SEP UPDATE

Changes in U.S. Economic Forecasts

June 30, 2022

Executive Summary

- In the latest Summary of Economic Projections (SEP), the inflation forecast through mid-2023 has been revised significantly upward, and the FF rate is expected to rise to near 3.5% in 2022Q4.
- According to the FRB/US model, the 10-year long-term interest rate will rise to near 4% in 2023Q1.
- With higher paths of interest rates, the exchange rate appreciates more quickly, and the path of household net worth is lower than in the previous update.
- As for real economic variables, higher paths of interest rates push down residential and business-fixed investment growth over the next two years.

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(Chart 1) Key Results (Baseline forecasts based on the latest SEP)

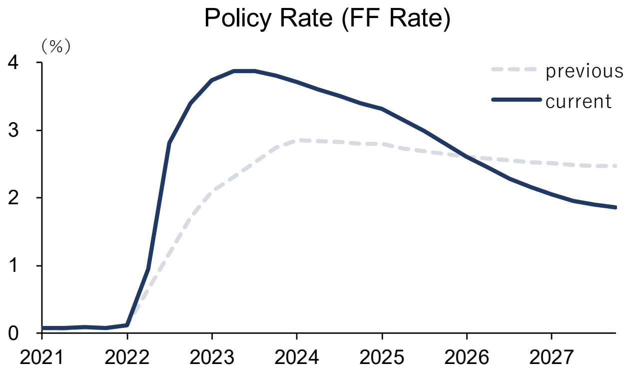
[%, Values in parentheses are based on the previous SEP update]

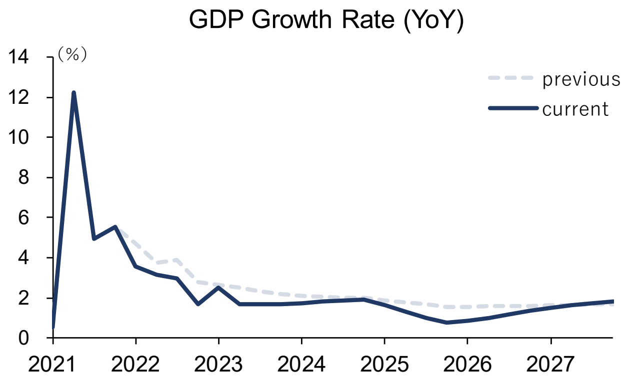
	2022Q4		2023Q4		2024Q4		2025Q4		2026Q4		2027Q4	
SEP Variables												
Federal Funds Rate	3.4	(1.7)	3.8	(2.7)	3.4	(2.8)	2.8	(2.6)	2.2	(2.5)	1.9	(2.5)
GDP Growth Rate (YoY)	1.7	(2.8)	1.7	(2.2)	1.9	(2.0)	0.8	(1.6)	1.3	(1.6)	1.8	(1.7)
Unemployment Rate	3.7	(3.5)	3.9	(3.5)	4.1	(3.6)	4.6	(3.7)	4.9	(3.8)	4.9	(3.9)
PCE Inflation rate (YoY)	5.2	(4.3)	2.6	(2.7)	2.2	(2.3)	1.8	(2.0)	1.7	(2.0)	1.6	(2.0)
Core PCE Inflation rate (YoY)	4.3	(4.1)	2.7	(2.6)	2.3	(2.3)	1.8	(2.0)	1.7	(2.0)	1.6	(2.0)
Model Variables												
1-Year Treasury Yield	3.8	(2.4)	3.6	(2.8)	3.1	(2.7)	2.4	(2.6)	1.9	(2.5)	2.3	(2.4)
2-Year Treasury Yield	3.7	(2.6)	3.3	(2.8)	2.7	(2.6)	2.2	(2.5)	2.1	(2.5)	2.4	(2.4)
3-Year Treasury Yield	3.5	(2.7)	3.0	(2.7)	2.5	(2.6)	2.2	(2.5)	2.2	(2.5)	2.4	(2.4)
5-Year Treasury Yield	4.1	(2.2)	4.0	(2.6)	3.8	(2.8)	3.5	(2.9)	3.2	(3.0)	3.1	(3.0)
10-Year Treasury Yield	3.8	(2.4)	3.9	(2.8)	3.9	(3.0)	3.8	(3.1)	3.6	(3.2)	3.5	(3.3)
30-Year Treasury Yield	3.7	(2.7)	4.0	(3.1)	4.1	(3.3)	4.1	(3.5)	4.0	(3.6)	3.9	(3.6)
Mortgage Rate	5.2	(3.9)	5.5	(4.3)	5.5	(4.6)	5.4	(4.7)	5.2	(4.8)	5.1	(4.9)
Nominal Exchange Rate (YoY)	11.3	(5.3)	1.8	(2.5)	-0.8	(0.7)	-1.9	(-0.5)	-2.0	(-1.1)	-2.1	(-1.2)
10-Year Expected PCE Inflation Rate	2.2	(2.2)	2.2	(2.1)	2.1	(2.1)	2.0	(2.1)	2.0	(2.0)	1.9	(2.0)
Household Net Worth (YoY)	0.1	(0.9)	0.2	(0.2)	0.1	(0.0)	0.0	(-0.1)	0.0	(-0.1)	0.1	(0.0)
Personal Consumption Growth Rate (YoY)	4.1	(4.1)	4.0	(3.1)	2.8	(2.4)	0.1	(1.5)	0.4	(1.0)	0.8	(0.8)
Residential Investment Growth Rate (YoY)	-9.4	(-5.5)	-8.3	(-5.4)	-0.5	(-2.0)	2.4	(0.2)	3.4	(1.5)	3.6	(2.0)
Business Fixed Investment Growth Rate (YoY)	3.8	(5.3)	-0.4	(3.0)	1.1	(2.4)	1.6	(2.2)	2.1	(2.2)	3.0	(2.2)
Government Spending Growth Rate (YoY)	2.4	(2.1)	2.7	(2.3)	2.5	(2.4)	2.4	(2.4)	2.3	(2.5)	2.3	(2.5)
Exports Growth Rate (YoY)	5.1	(6.0)	-1.5	(0.6)	0.3	(1.0)	2.2	(2.1)	3.6	(3.4)	4.8	(4.3)
Imports Growth Rate (YoY)	4.4	(6.8)	4.2	(3.0)	3.8	(2.3)	1.0	(2.4)	1.4	(1.8)	1.9	(1.5)

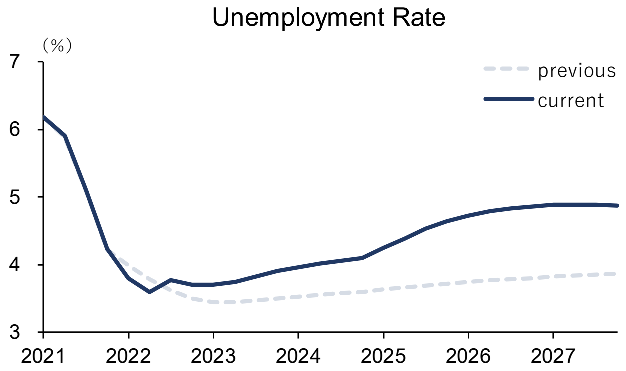
1. Changes in U.S. Economic Forecasts since the Last SEP Update

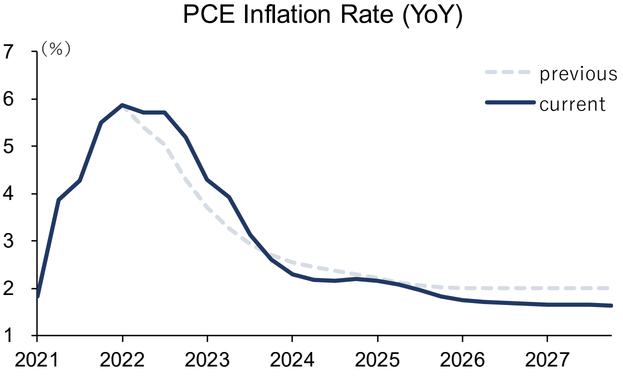
Chart 2: According to the SEP, the Fed is expected to accelerate the pace of policy rate hikes based on the expectation that inflation will remain elevated for some time. With more accelerated rate hikes, real GDP growth and unemployment are expected to be lower and higher, respectively.

(Chart 2) SEP Forecast Variables









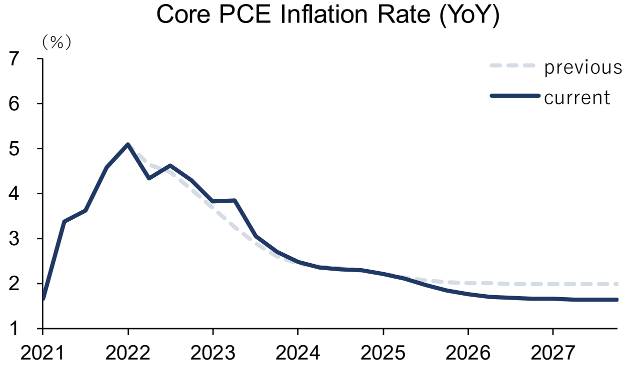
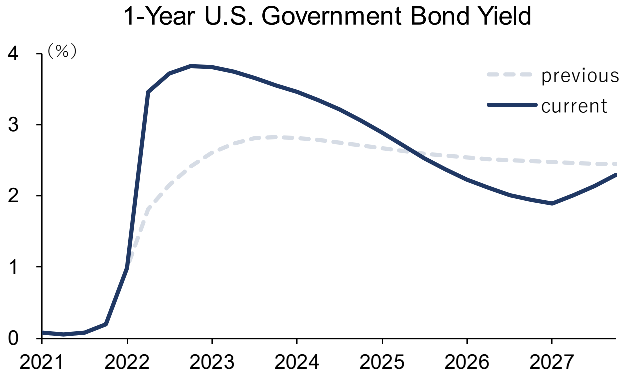
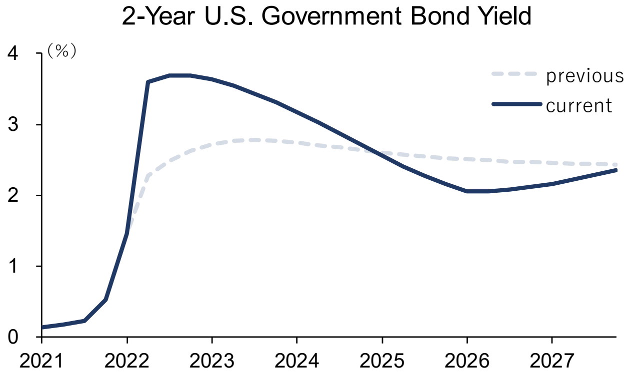
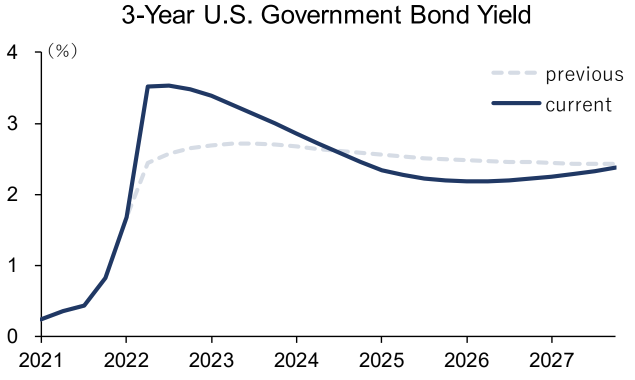


Chart 3-1: One-year, two-year, and three-year interest rates will rise more quickly and by a larger amount in the current update than in the previous update.

(Chart 3-1) Interest Rates (One-, Two-, and Three-Year)



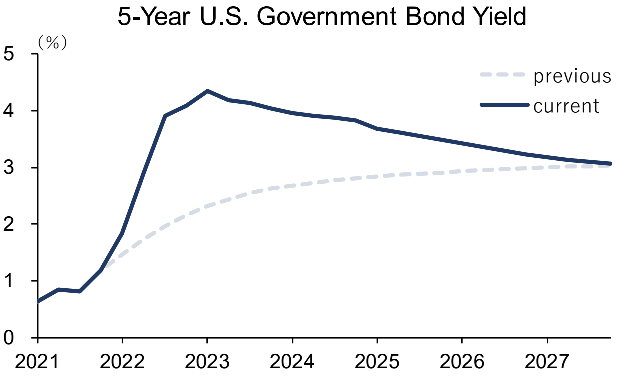


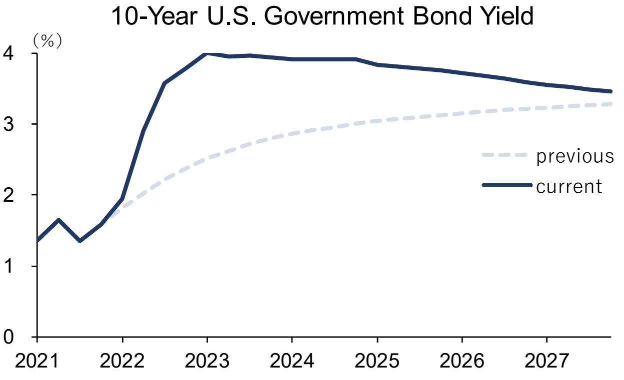


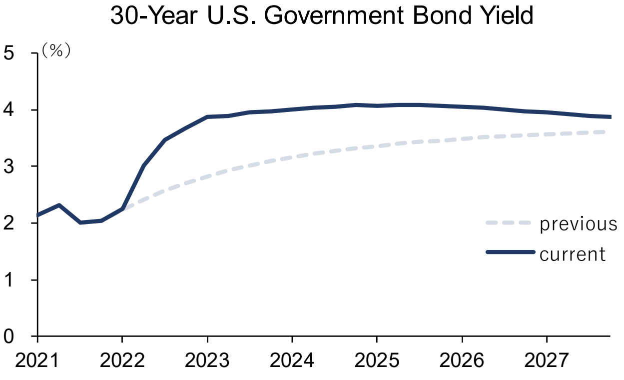
1. Changes in U.S. Economic Forecasts since the Last SEP Update

Chart 3-2: Medium- and long-term interest rates will also rise more quickly and by a larger amount in the current update than in the previous update.

(Chart 3-2) Medium- and Long-Term Interest Rates







1. Changes in U.S. Economic Forecasts since the Last SEP Update

Chart 4: The yield curve has moved up since the previous SEP Update.

(Chart 4) Yield Curve (As of June 2022)

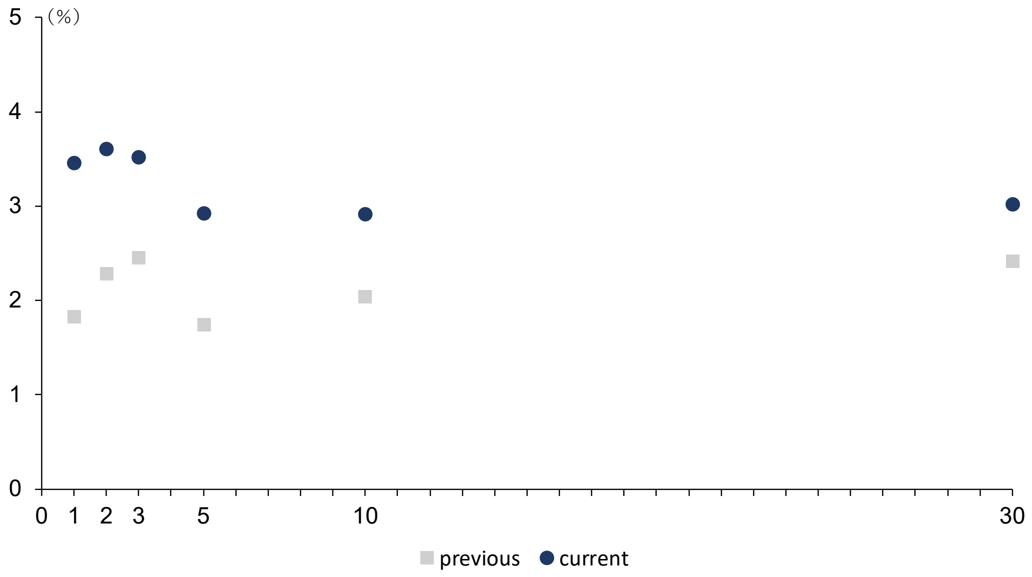
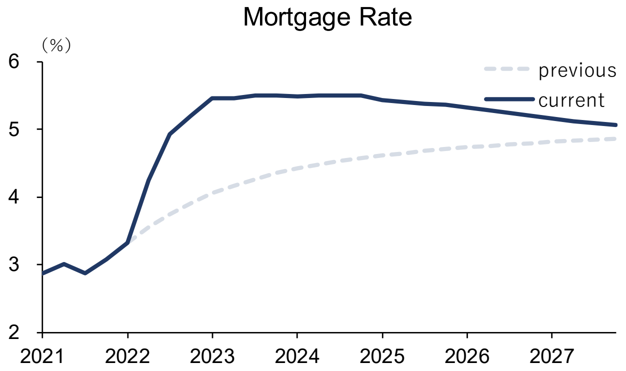
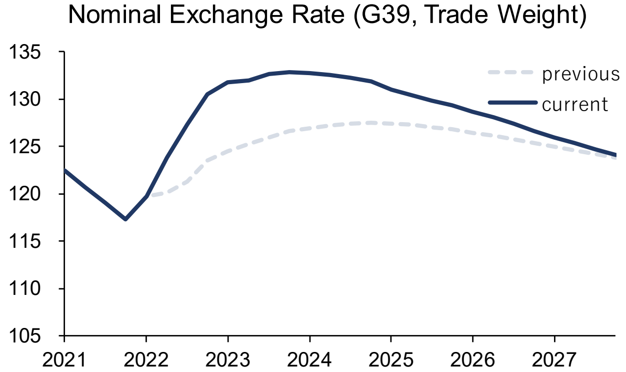


Chart 5-1: With interest rates rising faster than in the previous update, mortgage rates move up faster and by a larger amount. The exchange rate appreciates more quickly and by a larger amount. The path of long-run inflation expectations has not changed materially in the short- and medium-term.

(Chart 5-1) Mortgage Rate, and Nominal Exchange Rate, LR Inflation Expectations





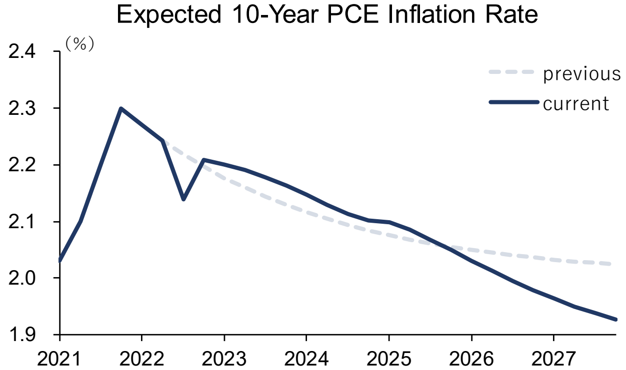
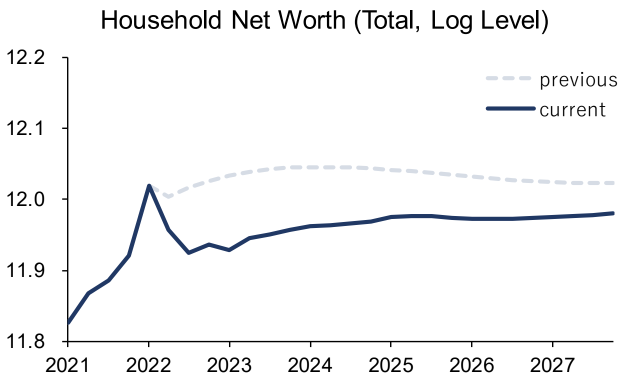
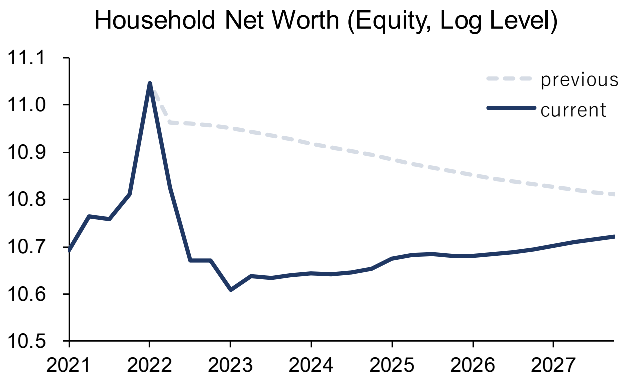
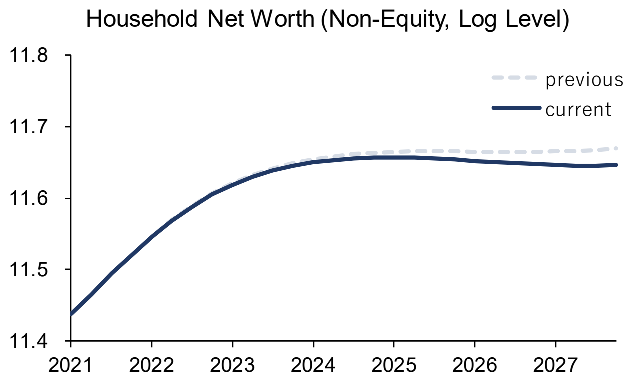


Chart 5-2: Households' net worth will decline in 2022 and gradually recover thereafter.

(Chart 5-2) Household Net Worth





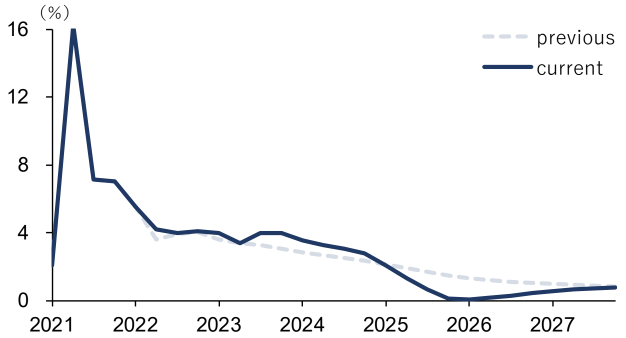


1. Changes in U.S. Economic Forecasts since the Last SEP Update

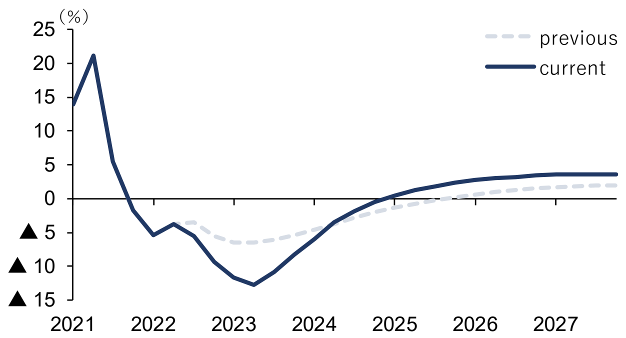
Chart 6: The path for consumption growth has changed little since the last SEP update. Housing and capital investment will decline faster and grow more slowly, respectively, than in the previous update. Growth in exports and imports will both slow down in the short run.

(Chart 6) GDP Components

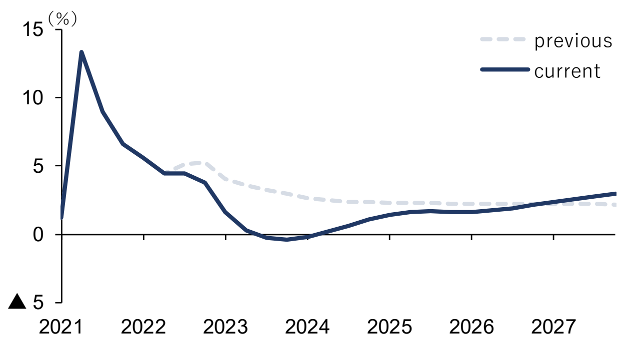
Personal Consumption Growth Rate (YoY)



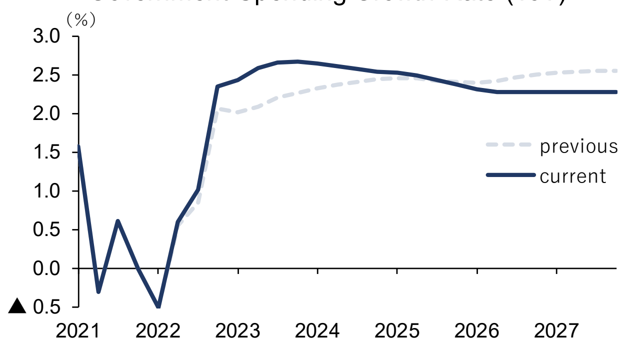
Residential Investment Growth Rate (YoY)



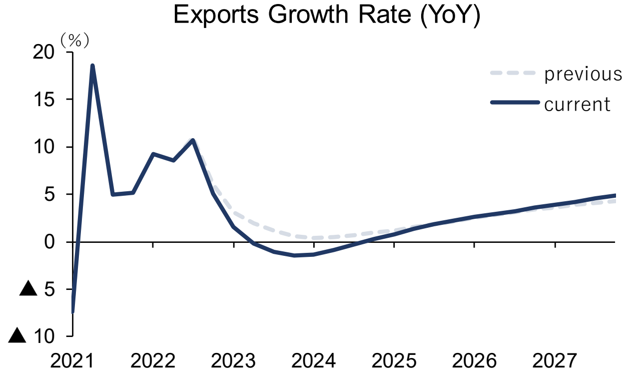
Business Fixed Investment Growth Rate (YoY)



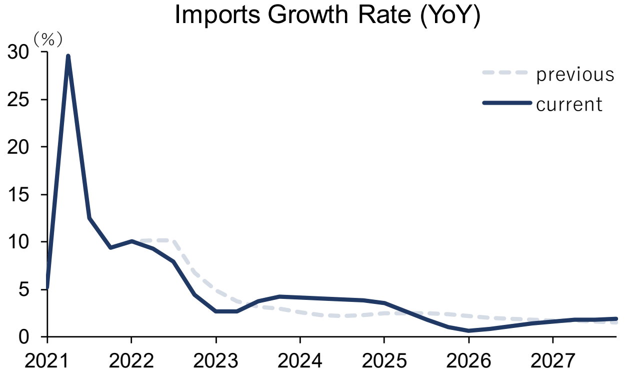
Government Spending Growth Rate (YoY)



Exports Growth Rate (YoY)



Imports Growth Rate (YoY)



2. U.S. Forecasts under the Optimal Monetary Policy

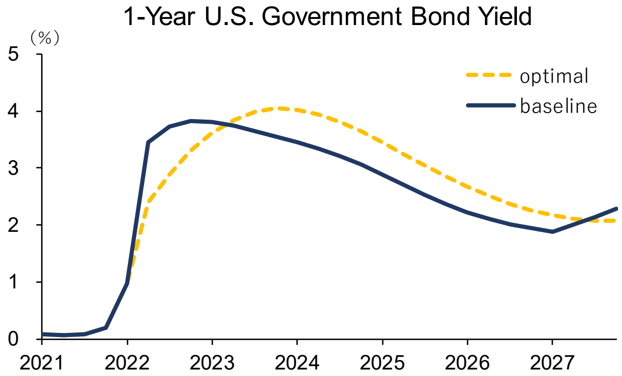
Chart 7: If the central bank optimally sets policy rates so as to minimize deviations from inflation and unemployment targets (2% and 4%—our assumption—respectively), the rise in the FF rate will be more gradual relative to the baseline. However, in the medium- and long-term, the path of the FF rate will be higher, reflecting the lower path of unemployment and the higher path of inflation associated with a more gradual rise in the near-term.

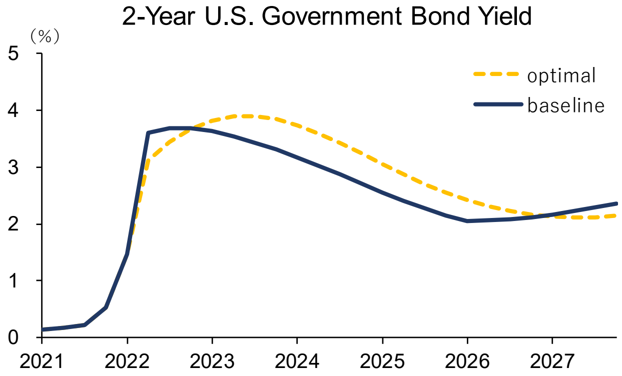
(Chart 7) SEP Forecast Variables

2. U.S. Forecasts under the Optimal Monetary Policy

Chart 8-1: A more gradual increase in the federal funds rate implies a more gradual increase in one-year rate than under the baseline. For two- and three-year rates, the difference is small in 2022. Thereafter, all three rates are higher under the optimal policy than under the baseline.

(Chart 8-1) Interest Rates (One-, Two-, and Three-year)





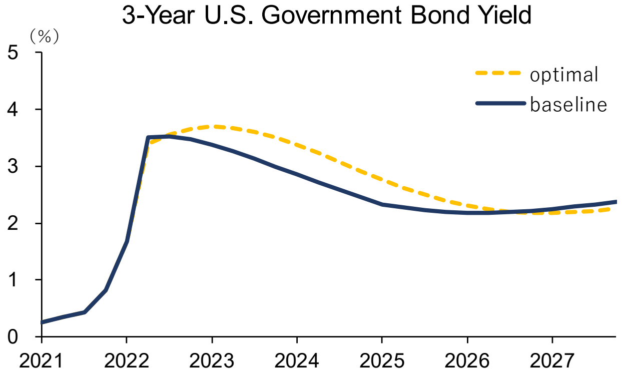
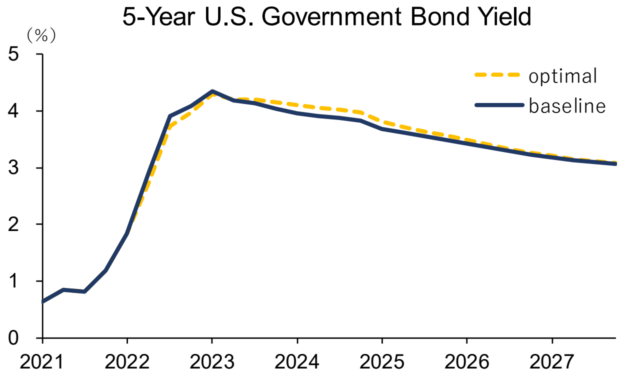
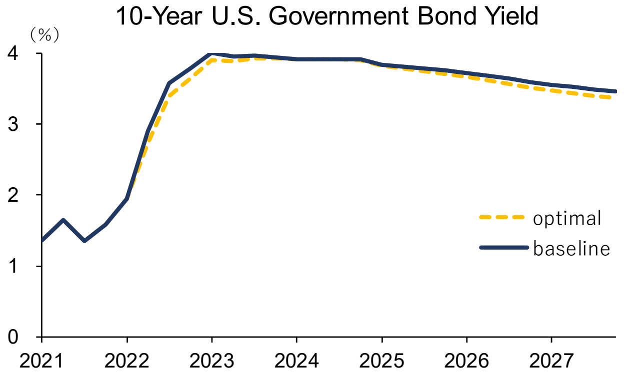


Chart 8-2: With a more gradual increase of the federal funds rate in the short-run and a higher path in the medium- and long-run offsetting each other (Chart 7), the paths of the longer-term rates are similar between the baseline policy and the optimal policy.

(Chart 8-2) Medium- and Long-Term Interest Rates





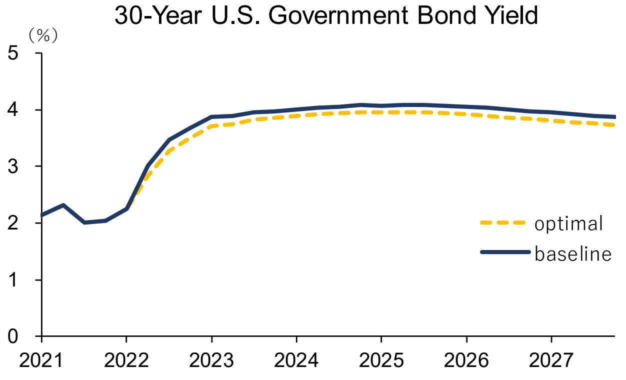


Chart 9: The yield curve is lower for shorter maturities under the optimal policy than under the baseline. For longer maturities, it is slightly lower.

(Chart 9) Yield Curve (As of June 2022)

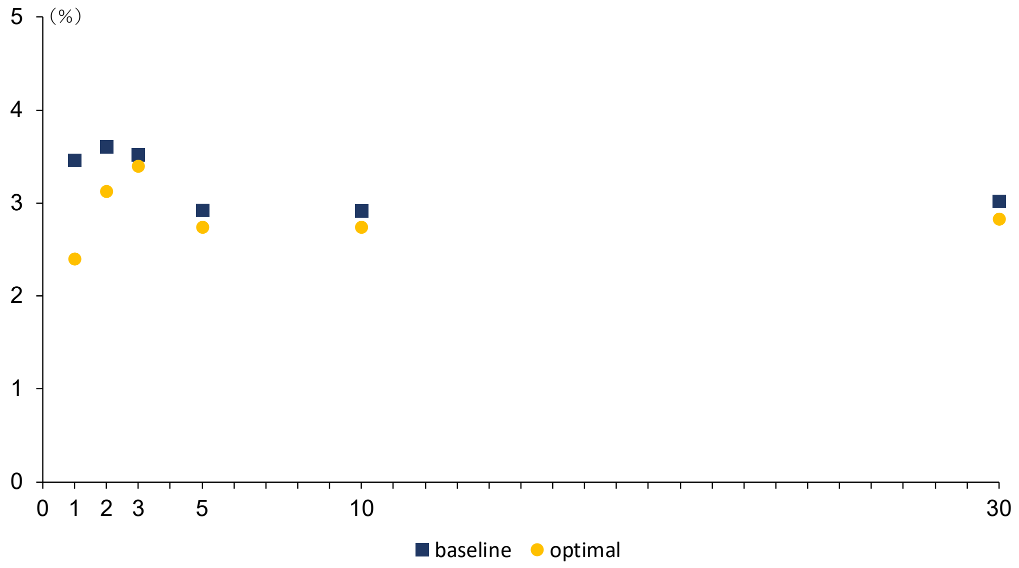
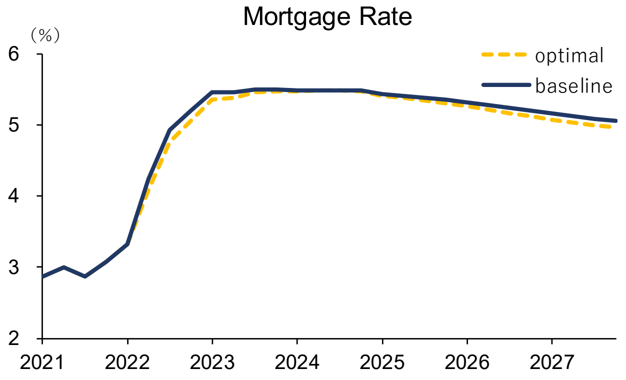
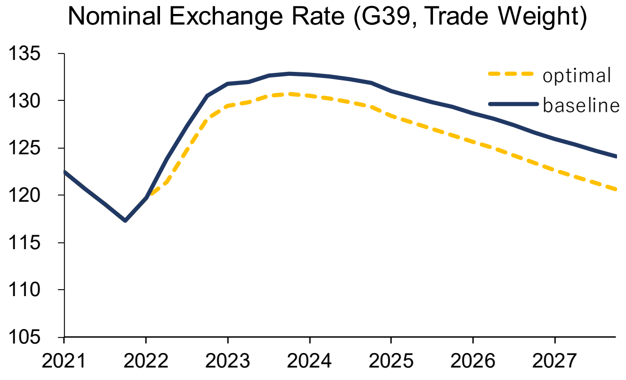


Chart 10-1: The path of the mortgage rate is about the same as, and the path of the nominal exchange rate is lower than, the corresponding path under the baseline. Long-run inflation expectations decline more slowly under the optimal policy.

(Chart 10-1) Mortgage Rate, and Nominal Exchange Rate, LR Inflation Expectations





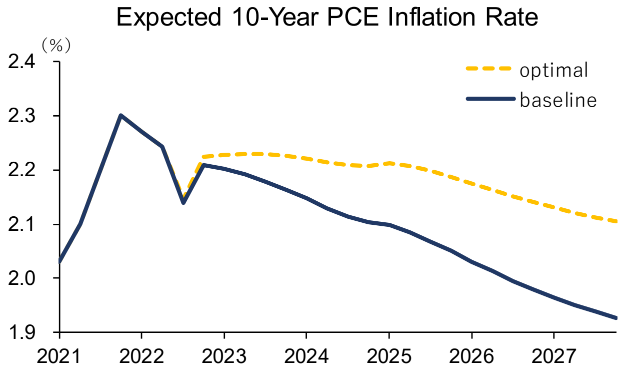
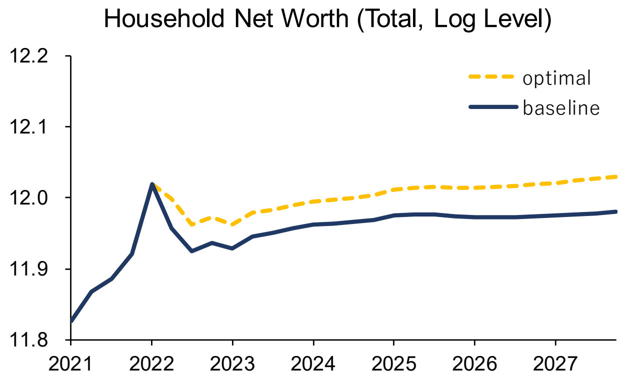
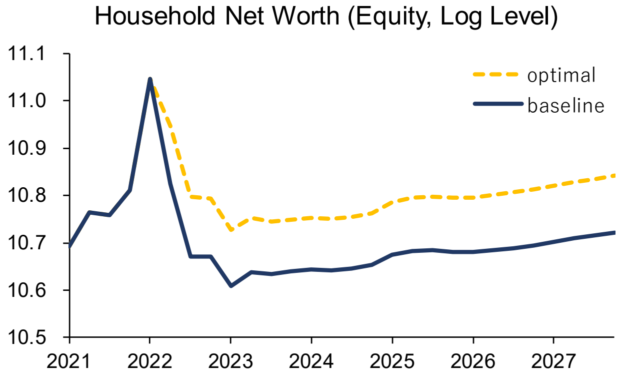


Chart 10-2: Household net worth—both total and equity—will fall by a smaller amount under the optimal policy than under the baseline.

(Chart 10-2) Household Net Worth





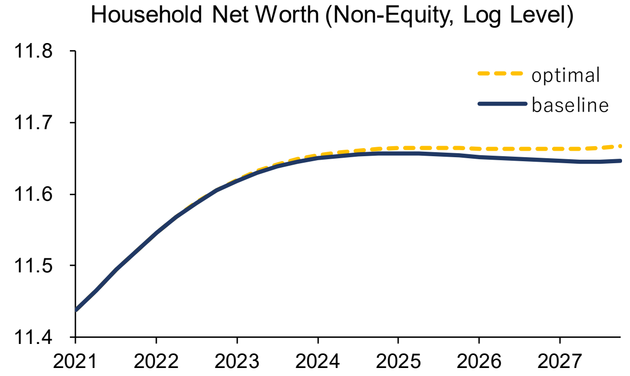
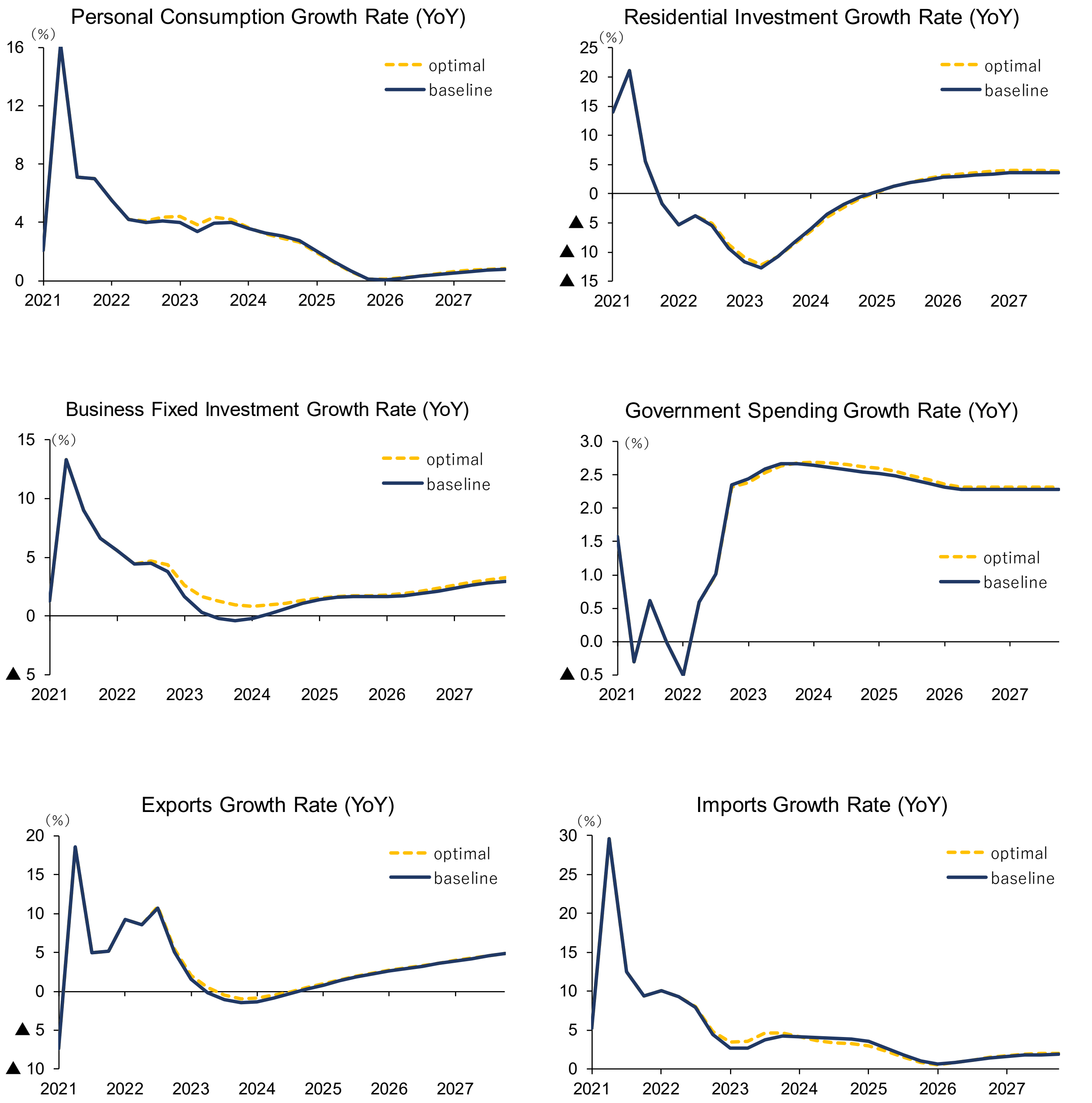


Chart 11: Slow-down in business-fixed investment is less pronounced under the optimal policy than under the baseline.

(Chart 11) GDP Components



What is the “SEP Update”?

- Every other FOMC meeting, the Fed publishes the "Summary of Economic Projections (SEP)," illustrating the FOMC members' forecasts of key macroeconomic variables over the next three years. The SEP is an important piece of information on the future direction of U.S. monetary policy and attracts a great deal of attention from market participants.

- The SEP contains projections of five variables—GDP growth, unemployment, inflation, core inflation, and the FF rate—in annual frequency over the next three years and their long-run values. However, some market participants might be interested in projections of other macroeconomic and financial variables and quarterly fluctuations in these variables. Our “SEP Update” provides projections consistent with the SEP of a variety of macroeconomic and financial variables, using a publicly available version of the FRB/US model, a macroeconomic model used frequently by the FRB in policy analysis.

- This document will be available for a fee beginning in the fall. https://utecon.net/en/dataproduct/

- We also offer consulting services on this product and related areas.

- We can also customize our analysis:
  - Projections of interest rates for various maturities
  - Projections based on alternative modeling assumptions, such as alternative monetary policy rules and alternative long-run assumptions, etc.
  - Analysis related to risks and uncertainty.

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