“Growth beyond imbalances, sustainable growth rates and output gap reassessment”

by Enrique Alberola, Ángel Estrada & Daniel Santabárbara

(Banco De España)

Discussant: David Turner (OECD)

3rd WB-BE Academic Conference “Financing growth: Levers, Boosters and Brakes”

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Paper addresses important conceptual, technical & policy issues

- **Conceptual**: No pre-crisis warning signal from inflation, but build-up of other imbalances.

- **Technical**: Can other information be used to anchor real-time estimates of potential?

- **Policy**: Just as output gaps most shaky, EU has incorporated them in fiscal frameworks.

Perspective of comments

- Is there a recipe which can be followed across many countries?
- How sensitive to various judgements?
- How does current paper differ from similar approaches, eg by Borio et al (2013)?

Estimating "finance-neutral" gaps

1) $y_t = y_t^* + \beta(y_{t-1} - y_{t-1}^*) + \sum_{j=1}^{J} \alpha_j (x_{jt} - \overline{x_j}) + \varepsilon_t$

2) $\Delta y_t^* = \Delta y_{t-1}^* + \nu_t$

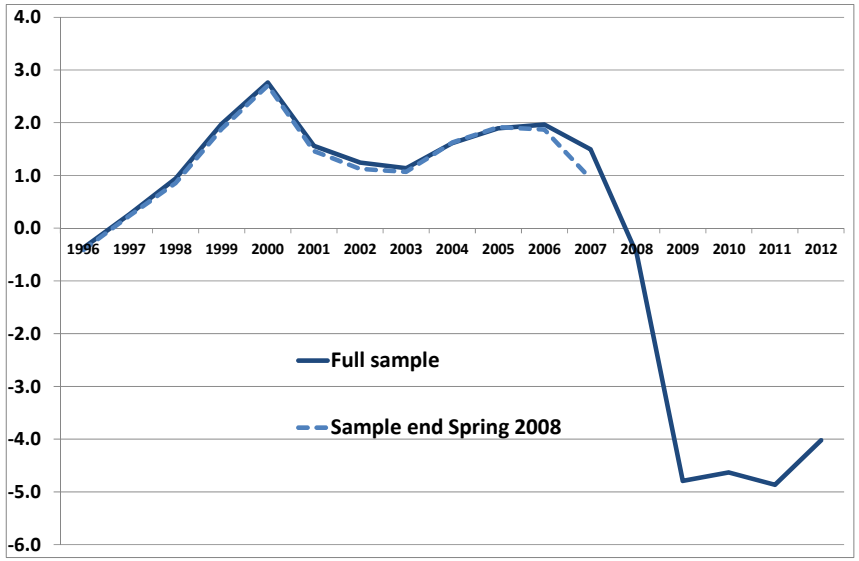
y = log real GDP, y* = log potential

x_j = financial imbalance indicators (real house price growth, real credit growth, real interest rates … + ?)

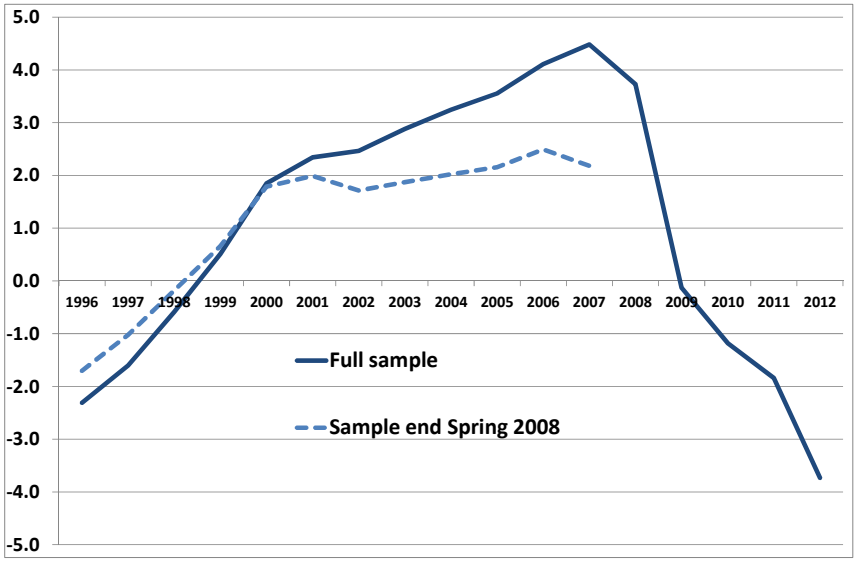
Can method of <u>Borio *et al.* (2013)</u> be applied generally across many countries?

(2) Financial variables do anchor output gap estimates for some countries

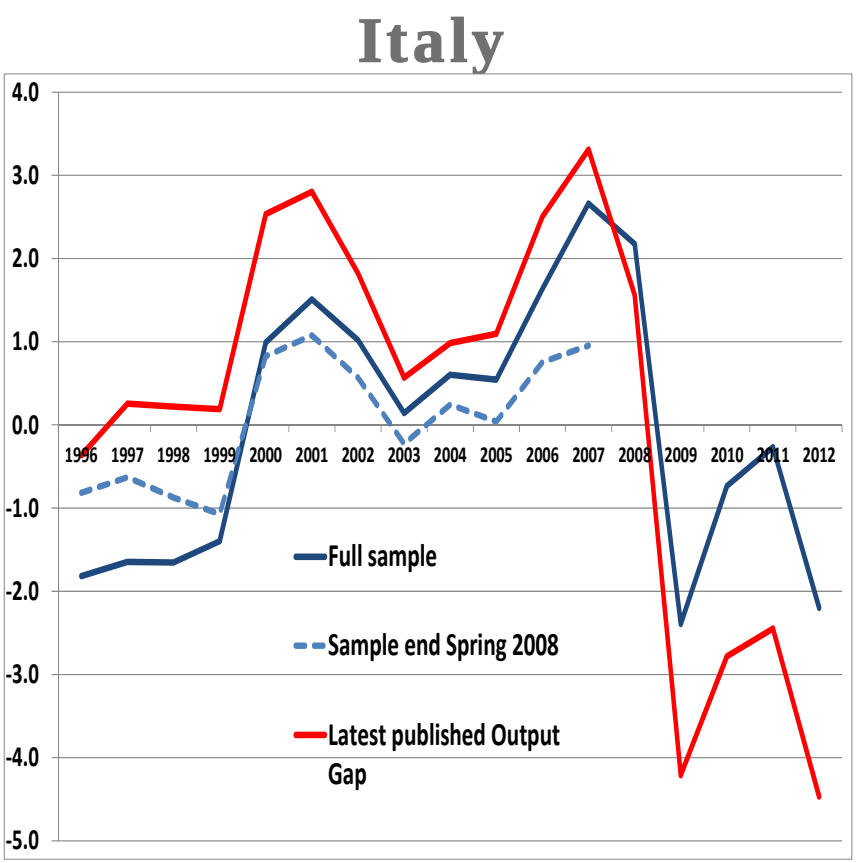
United States

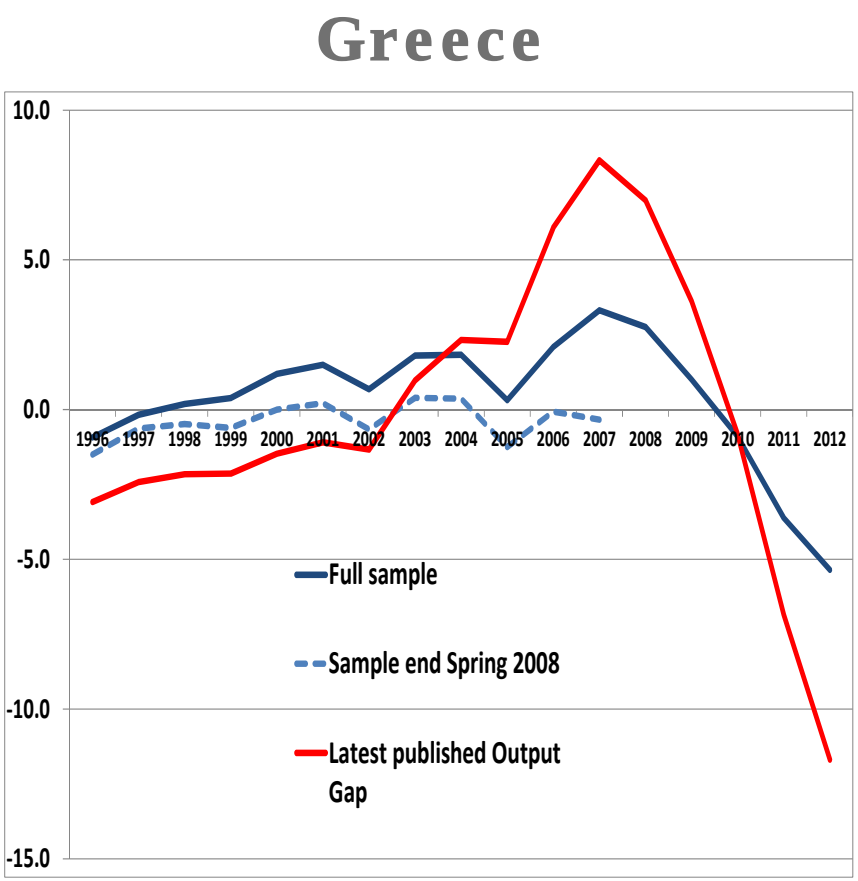


Spain



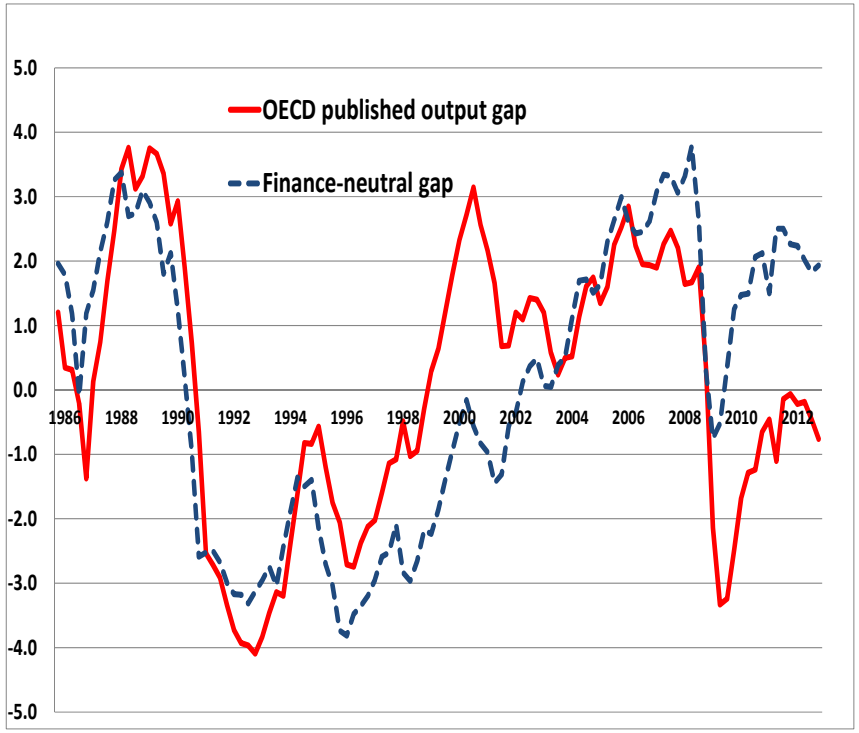
(2) But doesn't work so well for other countries ….





(1)… And for some countries generates questionable results: e.g. Canada

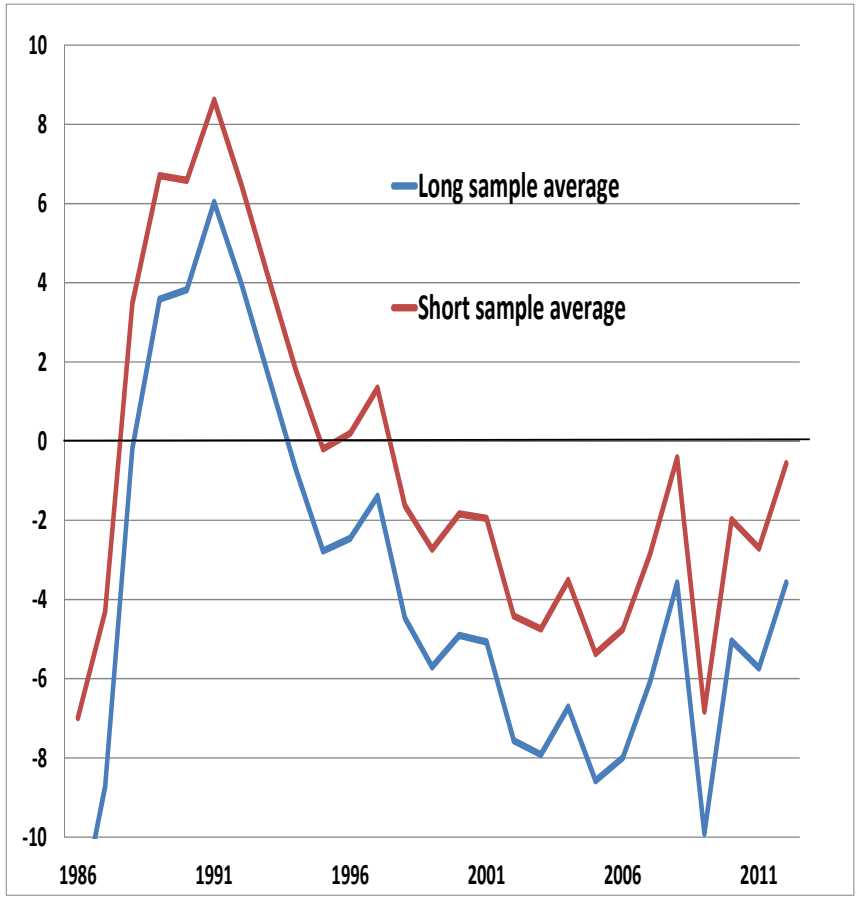
Canada



- Real short-term interest rates and house price growth as significant financial variables

- => Continuous overheating for last 10 yrs apart from a couple of Qs in 2009 ??

(2)… And for some countries generates questionable results: e.g. Japan

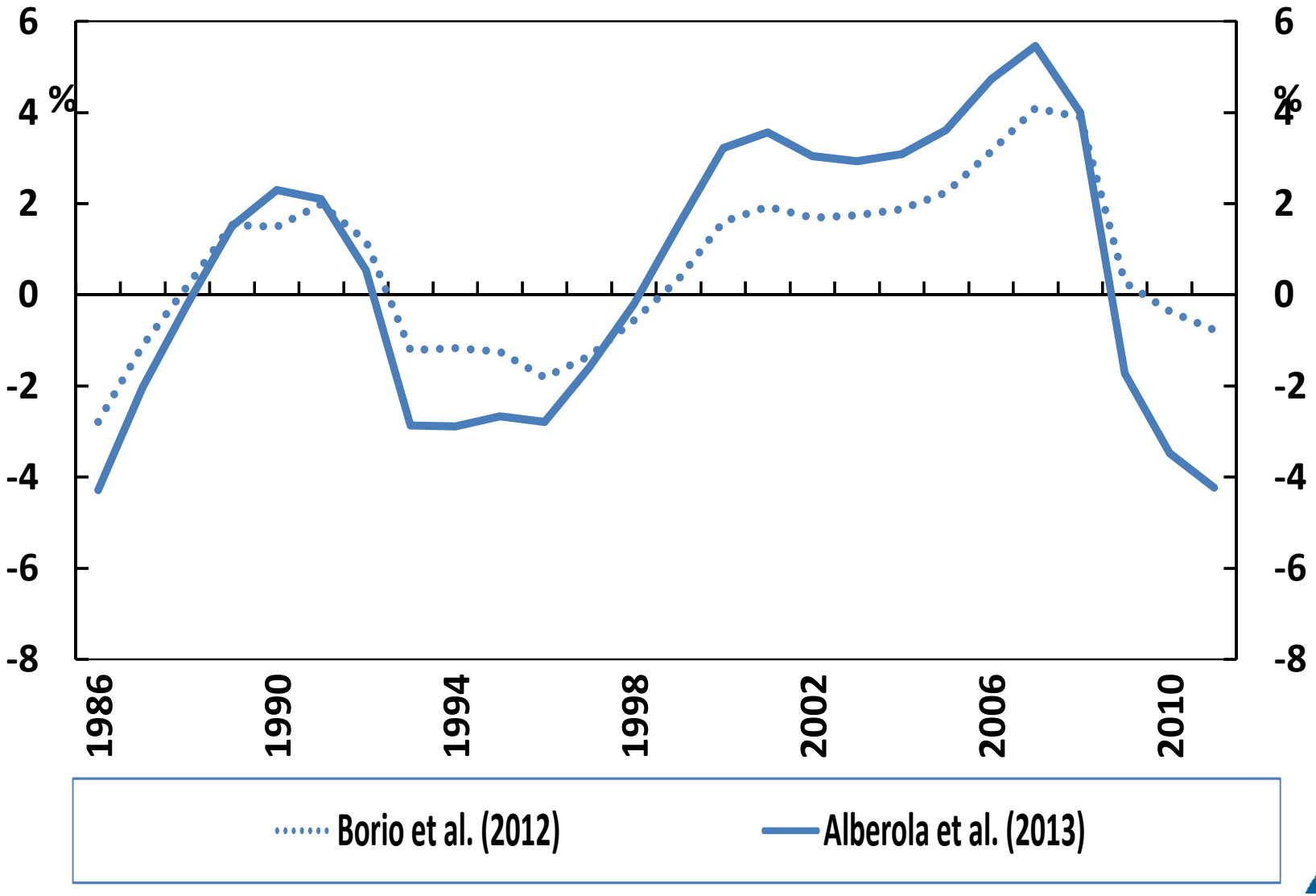


- Results very dependent on whether Real credit and house price growth average over long-sample (incl 70s) or shorter sample (form mid-80s)

Summary of results: mixed

	USA, UK, IRL, ESP	GRC, PRT, ITA, JPN, (CAN) + ….
Significance of credit, interest rates & housing imbalance indicators	Yes	Less so, Marginal
Plausible narrative (pre-crisis over-heating ..)	Yes	No
Reduces Real-time revisions	Yes	Not much

Current paper different results from Borio *et al*, e.g. Spain



Tentative conclusion: no simple recipe for anchoring trend output

- For countries where financial variables do help anchor y* is it in the right place? Danger of focussing on the last crisis not the next one?
- Same imbalance indicators don't work for all countries
- Dependent on choice & period over which averaged, especially at end-point.
- **Best approach?: calculate alternative gap measures in parallel & worry when they diverge from conventional measures**

What are the gains from a more disaggregated approach?

- Additional complication or better for story-telling ?

- ...but then would it be better to customise choice of anchor variables depending on factor of production, eg in labour market:
  - Net migration & trend participation
  - Long-term unemp & eqbm unemployment

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Additional slides

Selected References

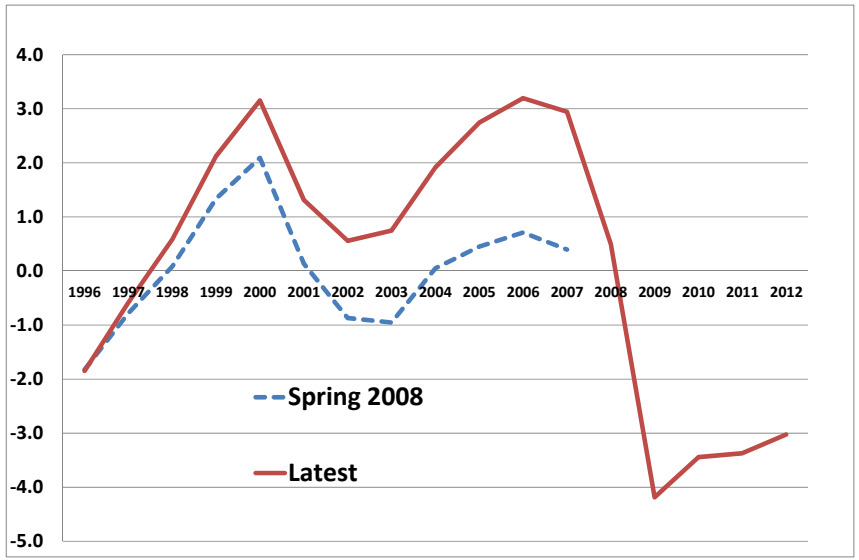
- Alberola E., A. Estrada and D. Santabarbara (2013), “Growth Beyond Imbalances, Sustainable Growth Rates and Output Gap Reassessment”, Bank of Spain.

- E. Rusticelli, P.Bagnoli and D. Turner (2014), “A Review of Alternative Concepts of Trend Output Incorporating Macroeconomic Imbalance Indicators” *OECD Economics Department Working Papers*, (forthcoming).

- Borio, C., P. Disyatat and M. Juseluis (2013), “Rethinking Potential Ouput: Embedding Information about the Financial Cycle”, *BIS Working Papers*, No. 404.

OECD published estimates of the output gap (%)

United States



Spain