain healthy 2016 and 2017**. The improving job market will contain the numerators of the loan quality ratios, and fast loan growth will expand the denominator. This will push the delinquency ratio down from 0.81% in 2015 to 0.75% in 2016 and 2017. Net charge-offs will likewise decline from 0.48% in 2015 to 0.45% in 2016 and 2017.

- **Credit union return on assets will decline marginally to 0.70% in 2016 and could dip to 0.65% in 2017**. Interest margins will be helped by strong loan growth in 2016 but hurt by the flattening yield curve. Mortgage refinancing and its resulting revenue will decline in 2016. The effect of overfunded loan loss allowance accounts, which kept loan loss provision expenses very low for the past few years, will dissipate in 2016. Higher funding costs, higher operating expenses due to a tighter labor market, and lower fee income from overdrafts and NSFs will also contribute to lower return on assets in 2016 and 2017.

- **Net worth ratios will increase to 11.0% in 2016 and 11.2% in 2017**. Even with the expected slight decline in earnings, capital ratios will continue to rise this year and next as soft savings inflows provide for only modest asset growth.

Credit Union Forecast

March 2016

	Actual Results		Quarterly Results/Forecasts				Annual Forecasts	
	5Yr Avg	2015	2016:1	2016:2	2016:3	2016:4	2016	2017
Growth rates:								
Savings growth	5.2%	6.8%	3.3%	0.5%	0.5%	0.8%	5.0%	4.0%
Loan growth	6.8%	10.5%	1.5%	3.5%	3.3%	1.8%	10.0%	9.0%
Asset growth	5.6%	7.3%	2.3%	1.0%	1.0%	1.3%	5.5%	4.5%
Membership growth	2.5%	3.5%	1.0%	0.9%	0.8%	0.3%	3.0%	2.8%
Liquidity:								
Loan-to-share ratio**	72.4%	77.7%	76.4%	78.7%	80.8%	81.6%	81.6%	85.5%
Asset quality:								
Delinquency rate**	1.08%	0.81%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
Net charge-off rate*	0.64%	0.48%	0.46%	0.45%	0.45%	0.45%	0.45%	0.45%
Earnings:								
Return on average assets (ROA)*	0.77%	0.75%	0.71%	0.71%	0.70%	0.69%	0.70%	0.65%
Capital adequacy:								
Net worth ratio**	10.7%	10.9%	10.8%	10.9%	11.0%	11.0%	11.0%	11.2%

*Annualized Quarterly Data. **End of period ratio. Additional information and updates available on our MCUE website.