Insight

CBO’s August Update: What Changed?

GORDON GRAY | AUGUST 27, 2014

Just about every summer, the Congressional Budget Office (CBO) updates its forecast for the economy and its projections for taxes, spending, the deficit, and the debt for next ten years. This report serves as a useful near fiscal year-end economic and budgetary barometer until CBO updates their estimates again the following winter. This year’s August update is no different, and reflects important phenomena that have occurred since CBO issued their economic projections in February. CBO updated their budget projections in April, but these rely upon the same economic projections in the February report.

Importantly, the August update reflects the interplay of both economic trends and budgetary changes. Indeed, the most significant changes in this report from CBO’s prior estimates stem from a downward revision in GDP and interest rates. These trends dominate the changes in the budget estimates contributing to a total of $1.074 trillion in revisions to in revenues and spending. On a net basis, CBO’s 10-year deficit projections, however, have only seen a reduction of $422 billion.

CHANGES TO THE ECONOMIC FORECAST

TABLE 1: DIFFERENCES IN ECONOMIC FORECAST BETWEEN AUGUST AND FEBRUARY OUTLOOK REPORTS

Image not found or type unknown

The most significant change from CBO’s last (February) economic report is in the level of projected GDP owing in large part to surprisingly sluggish growth for 2014. Because of this downside surprise, CBO roughly halved its growth estimate for 2014, resulting in a lower level of GDP at the beginning of 2015. Thereafter, CBO’s growth projections are essentially unchanged, but the lower jumping-off point for GDP in 2015, as well as slightly slower growth in potential GDP, mean that the level of national income is persistently, if only slightly, lower over the next decade than was projected in the February report. Despite the lower GDP growth, the unemployment rate has been projected downward. This can be attributed to a swifter decline in the unemployment rate and weaker rebound in labor force participation.

CBO has also reduced its estimates of prevailing interest rates. This reflects lower rates observed since CBO’s February forecast, and a reassessment of the competing upward and downward pressures on interest rates in the latter part of the decade that ultimately contribute to a net downward revision.

CHANGES TO BUDGET PROJECTIONS

TABLE 2: DIFFERENCES IN BUDGET PROJECTIONS BETWEEN AUGUST AND FEBRUARY OUTLOOK REPORTS

Image not found or type unknown

By far the prevailing force on changes to CBO's budget projections are revisions to the economic forecast. These contribute to lower projected tax revenue, largely due to lower GDP projections, of $503 billion. Economic revisions also contribute to lower spending, largely due to reduced interest rate projections, of $571 billion. Combined, economic factors contribute to estimated swings in tax and spending levels of $1.074 trillion. However, though these are the largest changes, on a net basis, the combined effects are significantly reduced.

Other factors contribute only slightly to changes in CBO's budget outlook. Changes in federal law – including additional veterans related funding, emergency defense spending, and a Highway Trust Fund patch – have only contributed to slightly higher spending and revenue projections since CBO last updated its budget estimates in April. Technical factors, such as estimated timing of certain tax payments, further contribute to CBO's changed budget estimates.