Business Cycle Dynamics of Economic Growth in the OECD Countries: Evidence from Markov-Switching Model

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An Abstract

This study estimates the Markov-switching model and examines the Keynesian business cycle dynamics of economic growth for a comprehensive set of eight OECD countries. The estimated duration of regime one is (i) shorter for Denmark, Sweden and Switzerland, (ii) moderate for France and (iii) longer for Belgium, Spain and the U.S. The persistence of regime two is observed to be (i) shorter for Belgium, Canada, Spain, Sweden and the U.S., (ii) moderate for Denmark and France, and (iii) longer for Switzerland. The stylized evidence for the persistence of a given state has important implications for Keynesian policy activism and the formulation of macroeconomic stabilization policies. The monetary and fiscal policies are used to reduce the amplitudes and time-durations of the economic growth cycles and, thus, stabilise the output around its long-run natural rate level and the inflation around its target level. The short-run downward rigidities in prices in the goods markets and in nominal wages in the factor markets tend to impinge upon the clearance of markets and the acceleration of economic growth during recessions, thereby leading to the pathologically longer durations of lower regimes. While the longer durations of upper regimes support the sustainability of the expansionary economic policies, the adequate precautions need to be taken for the inflationary implications of these policies.

Keywords: Business cycle, Economic growth, Probability, Markov-switching, Maximum-likelihood.

JEL Classification: C20, C30, C32, E30, O40.