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New Keynesian NAIRU and the Okun Law: An application for Colombia

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This paper proposes new monthly estimates for the non-accelerating inflation rate of unemployment (NAIRU) and the output gap for Colombia. These rely on a New Keynesian small open economy model following González et al (2013), augmented by an Okun’s Law equation. The resulting output gap closely follows the business cycle, as identified by other estimates currently employed by the central bank. The unemployment gap is negatively correlated to the output gap, in a magnitude consistent with simple Okun Law’s estimations. Unlike previous works, this paper presents shocks decompositions, which allow for some economic interpretation of the unemployment dynamics in terms of macroeconomic shocks. This framework might be well suited to evaluate the effects of monetary policy on the labor market, as suggested by an evaluation of forecasting accuracy.

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