Rhea Mogoginta
Babson College

Starbucks ERP Model

Forecast Thesis:
The US economy is slowly but steadily recovering from the COVID pandemic, thus US economic fundamentals shall continue to recover and remain strong in the upcoming years. I believe that the recent fall in inflation rates and unemployment rates over the past month will continue in an orderly trend. This economic recovery is also driven by consumer spending and productivity. The Federal Reserve is also expected to increase its growth forecast for next year's projections. Consequently, the Fed will have plenty of time to slowly taper and decrease the Federal Funds rates. Additionally, the market may still be volatile after the COVID trough so recovery will occur in steps.

Federal Funds Rate: With an optimistic rate view, the Fed Funds rate will remain similar to the market view in the ERP model but starts to decrease in Q3 of 2023. A 15-basis point decrease will occur from Q3 of 2023 would be reasonable.

Treasury Spread (10-year to Fed Funds): US economy will continue to recover at a steady pace. The economic expansion is driven by increased demand and will not fall into recession. As a result of positive economic outlook, this shall occur by increasing the spread in the ERP model. An initial increase of 15-basis point will occur but drops to 10-basis point over time.

Equity Market Volatility (VIX): Despite having the economy moving into the right direction, there is a possibility that there might be a factor interrupting economic recovery in the future. Thus, the equity market volatility may increase above the historic average when in the upcoming years the government sets out an unfavorable policy.

Equity Market Return Projections: Economic recovery will occur but slowly, therefore corporate earnings may flatten.