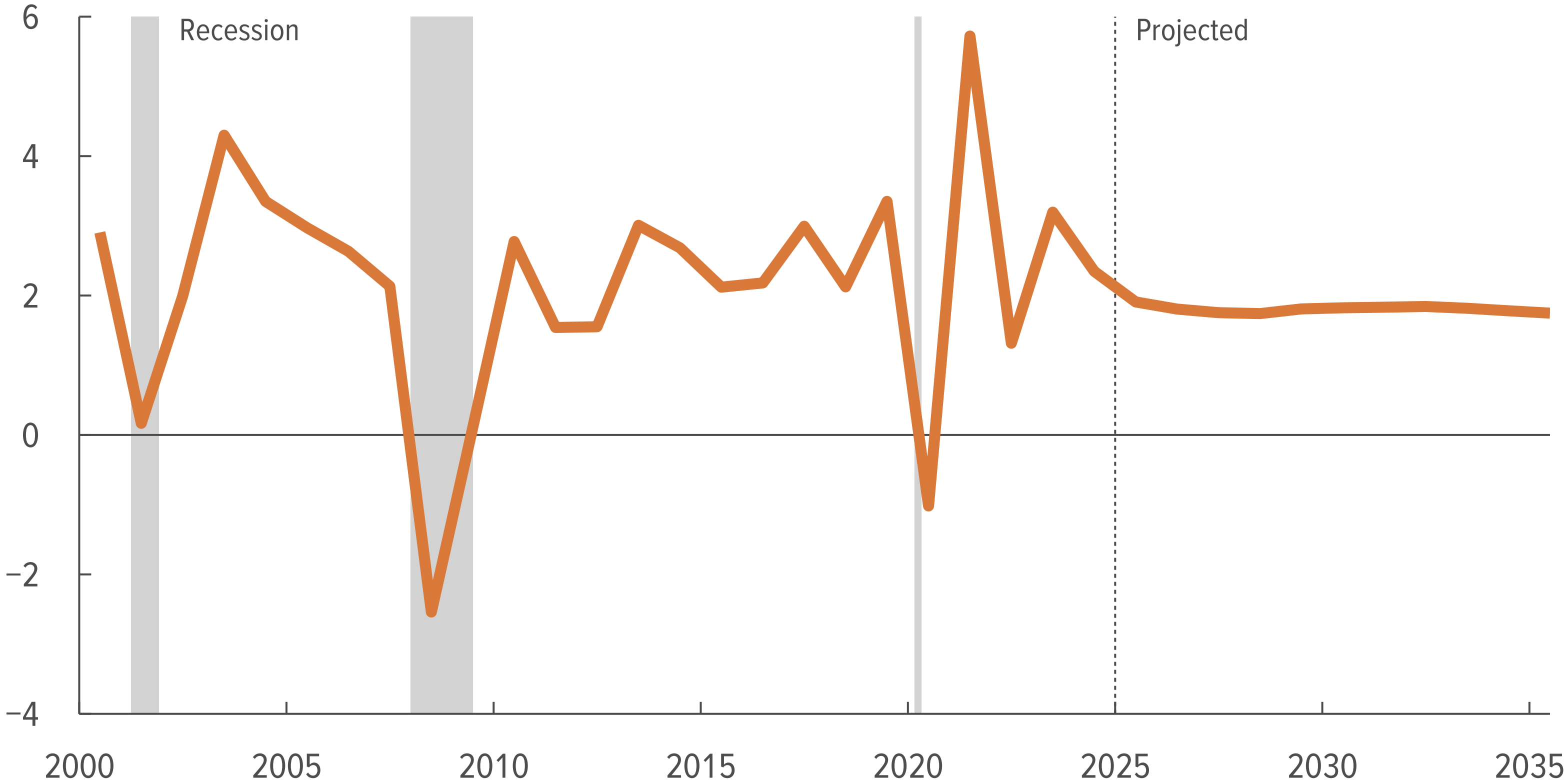
Congressional Budget Office
Nonpartisan Analysis for the U.S. Congress

Additional Information About the Economic Outlook: 2025 to 2035

Growth of Real GDP
Percent



JANUARY | 2025

At a Glance

In this report, the Congressional Budget Office provides additional details about the economic forecast that it published, along with the agency's baseline budget projections, in *The Budget and Economic Outlook: 2025 to 2035* earlier this year. By statutory requirement, CBO produces annual reports outlining the agency's projections of what the federal budget and the economy would look like in the current fiscal year and over the next 10 years if current laws governing federal taxes and spending generally remained in place throughout the projection period. The agency's current economic projections reflect laws enacted and policy measures taken through December 4, 2024.

In CBO's economic projections for the 2025–2035 projection period:

- Economic growth cools in calendar years 2025 and 2026 and then averages roughly 1.8 percent a year from 2027 to 2035;
- Inflation continues to ease over the next two years, reaching the Federal Reserve's target rate of 2 percent by 2027 and stabilizing thereafter; and
- In response to falling inflation, slower job growth, and a rising unemployment rate, the Federal Reserve continues to lower the federal funds rate in 2025 and 2026 and then keeps that rate roughly flat over the remainder of the projection period.

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Notes About This Report

The economic projections in this report reflect developments in the economy as of December 4, 2024, as well as laws enacted and policy measures taken through that date. The projections do not incorporate nonroutine administrative actions taken after that date.

All years referred to in this report are calendar years.

Numbers in the text, tables, and figures may not add up to totals because of rounding.

Unless this report indicates otherwise, historical data shown in the text, tables, and figures describing the economic forecast reflect data available from the Bureau of Economic Analysis and other sources in late January 2025. Those data now contain updated values for the third quarter of 2024, which were not available when the Congressional Budget Office developed its current projections.

Some of the figures in this report use shaded vertical bars indicate recessions, which begin just after a peak in economic activity and run through the subsequent trough.

CBO's economic projections are available at www.cbo.gov/data/budget-economic-data#4. Supplemental data for this analysis are available at www.cbo.gov/publication/61135#data. CBO's website includes a glossary of common budgetary and economic terms (www.cbo.gov/publication/42904) and a description of how CBO prepares its economic forecast (www.cbo.gov/publication/53537).

Additional Information About the Economic Outlook: 2025 to 2035

Overview

Each year, in accordance with statutory requirements, the Congressional Budget Office publishes projections of what it expects the federal budget and the economy to look like in the current fiscal year and over the next 10 years. In this report, CBO provides additional details about the economic forecast it published on January 17, 2025, in *The Budget and Economic Outlook: 2025 to 2035*.

The economic projections in this report reflect developments in the economy as of December 4, 2024. They do not incorporate nonroutine administrative actions taken after that date.[1] Like CBO's baseline budget projections, the agency's economic projections incorporate the assumption that current laws governing federal taxes and spending generally remain in place throughout the projection period.[2] As a result, CBO's projections reflect the scheduled expiration of temporary provisions of the 2017 tax act (Public Law 115-97). The agency's current economic projections reflect laws enacted and policy measures taken through December 4, 2024.

In CBO's economic projections, the economy grows more slowly in calendar years 2025 and 2026 than it did in 2024. Economic growth then averages roughly 1.8 percent a year from 2027 to 2035. CBO expects the rate of inflation to continue to ease over the next two years, reaching 2 percent by 2027 and stabilizing thereafter. In CBO's projections, the Federal Reserve continues to lower the federal funds rate in 2025 and 2026 and keeps the rate roughly flat thereafter.

Gross Domestic Product

Economic output, as measured by the nation's gross domestic product (GDP), grew by an estimated 2.3 percent in 2024 in real terms (that is, adjusted to remove the effects of changes in prices). In CBO's projections, the growth of real GDP moderates to 1.9 percent in 2025 and 1.8 percent in 2026 (see Figure 1). (Unless this report indicates otherwise, all annual growth rates are measured from the fourth quarter of one calendar year to the fourth quarter of the next year.)

The economy then grows at an average annual rate of 1.8 percent from 2027 to 2031. Beyond 2031, CBO's projection of real GDP is driven mainly by its projection of real potential GDP (the amount of real GDP that could be produced if labor and capital were employed at their maximum sustainable rates).

The Labor Market

As economic growth slows through 2027, the demand for labor is expected to soften, slowing the growth of payroll employment.[3] The unemployment rate, which was 4.1 percent in the fourth quarter of 2024, is projected to rise to 4.4 percent in the second half of 2027 and then gradually decline, averaging 4.4 percent from 2028 to 2035 (see Table 1). The labor force participation rate declines through 2035, primarily because of the rising average age of the population.

Inflation

The rate at which overall prices rise each year is expected to have declined during 2024 and is projected to slow further in 2025—to a rate close to the Federal Reserve's long-run goal of 2 percent. In CBO's projections, inflation as measured by the price index for personal consumption expenditures (PCE)—the Federal Reserve's preferred measure of inflation—falls from 2.5 percent in 2024 to 2.2 percent in 2025, reflecting softer demand for labor and slower increases in the cost of housing. Inflation continues to decline gradually and reaches 2.1 percent in 2026. CBO expects inflation to average 2.0 percent a year from 2027 to 2035.

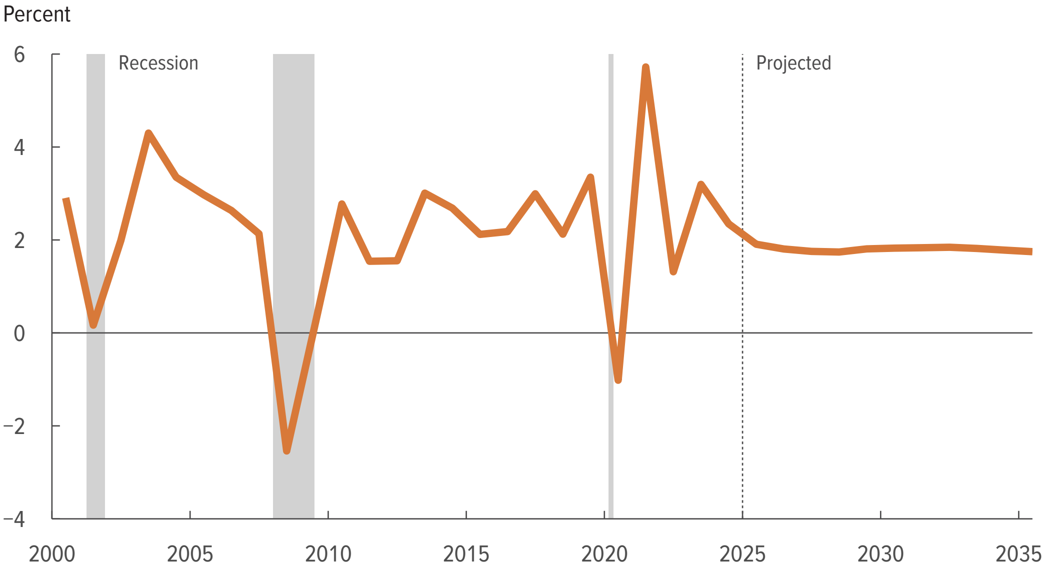
1. Congressional Budget Office, *CBO Explains How It Incorporates Administrative and Judicial Actions When Updating Its Baseline Projections and Producing Cost Estimates* (December 2024), www.cbo.gov/publication/60846.

2. Congressional Budget Office, *CBO Explains How It Develops the Budget Baseline* (April 2023), www.cbo.gov/publication/58916.

3. Payroll employment is the number of employed workers, excluding proprietors, private household employees, unpaid volunteers, farm employees, and unincorporated self-employed workers.

Figure 1.

Growth of Real GDP



In CBO's projections, the growth of economic output slows in 2025 because of a slowdown in spending by consumers and governments.

Data sources: Congressional Budget Office; Bureau of Economic Analysis. See www.cbo.gov/publication/61135#data.

Real GDP is nominal GDP that has been adjusted to remove the effects of changes in prices. Growth of real GDP is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

Recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are annual and are plotted at the midpoint (July 1) of each year.

GDP = gross domestic product.

Interest Rates

Interest rates decline through 2026 and remain roughly steady thereafter. In CBO's projections, the Federal Reserve continues lowering the federal funds rate—to 3.7 percent in the fourth quarter of 2025 and to 3.4 percent in the fourth quarter of 2026—and then keeps the rate roughly steady in later years.[4] The interest rate on 3-month Treasury bills is projected to follow a similar path. The rate on 10-year Treasury notes, which was 4.3 percent in the fourth quarter of 2024, is projected to fall to 4.0 percent in the fourth quarter of 2025 and to 3.9 percent in the fourth quarter of 2026. After that, the 10-year rate is roughly flat in CBO's projections.

Income

As the demand for labor softens, the growth of wages and salaries is projected to slow over the 2025–2035 period. However, GDP is expected to grow more slowly than wages and salaries during that period, so wages and salaries as a percentage of GDP are projected to increase through the end of 2029 and then remain generally stable. Domestic corporate profits as a percentage of GDP are projected to decrease through the end of 2029 and remain roughly steady thereafter.

Uncertainty About the Economic Outlook

CBO develops its projections so that they fall in the middle of the likely range of outcomes under current law (for this report, laws enacted through December 4, 2024). Those projections are highly uncertain, and many factors could lead to different outcomes. That uncertainty arises from various domestic factors as well as from developments outside the United States.

Comparison With CBO's Previous Economic Projections

Real GDP is estimated to have grown more in 2024 than CBO forecast in June 2024, when it published its

4. The Federal Reserve sets a target range for the federal funds rate that is 0.25 percentage points (25 basis points) wide. In this report, the term "federal funds rate" refers to the effective federal funds rate, the median interest rate that financial institutions charge each other for overnight loans of their monetary reserves, weighted by loan volume.

Table 1.

CBO's Economic Projections for Calendar Years 2025 to 2035

Percent

	Estimated, 2024	2025	2026	2027	Annual average 2028–2029	Annual average 2030–2035
			Change from fourth quarter to fourth quarter			
Gross domestic product						
Real[a]	2.3	1.9	1.8	1.8	1.8	1.8
Nominal	4.9	4.1	3.9	3.8	3.8	3.8
Inflation						
PCE price index	2.5	2.2	2.1	2.0	2.0	2.0
Core PCE price index[b]	2.9	2.3	2.1	2.0	2.0	2.0
Consumer price index[c]	2.7[f]	2.3	2.4	2.3	2.2	2.2
Core consumer price index[b]	3.3[f]	2.4	2.3	2.3	2.3	2.3
GDP price index	2.4	2.2	2.0	2.0	2.0	2.0
Employment cost index[d]	3.7	3.5	3.3	3.2	3.0	2.9
Payroll employment (average monthly change, in thousands)[e]	187[f]	90	58	46	52	57
			Fourth-quarter level			
Unemployment rate	4.1[f]	4.3	4.4	4.4	4.4[g]	4.3[h]
			Change from year to year			
Gross domestic product						
Real[a]	2.7	2.1	1.8	1.8	1.8	1.8
Nominal	5.2	4.4	3.9	3.8	3.8	3.8
Inflation						
PCE price index	2.5	2.2	2.1	2.0	2.0	2.0
Core PCE price index[b]	2.8	2.5	2.1	2.0	2.0	2.0
Consumer price index[c]	3.0[f]	2.2	2.4	2.3	2.2	2.2
Core consumer price index[b]	3.4[f]	2.6	2.4	2.3	2.3	2.3
GDP price index	2.4	2.2	2.1	2.0	2.0	2.0
Employment cost index[d]	3.9	3.5	3.4	3.2	3.1	2.9
			Annual average			
Unemployment rate	4.0[f]	4.3	4.4	4.4	4.4	4.4
Interest rates						
Effective federal funds rate[i]	5.1[f]	4.0	3.5	3.3	3.3	3.2
3-month Treasury bills	5.0[f]	3.8	3.3	3.2	3.2	3.1
10-year Treasury notes	4.2[f]	4.1	3.9	3.9	3.9	3.8
Tax bases (percentage of GDP)						
Wages and salaries	42.6	42.8	43.1	43.2	43.5	43.6
Domestic corporate profits[j]	11.4	11.1	10.7	10.3	9.6	9.5

Data sources: Congressional Budget Office; Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve. See www.cbo.gov/publication/61135#data.

GDP = gross domestic product; PCE = personal consumption expenditures.

a. Real values are nominal values that have been adjusted to remove the effects of changes in prices.

b. Excludes prices for food and energy.

c. The consumer price index for all urban consumers.

d. The employment cost index for wages and salaries of workers in private industry.

e. Calculated by dividing by 12 the net change in nonfarm payrolls from the fourth quarter of one calendar year to the fourth quarter of the next year.

f. Actual value for 2024.

g. Value for the fourth quarter of 2029.

h. Value for the fourth quarter of 2035.

i. The median interest rate that financial institutions charge each other for overnight loans of their monetary reserves, weighted by loan volume.

j. Adjusted to exclude the effects of tax rules on depreciation allowances and the effects of changes in prices on the value of inventories.

previous set of 11-year economic projections.[5] CBO is now projecting roughly the same rates of economic growth in 2025 and 2026 that it did last June (2.1 percent and 1.8 percent, respectively). After 2027, the agency's average projected rate of real GDP growth, 1.8 percent, is also unchanged.

In CBO's projections, the average unemployment rate and the average labor force participation rate over the 2025–2026 period are higher than the agency forecast last June. CBO expects the unemployment rate to be lower and the labor force participation rate to be higher, on average, after 2026 than the agency forecast in June.

CBO's current projections of inflation from 2025 to 2035 are similar to its June 2024 projections. The agency has revised its 2024 estimates downward because prices increased less in 2024 than CBO had anticipated, even though economic growth was stronger than expected. For 2025, CBO has raised its projection of inflation as measured by the growth of the PCE price index but has maintained its projection of another measure of inflation, the growth of the consumer price index for all urban consumers (CPI-U).

Short-term interest rates are expected to be lower through 2026 than CBO forecast last June. In the later years of the projection period, short-term interest rates are now expected to be higher and long-term interest rates are now expected to be lower than previously projected.

Over the entire 2024–2034 period, CBO revised its projections of wages and salaries downward as a percentage of GDP and revised its projections of corporate profits upward as a percentage of GDP, in response to revised and new data.

Comparison With Other Economic Projections

To evaluate the quality of its economic projections, CBO regularly compares them with the projections of other forecasters. For this report, the agency looked at recent forecasts of the *Blue Chip Economic Indicators*, the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*, and the Federal Reserve's Federal Open Market Committee and found that CBO's current forecast is within the middle two-thirds of the ranges for most variables reported in those three sources.

5. Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2024 to 2034* (June 2024), www.cbo.gov/publication/60039.

Recent Economic Developments

In CBO's estimates, the U.S. economy grew at a moderate pace in 2024, following strong growth in 2023. Growth of consumer spending, which was strong in 2023, abated slightly in 2024 as growth of disposable income softened. Inflation slowed in 2024—because of looser constraints on the supply of goods affected by disruptions related to the coronavirus pandemic and slower growth of shelter-related prices—but remained above the Federal Reserve's long-run goal. Responding to easing inflation, the central bank began reducing the federal funds rate in September. The growth of the labor force decreased, employment growth slowed, the unemployment rate increased from its postpandemic low of 3.5 percent in early 2023, and the number of job vacancies declined.

Output and the Labor Market

After growing by 3.2 percent in 2023, real GDP grew by an estimated 2.3 percent in 2024. Increases in consumer spending contributed an estimated 1.9 percentage points to that 2.3 percent growth rate, and increases in government spending contributed 0.4 percentage points. Nonresidential investment contributed 0.4 percentage points and residential investment contributed 0.1 percentage point to real GDP growth in 2024. Partly offsetting those factors, a decrease in net exports subtracted 0.6 percentage points from real GDP growth.

Growth in the demand for and supply of labor eased in 2024. Nonfarm payroll employment increased by an average of more than 180,000 jobs per month in 2024, ending the year about 7.2 million jobs (or roughly 5 percent) higher than its prepandemic peak in February 2020. Despite the increase in employment, the unemployment rate rose slightly in 2024—from 3.7 percent at the end of 2023 to 4.1 percent in December 2024—as the labor force expanded more quickly than employment did.[6]

The overall rate of participation in the labor force increased in 2024, mainly because of strong growth in the participation of workers ages 25 to 54.[7] The participation

6. The labor force consists of people age 16 or older in the civilian noninstitutionalized population who have jobs or who are unemployed (available for work and either seeking work or expecting to be recalled from a temporary layoff). The unemployment rate is the percentage of the labor force that is unemployed.

7. The labor force participation rate is the percentage of the civilian noninstitutionalized population age 16 or older that is in the labor force.

rate of workers age 55 or older has not fully recovered from its large drop in the early months of the pandemic.

The number of job openings per unemployed worker decreased in 2024 and is now slightly below its 2019 average. That decrease contributed to a slowdown in the growth of compensation.

Inflation and Interest Rates

Although inflation slowed significantly in 2024, it remained higher than the Federal Reserve's long-run goal of 2 percent. Inflation as measured by the growth of the PCE price index is estimated to have declined from 2.8 percent in 2023 to 2.5 percent in 2024, whereas the annual growth of the CPI-U dropped from 3.2 percent to 2.7 percent. By comparison, PCE inflation averaged 1.8 percent a year from 2000 to 2018, and CPI-U inflation averaged 2.2 percent. Large price increases in 2024 were mostly concentrated in the service sector; the price of many goods either increased slightly or declined. The PCE price index for goods is estimated to have declined by 0.4 percent in 2024, whereas the index for services is estimated to have risen by 3.8 percent.

Some factors that had fueled inflation in prior years, such as pressures on supply chains and steep increases in home prices, eased during 2024. In the first half of the year, the PCE price index grew at an average annual rate of 3.0 percent, driven by large increases in the prices of shelter services and services other than shelter and energy.[8] In the second half of 2024, in CBO's estimates, PCE inflation declined to an average annual rate of 2.0 percent as prices for most services began to grow more slowly and prices for goods continued to decline.

During 2024, new data gave the Federal Reserve greater confidence that inflation is on a sustainable path back to its long-run goal. Additionally, the Federal Reserve judged that the supply and demand for labor have come into better balance, eliminating a potential source of persistent inflationary pressures. As a result, it began lowering the federal funds rate in September 2024. The Federal Reserve lowered that rate by 0.50 percentage points in September and by 0.25 percentage points in both November and December.

In 2024, the interest rate on 10-year Treasury notes averaged 4.2 percent, higher than in any year since 2007. That rate varied substantially during 2024, falling from an average of 4.5 percent in April to an average of 3.7 percent in September before rising to an average of 4.4 percent in December.

Projections of Gross Domestic Product and Its Components

In CBO's projections—which reflect the assumption that current laws (for this report, those enacted through December 4, 2024) governing federal taxes and spending generally remain unchanged—the growth of real GDP cools through 2026. After 2031, the growth of real GDP stabilizes at approximately the same rate as the growth of potential output (the amount of real GDP that can be produced if labor and capital are employed at their maximum sustainable rates).

Specifically, the growth of real GDP, which was an estimated 2.3 percent in 2024, is projected to cool to 1.9 percent in 2025 because of slower growth in spending by consumers and governments (see Table 2). At the end of 2025, the expiration of some provisions of the 2017 tax act will further slow consumer spending, reducing economic growth to 1.8 percent in 2026. From 2027 to 2035, real GDP is projected to grow by 1.8 percent a year, on average, roughly in line with the growth of real potential GDP.

CBO constructs its economic projections by focusing on the interaction in the economy between aggregate supply and aggregate demand.[9] In CBO's short-run economic projections, which generally cover the next two to five years, fluctuations in real GDP are determined mainly by movements in aggregate demand, although they are also affected by supply-related factors, such as immigration, taxes on labor, and factors that affect the cost of new investments.

Over time, businesses are increasingly able to respond to changes in demand and in supply-related factors by altering their inputs to production. Thus, CBO's economic projections for later years mainly reflect the factors that underlie aggregate supply and determine potential output. CBO's assessment of potential output depends on its projections of key factors of production,

8. Shelter services, as defined by the Bureau of Labor Statistics, measure the flow of housing services that housing units provide to their occupants. The prices of such services are a component of inflation as measured by the PCE price index and the CPI-U, whereas home prices are not included in those measures.

9. Aggregate supply is the total productive capacity of the economy, which depends on the supplies of labor, capital, and technology. Aggregate demand consists of consumer spending, business fixed investment, inventory investment, residential investment, government spending, and net exports.

Table 2.

Projected Growth of Real GDP and Its Components

	Estimated, 2024	2025	2026	2027	Annual average 2028–2029	Annual average 2030–2035
	Change from fourth quarter to fourth quarter (percent)					
Real GDP	2.3	1.9	1.8	1.8	1.8	1.8
Components of real GDP						
Consumer spending	2.8	2.0	1.4	1.5	1.8	2.2
Business fixed investment[a]	3.1	2.8	2.8	2.8	2.3	2.7
Residential investment[b]	2.5	6.3	6.6	3.6	1.4	-0.8
Purchases by federal, state, and local governments[c]	2.4	0.2	0.2	0.2	0.1	0.2
Federal	2.7	-0.4	-0.1	-0.1	-0.1	0.2
State and local	2.3	0.6	0.5	0.4	0.3	0.2
Exports	1.7	1.9	3.5	3.8	2.8	2.2
Imports	5.4	2.3	1.8	1.6	1.3	2.3
Inventory investment (billions of 2017 dollars)[d]	16.5	-2.2	6.1	-0.1	1.7	1.1
	Contributions to the growth of real GDP (percentage points)					
Components of real GDP						
Consumer spending	1.9	1.4	1.0	1.0	1.2	1.5
Business fixed investment[a]	0.4	0.4	0.4	0.4	0.3	0.4
Residential investment[b]	0.1	0.3	0.3	0.2	0.1	*
Purchases by federal, state, and local governments[c]	0.4	*	*	*	*	*
Federal	0.2	*	*	*	*	*
State and local	0.2	0.1	0.1	*	*	*
Exports	0.2	0.2	0.4	0.4	0.3	0.2
Imports	-0.7	-0.3	-0.2	-0.2	-0.2	-0.3
Inventory investment[d]	0.1	*	*	*	*	*

Data source: Congressional Budget Office. See www.cbo.gov/publication/61135#data.

Real values are nominal values that have been adjusted to remove the effects of changes in prices.

GDP = gross domestic product; * = between -0.05 and 0.05 percentage points.

a. Purchases of new equipment, nonresidential structures, and intellectual property products (such as software) by private companies and nonprofit institutions.

b. Spending on home construction (new single-family and multifamily structures, manufactured homes, and dormitories), home improvements, and brokers' commissions and other ownership-transfer costs.

c. Based on the national income and product accounts.

d. The change in private inventories.

including hours worked, the supply of capital services (the services provided by capital goods, such as software, equipment, and factories, that constitute the actual input in the production process), and the pace and adoption of technological innovation in the economy.

Expiring Provisions of the 2017 Tax Act

CBO's current economic projections reflect the laws enacted and the policy measures taken through December 4, 2024. As a result, CBO's projections reflect the scheduled expiration of temporary provisions of the 2017 tax act—including the expiration at the end of 2025 of most provisions affecting individual income taxes and the phaseout by the end of 2026 of bonus depreciation provisions for businesses (which allow businesses to immediately deduct a portion of the cost of certain investments). Those expirations are projected to reduce the incentive for people to work and businesses to invest. They are also expected to increase the amount of taxes owed by individuals and corporations.

CBO has separately analyzed the effect of the expiration of the individual income tax provisions at the end of 2025.[10] The agency estimates that expiration will slow

10. Congressional Budget Office, "How the Expiring Individual Income Tax Provisions in the 2017 Tax Act Affect CBO's Economic Forecast" (December 2024), www.cbo.gov/publication/60986.

economic growth in the near term, primarily through its effect on the demand for goods and services in the economy. Such slower growth is incorporated in CBO's baseline, in which real GDP growth is 1.8 percent in 2026 and 2027.

In CBO's economic forecast, the effect of the expiration of the temporary provisions on consumer spending is determined by the distribution of the tax change among different groups of people. Most of the tax change affects people with higher income, who tend to spend a smaller portion of any additional income they receive than people with lower income do. As a result, the effect on consumer spending is limited.

In CBO's forecast, the labor supply responds gradually to expiration because changes in taxes in one year affect the supply of labor over three years. Some people choose to work less in 2026, as soon as expiration occurs. Other people need time to understand the consequences of expiration or expect the provisions to be extended retroactively and thus do not change how much they work until 2027 or 2028.

Consumer Spending

CBO estimates that the growth of real consumer spending slowed to 2.8 percent in 2024. In CBO's projections, the growth of such spending slows further, to 2.0 percent in 2025. Population growth and labor market conditions are among the factors expected to weigh on consumer spending over the next few years. Population growth slows as a surge in immigration that began in 2021 and peaked in 2023 declines, and unemployment increases over the 2025–2027 period. Those factors are partially offset by improvements in credit conditions, such as lower interest rates and looser lending standards.

In 2026, the growth of real consumer spending slows to 1.4 percent, as the scheduled expiration of temporary provisions of the 2017 tax act increases people's payments of individual income taxes. After 2026, consumer spending growth increases gradually, to 1.5 percent in 2027, 1.7 percent in 2028, and 2.0 percent in 2029. Real consumer spending then grows at an average annual rate of 2.2 percent from 2030 to 2035, consistent with the growth of potential output in those years.

Business Investment

CBO expects real business fixed investment—purchases of new equipment, nonresidential structures, and intellectual property products (such as software) by private companies and nonprofit institutions—to increase at a rate of 2.8 percent in 2025 after growing at an estimated annual rate of 5.4 percent during the previous four years. In CBO's projections, slower growth of demand for businesses' products and services reduces businesses' incentive to expand capacity, as does the continued phaseout of bonus depreciation. Within the category of business fixed investment, real investment in nonresidential structures—which is currently at elevated levels because of robust factory construction—is expected to decline modestly this year. By contrast, real investment in equipment and intellectual property products is expected to rise this year.

In CBO's projections, real business fixed investment continues to grow moderately through 2030 because demand for businesses' products and services grows more slowly than potential GDP. Real business fixed investment grows at an average rate of 2.5 percent a year from 2026 to 2030. After that, as the growth rate of GDP reaches the growth rate of potential GDP, the growth of real business fixed investment increases to an average rate of 2.8 percent a year from 2031 to 2035.

CBO anticipates that businesses' investment in real inventories (finished goods, work in process, and materials and supplies) will have little effect on GDP growth in 2025, after adding an estimated 0.1 percentage point to growth in 2024 (see Table 2). Investment in inventories is projected to continue to have little effect on GDP growth in subsequent years.

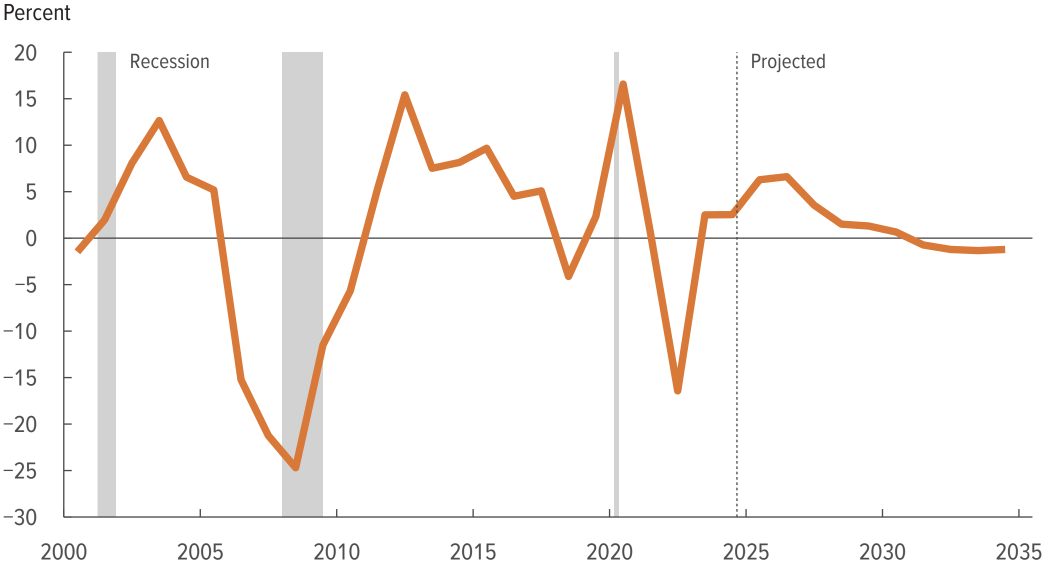
Residential Investment

CBO expects falling mortgage interest rates, pent-up demand, recent rapid population growth, and a scarcity of existing homes for sale to boost demand for new homes, leading real residential investment to rise by 6.3 percent in 2025 and 6.6 percent in 2026 (see Figure 2).[11] Pent-up demand stems from a desire for more living space after the pandemic, whereas rapid population growth is due to the large number of recent immigrants. The expiration of provisions reducing the deductibility of mortgage interest and property taxes boosts investment in owner-occupied housing in 2026, in CBO's estimation.

11. Residential investment includes spending on home construction (new single-family and multifamily structures, manufactured homes, and dormitories), home improvements, and brokers' commissions and other ownership-transfer costs.

Figure 2.

Growth of Real Residential Investment



In 2025 and 2026, real residential investment rises in CBO's projections. Falling mortgage interest rates, pent-up demand, recent rapid population growth, and a scarcity of existing homes for sale boost demand for new homes and bolster residential investment growth.

Data source: Congressional Budget Office. See www.cbo.gov/publication/61135#data.

Real values are nominal values that have been adjusted to remove the effects of changes in prices.

Real residential investment consists of spending on home construction (new single-family and multifamily structures, manufactured homes, and dormitories), home improvements, and brokers' commissions and other ownership-transfer costs.

Recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are annual and are plotted at the midpoint (July 1) of each year.

Net immigration is projected to slow, although it is expected to remain higher than during the 2010–2019 period. Because immigrants tend to live with family or friends initially and form their own households gradually, high rates of immigration from 2022 to 2027 will continue to stimulate construction of new homes during the second half of the 2020s, in CBO's estimation. CBO projects that housing starts (the beginning of construction on new residential housing units) will average more than 1.6 million per year from 2026 to 2030.[12]

Home prices (as measured by the S&P CoreLogic Case-Shiller home price index) rose by an average of 11.9 percent a year from 2020 to 2022 because of rising demand for homes and a limited inventory of existing homes for sale. Price growth cooled to 5.3 percent in 2023 and an estimated 3.6 percent in 2024 as higher mortgage interest rates and high home prices reduced demand. CBO expects the growth of home prices to slow further over the next two years—to 3.1 percent in 2025 and 2.7 percent in 2026 and 2027—before picking up slightly in later years.

Government Purchases

Total real purchases by federal, state, and local governments grew by 2.4 percent in 2024, CBO estimates. If current laws (for this report, those enacted through December 4, 2024) governing federal taxes and spending generally remain in place, those purchases will grow by 0.2 percent in 2025, CBO projects. Real federal purchases, which grew by 2.7 percent in 2024, decline by −0.4 percent in 2025 in CBO's projections because the continuing resolution that was in place when the agency was forecasting the economic baseline did not continue any of the supplemental funding that was provided for aid to Ukraine, Israel, and countries in the Indo-Pacific region in 2024.[13] Additionally, defense discretionary funding

12. Congressional Budget Office, *The Outlook for Housing Starts* (September 2024), www.cbo.gov/publication/60191.

13. The American Relief Act, 2025 (P.L. 118-158), enacted on December 21, 2024, provides $111 billion in funding to a broad range of federal agencies to respond to recent natural disasters and provide related assistance. That additional funding was not enacted in time for CBO to include its effects on the agency's economic forecast.

is projected to be lower than the amounts provided for 2024.[14] Purchases by state and local governments grew by 2.3 percent in 2024 and are expected to grow by 0.6 percent in 2025. That slower growth in 2025 reflects a normalization of state budgets, characterized by modest revenue growth after prior years of substantial increases and a reduction in onetime expenditures largely funded by pandemic-era federal aid to state and local governments, much of which has already expired or is set to expire.

In CBO's projections, real government purchases grow at an average annual rate of 0.2 percent from 2026 to 2035. Federal purchases increase by an average of 0.1 percent a year during that period. Purchases by state and local governments increase at a slightly faster pace during that period, by an average of 0.3 percent a year. That growth is mainly due to ongoing infrastructure projects, including investments in broadband, transportation, public transit, and water systems, funded by the infrastructure grants provided by the Infrastructure Investment and Jobs Act (P.L. 117-58). Although those grant programs began in 2021, their spending is projected to continue throughout the projection period.

Exports and Imports

In CBO's projections, the U.S. trade deficit (the gap between the value of U.S. imports and exports) increases as a percentage of GDP in the first half of 2025 before declining as a percentage of GDP through 2030. The trade deficit grew from 2.8 percent of GDP at the end of 2023 to 3.2 percent in the fourth quarter of 2024, CBO estimates. That estimated increase in the trade deficit in 2024 was driven in large part by strong growth in imports of capital goods (particularly computers and computer parts). For the first half of 2025, CBO projects a continued increase in the trade deficit as a result of continued strong growth in imported goods.

The trade deficit is expected to gradually shrink as a percentage of GDP from the second half of 2025 through 2030 and remain steady thereafter. That projected decline is mainly the result of stronger exports, supported by a weakening dollar and improved economic growth among major U.S. trading partners. During that period, nominal export growth is projected to average 4.8 percent a year, nominal import growth is expected to average 3.5 percent a year, and the trade deficit is expected to decline from 3.3 percent of GDP to 2.5 percent. Beyond 2030, the trade deficit is projected to remain steady at 2.5 percent of GDP as the growth of major U.S. trading partners declines slightly and the dollar's value declines at a slower pace.

Value of the Dollar. CBO's projections of the flow of exports and imports are influenced by its projections of the foreign exchange value of the U.S. dollar. After rising 3.5 percent over the second half of 2024, the exchange value of the dollar is projected to gradually decrease through 2034.[15] Those projections reflect CBO's expectation that interest rates in the United States will fall relative to interest rates in countries that are major U.S. trading partners, causing the value of the dollar to fall against the currencies of those trading partners. In all, CBO expects the foreign exchange value of the dollar to decline by approximately 15 percent between the fourth quarter of 2024 and the end of 2034.

Exports. Real exports are expected to grow this year at roughly the same pace as last year. That steady growth of exports reflects two roughly offsetting factors. One factor is the expected modest strengthening in economic conditions abroad, which would increase international demand for U.S. goods and services. CBO projects that the real economic output of major U.S. trading partners, which is expected to have increased by 1.9 percent in 2024, will grow by 2.1 percent in 2025.[16] Offsetting that increase in the demand for U.S. exports is the stronger dollar, which will reduce the price competitiveness of U.S. exports in international markets. After 2025, as the pace of foreign economic growth returns to its

14. Defense discretionary funding provided by the current continuing resolution is greater than the cap on such funding established by the Fiscal Responsibility Act (P.L. 118-5). The cap currently in effect is $850 billion, $36 billion less than the $886 billion in funding constrained by the cap that was provided in 2024.

15. CBO's measure of the exchange value of the U.S. dollar is an export-weighted average of exchange rates between the dollar and the currencies of leading U.S. trading partners.

16. The projected increase in the economic growth of major U.S. trading partners in 2025 results mostly from faster projected growth in Canada, Japan, and the economies of the euro area. CBO projects that economic growth in Canada will rise in 2025 as the contraction in investment slows and exports rise because of the weaker Canadian dollar. After contracting in 2024, economic growth in Japan is expected to rebound in 2025 as a result of stronger household consumption and investment. In the economies of the euro area, stronger growth of investment is expected to boost economic growth in 2025. CBO expects those factors to subside in 2026 and later years, bringing the growth rate of major U.S. trading partners back to its long-term trend.

prepandemic trend and the weakening dollar makes U.S. exports more competitive in international markets, real exports will grow at a moderate rate, averaging about 3.2 percent a year from 2026 to 2029, CBO projects.

Imports. The growth of imports was strong in 2024, driven by robust demand for imported capital goods. In anticipation of possible increases in U.S. import tariffs, CBO expects strong demand for real imports of goods early this year before the imposition of any additional tariffs. That rise in imports would imply a reduction in demand for imports in later quarters. Consequently, import growth is expected to be weaker over the second half of the year. CBO projects that the slow growth of consumer spending and domestic investment will limit the growth of real imports to 2.3 percent in 2025. Over the following three years, as the growth of consumer spending and investment slows further, the growth of real imports is projected to fall to 1.1 percent in 2028. After 2028, the growth rate of real imports rises as a result of stronger growth in domestic demand, averaging 2.2 percent a year from 2029 to 2034 in CBO's projections.

Potential Output

Although CBO's economic projections for the next several years depend strongly on expected changes in the overall demand for goods and services, the agency's projections for the rest of the 2025–2035 period are fundamentally determined by its assessment of key inputs to potential GDP. Those inputs include the potential number of workers in the labor force, the flow of productive services from the nation's stock of capital assets, and the potential productivity of labor and capital.

In CBO's projections, real potential GDP grows at an average rate of 2.2 percent a year from 2025 to 2029—slightly higher than the average rate since the business cycle peak in 2007—and then grows at an average rate of 1.9 percent a year from 2030 to 2035 (see Table 3). The higher growth rate of potential GDP over the next five years stems mainly from rapid growth in the labor force, reflecting a surge in the rate of net immigration from 2021 to 2027 compared with recent years. Since 2008, the potential labor force has grown by 0.6 percent a year, on average.[17] In CBO's projections, the potential labor force grows at an average annual rate of 0.9 percent from 2025 to 2029 and 0.4 percent from 2030 to 2035. The productivity of the potential labor force (which equals the ratio of real potential GDP to the potential labor force) is projected to grow by an average of 1.3 percent a year from 2025 to 2029 and 1.4 percent a year from 2030 to 2035 (see Figure 3).

Over the next 10 years, the growth rate of real GDP is projected to converge toward the growth rate of real potential GDP. By 2032, the output gap (the difference between actual and potential GDP, expressed as a percentage of potential GDP) narrows to −0.5 percent. It remains at that percentage thereafter, consistent with the long-term relationship between actual and potential output. From 2031 to 2035, the growth of real GDP is projected to average 1.8 percent a year, the same as the growth of real potential GDP.

About three-quarters of the U.S. economy's activity, and the bulk of its productivity growth, occurs in the nonfarm business sector. The potential output of that sector is projected to grow at an average rate of 2.3 percent a year over the 2025–2035 period. About 1.1 percentage points of that growth rate are attributable to growth of the sector's potential total factor productivity (the average real output per unit of combined labor and capital services, excluding the effects of business cycles). An additional 0.7 percentage points of that growth rate are attributable to increases in capital services, and the remaining 0.4 percentage points are attributable to increases in potential hours worked.

Projections of the Labor Market

Conditions in the labor market are expected to soften in the near term as the slowdown in economic growth over the 2025–2027 period moderates the demand for workers. In CBO's projections, the growth of employment wanes through late 2027, while the unemployment rate rises and the growth of wages slows (see Figure 4). The surge in immigration that began in 2021 and peaked in 2023 ebbs over the next few years, and net immigration stabilizes by 2028. That surge is expected to increase the size of the labor force over the entire 2025–2035 period. The percentage of people participating in the labor force is projected to decline through 2035 because of the aging of the population (see Figure 5 on page 14). After 2027, the unemployment rate and labor force participation rate are projected to gradually return to their past long-term average relationship to potential GDP, and the growth of employment, nominal labor compensation, and wages is projected to be slower than it is during the

17. The potential labor force is CBO's estimate of how big the labor force would be if economic output and other key variables were at their maximum sustainable amounts.

Table 3.

Key Inputs in CBO's Projections of Real Potential GDP

Percent

	Average annual growth							Projected average annual growth		
	1950–1973	1974–1981	1982–1990	1991–2001	2002–2007	2008–2024	Overall, 1950–2024	2025–2029	2030–2035	Overall, 2025–2035
Overall economy										
Real potential GDP[a]	4.0	3.1	3.2	3.3	2.3	1.9	3.1	2.2	1.9	2.0
Potential labor force[b]	1.6	2.4	1.6	1.2	1.0	0.6	1.3	0.9	0.4	0.6
Potential labor force productivity[c]	2.3	0.7	1.6	2.0	1.3	1.4	1.7	1.3	1.4	1.4
Nonfarm business sector										
Real potential output	4.1	3.4	3.5	3.8	2.4	2.3	3.3	2.5	2.2	2.3
Potential hours worked	1.4	2.1	1.6	1.4	0.1	0.7	1.2	0.9	0.5	0.6
Capital services[d]	4.3	4.0	3.9	4.2	2.9	2.5	3.7	2.4	2.2	2.3
Potential total factor productivity[e]	1.7	0.6	1.1	1.4	1.4	1.0	1.3	1.1	1.1	1.1
Contributions to the growth of real potential output (percentage points)										
Potential hours worked	0.9	1.4	1.1	0.9	0.1	0.5	0.8	0.6	0.3	0.4
Capital services[d]	1.4	1.3	1.3	1.4	0.9	0.8	1.2	0.8	0.7	0.7
Potential total factor productivity[e]	1.7	0.6	1.1	1.4	1.4	1.0	1.3	1.1	1.1	1.1
Total contribution	**4.0**	**3.4**	**3.4**	**3.8**	**2.4**	**2.3**	**3.3**	**2.4**	**2.1**	**2.3**
Potential labor productivity[f]	2.6	1.2	1.8	2.4	2.3	1.6	2.1	1.6	1.7	1.6

Data source: Congressional Budget Office. See www.cbo.gov/publication/61135#data.

Real values are nominal values that have been adjusted to remove the effects of changes in prices.

The table shows compound annual growth rates over the specified periods. Those rates are calculated from the fourth quarter of the year immediately preceding each period to the fourth quarter of the last year of the period.

GDP = gross domestic product.

a. CBO's estimate of the amount of real GDP that could be produced if labor and capital were employed at their maximum sustainable rates.

b. CBO's estimate of how big the labor force would be if economic output and other key variables were at their maximum sustainable amounts.

c. The ratio of real potential GDP to the potential labor force.

d. The services provided by capital goods (such as software, equipment, and factories) that constitute the actual input in the production process.

e. The average real output per unit of combined labor and capital services, excluding the effects of business cycles.

f. The ratio of potential output to potential hours worked in the nonfarm business sector.

next several years. The unemployment rate is projected to gradually decline starting in late 2028.

For the 2028–2035 period, CBO's projections of employment, the unemployment rate, labor force participation, and hourly compensation mainly reflect the agency's assessment of the overall performance of the economy and the effects of demographic trends over the long term. The aging of the population, low fertility rates, and net immigration are expected to strongly influence the size and composition of the workforce for decades to come.

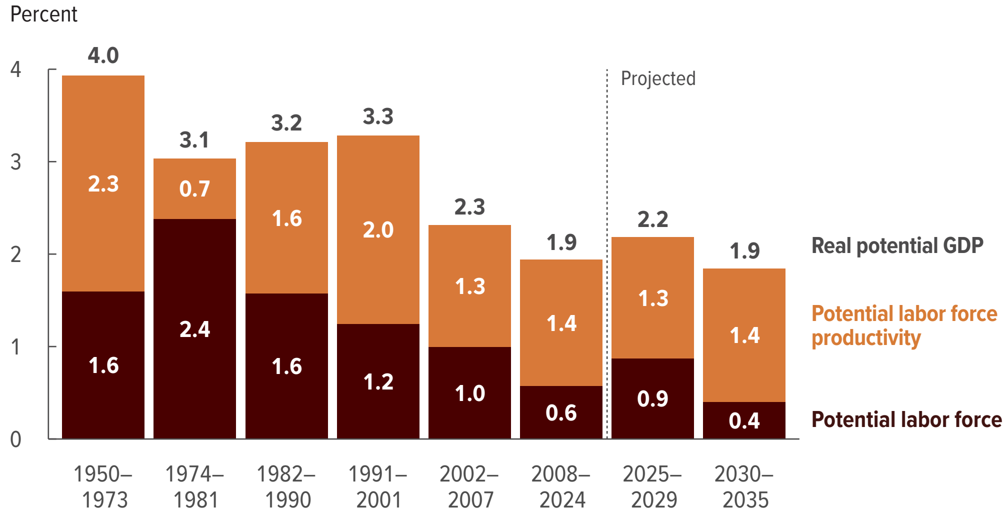
Employment

The growth of nonfarm payroll employment is projected to slacken through 2027 as the slowdown in real output growth dampens the demand for workers. CBO expects employment growth to slow from an average of 90,000 jobs per month, on net, in 2025 to an average of 46,000 jobs per month, on net, in 2027.

The growth of employment is projected to rebound slightly after 2027 but remain below the average increase over the past two decades because of the aging of the population, which causes the labor force

Figure 3.

Average Annual Growth of Real Potential GDP and Its Components



Real potential GDP is projected to grow at an average annual rate of 2.2 percent over the next five years, faster than it has grown since before the 2007–2009 recession. That faster growth stems mainly from a surge in net immigration from 2021 to 2027, which increases the growth of the labor force in CBO's projections.

Data source: Congressional Budget Office. See www.cbo.gov/publication/61135#data.

Real values are nominal values that have been adjusted to remove the effects of changes in prices.

Real potential GDP is CBO's estimate of the amount of real GDP that could be produced if labor and capital were employed at their maximum sustainable rates. Its growth is the sum of the growth of the potential labor force and of potential labor force productivity. The potential labor force is CBO's estimate of how big the labor force would be if economic output and other key variables were at their maximum sustainable amounts. Potential labor force productivity is the ratio of real potential GDP to the potential labor force.

The bars show average annual growth rates over the specified periods. Those rates are calculated using calendar year data.

GDP = gross domestic product.

to grow more slowly from 2028 to 2035. In CBO's projections, nonfarm payroll employment grows by an average of 56,000 jobs per month, on net, over the 2028–2035 period.

Unemployment

The unemployment rate and the number of unemployed people are projected to increase through 2027, reflecting the slowdown in economic growth. The overall unemployment rate was 4.1 percent in the fourth quarter of 2024. In CBO's projections, that rate rises to 4.4 percent by late 2027.

The unemployment rate is projected to decline slightly from 2028 to 2035. That decrease is in line with the projected decline during that period in the noncyclical rate of unemployment (the rate of unemployment resulting from all sources except changes in aggregate demand). That decline reflects the continuing shift in the composition of the workforce toward older workers, who tend to have lower rates of unemployment (when they participate in the labor force), and away from less educated workers, who tend to have higher rates of unemployment.

Labor Force

In CBO's projections, the labor force continues to expand at a moderate pace through 2027. Greater population growth over the next two years, mainly from increased immigration, more than offsets a projected decline in the labor force participation rate due to moderating demand for workers and the aging of the population. A large proportion of recent and projected immigration is expected to include people in the prime working ages of 25 to 54. Despite relatively high participation rates among those immigrants, CBO expects the effects of the aging of the population to reduce the overall labor force participation rate from 62.6 percent in 2024 to 61.9 percent in 2028.

CBO expects the labor force participation rate to keep falling thereafter—from 61.8 percent at the end of 2028 to 61.4 percent at the end of 2035. That decline is likewise due to the aging of the population, particularly the continued retirement of members of the baby boom generation. Consistent with the long-term average relationship between actual and potential output, the labor force participation rate in 2035 is expected to be slightly below CBO's estimate of the potential labor force participation

Figure 4.

Employment, Unemployment, and Wage Growth

In CBO's projections, the number of payroll employees grows more slowly in 2025 and 2026 than it did in 2024 as a slowdown in economic growth dampens the demand for workers.

As a result of that slowdown in economic growth, the unemployment rate rises through 2027.

Less demand for labor and falling inflation slow the growth of nominal wages over the next year. Wage growth declines gradually after 2025 but remains above its 2015–2019 average of 2.7 percent through 2035.

Data sources: Congressional Budget Office; Bureau of Labor Statistics. See www.cbo.gov/publication/61135#data.

Payroll employment is the number of employed workers, excluding proprietors, private household employees, unpaid volunteers, farm employees, and unincorporated self-employed workers. The average monthly change in payroll employment is calculated by dividing by 12 the net change in nonfarm payrolls from the fourth quarter of one calendar year to the fourth quarter of the next year.

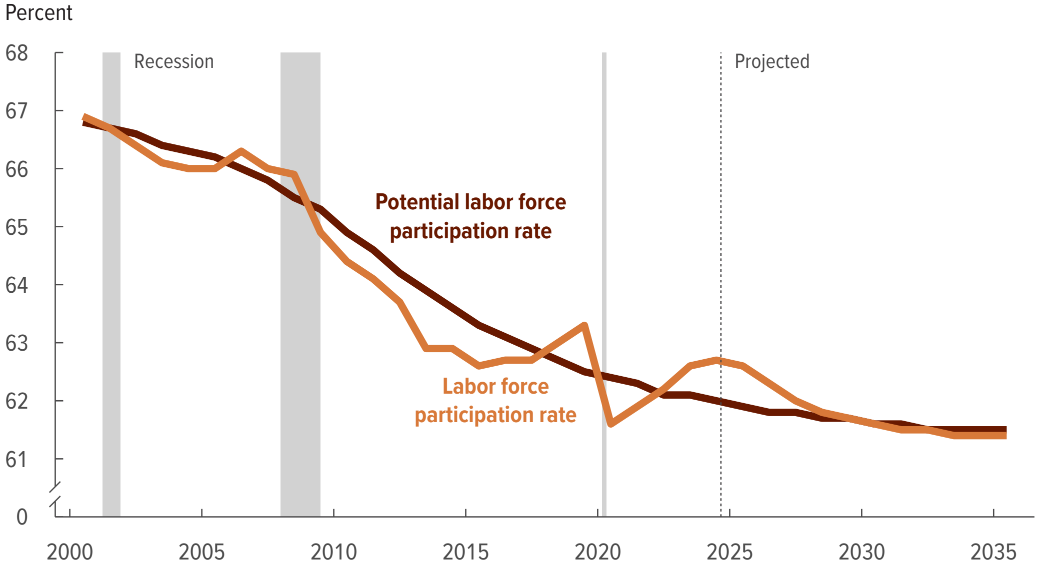
The unemployment rate is the percentage of people in the labor force who are not working but who are available for work and are either seeking work or expecting to be recalled from a temporary layoff. Data for the unemployment rate are fourth-quarter average values.

Wages are measured using the employment cost index for wages and salaries of workers in private industry. Annual wage growth is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

Recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are plotted at the midpoint (July 1) of each year.

Figure 5.

Labor Force Participation



The effects of slowing demand and the aging of the population reduce the overall rate of participation in the labor force from 62.6 percent in 2025 to 61.4 percent in 2035 in CBO's projections.

Data sources: Congressional Budget Office; Bureau of Labor Statistics. See www.cbo.gov/publication/61135#data.

The labor force participation rate is the percentage of people age 16 or older in the civilian noninstitutionalized population who have jobs or who are unemployed (that is, available for work and either seeking work or expecting to be recalled from a temporary layoff). The potential labor force participation rate is CBO's estimate of the rate that would occur if economic output and other key variables were at their maximum sustainable amounts.

Recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are annual and are plotted at the midpoint (July 1) of each year.

rate, which falls from 62.0 percent in 2024 to 61.7 percent in 2028 and 61.5 percent in 2035.

Hourly Wages and Salaries

In CBO's projections, slowing demand for labor and falling inflation restrain the growth of nominal wages. CBO expects the employment cost index for wages and salaries of workers in private industry—a measure of the hourly price of labor, excluding fringe benefits—to grow by 3.5 percent in 2025, down from 3.7 percent in 2024. Wage growth is projected to continue to slow gradually through 2029 but remain above 2.7 percent, its annual average from 2015 to 2019, before the pandemic. Real compensation per hour in the nonfarm business sector—a useful gauge of longer-term trends in labor costs—is projected to grow at an average rate of 1.6 percent a year over the 2029–2035 period, close to the projected average growth of labor productivity in that sector.

Projections of Inflation and Interest Rates

In CBO's projections, inflation continues to slow in 2025 and 2026, as the unemployment rate rises above the noncyclical unemployment rate and the factors that caused demand to grow more rapidly than supply after the pandemic continue to ease. The inflation rate reaches the Federal Reserve's long-run goal of 2 percent in 2026 and averages 2.0 percent from 2027 to 2035.

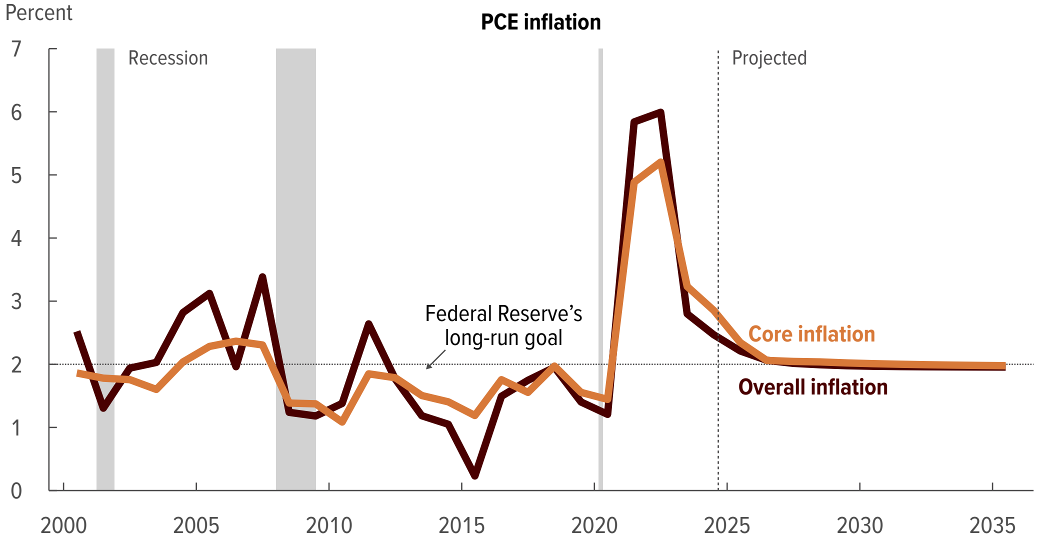
Short-term interest rates are projected to decline in 2025 and 2026. Long-term interest rates are also expected to decline—but by less than the decline in short-term interest rates—in those years. From 2027 to 2035, both short- and long-term interest rates are projected to stay roughly steady.

Inflation

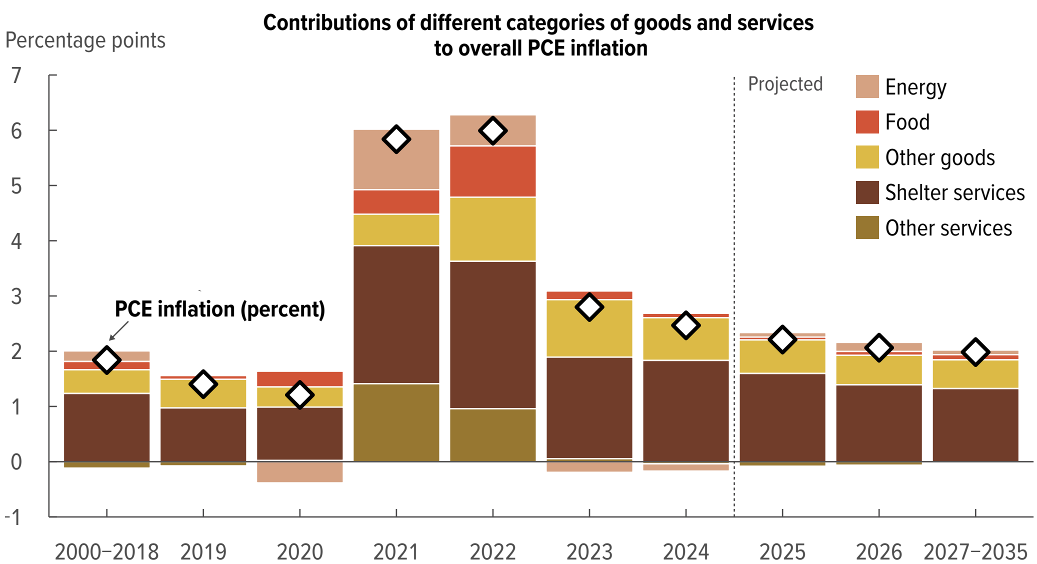
In CBO's projections, inflation slows in 2025 to 2.2 percent and reaches a growth rate roughly consistent with the Federal Reserve's long-run goal in 2027 (see Figure 6, top panel). CBO estimates that the growth rate of the PCE price index—the Federal Reserve's preferred measure of inflation—declined to 2.5 percent in 2024. CBO projects that PCE inflation will continue to fall, reaching 2.2 percent in 2025 and 2.1 percent in 2026. The core PCE price index, which excludes prices for food and energy, is estimated to have grown by 2.9 percent in 2024. Its

Figure 6.

Inflation



In CBO's projections, overall prices, as measured by the PCE price index, increase less in 2025 and 2026 than they did last year, although the overall rate of inflation remains higher than before the pandemic.



Inflation is projected to be lower in 2025 and 2026 than it was in recent years mostly because of the easing of upward pressure on the costs of shelter and other services.

Data sources: Congressional Budget Office; Bureau of Economic Analysis. See www.cbo.gov/publication/61135#data.

The overall inflation rate is the rate of growth of the PCE price index; the core inflation rate excludes prices for food and energy. Inflation is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

In the top panel, recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are annual and are plotted at the midpoint (July 1) of each year.

In the bottom panel, values in the bars represent the contributions, in percentage points, of each category of goods and services to the growth rate of the PCE price index. The sum of those categories' contributions equals the overall growth of that index. Values for 2000 to 2018 and for 2027 to 2035 are annual averages over those periods.

Other goods are core durable and nondurable goods, including vehicles and parts, electronics, home furnishings, and apparel. Shelter services are the flow of housing services that housing units provide to their occupants. Other services include medical services and transportation and recreation services.

PCE = personal consumption expenditures.

growth is expected to decelerate over the next two years, to 2.3 percent in 2025 and 2.1 percent in 2026.

Inflation is projected to be lower in 2025 and 2026 for three main reasons. First, CBO expects that inflation in the prices of goods will remain low in 2025 and 2026 following declines in 2024 (see Figure 6 on page 15, bottom panel). Second, the projected slowdown in economic growth and rise in unemployment in 2025 and 2026 will put downward pressure on prices by slowing demand for goods and services and will put downward pressure on the growth of wages by moderating demand for labor. Third, higher long-term interest rates from 2022 to 2024 put downward pressure on demand for goods and services in spending categories that are sensitive to interest rates because higher interest rates raise the cost of borrowing. Since changes in interest rates can have a delayed effect on prices, CBO expects the downward pressure on inflation from higher interest rates from 2022 to 2024 to persist into 2025 and 2026, causing inflation to ease even as long-term interest rates gradually decline after 2024.

Overall and core inflation as measured by the consumer price index for all urban consumers are projected to return to prepandemic trends more quickly than overall and core PCE inflation. Core CPI-U inflation is usually about 0.3 percentage points higher than core PCE inflation. In 2022 and 2023, growth of the core CPI-U outpaced growth of the core PCE price index by a larger amount because of the greater weight the CPI-U places on shelter costs, which rose faster than other prices. CBO estimates that the gap between those two measures of inflation narrowed toward its long-run average in 2024. However, the agency expects that the gap will become smaller than its historical average after 2024 as price increases ease for categories of goods and services, such as shelter services, that are assigned greater weight in the calculation of the CPI-U.

In CBO's projections for 2027 to 2035, the Federal Reserve achieves its long-run goal of 2 percent inflation. Both core and overall PCE inflation average 2.0 percent a year. Core CPI-U inflation grows by an average of 2.3 percent a year over that period, and overall CPI-U inflation averages 2.2 percent a year. Those rates are consistent with the average difference of 0.3 percentage points between CPI-U and PCE inflation seen during a period of low and stable inflation from 2000 to 2018; the rates are also consistent with the Federal Reserve's long-run goal for PCE inflation.

Interest Rates

CBO projects that in 2025 and 2026, as inflation continues to decline and economic activity continues to moderate, the Federal Reserve will continue lowering the federal funds rate. The federal funds rate is projected to decline to 3.7 percent in the fourth quarter of 2025, decline further to 3.4 percent in the fourth quarter of 2026, and remain roughly steady thereafter (see Figure 7). Interest rates on short-term Treasury securities, such as 3-month Treasury bills, are expected to move largely in concert with changes in the Federal Reserve's target range for the federal funds rate.

In CBO's projections, interest rates on long-term Treasury securities fall through 2026 and remain roughly flat thereafter. In 2025 and 2026, interest rates on long-term Treasury securities are projected to fall along with shorter-term rates, though not by as much. The interest rate on 10-year Treasury notes is projected to decline from 4.3 percent in the fourth quarter of 2024 to 3.9 percent in the fourth quarter of 2026.

After 2026, in CBO's projections, interest rates on short- and long-term Treasury securities are higher than they were, on average, in the decade before the pandemic. Federal debt is larger than it was in that decade, and productivity grows more quickly than it did, pushing up real interest rates. In addition, inflation is projected to be higher than it was before the pandemic, resulting in higher nominal interest rates.

Projections of Income

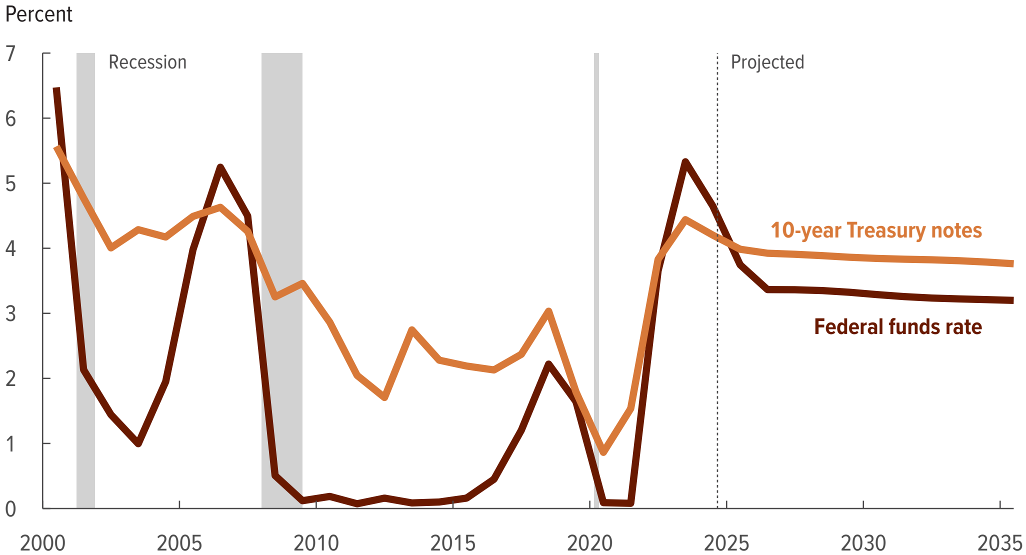
CBO's projections of federal revenues depend, in part, on its projections of the amount of income earned by households, businesses, and governments in the U.S. economy. That income can be divided into categories, such as wages and salaries, corporate profits, and proprietors' income, that are taxed at different rates—and some that are not taxed at all. CBO's projections of the components of income depend on its projections of real output, prices, interest rates, and labor market conditions. The two categories of income that tend to have the largest effect on revenues are wage and salary payments and domestic corporate profits.

Wages and Salaries

The growth of wages and salaries is projected to slow from 2025 to 2029 because of declines in labor force participation, slowdowns in the growth of wage rates, and, over the 2025–2027 period, increases in unemployment. However, GDP is expected to grow more slowly than wages and

Figure 7.

Interest Rates



In CBO's projections, the Federal Reserve continues lowering the federal funds rate—to 3.7 percent in the fourth quarter of 2025 and to 3.4 percent in the fourth quarter of 2026. The 10-year rate declines in 2025 and 2026 by less than short-term rates, restoring the typical relationship between the two.

Data sources: Congressional Budget Office; Federal Reserve. See www.cbo.gov/publication/61135#data.

The federal funds rate shown here is the effective federal funds rate—the median interest rate that financial institutions charge each other for overnight loans of their monetary reserves, weighted by loan volume.

Recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are fourth-quarter averages and are plotted at the midpoint (July 1) of each year.

salaries during the 2025–2029 period. As a result, wages and salaries are projected to increase as a percentage of GDP, from an estimated 42.5 percent at the end of 2024 to 43.6 percent by the end of 2029. From 2030 to 2035, wages and salaries are projected to remain roughly constant as a percentage of GDP, averaging 43.6 percent.

Corporate Profits

Domestic corporate profits, which have been elevated since the pandemic, are expected to experience little growth over the 2025–2029 period as wage costs and interest payments erode companies' profit margins. In CBO's projections, domestic corporate profits fall from an estimated 11.4 percent of GDP at the end of 2024 to 9.4 percent of GDP by the end of 2029 because of increases in wage and salary payments and net interest payments. From 2030 to 2035, domestic corporate profits stay relatively stable as a percentage of GDP, averaging 9.5 percent, close to their average over the past few decades.

Uncertainty About the Economic Outlook

CBO's economic projections are subject to a large amount of uncertainty, both in the short run and beyond. Areas of uncertainty include economic growth, the strength of the labor market, increases in prices and wages, credit conditions and asset prices, productivity growth, interest rates and monetary policy, developments outside the United States, and the effects of previously enacted legislation. Other sources of uncertainty include rare, hard-to-predict events that would have significant economic consequences, such as wars, pandemics, natural disasters, and financial crises.

CBO's baseline projections reflect the assumption that current laws governing federal taxes and spending generally remain in place. The agency's current projections reflect the laws enacted and the policy measures taken through December 4, 2024. Although new laws could be enacted that significantly alter federal taxes and spending, the following discussion is restricted to uncertainty stemming from other sources.

Uncertainty in the Short Run

The paths of wage growth, inflation, and economic growth are key contributors to the uncertainty of CBO's projections for the next few years. If inflation ended up being higher than CBO projects, the Federal Reserve would probably slow or even pause its interest rate cuts. Alternatively, weaker economic growth in the short term could reduce inflationary pressures more rapidly than CBO projects, leading to lower interest rates.

Growth of Wages and Prices. The rates at which wages and consumer prices will increase in coming years is highly uncertain. For wage growth, that uncertainty is related to how much the economy grows, how the demand for labor responds to economic growth, how changes in the demand for labor affect wage growth, and how past inflation feeds into wages in the future. If wages were to grow more rapidly than CBO projects, businesses could pass along the cost of higher wages to consumers by raising prices, which might result in higher inflation than the agency projects. Conversely, slower-than-expected wage growth might result in lower inflation than CBO projects.

The price of shelter services is another source of uncertainty. CBO estimates that growth in the PCE category of shelter services slowed in 2024, and it is projected to continue to slow in 2025 because of slower growth in the price of new rental agreements. Because of the way in which shelter services are calculated, new rental agreements have a delayed effect on overall shelter costs. Thus, it is difficult to predict the size and timing of the slowdown in shelter services inflation, and growth in those prices could be larger or smaller than CBO projects. In turn, the rates of PCE inflation and CPI-U inflation could be lower or higher than CBO projects.[18]

CBO's projections of inflation depend in part on people's expectations about price increases. (When people expect prices to rise significantly in the future, they tend to buy more now, thus fueling price increases.)[19] If inflation ended up higher than CBO projects for an extended period, inflation expectations could rise more materially, and inflation could be higher than the agency projects. Alternatively, if inflation turned out to be lower than expected, consumers could revise their long-run inflation expectations downward, and inflation could be lower than the agency projects. In CBO's projections, long-run inflation expectations remain firmly anchored near the Federal Reserve's long-run goal of 2 percent; however, inflation expectations could become unanchored because of proposed changes to tariff policy. For example, if consumers believed that those changes would raise the cost of goods and that the cost of goods would continue to rise, inflation expectations could become unanchored.

Growth of the Economy. CBO's forecast of slowing growth through 2027 is highly uncertain. A key source of uncertainty is the future path of interest rates. Higher-than-expected inflation would probably cause the Federal Reserve to lower interest rates more slowly than CBO anticipates. Those higher interest rates would put further downward pressure on interest-sensitive sectors of the economy, such as residential investment, net exports, and business investment. Alternatively, if inflation slowed more rapidly than CBO projects, interest rates would probably fall faster than the agency anticipates, helping interest-sensitive sectors of the economy.

Another important area of uncertainty is the size of the effects of interest rates on those interest-sensitive sectors. CBO's projected decrease in mortgage interest rates could have a larger or smaller effect on the construction of new homes and the sale of existing homes than CBO projects.[20] The purchase of a home often leads to the purchase of related consumer goods, so a different path for home sales would have downstream effects on consumer spending. Likewise, a rise in the exchange value of the dollar stemming from higher interest rates could have a larger or smaller effect on net exports than CBO projects. And the change in business investment in response to higher borrowing costs could be bigger or smaller than forecast.

The outlook for consumer spending is also uncertain. Consumer spending depends on the strength of the labor market, both directly through income and indirectly through consumer confidence. If unemployment rose less than expected, people would have more income to spend on discretionary goods and services. Furthermore, consumer confidence could be higher than expected if there was less uncertainty about future employment. Conversely, if unemployment rose more than expected, people might rein in their spending.

Consumer spending also depends on credit conditions. If conditions for consumer credit (such as interest rates and lending standards) were more restrictive than expected, some people might not be able to finance large

18. Chandler Lester, *How CBO Projects Inflation*, Working Paper 2024-01 (Congressional Budget Office, February 2024), www.cbo.gov/publication/59877.

19. For more information about the connection between inflation expectations and actual inflation, see Jeffrey Schafer, *Inflation Expectations and Their Formation*, Working Paper 2022-03 (Congressional Budget Office, March 2022), pp. 4–5, www.cbo.gov/publication/57398.

20. Congressional Budget Office, *The Outlook for Housing Starts* (September 2024), www.cbo.gov/publication/60191.

purchases, such as cars or furniture, and they might have to reduce credit card spending.

Uncertainty Beyond the Short Run

Areas of uncertainty that have particularly large implications for CBO's projections after the next few years include productivity growth, the demand for Treasury securities from U.S. and foreign investors, and net immigration. Higher rates of productivity growth would boost economic growth and interest rates above what CBO projects; lower rates of productivity growth would dampen economic growth and interest rates relative to CBO's projections. If investors' demand for Treasury securities fell short of or exceeded CBO's expectations, interest rates and the federal government's interest payments on its debt would be higher or lower than projected. Higher or lower rates of net immigration than CBO projects would increase or slow the growth of the labor force, leading to an increase or decrease in hours worked and overall economic growth compared with what the agency projects.

Productivity. Factors such as the pace and adoption of technological innovation contribute to uncertainty about productivity growth beyond the short run. Technologies that have a wide application to many production processes, such as artificial intelligence, increase productivity growth in the long run but take time to diffuse through the economy.[21] Moreover, the process of adopting those technologies could temporarily reduce productivity growth.

Demand for U.S. Federal Debt. Another area of uncertainty is the demand for Treasury securities from U.S. and foreign investors and the effect of that demand on the interest rates the federal government will pay on its rising stock of debt. One factor that could affect the demand for Treasury securities is the international importance of the U.S. dollar.[22] If use of the dollar to settle international transactions and foreign holdings of U.S. dollars and dollar-denominated assets were to shrink faster than CBO expects, foreign demand for Treasury securities would be lower than expected, and interest rates would be higher than anticipated. But if foreign demand for Treasury securities was stronger than projected, perhaps because of heightened geopolitical concerns, interest rates would be lower.

Uncertainty about the path of interest rates in the long term contributes to uncertainty about the economic effects of larger federal deficits and debt. CBO estimates that factors such as increased saving in the United States and other countries, slower growth of total factor productivity, and lower labor force participation have contributed to the downward trend in U.S. interest rates over the past several decades. Great uncertainty remains about how much those factors will continue to affect interest rates over the 2025–2035 period and beyond. In addition, both the extent to which projected increases in federal debt would put upward pressure on interest rates and the timing of that effect are highly uncertain.[23]

Immigration. Several factors contribute to the uncertainty of CBO's projections of net immigration. The surge in net immigration since 2021—which, CBO estimates, peaked in 2023 and is expected to slow but remain above its long-run average through 2027—could be smaller or larger than the agency forecasts.[24] For example, changing conditions in immigrants' countries of origin could affect the amount of immigration significantly. In addition, estimates and projections of net immigration by some groups, such as people who enter the country illegally, are particularly uncertain, as are projections of those groups' impact on economic activity as measured by GDP and other indicators.

Quantifying the Uncertainty of CBO's Projections

CBO's economic projections, especially for nominal GDP, are a primary input in the agency's baseline budget projections. Thus, the uncertainty of the economic forecast is the source of much of the uncertainty of the baseline budget projections.

To quantify the uncertainty of its economic projections for 2025 to 2028, CBO conducted 1,000 simulations of several key macroeconomic variables to produce probability distributions for the future path of those

21. Congressional Budget Office, *Artificial Intelligence and Its Potential Effects on the Economy and the Federal Budget* (December 2024), www.cbo.gov/publication/60774.

22. Daniel Fried, *The U.S. Dollar as an International Currency and Its Economic Effects*, Working Paper 2023-04 (Congressional Budget Office, April 2023), www.cbo.gov/publication/58764.

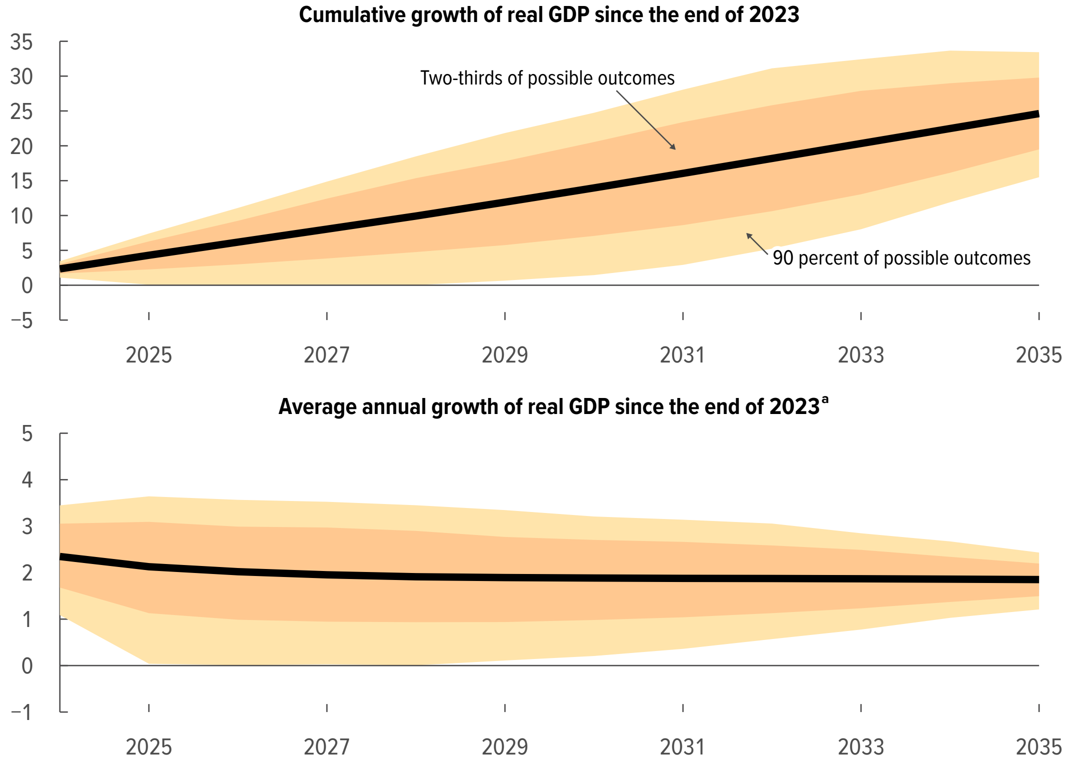
23. Andre R. Neveu and Jeffrey Schafer, *Revisiting the Relationship Between Debt and Long-Term Interest Rates*, Working Paper 2024-05 (Congressional Budget Office, December 2024), www.cbo.gov/publication/60314.

24. Congressional Budget Office, *Effects of the Immigration Surge on the Federal Budget and the Economy* (July 2024), www.cbo.gov/publication/60165.

Figure 8.

Uncertainty of CBO's Projections of the Growth of Real GDP

Percent



CBO estimates that there is approximately a two-thirds chance that from the end of 2023 to the end of 2035, real GDP will grow by a total of between 19.5 percent and 29.8 percent, for an average annual growth rate over the 2024–2035 period of between 1.5 percent and 2.2 percent.

Data sources: Congressional Budget Office; Bureau of Economic Analysis; Bureau of Labor Statistics. See www.cbo.gov/publication/61135#data.

To quantify the uncertainty of its projections for the next 10 years, CBO conducted 1,000 simulations of real GDP growth to produce probability distributions for the future path of that growth. For a discussion of the methods used to quantify uncertainty, see Congressional Budget Office, "Estimating the Uncertainty of the Economic Forecast Using CBO's Expanded Markov-Switching Model" (January 2023), www.cbo.gov/publication/58884, and "Estimating the Uncertainty of the Economic Forecast Using CBO's Bayesian Vector Autoregression Model" (January 2023), www.cbo.gov/publication/58883.

Real GDP is nominal GDP that has been adjusted to remove the effects of changes in prices. Annual growth of real GDP is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

GDP = gross domestic product.

a. Average annual growth is measured from the end of 2023 to the year plotted, so the value for 2026, for example, is the average of annual growth in 2024, 2025, and 2026.

variables.[25] On the basis of that analysis, CBO estimates that there is approximately a two-thirds chance that the annual rate of real GDP growth since 2023 will be between 1.1 percent and 3.1 percent by the end of 2025 and between 1.5 percent and 2.2 percent by the end of 2035 (see Figure 8).

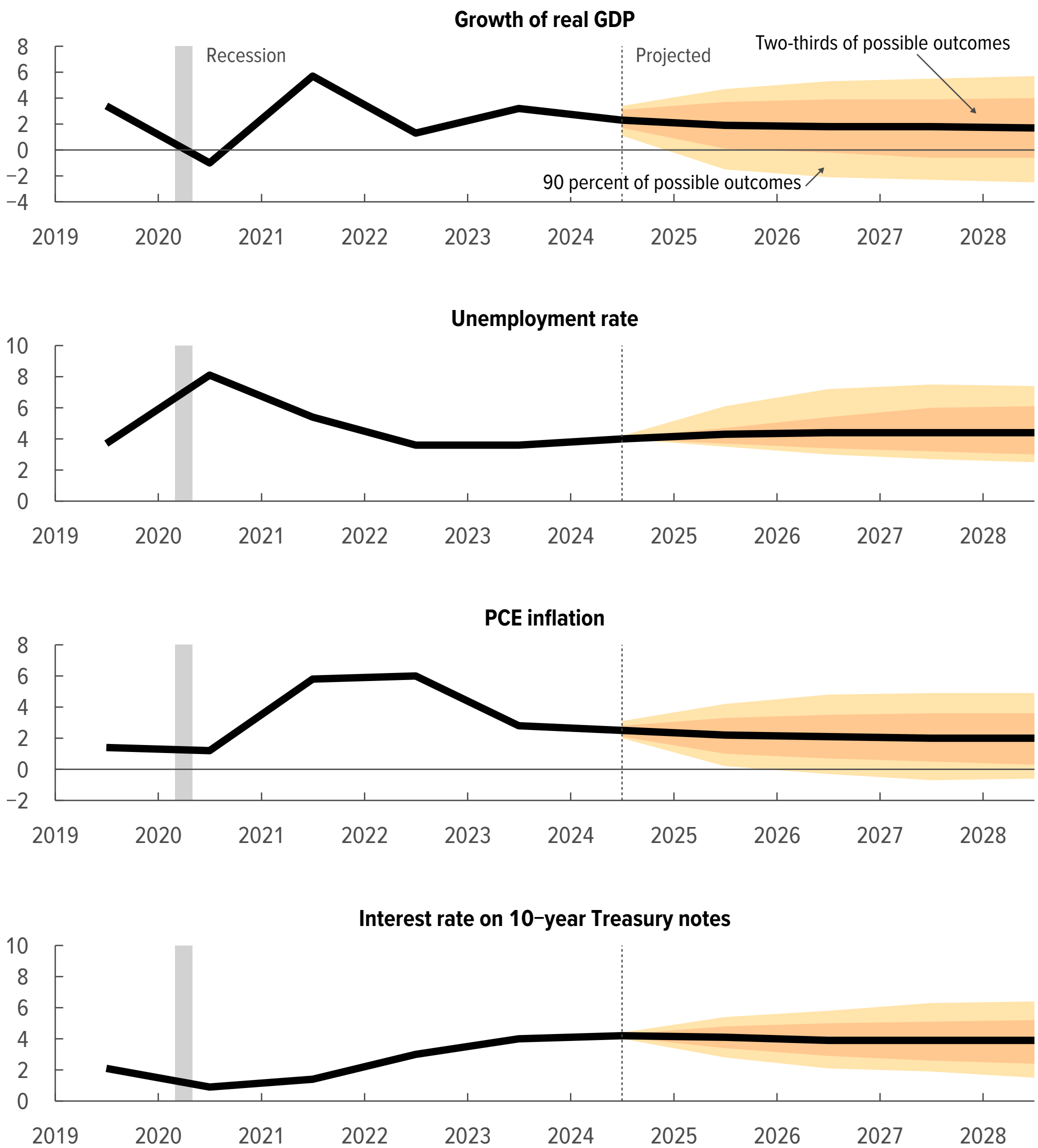
In addition, there is roughly a two-thirds chance that, in 2025, the unemployment rate will be between 3.7 percent and 4.7 percent, the rate of PCE inflation will be between 1.0 percent and 3.3 percent, and the interest rate on 10-year Treasury notes will be between 3.4 percent and 4.8 percent, CBO estimates (see Figure 9).

25. For a discussion of the methods used to quantify uncertainty, see Congressional Budget Office, "Estimating the Uncertainty of the Economic Forecast Using CBO's Expanded Markov-Switching Model" (January 2023), www.cbo.gov/publication/58884, and "Estimating the Uncertainty of the Economic Forecast Using CBO's Bayesian Vector Autoregression Model" (January 2023), www.cbo.gov/publication/58883.

Figure 9.

Uncertainty of CBO's Projections of Output, Unemployment, Inflation, and Interest Rates

Percent



CBO estimates that there is approximately a two-thirds chance that . . .

. . . the annual growth rate of real GDP will be between 1.7 percent and 3.1 percent in 2025 and between −0.6 percent and 4.0 percent in 2028.

. . . the average unemployment rate in 2025 will be between 3.7 percent and 4.7 percent.

. . . the inflation rate in 2025, as measured by the PCE price index, will be between 1.0 percent and 3.3 percent.

. . . the average interest rate on 10-year Treasury notes in 2025 will be between 3.4 percent and 4.8 percent.

Data sources: Congressional Budget Office; Bureau of Economic Analysis; Bureau of Labor Statistics. See www.cbo.gov/publication/61135#data.

To quantify the uncertainty of its projections for the next four years, CBO conducted 1,000 simulations of several key macroeconomic variables to produce probability distributions for the future path of those variables. For a discussion of the methods used to quantify uncertainty, see Congressional Budget Office, "Estimating the Uncertainty of the Economic Forecast Using CBO's Expanded Markov-Switching Model" (January 2023), www.cbo.gov/publication/58884, and "Estimating the Uncertainty of the Economic Forecast Using CBO's Bayesian Vector Autoregression Model" (January 2023), www.cbo.gov/publication/58883.

Real GDP is nominal GDP that has been adjusted to remove the effects of changes in prices. Growth of real GDP is measured from the fourth quarter of one calendar year to the fourth quarter of the next year. The unemployment rate is the percentage of people in the labor force who are not working but who are available for work and are either seeking work or expecting to be recalled from a temporary layoff. Data for the unemployment rate and the interest rate on 10-year Treasury notes are annual averages. The inflation rate based on the PCE price index is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

Recessions, which begin just after a peak in economic activity and run through the subsequent trough, are plotted using monthly data; all other data are annual and are plotted at the midpoint (July 1) of each year.

GDP = gross domestic product; PCE = personal consumption expenditures.

Table 4.

CBO's Current and Previous Economic Projections for Calendar Years 2024 to 2034

Percent

	2024	2025	2026	Annual average: 2024–2028	Annual average: 2029–2034	Annual average: Overall, 2024–2034
	Change from fourth quarter to fourth quarter					
Real GDP[a]						
January 2025	2.3	1.9	1.8	1.9	1.8	1.9
June 2024	2.0	2.0	1.8	1.9	1.8	1.8
Nominal GDP						
January 2025	4.9	4.1	3.9	4.1	3.8	3.9
June 2024	4.6	4.1	3.6	3.9	3.8	3.9
Inflation						
PCE price index						
January 2025	2.5	2.2	2.1	2.2	2.0	2.0
June 2024	2.7	2.1	1.9	2.1	2.0	2.0
Core PCE price index[b]						
January 2025	2.9	2.3	2.1	2.3	2.0	2.1
June 2024	3.0	2.3	2.1	2.3	2.0	2.1
Consumer price index[c]						
January 2025	2.6	2.3	2.4	2.4	2.2	2.3
June 2024	3.0	2.3	2.2	2.4	2.2	2.3
Core consumer price index[b]						
January 2025	3.2	2.4	2.3	2.5	2.3	2.4
June 2024	3.4	2.5	2.3	2.6	2.2	2.4
GDP price index						
January 2025	2.4	2.2	2.0	2.1	2.0	2.0
June 2024	2.6	2.0	1.8	2.0	2.0	2.0
Employment cost index[d]						
January 2025	3.7	3.5	3.3	3.3	3.0	3.1
June 2024	4.0	3.5	3.3	3.4	3.0	3.2
Real potential GDP[e]						
January 2025	2.3	2.3	2.3	2.2	1.9	2.1
June 2024	2.1	2.2	2.1	2.1	1.9	2.0

Continued

Comparison With CBO's June 2024 Economic Projections

Since June 2024, when CBO published its previous full economic forecast, the agency's projections of the average growth rate of real GDP over the 2024–2026 period have changed little (see Table 4). CBO raised its forecast of the average unemployment rate for 2024 to 2026 and lowered its forecast of employment growth over that period. Inflation is expected to be slightly higher, on average, in 2025 and 2026 than the agency projected in June 2024. The forecast of long-term interest rates for 2026 is also higher. After 2026, CBO's current and previous forecasts are generally similar. Comparing the latest projections with those published in June illuminates aspects of the current economic forecast and highlights the kinds of uncertainty that affect all such projections.

Output

CBO's current projections of the average growth rate of real GDP over the 2024–2026 period are roughly unchanged from its June 2024 projections. After 2026, growth of real GDP is now projected to be similar to what CBO expected last summer, averaging 1.8 percent a year over the 2027–2034 period. CBO's projections of the size of nominal GDP are larger throughout the 2024–2034 period than they were previously, in part because of upward revisions to earlier data about GDP. Nominal GDP is now projected to be about 2.3 percent larger in 2034 than CBO projected last June.

Table 4. Continued

CBO's Current and Previous Economic Projections for Calendar Years 2024 to 2034

Percent

	2024	2025	2026	Annual average: 2024–2028	Annual average: 2029–2034	Annual average: Overall, 2024–2034
				Annual average		
Unemployment rate						
January 2025	4.0	4.3	4.4	4.3	4.4	4.3
June 2024	3.9	4.0	4.2	4.2	4.5	4.3
Interest rates						
Effective federal funds rate[f]						
January 2025	5.1	4.0	3.5	3.9	3.3	3.5
June 2024	5.3	4.8	3.8	4.1	3.0	3.5
3-month Treasury bills						
January 2025	5.0	3.8	3.3	3.7	3.1	3.4
June 2024	5.2	4.5	3.6	3.8	2.8	3.3
10-year Treasury notes						
January 2025	4.2	4.1	3.9	4.0	3.8	3.9
June 2024	4.5	4.1	3.7	3.9	4.0	3.9
Tax bases (percentage of GDP)						
Wages and salaries						
January 2025	42.6	42.8	43.1	43.0	43.6	43.3
June 2024	43.3	43.5	43.7	43.6	43.9	43.8
Domestic corporate profits[g]						
January 2025	11.4	11.1	10.7	10.7	9.5	10.0
June 2024	10.2	10.1	9.8	9.8	9.0	9.4

Data source: Congressional Budget Office. See www.cbo.gov/publication/61135#data.

GDP = gross domestic product; PCE = personal consumption expenditures.

a. Real values are nominal values that have been adjusted to remove the effects of changes in prices.

b. Excludes prices for food and energy.

c. The consumer price index for all urban consumers.

d. The employment cost index for wages and salaries of workers in private industry.

e. CBO's estimate of the amount of real GDP that could be produced if labor and capital were employed at their maximum sustainable rates.

f. The median interest rate that financial institutions charge each other for overnight loans of their monetary reserves, weighted by loan volume.

g. Adjusted to exclude the effects of tax rules on depreciation allowances and the effects of changes in prices on the value of inventories.

The Labor Market

CBO's projection of the average unemployment rate for 2024 to 2026 is 4.2 percent—compared with 4.0 percent in the agency's June 2024 projection. That revision is mainly the result of the higher-than-expected unemployment rate at the end of 2024, which CBO expects will persist over the next few years. In CBO's projections, the unemployment rate starts higher but ends lower over the 2027–2034 period than it did in the June forecast. At the end of 2034, the unemployment rate is expected to be 4.3 percent, or 0.1 percentage point lower than in CBO's previous forecast.

That revision is due to a change in the agency's method for estimating the noncyclical rate of unemployment. The new method improves on the earlier method by incorporating information about wage and price inflation to estimate the noncyclical unemployment rate. Over the projection period, movements in the noncyclical unemployment rate are based solely on CBO's assessment of changes in the shares of the labor force for detailed demographic groups. Under the new method, a larger proportion of the labor force is expected to be composed of people who experience lower average unemployment rates.

CBO revised its projection of average employment growth downward over the 2024–2034 period. That downward revision resulted from a change in the way that CBO models the relationship between employment and potential employment in the medium to long run. The agency now projects the level of employment to be slightly below the potential level of employment after 2028, which is consistent with the relationship between actual and potential output. That change resulted in a slower growth in employment over the 2024–2034 period than CBO previously projected.

The labor force participation rate is projected to be higher, on average, over the 2024–2034 period than in CBO's June forecast. The agency expects the labor force participation rate to average 61.9 percent, compared with 61.7 percent in its previous forecast for that period. That upward revision is partly the result of the higher-than-expected labor force participation rate at the end of 2024, which CBO expects to persist over the next few years. A larger factor in the revision, however, is a change in the agency's method for estimating the potential labor force participation rate. CBO uses that new method to estimate the potential labor force participation rates for detailed demographic groups over time. Those rates are held constant over the projection period, and changes in the population shares of those demographic groups produce changes in the potential labor force participation rate. The revised method resulted in a potential labor force participation rate that is roughly 0.3 percentage points higher at the end of 2034 than the rate in the June forecast.

Inflation

CBO now expects inflation to be lower in 2024, as measured by the PCE price index, than it forecast last June: 2.5 percent instead of 2.7 percent. In June, the agency projected that CPI-U inflation in 2024 would be 3.0 percent; CPI-U inflation in 2024 was 2.7 percent. The revised near-term outlook for inflation reflects a larger slowdown in price growth during the second half of 2024 than CBO anticipated last June.

CBO's current projections of inflation for 2025 to 2034 are similar to its projections from last June for several reasons. CBO expects inflation to be near the Federal Reserve's goal of 2 percent annual growth in the PCE price index in 2025, and inflation remains close to that target after 2025. In CBO's projections, the Federal Reserve's policy actions, the continued easing of supply-related issues, and inflation expectations that continue to remain anchored near the Federal Reserve's goal keep inflation close to that 2 percent target after 2025.

Interest Rates

CBO now expects short-term interest rates to be lower over the 2024–2026 period than it forecast last June; in the agency's current projections, the federal funds rate averages 4.2 percent over that period instead of 4.7 percent. That change largely reflects the fact that inflation fell more, and the unemployment rate rose more, than the agency expected in 2024. As a result, the Federal Reserve began lowering the target range for the federal funds rate earlier than anticipated. Similarly, CBO revised downward its projection of the interest rate on 3-month Treasury bills over the same period.

CBO has increased its projections of short-term interest rates over the 2027–2034 period since last June. That revision was driven mainly by lower projections of the rate of private saving in the United States and, to a lesser degree, by higher projections of capital income as a fraction of total income. In the agency's estimation, both of those changes put upward pressure on interest rates, which would result in an increase in both short- and long-term interest rates, all else being equal.

Increases to long-term interest rate projections for 2030 to 2034 stemming from increases in expected short-term interest rates were more than offset by the effects of changes to CBO's method for forecasting interest rates on Treasury securities. For the current forecast, CBO reduced its estimate of the long-run spread between long- and short-term Treasury securities. That change reflects CBO's latest analysis of the statistical relationship among the interest rate on long-term Treasury securities, the expected interest rate on short-term Treasury securities, and the expected rate of inflation. The smaller estimated spread would result in a downward revision to the interest rate on long-term Treasury securities of roughly 0.6 percentage points in the long run. However, that downward revision is partly offset by the previously discussed upward revisions to short-term interest rates, resulting in an overall downward revision that averages 0.2 percentage points for 2029 to 2034.

Income

CBO has also revised its projections of two key categories of income. Wages and salaries as a percentage of GDP are now projected to be smaller from 2024 to 2034 than CBO projected in June. However, higher projections of

GDP mean that for much of the 2024–2034 period, the nominal projections of wages and salaries are higher than CBO projected in June. Domestic corporate profits as a percentage of GDP, by contrast, are now projected to be larger, on average, over the 2024–2034 period than previously forecast. Projections of nominal corporate profits are also higher both because of that upward revision to profits as a share of GDP and because of larger projections of nominal GDP.

CBO's projections of wages and salaries as a percentage of GDP have been revised downward in response to revisions to historical data and newly released data. In September 2024, the Bureau of Economic Analysis (BEA) released revised historical data for the national income and product accounts, which revealed that wages and salaries were revised downward by 0.8 percentage points (as a share of GDP) at the end of 2023. Similarly, incoming data from BEA showed that wages and salaries as a share of GDP in the third quarter of 2024 were 1.0 percentage point lower than CBO projected in June. As a result, CBO has lowered its projection of wages and salaries as a share of GDP by 0.6 percentage points at the end of 2025 and at the end of 2026. CBO has revised wages and salaries as a share of GDP downward by an average of 0.4 percentage points over the 2027–2034 period.

New information about corporate profits has prompted CBO to increase its projections of profits over the coming 10 years. BEA's historical revisions also revealed that domestic corporate profits were about 1.1 percentage points higher (as a share of GDP) at the end of 2023. In addition, corporate profits increased more from the end of 2023 to the third quarter of 2024 than CBO had expected. (Data for the fourth quarter of 2024 will be released in March.) For those reasons, CBO has raised its estimate of domestic corporate profits at the end of 2024 by 1.2 percentage points. CBO has raised its forecast of domestic corporate profits as a share of GDP by 0.9 percentage points at the end of 2025 and at the end of 2026. Over the 2027–2034 period, CBO has revised its forecast of domestic corporate profits as a share of GDP upward by an average of 0.5 percentage points.

Comparison With Other Economic Projections

CBO routinely compares its economic projections with those of other economists. CBO's current forecast is within the middle two-thirds of the ranges for most variables reported in three sources.

The *Blue Chip Economic Indicators*, which is published monthly, provides information as of January 10, 2025 (see Figure 10). The data it uses are slightly more recent than those in CBO's forecast, which was finalized in early December.

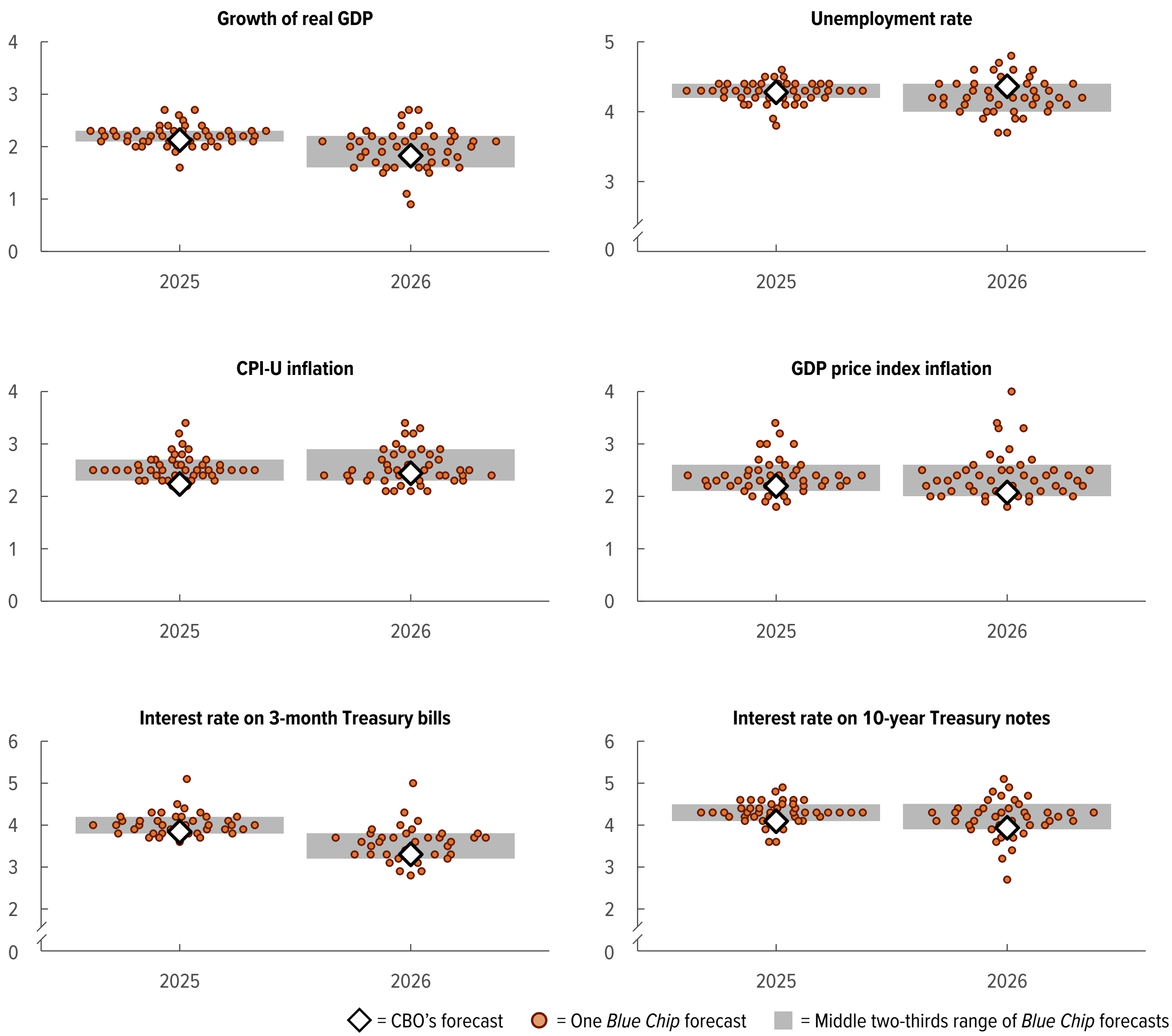
The Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*, which is published four times a year, includes both quarterly and annual projections (see Figure 11 and see Figure 12 on page 28). The forecasts in the most recent release, published on November 15, 2024, use data that were available when CBO's forecast was finalized.

The projections of the Federal Reserve's Federal Open Market Committee, which are published four times a year, were most recently released on December 18, 2024 (see Figure 13 on page 29). A key difference between CBO's economic projections and those made by Federal Reserve officials is that CBO develops its projections so that they fall in the middle of the likely range of outcomes under current law (for this report, laws enacted through December 4, 2024). The Federal Reserve uses a different concept: Each Federal Reserve official provides a "modal" forecast—a forecast of the most likely outcome—reflecting that person's assessment of appropriate monetary policy, and the Federal Reserve reports ranges of those modal values. It is unclear which concepts are used by private-sector forecasters.

Figure 10.

Comparison of CBO's Economic Forecasts With Those of the *Blue Chip* Forecasters

Percent



Data sources: Congressional Budget Office; Wolters Kluwer, *Blue Chip Economic Indicators*, vol. 50, no. 1 (January 10, 2025). See www.cbo.gov/publication/61135#data.

Each of the data points represents a forecast made by the more than 40 forecasters included in the *Blue Chip* survey. The middle two-thirds range omits the highest one-sixth and the lowest one-sixth of the forecasts.

Real GDP is nominal GDP that has been adjusted to remove the effects of changes in prices. Rates of real GDP growth and inflation are measured as changes from the average of one calendar year to the average of the next year.

The unemployment rate is the percentage of people in the labor force who are not working but who are available for work and are either seeking work or expecting to be recalled from a temporary layoff. The unemployment rate and interest rates are calendar year averages.

CPI-U = consumer price index for all urban consumers; GDP = gross domestic product.

Figure 11.

Comparison of CBO's Economic Forecasts With Those in the *Survey of Professional Forecasters*

Percent

Data sources: Congressional Budget Office; Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters: Fourth Quarter 2024* (November 15, 2024), https://tinyurl.com/mk827r8e. See www.cbo.gov/publication/61135#data.

Each of the data points represents a forecast made by the more than 30 respondents in the *Survey of Professional Forecasters*. The middle two-thirds range omits the highest one-sixth and the lowest one-sixth of the forecasts.

Real GDP is nominal GDP that has been adjusted to remove the effects of changes in prices. Quarterly growth of real GDP is measured from one quarter to the next quarter and is expressed as an annual rate; annual growth is measured as the change from the average of one calendar year to the average of the next year.

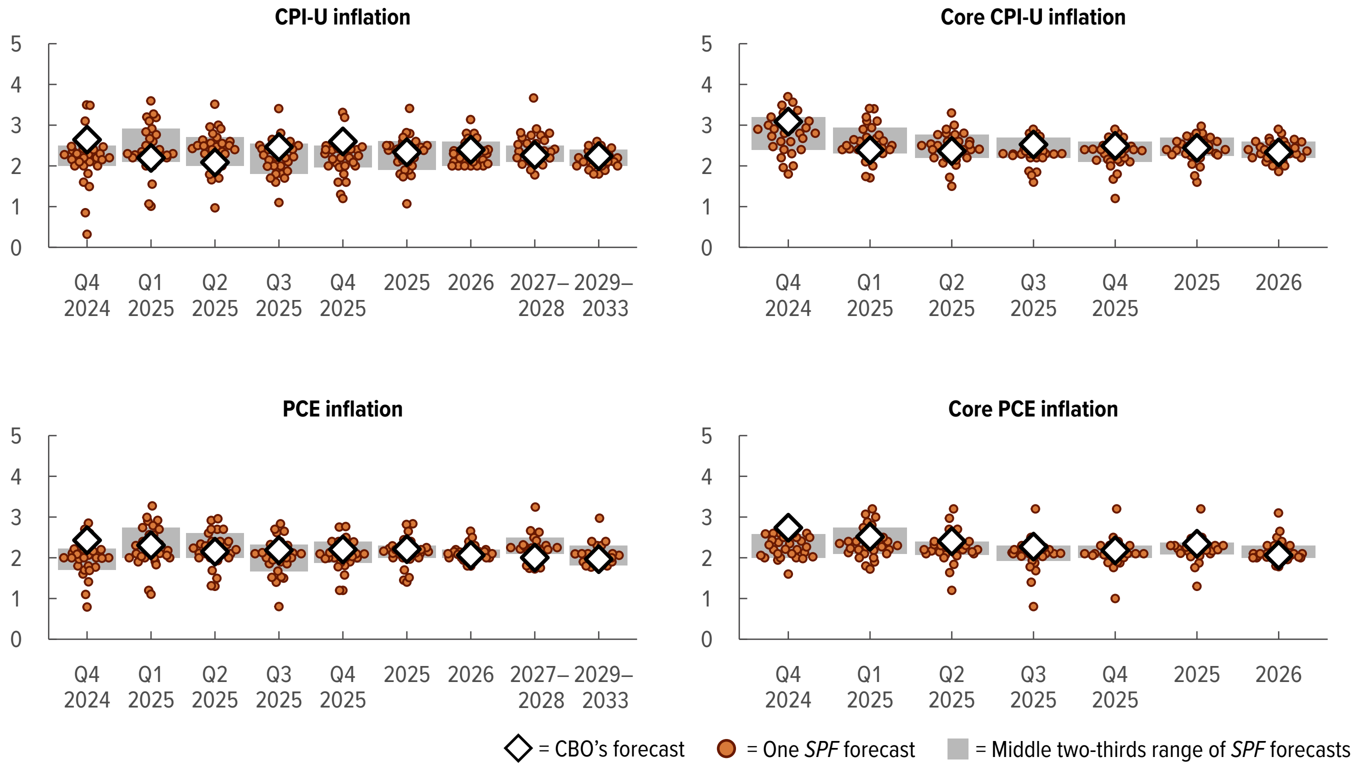
The unemployment rate is the percentage of people in the labor force who are not working but who are available for work and are either seeking work or expecting to be recalled from a temporary layoff. The unemployment rate and interest rates are quarterly or calendar year averages.

GDP = gross domestic product; *SPF* = *Survey of Professional Forecasters*.

Figure 12.

Comparison of CBO's Inflation Forecasts With Those in the *Survey of Professional Forecasters*

Percent



Data sources: Congressional Budget Office; Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters: Fourth Quarter 2024* (November 15, 2024), https://tinyurl.com/mk827r8e. See www.cbo.gov/publication/61135#data.

Each of the data points represents a forecast made by the more than 30 respondents in the *Survey of Professional Forecasters*. The middle two-thirds range omits the highest one-sixth and the lowest one-sixth of the forecasts.

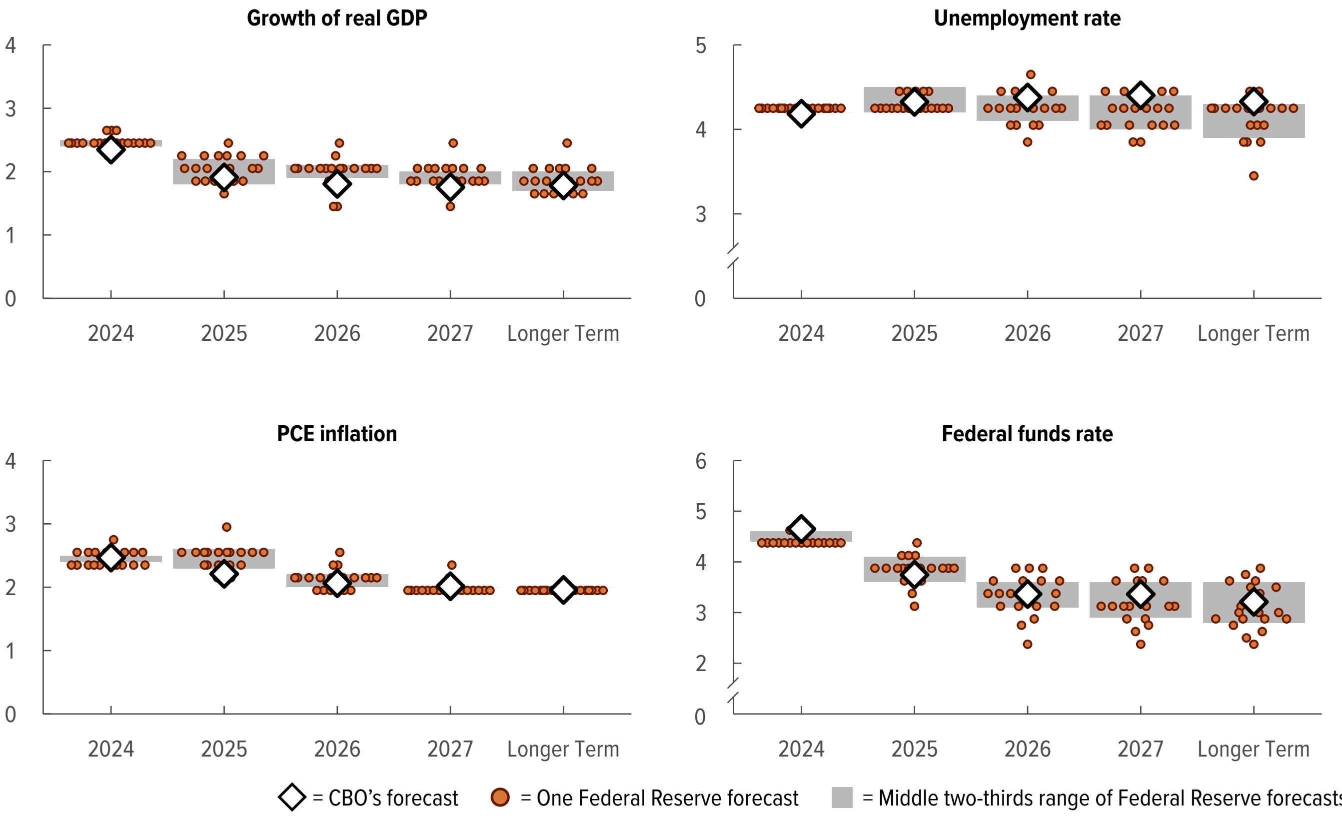
Quarterly inflation is measured from one quarter to the next quarter and is expressed as an annual rate; annual inflation is measured from the fourth quarter of one calendar year to the fourth quarter of the next year. Core inflation excludes prices for food and energy.

CPI-U = consumer price index for all urban consumers; PCE = personal consumption expenditures; *SPF* = *Survey of Professional Forecasters*.

Figure 13.

Comparison of CBO's Economic Forecasts With Those of the Federal Reserve

Percent



Data sources: Congressional Budget Office; Board of Governors of the Federal Reserve System, *Summary of Economic Projections* (December 18, 2024), Table 1, p. 2, https://tinyurl.com/bd4mzcku. See www.cbo.gov/publication/61135#data.

Each of the data points represents the midpoint of a forecast range (for real GDP growth, the unemployment rate, and PCE inflation) or an actual forecast (for the federal funds rate) made by one of the members of the Federal Reserve Board or one of the presidents of the Federal Reserve Banks in December 2024. The middle two-thirds range omits the three highest and three lowest projections.

Real GDP is nominal GDP that has been adjusted to remove the effects of changes in prices. Growth of real GDP is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

The unemployment rate is the percentage of people in the labor force who are not working but who are available for work and are either seeking work or expecting to be recalled from a temporary layoff. Data for the unemployment rate are fourth-quarter average values.

The inflation rate based on the PCE price index is measured from the fourth quarter of one calendar year to the fourth quarter of the next year.

The federal funds rate is the interest rate that financial institutions charge each other for overnight loans of their monetary reserves. Federal Reserve officials' forecasts of the federal funds rate are for the rate at the end of the year, whereas CBO's forecasts are fourth-quarter values.

GDP = gross domestic product; PCE = personal consumption expenditures.

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About This Document

This document is one of a series of reports on the state of the budget and the economy that the Congressional Budget Office issues each year. It satisfies the requirement in section 202(e) of the Congressional Budget Act of 1974 for CBO to submit to the Committees on the Budget periodic reports about fiscal policy and to provide baseline projections of the federal budget. In keeping with CBO's mandate to provide objective, impartial analysis, the report makes no recommendations.

The estimates in this report are the work of more than 100 staff members at CBO. Edward Gamber wrote the report, with contributions from Nicholas Abushacra, Aaron Betz, Daniel Fried, Ron Gecan, Mark Lasky, Chandler Lester, Kyoung Mook Lim, Michael McGrane, Jaeger Nelson, Christine Ostrowski, Natalia Reyes, Molly Saunders-Scott, and Jeffrey Schafer. Robert Arnold and Devrim Demirel provided guidance.

CBO consulted with members of its Panel of Economic Advisers during the development of this report. Although CBO's outside advisers provided considerable assistance, they are not responsible for the contents of this report; that responsibility rests solely with CBO.

Mark Doms and Jeffrey Kling reviewed the report. Christian Howlett, Rebecca Lanning, and Bo Peery edited it; Casey Labrack and Jorge Salazar created the graphics; and R. L. Rebach prepared the text for publication. The report is available at www.cbo.gov/publication/61135.

CBO seeks feedback to make its work as useful as possible. Please send comments to communications@cbo.gov.

Phillip L. Swagel
Director
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