

# Discussion on Trends, Cycles and the Output Gap

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# Conceptual Framework and Methodological Approaches

- ▶ Key concepts: actual output, potential output, output gap
- ▶ Short/medium-run vs. long-run potential output
- ▶ Three main estimation approaches:
  1. Statistical methods
  2. Production function approaches
  3. Structural modeling approaches
- ▶ Bank's use of multi-faceted strategy
- ▶ Recent enhancements: wider variables, stochastic volatility

# Recent Developments and Challenges

- ▶ Decline in potential supply growth:
  - \* Pre-GFC: 2.9% average
  - \* 2015-19: 1.8% average
  - \* Current long-run trend productivity growth: 1%
- ▶ Major shocks affecting estimates:
  - \* Brexit
  - \* COVID-19 pandemic
  - \* Global energy price shock
- ▶ Challenges in disentangling cyclical and structural changes

# Policy Implications and Current Estimates

- ▶ Role of potential supply estimates in monetary policy
- ▶ MPC mandate: avoid undesirable volatility in output and employment
- ▶ Output gap as complement to current inflation rates
- ▶ Current estimates:
  - \* Excess demand peaked at 1.75% of potential GDP in early 2022
  - \* Now close to zero, expected to widen to -1% in two years
- ▶ Rising participation rate since previous stocktake

# Key Questions for Discussion

1. How is estimation uncertainty incorporated into MPC decisions?
2. Disentangling Brexit effects from other structural changes?
3. Impact of pandemic-induced structural changes on estimates?
4. Factors driving low productivity growth and potential policy responses?
5. Sustainability of recent participation rate increase?
6. Confidence in current output gap estimates given multiple shocks?