Download

Keep in mind

In the journal Essays on Economic Policy (ESPE) - we disclose the results and policy proposals that arise from academic research carried out at the *Banco de la República*. When you read us, always keep in mind that the content of our articles, as well as the analyzes and conclusions derived from them, are the sole responsibility of their authors. The material disclosed in our ESPE magazine does not compromise or represent the opinion of *Banco de la República* or that of its Board of Directors.

AUTHORS AND/OR EDITORS

Gómez-González, Esteban Murcia-Pabón, Andrés Zamudio-Gómez, Nancy Eugenia

Publication Date:
Saturday, 31 December 2011

Abstract

This paper is an attempt at constructing a simple and effective macroprudential tool for policymakers. By integrating the joint occurrences of the main financial markets in Colombia into a single Financial Conditions Index (FCI), we hope to synthesize the information embedded in them regarding possible future economic outcomes. To do this, we use monthly data on 21 variables for the period comprised between July, 1991 - June, 2010 and apply Principal Component Analysis (PCA) on their correlation matrix. On the one hand, we evaluate the predictive capacity of the FCI in forecasting GDP growth at

different time horizons and find that it performs better as a leading indicator of real activity than other individual financial variables and an autoregressive model of GDP growth. Additionally, we are interested in testing the FCI's long-term capability to correctly anticipate periods of distress in the economy, and find that the index could be used as an effective early-warning indicator. Hence, our FCI seems to represent a useful instrument for both financial stability and macroprudential supervision purposes.