HARLAND CLARKE

Financial Industry Economic Update
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TRANSCRIPT

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Nathan: Good day, and welcome to Harland Clarke Informed Banker webcast, financial industry economic update.

This webcast is being recorded, and a replay will be provided to you within a few days. If you have questions, please use the question box located in the control panel. Your questions are private, and are only seen by our presenters.

I will now turn the call over to Sheila Easley of Harland Clarke. Sheila, the call is yours.

Sheila Easley: Thanks Nathan, and welcome to everyone who is joining us today for this month's installment of the Informed Banker. The series is just designed to cut through the noise and bring you specific timely information on topics that are critical to the community financial institutions.

We're excited for today's topic in the financial industry economic update presented by Samira Salem, a senior policy analyst at CUNA, or Credit Union National Association.

A little bit more about Samira's background, before we get started. Samira has nearly 20 years of experience in international economic development, community development, policy research, and social finance. She joined CUNA in 2018 as a senior policy analyst in the Research and Policy Analysis Division, and prior to joining CUNA, she worked for Forward Community Investments, FCI, a Madison based Community Development Financial Institution that serves communities throughout Wisconsin.

Earlier, Samira worked at the US International Trade Commission in Washington DC, where she was a Senior Trade Analyst for Labor and studied the impact of organizations on the US labor market outcomes. Prior to that, she had at an eight-year tenure at Washington DAI where she rated International Economic Development, where she served as an International Economic Development Specialist. Samira earned her PhD in Political Economy in Public Policy, and her MA in Economics from the University of Sothern California.

Samira, the floor is all yours.

Samira: Thank you, Sheila, and thank you to Harland Clark for the opportunity to be here with you today. I'd like to go ahead and get started, if we can. We can switch to the next slide, please. One more. Great.

The agenda for the day is; we'll start up with taking a look at the outlook for the US economy, give a quick update on the trade dispute, which happens to be just changing and shifting at a really quick pace, and the more close things up about with the credit unions, which I believe is really relevant to community banks as well. Next slide, please.

Well, US economic growth, as measured by Gross Domestic Product, over total about goods and services produced in the US continues to be solid, but most economists expect a slow down in growth. The US economy saw a really strong GDP growth of 3.1% in the first quarter of the year. This was, quite frankly, surprising to a lot of economists. Going into 2019, people expected there to be a slowdown because of the government shutdown. There was also a few recall volatility in the stock market. When this number came out, people were really quite surprised. It was really driven by net exports, and driven by inventory built up, both of which are a bit more transient.

Most economists, though, expect a slow down in economic growth. The waiting effects of the tax cuts, the tariff increases that we've seen, uncertainty around the additional tariff increases, and general economic uncertainty, will definite have a negative impact, on both consumer and business spending, and ultimately on growth.

CUNA economists actually met last week to update our forecast. In this environment, we expect that growth will revert to a longer term more sustainable level, which is around 2.1%. You can see our forecast for 2019 is actually 2.1%, and we have it slowing a little bit further even into 2020.

This level is actually not far off from what the congressional budget office forecast as a long term level of economic growth for the US economy. Their forecast or projections, rather, are just under 2%. This is still a healthy rate of economic growth. Assuming that nothing goes off the rails, this lower growth rate doesn't mean that we're forecasting a recession. What do we care about this in the financial services industry? Well, we know that when economic growth is high, wages in income typically will follow. People will feel like they have the ability to spend more, take up more loans. Credit unions, community banks, tend to do well. They will see strong loan growth and healthier portfolios as a result. Next slide, please.

The headline here is really that the labor market remains strong. Job gains have been solid, the unemployment rate remains at a historically low level of 3.6%. The unemployment rate first hit 3.6% in April, and we haven't seen this level of unemployment, or unemployment that low since 1969. To put that in context, that is the year the US put a man on the moon, and the song that topped the chart was *Sugar Sugar* by The Archies. It's been a while.

Also notice that in addition to that 3.6% unemployment rate, we also show that U6 unemployment rate, which is a bit higher, but is also trending down. What that U6 unemployment rate is, it's a broader measure of unemployment that actually tell us that workers who were previously on the sidelines are rejoining the labor market. That's really good news. It's probably no surprise to you, but there's a strong relationship between unemployment and loan growth rates. Next slide, please.

As the unemployment rate is low, people are more likely to spend more because they have jobs, they have a certain level of income, they'll take up loans, they're better able to pay their bill on time, credit unions, community banks, banks in general experience strong loan growth and healthy portfolios. You can see these lines moving in opposite directions, unemployment rate high, loan growth rate lower. Unemployment rate low, loan growth rate higher. Next slide, please.

If we just aggregate unemployment by race and ethnicity, we find that since the financial crisis, 2009 or so, the unemployment rate has fallen for all groups. This is really good news. That said, you'll notice that there are disparities between these lines, and across these groups. Asian-Americans consistently have the lowest unemployment rates, followed by whites. The African-American unemployment rate, well, at its lowest since the 1970s, is still more often double the rate, almost triple the rate of that of Asians, and significantly higher than the rate for Whites. Not everyone is fairing as well, even in this historically strong economy. Next slide, please.

The final piece of news on the labor marketfront has to do with the upticking wage growth. Wage growth had been stagnating for years. With the **[unintelligible 00:09:00]** of the labor market, economists had been expecting wage growth to pick up a bit earlier, or the strong labor market is finally beginning to benefit workers. We have seen average hourly earnings in 2018 increase 3%, as you see here. This is year-over-year. If we adjust the current inflation that's 1.1% increase, the May figure, which again is year-over-year, showed a 3.2% increase in average hourly earnings. If we look at the inflation-adjusted number, it's 1.3%. There has been a slight gain. Next slide, please.

In addition to being slow, wage growth also has been uneven, which is concerning, especially when it comes to the long term health of the economy.

A recent report by the Economic Policy Institute found that between 2017, wage growth has been strongest for the highest wage earners. For those at the 95th percentile, annualized real wage increases were 1.1%, while increases for the typical worker in the middle of the income distribution was only 0.3% annually for the entire period. Annual real wage growth for the poor, so those with the 10th percentile, was 0.5% annually. If you're able to disaggregate, or if we were to disaggregate wage growth by gender, by race and ethnicity, you would similarly see wage gaps. Again, this has negative consequences for these particular groups, and overall, for the US economy. Next slide, please.

Now let's move on to interest rates, the Fed funds rate. The Federal Reserve has a dual mandate. The first of these is full employment. We've seen that the labor market is doing well, we have a strong labor market. So check, they've met that. The second is stable crisis. This is where the Fed has been frustrated. The Fed has a 2% inflation target, and the US economy has consistently fallen short of this. There's no real pressure to increase interest rates at the moment. In fact, the Fed has been saying since January that they would remain patient when it comes to further Fed funds increases. Just yesterday, after the June Federal Open Market Committee meeting, they announced that while they will keep rates steady for now, they may no longer be in patient mode. Instead, they indicated that in this uncertain environment, and that was their words, they would be actively monitoring the economy, and may consider cutting the rate in the future. We may see a rate cut this year yet. Next slide, please.

This chart here is a reflection of what credit unions and banks are paying for funding and earning on their mortgage loans. As you can see, the spread has been tightening here, I'm sure you're very well aware of that. Again, the current federal funds target range is just two in a quarter to two and a half. This is still well below previous levels. As I mentioned before, the Fed has signaled or indicated in their most recent meeting that they might consider a rate cut. We might see some adjustment and movement here. Next slide.

Another indicator that economists tend to look at is household net worth. What we've seen is, over the last few years, certainly since the financial crisis, household net worth has been increasing, and that's a very good sign. Next slide.

At the same time, household debt is rising. In fact, it's higher now than it was prior to the financial crisis in absolute terms. Mortgage debt is close to what it was pre-financial crisis, and many people see this as a cause for concern. If you delve a little bit further and look at the quality of that mortgage debt, though, it is significantly higher. It's a significantly higher quality debt than what we saw around the financial crisis. Qualitatively, we're talking about something different. Next slide, please.

Just to give a perspective on this household debt, it is actually much lower than it's been in at least 10 years. Relatively speaking, as a percent of GDP, household debt has been declining. Next slide, please.

If we look at the actual debt service payments, it's the lowest it's been since at least 1980. Why might this be? We have lower interest rates that have helped to keep our monthly payments low. In addition, there have been, or there is longer and more flexible repayment schedules on loans. For example, average auto loans have longer terms than they did in the past. Household debt ultimately seems to be a lot more sustainable than it has been in the past. Next slide, please.

Consumer sentiment, while towards the beginning of this year, there was a little bit of a blip, you can see it went down, and has picked up again. It remains higher than its long run average, so some positive news. Part of the challenge here is, we're talking about an economy where we have a GDP growth which has been strong, but there is this sense that from many economists, that it will be slowing. You have a strong labor market, but there are some indications of some maybe fragilities in the economy, and consumer sentiment tends to be a lagging indicator. It's not quite yet picking up some of the things that even the Fed is starting to see, and they're starting to monitor a little bit more closely. We see this as good and positive, but by the same token, we're also cautious in how we interpret this because we feel that it might be lagging a little bit. Next slide, please.

Another piece of information or data point with respect to consumers. Again, the percent of consumers with new bankruptcies are down. It peaked in 2006 ,there were some law changes, then again in 2010 during the financial crisis. Currently, we see that it's less than one-third of what was in 2010. Next slide, please.

There are some headwinds when it comes to corporate debt, though. It is becoming a cause for a concern. While we know that household debt is more sustainable this time around, corporate debt is starting to show some warning signs. It has now grown to 47%. This is the highest level on record, the IMF, the Federal Reserve, Treasury, have all cited rising corporate debt as a cause for concern, particularly because much of this corporate debt seems to be due to lowering credit standards, which of course, happened with mortgage debt during the financial crisis. Nevertheless, we're still a long ways away from panicking about this. Corporate debt is still much less than the total mortgage debt which fueled the last crisis. The lowering of credit standards really doesn't seem to be nearly as severe as before the crisis. Next slide, please.

Next slide, please. Next, I think we're going to-- We have a poll here. Can we launch the poll, please, Nathan? Thank you. What we'd like to do is briefly talk about the trade dispute, but before we do, I just wanted to ask folks some questions. The first is, has the trade dispute had any impact on your operations? If you wouldn't mind answering, and then we will read out the results. 21% indicated Yes, and the remainder indicated No. Okay, that's probably what we're seeing. It would be interesting to dig a little bit further. Can we launch the next question, please?

Okay, a little bit more in depth here. For those whose members have been impacted by the trade dispute, how has this manifested itself in terms of your operations? Decrease in demand for consumer loans, increase in demand for business loans, decrease in demand for business loans, increase in demand for financial counseling, other, there's a lot there.

I believe we are calculating the results. All right. Here we go. Okay, so the results are 10%, so that they have experienced an increase in demand for consumer loans, 20%, a decrease in demand for business loans. It's starting to have a bit of an impact. The remainder indicated other. I'm assuming we have some time for Q&A. I would love to hear from those of you that indicated other, what impacts that you are seeing. If we can move to the next slide, and thank you very much for your responses there, that would be great.

Just quickly, I will try and do this very quickly. The US entered into a trade dispute with China last year, 2018. By the end of the year, the US had imposed tariffs of 10% on $200 billion worth of imports for China. The Chinese retaliated. We had a plan to increase the tariff rate to 25% on those, that $200 billion worth of Chinese imports. In the interim, the US and the Chinese entered into trade negotiations. As we all know, those trade negotiations fell apart in early May, and tariffs were increased to 25% on that 200 billion, and there's a threat for additional tariffs, additional jobs.

The New York Federal Reserve took a look at, so what are the costs of these additional tariffs that have been imposed on Chinese goods, imports, to US households. If you look at the right bottom box, the $831 is the cost to a typical US household annual costs, in fact, for this increase in tariffs. That's about $70 a month. It's not insignificant. I could go into the calculations on how they arrived at that, but I don't think we have time. I will try and wrap up with maybe one more slide, I'd like to get into credit union, community bank operations. If we could move there really quickly. One more please.

This slide is very simple. It basically shows that one of the points I made earlier, economic growth goes up, credit union, Community Bank banking, the loan growth also increases, they follow one another, goes down. Similarly, loan growth also goes down. Can we move on to the next slide?

Loan growth for credit unions has been fairly strong, triple-digit, for the last four years or so. We are seeing loan growth start to slow. We expect our forecasts for '19 and '20 for it to slow even further with the decrease, or with the slowing of economic growth. With that, I will turn it over to Sheila so we have a little bit of time for Q&A.

Sheila: Thanks, Samira. Great, great information. We appreciate you joining us today. I do have one question that I've gotten already, and as Samira had suggested, any of you who responded to the second poll question as other, feel free to describe how you've experienced or why you selected other. I can convey that information. Samira, the first question that we've gotten is, some analysts have predicted or suggested that the Fed lowers interest rates given signs of slowing growth and low inflation. Is this realistic?

Samira: Well, a couple of days ago, I probably would have said it's possible, but we wouldn't have expected the Fed to take that position. As of yesterday, as I mentioned earlir, the Federal Reserve actually put out a statement suggesting that they are no longer in this patient mode, that they are actually monitoring what they call this an uncertain environment to determine whether or not it warrants a rate decrease. It is a possibility, it really depends on what happens in the economy. There are a number of different factors that certainly could influence that.

Sheila: Excellent, thank you. We probably have time for about two more questions. The second question I've gotten is, let's see here. What are some of the biggest downside risks the US economy faces in the short to medium term?

Samira: Sure. The first is probably one that I mentioned a little bit about, is the trade dispute, is actually more of a little bit. There are threats for additional tariffs, certainly on China. There was some talk about Mexico, it sounds like that's off the table for now. Then discussion about auto tariffs, and those certainly would have an impact on, it's a big part of credit union's portfolios, I'm sure similarly for community banks and other banks as well. That's something that we're keeping an eye on. That's one thing, slowing global growth, the German economy, the Chinese economy, both of these, and the European Union has seen, almost across the board, a slowdown in economic growth through supply chains because they're huge export market for us. That certainly does have an impact on the US economy and our growth rates. Then finally, the rising corporate debt, which I mentioned towards the end. That is another headwind that we're keeping an eye on.

Sheila: Awesome. Thank you some, Samira. Well, it looks like that is all the time that we have for today. As a follow up to today's program, you can expect an email from Harland Clarke with a follow-up survey along with a link to the recording to this presentation.

Please, feel free to share that recording with any of your colleagues who may have missed today's session. Samira, thank you again for sharing with us today. Great information. I'd also like to extend a very sincere thank you to all the financial services professionals who made time in their busy schedules to be with us today. We hope to see all of you again at a future informed banker session. With that, I will conclude today's session. Thank you.

Samira: Thank you.