February 2023

NCUA's supervisory stress test (SST) consists of baseline and severely adverse scenarios, which regulation requires the NCUA to provide by 28 February each year. As in past SST exercises, the NCUA's 2023 SST scenarios follow the domestic scenarios published by the Federal Reserve Board of Governors (FRB) for the CCAR and DFAST exercises.

The near-term portion of the baseline scenario is similar to the January 2023 consensus projections from *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*. The scenario's long-range forecast is comparable to the October 2022 *Blue Chip* releases. The severely adverse scenario depicts the onset of a hypothetical severe global recession, with prolonged declines in both residential and commercial real estate prices, which spill over into the corporate sector and affect investment sentiment. These scenarios follow the FRB's Policy Statement on the Scenario Design Framework for Stress Testing and do not represent forecasts of the NCUA or the FRB.[1]

A summary of each scenario follows:

<u>Baseline Scenario</u> - The baseline scenario for the United States features an initial slowdown and then a gradual recovery.

- Growth in real GDP begins negative and slowly increases to a rate of approximately 2.0 percent over the second half of the scenario horizon.
- Unemployment starts at 3.9 percent and gradually increases to a high of 4.9 percent before receding to 4.6 percent at the end of the scenario;
- CPI inflation slowly declines from 3.2 percent at the end of 2022 to 2.2 percent for most of the last four quarters of the scenario;
- Short-term Treasury rates start at 4.7 percent, and then slowly decrease to 3.0 percent in 2025 Q1 and remain there through the rest of the scenario;
- 10-year Treasury securities decline from 3.9 percent to 3.0 percent over the 13-quarter scenario;
- Prime rates move in line with short-term Treasury rates. Mortgage rates and corporate bond yields decrease in line with long-term Treasury rates;
- Equity prices remain constant through the scenario, and equity volatility varies little over the scenario;
- Nominal house prices increase gradually by 2 percent per year and commercial real estate prices increase by 3 percent per year over the scenario.

<u>Severely Adverse Scenario</u> – The severely adverse scenario characterizes a severe global recession with considerable stress on commercial real estate and corporate debt.

- Real GDP declines nearly 8.75 percent from the fourth quarter of 2022 to its trough in the first quarter of 2024, before recovering;
- Unemployment increases in the scenario's first quarter and peaks at 10 percent in 2024 Q3. Unemployment slow decreases through the rest of the scenario;

[1] 12 CFR 252 Appendix A

- Inflation, measured as the quarterly change in the CPI and reported as an annualized rate, falls from below 3.25 percent at the end of 2022 to about 1.25 percent in the third quarter of 2023 and then gradually increases to above 1.5 percent by the end of the scenario;
- Short-term Treasuries fall significantly to near zero by the third quarter of 2023 and remain there for the remainder of the scenario;
- The 10-year Treasury yield falls by nearly 3.25 percentage points by the second quarter of 2023, and then gradually rise in late 2023 to about 1.5 percent by the end of the scenario. These interest rate paths imply that the yield curve remains inverted through the second quarter of 2023. Thereafter, the slope of the yield curve becomes positive and steepens over the remainder of the scenario;
- Conditions in corporate bond markets deteriorate markedly. The spread between yields on BBB- rated bonds and yields on 10-year Treasury securities widens to 5.75 percentage points by the third quarter of 2023, an increase of more than 3.5 percentage points relative to the fourth quarter of 2022. Corporate bond spreads then gradually decline to 2.25 percentage points by the end of the scenario. The spread between mortgage rates and 10-year Treasury yields widens to 3 percentage points by the third quarter of 2023 before narrowing to about 1.5 percentage points at the end of the scenario;
- The House Price and Commercial Real Estate Price indices fall sharply through 2024 Q4 and modestly increase from the low by the end of the scenario;
- Equity prices fall 45 percent from the fourth quarter of 2022 through the fourth quarter of 2023, and do not return to their initial level until the end of the scenario.