

## CBO's Rosy Scenario

Last week the Congressional Budget Office set out new projections for budget deficits and debt in the decade ahead, and they weren't quite as bad as they looked last year. The CBO now projects a deficit of 6.4% of GDP in 2033 versus a prior forecast of 7.3%. Total accumulated debt by 2033 is now forecasted to be 114% of GDP versus 119%. None of this is "good" news – deficits and debt would still be too high – but it is "less bad."

The problem is that the CBO's assumptions are way too rosy. In particular, it assumes the end of many of the tax cuts enacted in 2017 without any negative effects on the economy. Fat chance! More likely, growth would slow and revenue would come in low, meaning bigger budget deficits.

But it will also be tough to hit the CBO's revenue projections if we keep the 2017 tax cuts fully in place. The CBO is forecasting "real" (inflation-adjusted) economic growth of about 2.0% per year, on average for the decade ahead, the same growth we've experienced since the end of 2000 (before the 2001 recession) and since the end of 2019 (the business cycle peak prior to COVID). If we tax that economy at lower rates than CBO projects it'll yield less revenue than CBO projects, as well.

The bottom line is that no matter what candidates say this year on the campaign trails in their races for the White House, Senate, and House, both parties are going to have to find ways to limit deficits in the years ahead. If we get a GOP sweep – which we believe would result in a continuation of the 2017 tax cuts (and on which we put 35% odds, up from 30% last November) – we expect measures to fight the deficit to include curbs on "green energy" subsidies, more tariffs, and Medicaid reform.

If the Democrats sweep (20% odds) then we think a wide range of tax hikes will be on the table, including raising the top income tax rate (now 37%) back to 39.6%, raising the top long-term capital gains and dividends tax rates (now 20%) to at least 24%, reducing estate tax exemptions, raising the standard corporate tax rate (now 21%) to 35%, and possibly introducing a carbon tax, which the Clinton Administration very briefly considered in 1993. Back then, both Senators from Nebraska were Democrats, which helped keep President Clinton away from a carbon tax; now the Democrats get very little support from energy-intensive states.

But in a world where the current House majority is razor thin and some election maps are still being redrawn, it shouldn't shock anyone if we end up with "mixed government" in 2025-26, with the GOP holding at least one of the White House, Senate, and House, and the Democrats holding at least one, as well. We'd put the odds on that at about 40-45%, at present.

With mixed government, expect some brutal political fights. Does anyone think a Speaker Hakeem Jeffries would simply rollover for a Republican president and accept a full extension of the 2017 tax cuts, or anything close? Why wouldn't a Republican president test the Supreme Court by "impounding" (refusing to spend) money appropriated by Congress, which hasn't happened since the early 1970s? The bottom line is that for all the fighting, mixed government scenarios would likely generate no entitlement reforms and little deficit reduction, leaving plenty of time for the bond vigilantes to sharpen their knives.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-13 / 7:30 am	CPI – Jan	+0.2%	<b>+0.1%</b>		+0.2%
7:30 am	"Core" CPI – Jan	+0.3%	<b>+0.3%</b>		+0.3%
2-15 / 7:30 am	Initial Claims – Feb 10	220K	<b>216K</b>		218K
7:30 am	Retail Sales – Jan	-0.1%	<b>-0.1%</b>		+0.6%
7:30 am	Retail Sales Ex-Auto – Jan	+0.2%	<b>-0.1%</b>		+0.4%
7:30 am	Empire State Mfg Survey – Feb	-12.5	<b>-11.8</b>		-43.7
7:30 am	Philly Fed Survey – Feb	-8.5	<b>-5.9</b>		-10.6
7:30 am	Import Prices – Jan	0.0%	<b>-0.2%</b>		0.0%
7:30 am	Export Prices – Jan	-0.2%	<b>0.0%</b>		-0.9%
8:15 am	Industrial Production – Jan	+0.2%	<b>+0.2%</b>		+0.1%
8:15 am	Capacity Utilization – Jan	78.8%	<b>78.8%</b>		78.6%
9:00 am	Business Inventories – Dec	+0.4%	<b>+0.4%</b>		-0.1%
2-16 / 7:30 am	PPI – Jan	+0.1%	<b>+0.1%</b>		-0.1%
7:30 am	"Core" PPI – Jan	+0.1%	<b>+0.2%</b>		0.0%
7:30 am	Housing Starts – Jan	1.458 Mil	<b>1.481 Mil</b>		1.460 Mil
9:00 am	U. Mich Consumer Sentiment- Feb	80.0	<b>80.0</b>		79.0