



June 9, 2020

Honorable Nancy Pelosi
Speaker of the House
U.S. House of Representatives
Washington, DC 20515

Re: The Decline in CBO's Projections of Gross Domestic Product for 2020 and 2021

Dear Madam Speaker:

This letter responds to questions from your staff about the worsening of the economic outlook since the start of the 2020 coronavirus pandemic. The letter compares two projections of gross domestic product (GDP): the interim projections for 2020 and 2021 that the Congressional Budget Office published in May 2020, and the projections that the agency published in January 2020.¹

How Much Has CBO's Projection of GDP Fallen?

Nominal GDP is \$3.9 trillion lower over the 2020–2021 period in CBO's May projections than in its January projections (see Table 1). In the May projections, nominal GDP grows an average of zero percent from the fourth quarter of 2019 to the fourth quarter of 2021—the result of a decline in real (inflation-adjusted) GDP offset by some increase in overall prices. In the January projections, by contrast, nominal GDP growth averaged 4.1 percent over that period.

What Were the Largest Components of the Decline?

A \$2.7 trillion downgrade to CBO's projection of consumer spending made the largest contribution to the \$3.9 trillion change in projected GDP over the 2020–2021 period. It accounted for about two-thirds of the decline.

¹ See Congressional Budget Office, *Interim Economic Projections for 2020 and 2021* (May 2020), www.cbo.gov/publication/56351, and *The Budget and Economic Outlook: 2020 to 2030* (January 2020), www.cbo.gov/publication/56020. Unless this letter indicates otherwise, all years referred to are calendar years, not federal fiscal years.

Table 1.

**Difference in Nominal Gross Domestic Product
Between CBO's May 2020 and January 2020 Projections**

Billions of Dollars

	2020				2021				2020- 2021
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Gross Domestic Product	-114	-790	-604	-533	-489	-466	-461	-463	-3,920
Components of Gross Domestic Product									
Consumer Spending	-113	-579	-357	-301	-311	-324	-350	-366	-2,701
Private Investment (Business and residential)	-29	-199	-244	-242	-193	-156	-123	-105	-1,291
Purchases by the Federal Government	1	7	8	9	8	7	7	5	51
Purchases by State and Local Governments	0	-42	-53	-51	-49	-51	-51	-53	-350
Net Exports	28	23	41	52	57	57	57	55	371

Source: Congressional Budget Office.

The differences in the table are expressed at a quarterly rate (not at an annual rate, as commonly presented by the Bureau of Economic Analysis) to capture the actual dollar amount lost. An annual rate would represent a change in production in one quarter as if it persisted for a full year and therefore would be less appropriate in understanding exactly how gross domestic product changed in that one quarter alone.

Because of rounding, the differences shown for components of gross domestic product may not add up to the differences shown for gross domestic product.

Consumer spending is also the largest single component of GDP, making up 68 percent of the total in 2019.

The next largest contribution to the change in projected GDP came from a projected decline in private investment, accounting for \$1.3 trillion (or one-third) of the total. That projected decline arises mainly from a lower forecast of demand for the goods and services that businesses produce. Also, significantly lower oil prices will hit investment in the oil and gas industries disproportionately hard.

How Much Did State and Local Governments' Purchases Contribute to the Decline?

CBO's projection of state and local governments' purchases of goods and services fell by \$350 billion, making up 9 percent of the total decline in

GDP.² State and local governments' purchases accounted for 11 percent of GDP in 2019.³

How Has Recent Legislation Affected GDP?

CBO's May projections incorporated the effects of the pandemic, as well as the mitigating effects of the four laws enacted in March and April to address it and to directly assist households, businesses, and state and local governments affected by the economic downturn. In total, those four laws are projected to increase the federal deficit by \$2.2 trillion in fiscal year 2020 and by \$0.6 trillion in fiscal year 2021. Those amounts are projected to equal about 11 percent of nominal GDP in fiscal year 2020 and 3 percent in fiscal year 2021.

In CBO's assessment, those laws will partially mitigate the deterioration in economic conditions. In particular, greater federal spending and lower revenues will cause real GDP and employment to be higher over the next few years than they would be otherwise. The agency projected last month that the effects of the legislation on economic activity would be largest in the second and third quarters of 2020 and smaller thereafter.

The laws will affect the economy through several channels. For example, the payments and tax credits issued to individuals will boost the overall demand for goods and services by providing resources when many households are experiencing a significant loss in income. In addition, federal assistance for state and local governments will help pay for rising expenditures related to the pandemic as state and local tax revenues fall. Loans, grants, and changes in business tax provisions will provide liquidity to businesses experiencing financial distress because of social distancing and the sudden drop in economic activity, increasing the likelihood they will survive and preserve jobs for their employees until activity picks back

² In the national income and product accounts, the Bureau of Economic Analysis (BEA) reports government spending in three ways: government purchases (which BEA officially refers to as government consumption expenditures and gross investment), government current expenditures, and total government expenditures. For more information, see Bureau of Economic Analysis, "BEA Seems to Have Several Different Measures of Government Spending. What Are They For and What Do They Measure?" (May 28, 2010), www.bea.gov/help/faq/552.

³ State and local governments' purchases have been about three-quarters as large as their total spending over the past few years. State and local governments' total spending includes some items, such as Medicaid expenditures, that are not included in state and local governments' purchases but are instead transfers to people.

up. And payments to health care providers will help support further testing and treatment of COVID-19, the disease caused by the coronavirus.

The boost in overall economic activity from the recent legislation will be tempered by social distancing, in CBO's assessment, especially during the second and third quarters of this year. Continued business closures and the reduction in hours worked mean that the supply of certain goods and services will remain suppressed. At the same time, as people limit their social interactions, household and business demand for many goods and services will be subdued. Therefore, CBO estimates that as long as some degree of social distancing remains in place, the economic boost that might be expected from recent legislation will be smaller than it would be during a period of economic weakness without social distancing. CBO expects that some of the spending by individuals and businesses that is hampered by social distancing will be recovered in the future as stay-at-home orders and other interventions continue to ease.

How Would Additional Federal Funding for State and Local Governments Affect GDP?

CBO expects that additional federal funding for state and local governments would increase output by reducing the size of tax increases and spending cuts enacted by many of those jurisdictions to balance their budgets.⁴ The tax increases avoided, and services provided, would help residents in the short term. Providing such funds to state and local governments would, however, increase the federal deficit, and in the long term, increased federal deficits tend to slow the economy, in CBO's assessment.

CBO estimates that each additional dollar that was used to fund state and local governments by increasing the federal deficit would increase economic output over the next few years by about as much as would a dollar used to fund some policies recently enacted in the Coronavirus Aid, Relief, and Economic Security (CARES) Act, such as the funding provided to state governments for pandemic-related expenses. Other provisions of the CARES Act, such as increases in federal spending on Medicare, are expected to have larger effects on the economy. Still other provisions, such as business tax provisions and refundable tax credits, are expected to have smaller effects—although the size of the effects would depend on the specifics of the provisions and the corresponding extent to which

⁴ See Congressional Budget Office, letter to the Honorable John Yarmuth providing answers to questions related to federal funding for state and local governments (May 13, 2020), www.cbo.gov/publication/56360.

businesses and households spent the funds they received. In addition, funding for state and local governments would have different effects from those of the CARES Act on other outcomes—such as employment and the distribution of income—and on how outcomes vary by sector of the economy, geographic location, and demographic group.

What Is Contributing to the Uncertainty Surrounding CBO’s Projections?

An unusually high degree of uncertainty surrounds CBO’s May economic projections. The agency is particularly uncertain about how the pandemic will unfold this year and next year, how the pandemic and social distancing will affect the economy, how recent policy actions will affect the economy, and how economic data will ultimately be recorded for a period when extreme changes have disrupted standard estimation methods and data sources. Furthermore, if future federal policies differ from those underlying CBO’s economic projections—for example, if lawmakers enact additional pandemic-related legislation—economic outcomes could differ from those presented here.

What Work Does CBO Have Planned?

CBO will continue to evaluate the impact of the pandemic and the trajectory of the U.S. economy. Later this year, the agency will publish a more comprehensive economic forecast covering the years through 2030.

I hope this information is helpful to you. If you have further questions, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Phillip Swagel", with a long, sweeping flourish extending to the right.

Phillip L. Swagel
Director

cc: Honorable Kevin McCarthy
Minority Leader