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NEWS RELEASE

Credit Union Economics Group (CUEG)

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Editor's note: Photo attached

July 13, 2006

ECONOMISTS ADDRESS NEAR- AND LONG-TERM CREDIT UNION CHALLENGES

NAFCU Attendees Told to Expect Slower Loan Growth, Higher Savings Growth

TORONTO – Five members of the Credit Union Economics Group (CUEG) offered their thoughts on emerging issues related to the general economy, credit union liquidity, membership growth trends, and regulatory costs during a panel discussion Thursday, at NAFCU's 39th Annual Conference and Exhibition.

Organized in April of 2003, CUEG provides consensus macroeconomic forecasts and industry trend analyses aimed at helping credit unions with their planning and operations. The panel discussion attracted a standing-room audience of nearly 200 and was moderated by Dan Maynard, CFO of CrossRoads Community FCU, Cheektowaga, NY.

Tun Wai, NAFCU's chief economist and director of research, led off the group's presentation with a discussion of the latest quarterly CUEG forecast. Wai cited figures showing that U.S. economic activity is expected to slow in the near term and inflation will continue to be an important factor in the Federal Reserve's monetary policy deliberations.

"A key element for credit union pricing and planning is to know when the Federal Reserve will stop raising the Federal Funds rate," Wai said. "According to the recent CUEG forecast, we are at or near the peak of Federal Reserve rate increases for the near term.

"Our inflation forecast for 2006 has been raised from prior surveys, but it is not that different from 2005. The mean Federal Funds rate forecast by the group was 5.28 percent. This implies a split decision between 5.25 and 5.5 percent by CUEG members," Wai said.

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He added that credit union loan growth is expected to be slower than last year, while savings is expected to be slightly higher, but the loan-to-share ratio will continue to rise.

Bob Burrell, executive vice president/CIO of Western Corporate FCU (WesCorp), San Dimas, CA, discussed credit union liquidity, noting that, in general, credit unions remain very liquid. “Between 2001 and 2003, the system picked up an additional \$90 billion of liquidity, yet the rapid loan growth and slow share growth experienced in 2004 and 2005 have used up less than a quarter of that amount. However, within the system, the liquidity needs of individual credit unions vary dramatically,” Burrell said.



Tun Wai, right, NAFCU chief economist, discusses CUEG's latest economic forecast during a breakout session Thursday, at NAFCU's annual conference in Toronto. Other CUEG panelists were from left, Bruce Beaudette, Sunmark Federal Credit Union; Kendrick Smith, Eastern Financial Florida Credit Union; Dave Colby, CUNA Mutual Group; and Bob Burrell, Western Corporate Federal Credit Union.

The gap between high-growth credit unions and the rest of the industry seems to be accelerating, and credit union pricing strategies vary widely. Burrell noted that, in general, credit unions seemed to have remained competitive in the CD market, while avoiding raising pricing on money market and regular share accounts. Consequently, credit union share growth has been confined primarily to CDs the last two years.

Loan growth continues to be dominated by indirect auto lending and residential mortgage originations. In addition, member business lending activities continue to grow at a very rapid pace but remain only a small part of the loan portfolio for most credit unions.

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CUEG's latest forecast has loans growing at 8.5 percent in 2006, and slowing to 7.1 percent in 2007 (median forecast), while share balances are slated to rise 4.9 percent and 6.4 percent, respectively.

Dave Colby, CUNA Mutual Group's chief economist, discussed membership growth. "While credit unions continue to add members, gains are clearly slowing and becoming more difficult to achieve. This is despite tremendous expansion in potential membership with SEG and community charter approvals and new members gained through indirect lending programs," Colby said. Roughly 44 percent of 2005 membership increases may be attributable to indirect lending.

"Growth is always a strategic challenge, but just adding to the count and not building relationships is a cost drag at most credit unions. In an era of extremely tight margins and little room for error, non-performing members are being subsidized by the best members. This cannot last for long, and eventually the best members will be enticed away to other providers, thus weakening the entire credit union," Colby said.

To successfully achieve growth, credit unions must first take exceptional care of their best existing members, he said. "Going forward, it will be essential to develop a better understanding of the increasingly divergent needs and expectations of existing and potential members. Target marketing and focusing more resources on deepening relationships is a must."

Kendrick Smith, chief investment officer at Eastern Financial Florida Credit Union, Miramar, FL, and Bruce Beaudette, president & CEO of Sunmark Federal Credit Union, Schenectady, NY, discussed the regulatory burdens credit unions are facing and their effect on credit unions' bottom lines.

"The cost of compliance is going one direction – up," Smith said. The fastest rising costs are related to Anti Money Laundering and the Bank Secrecy Act.

"My credit union has invested heavily in providing various systems that assist in complying with BSA and Office of Foreign Assets Control requirements and to help fight fraud and provide security to our members," Beaudette said. "The cost is substantial to access our vendors' databases and to train staff on this complicated process." For example, accepting online membership applications can be particularly troublesome and requires much scrutiny, he said.

The Credit Union Economics Group (CUEG) is a working group of geographically dispersed credit union officials who have dedicated themselves to the current and future financial well being of these not-for-profit cooperatives. CUEG's objective is to provide credit unions with consensus macroeconomic forecasts and industry trend analyses that will be helpful in their planning and operations. This independent, non-profit group also provides a credit union perspective on regional economic trends by

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exchanging information with the NCUA, the Federal Reserve Board and the various Federal Reserve District Banks.

CUEG prepares a regional economic and descriptive credit union trends report bi-annually as well as a consensus macroeconomic and industry-trend forecast, available at www.cueg.org.

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