



How Changes in Economic Conditions Might Affect the Federal Budget: 2026 to 2036

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At least once a year, the Congressional Budget Office publishes a report providing 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 taxes and spending generally remained unchanged. The agency uses its economic forecast—which includes projections of income, inflation, interest rates, and other variables—as a basis for projecting revenues from each major revenue source (individual income taxes, payroll taxes, corporate income taxes, customs duties, and other taxes), spending for federal budget accounts, the resulting deficits or surpluses, and federal debt. If economic conditions differed noticeably from those in CBO's forecast, budgetary outcomes could diverge from those in the agency's baseline budget projections.

CBO analyzed how revenues, outlays, and deficits might change if the values of key economic variables differed from those in the agency's forecast.¹ To do so, CBO generated four economic scenarios that would result in larger budget deficits. In isolation, each of those scenarios would cause the cumulative deficit for the 2027–2036 period to be larger than it is in CBO's baseline projections—by an amount from \$166 billion to \$379 billion. (The total deficit projected for that period is \$24.4 trillion.)

The four scenarios that CBO analyzed are as follows:

- **Slower productivity growth.** If productivity grew at a rate that was 0.1 percentage point slower each year than it is in the agency's economic forecast, economic growth (as measured by annual changes in real gross

domestic product—that is, GDP adjusted to remove the effects of changes in prices) would slow, which would reduce gross domestic income and, in turn, federal revenues.² Although some of that decrease in revenues would be offset by reductions in outlays, annual deficits would be larger than projected by amounts that would reach \$65 billion in 2036, CBO estimates. The cumulative deficit for the 2027–2036 period would be \$317 billion (or 1.3 percent) larger than it is in CBO's baseline budget projections.

- **Slower growth of the labor force.** If the labor force grew at a rate that was 0.1 percentage point slower each year than the rate in CBO's economic forecast and the unemployment rate was the same as forecast, economic growth would slow, and annual deficits would be larger than those in the agency's baseline budget projections by amounts that would reach \$37 billion in 2036.³ The cumulative deficit for the 2027–2036 period would be \$166 billion (or 0.7 percent) larger than it is in the agency's baseline projections.

1. This analysis is based on the agency's most recent baseline budget and economic projections. See Congressional Budget Office, *The Budget and Economic Outlook: 2026 to 2036* (February 2026), www.cbo.gov/publication/61882.

2. Gross domestic income is the sum of all income earned, and costs incurred, in the domestic production of goods and services. It consists mainly of labor income (mostly from wages and salaries and employer-paid benefits) and capital income (including corporate profits, rental income, and other income derived from capital).

3. The labor force is the number of people in the civilian noninstitutionalized population age 16 or older who have jobs or are unemployed (available for work and either actively seeking work or expecting to be recalled from a temporary layoff). The civilian noninstitutionalized population excludes members of the armed forces on active duty and people in penal or mental institutions, detention facilities, or homes for the elderly or infirm. The unemployment rate is the percentage of people in the labor force who are unemployed.

- **Higher interest rates.** If all interest rates—including those on 3-month Treasury bills and 10-year Treasury notes—were 0.1 percentage point higher each year than they are in CBO’s economic forecast and other variables were the same as those in the agency’s forecast, the government’s net interest costs would be greater than they are in the agency’s baseline projections by amounts that grow each year through 2036. If other variables were the same as forecast, higher-than-forecast interest rates would cause deficits to exceed the agency’s baseline projections by \$60 billion in 2036 and by \$379 billion (or 1.6 percent) over the 2027–2036 period.
- **Higher inflation and interest rates.** If all wage and price indexes grew 0.1 percentage point faster each year than they do in CBO’s economic forecast but real values for GDP, interest rates, and other variables affected by inflation were the same as those underlying CBO’s baseline, annual deficits would be larger than projected by amounts that would climb to \$51 billion in 2036.⁴ With real GDP unchanged, higher inflation would push up nominal GDP, resulting in more taxable income. Higher inflation would also increase benefit payments from certain programs and, with real interest rates unchanged, would increase nominal interest rates. As in the previous scenario, those higher nominal interest rates would drive up interest payments on federal debt. The cumulative deficit for the 2027–2036 period would be \$311 billion (or 1.3 percent) larger than projected.

Those scenarios and the resulting budgetary and economic effects are referred to as CBO’s rules of thumb. For illustrative purposes, budget deficits are larger in each scenario than they are in the agency’s baseline. Differences between the economic projections and actual outcomes may result in deficits that are larger or smaller than those in CBO’s baseline budget projections. Because the rules of thumb are roughly symmetrical, they can be used to analyze changes in both directions. If, for example, productivity or the labor force grew 0.1 percentage point *faster* than projected, or if interest rates or inflation were 0.1 percentage point *lower* than projected, deficits would be smaller than they are in the agency’s baseline budget projections by about the same amounts as they are larger in the rules of thumb.

4. Wage and price indexes include the GDP price index, the consumer price index for all urban consumers (CPI-U), the chained CPI-U (in which the underlying basket of goods is updated monthly to reflect how consumers shift their spending in response to changes in prices for different goods), and the employment cost index for wages and salaries of workers in private industry.

Background

When economic conditions differ from those in the agency’s forecast, actual budgetary outcomes are likely to differ from CBO’s projections because economic conditions affect federal revenues and outlays in several ways.

- Revenues depend on the total amount of income that is subject to taxation, including wages and salaries, other income received by individuals, and corporate profits. Those types of income generally rise or fall (though not necessarily proportionally) in response to changes in economic growth and inflation. Additionally, how specific income sources are affected by changes in economic conditions can vary depending on the source of the change. The rules of thumb partially capture those effects but do not necessarily replicate the analysis of how changes would be distributed among income sources that CBO would produce using its full suite of projection models.
- The Treasury regularly refinances portions of the government’s outstanding debt and issues more debt to finance new deficits at market interest rates. Thus, the amount that the federal government spends to pay interest on its debt is directly tied to those interest rates.
- Spending for many mandatory programs—that is, programs whose spending is governed by statutory criteria and, in most cases, is not constrained by the annual appropriation process—is affected by economic growth and inflation, either directly (for example, through cost-of-living adjustments) or indirectly (for example, through the number of beneficiaries).
- Although actual spending for discretionary programs—programs whose spending is controlled by appropriation acts—is determined by lawmakers, CBO’s projections of such spending are affected by changes in inflation.⁵

5. For nearly all discretionary spending, CBO’s baseline projections reflect the assumption that over the projection period, funding for each account grows from the amount appropriated for the current year at the rate of inflation. The inflation measure that CBO uses to project funding for future years is a weighted mixture of the change in the employment cost index for wages and salaries of workers in private industry (which is applied to the portion of a program’s funding that is spent on compensation for federal employees) and the change in the GDP price index (which is applied to the portion of funding spent for all other purposes). The weights are determined using data about programs’ spending from the Office of Management and Budget.

Economic conditions are uncertain and difficult to foresee, and they differ from those in CBO's forecast for a variety of reasons. For example, net immigration from 2021 to 2024 was much higher than CBO and other forecasters anticipated, resulting in faster-than-projected growth of the labor force.⁶ Future changes in policy could also cause economic outcomes to differ from those in CBO's projections. Changes in trade policy, for instance, affect inflation and productivity growth. Even the economic effects of policy changes that are scheduled to take place under current law and are thus already reflected in the baseline are subject to considerable uncertainty. Finally, some changes in economic conditions, such as turning points in the business cycle, cannot be accurately predicted.

The Economic Variables That CBO Examined

CBO examined how differences in four key economic variables would affect its budget projections. In all four scenarios, the values of the economic variables differ from those in the agency's forecast by 0.1 percentage point each year starting in January 2026.⁷ In the first two scenarios—those that involve slower productivity growth and slower labor force growth—real GDP growth is slower and other economic variables that affect outlays and revenues, such as interest rates and wages and salaries, change as well.⁸ In the third and fourth scenarios—those that involve higher interest rates and

higher inflation—variables that are related to labor and productivity or that are measured in real terms remain unchanged by design.

For simplicity, CBO constructed the scenarios so that the values for the key economic variables differ from those in the agency's forecast by 0.1 percentage point in a direction that would worsen budget deficits. With previous editions of this report, CBO published a downloadable interactive workbook that allowed users to create their own alternative scenarios for the key variables, including scenarios that would reduce deficits, and analyze their effects on budgetary outcomes. This year, the agency has replaced that workbook with a new web-based interactive model.⁹

The four scenarios analyzed in this report are not intended to indicate how actual economic conditions might differ from CBO's projections; those differences will probably be greater than 0.1 percentage point, could occur in either direction, and could arise from sources other than the economic variables covered by the rules of thumb. For example, in CBO's projections, real GDP grows by 2.2 percent in calendar year 2026 (measured from fourth quarter to fourth quarter). However, the agency estimates that there is a two-thirds chance that the actual rate of real GDP growth will be between 0.5 and 3.9 percent that year. In calendar year 2029, real GDP growth is projected to be 1.8 percent, but CBO estimates that there is a two-thirds chance that the actual rate of growth will be between -0.2 and 3.8 percent.

Similarly, the rate of inflation (as measured by changes in the price index for personal consumption expenditures from fourth quarter to fourth quarter) is 2.7 percent in calendar year 2026 in CBO's projections, but the agency estimates that there is a two-thirds chance that the actual rate of inflation will be between 1.7 and 3.7 percent. In calendar year 2029, inflation is projected to be 2.1 percent, but CBO estimates that there is a two-thirds chance that the actual rate of inflation will be between 0.4 and 3.8 percent that year.

The agency also estimates that there is a two-thirds chance that the average interest rate on 10-year Treasury notes will be within 0.7 percentage points of the forecast rate of 4.1 percent in calendar year 2026 and within 1.3 percentage points of the forecast rate of 4.3 percent in calendar year 2029.

6. Congressional Budget Office, *Effects of the Immigration Surge on the Federal Budget and the Economy* (July 2024), www.cbo.gov/publication/60165.
7. CBO's economic projections reflect trade policy as of November 20, 2025; the agency's latest demographic projections, which are based on laws and policies in place as of September 30, 2025; and economic developments and laws in place as of December 3, 2025.
8. The two scenarios in which real GDP differs from amounts in the baseline are produced by incorporating alternative economic conditions into CBO's incomes model, which is used to project many components of income. See Congressional Budget Office, "Assessing the Budgetary Implications of Economic Uncertainty With CBO's Incomes Model and Budgetary Feedback Model" (January 2023), www.cbo.gov/publication/58885. All four scenarios are then used to calibrate CBO's budgetary feedback model. That model, like the rules of thumb, was constructed to approximate how the federal budget would respond to changes in the economy. However, it provides a more detailed and unified framework to quantify budgetary feedback from macroeconomic changes that are more complicated than those in the simplified rules of thumb. For more information about the budgetary feedback model, see Nathaniel Frentz and others, *A Simplified Model of How Macroeconomic Changes Affect the Federal Budget*, Working Paper 2020-01 (Congressional Budget Office, January 2020), www.cbo.gov/publication/55884.

9. Congressional Budget Office, "How Changes in Economic Conditions Might Affect the Federal Budget, 2026 to 2036: An Interactive Tool" (April 2026), www.cbo.gov/publication/61914.

Table 1.

Differences Between the Illustrative Scenarios and CBO's Economic Forecast in 2036

Percent

	Level of real GDP	Level of nominal GDP	Size of the labor force	Interest rate on 10-year Treasury notes (percentage points)	Level of the GDP price index	Level of the employment cost index ^a
Slower productivity growth	-1.3	-1.3	-0.2	-0.12	0	-1.1
Slower labor force growth	-0.8	-0.8	-1.0	-0.07	0	0.3
Higher interest rates	0	0	0	0.10	0	0
Higher inflation and interest rates	0	1.1	0	0.10	1.1	1.1

Data source: Congressional Budget Office. See www.cbo.gov/publication/62257#data.

In the scenario for each rule of thumb, the economic variable analyzed differs from that in CBO's economic forecast by 0.1 percentage point in the direction that would worsen the budget outlook, but that variable could be higher or lower than forecast.

Each rule of thumb is roughly symmetrical. If, for example, productivity growth was 0.1 percentage point faster than projected, real GDP would increase by about the same amount as it decreases in the table.

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

Productivity Growth. In this scenario, productivity growth is 0.1 percentage point slower each year than it is in CBO's economic forecast, causing real GDP to be 1.3 percent lower in 2036 than the agency forecasts (see Table 1). Slower productivity growth, in turn, affects additional economic variables, such as wage rates and interest rates. Other economic variables, such as unemployment and inflation, remain unchanged.

Labor Force Growth. In the second scenario, labor force growth is 0.1 percentage point slower each year than it is in the agency's economic forecast, causing real GDP to be 0.8 percent lower than forecast in 2036. If the population grew at the rate CBO projects, the slower growth of the labor force would cause the labor force participation rate to fall below the agency's current estimates.¹⁰ That difference would grow by a roughly equal amount each year until the labor force participation rate was 0.6 percentage points lower at the end of 2036 than forecast. As in the slower productivity growth scenario, slower labor force growth affects some additional economic variables but leaves others unchanged.

Interest Rates. In the third scenario, interest rates are 0.1 percentage point higher each year than those in CBO's economic forecast. Inflation is the same as in CBO's forecast, so this rule of thumb shows the effects of higher real interest rates. In this scenario, only changes

in interest payments by the federal government are included, whereas the other scenarios involve changes to the projected amounts of all interest payments, including those made or received by individuals or businesses.

Inflation and Interest Rates. In the fourth scenario, inflation and interest rates are 0.1 percentage point higher each year than they are in the agency's economic forecast. All economic indicators that are measured as nominal values, such as GDP and taxable income, increase in response to higher inflation, and all interest rates are 0.1 percentage point higher than they are in the economic forecast, as in the third scenario. Indicators that are measured as real values—such as real GDP, real income, and real interest rates—are the same as they are in CBO's economic forecast. Although real interest rates remain unchanged in this scenario, the interactive tool allows users to change inflation and interest rates independently, thus allowing real rates to differ.

Applying the Rules of Thumb

CBO's rules of thumb provide an approximate idea of how changes in the given economic variables would affect the federal government's revenues and outlays if current laws generally remained unchanged. The rules of thumb are roughly symmetrical and scalable, which means that they can be used to analyze scenarios in which values for those variables differ from the ones presented here, with some caveats.

Symmetry. Each rule of thumb is roughly symmetrical. Thus, if the growth of productivity or the labor force

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

was 0.1 percentage point faster than in CBO's economic forecast, or if interest rates or inflation were 0.1 percentage point lower, the effects would be about the same as those shown here but with the opposite sign.

Scalability. In addition to being symmetrical, the rules of thumb are roughly scalable—that is, an increase or decrease in the value of a given economic variable will produce a roughly proportional increase or decrease in the resulting budgetary effects. For example, if productivity growth was 0.2 percentage points slower each year than it is in CBO's economic forecast rather than 0.1 percentage point slower, as in the scenario discussed here, the effects on the cumulative deficit would be roughly double.

The scalability of the rules of thumb is limited. The more the values of economic variables differ from those in CBO's forecast, the less accurate the estimates produced using the rules of thumb are likely to be. Although the productivity and labor force scenarios incorporate a broad set of interactions among several economic variables, all four rules of thumb are nevertheless simplified and do not account for more complex interactions among variables—such as the interactions among real GDP growth, inflation, and the unemployment rate. In addition, certain elements of the tax code and some provisions of law related to mandatory programs also make it likely that as such differences increase, estimates produced using the rules of thumb will become less accurate.

Scaling the four rules of thumb, within certain limits, is expected to produce reasonable approximations of the estimates generated by CBO's economic and budget models. Relative to CBO's baseline estimates, annual deviations of up to 0.5 percentage points for the productivity growth scenario, 0.75 percentage points for the labor force growth scenario, and 1 percentage point for the interest rates and inflation scenarios are expected to produce reasonable results.

In general, differences outside those ranges in any given year would generate budgetary effects that could not be reasonably approximated by the rules of thumb and would thus require a more detailed analysis.

Year-by-Year Differences in Deviations From CBO's Forecast. The rules of thumb are based on scenarios in which the values of variables differ from the values in CBO's economic forecast by the same amount each year. The rules of thumb can be used to estimate the effects of scenarios in which the differences vary slightly from year

to year, but they cannot be used to accurately estimate the effects of significant variations in those differences over the 2027–2036 period.

For example, if the rate of labor force growth differed from the value in CBO's forecast by 0.5 percentage points in 2036 but was the same as the forecast value in all other years, the average annual difference over the period would be a little less than 0.05 percentage points. But CBO's estimate of the budgetary effects over the same period would not be half the amount shown in the scenario for slower labor force growth (in which labor force growth is 0.1 percentage point slower each year than it is in the agency's forecast), nor would the agency's estimate of the budgetary effect in 2036 be five times the value for 2036 in that scenario. Both estimates would be considerably smaller. The interactive tool published along with this report allows users to specify annual deviations from CBO's economic forecast and see the effects on budgetary outcomes.

Additional Caveats. If economic conditions changed in such a way that they reflected the changes incorporated in two or more of the simplified scenarios, the budgetary effects would most likely differ from the sum of the effects in the individual rules of thumb. For example, if productivity growth and labor force growth were both slower than they are in CBO's economic forecast, the two effects would interact and could lower output growth by more or less than the result obtained by simply adding the effects together.

In addition, the rules of thumb capture the budgetary effects of specified changes in the economy, but they do not account for the source of those changes. For example, life expectancy or immigration that differed from the projections in CBO's baseline could have similar effects on labor force growth—but each of those factors could have different budgetary implications. Likewise, the composition and distribution of changes in income could vary significantly for a given change in the economy. Changes in productivity, for example, could result in additional economic activity in the form of high-income wages, which face a higher tax rate, or in the form of business investment eligible for full expensing, which faces a lower tax rate and can affect the timing of tax receipts. The rules of thumb do not fully capture those effects.

Some changes in the economy could also result from changes in policy. For example, new legislation might increase government spending and thus affect inflation.

The rule of thumb for inflation approximates the budgetary effects that would result from the estimated changes in inflation—but it does not incorporate the budgetary effects of the increased spending itself, nor does it account for effects on the economy other than the change in inflation.

Changes in policy could also alter how changes in the economy affect the federal budget. For example, a new tax policy that changed tax rates would probably affect the relationship between changes in the economy and revenues. Consequently, changes in the economy would have budgetary effects different from those estimated using the rules of thumb.

Changes in Productivity Growth and Labor Force Growth

The growth of productivity and the growth of the labor force are important determinants of real GDP growth. Faster productivity growth and faster labor force growth both lead to greater economic growth and thus reduce budget deficits. Slower productivity growth and slower labor force growth both reduce the growth of GDP, thereby worsening budget deficits.¹¹

Slower Productivity Growth

The first rule of thumb illustrates the budgetary effects of productivity growth that is weaker than CBO currently anticipates.¹² Specifically, if productivity grew at a rate that was 0.1 percentage point slower each year than the rate in the agency's economic forecast, annual deficits would be larger than projected by amounts that would reach \$65 billion in 2036, CBO estimates. The cumulative deficit for the 2027–2036 period would be \$317 billion larger than it is in CBO's baseline budget projections (see Table 2).

In this scenario, slower-than-anticipated productivity growth leads to slower GDP growth because both labor and capital produce less per unit than projected in CBO's current economic forecast. If workers produced

less, the average hourly wage rate would be lower; therefore, the supply of labor would be slightly smaller than it is in the agency's forecast. As a result, labor income would be lower.

Meanwhile, if capital produced less output, the returns on that capital would decline, further decreasing total taxable income. Lower returns on capital would also drive down private investment. And because Treasury securities compete with other investments for investors' money, those lower rates of return on private investment imply that rates on Treasury securities would also be lower. (That decrease in interest rates is partially offset by greater government borrowing to finance larger deficits, which decreases the resources available for private investment and therefore puts upward pressure on interest rates.) Other variables, such as the unemployment rate, inflation, and the distribution of labor and capital income, could be affected as well; however, this simplified scenario does not include the effects of changes in those variables.

If actual productivity growth was 0.1 percentage point slower each year than it is projected to be, GDP and gross domestic income would be 1.3 percent lower in 2036 than they are in the current forecast, CBO estimates. Interest rates on Treasury securities would be lower than the rates in the agency's baseline in each year of the 2027–2036 period. In 2036, interest rates on 10-year Treasury notes would be 12 basis points lower than the rates in CBO's baseline (see Table 1 on page 4).¹³

Effects on Tax Revenues. If the rate of economic growth in each year was lower than CBO projects because of slower productivity growth, taxable income would also grow more slowly than projected, as would imports subject to customs duties. Consequently, tax revenues would fall below those in CBO's baseline budget projections by increasing amounts over time, resulting in a shortfall of \$122 billion in 2036. From 2027 to 2036, the drop in revenues stemming from the slower growth of income would add a total of \$614 billion to the cumulative deficit.

Effects on Mandatory Spending. Over the 2027–2036 period, slower income growth would also lead to a \$51 billion net decrease in mandatory outlays for

11. For further discussion about how changes in the labor force participation rate—which lead to changes in labor force growth—and changes in productivity affect GDP, as well as about the uncertainty of such projections, see Congressional Budget Office, *The 2016 Long-Term Budget Outlook* (July 2016), Chapter 7, www.cbo.gov/publication/51580.

12. The measure of productivity underlying this rule of thumb is total factor productivity, calculated as the average real output per unit of combined labor and capital services.

13. A basis point is one hundredth of 1 percentage point, or 0.01 percentage point. Basis points are commonly used as a unit of measure for differences of less than 1 percentage point.

Table 2.

How Changes in Productivity Growth and Labor Force Growth Might Affect CBO’s Baseline Budget Projections

Billions of dollars

	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	Total	
												2027–2031	2027–2036
Productivity growth is 0.1 percentage point slower each year													
Changes in revenues	-5	-13	-21	-31	-41	-52	-64	-76	-90	-105	-122	-158	-614
Changes in outlays													
Mandatory	*	-1	-2	-2	-3	-4	-5	-6	-8	-9	-11	-12	-51
Net interest													
Lower interest rates	-1	-4	-9	-14	-19	-25	-31	-37	-43	-49	-56	-71	-287
Debt service	*	*	1	1	2	3	4	5	6	8	10	7	40
Subtotal, net interest	-1	-4	-8	-13	-17	-22	-27	-32	-37	-41	-45	-65	-246
Total change in outlays	-1	-5	-10	-15	-21	-26	-32	-38	-44	-50	-56	-77	-298
Increase (-) in the deficit	-4	-8	-12	-15	-20	-26	-31	-38	-46	-55	-65	-81	-317
Labor force growth is 0.1 percentage point slower each year													
Changes in revenues	-2	-5	-9	-12	-17	-22	-27	-33	-40	-47	-55	-65	-266
Changes in outlays													
Mandatory	*	1	1	2	2	3	3	4	5	6	7	8	33
Net interest													
Lower interest rates	*	-2	-5	-7	-10	-13	-16	-20	-23	-26	-30	-38	-153
Debt service	*	*	*	1	1	1	2	2	3	4	6	3	20
Subtotal, net interest	*	-2	-4	-7	-9	-12	-15	-17	-20	-22	-24	-35	-133
Total change in outlays	*	-2	-3	-5	-7	-9	-11	-13	-15	-16	-18	-27	-100
Increase (-) in the deficit	-2	-4	-5	-7	-10	-12	-16	-20	-25	-31	-37	-38	-166

Data source: Congressional Budget Office. See www.cbo.gov/publication/62257#data.

The rules of thumb capture the budgetary effects of specified changes in the economy, but they do not account for the source of those changes. For example, life expectancy or immigration that differed from the projections in CBO’s baseline could have similar effects on labor force growth—but each of those factors could have different budgetary implications. The source could also be a change in fiscal policy, which would have additional budgetary effects. In addition, such a change in fiscal policy would probably have broader economic effects than those underlying the budgetary estimates shown here.

Each rule of thumb is roughly symmetrical. If, for example, productivity growth was 0.1 percentage point faster each year than projected, deficits would shrink by about the same amount as they grow each year in the table.

* = between -\$500 million and \$500 million.

programs whose spending is either directly or indirectly linked to average wage growth. Outlays for Medicare, Medicaid, unemployment insurance, and Social Security would decrease by \$57 billion.¹⁴ That decrease would be partially offset by a \$5 billion increase in outlays for the refundable portions of the earned income tax credit,

the child tax credit, and the American Opportunity Tax Credit.¹⁵

Effects on Net Interest Costs. Because slower productivity growth would push down interest rates, the total interest that the federal government would pay from 2027 to 2036 on the amount of debt in CBO’s baseline would decrease by \$287 billion. However, the net growth in deficits stemming from the above changes in revenues

14. Changes in interest rates could affect federal credit programs, the budgetary effects of which are calculated following the procedures specified in the Federal Credit Reform Act of 1990. Those effects are complicated and are not included in the rules-of-thumb scenarios. Additionally, changes in outlays for unemployment insurance are followed, with a lag, by changes in payroll taxes, which partially offset those changes in outlays. Those effects are not captured in the rules of thumb.

15. Tax credits reduce a taxpayer’s income tax liability. If the amount of a refundable credit exceeds a taxpayer’s liability before the credit is applied, all or a portion of the excess is refunded to the taxpayer and recorded as an outlay in the budget.



and outlays would require the federal government to borrow more. That additional borrowing would add \$40 billion to interest costs from 2027 to 2036. Together, those effects result in cumulative net interest outlays that would be \$246 billion less than the amount in the agency's baseline projections for the 2027–2036 period.

Slower Labor Force Growth

The second rule of thumb illustrates the budgetary effects of labor force growth that is slower than CBO anticipates. Specifically, if the annual growth of the labor force was 0.1 percentage point slower than it is in CBO's economic forecast and the unemployment rate remained unchanged, annual deficits would be larger than those in the agency's baseline budget projections by amounts that would grow each year and reach \$37 billion in 2036, CBO estimates. The cumulative deficit for the 2027–2036 period would be \$166 billion larger than it is in the agency's baseline projections (see Table 2 on page 7). The budgetary effects in this scenario would be considerably smaller than those in the scenario involving slower productivity growth because the resulting economic effects would be smaller (see Table 1 on page 4).

In this scenario, slower-than-projected growth of the labor force would push the average wage rate above the estimates in CBO's current forecast. Higher wage rates would bring about a small increase in the supply of labor, which would partially offset the effects on labor income of the decline in labor force growth. Nevertheless, total labor income would be less than it is in CBO's baseline because fewer workers would be participating in the labor force. Meanwhile, the number of workers using a given amount of capital would fall below the number in CBO's economic forecast, so the returns on that capital would decline as well. As described in the discussion of the scenario with slower productivity growth, the resulting decline in the rates of return on private investment implies that interest rates on Treasury securities would be lower than they are in CBO's economic forecast; those lower rates would be offset in part by higher rates from increased government borrowing to finance larger deficits. Other variables—including the unemployment rate, inflation, the distribution of labor income, and rates of retirement—could also be affected, but this rule of thumb does not reflect the effects of such changes.

In CBO's estimation, if the growth of the labor force was 0.1 percentage point slower than anticipated, GDP growth would also be slower in each year of the 2027–2036 period. In 2036, GDP and labor income would be 0.8 percent lower than they are in CBO's forecast. In addition, the labor force participation rate would fall

below the agency's current estimates by a roughly equal amount each year until the labor force participation rate was 0.6 percentage points lower at the end of 2036 than forecast. Interest rates would also be lower, as in the scenario with slower productivity growth, but the effects would be smaller; rates on most Treasury securities would be 7 basis points lower than the rates in CBO's forecast.

Effects on Tax Revenues. The slower economic growth would cause taxable labor income and profits, as well as imports subject to customs duties, to grow more slowly than projected, resulting in lower tax revenues than those in CBO's baseline. That shortfall would increase over time, reaching \$55 billion in 2036 and totaling \$266 billion over the 2027–2036 period.

Effects on Mandatory Spending. The higher-than-projected wage rates and the smaller-than-projected number of workers would, on net, add a total of \$33 billion to mandatory outlays from 2027 to 2036. Social Security benefits are based on beneficiaries' wages, and Medicare and Medicaid pay for health care services that become more costly as wages rise. Higher wages would therefore boost mandatory outlays for those programs by \$42 billion. But because there would be fewer workers and higher wages, \$8 billion of that amount would be offset by a decrease in outlays for unemployment insurance benefits and for the refundable portions of the earned income tax credit, the child tax credit, and the American Opportunity Tax Credit.

Effects on Net Interest Costs. From 2027 to 2036, the lower interest rates that resulted from the slower growth of the labor force would reduce the amount of interest that the federal government would pay on the amount of debt in CBO's baseline by \$153 billion. However, the reduction in revenues and the increase in mandatory spending would result in deficits larger than those in CBO's baseline, requiring the federal government to borrow more than projected. That additional borrowing would add \$20 billion to interest costs. Overall, CBO estimates that net interest outlays over the 2027–2036 period would be \$133 billion less than they are in the agency's baseline budget projections.

Changes in Interest Rates and Inflation

Changes in interest rates and inflation affect the federal budget. All else being equal, higher interest rates would increase the flow of interest payments to and from the federal government. Higher inflation and interest rates would raise both revenues and outlays over the 2027–2036 period, though the effects on outlays would be larger. Lower interest rates and inflation would have the opposite effects.

Table 3.

How Changes in Interest Rates and Inflation Might Affect CBO’s Baseline Budget Projections

Billions of dollars

	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	Total	
												2027–2031	2027–2036
Interest rates are 0.1 percentage point higher each year													
Changes in revenues	-2	-2	-2	-1	*	*	1	1	2	2	2	-4	4
Changes in net interest outlays													
Higher interest rates ^a	6	13	19	23	27	31	35	39	42	45	49	114	323
Debt service	*	1	1	2	3	5	6	8	9	11	14	12	60
Total change in net interest outlays	6	14	20	25	31	36	41	46	51	57	62	126	383
Increase (-) in the deficit	-8	-16	-21	-26	-31	-35	-40	-45	-50	-55	-60	-130	-379
Inflation and interest rates are 0.1 percentage point higher each year													
Changes in revenues	2	8	15	22	29	37	45	54	63	73	83	112	429
Changes in outlays													
Mandatory	*	3	7	11	16	21	27	33	39	46	53	59	257
Discretionary	0	1	2	4	6	8	10	12	15	17	20	22	96
Net interest													
Higher interest rates ^a	6	13	19	23	27	31	35	39	42	45	49	114	323
Higher inflation	2	2	2	2	2	2	2	2	2	2	2	8	16
Debt service	*	*	1	2	2	3	5	6	8	9	11	9	48
Subtotal, net interest	8	16	21	26	31	36	41	46	51	56	62	131	387
Total change in outlays	8	20	31	42	53	66	78	92	105	119	134	212	740
Increase (-) in the deficit	-6	-11	-16	-20	-24	-29	-33	-38	-42	-46	-51	-100	-311

Data source: Congressional Budget Office. See www.cbo.gov/publication/62257#data.

The rules of thumb capture the budgetary effects of specified changes in the economy, but they do not account for the source of those changes. The source could, for example, be a change in fiscal policy, which would have additional budgetary effects. In addition, such a change in fiscal policy would probably have broader economic effects than those underlying the budgetary estimates shown here.

Each rule of thumb is roughly symmetrical. If, for example, interest rates were 0.1 percentage point lower each year than projected, deficits would shrink by about the same amount as they grow each year in the table.

* = between -\$500 million and \$500 million.

a. Estimate excludes minor changes to projected Medicare payments resulting from changes to the market baskets, which include interest rates, that Medicare payments are indexed to. The effects of rate changes on the market baskets would increase Medicare outlays by less than \$400 million over the 2026–2036 period.

Higher Interest Rates

The third rule of thumb illustrates the budget’s sensitivity to an increase in interest rates when all other economic variables are left unchanged, including the amounts of interest paid and received by individuals and businesses. In this scenario, all interest rates on Treasury securities—including the rate on 3-month Treasury bills and the rate on 10-year Treasury notes—are 0.1 percentage point higher each year than they are in CBO’s economic forecast. In CBO’s estimation, deficits in this scenario would exceed those in CBO’s baseline budget projections by amounts that would grow each year and reach \$60 billion in 2036. The cumulative deficit for the 2027–2036 period would be \$379 billion larger than it is in the agency’s baseline projections (see Table 3).

Effects on Net Interest Costs. Most of the growth in deficits resulting from higher interest rates would arise because the government’s costs of borrowing would be greater. As the Treasury replaced maturing securities and increased its borrowing to cover future deficits, the budgetary effects of higher interest rates would mount. CBO estimates that in this scenario, the added costs of higher interest rates on the amount of federal debt in the baseline would grow each year and reach \$49 billion in 2036; those costs would total \$323 billion over the 2027–2036 period.

The larger deficits generated by an increase in interest rates would require the Treasury to borrow more than it borrows in CBO’s baseline projections. That additional borrowing would raise the cost of servicing the debt



by amounts that would increase each year and reach \$14 billion in 2036. From 2027 to 2036, the additional borrowing would add a total of \$60 billion to the cost of servicing the federal debt.

Effects on Revenues. As part of conducting monetary policy, the Federal Reserve buys and sells securities issued by the Treasury and by other federal entities. The Federal Reserve also pays interest on reserves (deposits that banks hold at the central bank). The interest the Federal Reserve earns on its portfolio of securities and the interest it pays on reserves affect its remittances to the Treasury, which are counted as revenues.

If all interest rates were 0.1 percentage point higher than CBO projects, the Federal Reserve's remittances over the next few years would be smaller than projected because higher interest payments on reserves would outstrip the additional earnings from interest on its portfolio. Over time, however, the current holdings in the portfolio would mature and be replaced with higher-yielding investments; as a result, after 2030, the Federal Reserve's remittances would be larger. Overall, rates that were 0.1 percentage point higher than those in CBO's economic forecast would (all else being equal) cause revenues from the Federal Reserve's remittances over the 2027–2036 period to be \$4 billion greater than projected.¹⁶

Higher Inflation and Interest Rates

The fourth rule of thumb illustrates the budgetary effects of inflation and nominal interest rates that are 0.1 percentage point higher each year than they are in CBO's baseline. All economic variables that are measured as nominal values, such as GDP, taxable income, and wage rates, increase by the same percentage in response to higher inflation. As a result, those variables that are measured as real values, such as real GDP and real interest rates, remain unchanged. In this scenario, all wage and price indexes grow 0.1 percentage point faster each year than they do in CBO's economic forecast, and all interest rates are 0.1 percentage point higher each year, as they are in the third rule of thumb. As a result, higher inflation would increase both revenues and outlays, although the effect on outlays would be greater, resulting in a

cumulative budget deficit that would be \$311 billion larger over the 2027–2036 period than projected (see Table 3 on page 9).

Effects on Revenues. Larger increases in prices and nominal wage rates generally lead to greater labor income, profits, and other income, which in turn generate larger collections of individual income taxes, payroll taxes, and corporate income taxes. Many provisions in the individual income tax system, including the income thresholds for the tax brackets, are indexed for inflation (that is, adjusted to account for changes in prices). Therefore, the share of taxpayers' income that is taxed at certain rates does not change much when income increases because of higher inflation, so tax collections tend to rise roughly proportionally with income under those circumstances. However, not all parameters of the individual income tax system are indexed for inflation. For example, the income thresholds for the surtax on investment income are fixed in nominal dollars, so if income rose because of inflation, the surtax would apply to a larger share of taxpayers' income.

For payroll taxes, rates are mostly the same for all income levels, and the maximum amount of earnings subject to the Social Security tax rises with average wages in the economy. Higher nominal wages would therefore lead to a roughly proportional increase in payroll tax revenues. Similarly, nearly all corporate profits are taxed at a single statutory rate—21 percent. Consequently, an increase in profits resulting from higher inflation would generate a roughly proportional increase in corporate tax revenues. Additionally, higher-than-projected inflation would result in greater taxable imports, resulting in more revenues from customs duties. Finally, higher nominal interest rates would first reduce and then increase revenues from the Federal Reserve's remittances to the Treasury. All told, inflation and interest rates that were 0.1 percentage point higher than forecast each year would add \$429 billion in revenues to the amounts in the agency's baseline budget projections from 2027 to 2036.

Effects on Mandatory Spending. Higher inflation and interest rates would also increase the cost of some mandatory programs, adding \$257 billion to projected spending over the 2027–2036 period, CBO estimates. Benefits for many mandatory programs, including Social Security, are automatically adjusted each year to reflect increases in prices. Specifically, those benefits are adjusted for changes in the consumer price index, one of the index's components, or another measure of inflation. Many of Medicare's payment rates are also

16. The Federal Reserve's deferred assets could affect when changes to its income and costs are reflected in the amounts it remits to the Treasury. Those effects are not reflected in the estimates presented here. For more information about the Federal Reserve's remittances and deferred assets, see Congressional Budget Office, "Recent Changes to CBO's Projections of Remittances From the Federal Reserve" (February 2023), www.cbo.gov/publication/58913.

adjusted annually for inflation. Spending on some other programs, such as Medicaid, is not formally indexed to changes in prices but nevertheless tends to grow with inflation because the costs of providing benefits under those programs increase as nominal wages and prices rise. In addition, to the extent that benefit payments for retirement and disability programs are linked to wages, increases in nominal wages resulting from higher inflation would boost future outlays for those programs.

Effects on Discretionary Spending. CBO's baseline budget projections reflect the assumption that discretionary funding will increase with inflation (as measured by a weighted average of the GDP price index and wages and salaries for workers in private industry) from the amounts currently provided.¹⁷ For most discretionary programs, inflation that was 0.1 percentage point higher each year than the rates underlying CBO's economic forecast would boost projected funding (and therefore outlays) in each year of the 2027–2036 period.¹⁸ Some appropriations—such as those for veterans' health care—are already provided for 2027. Inflation that was higher than the rates projected in CBO's economic forecast would not change that specified funding but would affect funding projected for the years following those advance appropriations.¹⁹ In total, inflation that was 0.1 percentage point higher each year than the rates underlying CBO's economic forecast would increase dis-

cretionary outlays over the 2027–2036 period by a total of \$96 billion.

Effects on Net Interest Costs. Higher inflation would increase net outlays for interest, primarily because all interest rates would be 0.1 percentage point higher each year. Higher inflation would also increase the cost to the government of inflation-protected securities.²⁰ The direct effect of such higher interest rates and inflation would be to add \$339 billion in interest costs to CBO's baseline projections of outlays. Moreover, the effects of higher inflation on noninterest spending (net of the effects on revenues) would increase federal debt, boosting interest costs by an additional \$48 billion over the 2027–2036 period.

How the Rules of Thumb Have Changed Since Last Year

The previous edition of this report, which described rules of thumb based on the same four scenarios, was published in March 2025.²¹ The rules of thumb reported this year and last year differ because of changes in CBO's assessment of how the economy and the budget would respond in each scenario, changes in the underlying economic forecast and budget projections, and changes in policy, such as the 2025 reconciliation act (Public Law 119-21) and administrative actions that increased tariff rates.

Those changes led CBO to revise its estimates of how much the cumulative deficit would increase over the budget period (2026 to 2035 in the previous report and 2027 to 2036 in this one) in each of the four scenarios:

- For the scenario involving slower productivity growth, the estimated increase in the deficit over the budget period was \$388 billion in last year's report and is \$317 billion in this year's;
- For the scenario involving slower growth of the labor force, the estimated increase in the deficit over the budget period was \$184 billion in last year's report and is \$166 billion in this year's;
- For the scenario involving higher interest rates, the estimated increase in the deficit over the budget

17. CBO's baseline budget projections reflect legislation that passed both Houses of Congress as of January 14, 2026. The continuing resolution then in effect provided discretionary funding for most programs through the end of January. In accordance with the Deficit Control Act of 1985, CBO's projections of discretionary funding for 2026 are annualized—that is, calculated as if the funding provided by the continuing resolution was in effect for the entire year. At the time this report was finalized, funding had been provided through the end of 2026 for all agencies except those whose funding is in the jurisdiction of the House Appropriations Subcommittee on Homeland Security. (Those agencies shut down when their funding lapsed on February 14, 2026.) In total, for the agencies funded through the end of the year, lawmakers provided \$1 billion more in budget authority than the amounts reflected in the baseline underlying this report.

18. In this analysis, transportation-related programs affected by obligation limitations are classified as discretionary programs. An obligation limitation is a restriction—typically included in an appropriation act—on the amount, purpose, or period of availability of budget authority. The limitation often affects budget authority that has been provided in an authorization act. Although the budget authority for many transportation programs is mandatory, the outlays governed by the obligation limitations for those programs are considered discretionary.

19. An advance appropriation is an appropriation of new budget authority that becomes available in a specified year after the year for which the appropriation act was enacted.

20. The principal of inflation-protected securities is adjusted for changes in the CPI-U (unadjusted to account for seasonal differences).

21. Congressional Budget Office, *How Changes in Economic Conditions Might Affect the Federal Budget: 2025 to 2035* (March 2025), www.cbo.gov/publication/61198.

period was \$351 billion in last year's report and is \$379 billion in this year's; and

- For the scenario involving higher inflation and interest rates, the estimated increase in the deficit over the budget period was \$324 billion in last year's report and is \$311 billion in this year's.

Several factors contribute to those differences. First, the economy is larger this year than it was last year, and therefore projections of the size of the economy over the budget period are also larger. The larger economy increases the size of the budgetary effects in each scenario.

Second, CBO updated its modeling of the economic effects of the scenarios. Some of the updates affect how longer-term interest rates respond to economic changes in the scenarios with slower growth of productivity and the labor force. Those updates bring the scenarios more in line with CBO's forecasting framework, in which longer-term rates reflect the projected path of short-term rates and of changes to the term premium (that is, the premium paid to bondholders for the extra risk associated with holding longer-term bonds).²² As a result of those updates, the estimated effects of changes in interest rates are larger in the scenarios with slower productivity growth and labor force growth, making the reduction in interest costs, relative to baseline projections, larger than in last year's analysis. In addition, other updates to CBO's modeling—including its modeling of private investment—affected how GDP responds to the scenarios: The scenario with slower labor force growth has a larger effect than in last year's report, reducing taxable income and therefore receipts, whereas the scenario with slower productivity growth has a smaller effect than in last year's report, increasing receipts.

Finally, major policy changes made over the past year have had important implications for how changes in the economy affect the federal budget. The 2025 reconciliation act affected the way individuals and businesses are taxed by, for example, reducing the effective marginal tax rates on labor income and on capital income from business investment and by increasing the effective marginal tax rate on investment in owner-occupied

housing.²³ Each of those provisions changed how revenues are affected by changes in the economy. In addition, increases in tariffs implemented through executive action resulted in a higher marginal tariff rate on imports. That higher rate increased the extent to which revenues change in response to changes in inflation, the size of the labor force, and productivity. (The marginal rates used in this analysis reflect those underlying CBO's February 2026 baseline projections and therefore do not incorporate the effects of changes in tariffs made after November 20, 2025, including those resulting from the Supreme Court's February 20, 2026, ruling on tariffs.)

23. Congressional Budget Office, *The Budget and Economic Outlook: 2026 to 2036* (February 2026), Appendix A, www.cbo.gov/publication/61882.

22. Staff of the Congressional Budget Office, *Key Methods That CBO Used to Estimate the Macroeconomic Effects of the 2025 Reconciliation Act*, Working Paper 2026-01 (Congressional Budget Office, February 2026), www.cbo.gov/publication/61257.

This report supplements *The Budget and Economic Outlook: 2026 to 2036*, which is available on the Congressional Budget Office's website at www.cbo.gov/publication/61882. In keeping with CBO's mandate to provide objective, impartial analysis, the report makes no recommendations.

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



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