Economic Monthly
[US]

Impact of COVID-19 pandemic and the low-interest environment on the federal budget

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29 OCTOBER 2020
(ORIGINAL JAPANESE VERSION RELEASED ON 30 SEPTEMBER 2020)

On 2nd September, the Congressional Budget Office (CBO) revised its budget projection for each of the 11 years from fiscal 2020 to fiscal 2030 (fiscal year is October of previous year to September of that year) from its previous projection which it released around half a year ago on 6th March, before the first wave of the COVID-19 pandemic had hit the US. The current projection for the federal budget for fiscal 2020 is a deficit of 16.3% of nominal GDP, which is a large downward revision from the previous projection: a deficit of 4.9%. The reason for this was the addition of approximately USD 1.8 trillion of outlays due to a series of economic policies passed by Congress in response to the COVID-19 pandemic, as well as a decrease of around USD 0.3 trillion in projected revenues.

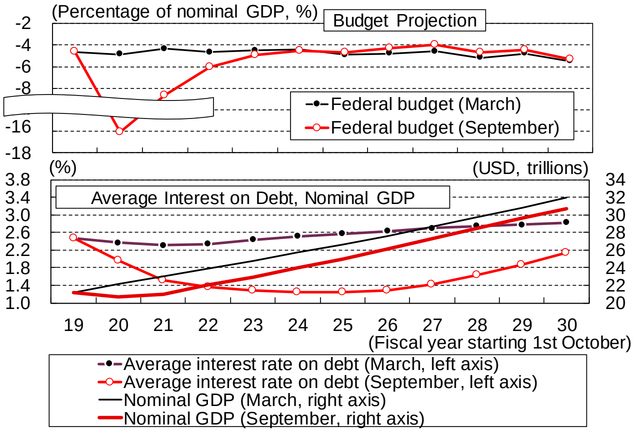
The total federal budget for the 10 years from fiscal 2021 was altered in accordance with changes to the economic outlook due to the pandemic, which means additional changes were made to each category of outlay and revenue. Nevertheless, the change from the previous projection in March is expected to remain small (Chart 1, small deterioration of budget as a percentage of nominal GDP and small improvement in terms of amount in USD). The main reason for this is changes in the monetary environment, which forms the basis for projections. The CBO anticipates prolonged monetary easing by the Federal Reserve Board in response to COVID-19 and a lowering of the forecast for interest payments[1]. A decrease in inflation will automatically result in a reduction of social security and health care costs, but this will be negated by the significant decrease in various forms of revenue and an increase in unemployment compensation payments as the economy worsens (Chart 2).

Revisions to the federal budget projections in September illustrate the size of the impact of the interest rate environment on the budget. At the Federal Open Market Committee (FOMC) meeting in September, it was once again implied that the current monetary easing policy will remain in place for a prolonged period[2] and that the level of US Treasury yields is likely to be lower than before the pandemic for the time being – in line with the CBO's assumption. While it is possible that this blessing in the form of low interest rates will continue for the time being, in the very long term, the US is forecast to experience an increase in social security outlays owing to its ageing population, which means its budget will be even more reliant on monetary policy and discussions on this matter are expected to grow in importance.

[1]The CBO revised its projection for the average interest rate on Treasury bills in fiscal 2030 from 2.8% to 2.1%: below the actual result of fiscal 2019 (2.5%). Furthermore, it lowered forecasts for each year from fiscal 2021 to 2030 by an average of 1.1%.

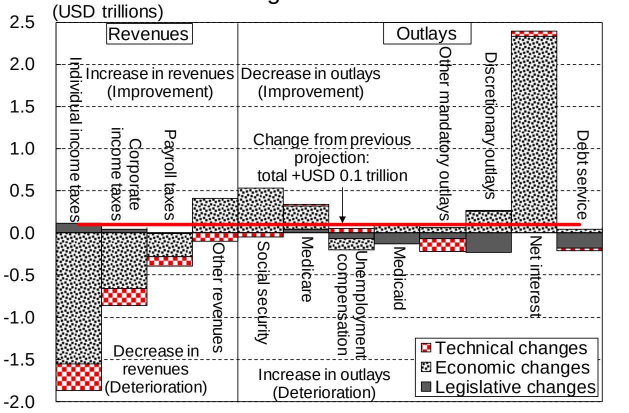
[2]At the September FOMC meeting, the Committee forecast in the Summary of Economic Projection that the FF rate will remain at current levels (0.00%~0.25%) until 2023, and gave some clarity to its forward guidance based on changes it made to its Longer-Run Goals and Policy Strategy at the end of August.

Chart 1: Federal Budget, Treasury Yields and Nominal GDP Outlook



Source: US Congressional Budget Office, MUFG Bank Economic Research Office

Chart 2: Change in Budgetary Projection for Total Federal Budget for Fiscal 2021 to 2030



Note: Each category in Mar. budgetary projection compared with Sep. projection
Source: US Congressional Budget Office, MUFG Bank Economic Research Office

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