Understanding Economic Indicators

Posted on

‘Economists have a full time job in trying to keep a country’s economy healthy. A healthy economy is one that is growing smoothly. Economic growth is the ability to use an economy’s resources more efficiently so that you are generating income. That income is of benefit to the people that live in the economy. It gives a measure of their spending power,’ says Andrew Hunt, Chief Economist with Thornton Management Asia, in Hong Kong.

An overheating, inflationary economy, or at the other end of the scale, an economy slipping into recession are unhealthy. It is the economist’s job to recognize the danger signs and predict when an economy is going to stall or over-accelerate.

Economic Indicators

Economists have several tools at their disposal to gauge the health of the economy. Hunt says that more and more economists are looking at capacity utilization as a means of measuring the efficiency of a particular economy. Capacity utilization measures how much manufacturing companies are using their facilities. The United States has been measuring capacity utilization for many years and that trend is now catching on in Europe. It is expected to be used as a reliable measure in Asia in the future, as more data be- comes available, says Hunt.

Examining capacity utilization means examining ‘how efficiently resources are being used in an economy to tell whether the growth rate is sustainable. If an economy is using its resources too intensively, then that growth isn’t likely to be sustainable. If the economy is not using its resources as efficiently as it might, then there’s obviously a potential to do something about that and to generate some economic growth that can be sustained in the long term.” says Hunt.

Experts in the United States agree that 83% capacity utilization is the optimum level. If the economy is running above that level, there are fears that you are demanding too much from the economy. Operations may overheat and break down. Central banks and markets get very concerned if an economy reaches that level of capacity utilization. It is threatening because it is hard to wind down without slowing down the whole economy. But if the economy is running at below 83 capacity level, there are spare resources and there is still healthy room for growth, without that growth being inflationary. In addition to examining capacity utilization, experts draw on a host of other key data to build a picture of the state of the economy. Unemployment figures are closely monitored by economists. If the jobless total falls, for instance, it is usually taken as a sign that the economy is on a growth track. Similarly, if the number of people out of work. climbs, the economy could be headed for recession. If manufacturers report an increase in factory orders, the economy is doing well. A backlog of orders for durable goods is also a good sign that the economy is expanding. Similarly, a rise in demand for new housing is a healthy sign. Gross Domestic Product (GDP) is another important indicator. If GDP, the value of goods and services produced, declines, that is the bellwether signal that the economy is in decline too. Consumer Confidence

But consumers are the driving force behind most economies. Individual spending is the largest single factor in economic growth and personal income and consumption figures are major indicators. If consumers feel good about the economic future, they will spend with confidence, boosting economic growth. If they feel unsure about the direction of the economy, they will spend less, slowing growth. Inflation Is Bad For You Inflation is bad for market confidence and it is bad for consumer confidence. Money loses its value and the man in the street has to spend a greater proportion of his income-assuming his income does not keep pace with inflation – on day to day necessities. The Consumer Price Index measures the economy from the point of view of the man in the street, showing how much basic costs such as food, housing and clothing have changed. Producer prices give a clear indication of the future direction of consumer prices. If the cost of raw materials goes up, retail prices are expected to increase in line. To gauge the impact of inflation, the following calculation can be used. Divide 72 by the annual inflation rate to find out how many years it will take for prices to double. For example, if the annual inflation rate is at 10%, it will take 7 years for prices to double. If inflation is at 2%, it will take 36 years for prices to double.

When prices go up, the standard of living falls for people on a fixed income. It can also seriously erode your standard of living if you are retired and your retirement payments are gauged by what you earned in a period of lower inflation.

Inflation can erode your savings too. For example, you may be saving 20% of your income, but if the inflation rate is also at 20% or even higher, you are not really moving ahead at all and will not be able to enjoy the same buying power in the future. One way to protect yourself against the negative effects of inflation is to invest some of your money in stocks or mutual funds. Equity investments, on average, tend to turn in a higher rate of return than the inflation rate.

Bank Regulation

The job of central banks is basically to achieve a balance between sustainable growth and an acceptable level of inflation. Central banks will adjust their monetary policy in a bid to help cure an ailing economy. Money supply will be regulated accordingly. If the economy is speeding ahead, banks may withdraw money from-circulation. In the first place, people have less money to spend. Withdrawing money will also mean that the value of money increases. Interest rates may go higher and it will cost companies more to borrow and invest money. That may slow economic growth.

Conversely, if the economy is working below capacity, banks will feel happier about easing monetary policy. They will allow more money into the economy, interest rates may come down, the economy may pick up and a new economic cycle will begin.