DATE: September 18, 1996
LETTER NO.: 96-CU-6

DEAR BOARD OF DIRECTORS:

SUBJECT: Midyear 1996 Trends Report

Enclosed is a report highlighting credit union financial trends during the first half of 1996. The analysis is based on data compiled from the midyear 1996 call reports submitted by all federally insured credit unions. We are providing this information to keep you informed of current conditions and trends in the credit union industry.

For the National Credit Union Administration Board,

NORMAN E. D'AMOURS
Chairman

Enclosure

FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS

January 1, 1996 to June 30, 1996

HIGHLIGHTS

All of the key financial indicators of credit union well-being remained positive and stable during the first half of 1996. The only area of potential concern may be the overall lengthening of asset maturities combined with a shorter-term share structure.

Assets of federally insured credit unions increased 5.5% during the first half of 1996.

Capital accumulation continued, but at a slower pace, 4.6%. The capital to asset ratio at midyear 1996 equals 10.9%.

Loans increased 4.6%, beginning the fourth consecutive year of strong loan growth.

Shares expanded 5.6%. The loan to share ratio now stands at 70.4%.

Investments increased 6.9%.

Profitability remained unchanged, as measured by the return on average assets ratio, 1.1%.

Delinquency declined slightly in the first half of 1996, after a slight increase in the last half of 1995. Delinquency is now 0.9%, compared to 1.0% at the end of last year.

Eastman Savings and Loan converted to a federal credit union on February 1, 1996, and is now known as **ESL Federal Credit Union**. ESL, with assets of $1.2 billion, is the first S&L to convert to a credit union.

CAPITAL

Capital accumulated at the rate of 4.6% during the first half of this year, compared to 6.3% in the first half of 1995. Midyear 1996 marks the first time since the middle of 1990 that capital growth did not meet or exceed asset growth (5.5%). The slowdown in capital growth is partly attributable to an increase in accumulated unrealized losses on Available for Sale securities. Unrealized losses currently equal $307 million, compared to losses of $8 million at yearend 1995. The other factor affecting overall capital was a slowdown in the growth rate of undivided earnings. Undivided earnings increased 4.6% in the first half of this year, after averaging between 9.0% and 9.5% over the course of the preceding year.

The capital ratio dipped slightly to 10.9%, compared to 11.0% at the end of 1995, but is still well above the level of 10.6% at midyear 1995.

The net capital ratio did not change from the yearend 1995 measure of 10.3%. The net capital to asset ratio at midyear 1995 was 9.9%.

ASSET QUALITY

LOAN TRENDS: Total loans outstanding expanded 4.6% in the first six months of this year. The increase in first mortgage real estate loans was the most significant in terms of dollar volume, expanding nearly $3.9 billion, or 9.9%. The increase in used auto loans followed closely behind, expanding $3.2 billion, or 10.6%.

New auto loans continue to make up the largest single loan category, but it appears that their high rate of growth since 1994 has begun to slow. In the first half of this year, new auto loans increased only 0.8%, following an increase of 3.7% in the last half of 1995 and 8.6% during the first six months of last year.

There was no appreciable increase in unsecured debt from the end of last year; however, this trend coincides with the usual seasonal pattern of flat growth in the first half of the year. As demonstrated in the last several years, the only significant expansion in unsecured loans occurs in the last half of the year, and typically ranges between 7% and 8%.

Because share growth (5.6%) outpaced loan growth (4.6%), the loan to share ratio dropped from 71.1% at the end of last year to 70.4%. The loan to share ratio was 69.2% at the middle of last year.

Loans as a percentage of total assets declined slightly, compared to the end of 1995. Loans constituted 62.7% of total assets at yearend 1995. While loans currently equate to 62.1% of assets, this is still above the midyear 1995 level of 61.2%.

DELINQUENCY TRENDS: The total dollar amount of delinquent loans remained fairly stable during the first half of this year, declining about 0.2%, while total loans outstanding increased 4.6%. Delinquent loans as a percentage of total loans for midyear 1996 was 0.9%, compared to 1.0% at the end of last year, and 0.8% at midyear 1995. The ratio of net charge-offs to average loans increased slightly, from 0.4% to 0.5%.

The number of credit union members filing for bankruptcy in the first half of 1996 increased 19.0% in the last 12 months. However, the number of members filing for bankruptcy represents less than 0.2% of all credit union members. The amount of loans subject to bankruptcy, about $580 million, represents a little less than 0.3% of total loans outstanding. The actual amount of losses that credit unions will incur will be even less, however, since many of these loans will be reaffirmed and repaid.

INVESTMENT TRENDS: Investments increased 6.9% during the first six months of this year, compared to 1.9% for the same period last year. This is directly attributable to share growth exceeding loan growth. However, compared to midyear 1995, investments as a percentage of assets declined, from 34.4% to 33.2%.

The increase in Federal agency securities contributed the most in terms of dollar volume investment growth during the first half of 1996. Nearly $3.3 billion of the total dollar volume increase of $6.9 billion is attributable to Federal agency securities. Although total investments declined throughout 1995, Federal agency securities were the only form of investment which increased steadily during the whole year.

Increased deposits in corporate credit unions were the second most significant contributor to the increase in total investments. Deposits in corporate credit unions increased $1.6 billion, or 6.4% in the first six months of this year. For the same period last year, increases in corporate credit union deposits were primarily responsible for the overall growth of the investment portfolio, up $2.5 billion, or 10.3%. However, in the last half of 1995, deposits in corporate credit unions declined $1.7 billion, or 6.4%.

The aggregate maturity structure of the investment portfolio is lengthening. During the first half of this year, investments with maturities or repricing intervals under one year had no appreciable growth, while investments with maturities between 1 and 3 years increased 15.5% and investments with maturities greater than 3 years increased 22.3%. The following table compares the changes in the maturity structure of the investment portfolio from yearend 1995 to midyear 1996.

Investment Maturity or Repricing Interval	% of Total Investments Dec. 1995	% of Total Investments June 1996
Less than 1 year	61.4%	57.5%
1 to 3 years	26.0%	28.1%
3 or more years	12.6%	14.4%

A comparison of the distribution of the total aggregate investment portfolio according to the classification of SFAS 115 for midyear 1995 and midyear 1996 is shown below. Only minor shifts appear between categories. These shifts probably are due to an increased familiarity with SFAS 115 (reclassification), as well as some actual changes in the composition of the portfolio.

EARNINGS

Gross income as a percentage of average assets remained unchanged from the value of the yearend ratio, 8.1%, and is only slightly higher than the midyear 1995 level of 7.9%. Net operating expenses as a percentage of average assets likewise has remained fairly stable over the past 12 months, increasing slightly from 2.6% to 2.7%.

Credit unions' cost of funds have held steady over the last year, reflecting the stability of prevailing market interest rates during this time. The cost of funds to average asset ratio did not change from the yearend value of 3.5%, and is only up slightly from the midyear 1995 measure of 3.4%.

The relative stability of gross income, operating expenses and the cost of funds has affected the bottom line in a similar manner. Profitability, as measured by the return on average asset ratio, has held steady at 1.1% over the last year.

ASSET/LIABILITY MANAGEMENT

LONG TERM ASSET TRENDS: The increases in longer term investments and lending so far this year have resulted in a higher proportion of long term assets. Long term assets (assets with maturities or repricing

intervals greater than 3 years) currently represent 18.5% of total assets, compared to 17.5% at the end 1995 and 18.2% at midyear 1995.

SHARE TRENDS: All categories of shares expanded in the first half of 1996, and total shares increased 5.6%. This compares with share growth rates of 4.1% in the first half of last year, and 1.7% in the second half of 1995.

In contrast to the large inflow of share certificates during 1995 and a significant outflow of regular shares last year, the largest increase so far this year has been in regular shares. Regular shares accounts increased $5.5 billion, or 4.6%, followed by share certificates, up $3.9 billion or 6.8%.

Growth rates for the various share categories are as follows:

- Share drafts, + $1.7 billion, 7.5%
- Regular shares, + $5.5 billion, 4.6%
- Money market shares, + $2.3 billion, 9.2%
- Share certificates, + $3.9 billion, 6.8%
- IRA/Keogh accounts, + $0.5 billion, 1.4%
- All other shares and deposits, + $1.3 billion, 31.7%

The aggregate maturity structure of shares in credit unions is becoming shorter. During the first half of this year, growth was concentrated in shares with maturities or repricing intervals under one year. These short-term shares increased $15.7 billion, or 6.4%. In contrast, shares with maturities or repricing intervals between 1 and 3 years declined 0.9%, and shares with maturities or repricing intervals greater than 3 years declined 5.3%.

Share Maturity or Repricing Interval	% of Total Shares Dec. 1995	% of Total Shares June 1996
Less than 1 year	90.4%	91.2%
1 to 3 years	7.3%	6.8%
3 or more years	2.3%	2.0%

OVERALL LIQUIDITY TRENDS: While not cause for concern yet, the trend toward longer term investing and lending, coupled with the trend in shorter term shares, raises questions about a potential increase in interest rate risk, as well as future liquidity problems. It is important for all credit unions to assess the rate sensitivity of their share portfolios, and determine the percentage of core deposits available to be matched to longer term assets. Each credit union should have a business plan which provides for an asset/liability management strategy which evaluates its balance sheet structure, local operating environment and past experience with interest rate sensitivity before committing to long-term asset positions which would be difficult to reverse.