

20/21 vision at the CBO [in some ways, it's better than 20/20]

By Warren Lovely

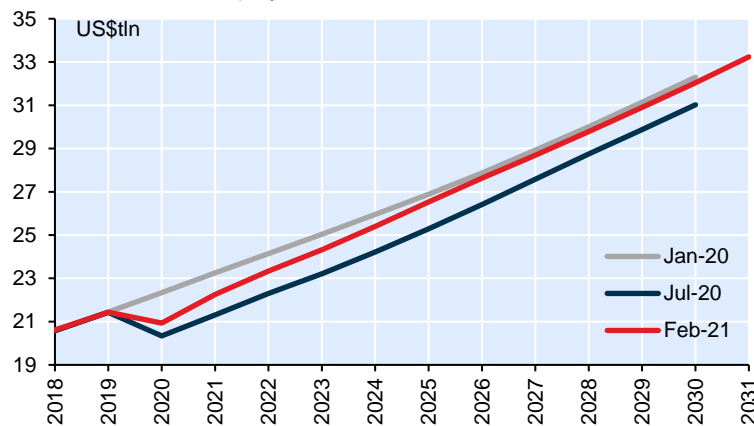
Had your eyes checked lately? If so, you likely had an optometrist spin a few dials and ask you “better 1 or better 2”, all with a view to locking in coveted 20/20 vision. We’re not sure how many eye doctors work at the Congressional Budget Office in Washington—presumably not too many—but fresh long-term budget projections from the CBO provide, on balance, a prettier picture than last go round. Parts of the outlook are surely in focus a bit more now that vaccines are being deployed. Call this 20/21 vision and there are some interesting elements. Briefly...

The CBO’s updated budget projections build on a related economic outlook that dropped at the start of the month and ushered in a non-trivial improvement vs. the CBO’s prior thinking. It will take some time, but nominal GDP is seen getting back on the pre-COVID trendline (Chart 1), previously considered unlikely. Meanwhile, and this is important for inflation hawks, the output gap looks to be all but closed by 2024 (Chart 2). Critically, the CBO’s economic and fiscal outlooks reflect laws in place as of January 12th (i.e., pre-Biden). As you’ve no doubt gathered, Joe has *big* plans for the early years of his administration, not the least of which involve showering a recovering economy with fiscal stimulus. The implication: forecasters could find themselves revising *up* U.S. real GDP growth for 2021 and 2022, accelerating closure of the output gap and adding to inflation tailwinds. We’ve upgraded our own call, seeing U.S. growth north of 5% this year. See our fresh *Monthly Economic Monitor*.

As for the CBO’s new budget figures, they’re of the placeholder variety, subject to material revision as Biden’s stimulus is firmed up. As it stands, the CBO puts the 2021 deficit at US\$2.3 trillion or 10.3%—second only to 2020 in terms of the largest post-WWII shortfall. The improved economic outlook pays fiscal dividends, spinning off more revenue and leaving the underlying deficit on an improved footing (Chart 3). But with or without fresh policy commitments, the U.S. looks to be running a proportionally *much larger* deficit than Canada as far as one can reasonably see. And head-to-head, the stimulus package Biden is talking about dwarfs the new stimulus Trudeau/Freeland have in mind over three years. As for debt, the Treasury has no shortage of it, even before factoring in the Democrat’s fiscal aspirations. For now, rates are low, making debt quite affordable. Still, relative to GDP, the U.S. debt stock looks to grow at least twice as fast as the stock of Canada bonds, fundamentally supportive for Canada-U.S. yield differentials even if, as we fully expect, the BoC eases up on its QE purchase pace well before the Fed.

Chart 1: Economic outlook brighter (even before Biden stimulus)

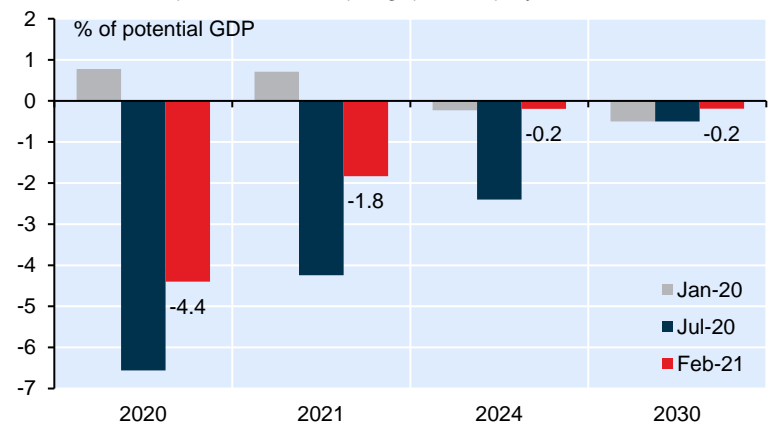
U.S. nominal GDP: CBO projections



Source: NBF, CBO

Chart 2: Output gap all but closed by 2024 (perhaps sooner)

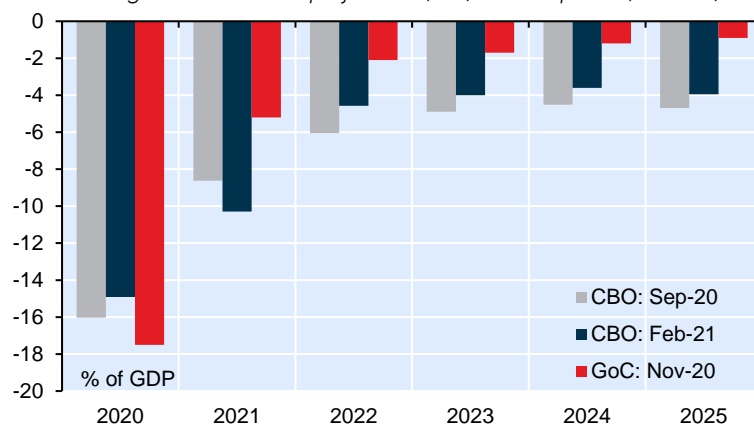
U.S. real GDP vs. potential (i.e., output gap): CBO projections



Source: NBF, CBO

Chart 3: Placeholder budget trajectory (as we wait on Biden)

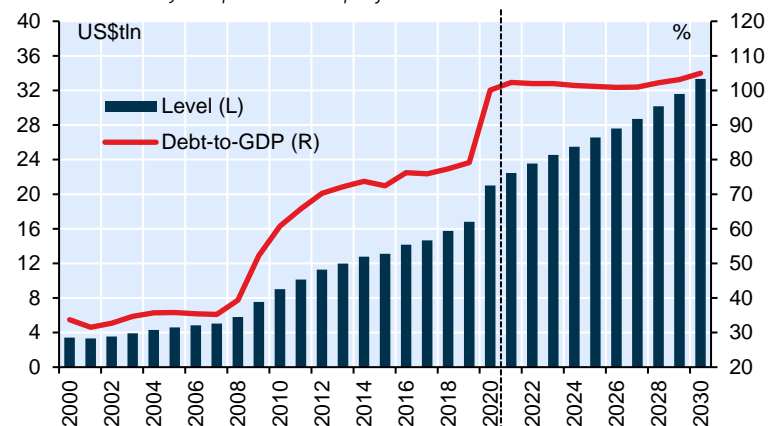
Federal budget balance: CBO projections (U.S.) & GoC update (Canada)



Source: NBF, CBO, Finance Canada | Note: Fiscal years do not overlap; CBO is before Biden stimulus; GoC is before C\$70-100bn of planned stimulus over 3 years

Chart 4: U.S. public debt burden as a step function

U.S. debt held by the public: CBO projections



Source: NBF, CBO



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