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Growth rate of potential GDP

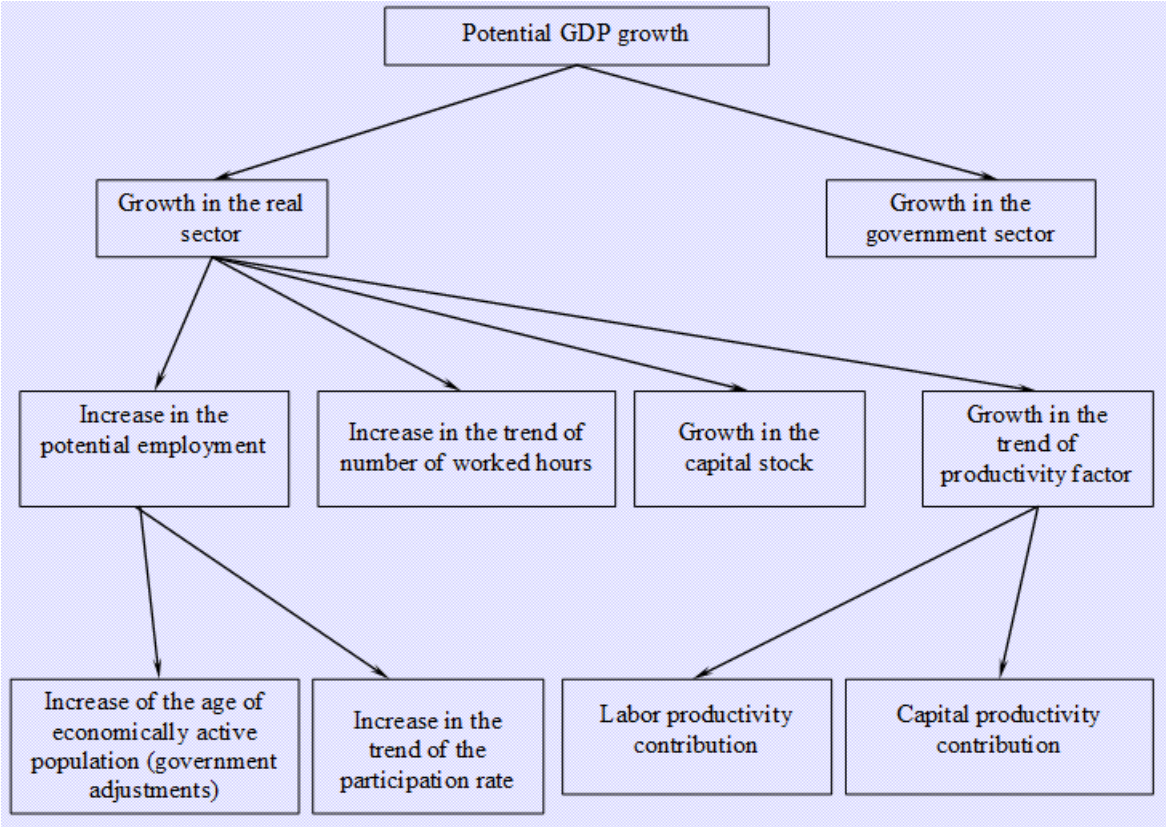
Technical box extracted from:

Inflation Report no.2, May 2013 [1]

The potential gross domestic product (GDP) is defined as the level of output that does not generate inflationary pressures. When actual GDP is above potential GDP, aggregate demand is generating inflationary pressures and the aggregate prices will therefore grow.

Representing the extent of excess demand in the economy, the potential GDP is relevant for deciding upon the monetary policy stance. Over the forecast horizon, the monetary policy anchors the inflation towards the target set through aggregate demand management.

Chart no. 1. GDP growth decomposition



The specific features of the potential GDP concept differ depending on the time horizon considered. In the long run, the potential GDP is conditioned largely by the structural characteristics of the economy. Potential GDP growth rate is mainly determined by fundamental factors such as the productivity capacity, the technological level, the organization of the economy, demographic and educational factors that affect the workforce, etc.

Changes in these factors occur usually over relatively long periods, and the effects are significant and

lasting. Potential GDP growth rate corresponds to long-run equilibrium values and only the impact of significant or structural changes or shocks can have an essential impact. Among the factors that could have a negative impact on potential GDP changes include: sudden population aging, reduction in the capital stock due to business failures, low volume of domestic and foreign investment, the deterrent effect on employment, and the impact of negative shocks on productivity.

In the medium-term, potential GDP growth may deviate from its long run equilibrium level, towards which it tends to return after the effects of some temporary factors have faded. Among the factors affecting the medium term potential GDP growth are: FDI inflows, temporary labor force migration, changes in agriculture potential and the impact of weather conditions.

Potential GDP is not a directly observable indicator. Therefore, its determination is a difficult task, especially in the case of emerging economies in the process of a structural transformation such as Moldovan economy. The potential GDP is deducted indirectly, based on information provided by the development of observable macroeconomic variables, such as actual GDP, inflation, interest rates, exchange rates, unemployment rates, etc. Therefore, any estimate of potential GDP is accompanied by some uncertainty.

See also

Tags
GDP [2]
gross domestic product [3]
potential GDP [4]
actual GDP [5]

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