



February 15, 2008

Honorable Kent Conrad
Chairman
Committee on the Budget
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

In preparation for new baseline projections that will be released at the beginning of March, the Congressional Budget Office (CBO) has updated its macroeconomic forecast. CBO has occasionally issued revisions to the forecast it publishes in January, but they are relatively uncommon. This revision is motivated by three recent developments: new data about the weakness of the economy, actions by the Federal Reserve, and the stimulus package passed by the Congress and signed into law by the President.

CBO's previous forecast, which was embodied in budget projections released in January, was finalized in early December 2007. However, data released since then—especially regarding the labor market—indicate that economic conditions are weaker than previously projected, and conditions in some segments of financial markets remain worrisome. Other indicators—such as production indices and information on retail sales and sales of new homes—also suggest a slowing in economic activity.

At the same time, changes in monetary policy have been more substantial than CBO assumed in December, and fiscal policy stimulus has been enacted. The Federal Reserve reduced the target for the federal funds rate by 125 basis points in January, and financial markets anticipate further easing in the near future. In addition, the Economic Stimulus Act of 2008 will provide about \$150 billion in tax rebates and business tax deductions in fiscal year 2008. CBO anticipates that the recent monetary and fiscal policy actions will provide significant support to the economy in 2008.

The net effect of those developments since CBO's previous set of projections is slightly stronger projected economic activity for 2008 (because the impact of monetary and fiscal policy stimulus slightly outweighs the deterioration in

economic conditions absent those policy changes) and slightly weaker projected economic activity for 2009 (in part because the withdrawal of fiscal stimulus temporarily reduces economic growth). CBO's projections are similar to the most recent *Blue Chip* consensus forecast, an average of the estimates of about 50 private-sector forecasters. Although CBO's projections do not show the slowdown in economic growth becoming severe enough to meet the economic definition of recession, the risk of a recession remains elevated, and economic activity will remain subdued for some period as the economy continues to work through the effects of problems in the housing and financial markets and the high price of oil.

More specifically, CBO now forecasts that real (inflation-adjusted) gross domestic product (GDP) will grow by 1.9 percent in calendar year 2008 and 2.3 percent in 2009 (see Table 1). Inflation is expected to ease during that period, largely because rapid growth in both energy and food prices temporarily exacerbated inflation in 2007. As measured by growth from the fourth quarter to the fourth quarter, the GDP price index is forecast to grow by 1.7 percent in both 2008 and 2009, while the consumer price index for all urban consumers is forecast to rise by 2.1 percent and 1.9 percent, respectively. In the forecast, the rate of unemployment rises from 4.6 percent in 2007 to 5.2 percent in 2008 and 5.5 percent in 2009 and declines thereafter. The rate on three-month Treasury bills averages 2.1 percent in 2008 and 2.4 percent in 2009; and the rate on 10-year Treasury notes averages 3.6 percent and 3.8 percent in those years.

Inflation is expected to be somewhat lower in both 2008 and 2009. Similarly, interest rates are anticipated to be lower than what was assumed in the January forecast—considerably lower in the case of short-term rates. Compared with what CBO previously forecast, the rate on three-month Treasury bills is expected to be nearly a full percentage point lower in 2008 and nearly 2 percentage points lower in 2009.

The differences between CBO's current forecast and the one released in January are limited to the near term, and the agency's medium-term projections are largely unchanged. (Table 2 compares the previous forecast and the current one.)

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CBO's forecast is generally in line with the *Blue Chip* consensus forecast, although CBO foresees lower inflation and interest rates in the near term than does the *Blue Chip* (see Table 3). The Administration's forecast anticipates stronger growth in the near term, but that forecast was prepared in November 2007, before much of the recent weakness became apparent. CBO's forecast for the longer term is similar to the Administration's.

If you have any questions about the forecast, I would be happy to answer them.

Sincerely,

A handwritten signature in black ink, appearing to read "Peter R. Orszag". The signature is fluid and cursive, with the first name "Peter" being the most prominent.

Peter R. Orszag
Director

cc: Honorable Judd Gregg
Ranking Member

Identical letter sent to the Honorable John M. Spratt Jr.

Table 1.**CBO's Economic Projections for Calendar Years 2008 to 2018**

	Actual 2007	Forecast		Projected Annual Average	
		2008	2009	2010 to 2013	2014 to 2018
Year to Year (Percentage change)					
Nominal GDP (Billions of dollars)	13,843	14,358	14,946	18,278 ^a	22,625 ^b
Nominal GDP	4.9	3.7	4.1	5.2	4.4
Real GDP	2.2	1.9	2.3	3.2	2.5
GDP Price Index	2.7	1.8	1.7	1.9	1.9
PCE Price Index ^c	2.5	2.4	1.8	1.8	1.9
Core PCE Price Index ^d	2.1	1.8	1.8	1.8	1.8
Consumer Price Index ^e	2.9	2.8	1.9	2.1	2.2
Core Consumer Price Index ^f	2.3	2.2	1.9	2.1	2.2
Calendar Year Average (Percent)					
Unemployment Rate	4.6	5.2	5.5	4.9	4.8
Three-Month Treasury Bill Rate	4.4	2.1	2.4	4.6	4.7
Ten-Year Treasury Note Rate	4.6	3.6	3.8	5.1	5.2
Tax Bases (Billions of dollars)					
Economic profits	1,601	1,588	1,588	1,831 ^a	2,310 ^b
Wages and salaries	6,367	6,651	6,936	8,421 ^a	10,364 ^b
Tax Bases (Percentage of GDP)					
Economic profits	11.6	11.1	10.6	10.2	10.0
Wages and salaries	46.0	46.3	46.4	46.2	45.9
Fourth Quarter to Fourth Quarter (Percentage change)					
Nominal GDP	5.1	3.3	4.8	5.1	4.3
Real GDP	2.5	1.6	3.0	3.1	2.4
GDP Price Index	2.6	1.7	1.7	1.9	1.9
PCE Price Index ^c	3.4	1.8	1.8	1.8	1.9
Core PCE Price Index ^d	2.1	1.7	1.8	1.8	1.9
Consumer Price Index ^e	4.0	2.1	1.9	2.1	2.2
Core Consumer Price Index ^f	2.3	2.0	1.9	2.1	2.2

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: GDP = gross domestic product; PCE = personal consumption expenditure.

a. Level in 2013.

b. Level in 2018.

c. The personal consumption expenditure chained price index.

d. The personal consumption expenditure chained price index excluding prices for food and energy.

e. The consumer price index for all urban consumers.

f. The consumer price index for all urban consumers excluding prices for food and energy.

Table 2.**CBO's Current and Previous Economic Projections for Calendar Years
2008 to 2018**

	Actual 2007	Forecast		Projected Annual Average	
		2008	2009	2010 to 2013	2014 to 2018
Nominal GDP (Billions of dollars)					
February 2008	13,843	14,358	14,946	18,278 ^a	22,625 ^b
January 2008	13,828	14,330	14,997	18,243 ^a	22,593 ^b
Nominal GDP (Percentage change)					
February 2008	4.9	3.7	4.1	5.2	4.4
January 2008	4.8	3.6	4.7	5.0	4.4
Real GDP (Percentage change)					
February 2008	2.2	1.9	2.3	3.2	2.5
January 2008	2.2	1.7	2.8	3.1	2.5
GDP Price Index (Percentage change)					
February 2008	2.7	1.8	1.7	1.9	1.9
January 2008	2.5	1.9	1.8	1.9	1.9
Consumer Price Index ^c (Percentage change)					
February 2008	2.9	2.8	1.9	2.1	2.2
January 2008	2.8	2.9	2.3	2.2	2.2
Unemployment Rate (Percent)					
February 2008	4.6	5.2	5.5	4.9	4.8
January 2008	4.6	5.1	5.4	4.9	4.8
Three-Month Treasury Bill Rate (Percent)					
February 2008	4.4	2.1	2.4	4.6	4.7
January 2008	4.4	3.2	4.2	4.6	4.7
Ten-Year Treasury Note Rate (Percent)					
February 2008	4.6	3.6	3.8	5.1	5.2
January 2008	4.6	4.2	4.9	5.2	5.2
Tax Bases (Billions of dollars)					
Economic profits					
February 2008	1,601	1,588	1,588	1,831 ^a	2,310 ^b
January 2008	1,599	1,620	1,649	1,842 ^a	2,320 ^b
Wages and salaries					
February 2008	6,367	6,651	6,936	8,421 ^a	10,364 ^b
January 2008	6,368	6,615	6,913	8,401 ^a	10,354 ^b
Tax Bases (Percentage of GDP)					
Economic profits					
February 2008	11.6	11.1	10.6	10.2	10.0
January 2008	11.6	11.3	11.0	10.3	10.1
Wages and salaries					
February 2008	46.0	46.3	46.4	46.2	45.9
January 2008	46.0	46.2	46.1	46.1	45.9
Memorandum:					
Real Potential GDP (Percentage change)					
February 2008	2.8	2.8	2.7	2.6	2.5
January 2008	2.8	2.8	2.7	2.6	2.5

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: GDP = gross domestic product; percentage changes are measured from one year to the next.

a. Level in 2013.

b. Level in 2018.

c. The consumer price index for all urban consumers.

Table 3.

Comparison of Economic Forecasts by CBO, the Administration, and the *Blue Chip* Consensus for Calendar Years 2008 to 2013

	Actual 2007	Forecast		Projected Annual Average, 2010 to 2013
		2008	2009	
Fourth Quarter to Fourth Quarter (Percentage Change)				
Nominal GDP				
CBO	5.1	3.3	4.8	5.1
Administration	5.1	4.8	5.1	4.9
<i>Blue Chip</i> consensus	5.1	3.8	5.0	n.a.
Real GDP				
CBO	2.5	1.6	3.0	3.1
Administration	2.7	2.7	3.0	2.9
<i>Blue Chip</i> consensus	2.5	1.6	2.8	n.a.
GDP Price Index				
CBO	2.6	1.7	1.7	1.9
Administration	2.3	2.0	2.0	2.0
<i>Blue Chip</i> consensus	2.6	2.2	2.1	n.a.
Consumer Price Index ^a				
CBO	4.0	2.1	1.9	2.1
Administration	3.9	2.1	2.2	2.3
<i>Blue Chip</i> consensus	4.0	2.4	2.3	n.a.
Calendar Year Average (Percent)				
Unemployment Rate				
CBO	4.6	5.2	5.5	4.9
Administration	4.6	4.9	4.9	4.8
<i>Blue Chip</i> consensus	4.6	5.2	5.3	n.a.
Three-Month Treasury Bill Rate				
CBO	4.4	2.1	2.4	4.6
Administration	4.4	3.7	3.8	4.1
<i>Blue Chip</i> consensus	4.4	2.4	3.1	n.a.
Ten-Year Treasury Note Rate				
CBO	4.6	3.6	3.8	5.1
Administration	4.7	4.6	4.9	5.2
<i>Blue Chip</i> consensus	4.6	3.8	4.4	n.a.

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board; Aspen Publishers, Inc., *Blue Chip Economic Indicators* (February 10, 2008); Council of Economic Advisers, Department of the Treasury, and Office of Management and Budget, "Administration Economic Forecast" (joint press release, November 29, 2007).

Notes: The *Blue Chip* consensus is the average of about 50 forecasts by private-sector economists.

The latest *Blue Chip* consensus does not extend past 2009.

GDP = gross domestic product; n.a. = not applicable.

a. The consumer price index for all urban consumers.
