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# *Economics Group*


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# Capitol Hill Update: Long-Term Fiscal Outlook Remains Bleak

***Last week, the Congressional Budget Office (CBO) released its annual long-term budget outlook, which continued to show a rise in the nation's debt as a share of GDP. The longer we wait, the tougher the decisions.***

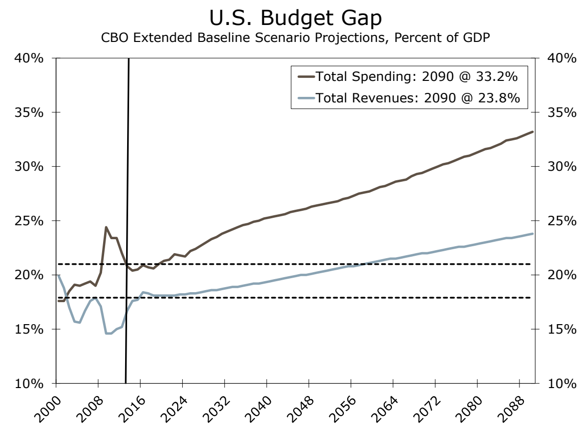
## Continued Growth In the Budget Gap

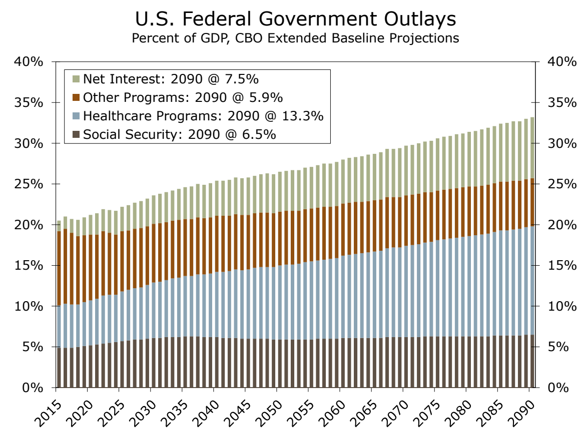
CBO's annual report of the Long-Term Budget Outlook continued to show that federal fiscal policy remains on an unsustainable long-run path. The latest estimates indicate that over the next 10 years, the debt-to-GDP ratio will rise to 78 percent of GDP and grow even higher, reaching 103 percent by 2040. The main challenge remains the large and growing gap between total revenues and total spending. As can be seen in the top graph, the budget gap is expected to narrow over the next few years before growing rapidly once again. Even with revenue growth exceeding the long-run average of 17.9 percent of GDP, the explosive growth in federal outlays creates large budget deficits which result in higher debt accumulation. The primary reason cited by the CBO for the rapid growth in outlays relates to the aging of the population and rising healthcare costs. These factors result in rapid growth in entitlement programs, including healthcare programs (middle graph). More striking, however, is the rapid acceleration of net interest outlays as a share of GDP. The CBO estimates that by 2090, net interest outlays will be larger as a share of the economy than Social Security outlays, assuming an average 10-year Treasury rate of 4.7 percent. The dramatic growth in the cost of servicing the debt underscores the importance of addressing the anticipated growth in entitlement outlays in order to reduce the adverse effects of higher interest outlays in the future.

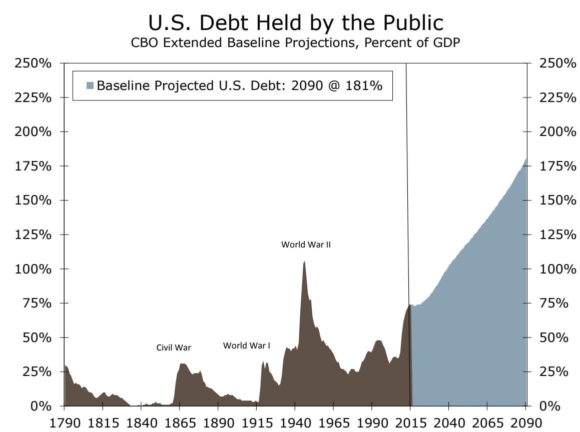
## A New Way To Look at Future Debt Projections

The current challenges facing Greece and other European nations provide a valuable lesson in what could happen when debt rises to unsustainable levels. While there is active debate about the exact level of debt as a share of the economy that begins to adversely affect growth, there is clear evidence that the higher a nation's debt level, the greater the adverse effect on GDP growth. One of the little talked about parts of the CBO report on the Long-Term Budget Outlook is the section that discusses the economic feedback effects of federal fiscal policy. The CBO finds that the resulting higher debt levels by 2040 would reduce output and increase interest rates. Under the extended baseline scenario, the CBO projects that the debt-to-GDP ratio would top out at 103 percent by 2040. However, after the negative economic feedback effects of higher debt levels are included, the debt-to-GDP ratio would actually come closer to 107 percent of GDP.

In short, there are no new themes from the CBO in terms of the long-term budget outlook. The nation's fiscal policy remains on an unstainable path. As we have seen over the past several years, Congress remains focused on short-term patches. Even the budget cuts, known as sequestration, have done little to alter the long-run path of fiscal policy. Only time will tell if we heed the warnings from the CBO and become serious about correcting our fiscal imbalance.




Source: Congressional Budget Office and Wells Fargo Securities, LLC

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