The Congressional Budget Office (CBO) today released its new budgetary and economic forecasts. This non-partisan body of Congress thereby gives us a base scenario, which provides a better understanding of trends in federal public finances. At the beginning of next month, the White House and both chambers of Congress should also be issuing their own budget proposals. Recent history shows that it has been quite rare for these budget proposals to become law. In the very near term, the latest budgetary compromises are dictating the budget for this year and the next.

The CBO’s new estimates show that federal public finances have improved significantly in just over a year now. Higher taxes resulting from the fiscal cliff at the beginning of 2013, the Sequester that started in March, better economic growth and special revenues from sources such as federal mortgage agencies have all contributed to higher revenue growth and lower expenses. As such, 2013’s deficit was only US$680B, compared to last year’s forecast of US$845B. This improvement should continue in the coming years: the CBO’s forecasted deficits for 2014 and 2015 are US$514B and US$478B respectively, a big contrast with the US$1,087B deficit on the books for 2012.

Real GDP’s annual change should accelerate based on the CBO’s forecast, rising from 1.7% in 2013 (the first estimate of national accounts has this growth at 1.9%) to 2.7% in 2014 and 3.3% in 2015. The CBO also forecasts that the jobless rate will remain relatively stable (6.7% on average in the last quarter of 2014, the same rate as recorded in December 2013). Our own forecasts are more optimistic in the short term, with real GDP advancing 2.9% in 2014 and the jobless rate dropping to 6.1% at the end of the year. In such circumstances, public finances for the year could improve even more.

Also according to the CBO, the budget situation will again deteriorate starting in 2016 when the deficit reaches US$539B. Deficits will widen annually until the end of the forecast horizon in 2024, when a budget shortfall of US$1,074B is expected. This represents 4.0% of GDP, whereas this year’s deficit should be 3.0% of GDP. Expenses should start to accelerate under the weight of mandatory spending, beginning with expenses related to healthcare that will be grappling with a change in demographics. Debt servicing will also expand. As a percentage of GDP, revenues should be stable, but growth will still be slow because the U.S. economy’s potential will be modest. The CBO is calling for a potential growth rate of 2.0% by 2017 and 2.2% thereafter.

Implications: The U.S. federal government’s budget situation has already improved greatly and should continue to do so in the short term. Yet there are still significant challenges in store, as the problems caused by the inevitable ageing of the population persist.

Francis Généreux
Senior Economist