NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA

DATE: **August 2004** **LETTER NO.: 04-CU-11**

TO: **Federally Insured Credit Unions**

SUBJ: **Credit Union Financial Trends for the First Half of 2004**

ENCL: **Financial Trends in Federally Insured Credit Unions**
January 1 – June 30, 2004

DEAR BOARD OF DIRECTORS:

Enclosed is a report highlighting credit union financial trends for the first half of 2004. We based our analysis on data compiled from the midyear 2004 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.

Thank you for your cooperation in providing this data.

Sincerely,

/s/

JoAnn Johnson
Chairman

Enclosure

FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS

January 1 – June 30, 2004

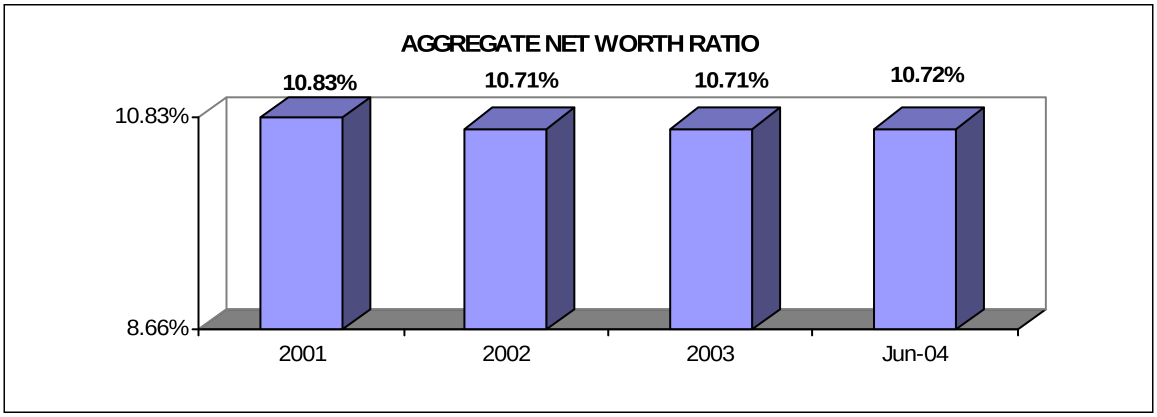
HIGHLIGHTS

This report summarizes the trends of all federally insured credit unions that reported as of June 30, 2004.

- **Assets** increased $25.4 billion, or 4.17%.
- **Net Worth** increased $2.8 billion or 4.22%. The Net Worth to assets ratio increased from 10.71% to 10.72%.
- **Loans** increased $18.7 billion, or 4.98%. The loan to share ratio increased from 71.19% to 71.84%.
- **Shares** increased $21.3 billion, or 4.03%.
- ***Cash on hand*, *cash on deposit*, *cash equivalents*, plus short-term investments (less than 1 year)** decreased $0.4 billion, or .41%.
- **Long-term investments (over 1 year) increased** $5.3 billion, or 4.90%.
- **Profitability,** as measured by return on average assets, decreased from 0.99% to 0.92%, but remains strong.[1]
- **Delinquent** loans as a percentage of total loans decreased from 0.76% to 0.67%.

CAPITAL

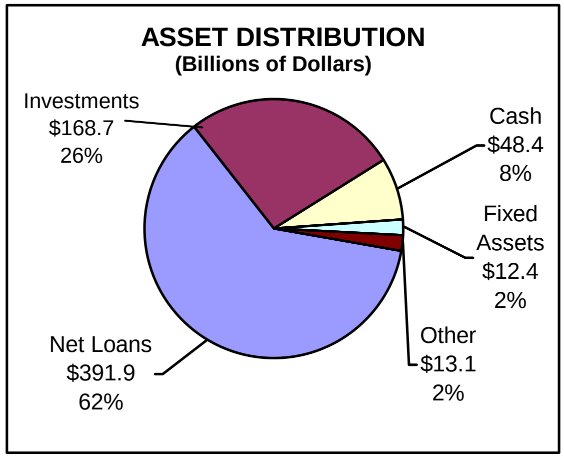
Total Net Worth increased $2.76 billion (4.22%) during the first half of 2004. The aggregate net worth to total assets ratio increased from 10.71% at the end of 2003 to 10.72% as of June 30, 2004. Annualized net worth growth of 8.44% outpaced annualized asset growth of 8.34%. The average net worth ratio (non-dollar weighted) among individual credit unions decreased from 13.32% at the end of 2003 to 13.22% as of June 30, 2004.



1. The Return on Average Assets ratio is annualized net income divided by average assets for the period.

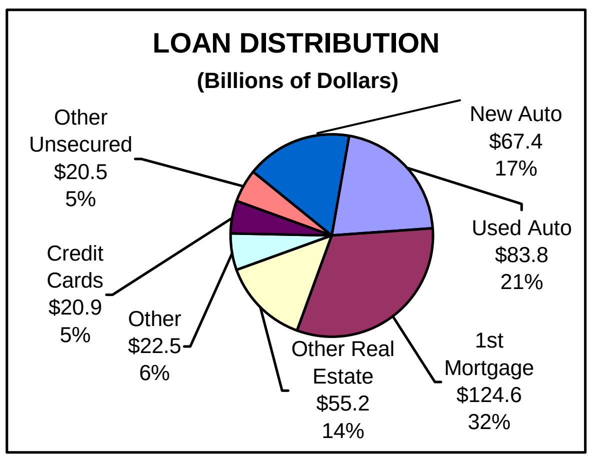
ASSET QUALITY

LOAN TRENDS: All loan categories experienced growth except for Unsecured Credit Card Loans and All Other Unsecured Loans. Loan growth of 9.96% (annualized) resulted in an increase in total loans of $18.7 billion. Loan growth was higher than share growth, causing the loan to share ratio to increase slightly from 71.19% in 2003 to 71.84% in the first half of 2004. Growth in the various loan categories is as follows:

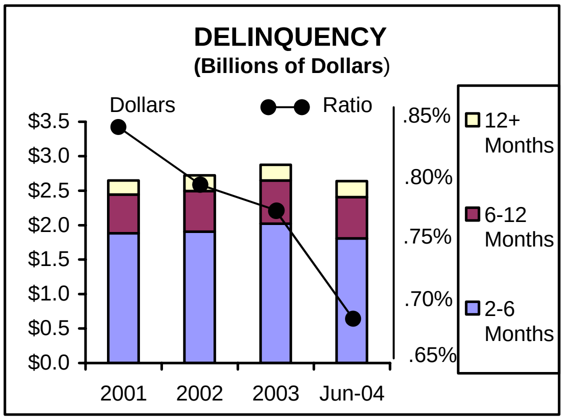


Loan Category	2003 Balance In Billions	June 2004 Balance In Billions	Growth In Billions	Growth Rate
Unsecured Credit Card	$21.7	$20.9	-$0.8	-3.75%
All Other Unsecured	$20.8	$20.5	-$0.3	-1.66%
New Vehicle	$63.8	$67.4	$3.6	5.73%
Used Vehicle	$81.2	$83.8	$2.6	3.17%
First Mortgage Real Estate	$117.5	$124.6	$7.1	6.04%
Other Real Estate	$50.1	$55.2	$5.1	10.20%
Leases Receivable	$1.5	$1.6	$0.1	6.92%
All Other	$19.5	$20.9	$1.4	6.95%

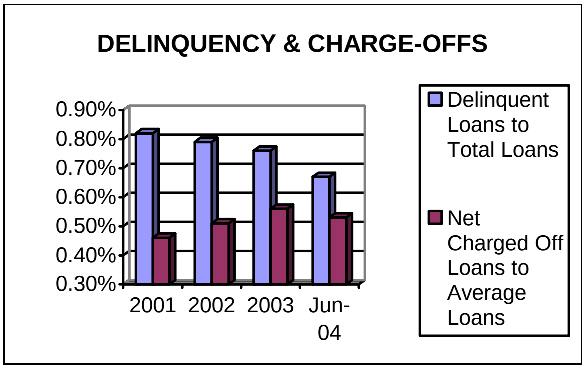
First Mortgage real estate loans account for 31.56% ($124.6 billion) of all loans. Loans held for sale increased 7.12%, from $.99 billion to $1.1 billion.



DELINQUENCY TRENDS: Delinquent loans decreased 8.25% ($237.1 million). The delinquent loans to total loans ratio also declined from 0.76% at the end of 2003 to 0.67% at the end of the first half of 2004. The decline in delinquency exceeded the increase in loans charged off in the first half of 2004 as well.



On an annualized basis, loan dollars charged off increased 3.38% ($78.5 million), whereas recoveries on charged off loans increased 17.93% ($57.6 million). This resulted in net charged off loans increasing by $20.9 million; however, due to stronger loan growth, the annualized average net charge-off ratio declined from .56% to .53% of average loans in the first half of 2004.



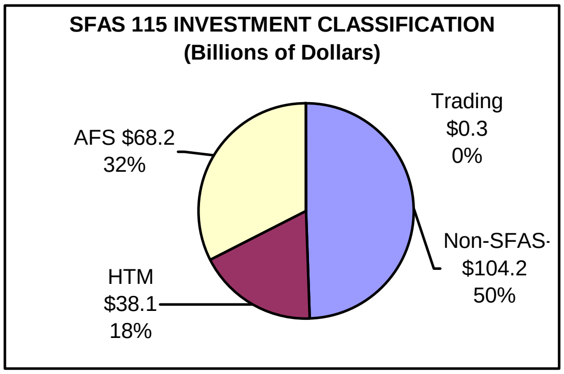
INVESTMENT TRENDS: Cash on hand, *cash on deposit*, and *cash equivalents* decreased 5.85% ($3.0 billion). These combined categories, along with investments with maturities of less than one year, decreased .41% ($0.4 billion).

Investments with maturities greater than a year increased 4.90% ($5.3 billion).

Non-SFAS 115 investments (including cash on deposit and cash equivalents) increased 1.01% ($1.0 billion) to $104.2 billion.

Held-to-maturity investments decreased 3.96% ($1.5 billion). *Available-for-sale* investments increased 4.04% ($2.6 billion). Trading securities decreased .66% ($1.7 million).

At the end of the first half of 2004, SFAS 115 investments made up 50.41% of the investment portfolio. Non-SFAS 115 investments, cash on deposit, and cash equivalents accounted for 49.47% of the portfolio.



The following table compares the changes in the maturity structure of the investment portfolio over the past year:

Investment Maturity or Repricing Interval	% of Total Investments 2003	% of Total Investments June 2004
Less than 1 year	47.32%	46.08%
1 to 3 years	34.20%	35.12%
3 to 10 years	16.96%	17.50%
Greater than 10 yrs	1.52%	1.30%

EARNINGS

Sustained asset growth and low market interest rates continue to impact income as shown in the table below. Total net income decreased 0.60% ($34.4 million). The return on average assets decreased seven basis points to 0.92%. The net interest margin declined 10 basis points to 3.31%.

Ratio (% Ave. Assets)	As of 2003	As of June 2004	Effect on ROA
Net Interest Margin	3.41%	3.31%	-10bp
+ Fee & Other Inc.	1.12%	1.08%	- 4bp
- Operating Expenses	3.23%	3.18%	+ 5bp
- PLL	0.35%	0.33%	+ 2bp
+ Non-Opr. Income	0.04%	0.04%	+ 0bp
= ROA	0.99%	0.92%	- 7bp

ASSET/LIABILITY MANAGEMENT

SHARE TRENDS: On an annualized basis, total shares increased 8.07% ($42.6 billion) in the first half of 2004, compared to 9.11% in 2003.

OVERALL LIQUIDITY TRENDS: In the first half of 2004, credit unions had approximately 16.28% of total assets in cash and short-term investments, compared to 17.03% at the end of 2003. Net long-term assets (defined as assets with maturities or repricing intervals greater than 3 years - 5 years for real estate loans), equaled 25.77% of total assets at the end of the first half of 2004, compared to 25.34% at the end of 2003.

INTEREST RATE RISK: Interest rates remained at or near historically low levels the first half of 2004. This continued the downward re-pricing of assets, further compressing the net interest margins of credit unions. If interest rates rise, credit unions holding significant portions of longer term, fixed-rate assets could see even lower net interest margins, squeezed earnings, and reduced net worth. Increasing exposure to this scenario can be seen with the 20.85% growth of fixed rate first mortgage loans and the 32.78% decline of adjustable rate first mortgages in the first half of 2004.[2]

2. Fixed rate first mortgages includes all balloon/hybrid loan products. This reflects a change in the March 2004 5300 Call Report where the balloon/hybrid category was added.

CONCLUSION: Financial performance of the industry remains strong despite the challenges presented by the low interest rate environment. Credit unions need to remain vigilant in monitoring the impact of changing interest rates and make any needed adjustments to maintain an acceptable level of risk.