Tracking Business Cycles

For many decades, the use of qualitative indicators to serve as a monitoring tool has earned wide recognition by both government authorities and business organizations, thanks to the close correlation between the indicators and the status of the economy. Today, it is a common feature for many major industrial countries, and in developing nations as well, to have similar surveys being conducted on a regular basis. One of the earliest use of qualitative indicators can be traced to the business survey developed in the early 1920's by the Institute of Supply Management (formerly known as the National Association of Purchasing Management) to survey its members on commodities across the country and has since become an indispensable tool in analyzing the American economy.

The importance of such qualitative business surveys are justified by the ability of these surveys in tracking the changes in business cycle by looking for judgements on past, current and future economic growth. In a detailed definition by Burns and Mitchell (1946), business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises: a cycle consists of expansion occurring at about the same time in many economic activities, followed by a similarly general recession, contraction, and revival which merge into expansion phase of the next cycle; this sequence of changes is recurrent but not periodic; business cycles vary in duration from more than one year to ten or twelve years; they are not divisible into shorter cycles of similar character with amplitudes approximating their own. What this simply means, in broad terms, is that movements in economic activity generally follow a cyclical course comprising of four stages: expansion, peak, contraction, and trough.

There are several advantages in analyzing qualitative indicators obtained from business surveys. Both Schreyer and Emery (1996) believed that, compared with quantitative indicators, qualitative indicators do actually reveal information about the future and are useful inputs for forecasting activities. Also, the plus side in using qualitative indicators is that survey findings can be made known to the public faster with less delay compared with official economic statistics. It is agreed by Lindström (2002) that business survey data are important for prediction purposes, since official information, as a result of time-consuming data processing, is usually published with a time lag, whereas business survey data are typically made available in the first or second week after the end of each period.

At MIER, such a survey was also launched in the second quarter of 1987 for the same purpose as well. Called the Business Conditions Survey, it is carried out every quarter covering a sample size of 750 firms across eleven manufacturing industries in Malaysia, with the primary objective of seeking information and views on trends in output activities, inventories of finished goods, the state of order books, business outlays on plant and equipment, selling price expectations, production expectations and so forth. The results obtained from the survey contain valuable insights into the various manufacturing activities, which accounts for over 30 per cent of the country's Gross Domestic Product (GDP).

From the survey, an index called the Business Conditions Index (BCI) is generated. The index has a demarcation level of 100 points, which indicates that a reading of 100 points and above denotes expansionary situations, while any below 100 points reflect contractionary tendencies. According to Kershoff (2000), the measurement of business confidence is important, as this will dictate the current and expected state of the economy. Together with the Consumer Sentiments Index (CSI), derived from another survey conducted by the Institute on consumer attitudes and expectations, both indices are then incorporated into the Institute's short-term economic outlook, with the BCI depicting the supply side and the CSI reflecting the demand side of the story. It is also important to note that, in principle, the survey does not attempt to quantify trends but attempts, instead, to track the direction of growth. Therefore, the results gathered from the survey are useful to detect changes in the short-term outlook in the business environment and also to gauge the impending economic climate by seeking important insight into the processes of change in the judgements and expectations of various businesses.

Since its inception, the BCI has been consistent in tracking the direction of the Malaysian economy. For example, during the Asian crisis in 1997/98, there was a sharp decline in the BCI with an all-time low reading of 82.0 points in 1Q98. The reading is consistent with the contraction in the GDP growth into negative territory. To give another example, the conclusion of the war in Iraq and the containment of the Sars outbreak between April-June 2003 combined with the RM7.3 billion economic stimulus package lifted sentiments higher, as the manufacturing sector moved into an expansionary mode. The BCI rose above the demarcation level to read 104.9 points in 2Q03 from the previous reading of 99.3. The strength of the reading was mainly driven by improvements in current business conditions and expectations about the future, particularly for production activities and bookings from external markets. True enough, the following quarter saw the economy grow by 5.1 per cent, thanks to an improvement in business climate.

Evidently, an effective monitoring tool is vital to track the changing cycle of the economy, and for the authorities to arrive at sound economic policies. Thus, the ability of business surveys to capture the cyclical position on the economy, based on sentiments and perceptions, is considered one of the most essential and reliable tools for near-term economic forecasting and policy making.

The writer is a senior research officer with the Malaysian Institute of Economic Research (MIER)