

METHODOLOGIES FOR ESTIMATING THE OUTPUT GAP WITH AN APPLICATION TO CYPRUS

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Abstract

Output gap estimates are used in the calculation of structural fiscal balance indicators which are subsequently employed for the surveillance of economic growth and stability. This paper reviews the main methodologies for estimating the potential output and output gap. Methodologies can be grouped into two categories: the non-structural ones, which are not based on economic theory and are mainly statistical procedures; and the structural methodologies, which are based on economic foundations. The main advantages and disadvantages of each group of methodologies are discussed. Special attention is given to the production function approach adopted by the European Commission for the surveillance of the EU member states.

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