



TRENDWATCH 4Q22



February 15, 2023



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Today's Lineup

Market Update

Jason Haley, Chief Investment Officer, Investment Management Group, ALM First

4Q 2022 Credit Union Results

Alix Patterson, Chief Experience Officer, Callahan & Associates
William Hunt, Senior Analyst, Callahan & Associates

Lean Rocket LOCAL

Martha Fuerstenau, President/CEO, American 1 Credit Union





Callahan Quarterly TrendWatch | February 15, 2022

ALM FIRST MARKET UPDATE

Speaker



Jason Haley
Chief Investment Officer

Current Economic Themes

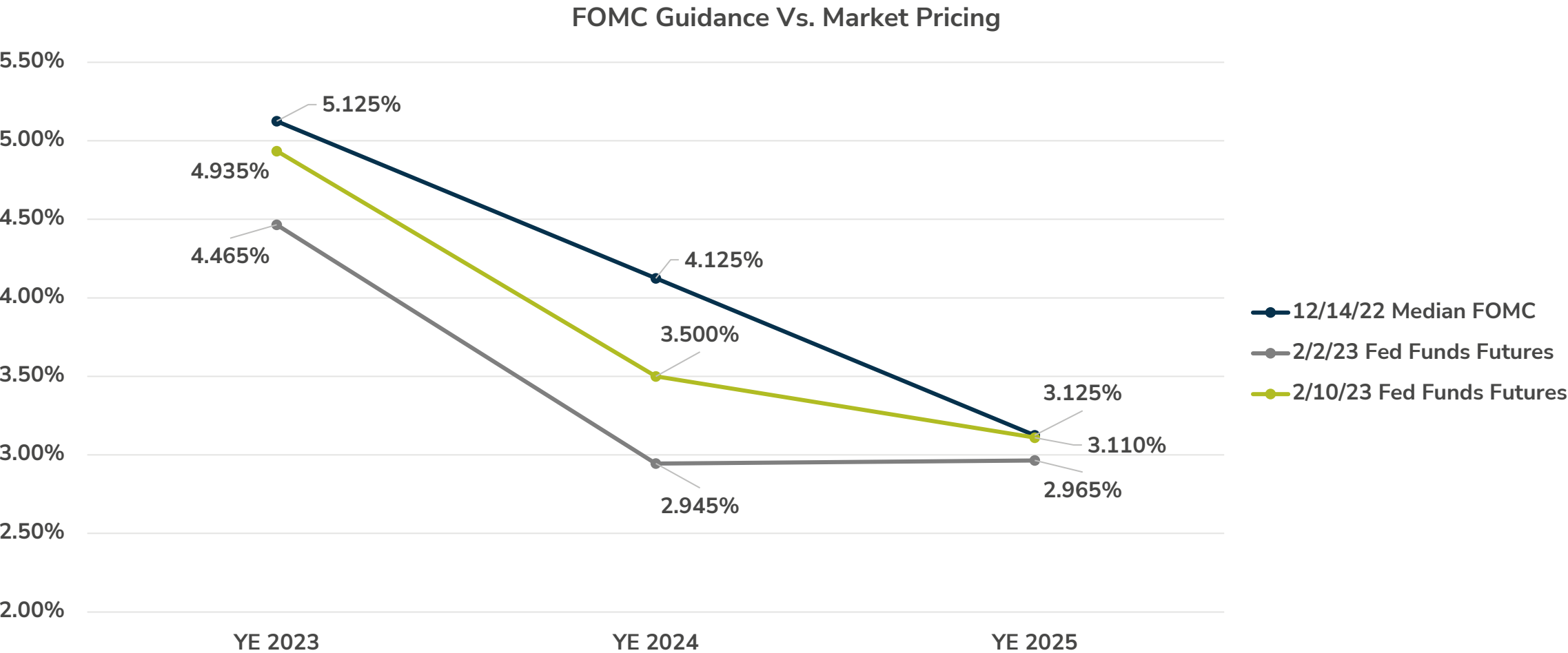
- **Markets vs. the Fed**

- Ever since inflation show signs of easing in early November, financial markets have fought the Fed's guidance of 'higher for longer,'
 - Until recently, the bond market was pricing for a lower terminal fed funds rate and 50 bps of rate cuts in 2H 2023
- 'Peak inflation' narrative drove a significant improvement in fixed income performance in January, attributable to a sharp decline in rates, tighter spreads, and reduced interest rate volatility
- The Fed announced another 25 bp rate hike on February 1, and the official statement pointed to "further increases" (plural) in the fed funds rate

- **GDP softens, but the labor market remains hot**

- Headline GDP growth came in above expectations (2.9% vs. 2.6%), but the underlying details were softer
- The Q4 Employment Cost Index moderated to 1%, sparking a bond market rally
- Job openings rose nearly 600k in December, bringing the openings-to-unemployed ratio back near 2:1
- January jobs report was a huge upside surprise, including 500k+ job growth and decline in UE rate to 3.4%, lowest since 1969

Market Pricing Moving Closer to Fed Guidance Post-Jobs



Source: Bloomberg, ALM First

Debt Ceiling Showdown (Circus)

- **How did this begin?**

- Debt ceiling was first introduced in 1917 and modified in 1939 to its current version
- There have been numerous government shutdowns over the years, with limited impact to the U.S. economy, but there have been no defaults on federal debt

- **Here we go again**

- Debt ceiling standoffs have unfortunately become more frequent since 2011, with the minority Congressional party using the debt ceiling as a financial nuclear weapon of sorts in negotiating spending packages
- In late January, the current limit of \$31.4 trillion was reached, and Treasury is not allowed to issue net new debt until it is raised
- Extraordinary measures (mostly the \$450 billion deposited at the Fed) will allow the Treasury to continue funding the government until June according to Secretary Yellen, but there are still unknowns, including April tax receipts
 - Some street economists project a much later “X date” (drop-dead date)

Potential Implications of U.S. Default

- **Further downgrades of U.S. credit rating**
 - Would be more broad-based and severe than the 2011 downgrade by S&P, likely followed by increased borrowing costs for the U.S. government
 - Could also trigger an increase in the risk weighting of Treasuries and loss of HQLA level 1 status
- **Downgrades of GSEs and large U.S. banks**
 - Institutions perceived to be backstopped by the U.S. government would also likely be downgraded and incur higher funding costs
- **Reduction in foreign investment in U.S. debt**
 - Would expectedly send U.S. yields higher and the U.S. dollar lower
- **Loss of reserve currency status**
 - This status provides cover for a multitude of U.S. fiscal sins and is closely tied to the above risk
- **General reduction in confidence and capital expenditures**
 - Loss of confidence typically reduces spending/investing and slows the economy
- **Long story short: A U.S. default would be very bad (for everyone)**

Looking Ahead

- **Fixed income market conditions have improved to start the year**
 - Overall demand and liquidity conditions have been much better relative to much of 2022
 - Bonds are positioned for a much better year in 2023 relative to last year
- **Economic metrics still generally sound**
 - U.S. economy is slowing, but overall fundamentals remain sound
 - Household and corporate balance sheets remain in relatively good condition
 - Housing market has stabilized of late, but auto delinquencies are starting to pick up
 - Debt ceiling is biggest external risk for now, but geopolitical uncertainty looms as well
- **CU industry liquidity experiences a major swing**
 - Funding/liquidity has been a predominant theme for CUs and banks in recent months
 - Demand for FHLB advances, brokered CDs, Fed discount window, repo, and other non-core funding sources has increased significantly
 - NIM and overall profitability improved in Q4, but rising cost of funds in 2023 could pressure margins as the year evolves

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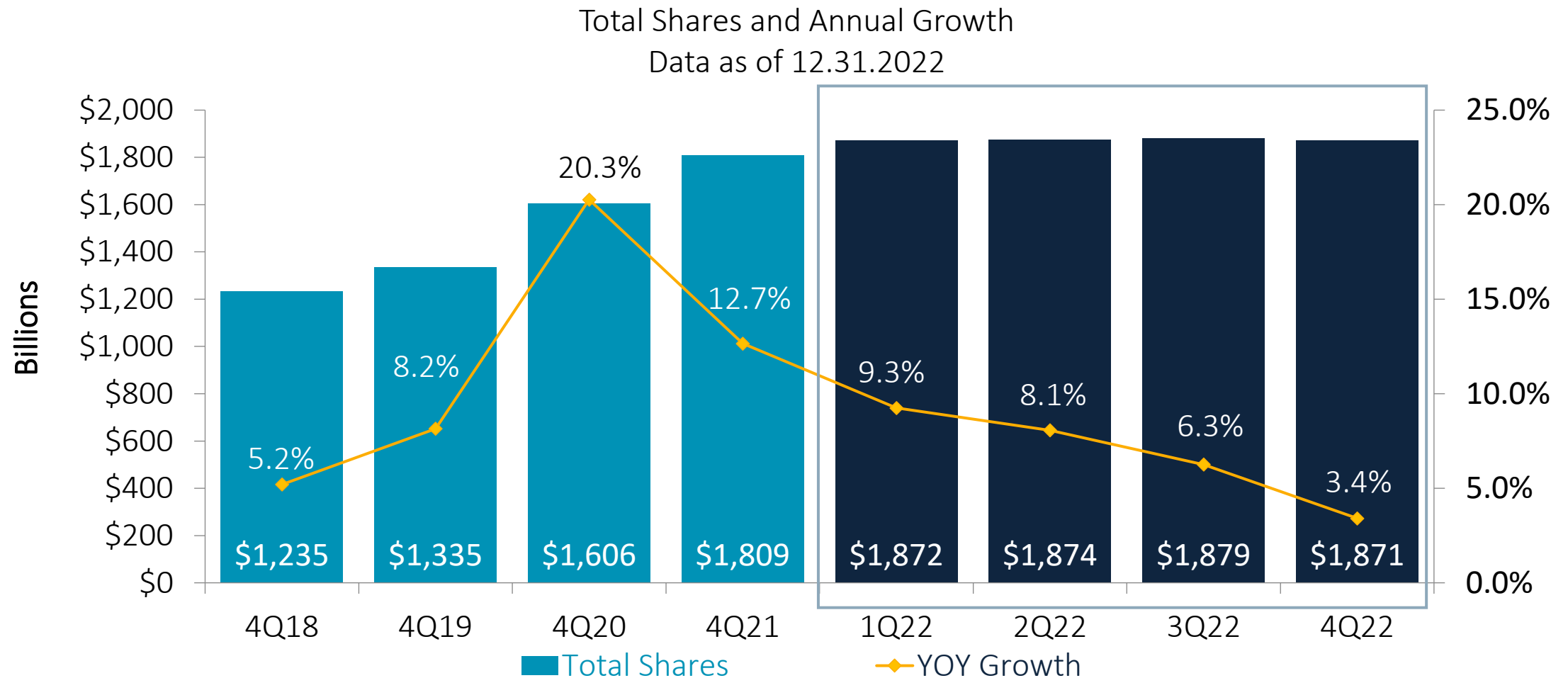
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Annual industry loan growth achieves new record

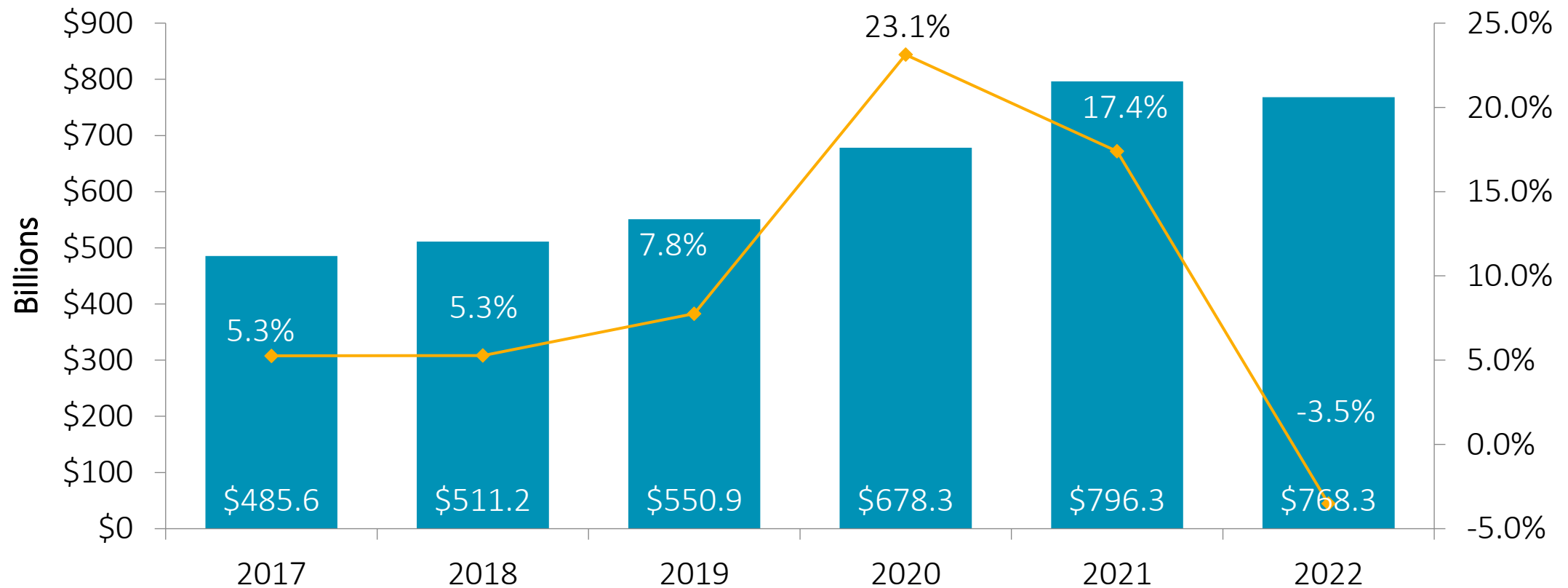
	12/31/2022	12-Mo. Growth	12/31/2021	12-Mo. Growth
Assets	\$2,191.7B	5.2%	\$2,083.4B	11.7%
Loans	\$1,521.8B	20.0%	\$1,268.4B	8.0%
Shares	\$1,870.7B	3.4%	\$1,809.0B	12.7%
Investments	\$573.6B	-20.5%	\$721.3B	19.9%
Capital	\$207.2B	-5.8%	\$220.1B	6.6%
Members	136.7M	4.4%	131.0M	4.2%

Lowest year-over-year growth in shares since September 2014

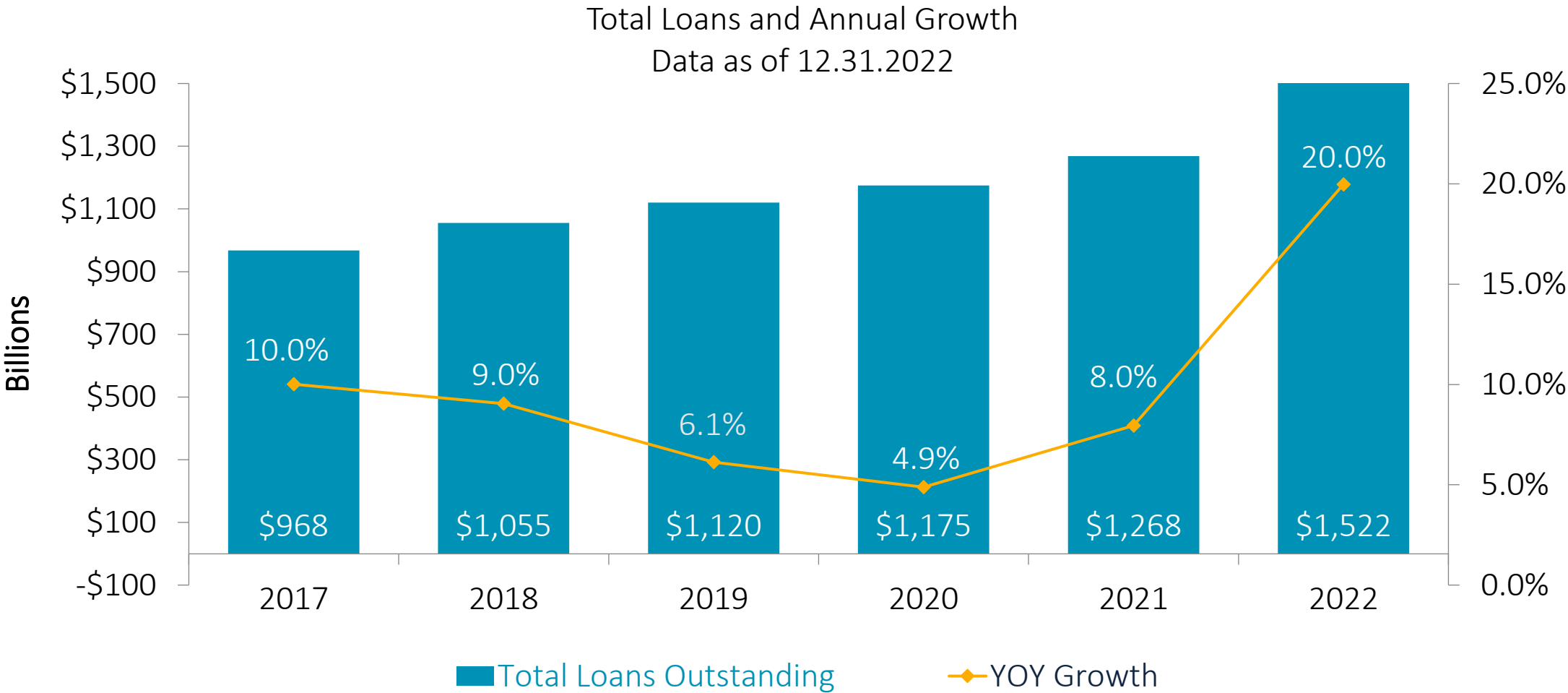


Loan originations (\$) decline from a year ago as real estate markets cool

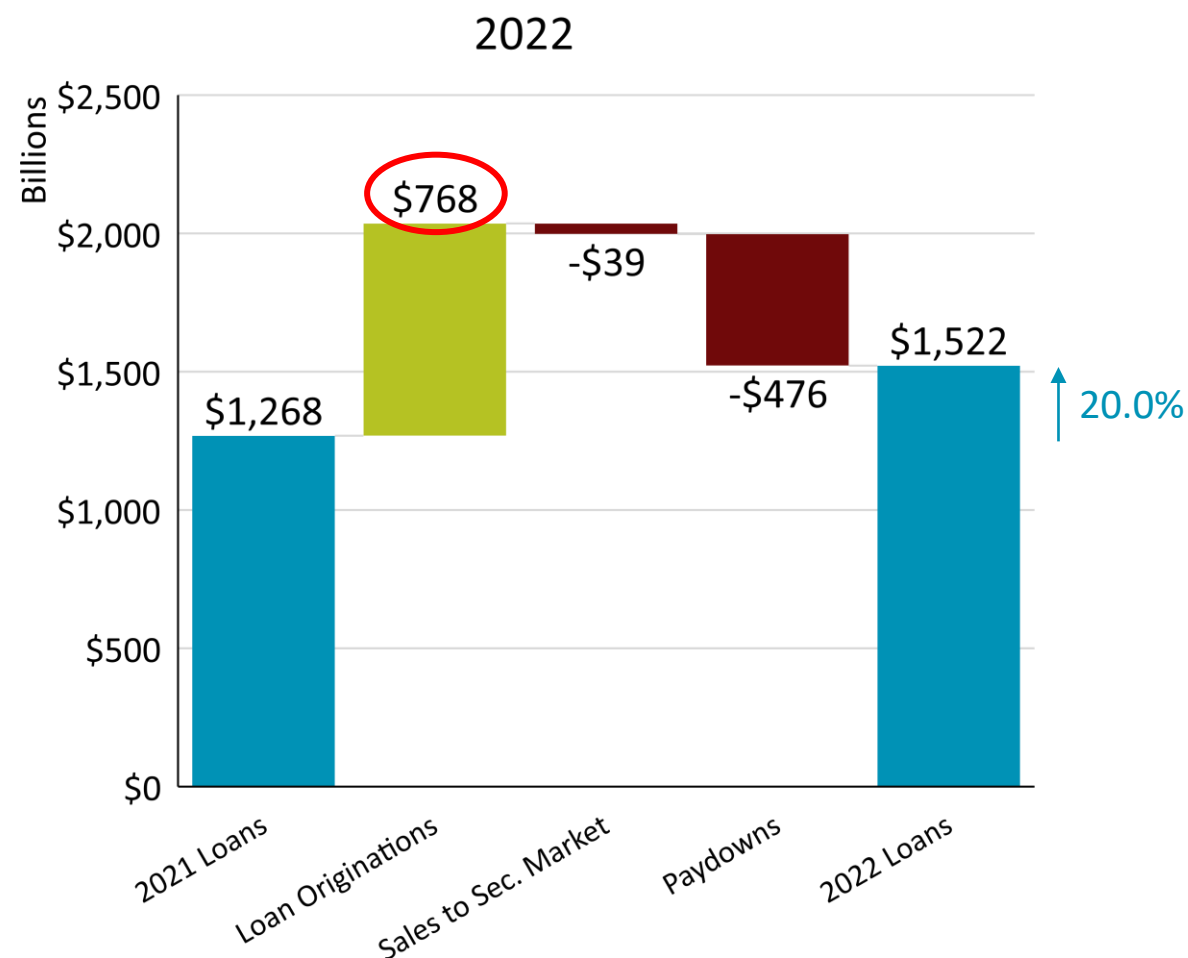
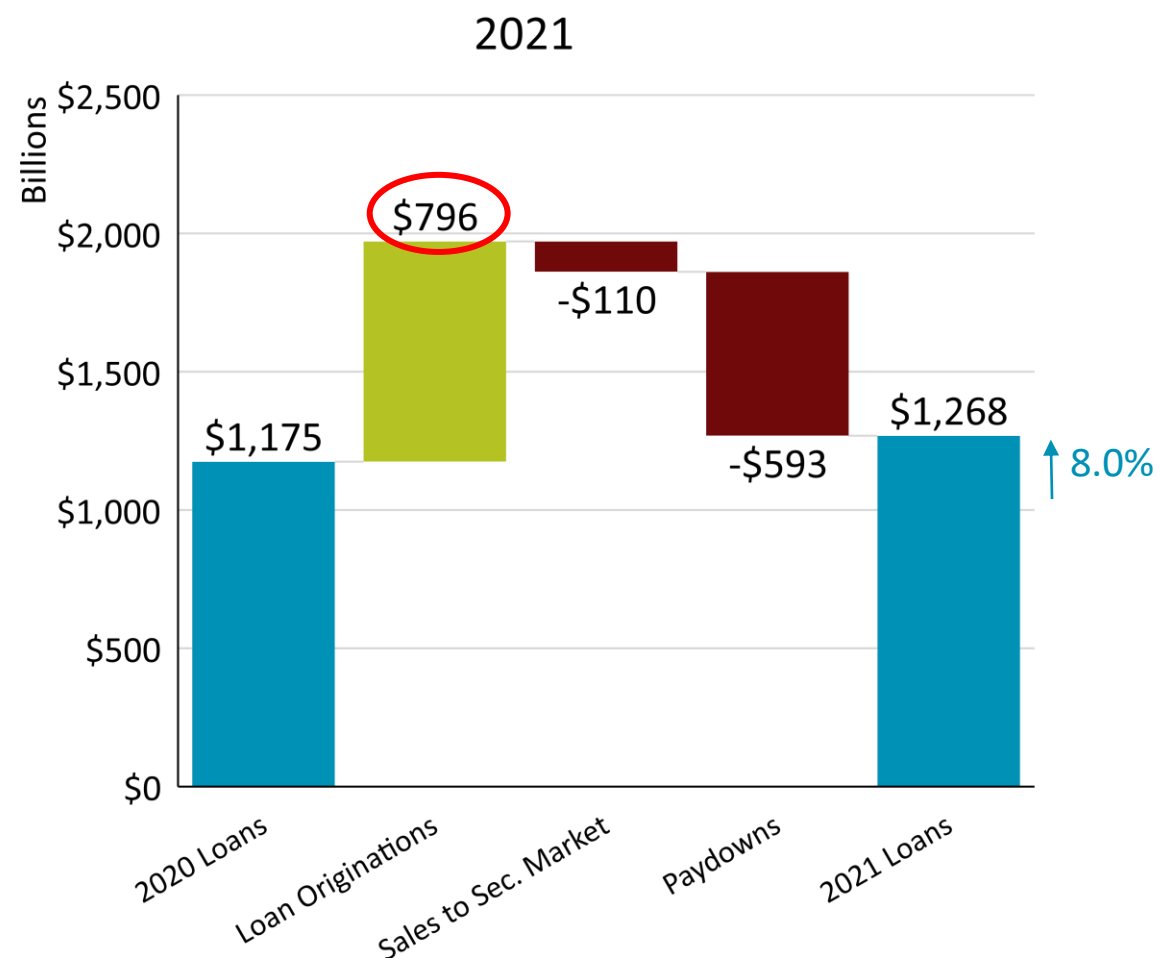
YTD Loan Originations and Annual Growth
Data as of 12.31.2022



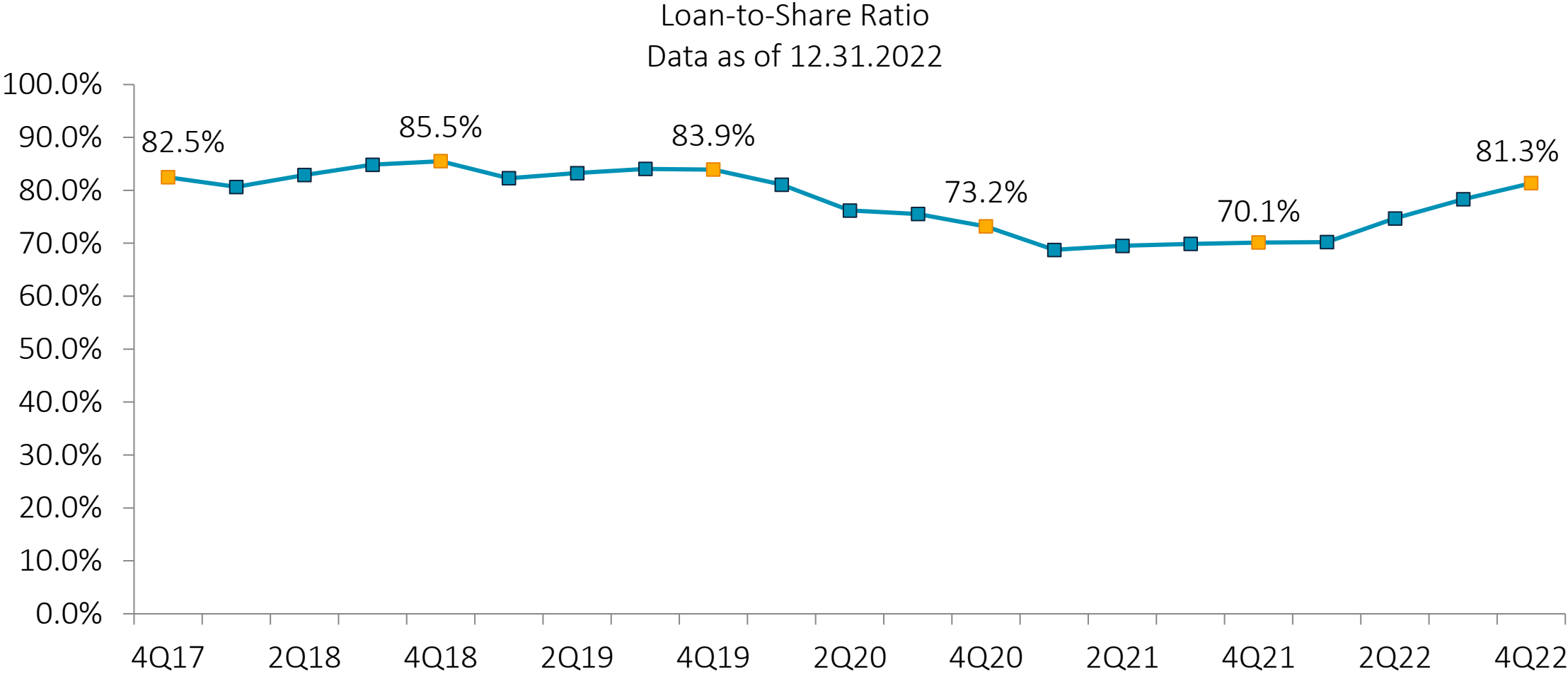
Loan growth surges as secondary market sales and early paydowns slow



Changes in loan activity after origination allow for balance sheet growth even as originations decelerate

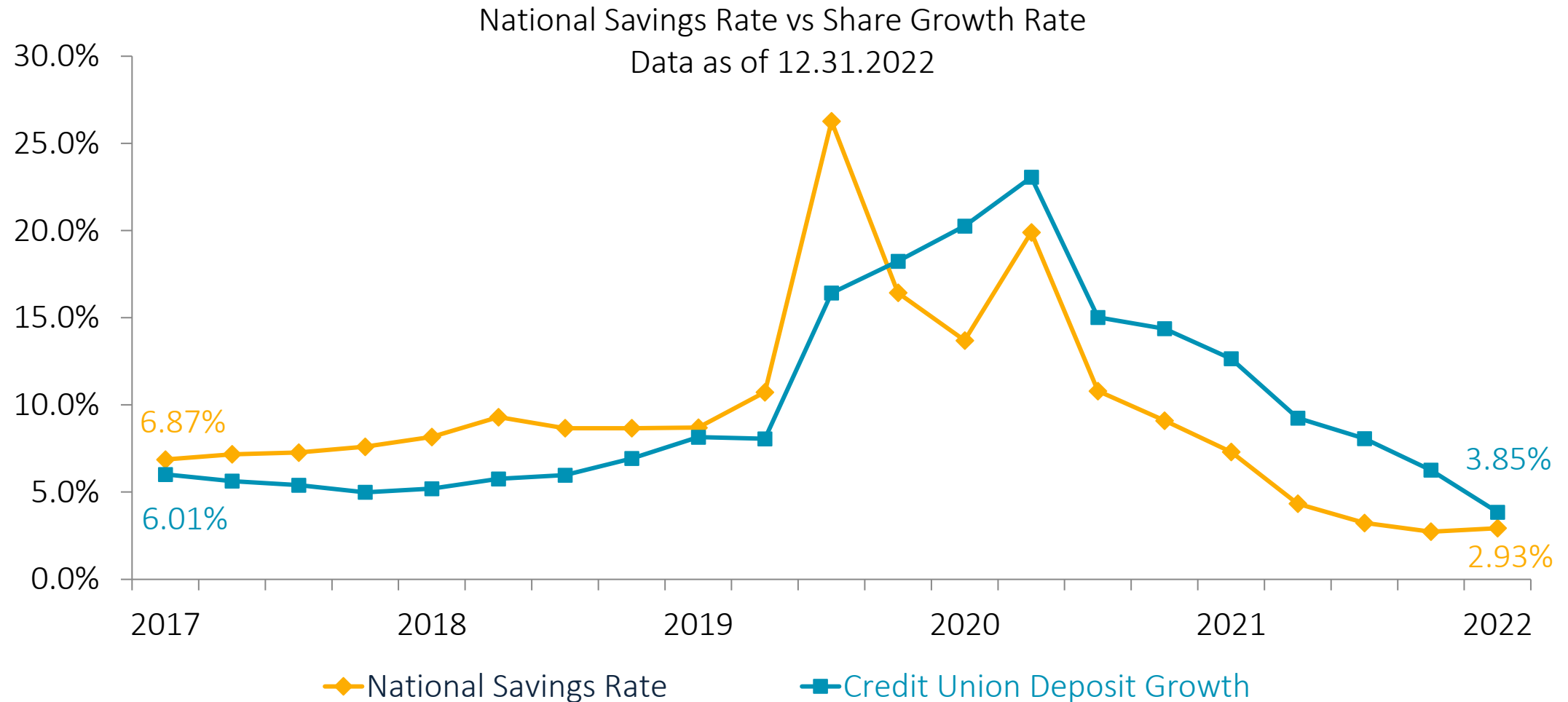


The loan-to-share ratio is up 11.2 percentage points from a year ago

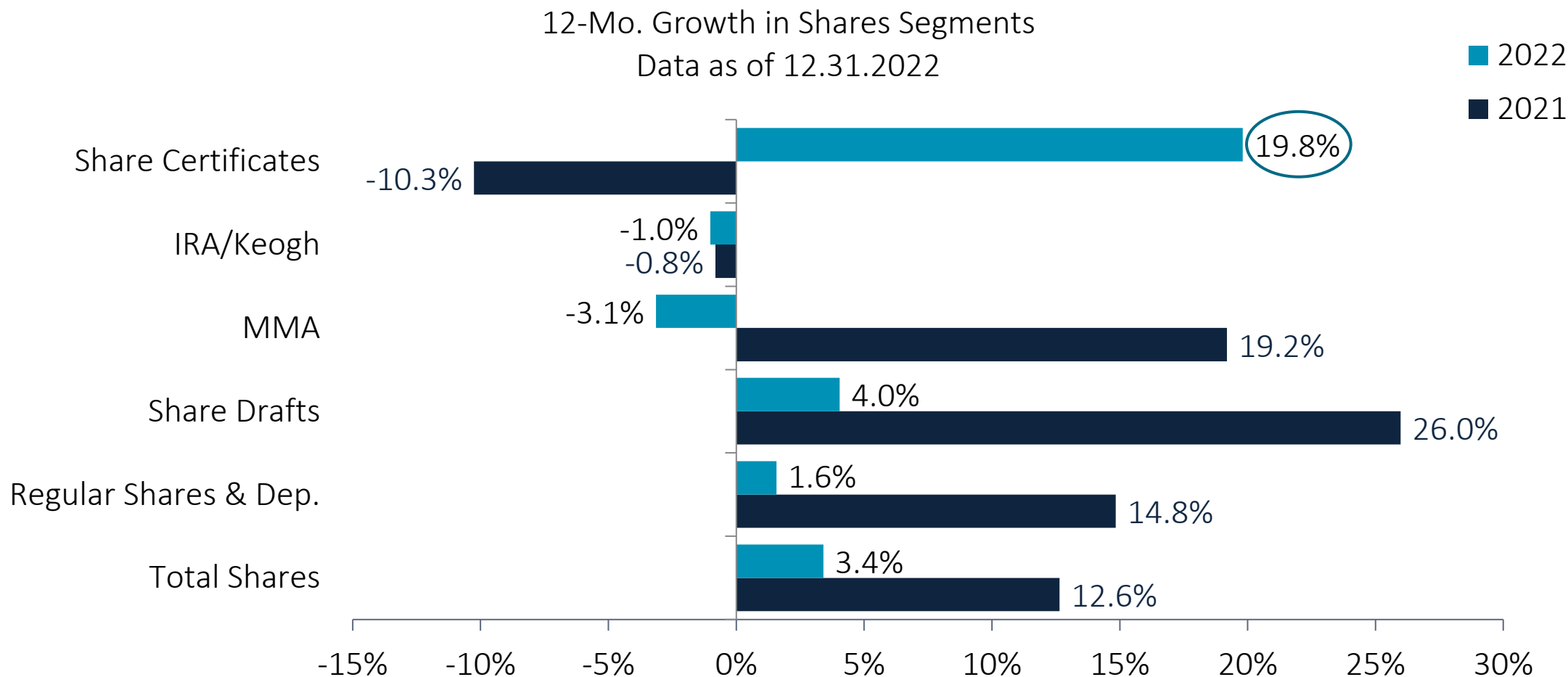


Savings

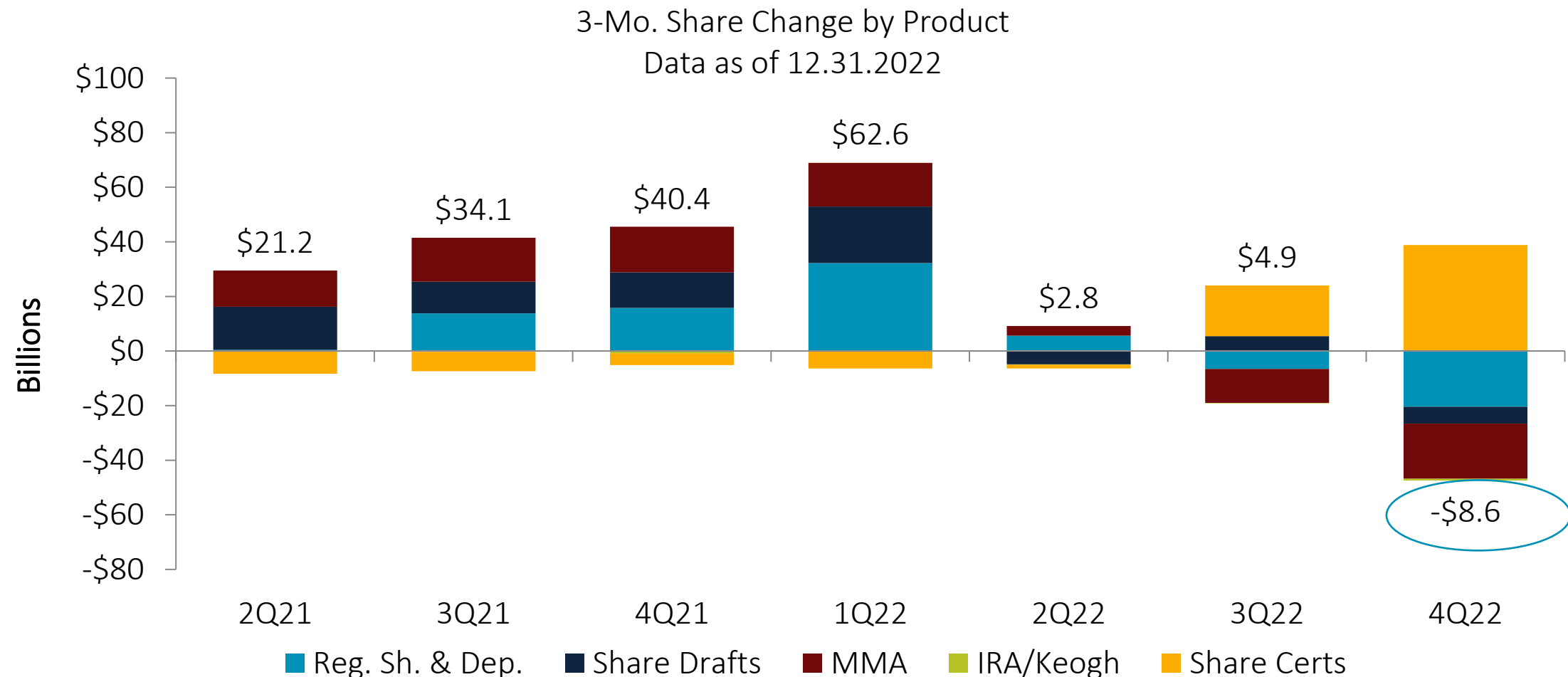
The national savings rate drops to near zero



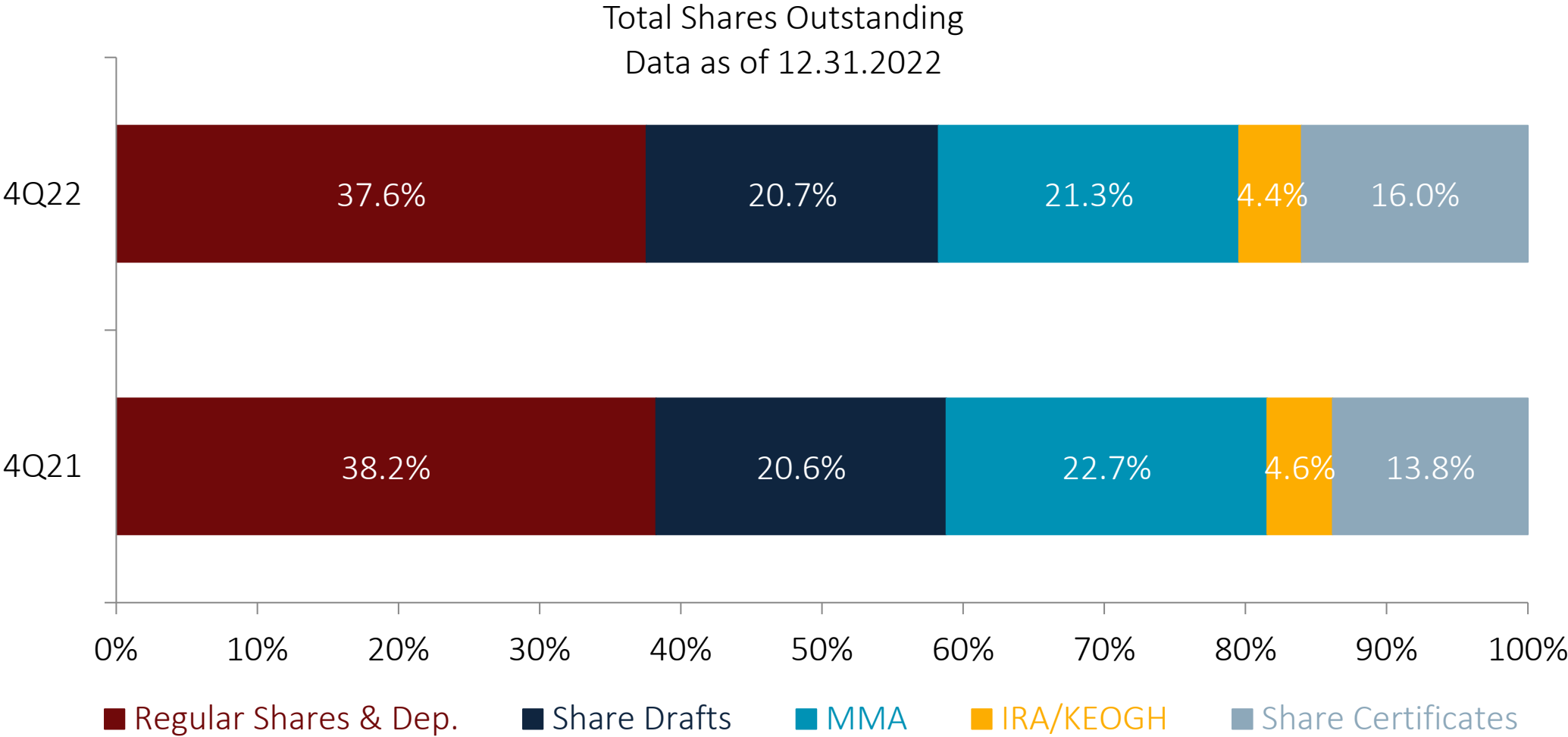
Year-over-year growth in share certificates is the highest since the pandemic



Share certificate balances jump \$38.8 billion in the fourth quarter

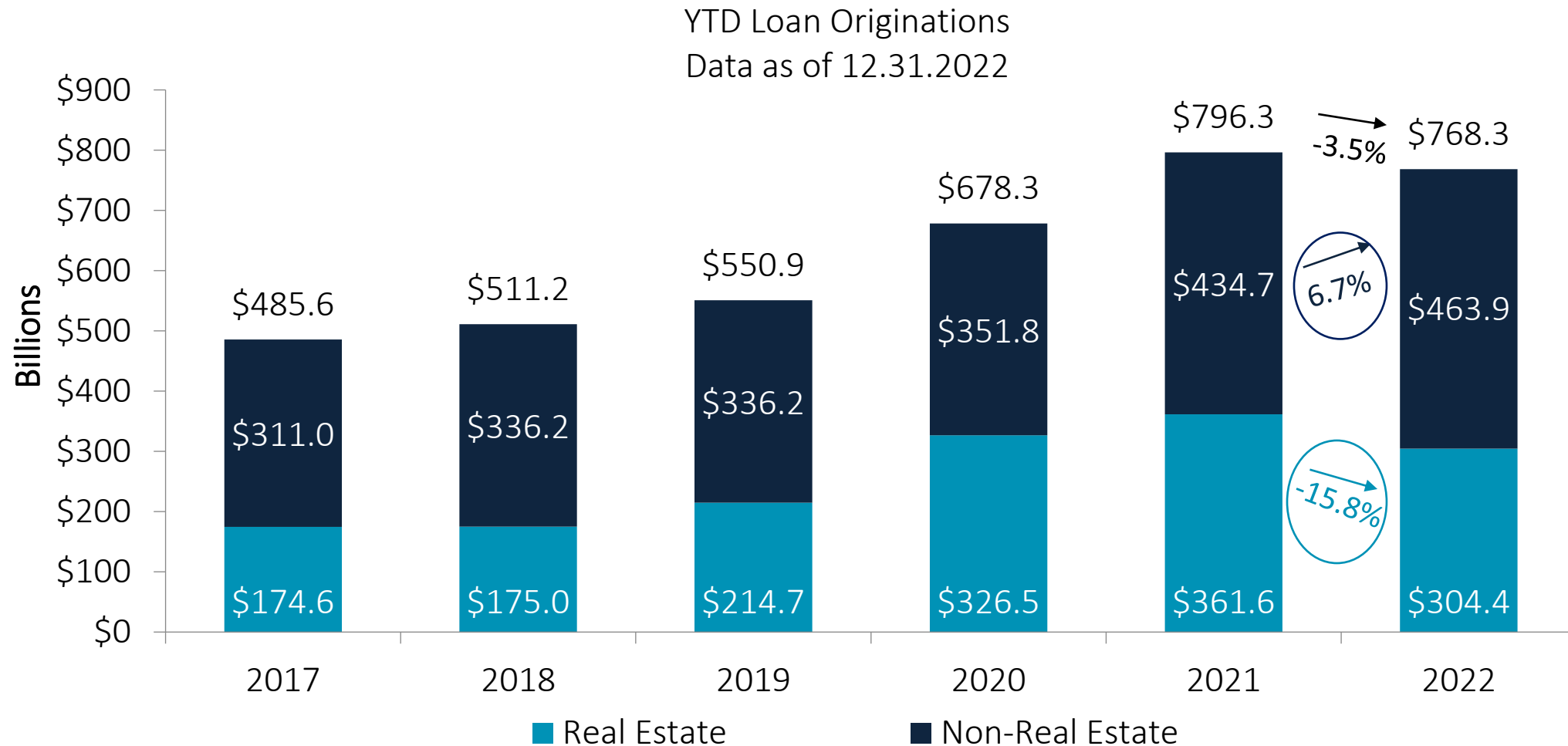


Share certificates regain ground as credit unions seek to attract deposits

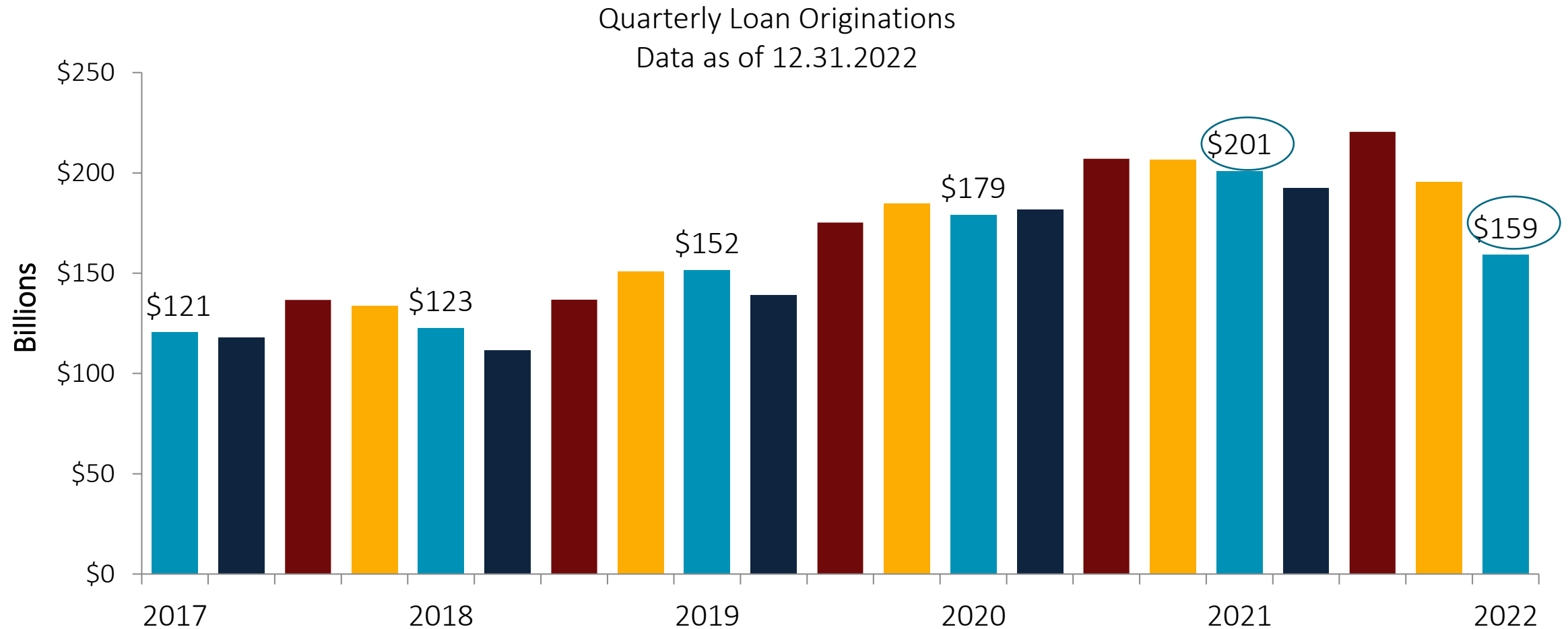


Lending

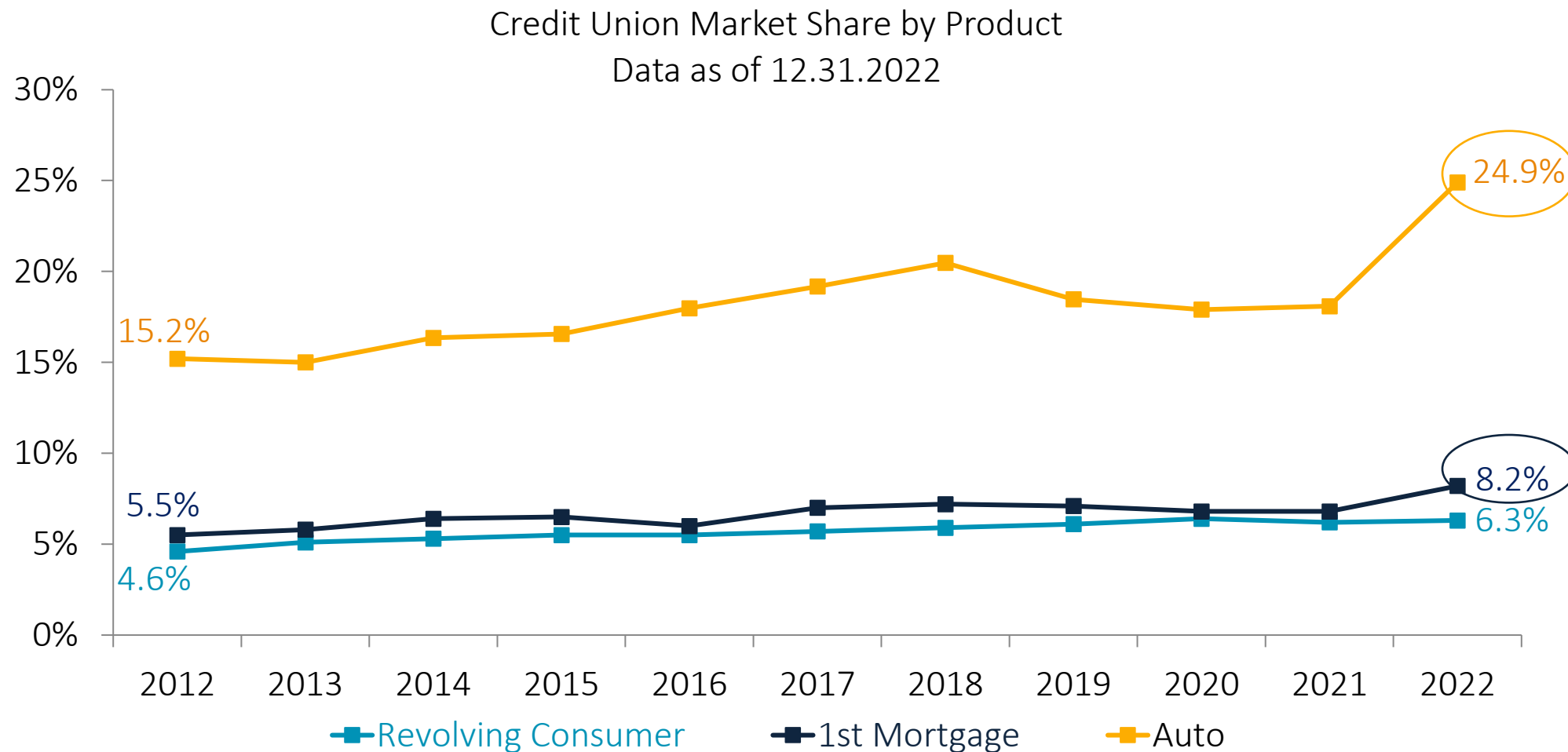
YTD dollar value of loans granted declines for the first time since 2019 as real estate originations contract



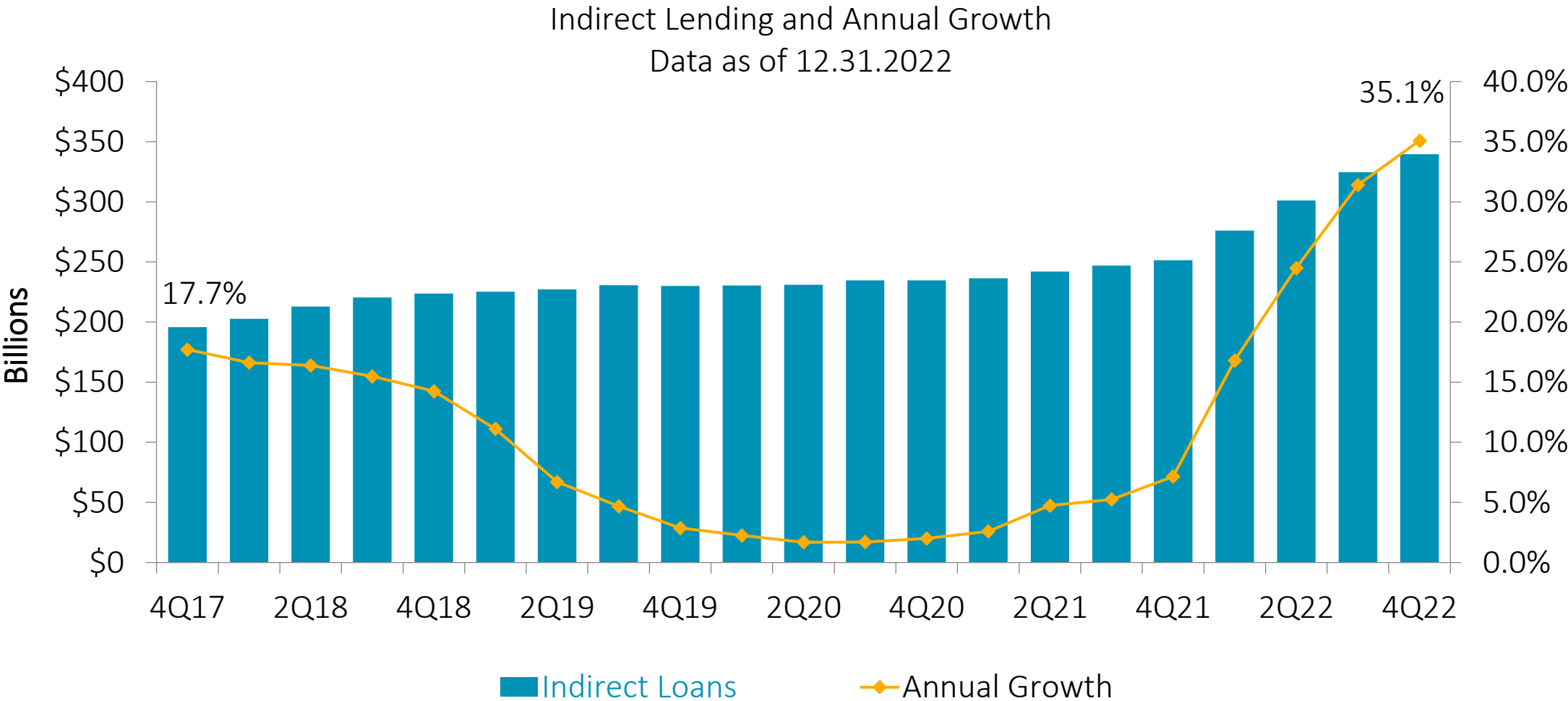
Quarterly loan originations are down 20.8% from a year ago



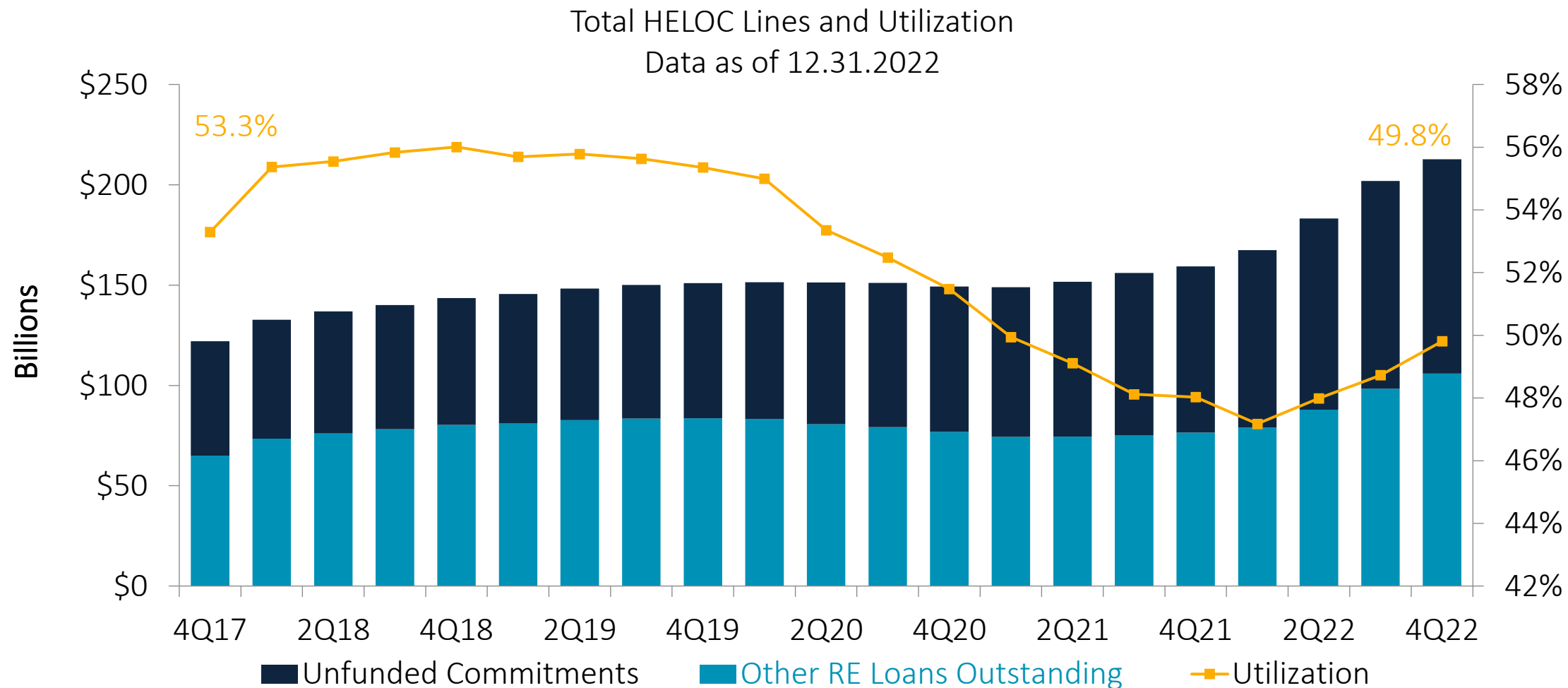
Credit unions leaned into loan demand in 2022, with indirect channels driving a sizeable boost in auto share



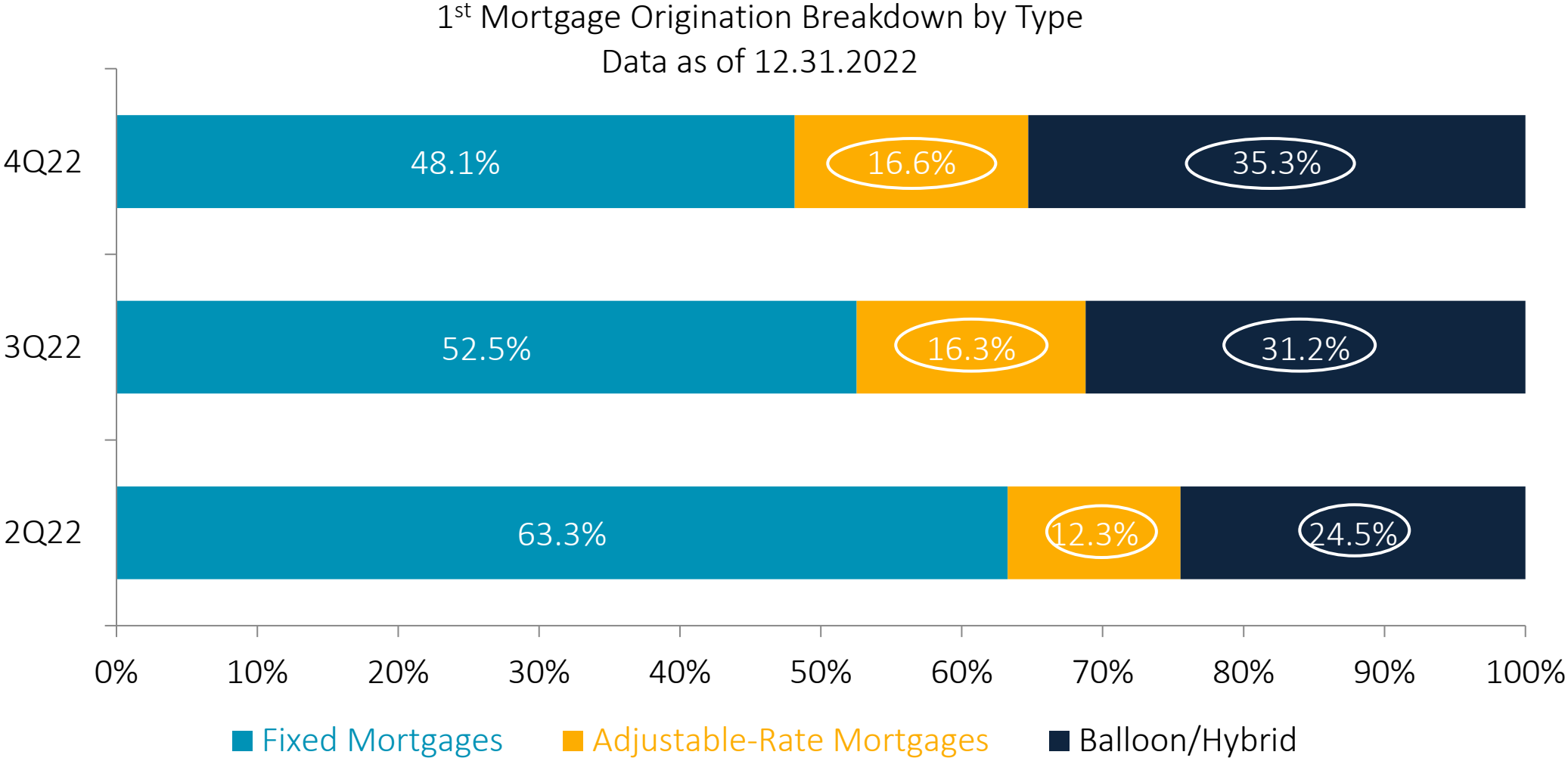
Indirect continues its year-over-year surge as credit unions try to drive loan growth



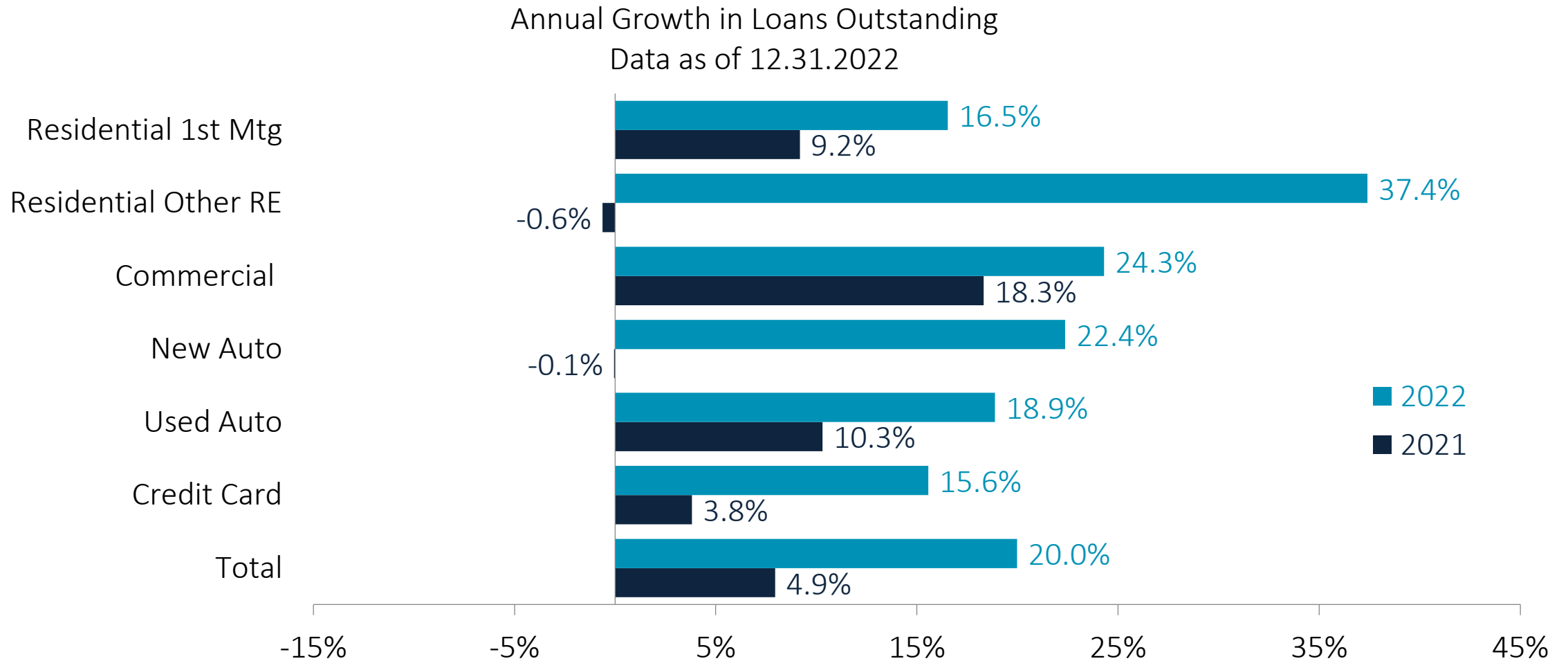
Members are starting to tap into recently expanded HELOCs



Balloon mortgages surge in popularity as members look to lower their monthly payments



Double-digit growth reported across the loan portfolio



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**“I THINK THE DECLINE OF DEMOCRACY
IS A MORTAL THREAT TO THE LEGITIMACY
AND HEALTH OF CAPITALISM.”**

-Rebecca Henderson, Harvard Business School

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CORE FOCUS



PURPOSE/CAUSE/PASSION

Creating financial wellness in our community

NICHE

Personal everyday banking

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TARGET MARKET



DEMOGRAPHICS

Individuals and families living paycheck to paycheck, less than \$100,000 household income.

GEOGRAPHIC

Lives or works within 20 miles of a branch.

PSYCHO-GRAPHIC:

Values convenience and simplicity, personalized service, building relationships, values credit union strengthening community, open to receiving financial education and guidance on financial decisions, and individuals new to banking.

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LEAN ROCKET

LOCAL

powered by

Amer1can

CREDIT UNION

OUR COMMITMENT

\$5 MILLION OVER FIVE YEARS



LEAN ROCKET
LOCAL
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CREDIT UNION

New \$5M loan program will help small
Lean Rocket Lab and American 1 Credit Union announce

American 1, Lean Rocket Lab Partner on \$5 Million

CRAIN'S DETROIT BUSINESS

**Business accelerator, credit union team up for
small business loan program**

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Lean Rocket LOCAL will take the current success of Lean Rocket Lab and expand its mission to support its efforts to launch and scale neighborhood and placed based businesses and organizations.

FOUR PRONG APPROACH

- Educational Capital
- Financial Capital
- Human Capital
- Social Capital

11
FELLOWS

BOOTCAMP
6 WEEKS

A MINIMUM
INVESTMENT OF
\$2,500

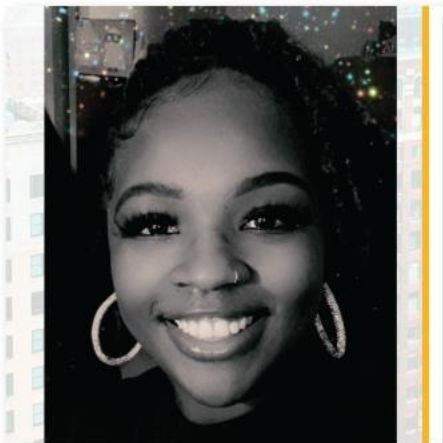
1
YEAR OF INTENSIVE
SUPPORT + PITCH

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**11
FELLOWS**





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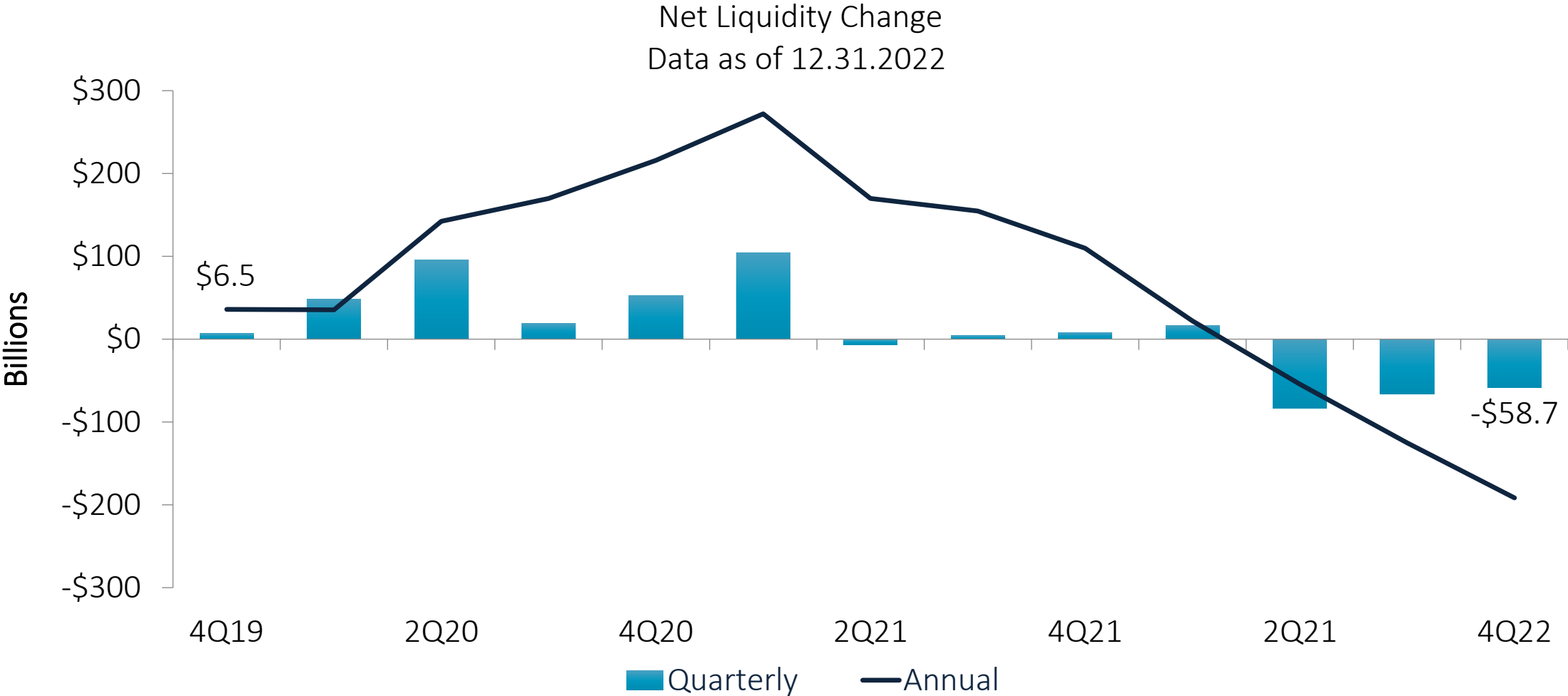
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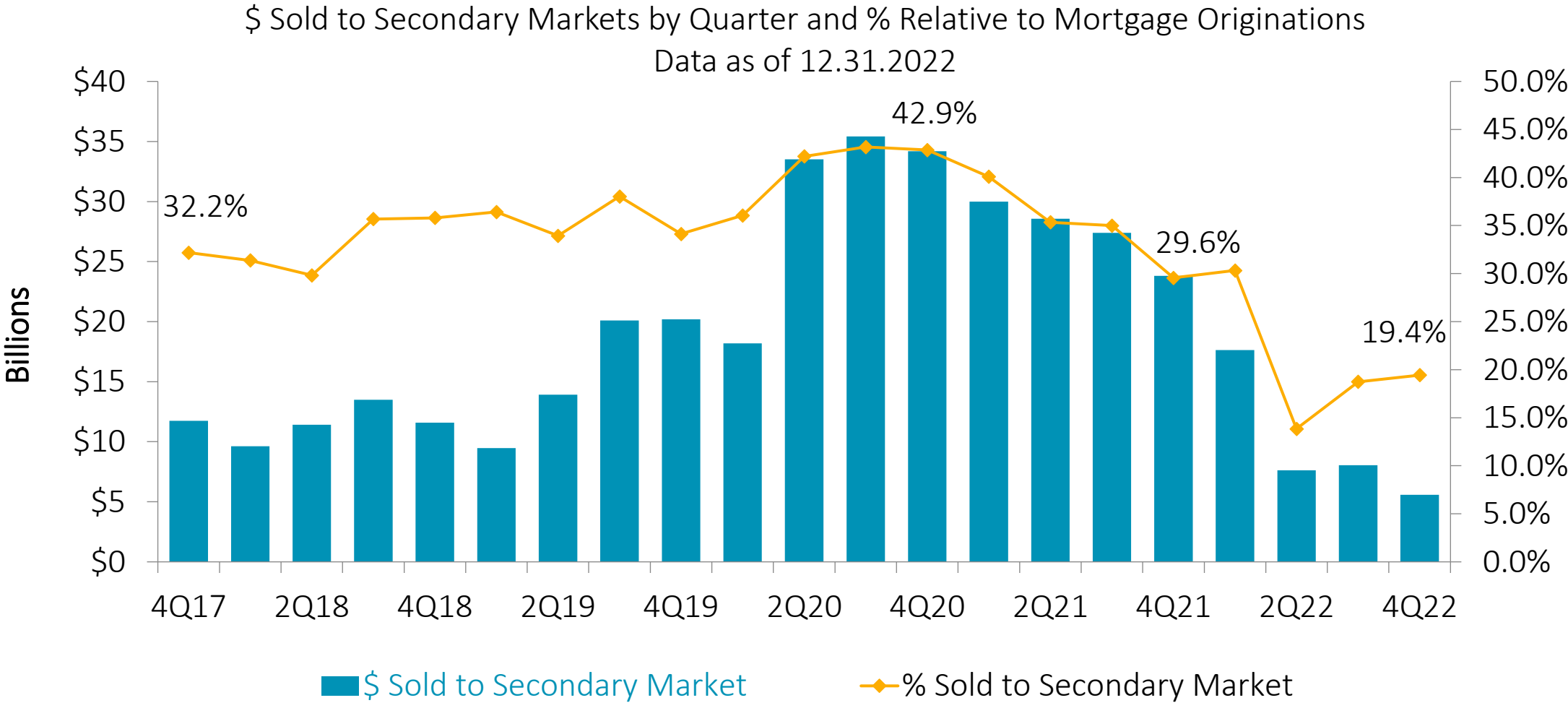
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Liquidity

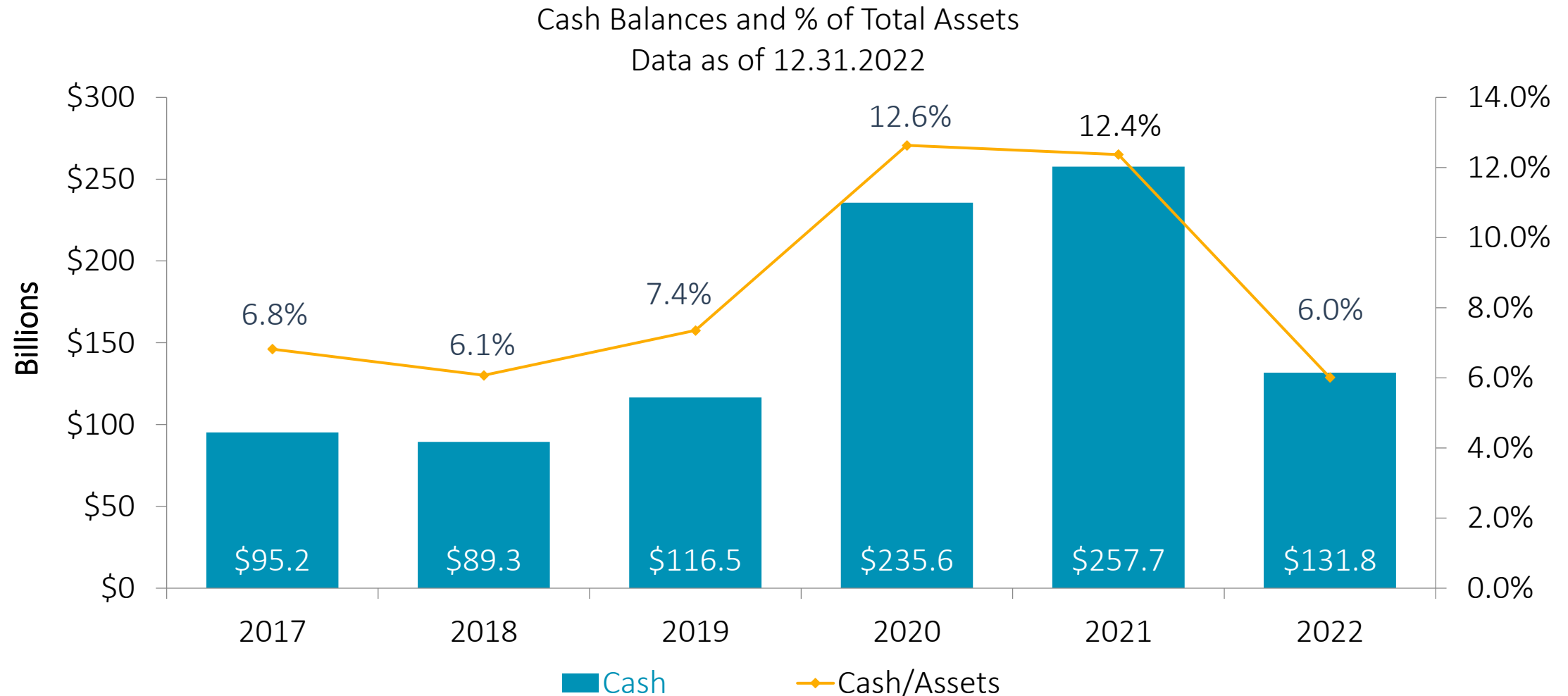
Accelerating loan growth and flatlining share growth caused a \$191.7 billion decrease in annual net liquidity



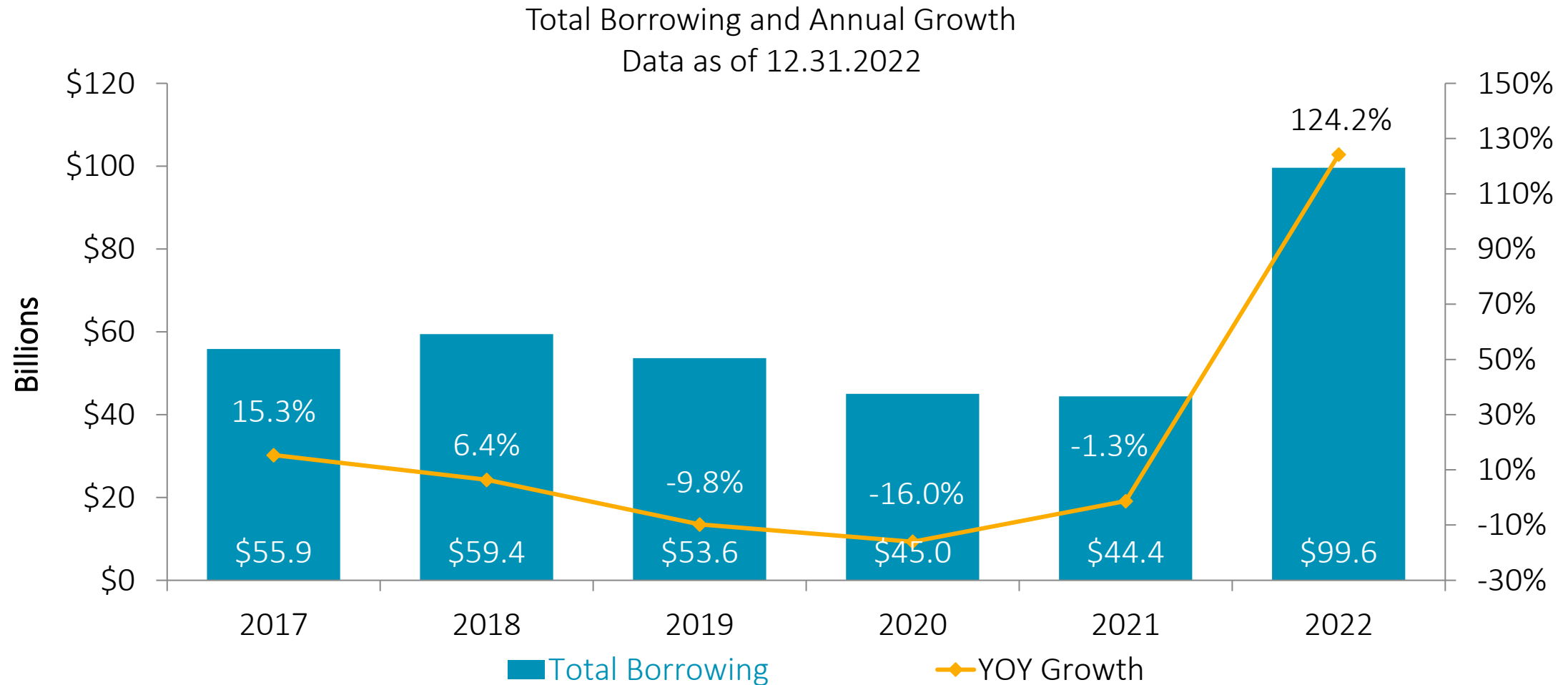
The % of new mortgages sold to the secondary market increased slightly on a quarterly basis, most likely for liquidity needs



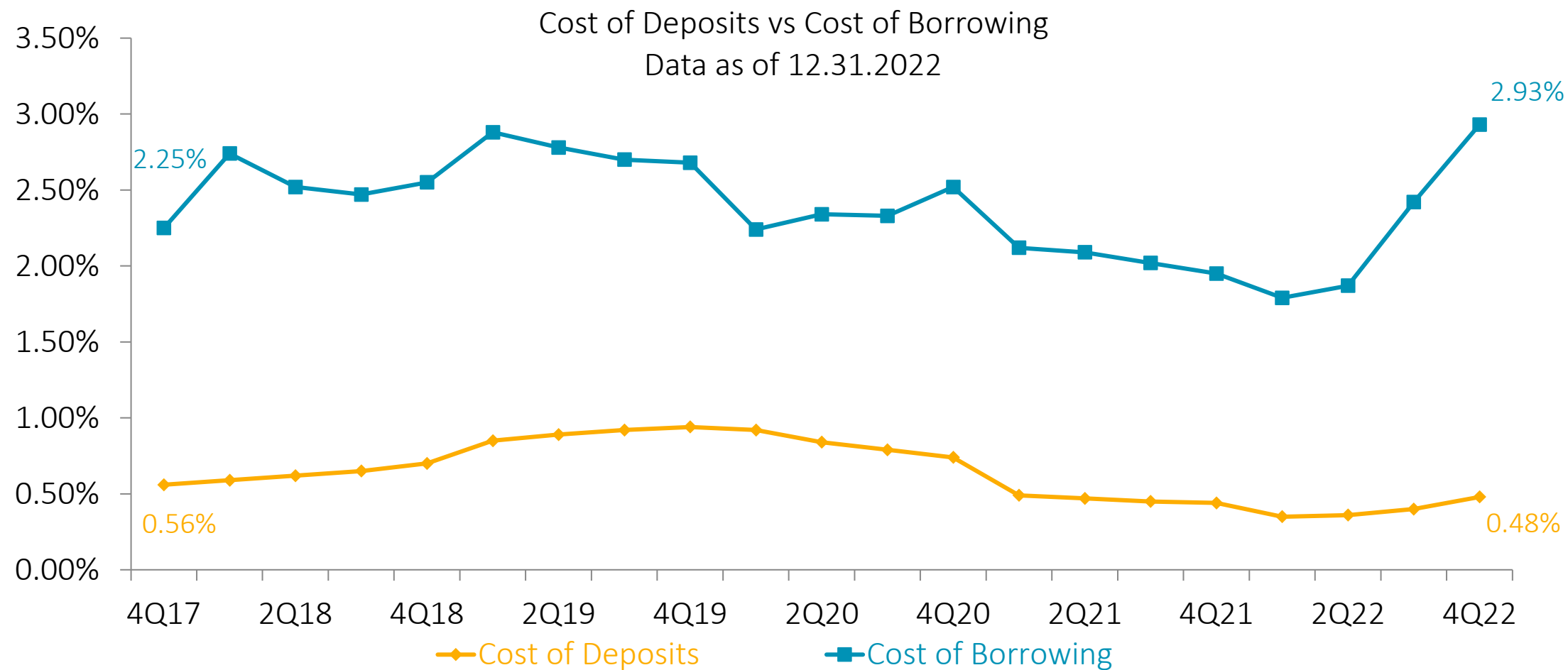
Cash is the smallest % of the balance sheet since 2008



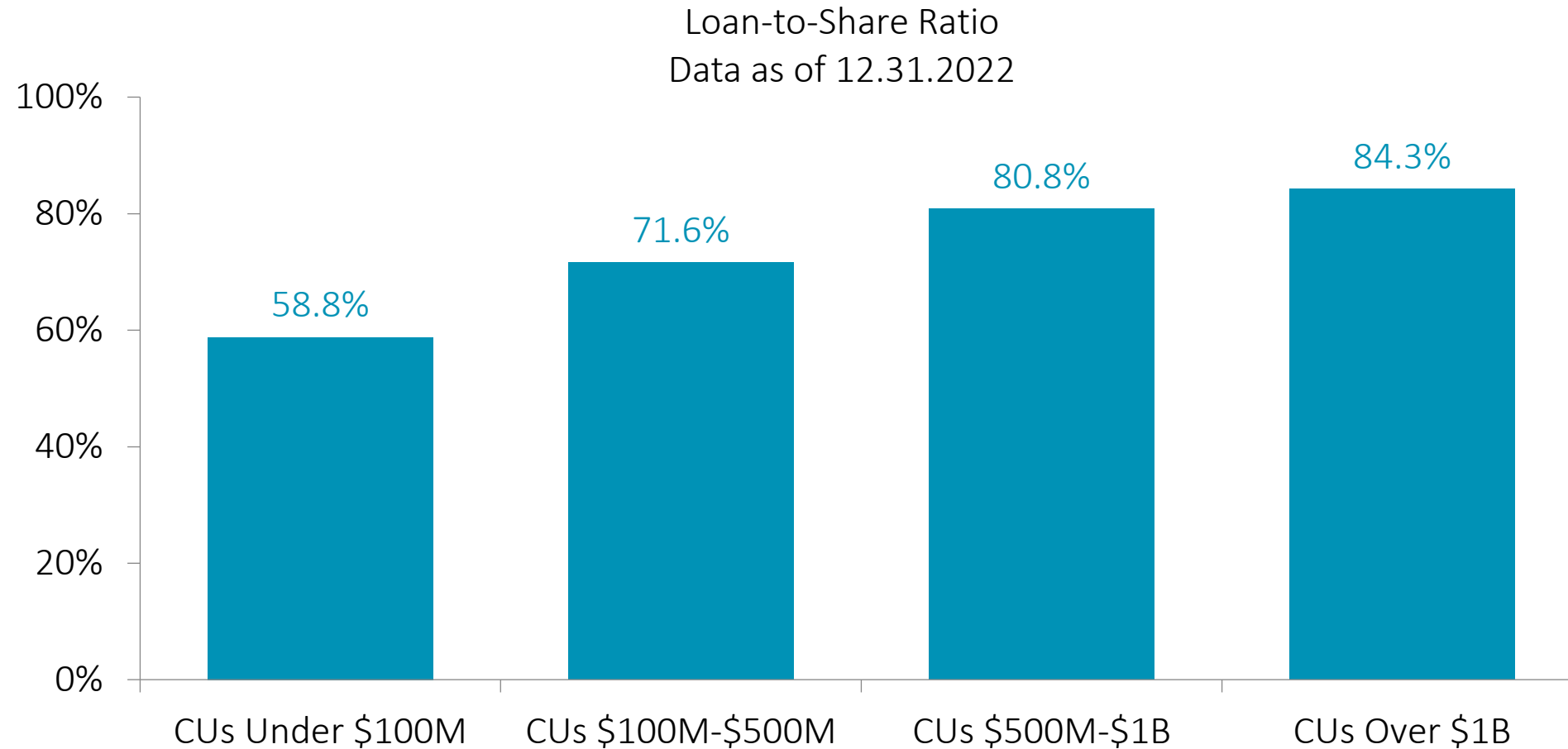
Credit unions expanded borrowings to meet liquidity demands



As interest rates rise, cooperatives are finding it more expensive to borrow funds

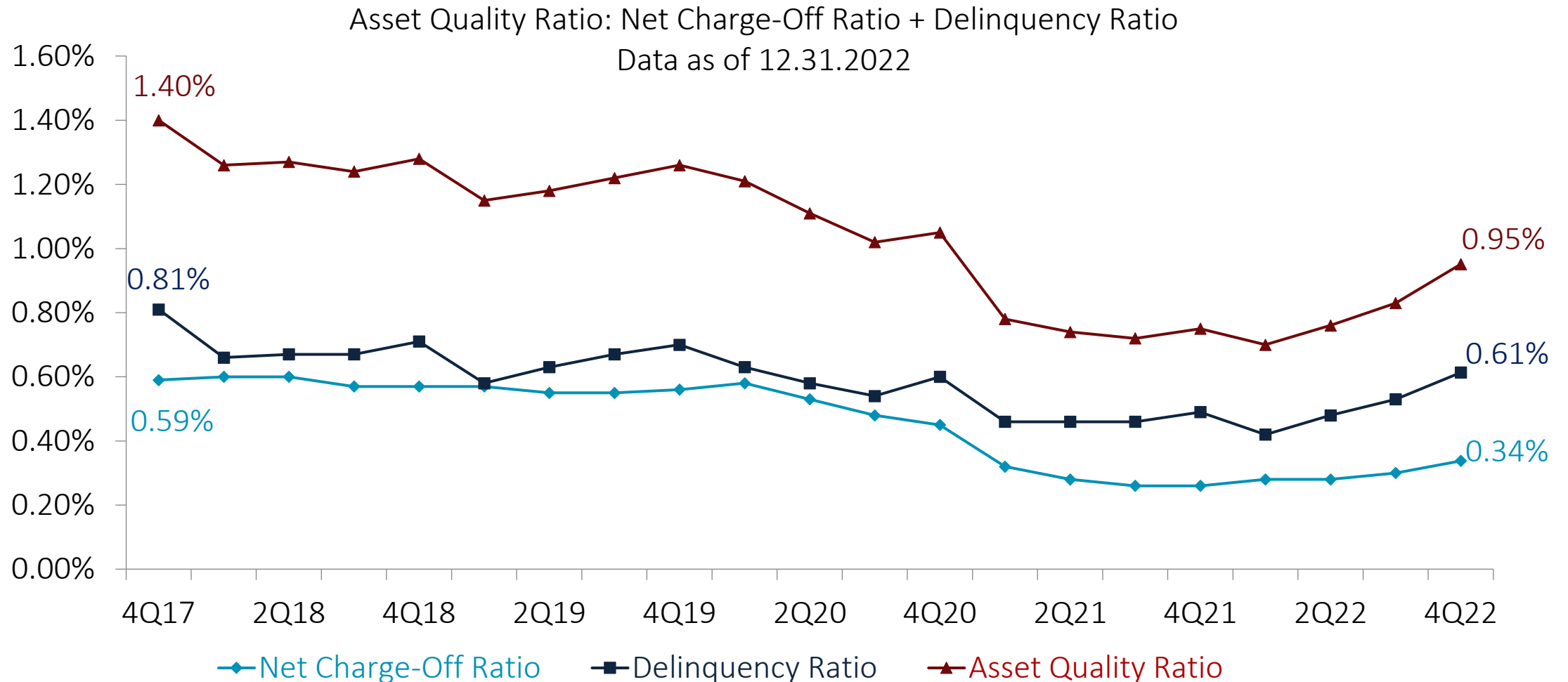


Smaller CUs feel less of a need to attract deposits because their liquidity situation is different



Asset Quality

Asset quality worsens by 20 basis points over the year



Credit cards and auto loans are driving the increase in delinquency

Annual Change in Delinquency
Data as of 12.31.2022



Total
0.61%
↑ 0.08%



Residential 1st Mortgage
0.44%
↑ 0.04%



Auto
0.67%
↑ 0.14%



Residential Other RE
0.43%
↑ 0.09%



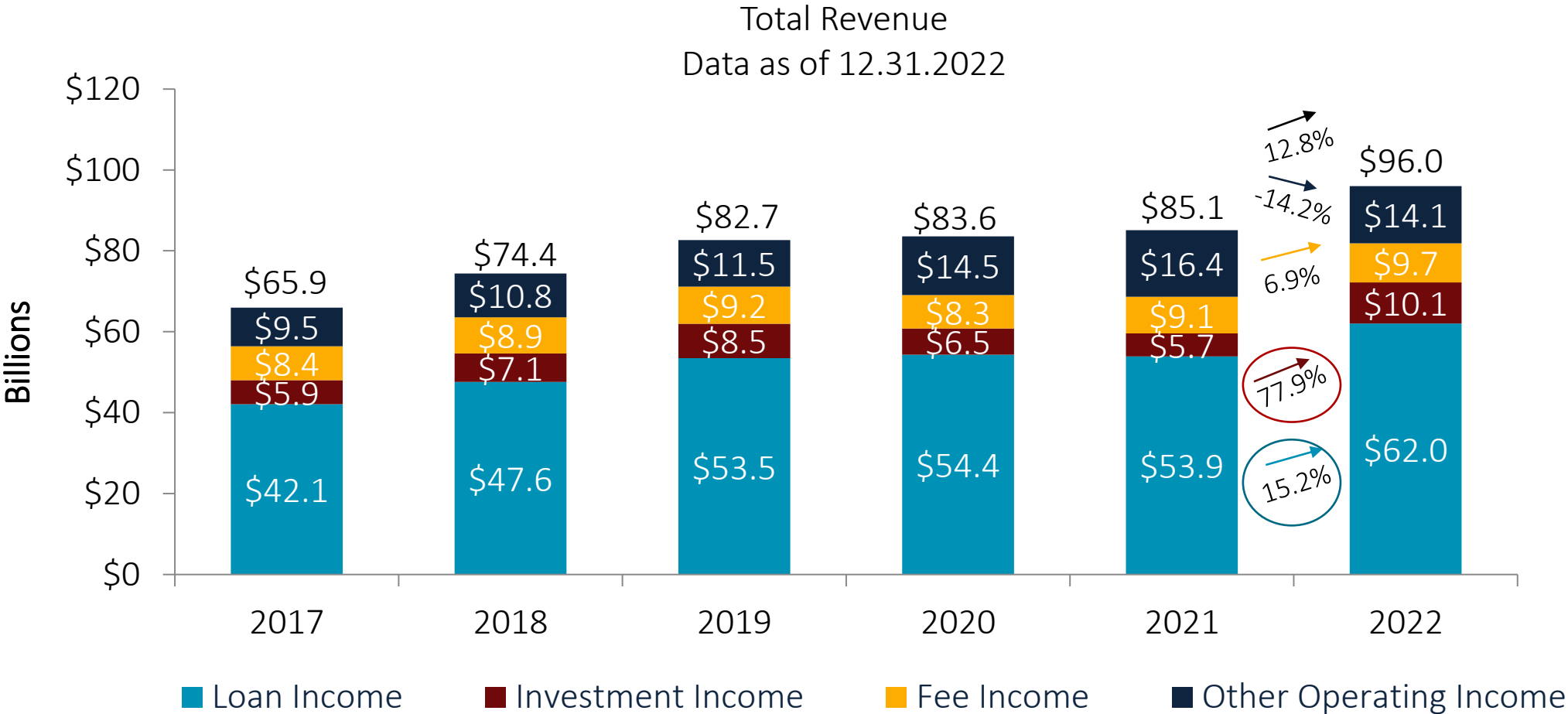
Credit Card
1.48%
↑ 0.19%



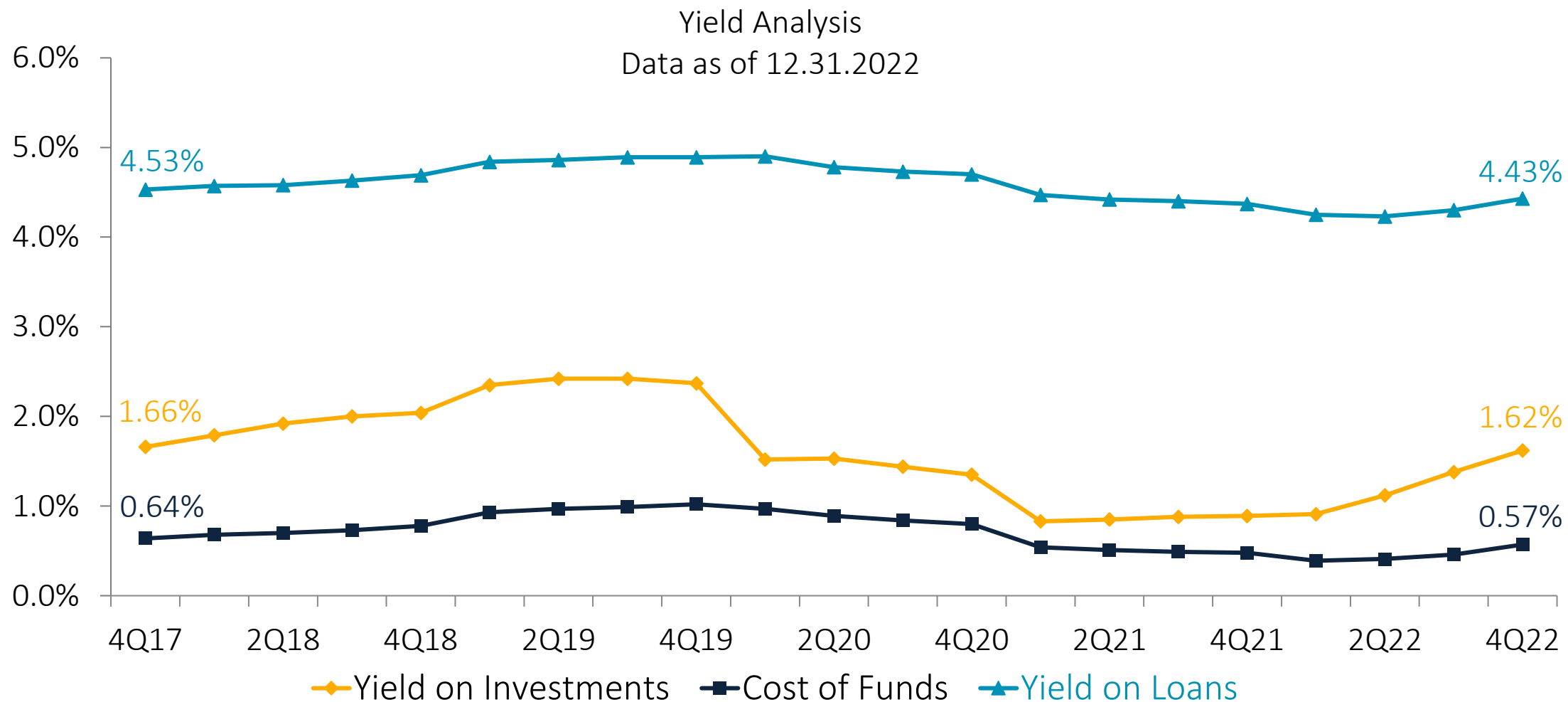
Commercial
0.33%
↓ 0.09%

Earnings & Capital

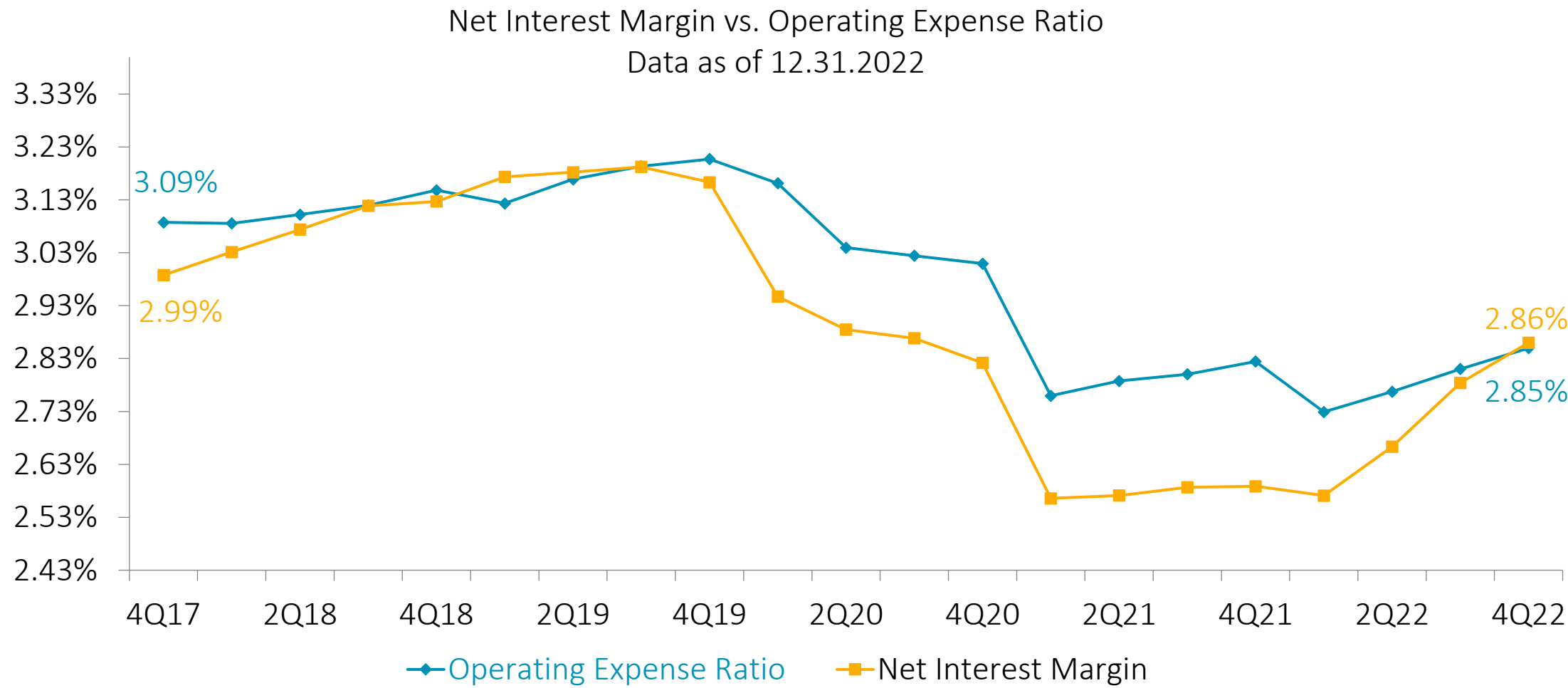
Loan and investment income boost revenue despite decline in other operating income



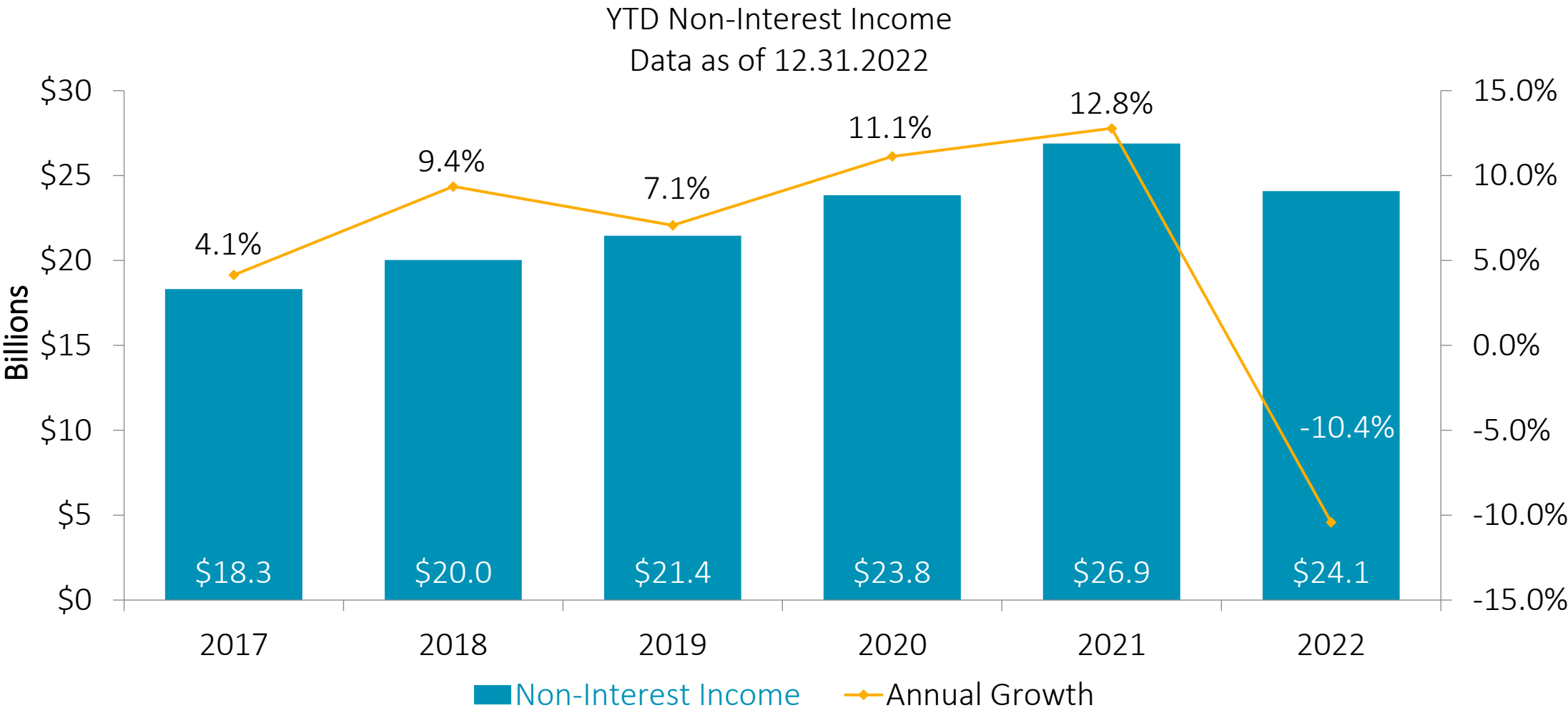
Yields tick up, but cost of funds rises at a slower pace



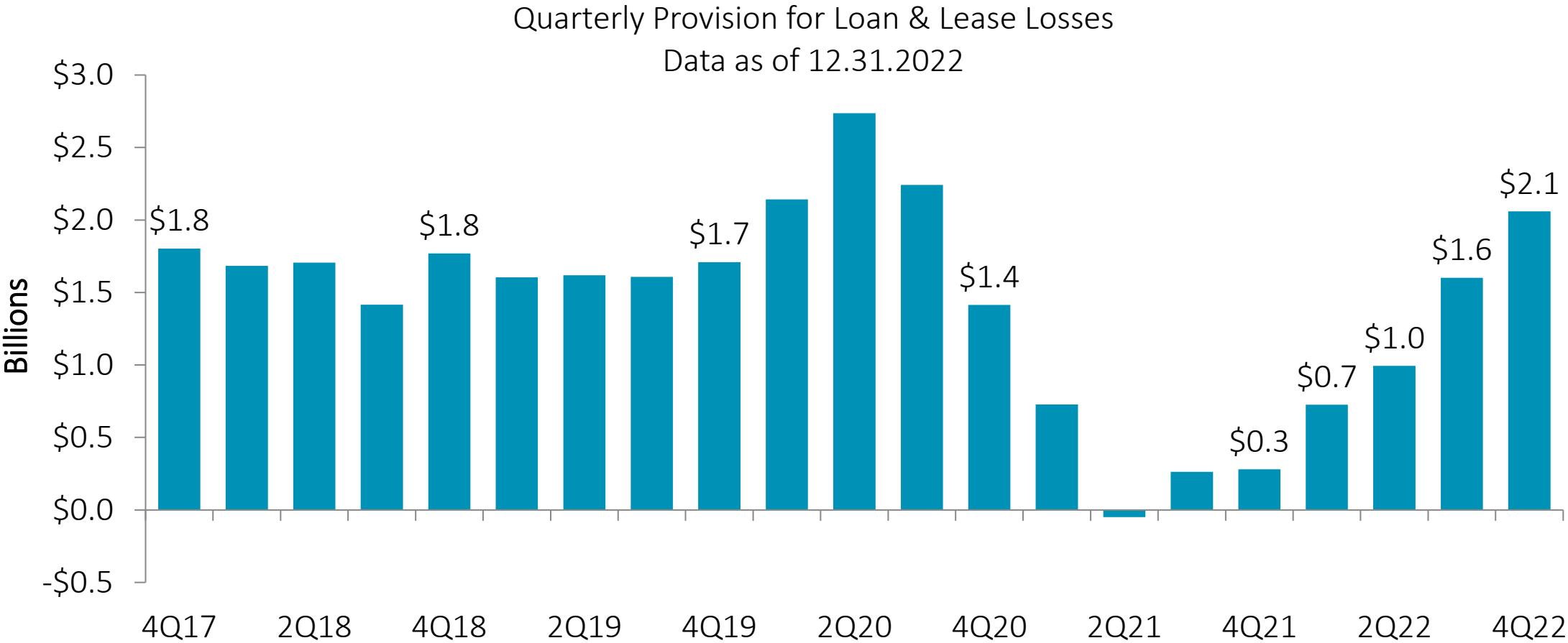
Net interest margin is higher than operating expense ratio for first quarter since 2019



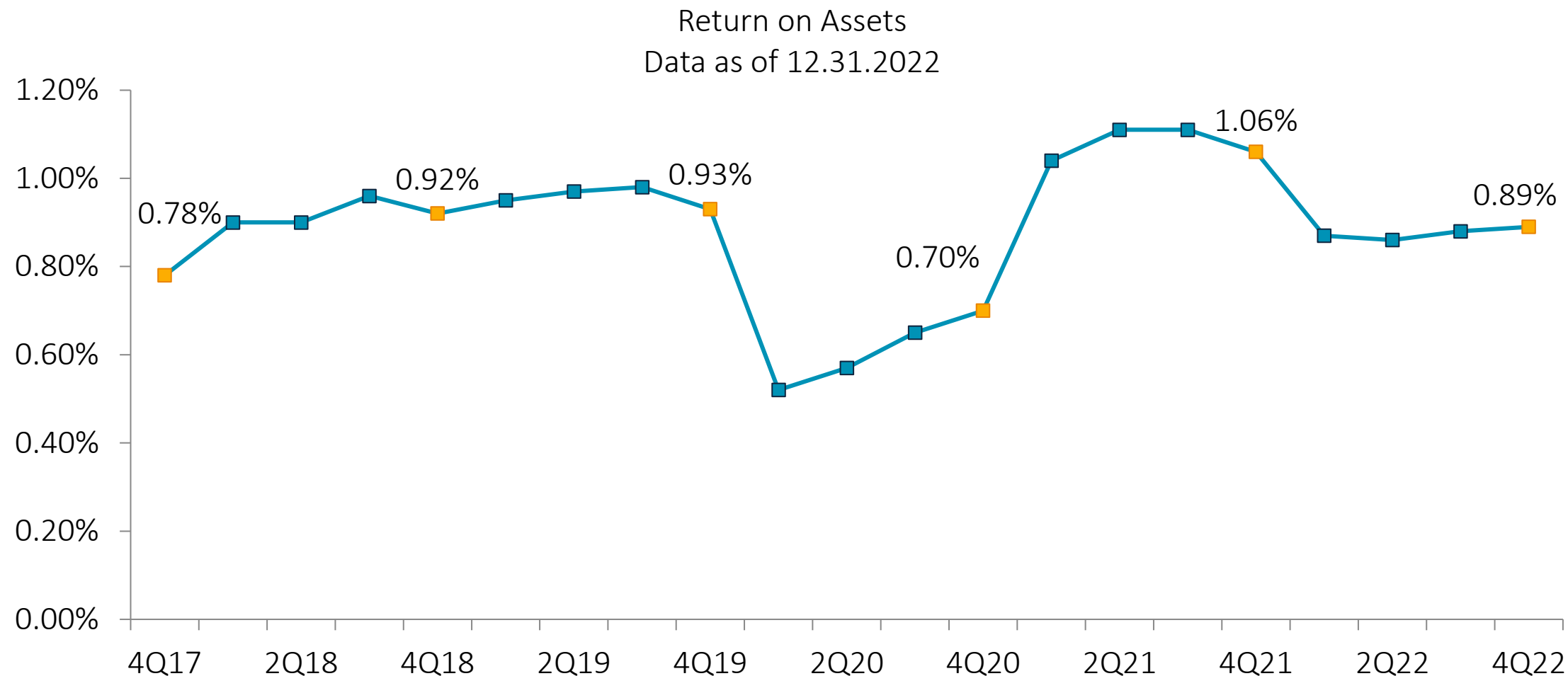
Non-interest income declines overall as other operating income falls 14.2%



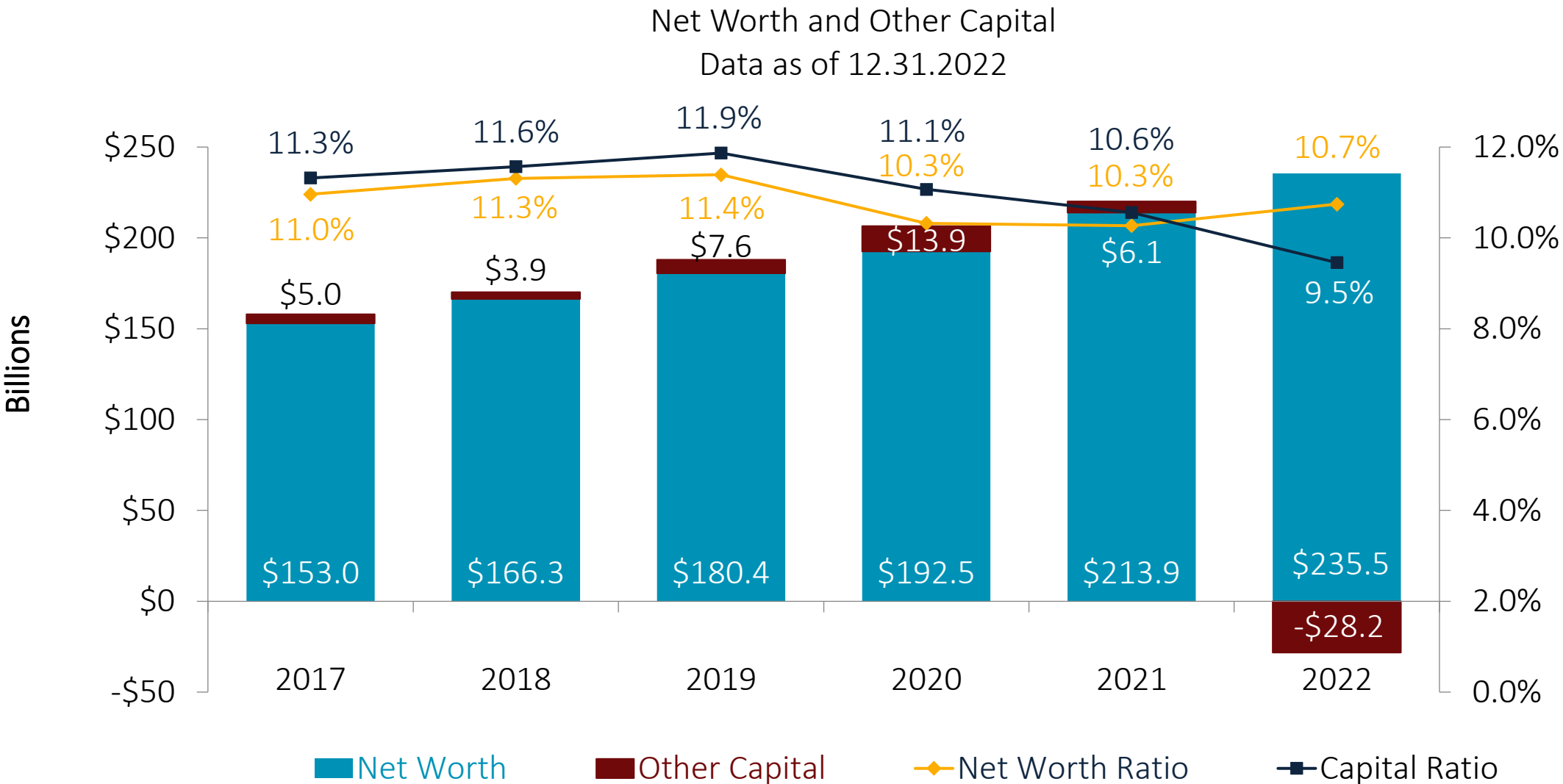
Credit unions stock up on provisions as delinquency rises



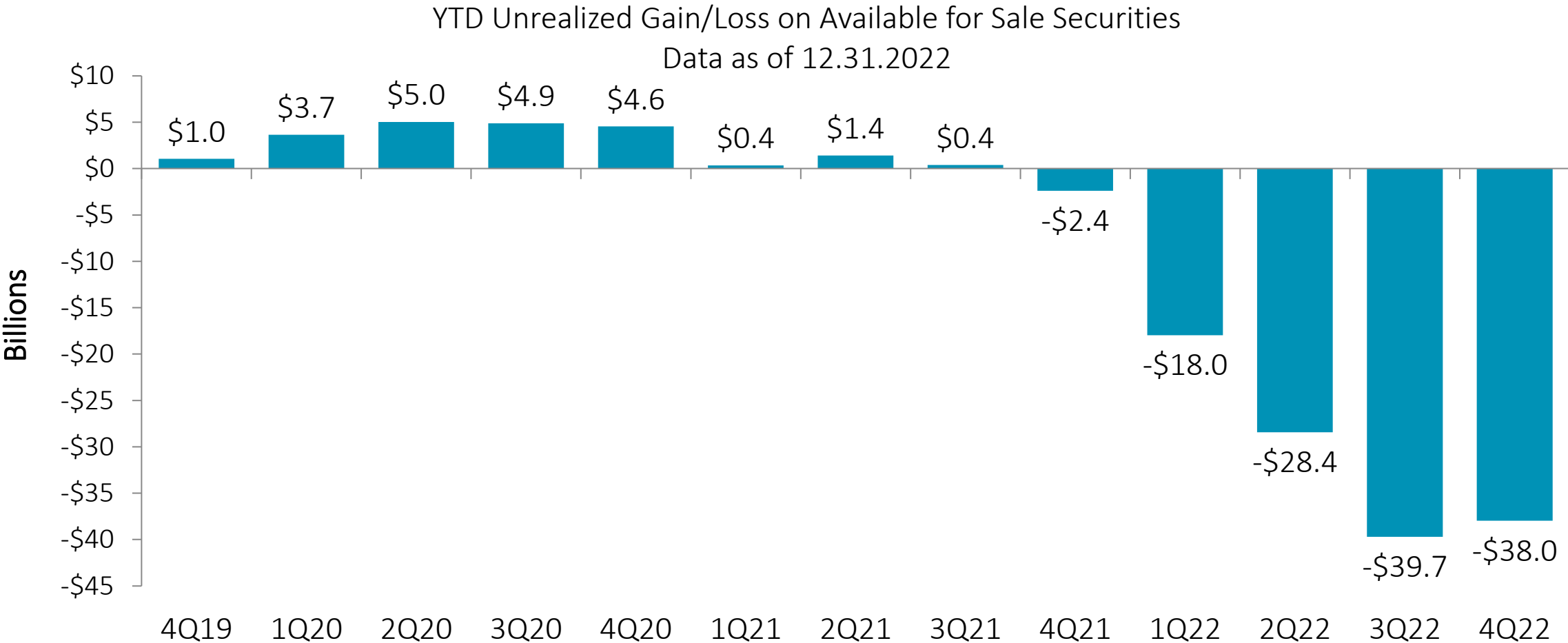
ROA falls 17 basis points but remains historically healthy



Unrealized losses reduce the capital ratio 110 basis points

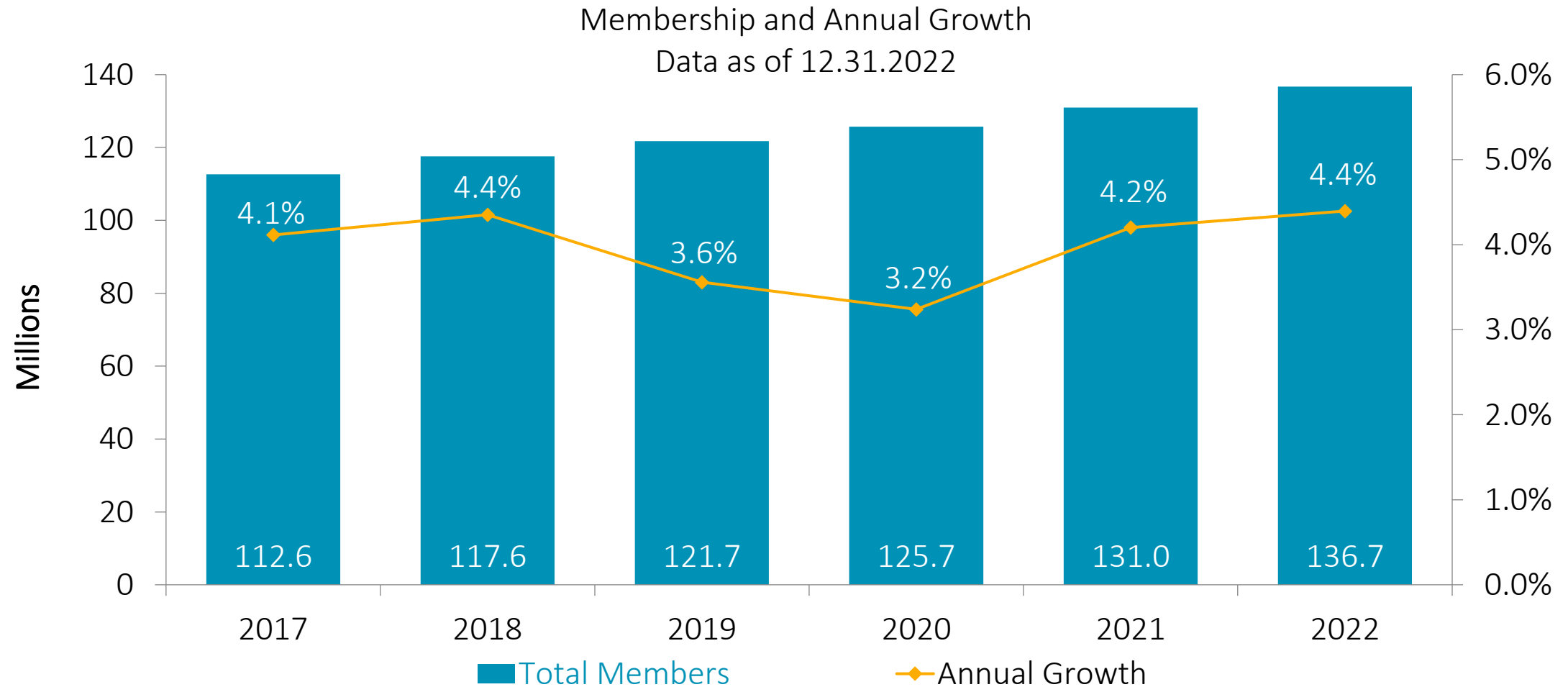


Unrealized losses on securities decrease slightly as securities mature, but portfolios remain in the red

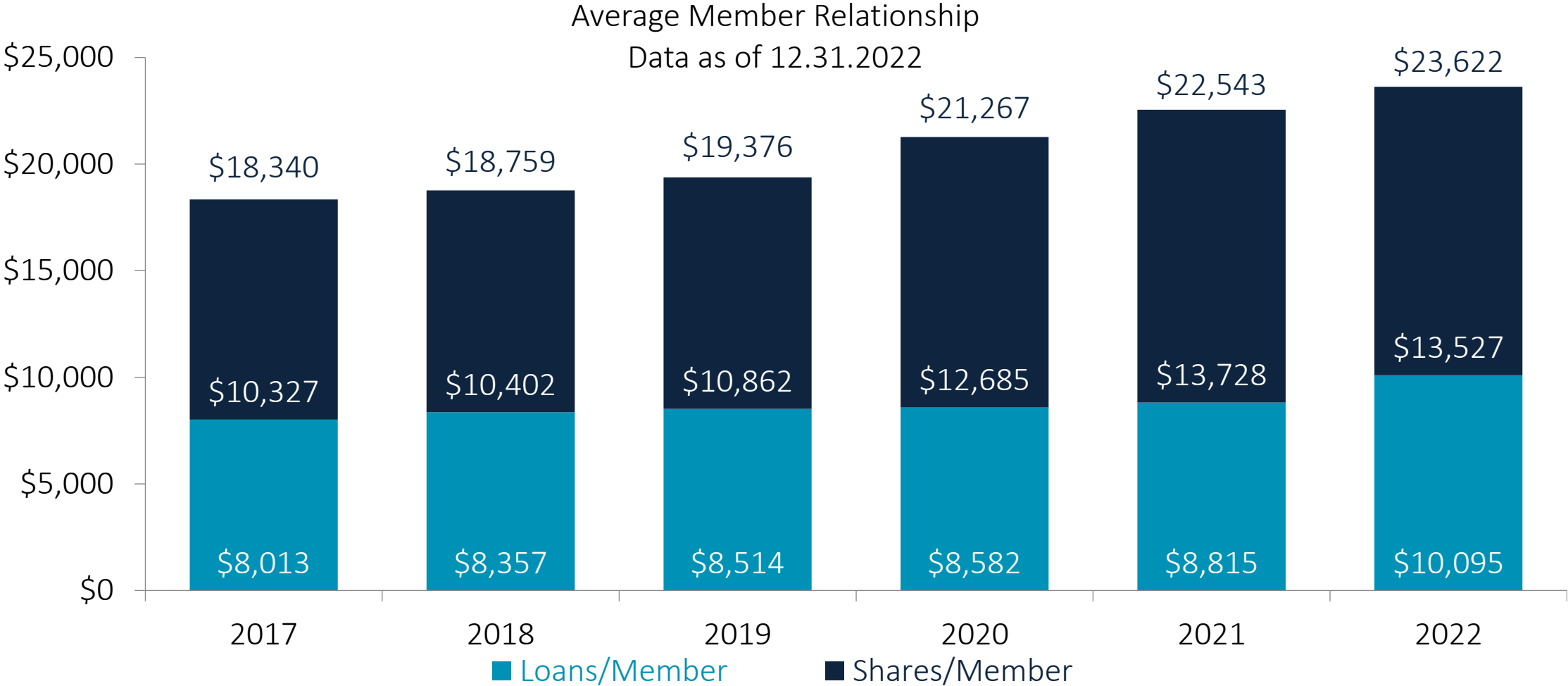


Membership & Our Value

Credit unions added over 5.7 million members this year

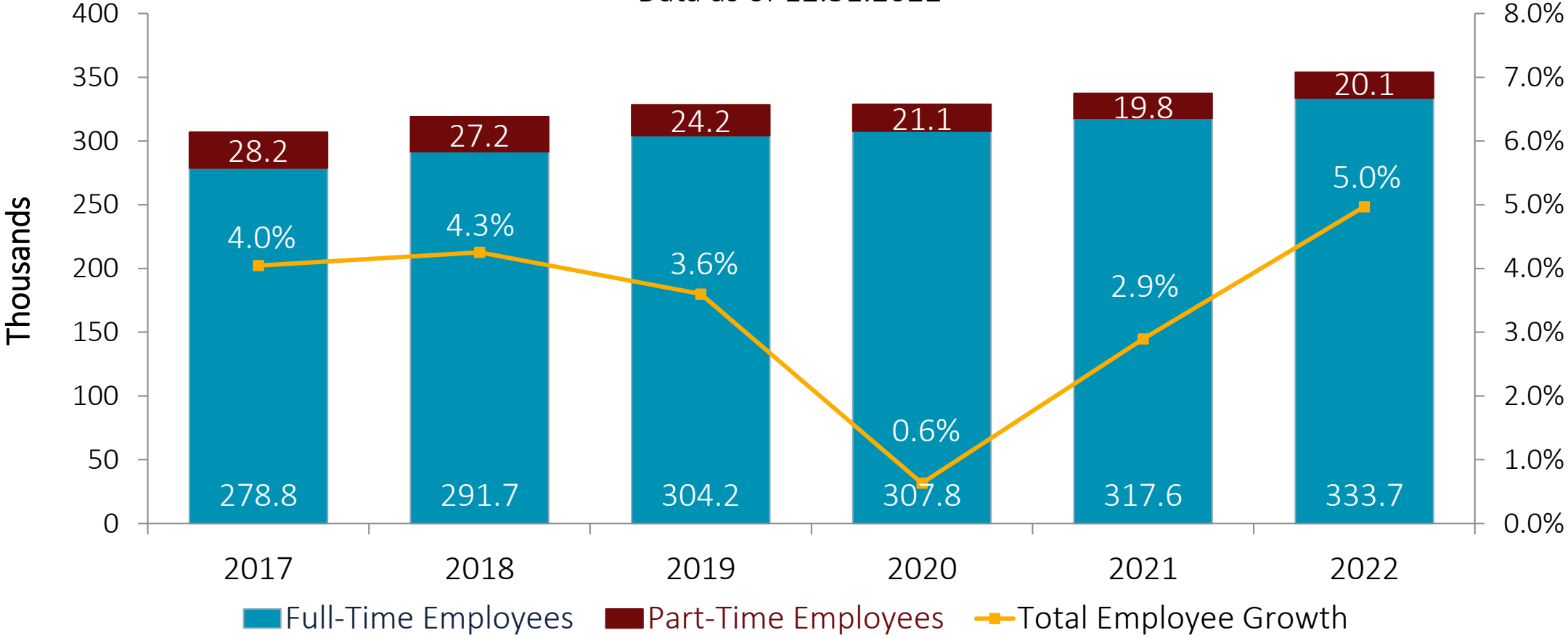


Average member relationship reaches all-time high despite decline in average share balance



Credit unions are hiring more full-time employees to handle membership expansion and loan servicing

FT & PT Employees and Annual Total Employee Growth
Data as of 12.31.2022





Navigating 2023

- Though national employment levels remain strong, inflation and high interest rates are straining finances for many members.
- The industry is healthy from an earnings, capitalization, and lending standpoint, but liquidity and asset quality are areas to watch.
- Credit unions aren't solely lenders. They are tasked with stewarding the overall financial wellbeing of membership. Financial education and savings programs will be more valuable now than ever.

THANK YOU FOR WATCHING



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