Finance neutral potential output: an evaluation on an emerging market monetary policy context

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In this paper output gaps that include financial cycle information are evaluated against models used in policy analysis by the Colombian central bank. Employing this dataset is no trivial matter, since policy related models are the only relevant yardstick, and emerging economies (such as Colombia) have been historically more vulnerable to financial imbalances. Unlike previous works, finance neutral gaps were evaluated in a monetary policy context exactly as it is routinely performed by a central bank. The distribution of output gap revisions is analyzed, and a metric to compare real time robustness across models is developed. This metric constitutes a novel way to summarize the distribution of real time uncertainty around output gaps, and policy makers should employ it to compare different methods. Also the real time policy performance of finance neutral gaps is studied, separating suggested ex-post from operational ex-ante usefulness. Results suggest finance neutral gaps are neither more robust in real time nor more operationally useful than the benchmark estimates. This implies that policy makers should consider uncertainty to the extent that it affects the estimations real time forecasting capabilities.

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