NCAER

# Understanding Business Expectations: The usual and unusual

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(Research assistance of Charu Jain and Kartikeya Rao is gratefully acknowledged)

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# Outline of Presentation

- Business expectations

- What do they track?

- Implications for forecasting economic activity

# Business expectations:

## what are they? And why measure?

# The Business expectations

- Business sentiments? Animal spirits?
- Business intentions?
- Business conditions: constraints, opportunities?
- Do we want short-term indicators of the economy or long-term indicators?

# The need for surveys

- Business decisions, Policy decisions require data

- There is a lot of 'hard data' but may not reflect subjective business conditions

- Hard data has limited information on future course of business

- The surveys may provide leading indicators of business performance

# The hard data

- The hard data is for the present and comes with a lag

  - IIP
  - Exports/ imports
  - Monetary variables
  - Fiscal variables

# The Business Exapectations Surveys in India

- NCAER
- FICCI
- Dun & Bradstreet
- CII
- RBI Industrial Outlook Survey

# What do the surveys track?

# NCAER's Business Confidence Index

- Four components: $BCI = 0.25 * \Sigma C_i \, i=1,4$

- Over the next six months:
  - Overall economic conditions
  - Financial position of the firm

- Now:
  - Investment climate
  - Capacity utilisation

Note: NCAER-MasterCard Worldwide Index of Business Confidence since Oct 2009; NCAER-ET BCI previously till 2004
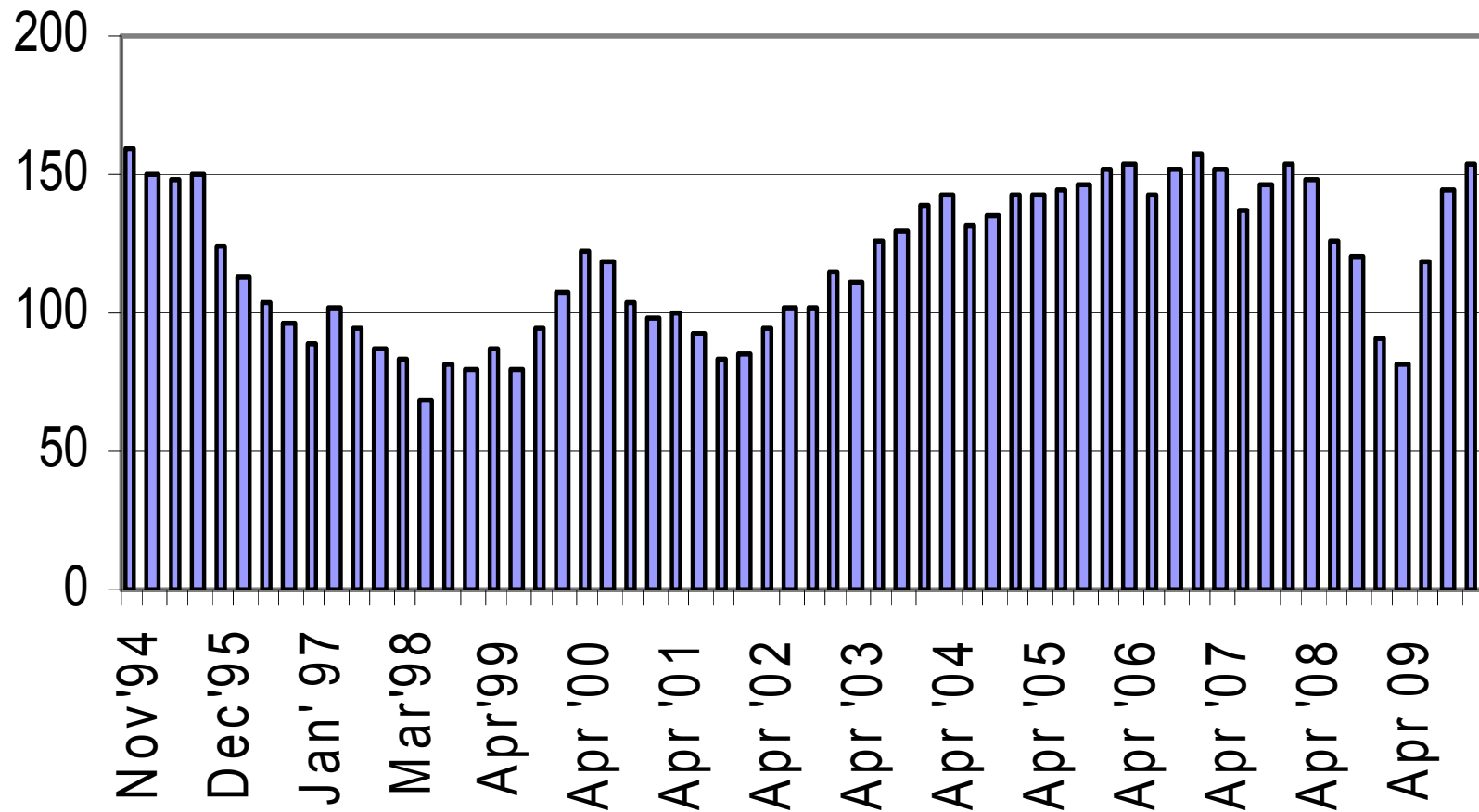
# The NCAER Business Confidence Index
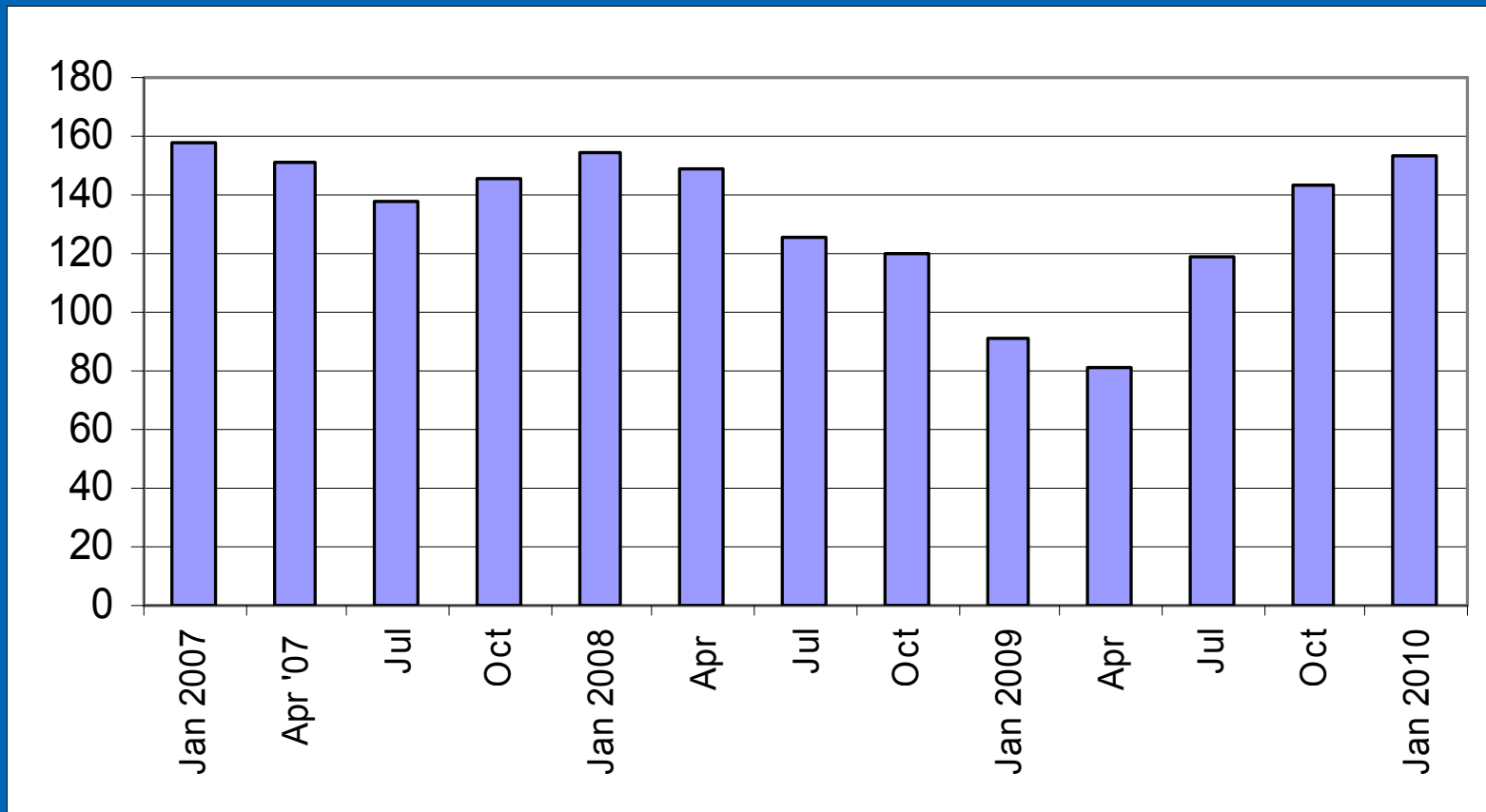


NCAER-MasterCard Business Confidence Index from Oct 2009;
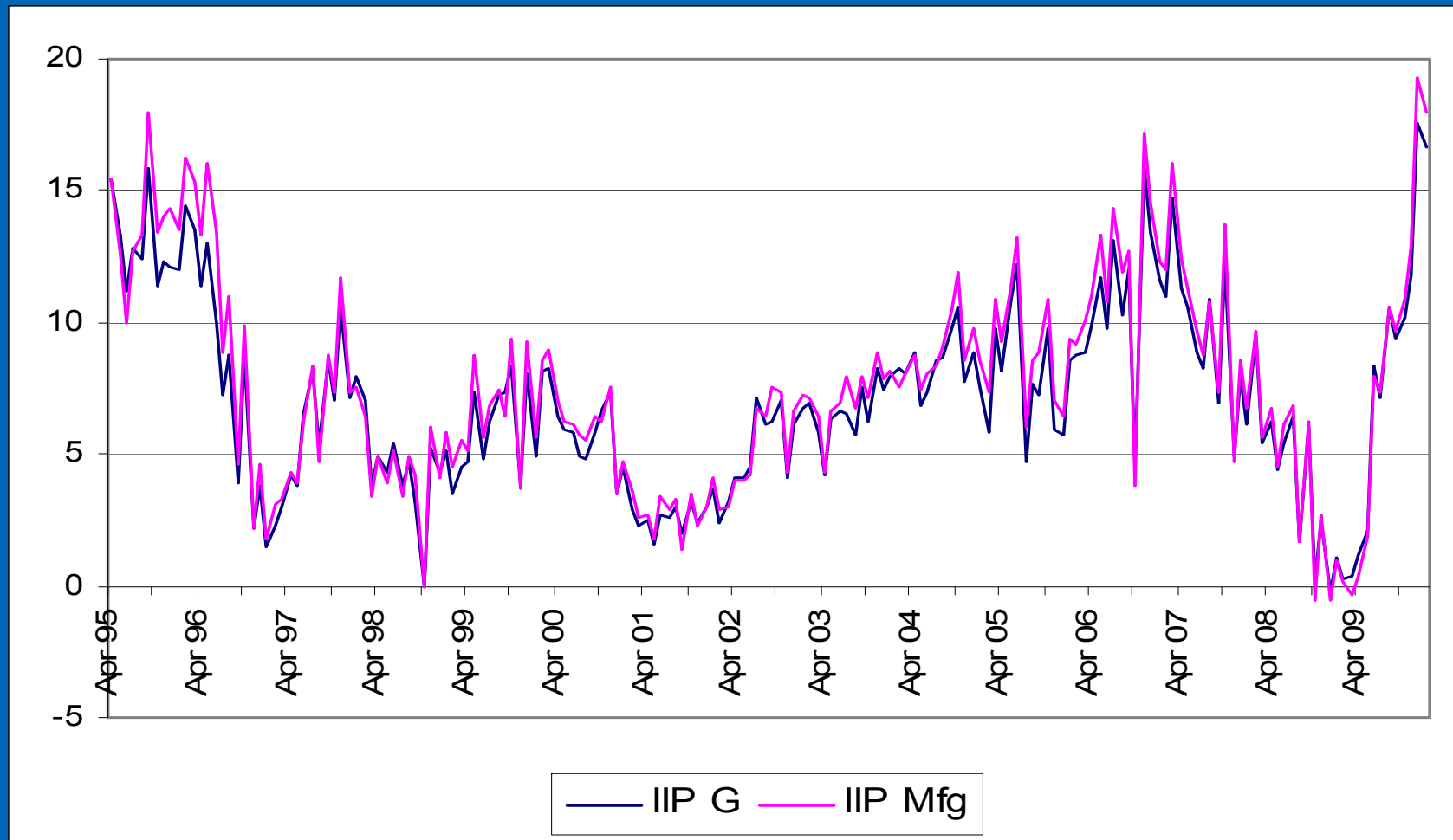NCAER-ET Business Confidence Index for previous quarters upto 2004

# The BCI: a historical view

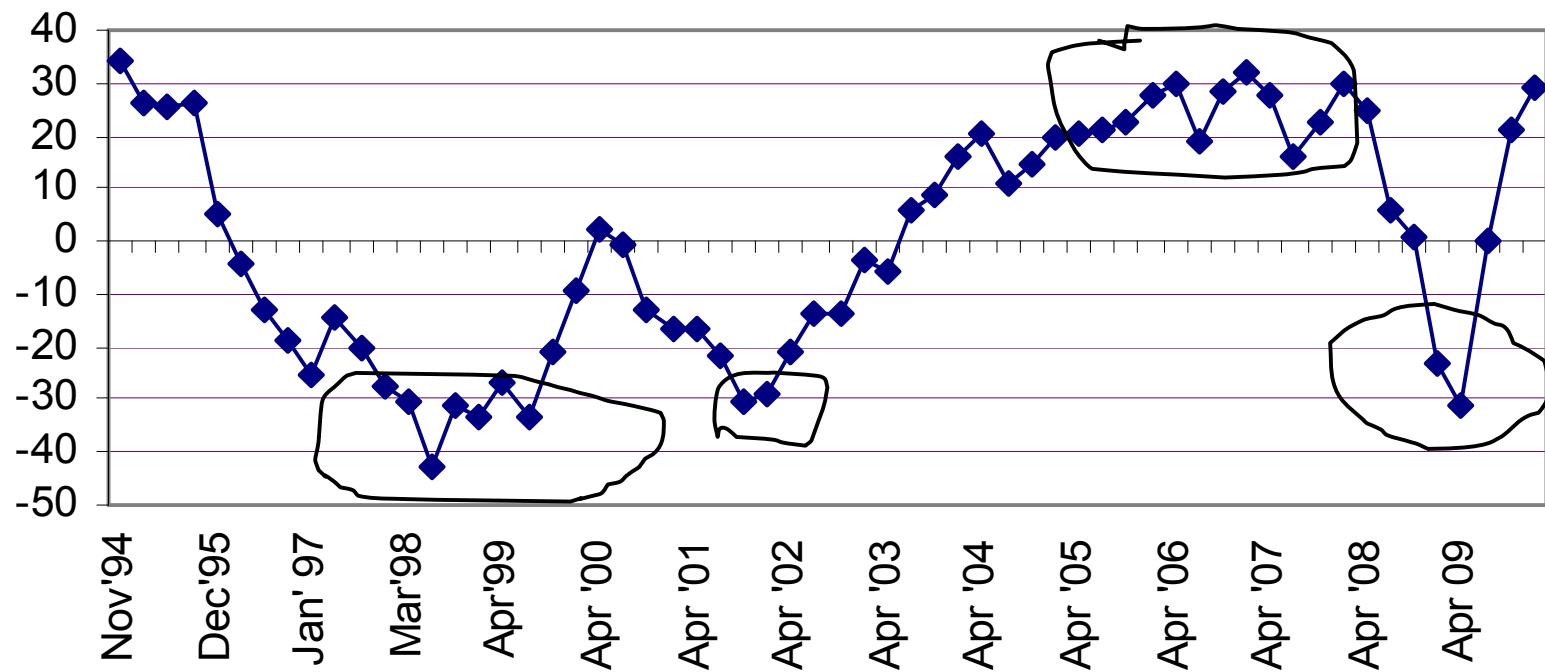# The usual and unusual: IIP Mfg % YOY



Monthly data
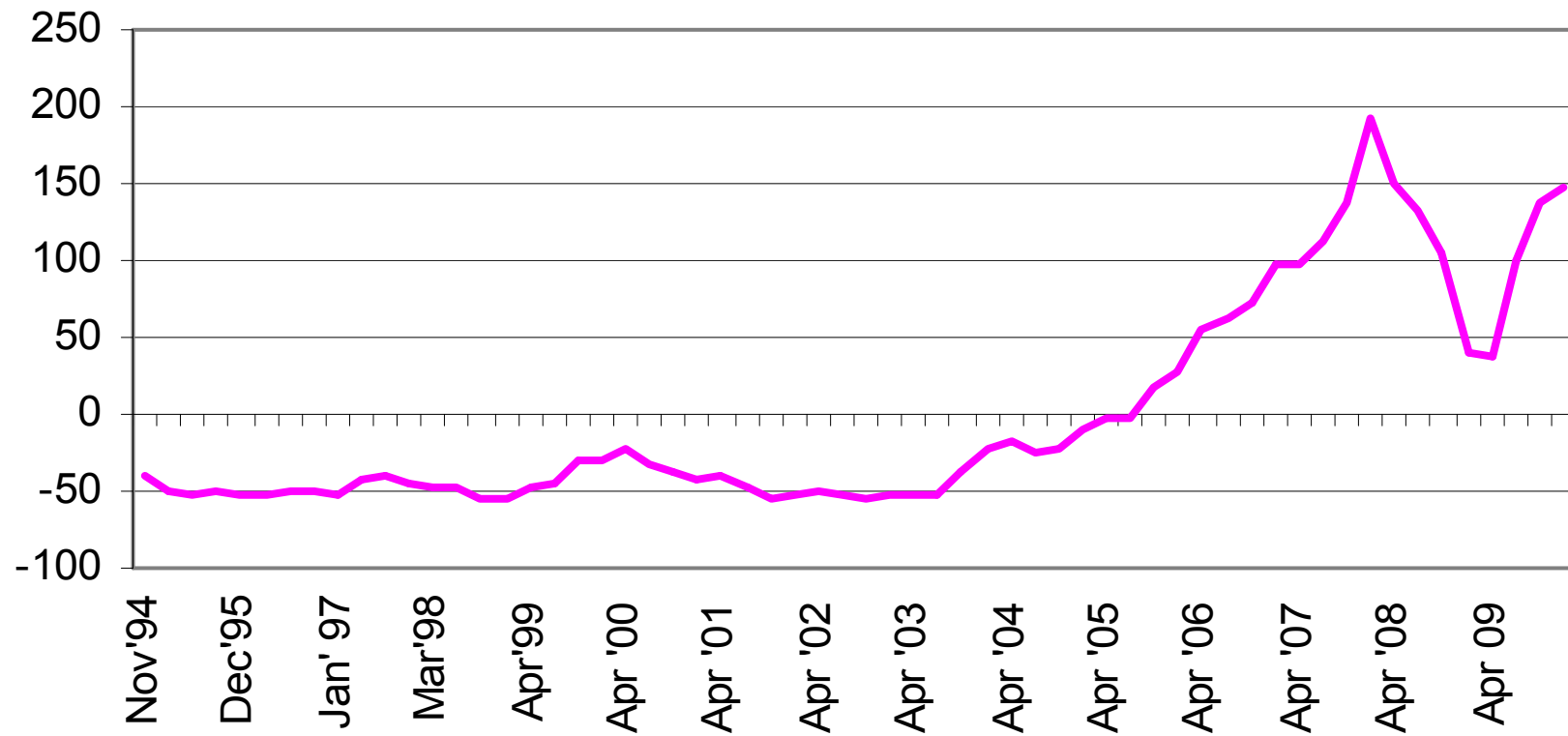
# The peaks, troughs and the usual in sentiments
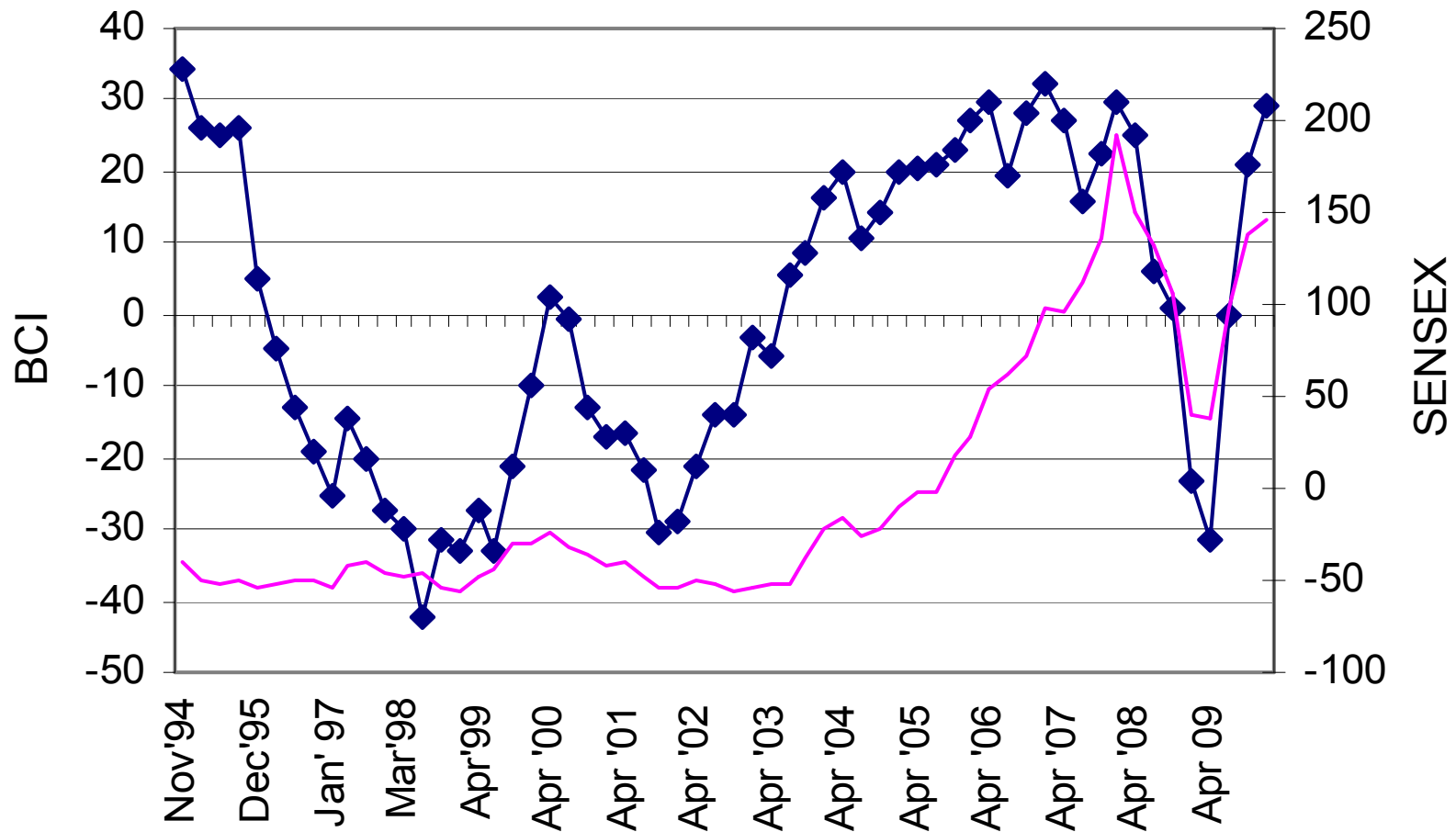

Business Confidence Index % deviation from mean

# Other barometers of business sentiments
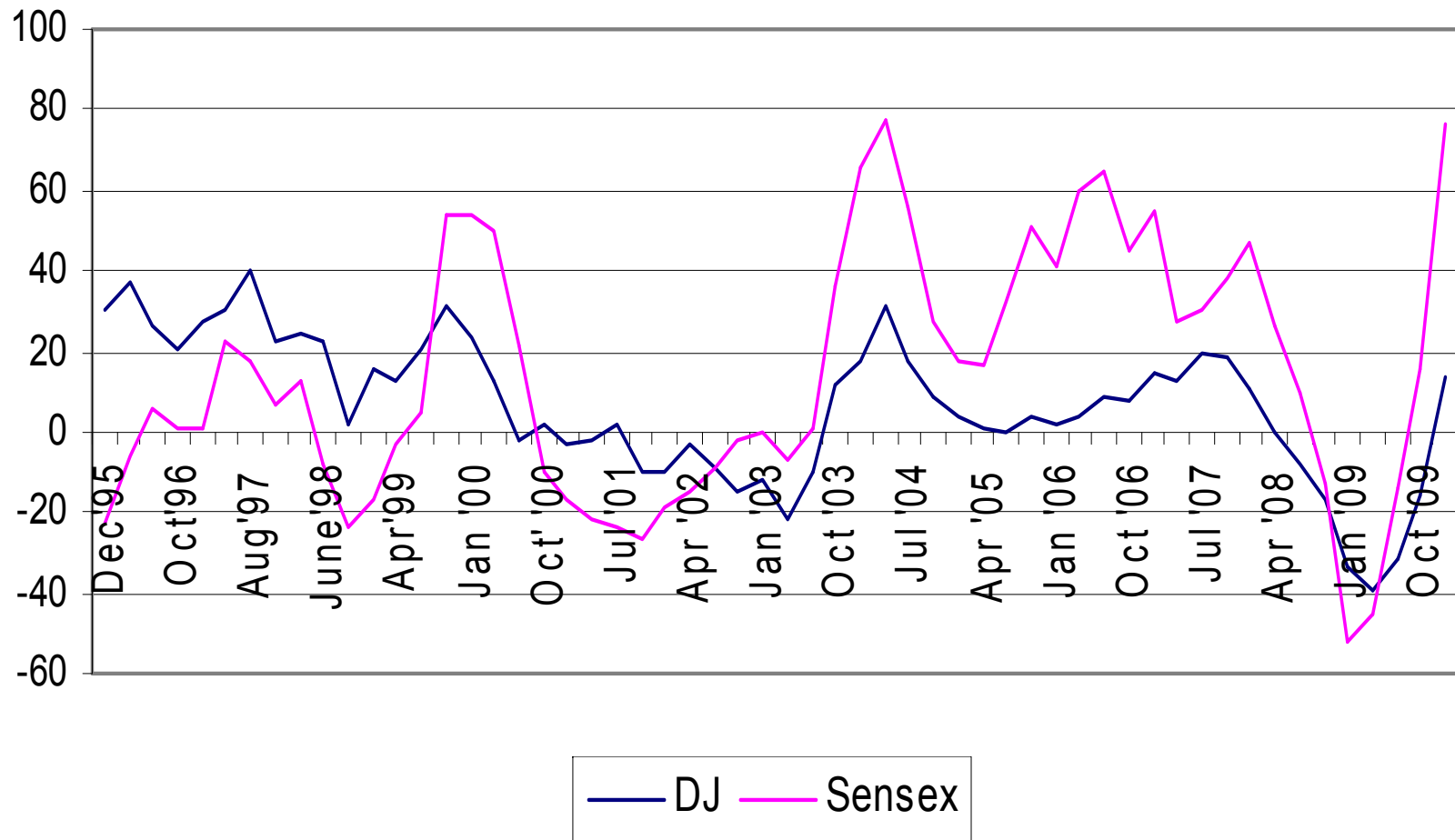
## Sensex %deviation from mean

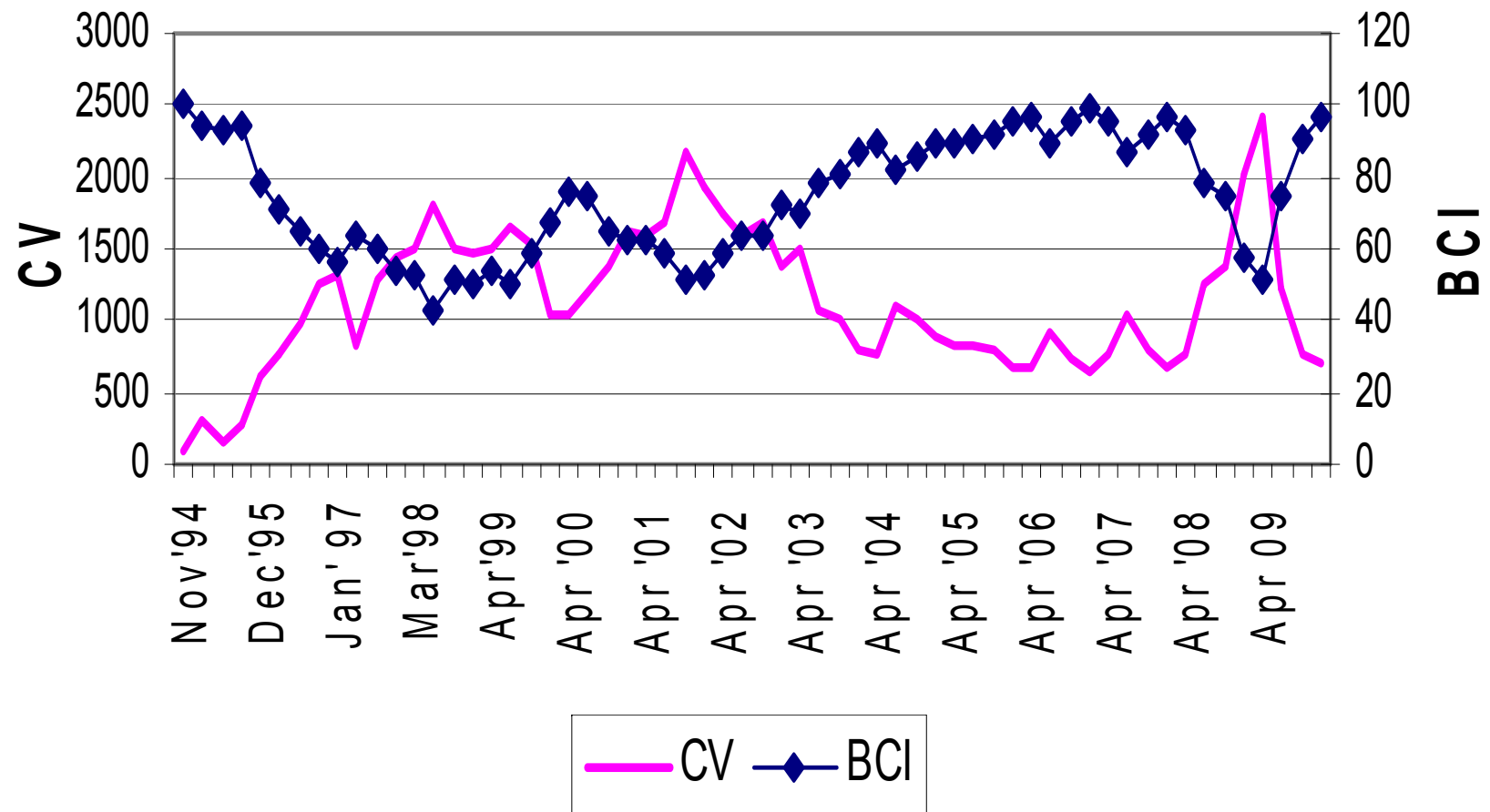# The BCI responds to more than Sensex: % dev from mean

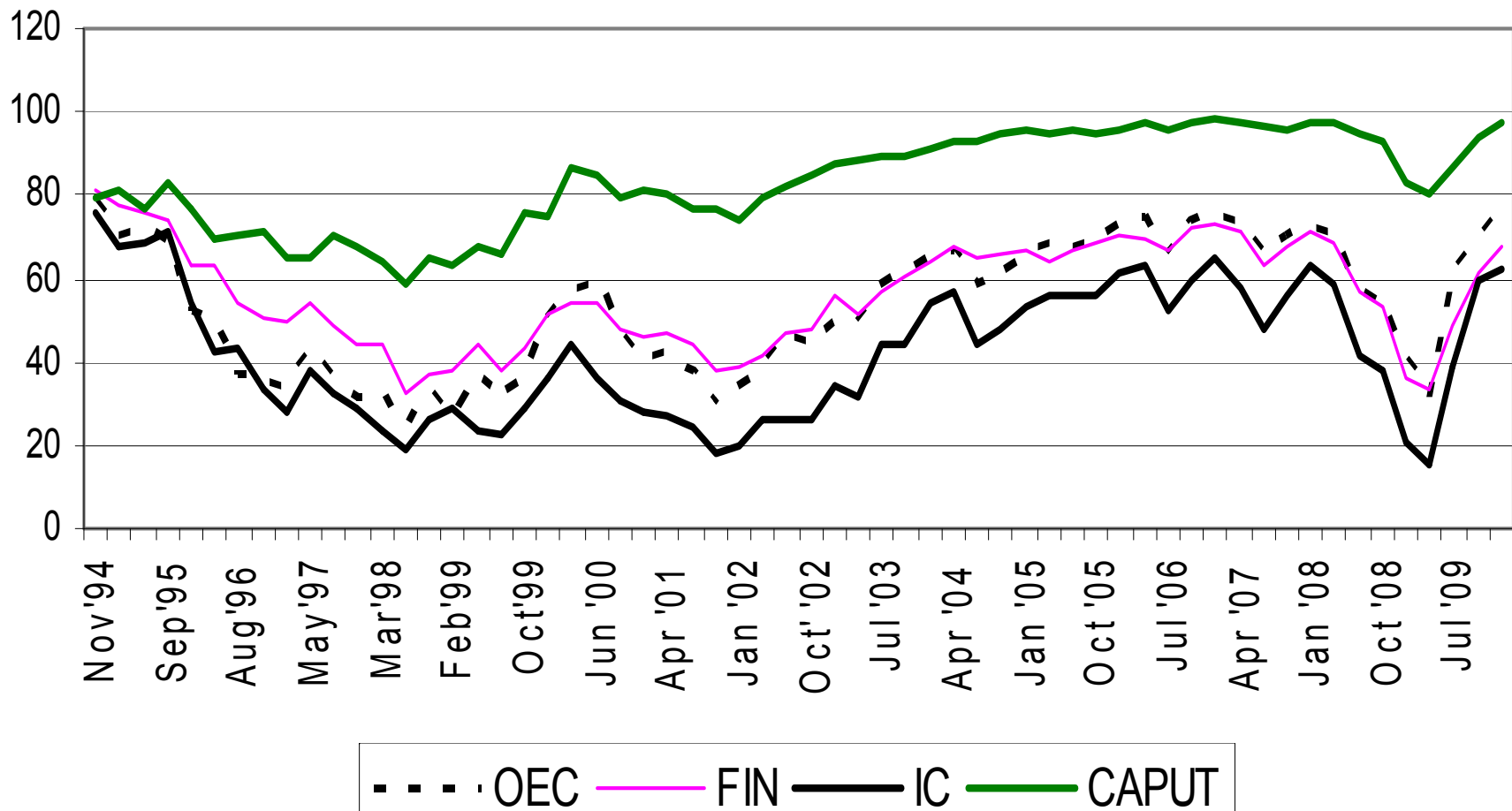# Sensex mirrors Dow-Jones: % YOY
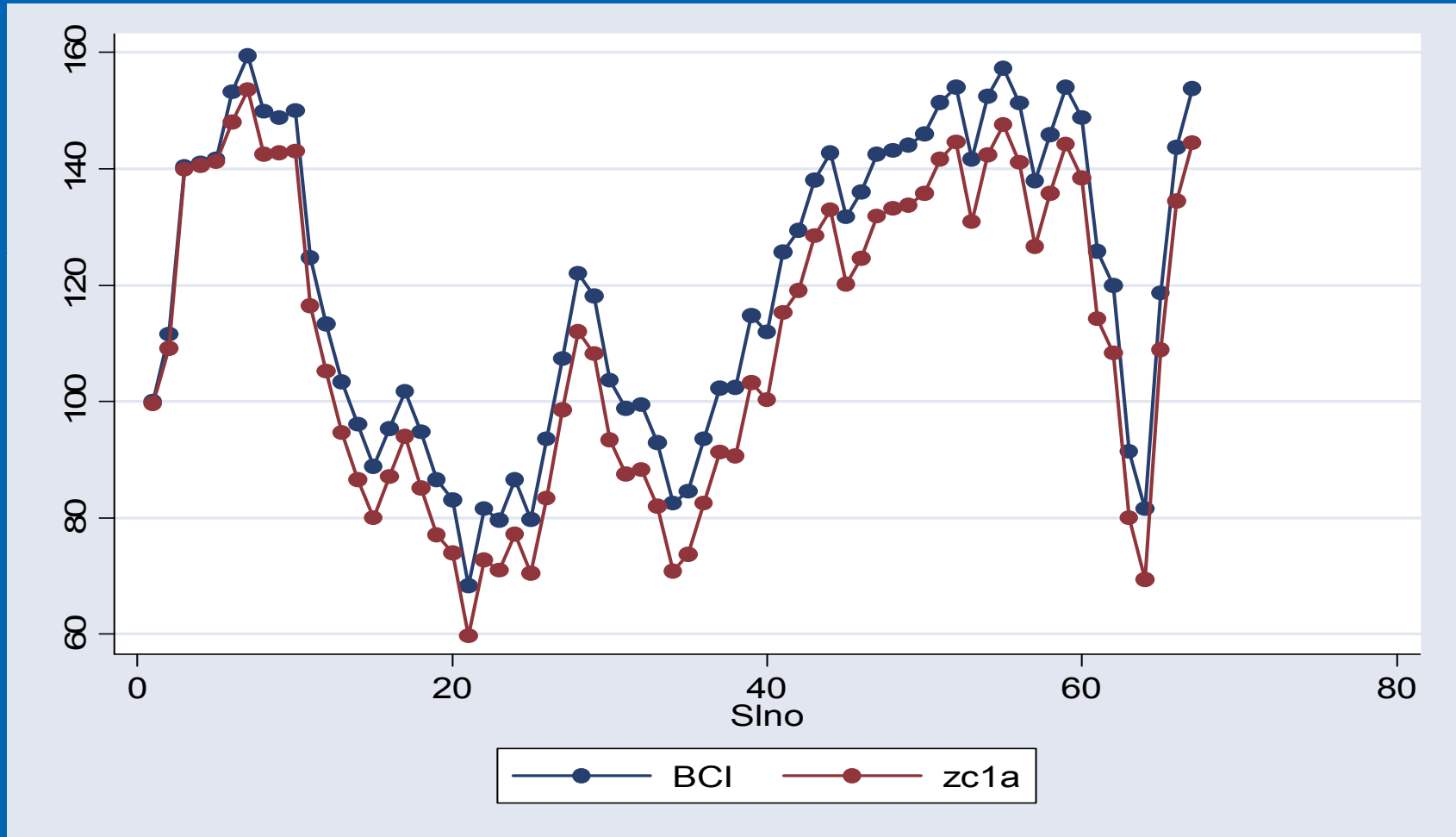
# Downturn is accompanied by greater uncertainty

# Sentiments not entirely romantic

# BCI and the First PC of Its Components



First PC Weights: C1: 0.59, C2: 0.45, C3: 0.58, c4: 0.33

# Structure of expectations: correlation coefficients

| Variable | OEC | FIN | IC | CAPUT | BCI | First PC | MBCI |
|---|---|---|---|---|---|---|---|
| OEC | 1.0000 | | | | | | |
| FIN | 0.9249 | 1.0000 | | | | | |
| IC | 0.9291 | 0.9610 | 1.0000 | | | | |
| CAPUT | 0.7964 | 0.6451 | 0.5992 | 1.0000 | | | |
| BCI | 0.9874 | 0.9589 | 0.9530 | 0.8011 | 1.0000 | | |
| First PC | 0.9869 | 0.9659 | 0.9665 | 0.7685 | 0.9985 | 1.0000 | |
| MBCI | 0.7387 | 0.6726 | 0.6593 | 0.7700 | 0.7580 | 0.7427 | 1.0000 |

# Implications to forecasting

# Are expectations leading indicators of economic activity?

| Variable | Order of Integration (DF test) | Causality to IIPMFG | Granger test F statistic |
|---|---|---|---|
| OEC | I(1) | No | 1.69 |
| FIN | I(1) | No | 2.08 |
| IC | I(0) | Yes | 3.76** |
| CAPUT | I(0) | No | 0.14 |
| BCI | I(1) | No | 1.68 |
| Ln MOEC | I(1) | No | 0.65 |
| Ln MFIN | I(1) | Yes | 1.94 |
| Ln MIC | I(0) | Yes | 4.13** |
| Ln CAPUT | I(1) | No | 0.10 |
| Ln MBCI | I(1) | No | 0.65 |
| Ln IIPMFG (deseasonalised) | I(2) | --- | --- |

# The NCAER Business Confidence Index
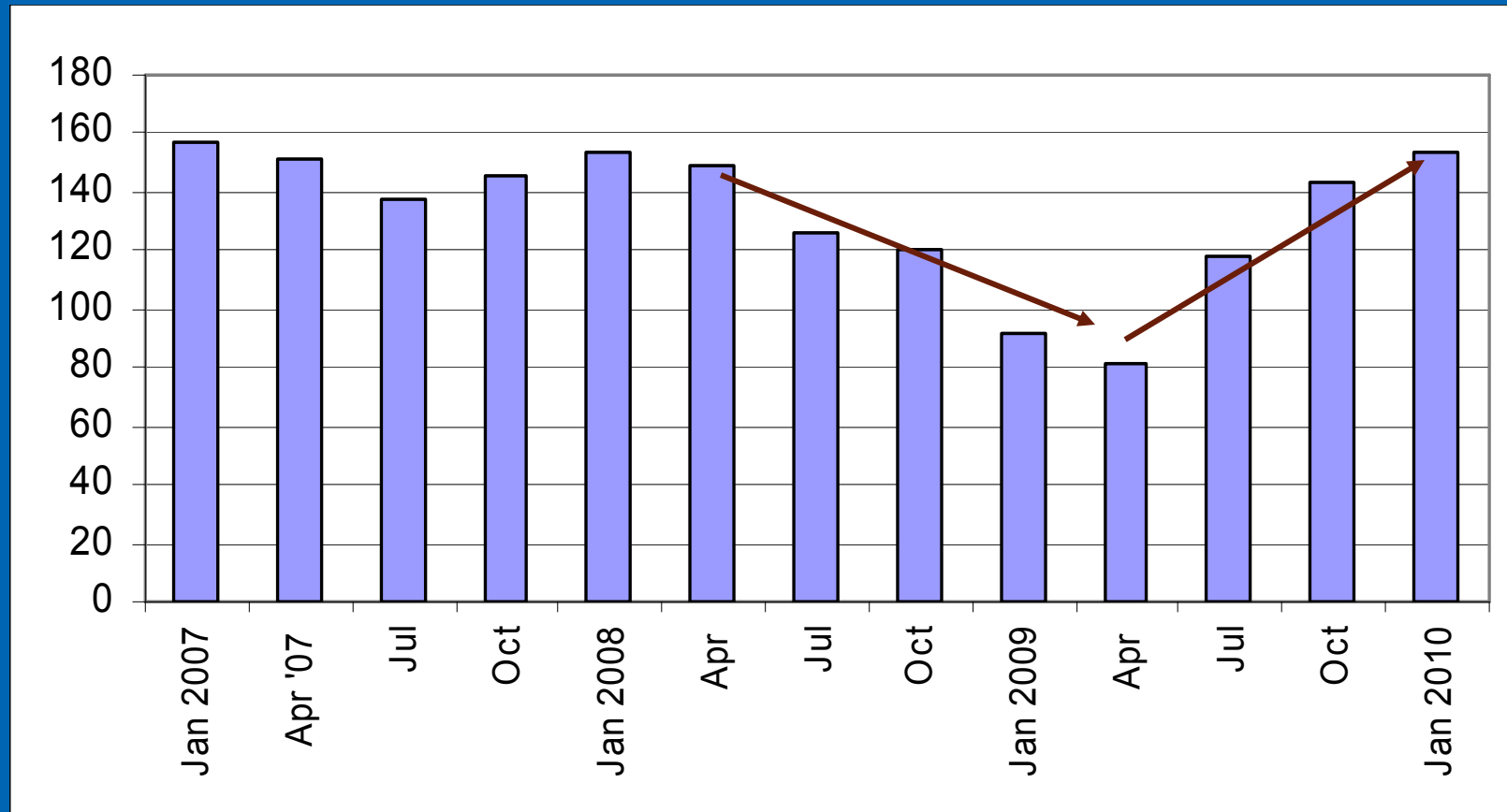


NCAER-MasterCard Business Confidence Index from Oct 2009; NCAER-ET Business Confidence Index for previous quarters upto 2004

# Some observations

- BCI reflects the present level of economic activity
- It probably is also a leading indicator
- It tells us a bit more than the SENSEX
- Sentiments are driven by the micro level conditions

# Thank You