

The Budget and Economic Outlook

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Some Features of CBO's February 2021 Budget and Economic Projections

In the projections, the recent economic recession and recovery are shaped by the 2020–2021 coronavirus pandemic and associated social distancing.

Vaccination is expected to reduce the number of new cases of COVID-19, resulting in a gradual but steady reduction of social distancing.

The projections generally incorporate the effects of fiscal policies under current law—including the Consolidated Appropriations Act, 2021, but not the American Rescue Plan Act of 2021.

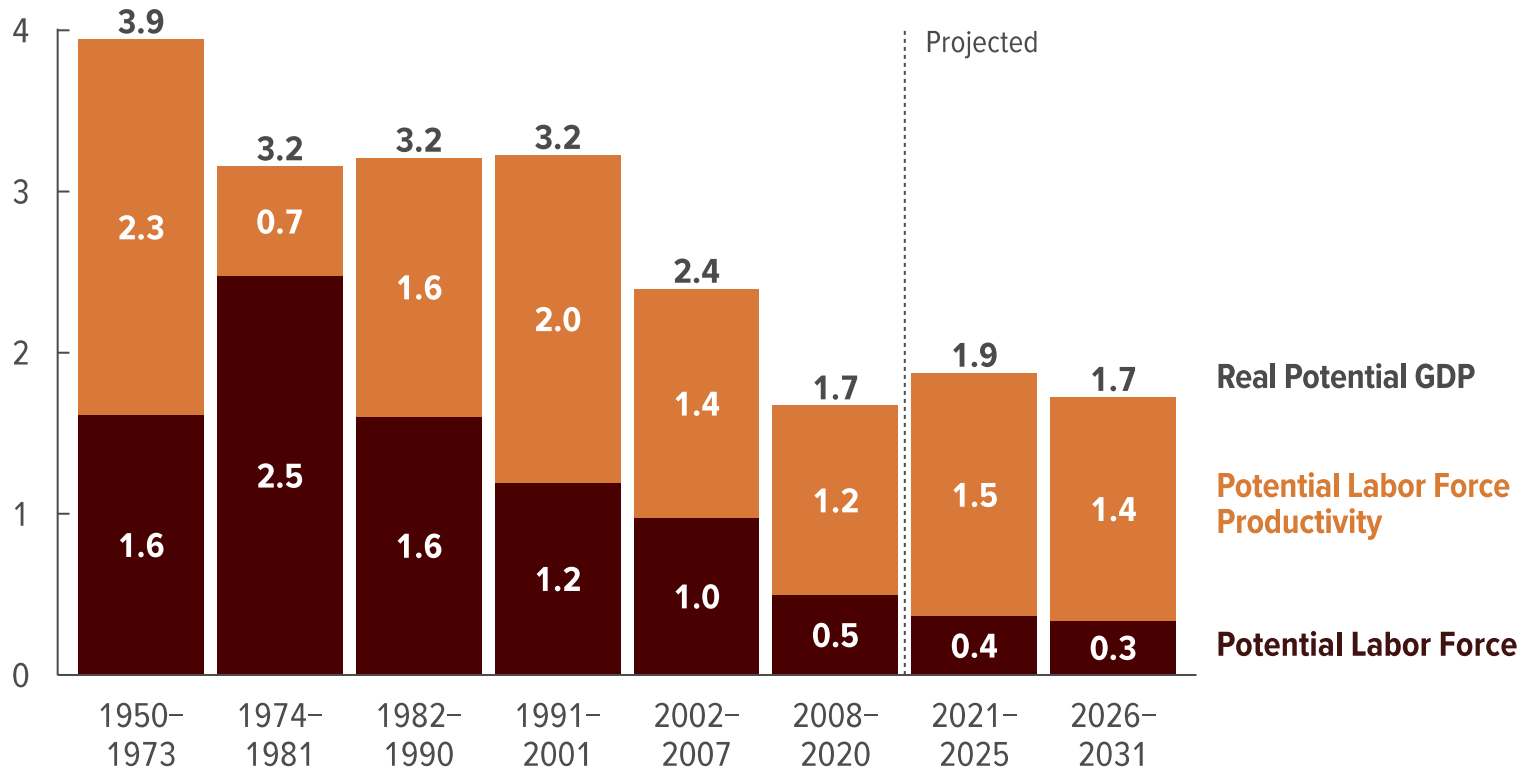
Large deficits decrease after 2022 in the projections, but primary deficits remain large, and the ratio of debt to gross domestic product (GDP) begins to climb steadily in 2028.

Major sources of uncertainty surrounding the projections:

- The pandemic (vaccinations, variants, etc.)
- The effectiveness of monetary and fiscal policies
- Financial markets
- Long-term effects on economic growth and industrial structure

Composition of the Growth of Real Potential GDP

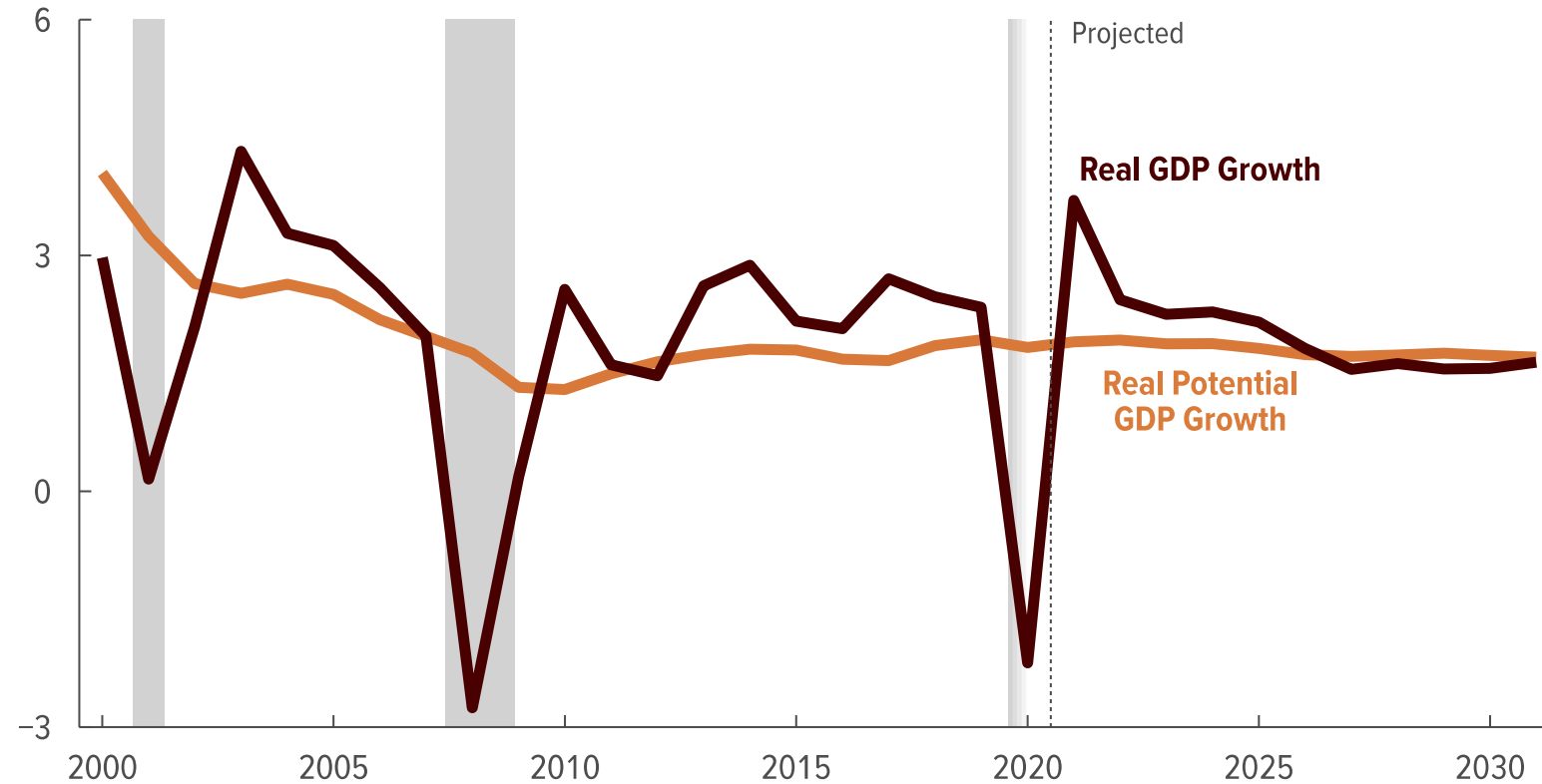
Percentage Change



Over the next decade, real potential GDP is projected to grow faster than it has since the last recession because of faster growth in potential labor force productivity. However, growth in the potential labor force is projected to be slower than in previous periods, largely because of the aging of the population.

The Growth of GDP and Potential GDP

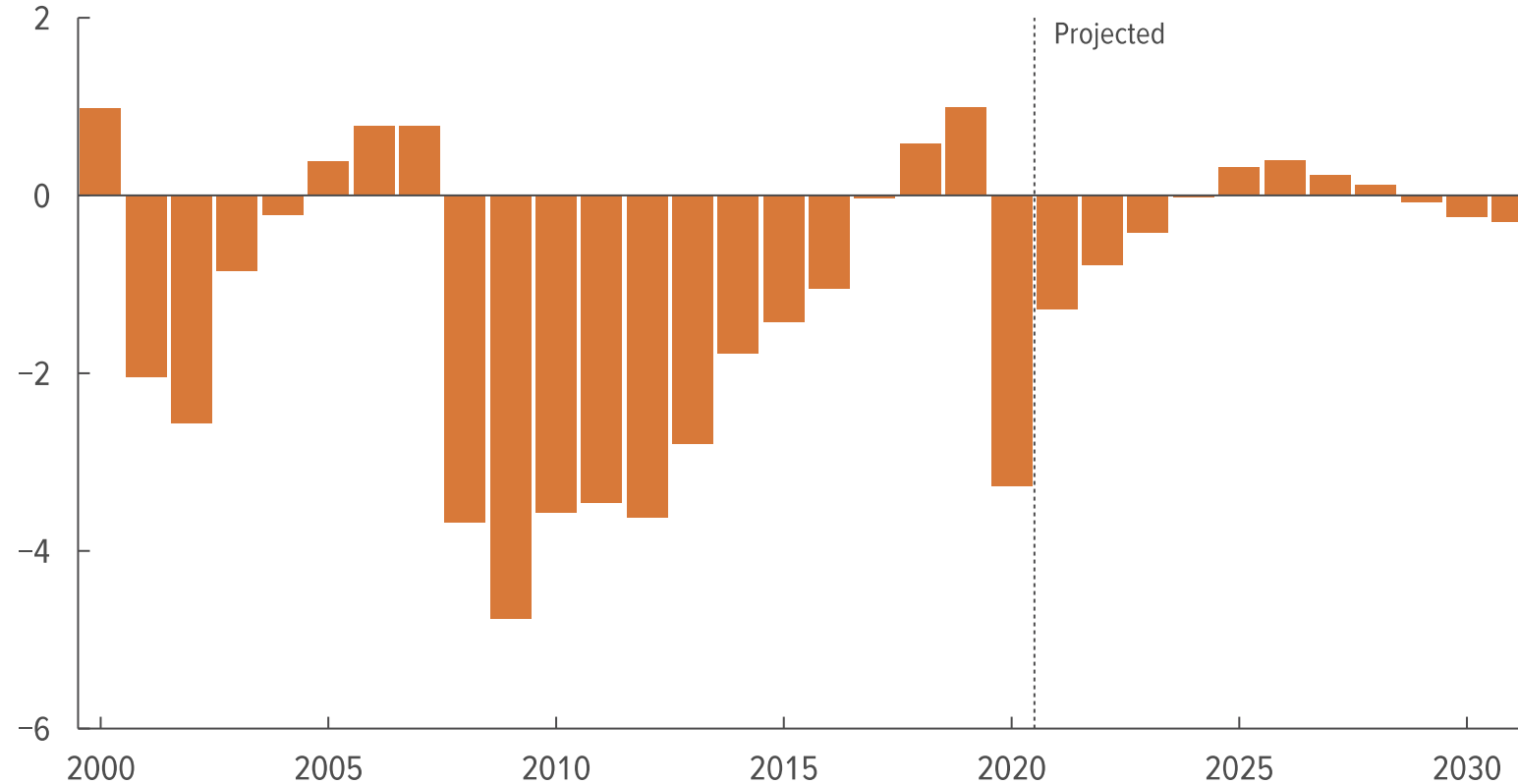
Percentage Change



In CBO's projections, the annual growth of real (inflation-adjusted) GDP exceeds that of real potential GDP until 2027.

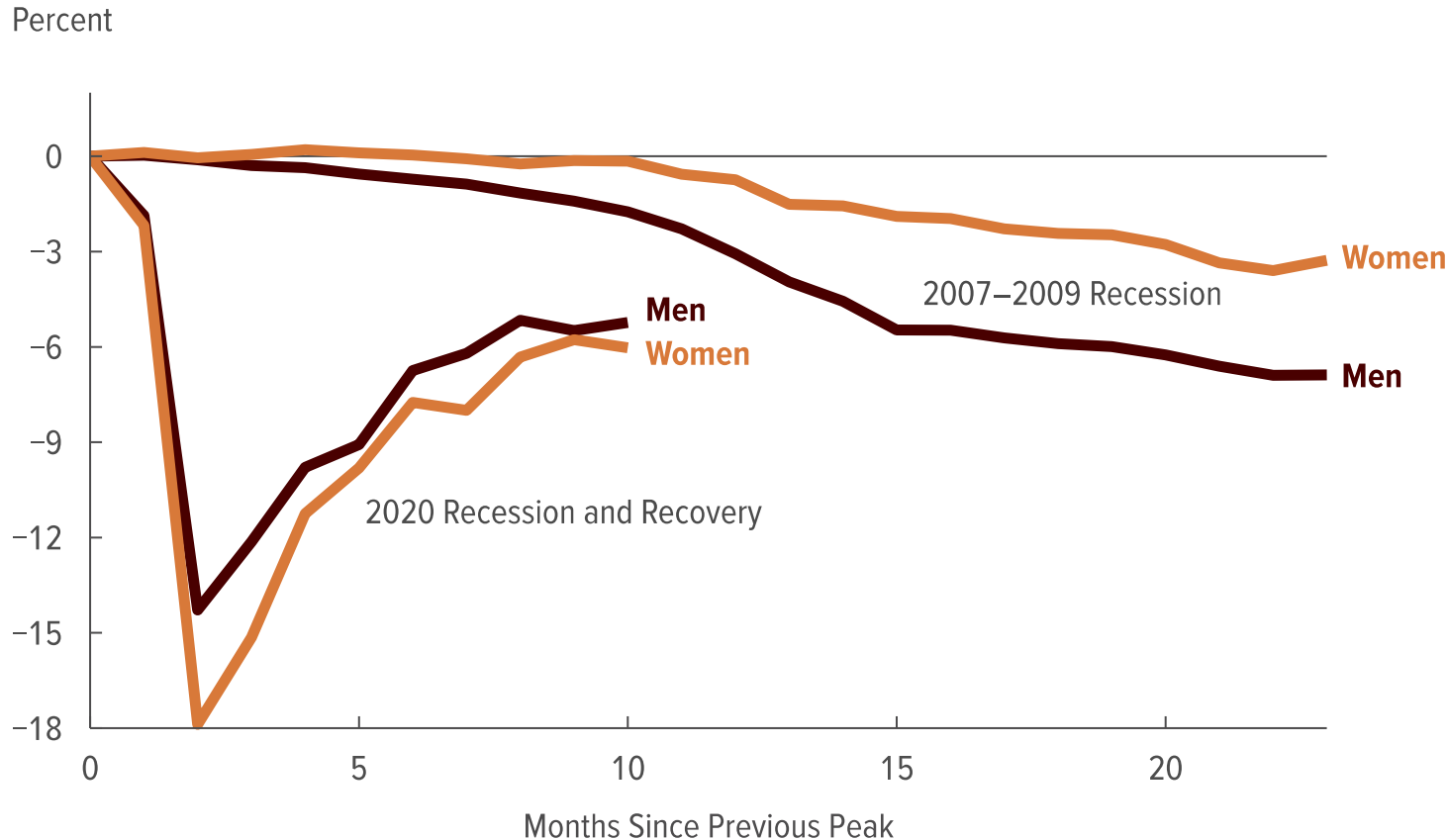
The Output Gap

Percentage of Potential GDP



The output gap between real GDP and real potential GDP is positive for several years, starting in 2025, before moving back toward its historical average.

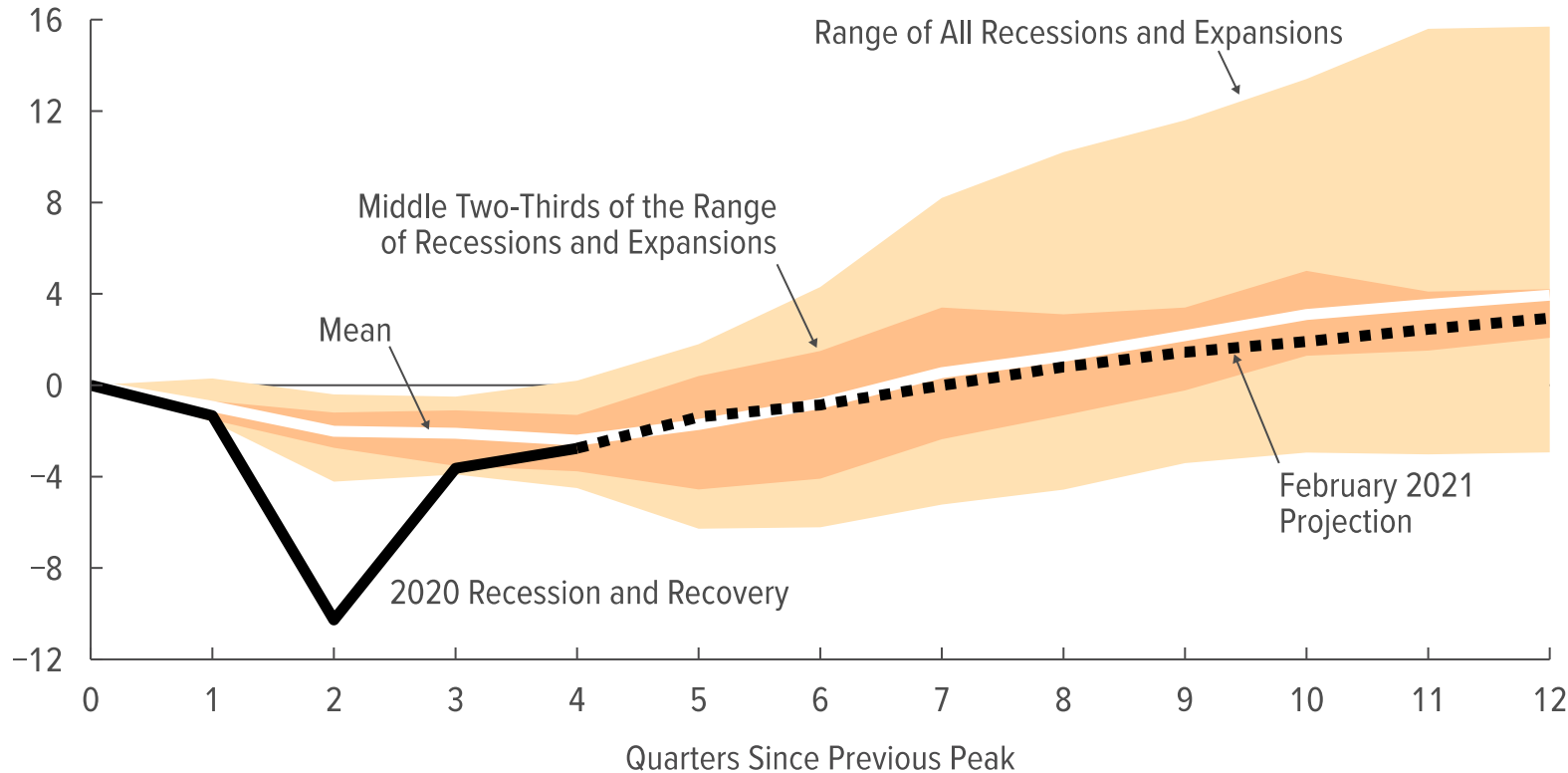
Change in Employment Since the Business-Cycle Peak



In early 2020, the percentage decline in employment was larger for women, for two main reasons. First, the industries and occupations most affected by the pandemic were also those that tend to employ large numbers of women. Second, widespread school closures and disruptions of child care probably prompted many women to stop working in order to provide care at home.

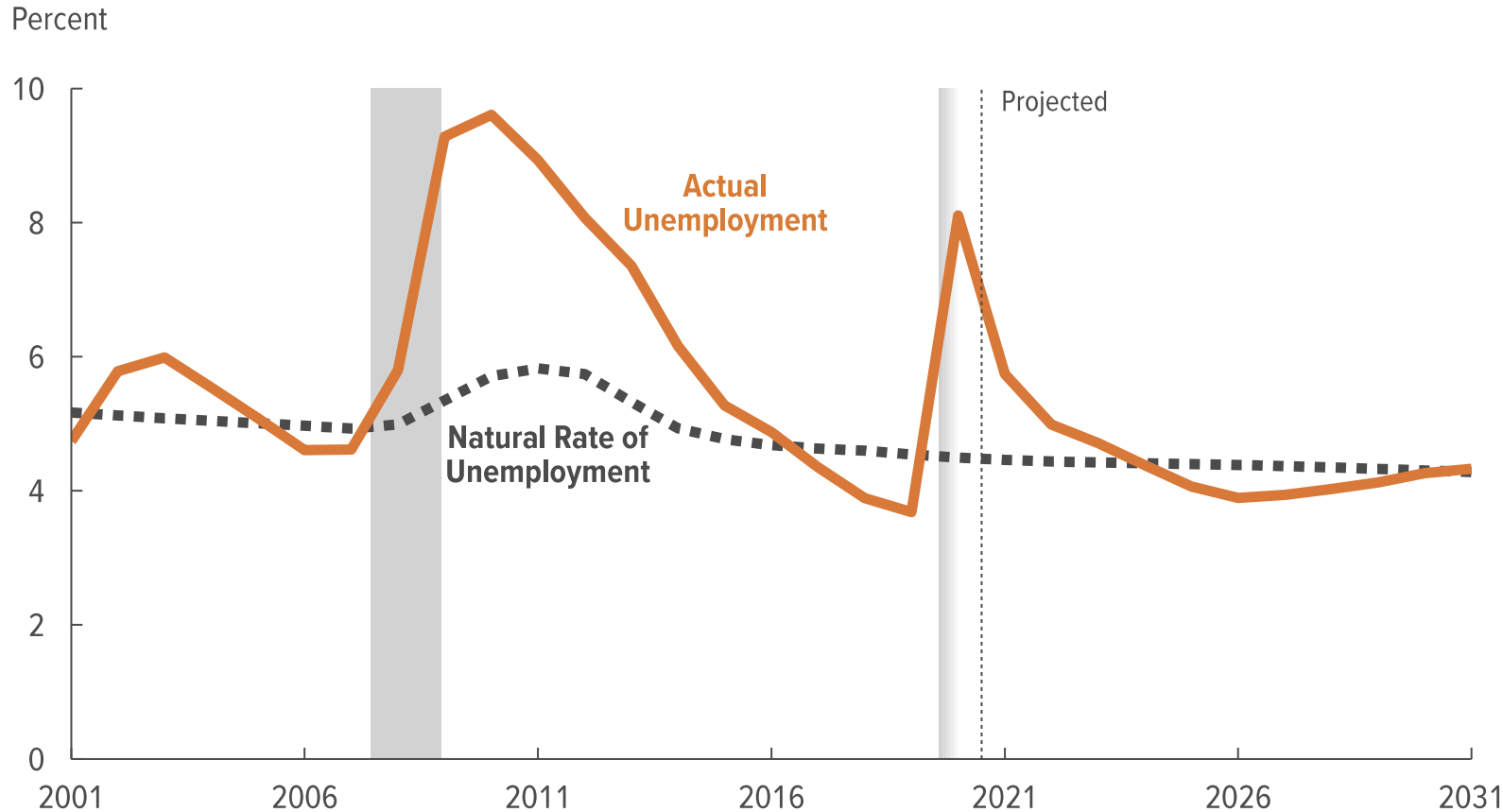
Real GDP per Potential Worker Across Business Cycles

Percentage Change From Previous Peak



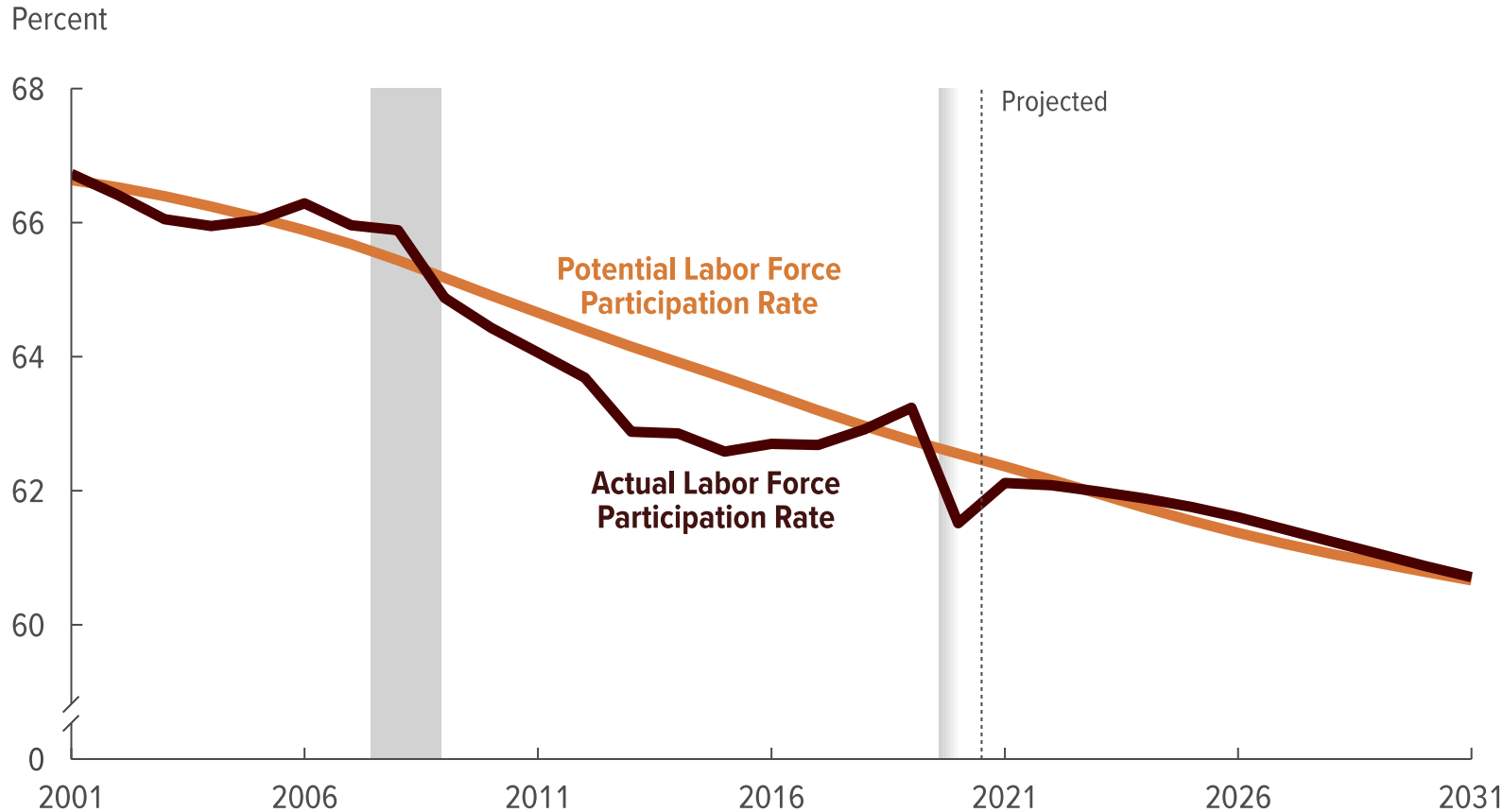
The 2020 recession was much sharper and more severe than any recession in the recent historical record, but the initial stage of the recovery was also unusually strong. In CBO's projections, four quarters after the previous business-cycle peak at the end of 2019, real GDP per potential worker grows roughly as much as it did, on average, during economic recoveries and expansions since World War II.

Unemployment



The unemployment rate remains above 6 percent—as the result of resurging COVID-19 infections and restrengthened social distancing measures—over the winter of 2020–2021 before starting to gradually fall again for several years.

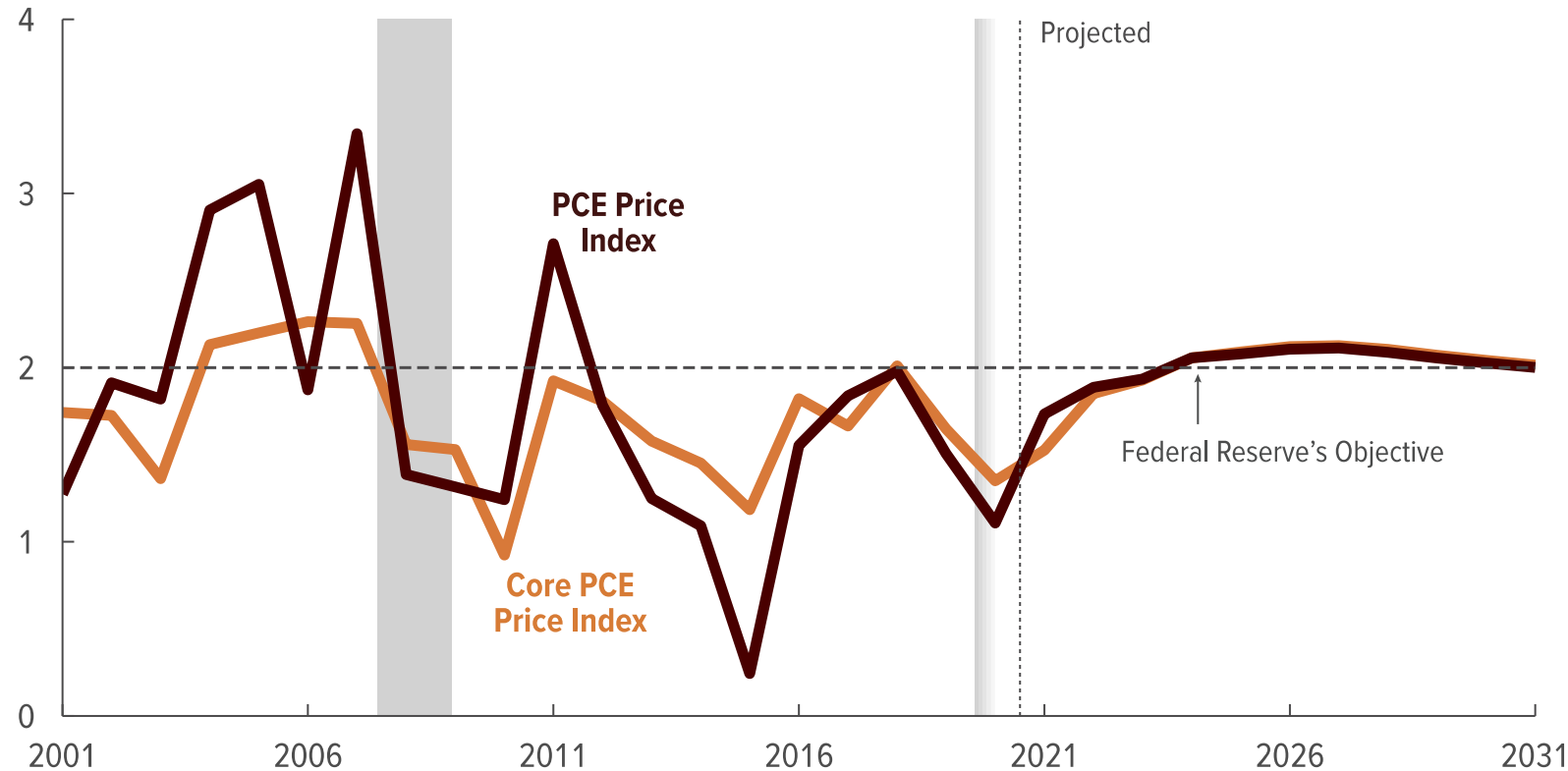
Labor Force Participation



The labor force participation rate fell during the pandemic-induced recession and is not expected to improve from its current level until the second quarter of 2021, when immunity to COVID-19 is projected to rise substantially. The participation rate then remains close to that level for several years as the effects of continued economic recovery and the aging of the population offset each other.

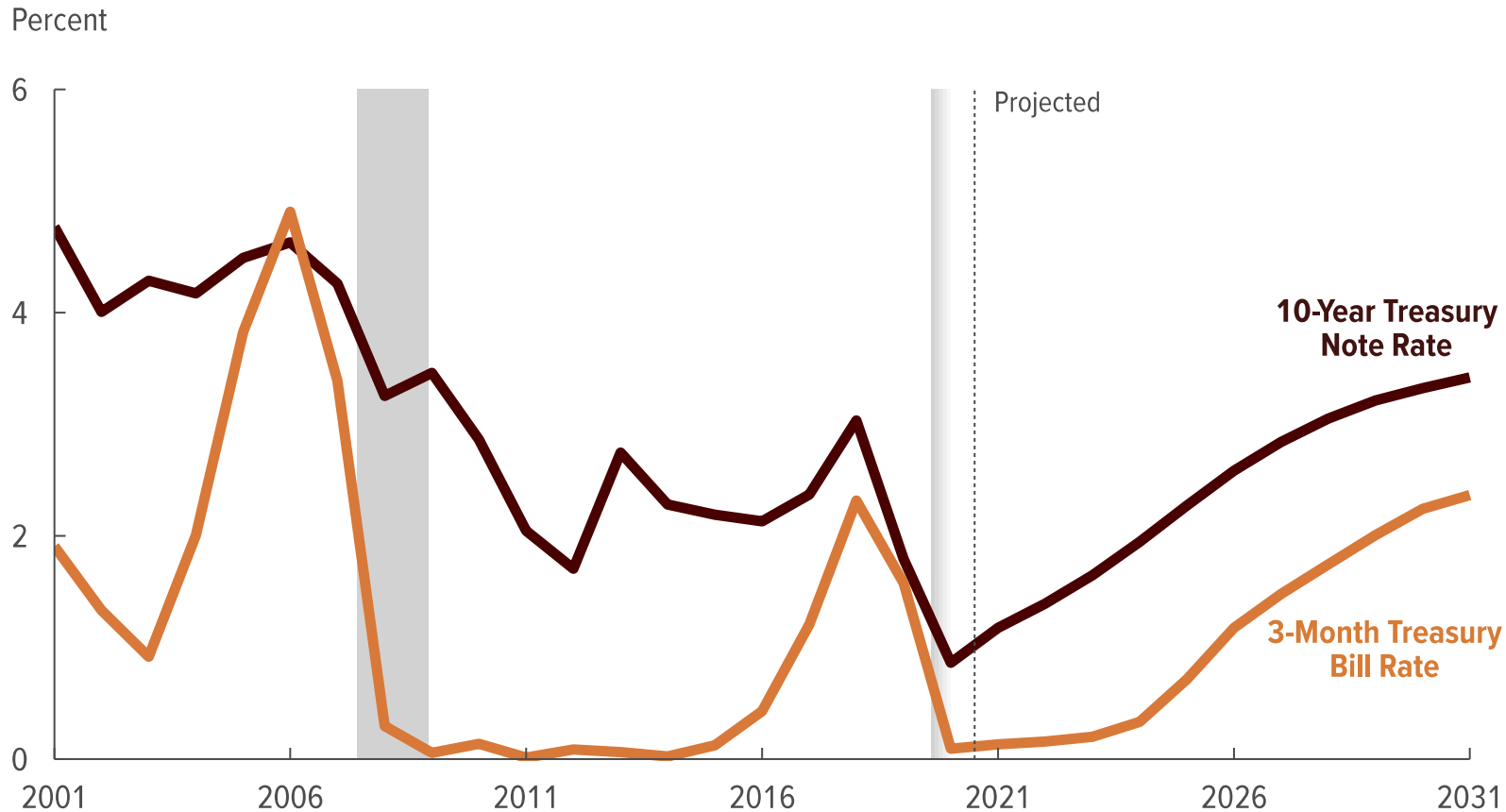
Inflation

Percentage Change



In CBO's projections, weak labor market conditions lead to lower inflation in 2021. After 2021, inflation rises until it reaches the Federal Reserve's objective of 2 percent by 2024.

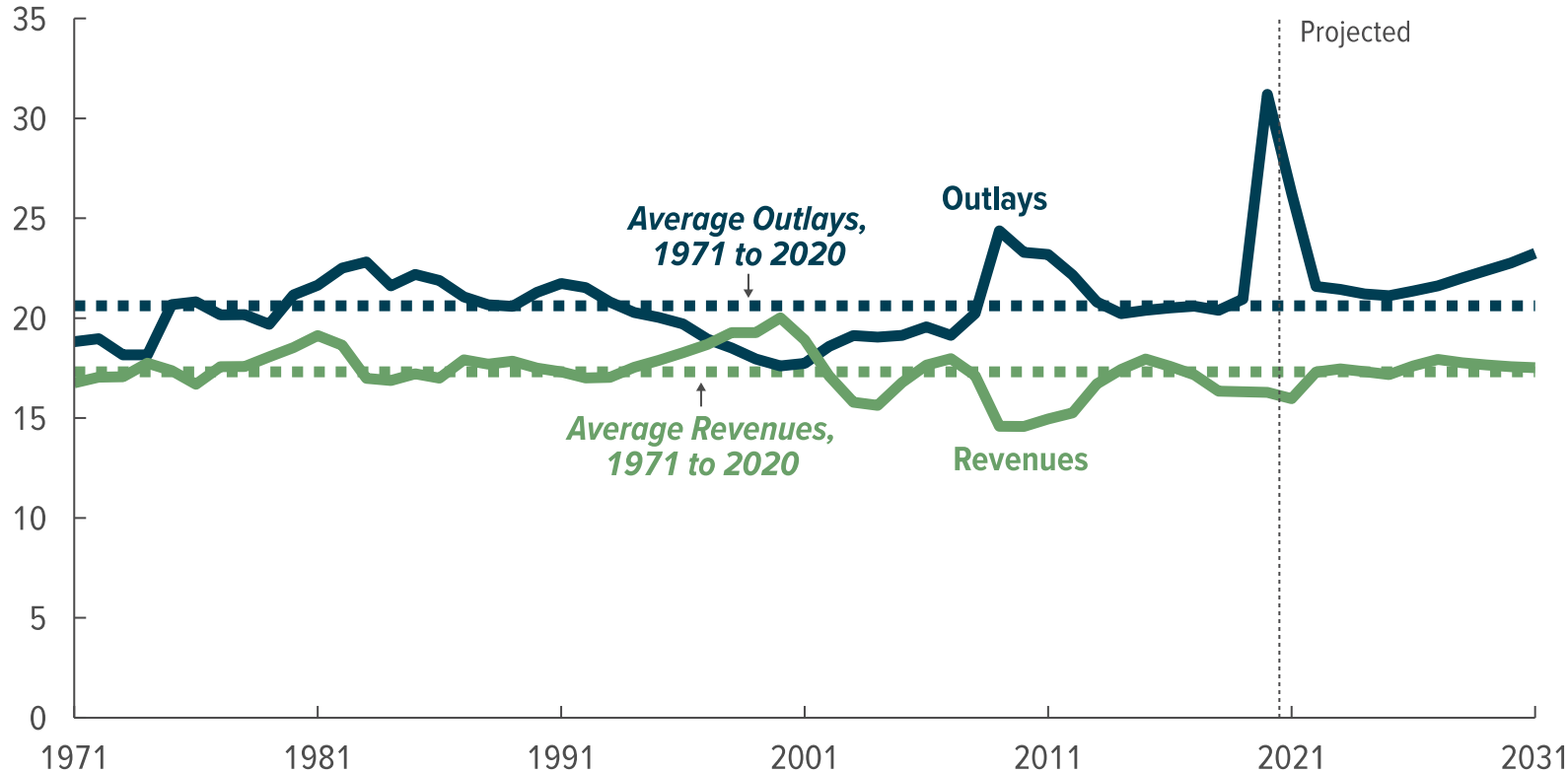
Interest Rates



In CBO's projections, short-term rates rise as the Federal Reserve raises the federal funds rate. Long-term rates are expected to rise for several reasons, including expectations about short-term rates, decreasing purchases of long-term securities by the Federal Reserve, and rising debt relative to GDP.

CBO's Baseline Projections of Total Revenues and Outlays

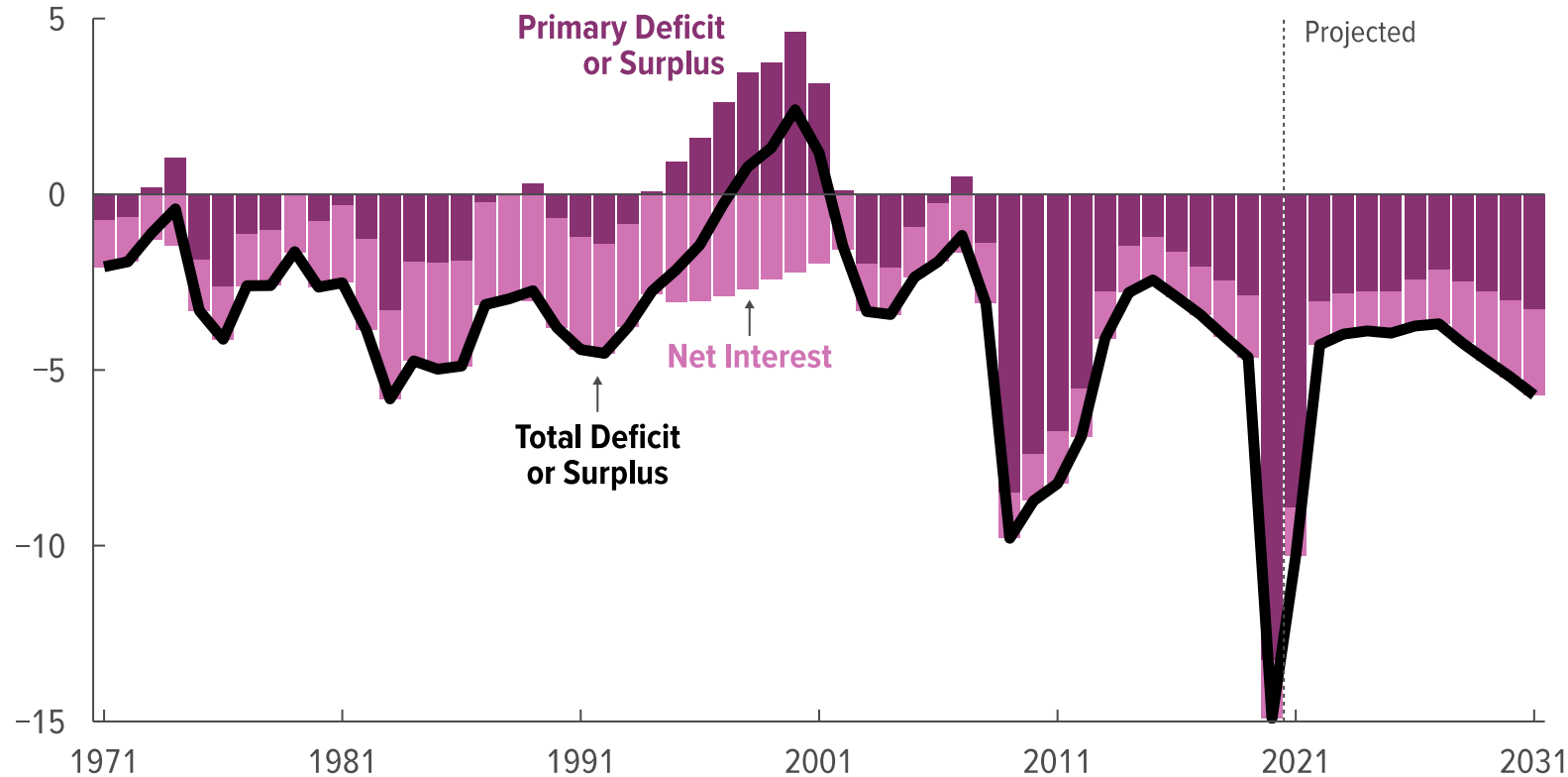
Percentage of GDP



Outlays are projected to drop from recent highs as pandemic-related spending wanes, before returning to an upward trend. Revenues are projected to hover around their historical average as a share of the economy.

Total Deficits and Surpluses

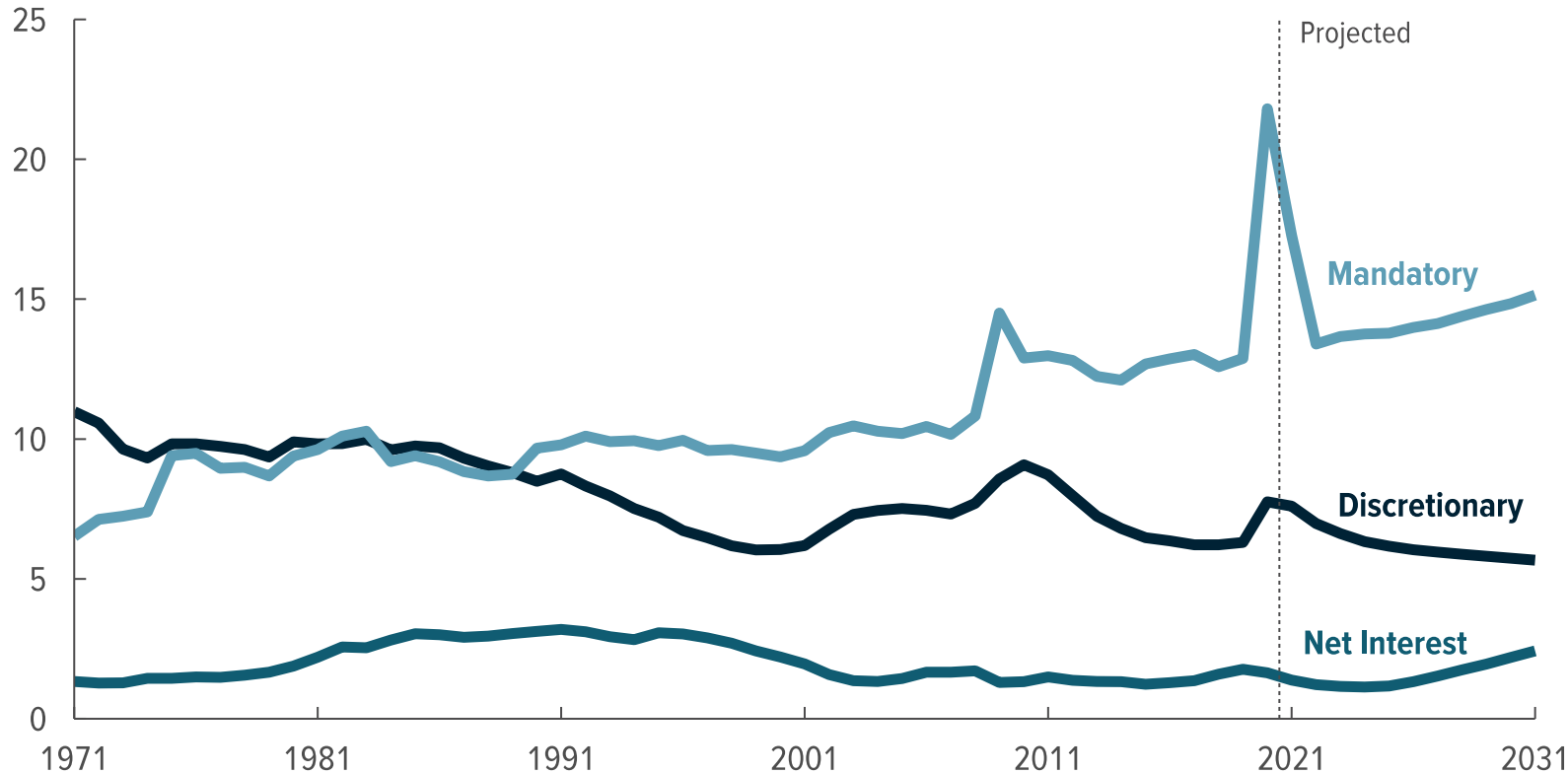
Percentage of GDP



In CBO's projections, both total deficits and primary deficits shrink as a percentage of GDP for the next few years and then generally increase thereafter. Total deficits grow more rapidly than primary deficits near the end of the projection period because of rising interest costs.

CBO's Baseline Projections of Outlays, by Category

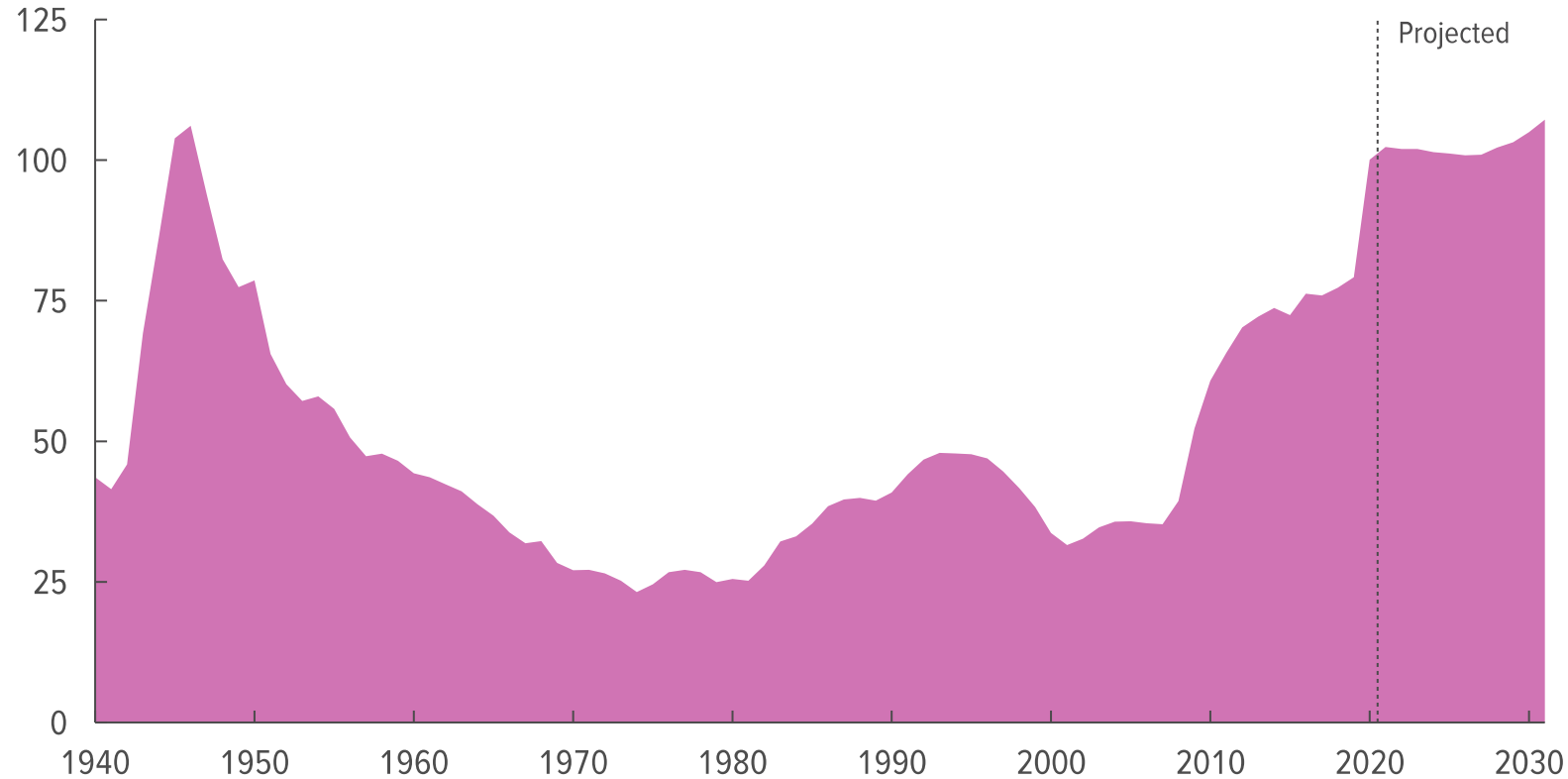
Percentage of GDP



Each category of spending drops in the near term. In later years, rising spending for Social Security and the major health care programs boosts mandatory outlays, and net interest costs increase as interest rates rise.

Federal Debt Held by the Public

Percentage of GDP



By 2031, federal debt held by the public is projected to reach 107 percent of GDP, the highest in the nation's history.

Recent CBO Publications About the Budget and Economic Outlook

The 2021 Long-Term Budget Outlook (March 2021), www.cbo.gov/publication/56977

Additional Information About the Budget Outlook: 2021 to 2031 (March 2021),
www.cbo.gov/publication/56996

Additional Information About the Economic Outlook: 2021 to 2031 (February 2021),
www.cbo.gov/publication/56989

The Budget and Economic Outlook: 2021 to 2031 (February 2021),
www.cbo.gov/publication/56970

The Historical Decline in Real Interest Rates and Its Implications for CBO's Projections,
Working Paper 2020-09 (December 2020), www.cbo.gov/publication/56891

The Effects of Pandemic-Related Legislation on Output (September 2020),
www.cbo.gov/publication/56537