United States: The U.S. Economy Finally Reaches Its Potential

The release of the national accounts for the third quarter has already delivered a nice surprise: real GDP expanded by an annualized 3.0%, a result that tops expectations. Something else stood out: real GDP has finally reached its potential level estimated by the Congressional Budget Office (CBO). The difference between the two, or the output gap, finally tilted back into positive territory after 38 consecutive quarters below zero.

The growth of the U.S. economy during the recovery was often qualified as modest. The fact that we had to wait almost 10 years to see the real GDP reach its potential confirms this. During the cycle, the reconciliation between these two measures was greatly supported by the relatively slow advances in GDP potential. This slowness stems mainly from two factors: modest productivity growth and less favourable demographics, such that the annual average potential growth has only been 1.4% since the end of the recession, compared to 2.5% in the 2000s or 3.3% in the 1990s.

We have to keep in mind that measuring potential comes with a considerable degree of uncertainty. The measurement most often used in the United States is that of the CBO, which is similar to the measurements used by the OECD or the European Commission. These measurements recently suggested that the output gap was on the verge of tilting from a negative to a positive reading.

**IMPLICATIONS**

The closing of the gap between real GDP and its potential reflects the absorption of excess production capacity in the U.S. economy, suggesting that some inflationary forces could emerge in the United States. The relentless negative output gap observed during the cycle was one of the main elements behind the weak inflation. An output gap that is consistently in positive territory would validate the Federal Reserve’s quest to normalize its monetary policy.