MERIDIAN ECONOMICS

Trusted Insight, Effective Solutions

23 March 2020

To My Many Associates:

As you might anticipate, I've been getting a lot of questions as of late over the current economic climate, what to expect, what institutions might do and what advice we can pass to our members as the nation navigates through our current crisis… I thought I'd share a few thoughts:

1) A Wall Street reporter asked if there were other suggestions- beyond the governments' provisions and protocols - that might help … I suggested turning off their televisions and staying away from the internet - in particular, to avoid all the demonstrable doom and gloom that is being projected… If the daily communication of prevailing conditions wasn't so key, I'd be serious about my sarcasm… Point being, the projected path of the virus will diminish if we all follow the protocols. This could mean new cases peaking in as little as three months…. But people still make poor, selfish choices that could threaten all of us while delaying the recovery… So this is a very fluid situation.

2) First, this in no way resembles the market conditions that created the 2008-09 recession… If fact, it is more comparable to the immediate impact of the Sep 2001 terror attack on the US that sent similar disarray in the same sectors of the economy that today's virus is attacking… But unlike in 2001, today we're dealing with a virus that prevents consumer spending behavior's assistance to a more immediate recovery stemming from "stay-home" protocols… This is even more important to our friends in the West Coast and Northeast, namely New York City area, where approximately 60% to 75% of all new cases are being reported.

3) Second, although the economic slowdown will have an impact on the wages of many Americans, a greater majority of citizens will see less impact to household income over the next few months… Consumer spending behavior will adversely impact GDP that may or may not be offset by the increase in government spending… The Administration's and Federal Reserve's stimulus package will go far to support business and consumer wages by protecting cash flows in both - even if it means exploding fiscal deficits that we'll have to deal with later.

4) Third, consumer spending, other than for toilet paper and sanitizer, will start to slow and most likely will the demand for products and services from institutions that provide financing for big ticket items, namely cars, homes and appliances - unfortunately, services that we provide … Therefore, loan demand - and originations - will slow and most likely will not cover scheduled principal run-off over the next three to six months…. Therefore, a 2% to 3% decline in loan portfolio holdings over this period of time is not out of the question … The good news is that it will also create pent-up demand that will boil over once the recovery period commences - hopefully later this fall.

5) Fourth, we've most likely returned to an environment (at least for three to four months) that market rate levels (namely lower) will have little effect on stimulating market demand - other than supporting whatever A-paper loan applicants remain in the market… To these, and many B-paper loan applicants, competitive rates might still make a little difference - remember 3.00% vehicle loan rates are still 275bps over cash and 225bps over investment yields… For most, C&D-paper applicants may be too much credit risk to take under the current environment and would require too much additional pricing spread - making the loan rate virtually unaffordable to our members.

6) Also, in addition to watching which loans we should portfolio over the next few months, some might return to underwriting provisions that lower LTV qualification to 75% or 80%… This most likely will not impact the standards for A- or B-paper applicants anyway or mortgage refinancing applicants. There is some speculation that the current crisis could ultimately resulting in lowering home values thus affecting subsequent LTV and collateral values…. It is highly unlikely that we would come anywhere close to the average 20% decline experienced during the 2008-09 recession….

7) Fifth, the cash flow aspect of spending behavior will be seen at credit union tills…. Cash withdrawals are to be expected at first as members stockpile personal needs but then reduce their expenses as we struggle through the next few months… Flight-to-quality, protecting their principal, means having no where else to place their funds other than in their bank accounts or under their mattresses … This could sustain or slightly increase shares during a time when institutions are already cash flush and overnight rates having fallen to post-2009 recession levels and investment security yields falling below 1.00%.

8) So, as for shares and deposits, it you don't need the cash, currently retain a strong liquidity profile and anticipate a drop in loans over the next few months, don't pay a relatively high rate to retain term certificates, in fact, use the opportunity to rid high cost CDs or other "hot money." … The market should drop certificate rates anyway but certainly don't be afraid to lower now… The rates on transaction accounts (drafts, savings and money markets) are already relatively low so anticipate little change…

9) Lastly, the combination of credit risk and share pricing initiatives will help to manage our gross interest margins while protecting our liquidity and net worth profiles through the end of this year…. The economic stimulus package will help to sustain us (consumer and institutional) during the darkest part of the crisis but will also position us and the economy's recovery to accelerate once recovery has commenced…. Stubbornly trying to stick to growth budgets established last fall is impractical and, for most of us, would most likely produce lower interim earnings and threaten net worth greater than properly adjusting balance sheets today to enhance what the recovery will provide later…. To some, it means shrinking balance sheets while to others it means curtailing credit extension or even increasing our A-paper initiatives….

Brian

Brian Turner
President & Chief Economist
972.740.9531
bturner@Meridian-ally.com
www.Meridian-ally.com