CUES 111: A 'Nice Recovery' Forecasted for 2021 Economy, Despite the Hard Knocks of COVID-19—an Interview with Steve Rick

James Lenz:
You're listening to the CUES podcast, episode 111

Hello CUES Nation! Welcome to another episode of the CUES Podcast! My name is James Lenz – CUES Professional Development Manager. I am excited to be with you today! On behalf of Credit Union Executives Society, we thank you for making this show a regular part of your personal professional development.

As so many of you know, we use this special delivery channel to speak with credit union industry leaders and cross-industry experts for a wide range of perspectives on trends and topics relevant to you.

You tell us that one of the reasons you like the show so much is because of the variety of topics that we deliver on – our shows often fall under the umbrella of strategy, leadership, organizational development, and culture. You think we might run out of topics – but no we don't! As long as the members' communities change, as long as members' expectations change - AND their behavior, AND as long as technology continually evolves – so should credit union strategy! Organizational culture needs to also continually adapt and evolve.

And that means how we think of leadership today and yesterday – may not be the same as we think about it tomorrow. Certainly, strong and highly effective leaders need to be very reflective individuals. And that's why I am so excited about my upcoming interview with Laurie Maddalena. We will be discussing this very topic – The Leadership Evolution – so look out for that show soon! We are expecting a May release.

There is just so much to learn. What's very challenging for me is making decisions without evidence to support those decisions. I get excited about making data-based decisions & solving complex problems. As leaders – we all know, due to the pandemic, we've had to make some tough decisions with very little information at hand – both personally and professionally. And that doesn't make us feel real comfortable, of course. There have been so many unknowns, right?

Well…to provide some level of relief and improved contextual understanding, we are dedicating the next 3 episodes to help you do just that. In relatively quick fashion, we are delivering to you – CUES Podcast Nation - a 3-part series focused on the economic outlook. That's right! Today starts the first of three episodes where we bring in an economist to help you speculate and understand this dynamic market. We are bringing in 3 economists. One economist for each episode. Each economist will bring their own perspective and insights to best serve you!

Today's special guest is Steve Rick, Director and Chief economist at CUNA Mutual Group. In his role at CUNA Mutual Group, Steve's primary responsibilities include conducting strategic research, analysis, and forecasting of the financial services industry with special emphasis on the consumer and credit union markets.

Rick's forecasts serve as a starting point for the strategic planning process and help to create a clear understanding of the underlying trends and links between the general economy, the financial services industry, and CUNA Mutual's policy owners. Steve publishes the Credit Union Trends Report, a monthly "pulse check" on the economic state of the credit union movement. He has authored a textbook on asset-liability management for credit union executives.

Before joining CMG Rick was the Senior Economist for CUNA & Affiliate's Economics & Statistics Department for 22 years. Steve is also a senior lecturer at the University of Wisconsin-Madison, AND he serves on the Board of Directors of the University of Wisconsin Credit Union, a $2.4 billion financial institution. Oh – we have an extra special surprise in this episode – one of you will be joining us in this episode. We are bringing on a member of CUES Podcast nation to ask our guest a question. Now let's join the conversation with Steve -

Yes, Rick, we often start the show by asking our guests if they have a mantra or, you know, success quote that they live by, to allow our listeners to get to know you a little bit and add some perspective. Rick, do you have a mantra or quote that you live? Rick, do you have a mantra or quote that you would be willing to share with our listeners?

Steve Rick:
Yeah, I do. Actually, on my wall, I have a poster here. It's a quote by Mark Twain. And years ago, he said, The secret of getting ahead is getting started. You know, remember when you were in high school or college, and you had to write that term paper, and it was so difficult, but once you actually started doing it and get started, that's really the secret of getting ahead is just to get started. You just got to pull the trigger and go. And I've used that in my business career. And it's it seems to have worked for me. And I hope I can help others.

Lenz:
Yes, served you well, I heard that one before. And definitely a big piece of advice there. Thank you so much. Now as we speak, during the middle and end of February of 2021. There's both positive and negative news for the upcoming year for this year. On the positive side, the vaccine has been distributed, distributed, the impact of the vaccine brings hope it brings hopes, that brings hope to individuals to families to so many people that have been impacted. And it's been so devastating. So it gets so many thanks to all the health care workers for their effort, time, energy and perseverance. But again, there's a greater sense of hope. Now, with the progression of the vaccine distribution. On the negative side, there are still so many unknowns. Today, we are going to focus on the economic outlook perhaps the first place we could look at is the four-letter word jobs. Rick, wasn't it a little over a year ago that we had the lowest employment rate in the United States, and then the pandemic hit? What was the highest unemployment rate in 2020? And where are we now in terms of the unemployment rate? What are your projections for the labor market for the remainder of 2021, then heading into next year, Rick?

Rick:
Sure. You know, last year and 2020, back in February, so one year ago, we had an unemployment rate of 3.5%. Now To put that in perspective, economists believe about 4.5% is kind of the long-run natural unemployment rate, if you will, that's where the economy tends to go to 4.5. So at 3.5, we consider that a very tight labor market translation.

You know, employers had a really hard time finding qualified workers to come, you know, work at maybe at their bank or credit union or Harley Davidson motorcycle, they're in Milwaukee, it was very difficult. So they're working overtime. And of course, wage costs go up, you're paying time and a half, or you're paying higher wages just to attract people in so it was a tight labor market. But then, of course, we got hit with the covid-19 pandemic. And by April, we were up to 14.7% unemployment, right, mainly due to all those government shutdowns.

Remember, those government-mandated non-essential businesses were shut down. Fortunately, the good news, we're back down to 6.3% unemployment rate today. But, if you kind of count all the people who have left the labor force, who did have a job last year, but have kind of left the labor force, kind of given up searching for a job. Now the unemployment rate could be closer to 9-10% once you include all those workers who are left.

For my forecast for the rest of this year, we do believe we will reach herd immunity, probably by the fourth quarter of this year, and you know it will be slowly approaching it you know, that's where what 75 to 80% of our population has been vaccinated and is now immune. So we're hoping by the end of this year, to have the unemployment rate down to 5.5%. Remember, 4.5 is our target. We expect to hit that 4.5 by the end of next year. 2022. So it's almost going to be about another two full years to get back to that natural unemployment of 4.5%.

Lenz:
That's great perspective. Thanks for adding those notes there. We have now we have a high unemployment rate now, actually not as high as I thought based on what you just said. But there is concern consumer spending is taking a hit. We've also got predictions of evictions, foreclosures, personal bankruptcies. To counter the economic downturn and provide relief for impacted households and businesses, governments across the world have enacted record amounts of stimulus. What kind of impact do these measures take? Will they take? And what do you see happening next?

Rick:
Well interesting, you know, in December, we had another one of the stimulus bills passed, which paid out another $600 in stimulus checks, which basically went into the bank accounts of millions of Americans back in January. So just think, all these banks and credit unions got the $600 checks piled in. This morning, just this morning, about an hour or so ago, the latest retail sales report was released for January. And guess what happened? We saw sales pickup 5.3% compared to December. Now, that's a huge jump. I mean, yeah, this these numbers I got for

one month 5.3%. And if we can compare this January of 2021, compared to January 2020, you know, January 2020, that was before the pandemic. We're up 7.4%. Now, that is a huge increase, 7.4% in spending. And when we talk about recent retail sales, that's the stuff when you and I go to a store, we buy something and put it in a bag and then put it in our trunk of our car. That's where we're talking about is stuff you buy, actually get your hands on the goods part of the academy. So we're actually seeing a nice recovery already.

You may have heard the economist Larry Summers, very smart guy, Harvard economist, worked in the Obama administration as the Secretary of the sector of the Treasury. He's actually worried that we could see an overheating economy. He's worried about if we do pass another $1.9 trillion stimulus package, we could see inflation pick up in this country, which would kind of be alright, because we've had low inflation for the last few years. And the Federal Reserve wants to see inflation at about 2% on average for the long run. So we could see actually just giving my forecast, we're forecasting GDP growth this year, in 2021, of about 4.5 percentage points. So we're going to be making 4.5% more stuff, if you will, than we did last year. And last year, you know, we got the latest numbers, we dropped 3.5% in the production of goods and services last year. So, a nice recovery for 2021. Or mainly because all of these, if we get another $1,400 stimulus check sometime this spring, you know, if President Biden gets his 1.9 trillion stimulus, we could see a really strong economy going into the second half of this year.

Lenz:
Interesting news and insights there. I think you may have answered this, but what will it take to get back to the very low unemployment rates that we had before the pandemic?

Rick:
There is some scarring taking place in the economy, some permanent impacts where, you know, we as we know, there's businesses that have gone out of business, and they're not coming back, especially in the retail space. As you know, we call this the retail apocalypse. You know, a lot of these small stores are not gonna be able to compete either with online, you know, say the Amazon dot coms of the world, and they're just gone. And so you have a lot, I mean, I'm sure you've driven by strip malls and your local mall, and half the stores are empty, well, they're not coming back. And so a lot of those employees are going to have to be retrained into other fields. And it always takes a while to retrain people. People just don't get a new skillset right away. They don't automatically become a nurse or a computer program. It's going to take years. So there's some economic scarring out there taking place. But you know, we will once the economy has opened up this spring, the service sector of the economy, which has really hurt, I think of hotels and restaurants and movie theaters, you know, I think they will reopen and hire some people back. But as we know, there's some movie theaters that are permanently shut down, restaurants that are never coming back. And so it's gonna take a while, like I said, maybe two years, before we get back to that natural unemployment rate of 4.5%.

James:

Interesting. It's certainly been a crazy time for credit unions … pandemics, social unrest, and an uncertain economy were all hallmarks of 2020. What things have you seen credit unions do that have served them well in responding to last year's big issues?

Rick:
Well you know the biggest topic last year, well, two things. One, that huge surge in deposits. We just got the latest numbers in for the full year 2020. And credit union deposit growth was over 20%, which is the fastest we've seen since really the middle 1980s. Now why do you have to go back to the 1980s? Remember that there was a savings and loan crisis back in the 1980s where hundreds of savings and loans failed, where all those customers of those savings and loans moved their money over to credit unions so we had a big surge in deposits. So you need something like that to see a huge surge this year. Well, why did credit unions get a 20% surge this year? Well, one, we had those $1,200 stimulus checks last March, you know, in March of 2020, remember that. And a lot of economists have done research on that. And they found out that 80% of that $1,200 stimulus checks were either saved or used to pay down debt. Think of a credit union. You got 80% of this $1,200 check either put into savings that is maybe at a credit union or was used to pay off their credit card or a home equity loan. So last year, credit unions have had weak loan growth and very fast deposit growth, because of, you know, to a large extent, these stimulus checks, but also because, you know, we were at a pandemic, and people weren't going out to restaurants, movie theaters, and sporting events. So they're just saving money in that respect. And they're not driving to work. So saving money buying gasoline and not buying nearly as much gas as they've done. So for credit unions, it was a huge year last year, but with the stimulus checks going up this year, we're gonna see credit unions probably see another year of 15% deposit growth. So just think that 20% last year, 15%, this year, add those two numbers together roughly, 35% growth in deposits, or you could say asset size for the typical credit union in the United States. So it was a remarkable two years that we're going through.

James:
What are what are some trends that you're seeing, as we move into 2021, that credit unions might want to watch and respond to?

Rick:
A big trend right now is still the mortgage refi boom, you know, for credit unions that were into mortgages last year, they did actually extremely well. If you were a big mortgage player, you had probably, you know, close to record profits, because, you know, we originate these mortgages, and then we sell a lot of them off into the secondary market, you know, to Fannie Mae or Freddie Mac, and they were paying a very nice premium for those mortgages last year.

So that one category called "gains on sales of mortgages" was huge for creditors who are big into mortgage lending. And we expect the mortgage refi boom to continue through the first half of this year before your interest rates slowly start to creep up. And then that mortgage refi boom will taper off. But right now, credit unions are still in I mean, what's really driving this economic recovery is housing. Home prices are up 13% year over year. It almost seems like we have another housing bubble going. Remember back in 2005, 2006, we had the last housing bubble, but I'm going to use the four most dangerous words an economist can use. This time is different. It's not the same housing bubble we saw back then. Last time, it was a demand-side problem. Member banks and some credit unions were kind of lending money to basically just about anybody, you know. If you had a heartbeat, you could get a mortgage loan. We don't do that anymore, fortunately. But home prices are rising again. Why? Because it's a supply-side phenomenon. We don't have enough supply and economic theory tells us when it's a supply-side phenomenon, it's not really going to be a bubble. We're just not building homes fast enough mainly because we just can't find workers, you know, we can't find the carpenters, plumbers, electricians to help build these homes for the demand that we see out there.

Lenz:
Yeah, I've noticed that in our own home has risen incredibly. And they're just, uh, you know, I got a nephew looking for a home and there is nothing out there that does not have an offer on. It's just it is a supply-side. So do you see and you said it's harder to find workers to do that. But I mean, what is that spring and summer and fall look like for the housing market in terms of production? I know. Housing prices are high land prices have risen incredibly as well, and the supply of materials to build houses is skyrocketed as well.

Rick:
Yeah, we're seeing we're seeing how housing starts pick up 20-30% compared to a year earlier, so it is surging. I mean, we are trying our best to get these housing starts going. But we should be producing a lot more than we currently are. The shortage, like you said, the shortage of buildable land, prices for lumber and other things that go into a house are rising very dramatically. And like I said, we've got that labor shortage going on. But it's a good thing to have, you know. Get some of these people who are maybe unemployed and get them retrained to become a carpenter or a plumber or electrician working in the housing sector.

Lenz:
Interesting, again, so many insights, so many changes. I love how you've kind of synthesized all these trends, what's going on to share with our listeners. Just a couple more things. What are your expectations for the impact of the economy of the new Biden administration? You touched on a bit anything you want to add there?

Rick:
Just getting the vaccination out there. I mean, the way they've kind of redoubled their efforts to get that vaccine into the arms of millions of Americans. And you see, we're over one and a half million Americans are getting vaccinated, you know, every day, which is great. To get that up even more up to 2, 3 million a day is what we really need to be saying. And once again, there are some constraints, you got to train people in order to administer the vaccine. But we are moving in the right direction. As I said, we hopefully will reach that herd immunity in the fourth quarter of this year, which will mean the economy would be somewhat back to normal. We can all go on, start living our lives again, going out visiting, people taking a trip. And once again, that

will be good for the hotel industry, the airline industry, the restaurant industry. A lot of things will come back in the second half of this year.

Lenz:
Sounds like a very positive outlook coming ahead here. Besides economic considerations, what are some other ways that the new administration might impact credit unions?

Rick:
Well you know that there is talk right now, well, kind of indirectly about forgiving $10,000 say worth of student loan debt. So if we kind of free up say that millennial generation, that's a generation that's really saddled with a lot of debt and people between the ages of 25 and 39. So if we can kind of relieve some of that debt burden on them, that'll free them up to be able to maybe purchase that home, or purchase that car, and maybe get that loan from a credit union for a mortgage loan or an automobile loan. Well yeah, the millennial generation is saddled with debt, which has postponed when they can actually really start a family and build a house. So that's one proposal that we'll see playing out. I just saw Joe Biden was on TV last night. He was here in Wisconsin, giving a town hall meeting on CNN. And he was asked that question, he said, “Hey, I'm for a $10,000 kind of loan forgiveness.” But there are some progressives in the Democratic party who want to go up to $50,000 in loan forgiveness, which would really free up a lot of let’s say millennial generation of their debts. But he said he wasn't for that. He says only for 10,000. But once again, that'll help out millions of Americans relieve some of that debt burden they have from their college years.

Lenz:
And one final thing and bring it right back to credit unions, right? What can credit unions do to best manage these kinds of changes for the organizations and their members?

Rick:
You know, the big challenge this year is going to be net interest margins, you know, the difference between our yield on our assets, what we're earning on our loans and investments, and what our cost of funds is, what are we paying our members for the use of their deposits. And we're gonna see the tightest net interest margins in history this year, mainly as these low-interest rate environments going to be here. So all those old loans are going to be repricing into new, lower-rate loans. And all those old investments are rolling over into new lower rates. So we're gonna see very record low yield on assets and record all net interest margins. So credit unions are really focusing on basically managing their costs, you know, giving their cost down to match that very low net interest margin. So cost containment is still going to be a major issue, just like it was last year for credit unions. How can they restructure? How can become more efficient, more productive? You know, we are seeing a little bit of economies of scale. If you think of the, you know, operating expenses as a percent of your total assets. Remember that assets in the denominator of that ratio has grown 35% in the last year. So it's giving us a little bit of economies of scale. We're getting more size from all these deposits. But once again, containing costs can be a major issue because we're forecasting return on assets, you know, ROA, basically lower than it was in 2020.

So there are going to be some earnings pressures this year due to very tight net interest margins.

At this point in the show, Cynthia Ryan, EVP chief operations of Connect CU, Ft. Lauderdale, Florida, is introduced. She says what she likes about the CUES Podcast.

The CUES Podcast … I like listening to the different topics, so I spent a lot of time listening at home and at work.

Then James Lenz asks introduces Steve and Cynthia

Hi Steve, How are you?

Hi Cynthia, how are you doing?

So, Steve, I know you're great with these kinds of questions.

With the member savings rate substantially increased, what are a few strategies that we as credit unions should employ to improve our balance sheets?

Rick talks about rebalancing risk exposure.

Lenz:

Wow, this has been such a great economic outlook and forecast. You've been so helpful. If listeners want to connect with you and your organization, what is the best way to connect?

Rick:
Oh, my email is Steve.Rick@cunamutual.com if they would like to email me some questions, comments or issues relating to credit unions or the economy.

Lenz:
Thank you so much for sharing your insights and perspectives. Have yourself a great day.

Rick:
Thanks, James. It's been fun.

The outro plays here