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NCUA Rules and Regulations Part 702, Subpart E requires the NCUA to provide supervisory stress test (SST) scenarios each year no later than the 28th of February. NCUA's 2020 stress tests will only consist of a baseline and a severely adverse scenario. As in past SST exercises, NCUA's 2020 scenarios closely follow the domestic scenarios published by the Federal Reserve Board of Governors (FRB) for the CCAR and DFAST exercises. Past SST exercises consisted of three scenarios: baseline, adverse, and severely adverse. Due to changes in legislation, the FRB now only produces two scenarios for their capital adequacy exercises. As such, NCUA will only require credit unions to conduct the same two stress tests as published by the FRB.

The baseline scenario follows a profile similar to the January 2020 consensus projections from *Blue Chip Economic Indicators*. The severely adverse scenario describes a hypothetical set of conditions designed to assess the resilience of credit unions under adverse conditions. These scenarios do not represent forecasts of NCUA or the Federal Reserve Board of Governors.

The 2020 Severely Adverse scenario represents economic stress similar to 2019 scenarios; however, the Treasury yield curve steepens through the scenario, and unemployment increases a greater amount to peak due to lower initial unemployment rates.

Each scenario is summarized as follows:

<u>Baseline Scenario</u> - The baseline scenario is a moderate economic expansion:

- Real Gross Domestic Product (GDP) grows between 1.6 and 2.0 percent. In the fourth quarter of 2021, GDP reaches 2.0 percent and remains at this level for the remaining quarters;
- Unemployment begins the testing horizon at 3.6 percent and gradually increases to 3.9 percent at the beginning of 2022;
- Consumer Price Index (CPI) inflation fluctuates in a narrow range throughout the horizon. Inflation begins at 2.2 percent, modestly falls to 1.9 percent in 2020 Q4, and reaches 2.2 percent for the final four quarters of the test period;
- At the beginning of 2020, short-term Treasury rates are 1.6 percent and modestly fall to 1.4 percent at the end of the year. The rate gradually increases to 1.8 percent in 2023 Q1;
- 10-year Treasury securities rise from 1.8 percent to 2.7 percent at the beginning of 2023;
- Prime rates move in line with short-term Treasury rates. Mortgage rates and corporate bond yields rise in line with long-term Treasury rates;
- Equity prices fluctuate in a narrow range between 4.5 percent and 4.7 percent annual rates of return, while equity volatility slowly increases over the testing horizon;
- Nominal housing prices rise about 2.5 percent through 2021, then incrementally increase each year to 3.0 percent at the beginning of 2023. Commercial real estate appreciates at a rate of 5.1 percent through 2021 and falls to 3.1 percent at 2023 Q1.

Severely Adverse Scenario – The severely adverse scenario represents a severe global recession with heightened stress on corporate debt and commercial real estate.

- Real GDP quickly falls at the beginning of the scenario, bottoming out in 2020 Q2 at -9.9 percent. GDP begins growing again in 2021 Q4 and ends the test period at 4.7 percent;
- Unemployment immediately increases to 4.5 percent at the start of the scenario and climbs to 10 percent in 2021 Q3. Unemployment gradually decreases through the recession to 8.5 percent at the end of the test horizon;
- Inflation follows a recessionary track and falls to 1.0 percent in 2020 Q3 then slow increases and peaks in 2022 at 1.8 percent;
- Short-term Treasury rates immediately fall to 0.01 percent and remain at this level for the testing horizon;
- The 10-year Treasury rate immediately falls to 0.7 percent and increases to 2.2 percent by the end of the forecast horizon;
- Investment grade spreads and residential mortgage spreads quickly widen by 5.5 percent and 3.5 percent respectively. Both rate spreads gradually narrow through the horizon;
- The House Price and Commercial Real Estate Price indices fall sharply through 2022 Q1. Both indices modestly increase from the low by the end of the horizon;
- Equity prices fall sharply in 2020 and regain losses by the end of the period.