ECONOMIC INDICATORS

Objective

This chapter deals with the concepts of macroeconomics and various economic indicators that impact the economy and consequently the capital markets.

Macroeconomics

Theoretical

- Macroeconomics is a branch of economics that deals with the performance, structure, behavior and decision-making of the entire economy, be that a national, regional, or the global economy.

Practical

- Macroeconomists develop models that explain the relationship between such factors as national income, output, consumption, unemployment, inflation, savings, investment, international trade and international finance.

Operational

- It attempt to understand the causes and consequences of short-run fluctuations in national income (the business cycle), and the attempt to understand the determinants of long-run economic growth (increases in national income).

Macroeconomics: Actors

- **Government**

  Decisions taken by the government and policies implemented directly affects the economy.

- **Workforce Market**

  When employment increases, average standard of living of people increases and thus improves the economy.

- **Household**

  Increase in consumption at retail level (household) is an indication of how well the economy of a country is doing.

Macroeconomics: Actors

- **Financial and commodity markets**

  Performance of an economy is measured by the way the markets perform, where rise in markets is often followed by boom in economy.

- **Foreign participants**

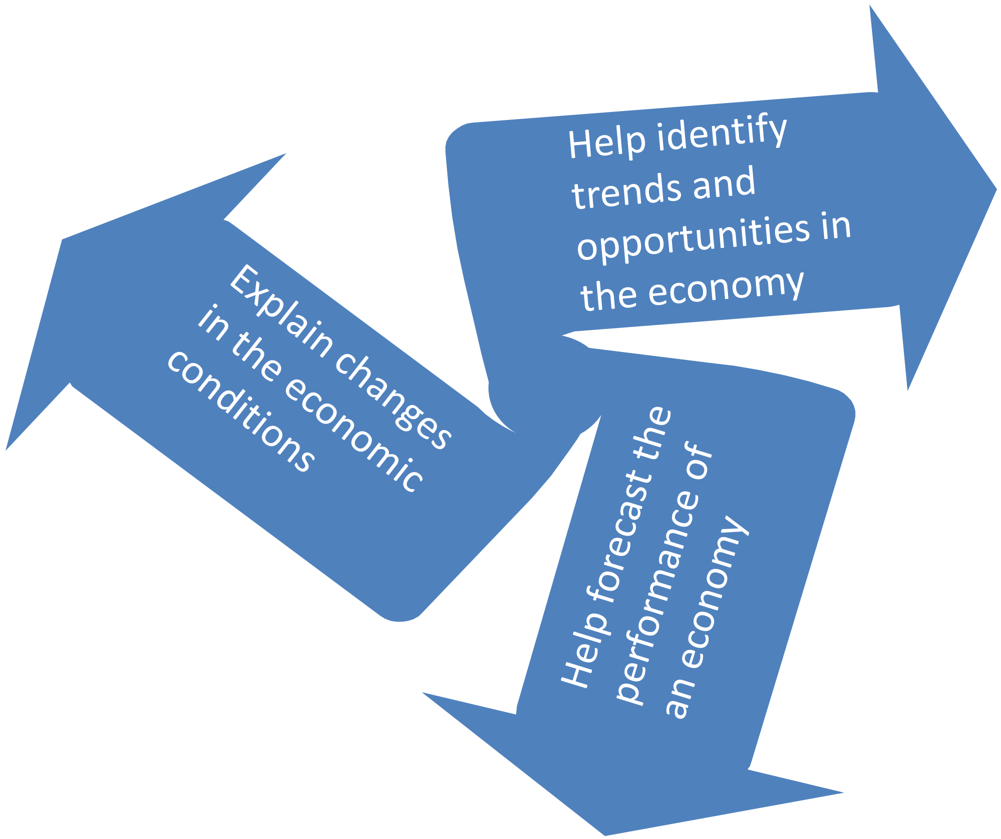
  Investors from outside the country bring investments and along with, the crucial foreign exchange reserves. Increased foreign investors is a positive sign for economy.

Macroeconomics: Actors

- An **economic indicator** (or **business indicator**) is a statistic about the economy.
- Economic indicators allow analysis of economic performance and predictions of future performance. One application of economic indicators is the study of business cycles.
- Economic indicators include various indexes, earnings reports, and economic summaries.
- Classification by timing:
  - Leading indicators — exp. Stock Market
  - Lagging indicators — exp. Unemployment
  - Coincident indicators — exp. IIP
- Classification by direction:
  - Procyclic — exp. Gross Domestic Product (GDP)
  - Countercyclic — exp. unemployment rate

Economic Indicators

Why Are Economic Indicators Important?



Economic Factors

- Economic policy
  - Government Fiscal Policy (budget/spending practices).
  - Monetary Policy (Central bank influences supply and "cost" of money, level of interest rates).
- Government budget deficits or surpluses
  - Increased budget deficits indicate weakness in the financial state of a country and vice-versa.
- Balance of trade levels and trends
  - Balance of trade is the difference between value of imports and exports. Surplus of exports over imports will increase the foreign currency reserves and is good for economy.
- Inflation levels and trends
  - Increase in inflation decreases the purchasing power of a currency. Thus consistent rise in inflation creates negative impact on the economy.

Political Conditions

- Internal & Regional
  - Regional factors play a crucial role in the development of a country. Economic growth is generally concentrated in specific areas of a country.
- International political conditions
  - Ex: America and Iraq
- Political instability
  - A stable government is always hailed by international investors who are analyzing whether to invest in a country.
- Anticipations about the new ruling party
  - Exp: Greece, Egypt

MAJOR ECONOMIC FACTORS

Objective

This topic discusses details of the economic data values and their effects. It also deals with various instruments used by the Central bank of a country such as Repo rate, CRR etc. The participant should also understand impact of these indicators.

Major Economic Factors

- GDP
- Unemployment
- Inflation
- CRR
- SLR
- Repo Rate
- Reverse Repo Rate
- Demand and Disposable Income
- Interest Rates
  - LIBOR

GDP: Definition

- Total amount of goods and services a country produces in specific time period is known as gross domestic product
- Real GDP: Takes inflation into account
- Nominal GDP: Reflects only changes in prices
- Drawback : Information has to be collected after a specified time period has finished, a figure for the GDP today would have to be an estimate

GDP: Uses

- Stepping stone to Analysis
- Expansions (booms)
- Economic recessions (slumps)
- Can be compared across economies
- Can be used to decipher the business cycles
- Forecast the future state of the economy
- GDP collected over a period of time can be compared
- Determine which foreign countries are economically strong or weak
- Government policy, consumer behavior or international phenomena

GDP: Release

- Considered as benchmark for economy
- GDP numbers are issued quarterly
- Issued by government statistical agency
- Revised and estimated number are issued
- GDP Growth rate matters more than actual GDP value
- Trend matters more than the number
- But, Benchmarked against zero. (For India 8%, China 11%)

Unemployment : Definition

- Unemployment figure indicates number of people who are unable to find work from the available pool of labor (the labor force)
- Unemployment rate: Percentage of People unable to find work over the total labor force of the country
- If GDP is growing over the years, Unemployment tends to be low
- Inflation and Unemployment rate have inverse relation

Unemployment : Release

- Considered as one of the benchmark for economy
- Released monthly by NCAER in India. US Department of Labor in US
- Non Farm Payroll (NFP). 80% of the workers who produce the entire gross domestic product of the United States
- Persons are classified as unemployed
  - If they do not have a job
  - Have actively looked for work in the prior 4 weeks
  - And are currently available for work

Inflation: Definition

- Inflation rate, the rate at which prices rise
- Measured in two ways: through the
  - Consumer Price Index(CPI) gives the current price of a selected basket of goods and services that is updated periodically , as pertaining to end consumer
  - Wholesale Prince Index(WPI) gives the current price of a selected basket of goods and services that is updated periodically , as pertaining to wholesale price
- Demand-Pull Inflation - demand is growing faster than supply, prices will increase. This usually occurs in growing economies
- Cost-Push Inflation - When companies' costs go up, they need to increase prices to maintain their profit margins. Increased costs can include things such as wages, taxes, or increased costs of imports

Inflation: Release

- Released fortnightly by the government
- Wholesale Price Index
  - Price comparison at wholesale level
- Consumer Price Index
  - Price comparison at retail level
- Basket of goods
  - Basket of goods considered – food grains, basic necessities
- Gold
  - price increases similar to inflation, considered hedge against inflation
- Political sensitive
  - BOE governor has to write a letter to chancellor if inflation goes above 3% per annum

Statutory Liquidity Ratio (SLR)

- It is the amount that a bank has to maintain in the form of cash, gold, or approved securities
- The quantum is specified as some percentage of a bank's total demand and time liabilities i.e., the liabilities that are payable on demand anytime, and those liabilities that are accruing in one month's time due to maturity
- This ratio is fixed by the RBI
- Changed during the RBI meeting

Cash Reserve Ratio (CRR)

- Cash Reserve Ratio is a central bank regulation that sets the minimum reserves each bank must hold to customer deposits and notes
- Normally be in the form of fiat currency stored in a bank vault (vault cash), or with a central bank or Banks keep bonds (of certain rating) with central banks in lieu of cash
- An increase in the CRR leads to banks parking more money with RBI reducing the funds available with banks
- On the other hand a reduction in the CRR keeps more money with banks boosting liquidity in the markets
- CRR is changed during RBI governors meeting
- CRR is a liquidity management tool of the RBI

Repo Rate & Reverse Repo Rate

- Repo Rate is the rate at which banks borrow rupees from RBI
- A reduction in the repo rate will help banks to get money at a cheaper rate
- When the repo rate increases borrowing from RBI becomes more expensive
- Influencing the country's economy, borrowing, and interest rates
- Western central banks rarely alter the reserve requirements because
  - It would cause immediate liquidity problems for banks with low excess reserves
  - Prefer to use open market operations to implement their monetary policy
  - People's Bank of China uses changes in reserve requirements as an inflation-fighting tool, and raised the reserve requirement nine times in 2007
- The repo rate is a rate management tool

Repo Rate & Reverse Repo Rate

- Reverse Repo Rate is the rate at which banks lend rupees from RBI.
- An increase in the reverse repo rate will get banks to park their money at a higher rate to RBI.
- Influencing the country's economy, borrowing, and interest rates.
- The reverse repo rate is a rate management tool for the broader economy.
- Changed during governors meeting.

Demand and Disposable Income

- Demand comes from
  - Consumers (for investment or savings - residential and business related)
  - Government (spending on goods and services of federal employees)
  - Imports and exports
- Example: Factory Orders
- Real Personal Income: Personal income per capita (using population figures), and adjusted for inflation
- Disposable Personal Income (DPI): Personal income minus tax payments
- Personal Savings Rate: DPI minus personal outlays (and expressed as a percentage of DPI)
- Monthly updated by Department of commerce

Interest Rates

- Interest rates are the rates levied by the banks for lending a loan
- Changes in Interest rates are caused by:
  - Economic Growth
  - Providing adequate Liquidity
  - Control Inflation
  - Risk of Investment
  - Political Consideration
- Tracked by LIBOR (London Inter Bank Offer Rate) and MIBOR (Mumbai Inter Bank Offer Rate)

LIBOR

- The **London Interbank Offered Rate** (or **LIBOR**) is a daily reference rate based on the interest rates at which banks borrow unsecured funds from other banks in the London wholesale money market (or interbank market)
- LIBOR is determined every morning at 11:00am London time. A department of the British Bankers Association averages the inter-bank interest rates being offered by its membership
- LIBOR is calculated for periods as short as overnight and as long as one year
- LIBOR is calculated for various currencies Dollar, Euro, Pound