01. ECONOMIC ASSUMPTIONS

This chapter presents the economic assumptions that underlie the Administration's 2027 Budget.[1] It provides an overview of the recent performance of the American economy, presents the Administration's projections for key macroeconomic variables, compares them with other prominent forecasts, and discusses the inherent uncertainty of multiyear forecasts.

The chapter proceeds as follows. The first section provides an overview of the recent performance of the U.S. economy based on a broad array of key economic indicators. The second section presents a detailed exposition of the Administration's economic assumptions underlying the 2027 Budget and how key macroeconomic variables are expected to evolve over the 11-year window from 2026 through 2036. The third section compares the forecast of the Administration with those of the Congressional Budget Office (CBO), the Federal Open Market Committee of the Federal Reserve (FOMC), and the consensus from the Blue Chip Economic Indicators panel of professional forecasters available at the time the Administration's forecast was being finalized. The fourth section discusses the sensitivity of the Administration's projections of Federal receipts and outlays to alternative paths of macroeconomic variables. The fifth section considers the errors in past Administration forecasts, comparing them with the errors in forecasts produced by the CBO and the Blue Chip Economic Indicators panel of professional forecasters. The sixth section uses information on past accuracy of Administration forecasts to provide context for the uncertainty associated with the Administration's current forecast of the budget balance.

[1] Economic performance, unless otherwise specified, is discussed in terms of calendar years (January-December). Budget figures are discussed in terms of fiscal years (October-September).

Recent Economic Performance

In only the first year of this Administration, the President is already delivering on many top economic priorities: reshoring critical manufacturing, unleashing American energy, securing our supply chains, and powering the future of AI and advanced technology. The President's policies have unleashed trillions of dollars in support of U.S. dominance in manufacturing. The early successes of this Administration can also be seen in more traditional measures of the economy, such as declining rates of inflation and a strong labor market.

Employment. The labor market was solid in 2025. The unemployment rate averaged 4.3 percent over the year, and ended 2025 at 4.4 percent. Other indicators of labor market health also showed signs of strength in 2025, with several measures remaining near multidecade lows, including the manufacturing unemployment rate, the number of marginally attached and discouraged workers as shares of the labor force, and the share of the labor force working part-time for economic reasons (e.g., those unable to find full-time employment). Notably, sustained labor market strength in 2025 occurred simultaneously with a reduction in inflation.

The economy added an average of 10,000 jobs per month in 2025. Total employment at the end of the year was roughly 7.5 million above its pre-pandemic peak. Additionally, by the end of 2025 the prime-age labor force participation rate exceeded its pre-pandemic level by 1 percentage point.

Inflation. Price increases continued to slow over 2025. For example, inflation measured by the Consumer Price Index for all Urban Consumers (CPI-U) was 2.7 percent over the year ending in December 2025, compared with a 2.9 percent increase over the year-earlier 12 months. Core CPI-U inflation, which excludes food and energy prices, was 2.6 percent over the year ending in December 2025, down from a 3.2 percent increase over the year-earlier 12 months. While overall and core CPI-U 12-month inflation have fallen, they remain elevated relative to the Federal Reserve's target.[2] 12-month price increases slowed across several major components of the CPI-U from December 2024 to December 2025. One of the factors supporting slower inflation in 2025 was a reduction in shelter inflation and, more broadly, in overall service inflation. Consumer price inflation for shelter declined by 1.4 percentage points to 3.2 percent. The broader services

[2] The Federal Reserve's inflation target is 2 percent annual growth as measured by the Personal Consumption Expenditures price index. The rate of CPI-U annual inflation consistent with this target is approximately 2.3 percent.

Table 01—1. Economic Assumptions[1]

Calendar Years; In Billions of Dollars

	Actual 2024	Projections											
		2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
Gross Domestic Product (GDP)													
Levels:													
Current Dollars	29,298	30,705	32,525	34,223	35,989	37,845	39,772	41,755	43,821	45,988	48,261	50,646	53,154
Real, Chained (2017) Dollars	23,358	23,816	24,562	25,333	26,118	26,928	27,746	28,561	29,389	30,242	31,119	32,021	32,950
Chained Price Index (2017=100)	125	129	132	135	138	140	143	146	149	152	155	158	161
Percent Change[3]													
Current Dollars	4.9	5.1	5.7	5.2	5.2	5.2	5.0	4.9	4.9	4.9	4.9	4.9	5.0
Real, Chained (2017) Dollars	2.4	1.8	3.5	3.1	3.1	3.1	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Chained Price Index (2017=100)	2.5	3.2	2.2	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Incomes													
Domestic Corporate Profits	3,344	3,565	3,910	4,067	4,159	4,283	4,444	4,628	4,828	5,048	5,259	5,483	5,682
Employee Compensation	15,027	15,783	16,531	17,430	18,381	19,409	20,485	21,597	22,768	23,996	25,303	26,672	28,127
Wages and Salaries	12,388	13,006	13,607	14,359	15,137	15,984	16,869	17,783	18,748	19,748	20,825	21,951	23,148
Nonwage Personal Income	7,247	7,504	8,062	8,676	9,295	9,919	10,505	11,059	11,587	12,197	12,791	13,387	13,969
Consumer Price Index (All Urban)[4]													
Level (1982–1984=100)[2]	313.7	322.2	330.1	337.7	345.3	352.9	360.7	368.6	376.7	385.0	393.5	402.1	411.0
Percent Change:[3]	2.7	2.8	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Unemployment Rate, Civilian, Percent													
Annual Average	4.0	4.2	3.9	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Q4 Level	4.2	4.2	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Interest Rates, Percent													
91-Day Treasury Bills	5.0	4.1	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
10-Year Treasury Notes	4.2	4.3	3.7	3.5	3.5	3.4	3.3	3.3	3.3	3.3	3.3	3.3	3.3

[1] Based on information available as of November 2025

[2] Annual average

[3] Fourth-quarter-over-fourth-quarter

[4] Seasonally Adjusted

category declined from the end of 2024 to the end of 2025 by 1.4 percentage points to 3.0 percent.

Wages. Wage growth over 2025 was robust across a variety of measures. Over the year ending in December 2025, average hourly earnings (AHE) rose 4.1 percent across all private-sector workers, and 3.9 percent across private-sector workers in production and nonsupervisory positions. Similarly, wages and salaries increased 3.4 percent across all private-sector workers, according to the Employment Cost Index (ECI)—ECI is a measure of worker compensation that holds constant the composition of the workforce. Wage growth in 2025 outpaced consumer price inflation. For example, over the year ending in December 2025, real AHE rose 1.4 percent across all private-sector workers and 1.2 percent for private-sector workers in production and nonsupervisory positions. Wages and salaries as measured by the ECI also increased in real terms over the year, rising 0.7 percent across all private-sector workers. Looking ahead, sustaining the labor market's solid performance while continuing to bring inflation down further for American consumers remains an important economic priority for the Administration.

Gross Domestic Product[3]

Overview. Real GDP, which adjusts for inflation, rose 2.0 percent over 2025 (fourth-quarter-over-fourth-quarter), the highest among major advanced economies (G7). GDP growth in 2025 was driven most by consumption and business fixed investment. Net exports became less negative as exports grew and imports declined. Government expenditures subtracted 0.2 p.p. from real GDP growth over the four quarters of 2025, held down by the government shutdown in late 2025.

Consumption. Household consumption of goods and services accounts for more than two-thirds of U.S. GDP. Real personal consumption expenditures (PCE) increased

[3] The data reported here on GDP and its underlying components reflect "second" estimates from the Bureau of Economic Analysis. These estimates are subject to revision.

by 2.1 percent over the four quarters of 2025. The consumption of durable goods increased 0.1 percent over 2025, while the consumption of nondurable goods rose 2.2 percent and the consumption of services rose 2.4 percent over 2025.

Nonresidential Fixed Investment. Real nonresidential fixed investment rose 5.5 percent over 2025 (fourth-quarter-over-fourth-quarter). 2025 growth marked an increase over the 2024 real nonresidential fixed investment growth of 0.9 percent. Investment in equipment was the primary contributor to 2025 business investment growth, rising 9.5 percent during the four quarters of 2025. Intellectual property investment also experienced an increase in growth to a strong 8.1 percent over the four quarters of 2025, while structures investment declined by 5.7 percent over the period.

The Government Sector. Real government expenditures on consumption and investment decreased 1.2 percent over 2025 (fourth-quarter-over-fourth-quarter), which reflects a 6.5 percent decrease in Federal spending and a 2.1 percent increase in State and local government spending over 2025. Within the Federal spending category, nondefense spending decreased 11.1 percent and defense spending decreased 3.0 percent over the fourth quarters of 2025. Driven by the lapse in appropriations in October 2025, the percent decrease in nondefense spending marks the largest decline since 1960.

Trade. Real exports of goods and services increased 1.0 percent over 2025 (fourth-quarter-over-fourth-quarter), reflecting a 1.9 percent increase in goods exports and 0.5 percent decrease in services exports. Real imports declined 2.0 percent over the same period, reflecting a 2.8 percent decrease in goods imports and a 0.8 percent increase in services imports.

Economic Projections

The Administration's economic assumptions for the 2027-2036 budget window inform the 2027 Budget and assume implementation of the Administration's policy proposals. The Administration's projections, which were finalized in early November 2025, are reported in Table 2-1 and summarized below. The overall picture of this forecast is one of a robust and thriving economy: strong overall economic growth is paired with a low unemployment rate and stable (on-target) inflation.

Real GDP. The Administration's economic assumptions project real GDP growth of 3.5 percent over the four quarters of 2026. Real GDP growth is then expected at 3.1 percent per year during the three years 2027-29, and to average 2.9 percent over the remainder of the forecast horizon.

Unemployment. The Administration's economic assumptions project a 3.9 percent unemployment rate on average during 2026. The unemployment rate is expected to fall during 2026-27, and stay at 3.7 percent during the remainder of the forecast horizon.

Interest Rates. Interest rates are expected to decline substantially over the forecast horizon. The 91-day Treasury bill rate is expected to average 3.2 percent in 2026, down from 4.1 percent over 2025, with a terminal rate of 3.1 percent in 2027. The 10-year rate is projected to average 3.7 percent over 2026, down from 4.3 percent over 2025, and then fall steadily to a terminal rate of 3.3 percent in 2030.

Inflation. The Administration's forecast anticipates a return to low and stable rates of inflation for the overall economy. As measured by CPI-U, currently elevated rates of inflation are projected to subside during 2026, and maintain an average rate of 2.2 percent over the remaining of the window.

Comparison with Other Forecasts

This section compares the Administration's forecast with contemporaneous forecasts from CBO, the FOMC, and the Blue Chip panel of professional forecasters.

There are important methodological differences across these forecasts. Aside from the inherent uncertainty of forecasting economic variables, different projections make different assumptions about which policies of the Administration will be enacted. The Administration's forecast assumes implementation of the Administration's proposed policies such as deregulation, energy abundance, reindustrialization, etc. In contrast, the CBO forecast assumes no changes to current law. It is unclear to what extent FOMC members or Blue Chip panelists incorporate policy implementation expectations into their respective outlooks. The Blue Chip panel comprises a large number of private-sector forecasters, who have different expectations about the enactment of the Administration's proposed policies and different views about how those policies might affect economic growth.

A second key difference is that the various forecasts were published on different dates. For example, while the forecast published by the Administration is based on data available as of early November 2025, the Blue Chip forecasts are drawn from a survey administered in early October. In addition, both the Federal Reserve's FOMC projections and the CBO forecast were published in September.

Real GDP. The Administration forecasts an average real GDP growth rate of 3.0 percent (fourth-quarter-over-fourth-quarter) during the 11 years from 2026 to 2036. This forecast is significantly higher than the forecasted growth rates of the Blue Chip consensus, the median FOMC member, or the CBO over the same forecast window. Over the coming year, the Administration forecasts a 2026 growth rate of 3.5 percent, which is above the 1.8 percent Blue Chip average and the FOMC median, and also above the 2.2 percent forecast from CBO.

Unemployment. The Administration forecasts an unemployment rate that decreases from an average of 4.2 percent in 2025 to 3.9 percent in 2026, before averaging 3.7 percent over the remainder of the window. The Blue Chip consensus, CBO, and the median FOMC participant all forecast a modestly higher average unemployment rate during 2026, as well as over the remainder of the forecast window. Over the long run, the Administration projects a terminal unemployment rate of 3.7 percent, compared

Table 01—2. Comparison of Economic Assumptions[1]

	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
PERCENT CHANGE, FOURTH-QUARTER-OVER-FOURTH-QUARTER												
Real GDP												
2027 Budget (November 2025)	1.8	3.5	3.1	3.1	3.1	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Blue Chip (October 2025)[2]	1.6	1.8	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
CBO (September 2025)[3]	1.4	2.2	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.7	--
Federal Reserve (September 2025)[4]	1.6	1.8	1.9	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Consumer Price Index (CPI-U)												
2027 Budget (November 2025)	2.8	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Blue Chip (October 2025)[2]	3.0	2.7	2.5	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
CBO (September 2025)[3]	3.1	2.4	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.3	--
Federal Reserve (September 2025)[4]	3.0	2.4	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
CALENDAR YEAR AVERAGE												
Unemployment Rate:												
2027 Budget (November 2025)	4.2	3.9	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Blue Chip (October 2025)[2]	4.3	4.5	4.4	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
CBO (September 2025)[3]	4.3	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.3	4.3	4.3	--
Federal Reserve (September 2025)[4,6]	4.5	4.4	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
91-Day Treasury Bills (discount basis):												
2027 Budget (November 2025)	4.1	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Blue Chip (October 2025)[2]	4.2	3.3	3.2	3.0	3.1	3.0	3.1	3.0	3.0	3.0	3.0	3.0
CBO (September 2025)[3]	4.1	3.5	3.2	3.2	3.1	3.1	3.1	3.1	3.0	3.0	3.0	--
10-Year Treasury Notes:												
2027 Budget (November 2025)	4.3	3.7	3.5	3.5	3.4	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Blue Chip (October 2025)[2]	4.3	4.1	4.1	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
CBO (September 2025)[3]	4.3	4.2	4.0	3.9	3.9	3.9	3.8	3.8	3.8	3.8	3.8	--

Sources: Administration; CBO, The Budget and Economic Outlook: 2025 to 2035 (January 2025); CBO, An Update to the Economic Outlook: 2025 to 2028 (September 2025); Blue Chip Economic Indicators, Aspen Publishers, Inc. (October 2025); Federal Reserve Open Market Committee (September 16 2025)

[1] Calendar Year

[2] Real GDP & CPI-U growth rates are year-over-year after 2026. Values for 2032-2036 are 5 year averages.

[3] Values for 2025-2028 are from September 2025 report. Values for 2029-2035 are from January 2025 report.

[4] Median of FOMC Participants' Projections

[5] PCE Inflation

[6] Average rate during 4th quarter

with 4.2 percent for both the Blue Chip consensus and the median FOMC participant, and 4.3 percent for CBO.

Interest Rates. The Administration's 91-day interest rate forecast is relatively consistent with the Blue Chip consensus and CBO over the forecast horizon, including slight declines in 2026 relative to 2025. In contrast, the Administration's forecast for the 10-year Treasury rate is lower than Blue Chip and CBO over most of the forecast window. For example, the Administration projects a 3.7 percent average rate in 2026 compared to 4.1 and 4.2 percent for Blue Chip and CBO forecast, respectively. This pattern holds in the outyears as well, where the Administration projects a 3.3 percent terminal rate compared with 4.0 percent by Blue Chip and 3.8 percent by CBO.

Inflation. The Administration's forecast for CPI-U inflation (on a fourth-quarter-over-fourth-quarter basis) is broadly consistent with outside forecasts throughout the budget window. The Administration, Blue Chip consensus, CBO, and the median FOMC participant all project that inflation will continue to moderate through 2026. The Administration's projection for the long-term CPI-U inflation rate of 2.2 percent matches the long-term projection for the Blue Chip consensus, is 0.1 percentage point lower than CBO, and is consistent with the FOMC's 2.0 percent target for PCE inflation.

Sensitivity of the Budget to Economic Assumptions

Federal spending and tax collections are heavily influenced by developments in the economy. Income tax receipts are a function of growth in incomes for households and firms. Spending on social assistance programs may rise when the economy enters a downturn, while increases in nominal spending on Social Security and other

Table 01–3. Sensitivity of the Budget to Economic Assumptions

Fiscal Years; In Billions of Dollars

BUDGET EFFECT	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	Total 2026–2036
Real Growth and Employment												
Budgetary effects of 1 percentage point lower real GDP growth:												
For calendar year 2026 only, with real GDP recovery in 2027–2036[1]												
Receipts	–23.8	–39.0	–19.5	–2.8	0.2	0.2	0.2	0.2	0.2	0.2	0.2	–59.7
Outlays	14.2	33.6	16.2	3.8	3.2	2.8	2.4	2.0	1.8	1.7	1.6	68.9
Increase in deficit (+)	38.0	72.6	35.7	6.6	3.0	2.6	2.1	1.7	1.5	1.4	1.4	128.7
For calendar year 2026 only, with no subsequent recovery[1]												
Receipts	–23.8	–51.5	–59.8	–62.8	–65.9	–69.1	–72.4	–75.8	–79.4	–83.3	–87.3	–707.3
Outlays	14.2	40.8	43.4	47.6	51.4	55.5	59.4	63.2	67.3	71.7	76.4	576.7
Increase in deficit (+)	38.0	92.3	103.2	110.4	117.3	124.6	131.8	139.1	146.7	155.0	163.7	1,284.0
Sustained during 2026–2036, with no change in unemployment												
Receipts	–23.8	–76.6	–139.9	–209.0	–284.1	–365.5	–453.2	–547.9	–650.2	–760.7	–879.8	–4,366.9
Outlays	0.1	1.4	3.4	5.3	6.5	6.3	3.8	–1.9	–11.7	–26.0	–45.8	–58.7
Increase in deficit (+)	23.9	78.0	143.3	214.3	290.7	371.8	457.1	546.0	638.5	734.6	834.0	4,308.2
Inflation and Interest Rates												
Budgetary effects of 1 percentage point higher rate of:												
Inflation and interest rates during calendar year 2026 only												
Receipts	25.5	52.0	54.9	55.6	58.2	61.1	64.0	67.0	70.2	73.5	77.1	633.5
Outlays	64.3	108.5	78.7	76.5	76.5	77.2	74.6	77.8	76.5	78.1	81.7	806.0
Increase in deficit (+)	38.8	56.5	23.8	21.0	18.2	16.2	10.6	10.8	6.3	4.6	4.6	172.5
Inflation and interest rates, sustained during 2026–2036												
Receipts	25.5	79.4	139.5	204.0	275.0	352.8	437.7	530.6	632.1	743.1	864.2	4,258.4
Outlays	64.1	200.4	307.6	410.1	518.3	627.6	739.5	866.6	979.7	1,091.9	1,239.8	6,981.4
Increase in deficit (+)	38.6	121.0	168.1	206.1	243.3	274.8	301.8	336.0	347.6	348.8	375.5	2,723.0
Interest rates only, sustained during 2026–2036												
Receipts	1.7	3.9	4.9	5.4	5.8	6.2	6.5	6.8	7.1	7.3	7.5	61.4
Outlays	44.1	142.4	206.0	265.2	318.1	370.0	417.4	463.2	505.8	548.2	590.6	3,827.0
Increase in deficit (+)	42.4	138.4	201.1	259.9	312.3	363.8	410.9	456.4	498.8	540.9	583.1	3,765.6
Inflation only, sustained during 2026–2036												
Receipts	23.8	75.4	134.5	198.5	268.9	346.3	430.8	523.3	624.5	735.0	855.9	4,193.1
Outlays	20.0	58.4	102.4	146.2	202.3	260.6	326.4	409.0	481.2	553.0	660.9	3,200.4
Decrease in deficit (–)	–3.7	–17.0	–32.1	–52.2	–66.6	–85.7	–104.5	–114.2	–143.3	–182.0	–195.0	–992.7
Interest Cost of Higher Federal Borrowing												
Outlay effect of $100 billion increase in borrowing in 2026	1.7	3.3	3.4	3.5	3.6	3.7	3.8	3.9	4.1	4.2	4.3	39.5

[1] The unemployment rate is assumed to be 0.5 percentage point higher per 1 percent shortfall in the level of real GDP.

Table 01—4. Forecast Errors, 2002-Present

	Administration	CBO	Blue Chip
Growth: Real GDP [1]			
2-Year Average Annual Real GDP Growth			
Mean Error	1.0	0.4	0.4
Mean Absolute Error	1.1	0.8	0.8
Root Mean Square Error	1.5	1.1	1.2
6-Year Average Annual Change in the Consumer Price Index			
Mean Error	1.3	0.9	0.8
Mean Absolute Error	1.3	1.1	0.9
Root Mean Square Error	1.5	1.2	1.1
Inflation (CPI-U) [1]			
2-Year Average Annual Change in the Consumer Price Index			
Mean Error	–0.1	–0.4	–0.2
Mean Absolute Error	0.8	0.8	0.7
Root Mean Square Error	1.1	1.0	0.9
6-Year Average Annual Change in the Consumer Price Index			
Mean Error	0.1	0.0	0.2
Mean Absolute Error	0.4	0.3	0.4
Root Mean Square Error	0.5	0.4	0.5
Interest Rates: 91-Day Treasury Bill [2]			
2-Year Average			
Mean Error	0.2	0.2	0.4
Mean Absolute Error	1.0	1.0	1.0
Root Mean Square Error	1.5	1.6	1.6
6-Year Average			
Mean Error	1.8	1.8	1.9
Mean Absolute Error	1.8	1.8	1.9
Root Mean Square Error	2.0	2.1	2.2

[1] Average annual growth rate

[2] Annual average interest rate

programs are dependent on consumer price inflation. A robust set of projections for macroeconomic variables assists in budget planning, but unexpected developments in the economy have ripple effects for Federal spending and receipts. This section seeks to provide an understanding of the magnitude of the effects that unforeseen changes in the economy can have on the budget.

To make these assessments, the Administration relies on a set of heuristics that can predict how certain spending and receipt categories will react to a change in a given subset of macroeconomic variables, holding nearly everything else constant. These sensitivity analyses provide a sense of the broad changes one would expect after a given development, but do not attempt to anticipate how policy makers would react and potentially change course in such an event. For example, if the economy were to suffer an unexpected recession, tax receipts would decline and spending on programs such as unemployment insurance would rise. However, policy makers might enact policies to stimulate the economy, leading to secondary and tertiary changes that are difficult to predict. Another caveat is that it is often unrealistic to suppose that one macroeconomic variable might change while others would remain constant. Most macroeconomic variables interact with each other in complex and subtle ways. Be mindful of these considerations when examining Table 1-3.

For real GDP growth and employment:

- The first panel in the table illustrates the effect on the deficit resulting from a one percentage point reduction in real GDP growth, relative to the Administration's forecast, in 2026 that is followed by a subsequent recovery in 2027 and 2028. The unemployment rate is assumed to be half a percentage point higher in 2026 before returning to the baseline level in 2027 and 2028.
- The next panel in the table reports the effect of a reduction of one percentage point in real GDP growth in 2026 that is not subsequently made up by faster growth in 2027 and 2028. Consistent with this output path, the rate of unemployment is assumed to rise by half a percentage point relative to that assumed in the Administration's forecasts.
- The third panel in the table shows the impact of a GDP growth rate that is permanently reduced by one percentage point, while the unemployment rate is not affected. This is the sort of situation that would arise if, for example, the economy was to experience a permanent decline in productivity growth.

For inflation and interest rates:

- The fourth panel in Table 2-3 shows the effect on the budget in the case of a one percentage point higher rate of inflation and a one percentage point higher nominal interest rate in 2026. Both inflation and interest rates return to their assumed levels in 2027. This would result in a permanently higher price level and nominal GDP level over the course of the forecast horizon.
- The fifth panel in the table illustrates the effects on the budget deficit of a one percentage point higher inflation rate and interest rate than projected in every year of the forecast.
- The sixth panel reports the effect on the deficit resulting from an increase in interest rates in every year of the forecast, with no accompanying increase in inflation.
- The seventh panel in the table reports the effect on the budget deficit of a one percentage point higher inflation rate than projected in every year of the forecast window, while the interest rate remains as forecast.
- The table also shows the effect on the budget deficit if the Federal Government were to borrow an additional $100 billion in 2026, while all of the other projections remain constant.
- These simple approximations that inform the sensitivity analysis are symmetric. This means that the effect of, for example, a one percentage point higher

Table 01–5. Differences Between Estimated and Actual Surpluses or Deficits for Five-Year Budget Estimates Since 1985

	Current Year Estimate	Budget Year Estimate	Estimate for Budget Year Plus			
			One Year (BY + 1)	Two Years (BY + 2)	Three Years (BY + 3)	Four Years (BY + 4)
Mean Error	–0.4	0.7	1.5	2.1	2.6	3.0
Mean Absolute Error	1.4	1.8	2.5	3.0	3.5	3.9
Root Mean Squared Error	2.3	2.8	3.5	4.1	4.5	4.7

rate of growth over the forecast horizon would be of the same magnitude as a one percentage point reduction in growth, though with the opposite sign.

Forecast Errors

Growth, Inflation, and Interest Rates

This section evaluates the historical accuracy of past Administration forecasts for real GDP growth, inflation, and short-term interest rates from 2002 to the present day, and compares this accuracy with that of forecasts produced by the CBO and Blue Chip panel. For this exercise, forecasts produced by all three entities are compared with realized values of these variables. As with any forecast, the Administration's projections are subject to inherent uncertainty because they are based on underlying assumptions about future social, political, and global conditions. It is impossible to foresee every eventuality over a one-year horizon, much less over ten or more years.

The results of this exercise are reported in Table 2-4 and contain three different measures of accuracy. The first is the average forecast error. A forecast with an average error of zero is unbiased, in the sense that realized values of the variables have not been systematically above or below the forecasted value. The second is the average absolute value of the forecast error, which offers a sense of the magnitude of errors. Thus, even if a forecast's errors are unbiased, the forecast can still be very inaccurate with very large positive and negative errors cancelling one another out. The table also reports the square root of the mean of squared forecast error (RMSE). This metric applies a harsher penalty to forecasts with larger errors. The table reports these measures of accuracy at both the 2-year and the 6-year horizons, thus evaluating the relative success of different forecasts in the short and medium run.

Past Administration forecasts have 2-year real GDP growth and average annual interest rates that were higher than realized, on average, by 1.0 percentage point and 0.2 percentage point, respectively. This is partly due to the assumption that Administration policy proposals contained in the Budget will be enacted, which may not come to pass. The 2-year average forecast error for CPI-U inflation is -0.1 percentage point, and similar to other forecasts' errors.

Uncertainty and Deficit Projections

This section assesses the accuracy of past budget forecasts for the deficit or surplus, measured at different time horizons. The results of this exercise are reported in Table 1-5, where the average error, the average absolute error, and the RMSE are reported.

In Table 1-5, a negative number signifies that the Federal Government budget ran a larger surplus or a smaller deficit than was expected, while a positive number in the table indicates a smaller surplus or a larger deficit. In the current year in which the budget is published, the Administration has tended to understate the surplus (or, equivalently, overstate the deficit) by an average of 0.4 percent of GDP. For the budget year, however, the historical pattern has been for the budget to understate the deficit by an average of 0.7 percent of GDP.[4] One possible reason for this is that past Administrations' policy proposals have not all been implemented. The forecast errors tend to grow with the time horizon, which is not surprising given that there is much greater uncertainty in the medium run about both the macroeconomic situation and the specific details of policy enactments.

[4] Additionally, the CBO's deficit forecasts have on average been smaller than what materialized.