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LOAN GROWTH TRENDS, OPPORTUNITIES & CHALLENGES

(5-Minute Read)

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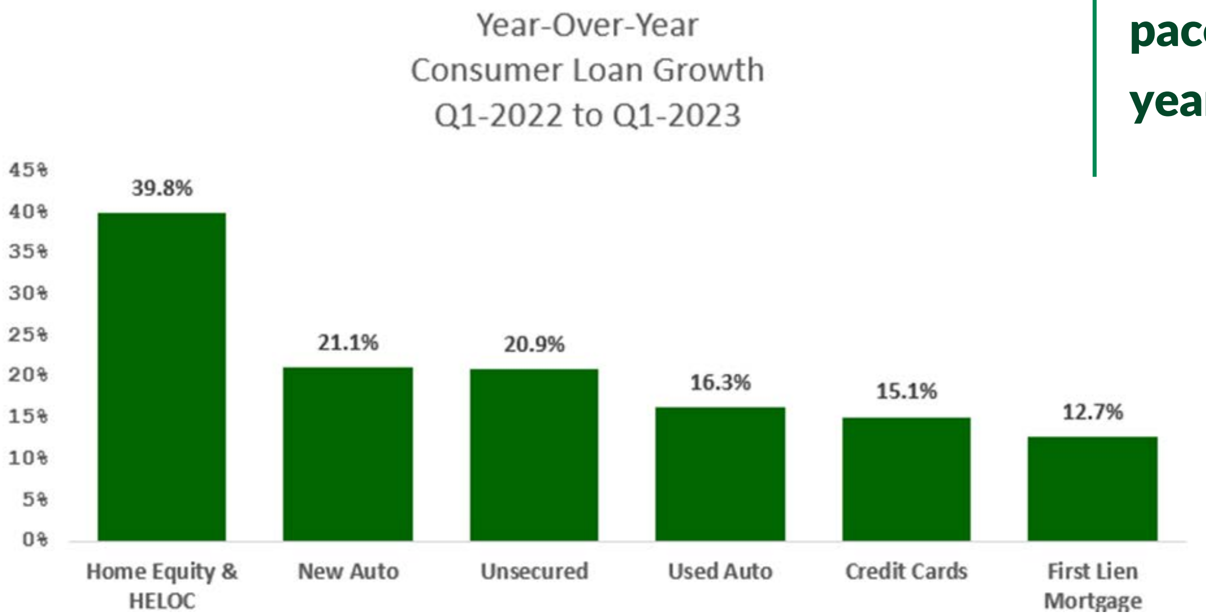
Loan Growth Trends, Opportunities & Challenges

Credit union loan growth continues at an impressive pace, particularly in the area of retail lending. This encouraging trend undoubtedly benefits many, yet it prompts us to reflect on loan concentrations and the possible risk that comes along with swift expansion. We find it important to focus on the recent growth trend. Additionally, given the possibility of a recession, we must consider the potential strain on loans and the tools available to measure and mitigate these risks.

> **Credit Union lending grew by the fastest pace in 30 years**



Loan Growth Trend

In the year 2022, credit union lending increased by 20%, marking the most rapid growth observed in the last three decades. To provide some context, the loan growth rates over the previous 10 years ranged from 4.9% to 10.5%, with an average annual growth rate of 8.7%. Recent loan growth has been broad-based across all loan segments.

Much of the consumer lending growth is related to the end of government stimulus funds which were intended to boost the economy during the COVID-19 pandemic. While some of these funds remain on deposit, they are starting to flow out as people get back to work in offices and return to normal spending habits. Demand for large-ticket items is up sharply in large part due to pent-up demand. Cars, boats, kitchen remodeling, and other large-ticket items generally involve borrowing.

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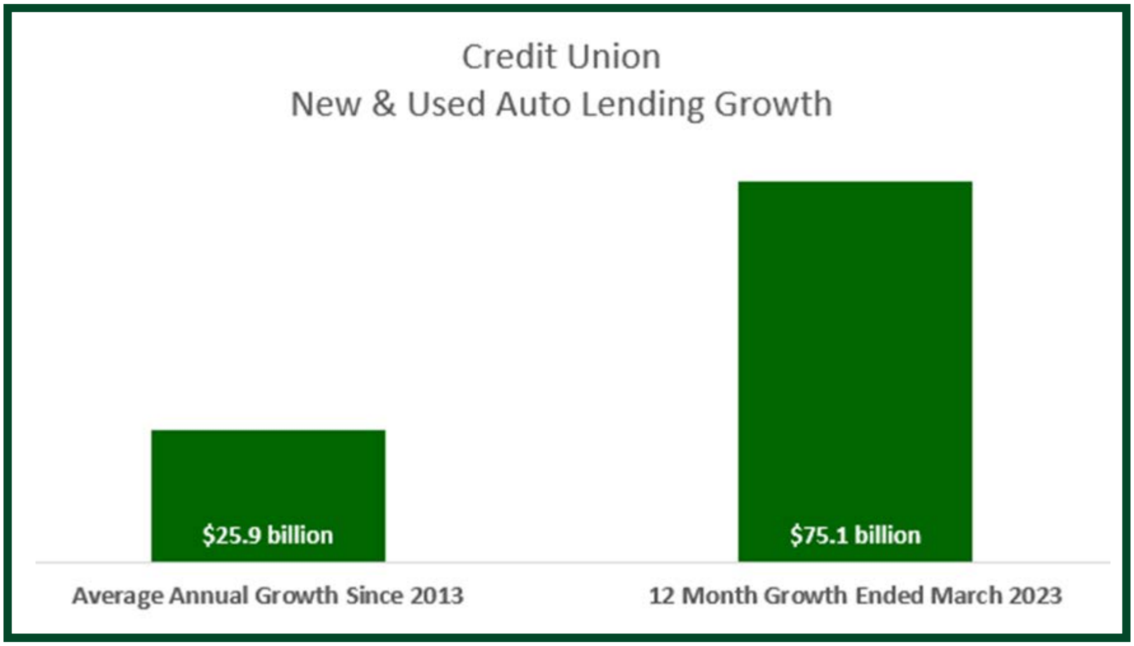
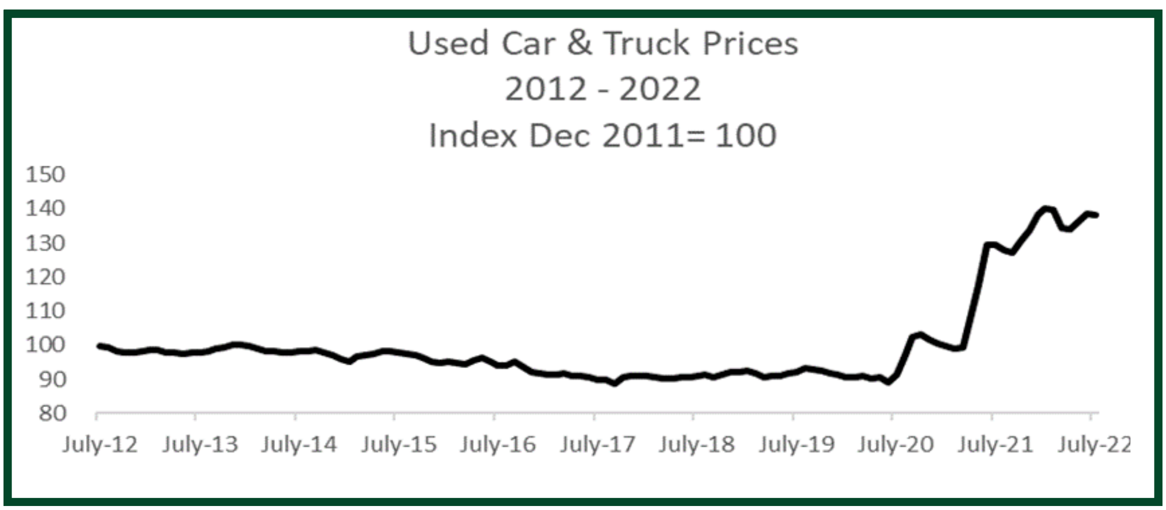
Loan Segment Commentary: All loan segments involve different opportunities and risk. The following include a detailed analysis of each segment.

Auto Loans: New & used auto loans include both direct and indirect lending. Recent auto loan growth is unprecedented. For the previous 4 quarters ending with March 2023, auto loans grew by just over $75 billion. This is the largest year-over-year increase in at least 10 years and is more nearly triple the volume of a year.





Largest quarter over quarter increase in at least 10 years

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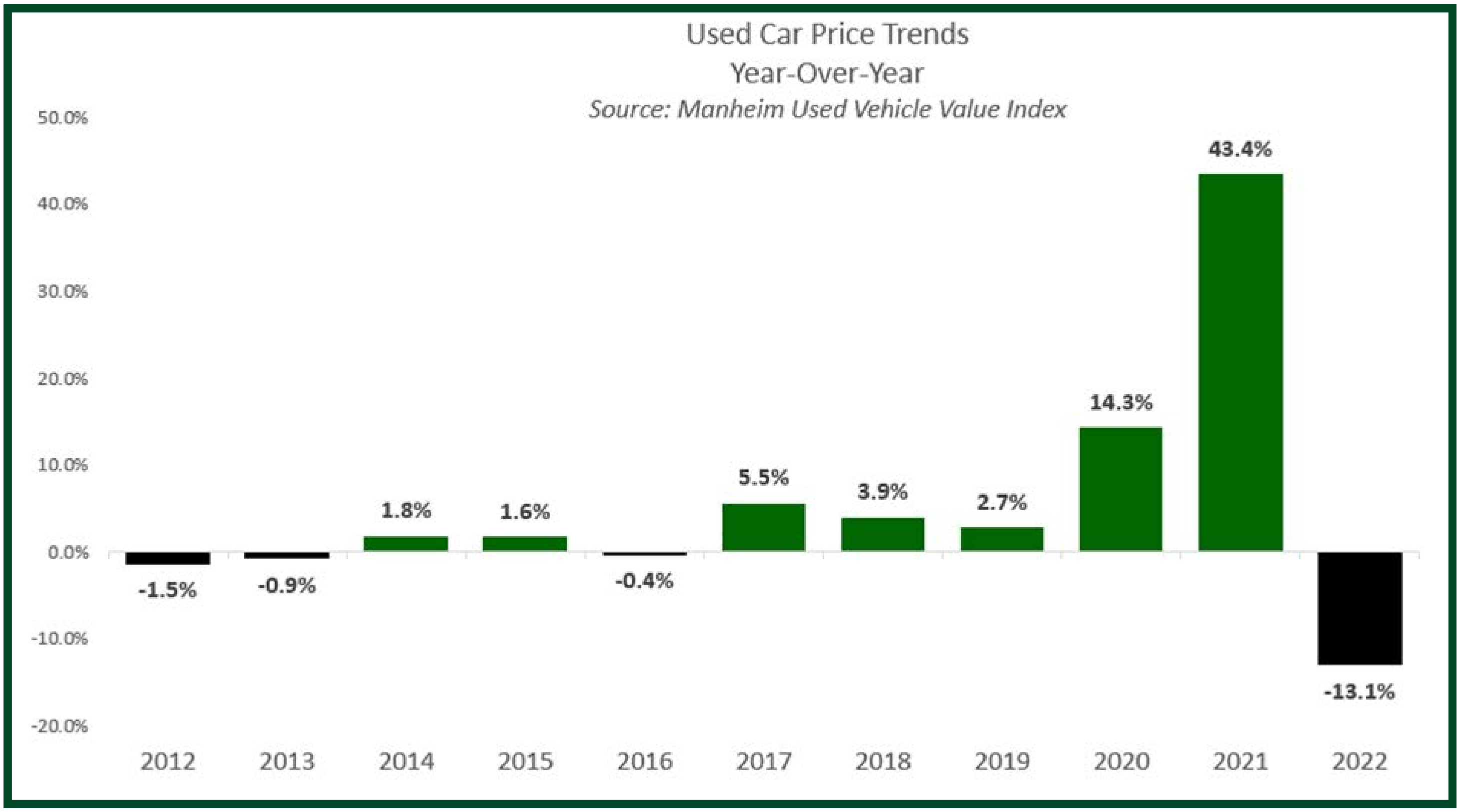
Many clients have told us that recent indirect auto loan growth has been fueled by competitors exiting the indirect lending market. The competitive landscape and growth trend should lead to board-level discussions about dealer reserves, offering rates, risk-based pricing grids, and the true yield of indirect lending. After subtracting dealer reserves and charge-offs, we sometimes find that these programs don't provide yields sufficient to offset the risk.

Auto lenders should also consider that higher prices may lead to loan stress as the economy weakens. Manheim is the largest used car auction marketplace in the U.S. and has tracked used car & truck prices for over 60 years. The recent trend is clear. The fluctuation in used vehicle prices has stayed relatively steady over a long period, until 2020, when prices increased by an average of 14.1%. This surge in prices gathered more momentum in 2021, with prices increasing by a staggering 43%. However, in 2022, we saw an average price decrease of 13.1%. This is completely unfamiliar market. We traced price trends all the way back to 1997 and found no other instance where used vehicle prices dropped as significantly as they did in 2022. Unfortunately, there is no way to predict the timing or severity of potential auto loan delinquency or charge-offs related to both lending at inflated prices and an economic slowdown.



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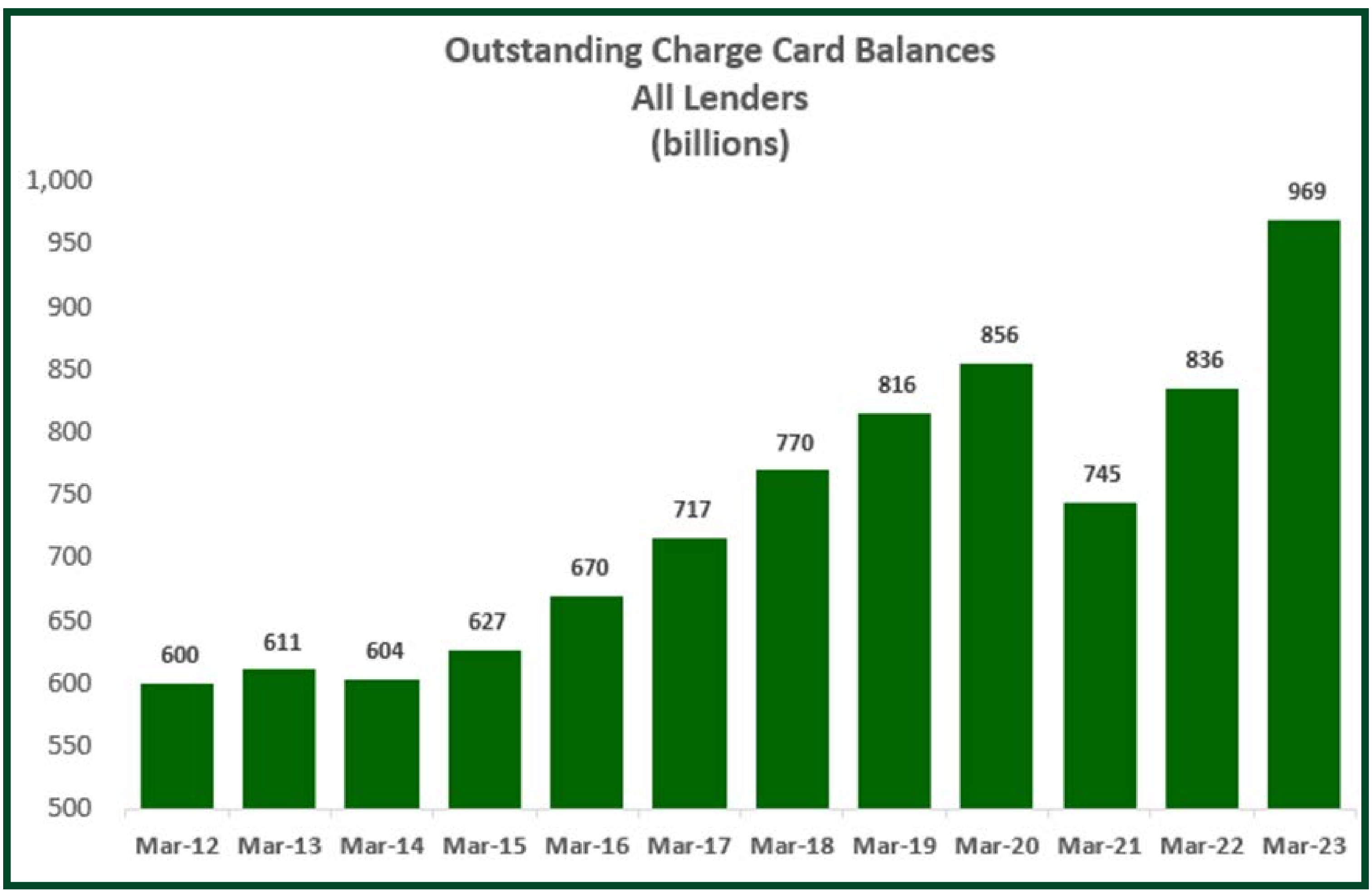
Unsecured & Credit Cards:
There is a great deal of information about credit card delinquencies and charge-offs, but not as much information about other unsecured loans. We can get a good sense of consumer loan health by considering credit card trends. Credit card balances were trending higher prior to the COVID-19 pandemic but fell sharply starting in early 2021. Balances have rebounded and are now well above the pre-pandemic level. Charge card balances are very close to $1 trillion for the first time.



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First Mortgage Real Estate: Mortgages are by far the largest lending sector in the United States. Low-interest rates over the past couple of years resulted in new loan volume and substantial refinance activity. Starting in early 2022, mortgage loan volume fell sharply. Home price trends remind us of the housing market crash 15 years ago that resulted in a worldwide recession. It makes sense to ask if another boom-bust cycle is on the horizon. The short answer is that it is 'not very likely for these reasons:

- **Today's lending is based on higher lending standards,**
- **Pandemic mortgage-related forbearance & government stimulus payments,**
- **A much greater equity cushion. During the recent refinance boom, many borrowers opted for 15-year loans, which build equity much faster, and**
- **Many homes have appreciated in value, adding to equity**

HELOC & Home Equity: Growth of 2nd mortgages and HELOC loans are particularly strong. Homeowners with sub-4.00% mortgages are likely to remain in their homes for a long time. In addition, 15-year loans were the preferred option during the refinance boom. These loans build equity faster and borrowers will eventually tap the excess equity for a variety of reasons.

Action Items

The U.S. economy has not been faced with simultaneous inflation and recession since the early 1980s. Very few people currently in our industry were in leadership roles the last time we were faced with these issues. The Federal Reserve's goals are to first bring inflation down. To do so, they have already increased short-term rates at a pace not seen since 1994. Rate increases may continue, which will likely result in slower economic growth or a downturn. The Fed will likely not lower rates again until inflation is under control. These conditions point to volatility. We have several action items:

- **As the loan mix changes, review concentration risk limits.**
- **Toy' loans like motorcycles, boats, and RVs could be troublesome due to high gas prices and potential recession.**
- **Consider raising loan yields and adjusting risk-based pricing guidelines to help protect margins.**
- **Use McQueen's 24-7 On Demand ALM Simulator to quickly run what-if scenarios related to loan growth, run-off, or balance sheet shifts.**

We encourage you to talk to us about your specific needs.

Borrowers will eventually tap the excess equity

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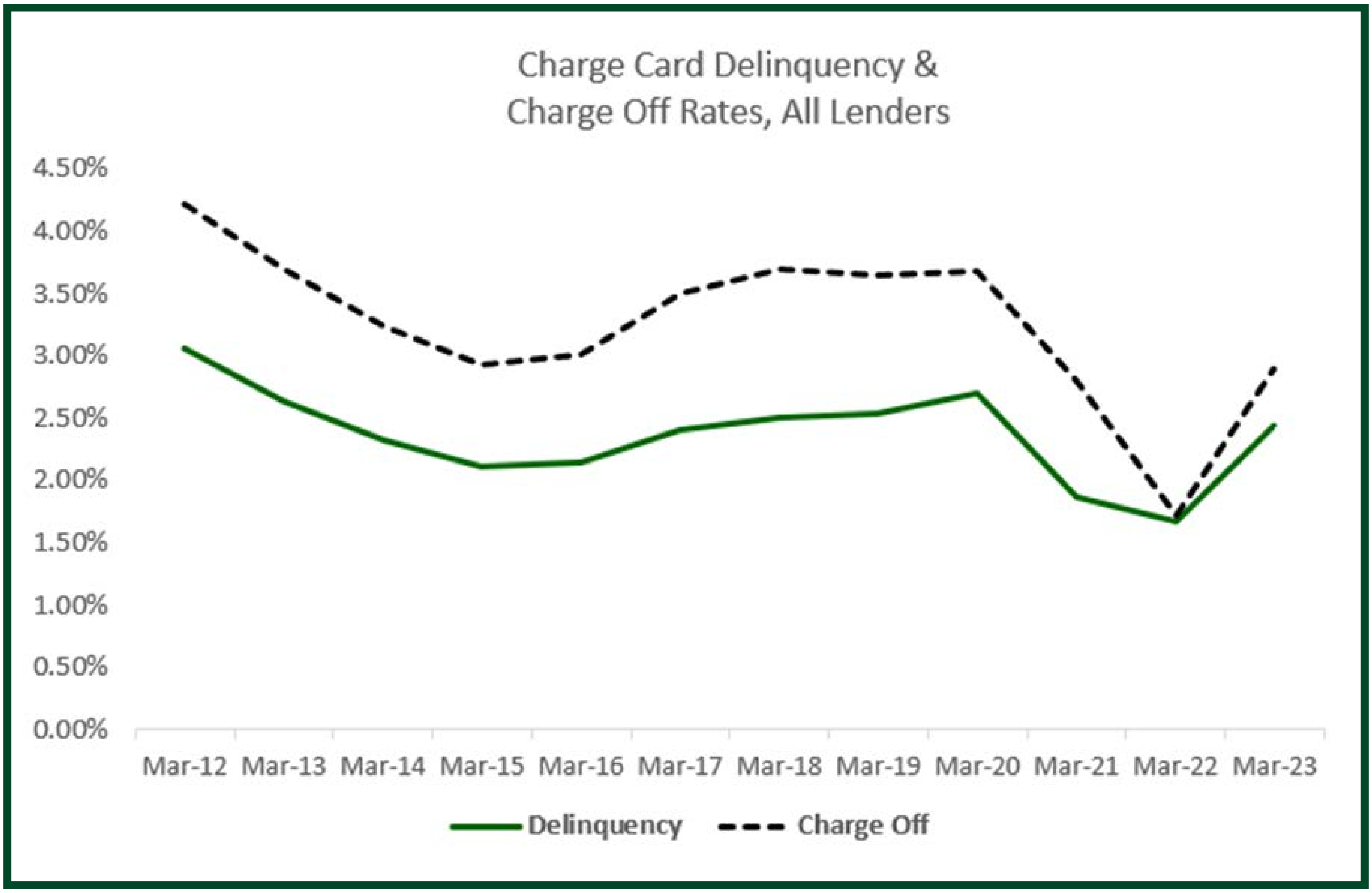
Credit Union Loan Growth Trends, Opportunities & Challenges

Delinquencies and charge-offs also improved during the pandemic related to massive government stimulus intended to boost the economy. The delinquency rate has increased to nearly the pre-pandemic level and the charge-off rate is recently been trending higher.



We encourage clients to review unsecured and credit card growth as well as the potential for delinquencies and charge-offs to revert to the former levels.