THE ECONOMIC ASSUMPTIONS UNDERLYING THE FISCAL 2011 BUDGET

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I am going to take just a few minutes to summarize the key economic assumptions underlying the fiscal year 2011 budget. As you may know, the Council of Economic Advisers, the Office of Management and Budget, and the Department of the Treasury work together to produce the Administration forecast. Our forecast was finalized on November 17, 2009, and so was based on data through mid-November. As the professional forecasters who contributed to the forecast frequently say, we are economists, not soothsayers. All forecasts are subject to substantial margins of error. And, in the wake of a severe downturn such as we have been through, usual patterns surely provide less guidance than in more ordinary times. But, we have attempted to base the budget projections on our best estimate of what lies ahead.

Real GDP Growth

First, let me talk about our forecast for real GDP growth. In this discussion, I will focus on fourth-quarter to fourth-quarter percent changes because these are the most straightforward to interpret and compare. The Administration forecasts growth of 3 percent in 2010, followed by growth of 4.3 percent in both 2011 and 2012. Our estimate of growth in 2010 is virtually identical to the consensus of private forecasters surveyed by Blue Chip Economic Indicators (Blue Chip) and is right in the middle of the central tendency of the Federal Reserve's Federal Open Market Committee (FOMC) forecast released in November.

Our medium term forecasts are also within the range of other forecasts, but there is substantial variation across the different forecasts. As shown in Chart 2-5 of the *Analytical Perspectives* volume, our average annual GDP growth projection for the five years after the GDP trough is 3.8 percent, similar to the 4.2 percent historical average during recoveries.

The forecast CBO released last week was considerably more pessimistic about 2010 and 2011 than both the Administration forecast and the Blue Chip Consensus. As CBO noted in its release, CBO is required to make forecasts under the assumption that none of the Recovery Act provisions are extended, no new jobs bill is enacted, and all of the 2001/2003 tax cuts expire at the end of the year. CBO's report explained that under the assumption that some of these policies will be extended, its forecast would have looked similar to other forecasts.

Unemployment Rate

For the unemployment rate, the Administration projects that it will end 2010 at 9.8 percent. By the fourth quarter of 2011, the unemployment rate is projected to be 8.9 percent, and by the fourth quarter of 2012, 7.9 percent. These estimates are again in the range of other forecasts for both the short and medium run.

The projections for the unemployment rate reflect the particularly severe toll the recession has taken on the labor market and American workers. To counteract the painfully high rate of unemployment and accelerate the recovery of the labor market, the President has called for a number of targeted actions to jump-start private sector job creation. Among these is the Small Business Jobs and Wages Tax Cut that he announced last week.

Inflation

Finally, for the inflation rate (measured using the GDP price index), we project that inflation will be 1 percent over the four quarters of 2010, 1.4 percent over 2011, and 1.7 percent over 2012. These projections are lower than those of some forecasters and higher than others. The low levels of projected inflation reflect the effects of continued high levels of slack in the economy. Under these conditions, we see little risk of noticeably increased inflation. At the same time, inflationary expectations appear to be well anchored, and so we do not project rapid declines in inflation or deflation. The Administration anticipates that inflation will level off at 1.8 percent, squarely within the Federal Reserve's long-run projection range of 1.7 to 2 percent.

There is no question that the past year has been an incredibly difficult one for the American economy and the American people. Because of the actions taken over the past year, the trajectory of the economy is greatly improved. Real GDP expanded strongly in the fourth quarter of 2009 and shows every sign of continuing to grow steadily. However, as our forecast makes clear, the path back to full employment will take time and continued vigilance. The President is committed to taking every responsible action to accelerate job creation and speed recovery.

Table 1. Economic Forecasts
Administration, CBO, Federal Reserve, and Consensus

	2009	2010	2011	2012
Real GDP (Q4-to-Q4 percent change)				
Actual	0.1			
Administration	-0.5	3.0	4.3	4.3
Federal Reserve, FOMC[1]	-0.4 to -0.1	2.5 to 3.5	3.4 to 4.5	3.5 to 4.8
Blue Chip, Jan 2010	-0.3	2.9	3.2	
CBO[3]	-0.4	2.1	2.4	5.1
Unemployment rate (fourth quarter, percent)				
Actual	10.0			
Administration	10.3	9.8	8.9	7.9
Federal Reserve, FOMC[1]	9.9 to 10.1	9.3 to 9.7	8.2 to 8.6	6.8 to 7.5
Blue Chip, Jan 2010	10.0	9.8	8.9	
CBO[3]	10.1	10.0	9.1	7.2
Price index for GDP (Q4-to-Q4 percent change)				
Actual	0.7			
Administration	0.9	1.0	1.4	1.7
Federal Reserve, FOMC[1] [2]	1.4 to 1.5	1.0 to 1.5	1.0 to 1.6	1.0 to 1.7
Blue Chip, Jan 2010	0.9	1.4	1.7	
CBO[3]	0.9	1.0	0.9	1.1

[1]Central tendency, as published in the Minutes of the November 2009 FOMC meeting.
[2]Core PCE price inflation.
[3]Assumes no ARRA provisons are extended, no jobs bill, and expiration of 2001/2003 tax cuts. The CBO data and the description of the methodology are from *The Budget and Economic Outlook: Fiscal Years 2010 to 2020,* January 2010.