CUNA CFO COUNCIL

NEWS

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AN ELECTRONIC REPORT FROM THE CUNA CHIEF FINANCIAL OFFICER COUNCIL

THE ABCS OF CREDIT UNION FINANCE IN 2000

Forecasting credit union operating results can be both difficult and confusing. Collecting reams of data and identifying relevant trends is often time-consuming and expensive. But forecasting need not be so hard. Read on, and you'll see that we've made understanding the issues as easy as learning your ABCs.

Asset costs: Credit union funding costs are likely to increase from now on and into 2000. Credit union dividend/interest costs as a percent of average assets declined four basis points (bp) in 1998 and fell roughly 20 bp further to 6.99% in the first six months of 1999. That won't last. Recent increases in short-term interest rates and further increases in 2000 will increase these costs. Higher rates and the dissipation of year 2000 (Y2K)-related liquidity concerns will induce members to move money from regular shares and other short-term accounts into longer-term, higher-cost certificate accounts.

Bankruptcies: U.S. non-business bankruptcies hit a record 1.4 million in 1998—double that of 1990 and four times that of 1985. Credit union borrower-bankruptcies likewise hit an all-time high of 253,000 in 1998, although the rate of growth was small (+1%). The tremendous volume of mortgage refinancings in 1998 and the resulting paydown of unsecured credit will moderate bankruptcy filings in 1999. Based on seasonally adjusted annualized data from the first six months of 1999, credit unions could see an 8% drop in filings this year. But that still would keep filings per 1,000 members at more than 3.0. And barring meaningful congressional action, bankruptcy filings will drift up again in 2000.

Consumer confidence: This is the fuel that feeds the fire of economic growth. Confident consumers buy things. The more confident consumers are, the more likely they are to buy big-ticket items such as cars, houses, and refrigerators—and the more likely they are to finance those items at their credit union. According to the Conference Board, consumer confidence was 135.8 in August—still near all-time highs despite rising interest rates, higher gasoline prices, and severe weather. Confidence in the future likewise remains high and the consumer-shopping spree continues, with consumer spending generating virtually all U.S. economic growth during the first six months of this year.

Delinquency rates: Delinquencies will be somewhat higher in 2000. They dropped to 0.8% at midyear 1999, after falling in both 1997 and 1998, sparked by refinancings and related declines in unsecured credit balances. But rising rates, lower overall loan growth, potential growth in unsecured balances, and a seasoning of portfolios all argue for an uptick in 2000.

Earning assets: Asset yields should decline in 1999 and will increase only moderately in 2000 due to relatively low loan growth. Credit union asset yields decreased 16 bp in 1998 and fell roughly 40 bp further in the first six months of 1999. Recent increases in short-term interest rates and further increase(s) in 2000 will boost yields, but slow loan growth means many credit unions will put funds to work in lower-yielding investments.

Federal funds: Despite recent hikes, interest rates remain lower than a year ago. But don't expect them to remain there long. In the next 18 months, faster-than-expected growth in Asian economies, labor market shortages, and higher energy and health-care costs could cause further Fed tightening. We foresee further rate increases but expect the average federal-funds rate to remain less than 6% in 2000.

Gross domestic product (GDP): The economy should continue to grow through 1999. But interest rate increases and slower productivity growth should slow the growth rate in 2000—expect GDP growth of about 4% in 1999 and 2.75% to 3.25% in 2000.

High-cost savings: In June, more than 47% of credit union savings balances were in high-cost savings (individual retirement accounts, money market accounts, and share certificates), compared with 37% in 1994. Higher rates mean growth, so high-cost savings easily could eclipse 50% of total savings by year-end 2000.

Investments: Investments grew relatively fast recently as lag loan demand lagged savings growth. Savings growth will lag loan growth both in 1999 and into 2000, so investment growth should weaken somewhat, with most of the growth in short-term investments.

Jobless rate: The unemployment rate dipped to 4.2% in August after hitting that same 29-year low in May. The threat of labor shortages and increasing labor costs may lead the Fed to increase rates in the coming months, but unemployment should stay less than 5.25% throughout 2000.

"Kapital": Relatively fast asset growth and slightly lower earnings will put pressure on kredit union kapital ratios in the koming months. Kredit union net kapital finished 1998 at 10.9%, down from 11.1% in 1997 and the first decline in a dozen years. Net kapital will rise slightly in 1999 but stay near 11% throughout 2000.

Loans: Increases in market interest rates should moderate loan demand in the next 18 months. Loans grew at a seasonally adjusted annual rate of 8.7% through June 1999, but expect full-year growth of 12%. Softening demand for mortgages and continued weakness in unsecured credit and new-vehicle loans suggest overall growth of around 8% in 2000.

Mortgages: Credit union full-year mortgage originations eclipsed $32 billion in 1998. That's roughly 33% higher than the record level reached in 1993. And annualized growth for the first six months of 1999 suggests a new record for originations. However, with the 30-year, fixed rate now near 8%, that seems increasingly unlikely. Mortgage balances grew nearly 20% in 1998 but should slow to about 10% to 15% in 1999 and moderate further in 2000. With higher rates, plan for consumer demand to shift markedly to adjustable-rate loans.

Net charge-offs: Net charge-offs were 0.59% in 1998—the same as in 1997 and near the level of those recorded during the last (very mild) recession. Net charge-offs may dip slightly in 1999 but should head back up in 2000. While net charge-offs will remain low by historical standards, recent statistics show nearly one-half of net charge-offs are due to bankruptcy.

Operating expenses: Operating expenses as a percent of average assets have increased in each of the past five years, with a 1998 total of 331 bp. In 1999, the total may be flat, but next year expenses may drift up. While Y2K-related expenses will end in 2000, recent surveys suggest technology-related spending will increase fairly rapidly, and a tight labor market may increase both compensation and fringe benefit costs.

Prices: Inflation will increase during the next 18 months but should remain tame by historical standards. The Consumer Price Index will increase 2.25% in 1999 and 2.5% in 2000.

Quickly: That's how fast credit union assets have been growing lately. The passage of H.R. 1151 reopened credit union doors to many that had been locked out by court injunction. That's part of the reason for the tremendous 11% jump in credit union assets in 1998. But that may change. Credit unions face several new regulations in 2000, including the Prompt Corrective Action regulation, which requires the National Credit Union Administration to take predetermined action against credit unions allowing capital to sink below certain levels. Fast asset growth combined with an expectation of lower earnings means managing growth will be a new issue for some credit unions. To find out more about prompt corrective action dictates or to try our growth rate calculator, visit CUNA & Affiliates' World Wide Web site at *www.cuna.org.*

Return on assets (ROA): ROA (net income as a percent of average assets) should drop slightly in 1999 and in 2000 due to slight increases in funding costs, loss provisions, and operating expenses. ROA has declined in each of the past five years and finished the first six months of 1999 at 90 bp. Hidden in that number is the fact that 40% of credit unions had ROA of less than 50 bp for that time period. The full-year 1999 results should be about 88 bp, and for 2000, about 85 bp.

Savings: Savings grew nearly 11% in 1998—almost double the loan growth rate. Money market accounts led the way with an increase exceeding 20%, share drafts and certificates grew about 19% and 13%, respectively. Growth should moderate in 1999 and 2000, but certificates may show stronger growth. Our crystal ball suggests overall savings growth of 8% in 2000.

Treasury bond yields: Expect the long end of the yield curve to drift up a bit more in the coming months as market participants seek compensation for increasing inflation. Nevertheless, plan for small increases, with very little steepening of the yield curve. The 30-year Treasury bond yield will average 6.25% to 6.75% in 2000.

Unsecured credit: Record mortgage refinancings in 1998 caused many members to fold unsecured credit into their home loan. Overall, unsecured loan balances declined 1% movement-wide. This kept asset quality statistics near historical lows and is apt to result in the first decline in bankruptcy filings in recent memory. However, members feel wealthier and may begin reloading these balances—though not with abandon.

Vehicle loans: New-car loans have languished in the recent past, with growth less than 1% in 1997 and a decline of 3% in 1998. That will change in 1999 with projected growth of 12%, but 2000 should bring significant slowing. Captive finance companies will remain extremely aggressive in the face of falling demand, and that will make inroads fairly difficult. Used-car loan growth, on the other hand, should exceed 10% in 1999 and 7.5% to 8.5% in 2000.

World economy: We clearly are operating today in a world economy. Unexpected strength in foreign economies will increase import prices on both finished goods and raw materials. And that could spell trouble for inflation.

Xanadu: Economists lately have fallen into one of two camps. One believes we now live in some sort of Xanadu—a "new economy"—where high growth, low inflation, and low unemployment can exist together indefinitely. Another believes the business cycle is alive and well and that most of the conditions that have produced the current unprecedented economic situation are temporary. For what it's worth, CUNA economists are in the second camp, and our forecast reflects that fact. What really matters is what the Federal Reserve policymakers think. As you plan for 2000, remember that regardless of what they say, those policymakers are acting as though they think the business cycle is alive and well.

Y2K: Y2K problems won't stop the Federal Reserve from taking "appropriate action" on interest rates. Fed economists expect Y2K to add 0.3% to 0.4% to economic growth later this year, then shave a few points off early in 2000. According to Bloomberg News, 99% of federally insured financial institutions received excellent ratings for Y2K readiness. For their part, credit unions have engaged in a Herculean effort to ensure members have access to their accounts as Jan. 1, 2000, approaches. In 2000, the technological focus will shift to things such as Internet access, Web site development, and service provision and spending.

Zero percent: That's the probability that all these forecasts for 2000 will be 100% correct, although they are our best estimate of what will happen.

So be sure to stress-test your plans, examining what might happen to your operations if the economy is weaker (or stronger) than we think it will be; if your loan and savings balances expand slower (or more quickly) than the norm; or if your income takes an unexpected turn. ◆

Mike Schenk is vice president of CUNA's economics and statistics department, 800-356-9655, ext. 4228.
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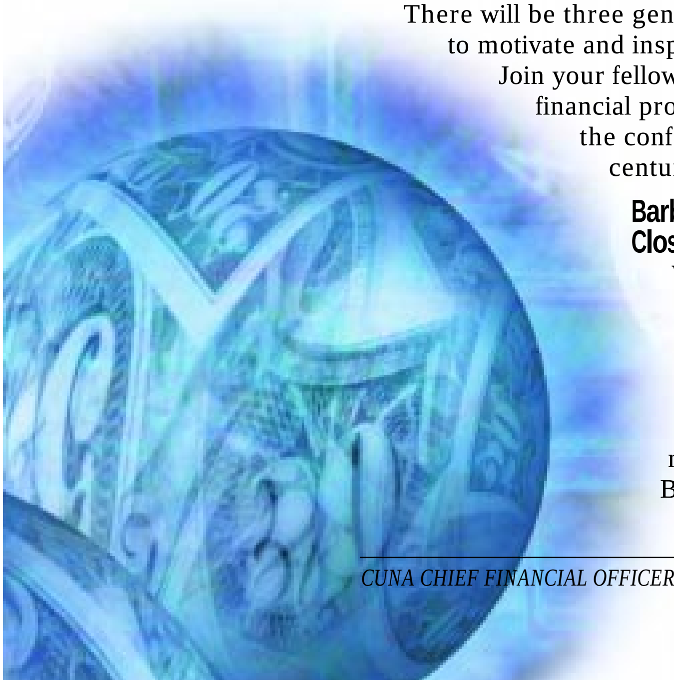
SIXTH ANNUAL CFO COUNCIL AND ROUNDTABLE

The location says it all: Disney World celebrates human ingenuity and creativity, embraces new methods, new technology, and original perspectives.

Following in Disney's footsteps, the Sixth Annual CFO Council and Roundtable will focus on creative solutions, blend perspective and scholarship, and effectively mix the traditional with the unique. The Conference, slated for May 21-24, 2000 is an essential punctuation mark in every CFO's career, as guest speakers will discuss a plethora of appurtenant topics of the new millennium. With a strong emphasis on asset liability management the subtopics will include:

- Risk Management for Complex Credit Unions
- Accounting Changes
- Technology in the New Millennium
- NCUA Update
- Product Pricing and Credit Union Trends
- ALM Reporting
- Real Estate Lending and Risk Management
- Discipline Without Punishment
- Streamline Job Tasks
- Product Profitability

If you are looking for ways to increase your professional expertise, consider attending the one and only conference developed by your peers. The executive committee members are polishing the final details. This conference will be packed with advanced educational session, valuable networking opportunities, and time for adventure at Disney. Shortly you will be receiving the conference brochure detailing all educational session and speakers. There will be three general sessions to motivate and inspire you. Join your fellow CFOs and financial professionals at the conference of the century.



Barbara Sanfilippo to Close Conference

We are pleased to announce that we have asked Barbara Sanfilippo to be our closing speaker. As many of you know, Barbara is an enthusiastic, highly-rated keynote speaker and industry consultant. Romano & Sanfilippo works with credit unions in developing their sales and service culture and their monthly article appears in the *Credit Union Journal.*

However, what you don't know is that she is also a popular motivational speaker at many other industry conventions. Therefore, she will be delivering her new keynote, "Dream Big! What's the Best That Can Happen?" at our closing session. This exciting program is based on her latest book of the same title which you can purchase on site. We'll take a look at how to define what success means to us, create more cappuccino moments and create our biggest dreams. Be sure to stay to the very end to hear this inspirational, life changing and entertaining program. You can visit Barbara at *www.romanosanfilippo.com*

ALM Reporting: How do you do it?

The 2000 CUNA CFO Conference, May 21-24 will include a session on **"ALM Reporting: Best of the Best"**. With the advent of NCUA 99-12 "Real Estate Lending and Balance Sheet Risk Management", we are all probably reviewing our "NEV" and "income at risk" limits. The 1999 conference included a session demonstrating the different styles of Board Packet presentations. This "learning from ourselves" was so well received that this year's conference planners decided to keep the series going with an ALM emphasis.

We need your help:

Once again, the success of this project will depend on the participation we receive in advance. This is not a contest, rather, in the best form of CU cooperation, it is a venue to share ideas. Each of us will probably achieve a "re-engineered presentation" by adopting sections of several reports. The goal of the workshop is to present a diversity of ideas.

Confidentiality:

Some have indicated that their management might not feel comfortable with submitting a sample. We hope the following will overcome this important concern:

1. Submit any date you like (if it is "stale" it is less sensitive).
2. Remove all references to name of credit union. Leave the data as unchanged as possible because deleting or changing might make the presentation hard to understand.

3. One person will know the name of the credit union. This amount of identification is needed in the event of questions during workshop preparation. It will also be helpful after the conference in the event that attendees desire follow-up and the submitter agrees to be identified at that time.

What to send:

The workshop will include examples of ALM policies and Board/Committee reports. Hopefully you can send examples of each, however, if only one or the other is submitted, we will use it.

Send a quality copy that can be reproduced with good readability.

How to send:

Remove all references to the name of your credit union. Attach a cover memo/letter providing:

Credit union name, address
Contact name, phone #, extension, e-mail address (if available)

Indicate if you are willing to take calls regarding your packet after the conference.

Regular mail to:

Larry Hoffman, CFO
Anheuser- Busch Employees' Credit Union
1001 Lynch Street
St. Louis, MO 63118

Or e-mail to: *lhoffman@abecu.org*
(attach as file in MS Word or Excel format)

When:

Send as soon as possible, but no later than March 15th.

Questions:

Call Larry Hoffman at (314) 771-7700, extension 400 or e-mail him at the above address, or contact Vince Market at (215) 953-5369; e-mail address *vmarket@philtelco.org* ◆

FEDERAL OPEN MARKET COMMITTEE INFORMATION

Because of the importance of the Federal Open Market Committee (FOMC) actions on the direction of interest rates, and the implications of rate changes to credit union business, we decided to include a schedule for upcoming FOMC meetings for 2000 along with a historical perspective on FOMC actions. ◆

FOMC Meetings in 2000:

February 1,2	August 22
March 21	October 3
May 16	November 15
June 27,28	December 19

Chronology of Federal Reserve Policy Changes Since 1987

				Date of Movement	# of Days Since Previous Move	Movement In Fed Funds	New Rate Levels	
							Fed Funds	Discount
Tightening:	Duration (in months)	9	1987	2-Jan	134	13	6	n/c
	Number of moves:	7		30-Apr	118	50	6 1/2	n/c
	Cumul. change in fed funds:	144		20-May	138	25	6 3/4	n/c
				2-Jul	43	-13	6 5/8	n/c
				3-Sep	63	25	6 7/8	n/c
				4-Sep	1	50	7 3/8	6
				8-Oct	34	-6	7 5/16	n/c
Easing:	Duration (in months)	4		19-Oct	11	-25	7 1/16	n/c
	Number of moves:	4		4-Nov	16	-25	6 13/16	n/c
	Cumul. change in fed funds:	-81	1988	28-Jan	85	-19	6 5/8	n/c
				11-Feb	14	-13	6 1/2	n/c
Tightening:	Duration (in months)	14		30-Mar	48	25	6 3/4	n/c
	Number of moves:	15		9-May	40	25	7	n/c
	Cumul. change in fed funds:	331		25-May	16	25	7 1/4	n/c
				22-Jun	28	25	7 1/2	n/c
				19-Jul	27	19	7 11/16	n/c
				8-Aug	20	6	7 3/4	n/c
				9-Aug	1	38	8 1/8	6 1/2
				10-Nov	93	13	8 1/4	n/c
				22-Nov	12	13	8 3/8	n/c
				15-Dec	23	31	8 11/16	n/c
			1989	5-Jan	21	31	9	n/c
				9-Feb	35	31	9 5/16	n/c
				23-Feb	14	25	9 9/16	n/c
				24-Feb	1	19	9 3/4	7
				17-May	82	6	9 13/16	n/c
Easing:	Duration (in months)	40		6-Jun	20	-25	9 9/16	n/c
	Number of moves	24		7-Jul	31	-25	9 5/16	n/c
	Cumul. change in fed funds:	-681		27-Jul	20	-25	9 1/16	n/c
				22-Aug	26	-6	9	n/c
				6-Nov	76	-50	8 1/2	n/c
				20-Dec	44	-25	8 1/4	n/c
			1990	13-Jul	205	-25	8	n/c
				29-Oct	108	-25	7 3/4	n/c
				16-Nov	18	-25	7 1/2	n/c
				7-Dec	21	-25	7 1/4	n/c
				18-Dec	11	-25	7	6 1/2
			1991	8-Jan	21	-25	6 3/4	n/c
				1-Feb	24	-50	6 1/4	6
				8-Mar	35	-25	6	n/c
				30-Apr	53	-25	5 3/4	5 1/2
				6-Aug	98	-25	5 1/2	n/c
				13-Sep	38	-25	5 1/4	5
				30-Oct	47	-25	5	n/c
				6-Nov	7	-25	4 3/4	4 1/2
				6-Dec	30	-25	4 1/2	n/c
				20-Dec	14	-50	4	3 1/2
			1992	9-Apr	111	-25	3 3/4	n/c
				2-Jul	84	-50	3 1/4	3
				4-Sep	64	-25	3	n/c
			1993	(None)				n/c
Tightening:	Duration (in months)	12	1994	4-Feb	518	25	3 1/4	n/c
	Number of moves:	7		22-Mar	46	25	3 1/2	n/c
	Cumul. change in fed funds:	300		18-Apr	27	25	3 3/4	n/c
				17-May	29	50	4 1/4	3 1/2
				16-Aug	91	50	4 3/4	4
				15-Nov	91	75	5 1/2	4 3/4
			1995	1-Feb	78	50	6	5 1/4
Easing:	Duration (in months)	7		6-Jul	155	-25	5 3/4	n/c
	Number of moves:	3		19-Dec	166	-25	5 1/2	n/c
	Cumul. change in fed funds:	-75	1996	31-Jan	43	-25	5 1/4	5
Tightening:	Duration (in months)	N/A	1997	25-Mar	419	25	5 1/2	n/c
	Number of moves:	1						
	Cumul. change in fed funds:	25						
Easing:	Duration (in months	2	1998	29-Sep	553	-25	5 ¼	5
	Number of moves:	3		15-Oct	16	-25	5	4 ¾
	Cumul. change in fed funds:	-75		17-Nov	33	-25	4 ¾	4 ½
Tightening:	Duration (in months)	8	1999	30-Jun	225	25	5	n/c
	Number of moves:	4		24-Aug	55	25	5 ¼	4 ¾
	Cumul. change in fed funds:	100		16-Nov	84	25	5 ½	5
			2000	2-Feb	78	25	5 ¾	5 ¼

Note: The actual dates of some polity changes prior to 1994 are uncertain. The Fed did not formally announce policy changes at the time, and various sources do not always agree. Funds target levels prior to 1994 are also open to debate in some cases. Where Fed sources show a range rather than a single rate for the target, we have treated the midpoint of the range as the target.

Source: R.H. Wrightson Associates, Inc.

Source: www.yardeni.com

CUNA CFO COUNCIL NEWS

CFO News is fax broadcast bimonthly by the CUNA Council. Send news and CFO Council information to Vince Market, CFO, Philadelphia Telco CU, Trevose, PA., phone 215/953-5369; fax 215/953-5388 or Harry Jacobson, Asset/Liability Manager, Navy FCU, Merrifield, VA., phone 703/206-3606; fax 703/255-7755. For council membership and administration information, call Pam Lee, manager of CUNA council administration, at 1-800-356-9655, extension 4141 or e-mail her at plee@cuna.com.

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