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FINANCIAL CONDITIONS INDEX AS A PREDICTOR IN LOW-INFLATION ENVIRONMENT

Abstract:

The nature of the financial crisis in 2008 imposed new challenges for macroeconomic theory and policy-makers. In this context, a financial conditions index (FCI) could be a useful tool to identify the state of financial conditions in a country. We construct a FCI for Mexico to analyse the role of prices of financial assets in the formulation of monetary policy under the inflation-targeting regime. We estimate FCIs by two different methodologies using monthly data from 1990 to 2017. The variables are considered according to the mechanism of transmission of monetary policy and incorporating other important financial variables, those characterise developing countries. Our results show that FCI is a good predictor in a low/non-inflation environment.

Keywords:

Financial Conditions, Monetary policy, Vector autoregressive models

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