



## B.C. ECONOMIC INDEX

### THE BC ECONOMIC INDEX: BACKGROUND

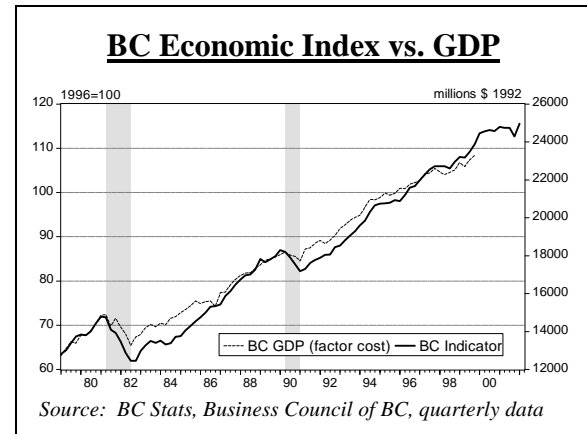
The Business Council developed the BC Economic Index to help monitor the provincial economy. It is comprised of seven individual economic data series that, when combined, closely track business cycles in the province.

At the end of each quarter the Business Council will compute the value of the index for the quarter and publish a brief commentary to provide a concise overview of the performance of the provincial economy.

#### Why Develop an Index?

The desire to accurately evaluate periods of contraction and expansion associated with business cycles is widespread. At the national level, it is relatively simple to monitor current economic conditions because Statistics Canada reports monthly estimates of real gross domestic product (GDP) with a relatively short delay. This information is supplemented by composite leading indexes and consumer confidence surveys that provide businesses and consumers with a simple and concise indication of the current state of the national economy, which is helpful in evaluating the near term outlook.

At the provincial level, similar information is not available. Estimates of economic output for the provinces are only published annually and with a fairly long delay. Without frequent estimates of GDP it is difficult to assess the current state of the economy. Economists and other analysts are left monitoring provincial economic conditions using various indicators such as employment, housing starts, retail sales, building permits and so on.



The difficulty with this approach is that the individual data series do not always provide a clear picture of what is going on in the economy; these series are typically volatile from month-to-month, and often move in opposite directions. An overall assessment of economic conditions requires a substantial amount of subjective evaluation and experience in determining which are the most relevant indicators and when they are providing accurate signals.

The BC Economic Index is designed to eliminate some of the guess work by providing a single, unbiased and easy-to-understand measure of current economic conditions. Over the past decade coincident economic indexes have gained popularity in the US, where a number of US Federal Reserve Banks have developed indexes to monitor regional economic conditions. In Canada the development of similar indexes has been limited.

#### What the Index Does and Does Not Do

The BC Economic Index is a coincident index of economic conditions in the province. It is designed to track real provincial GDP (which is the broadest

measure of economic activity available) and, in particular, to identify turning points in the provincial business cycle. The index is not a leading indicator and therefore does not necessarily anticipate or forecast what direction the economy is headed, except to the extent that better information on the current state of the economy helps determine the near-term outlook. The Index also is not designed to indicate what the current growth rate of the economy is, although periods of strong/weak economic growth are well correlated with changes in the Index.

### **Building the Index**

The BC Economic Index is patterned after the well-known US composite economic indexes, originally developed by the Bureau of Economic Analysis and now maintained by the Conference Board. As with these indexes, the BC Economic Index is comprised of an average of different provincial economic data series.

There are a large number of data series measuring different aspects of the provincial economy, but the number of potential series that can be used in an index measuring economic conditions is limited by the fact that each series needs to be produced in a timely manner, must not be substantially and regularly revised, and must be available going back to approximately 1978 so the index can be constructed and evaluated over a relatively long period. Series that met these general criteria were then tested to determine how closely they were correlated with the real GDP reference series.

Based on their relationship with fluctuations in GDP, seven individual series were selected for inclusion in the Index:

- Total employment;
- Real retail sales;
- Real manufacturing shipments;
- Housing starts – single family dwellings;
- International entries into BC;
- Real non-residential building permits; and,
- The Canadian composite leading index.

Data series that are measured in dollars are adjusted for inflation, and moving averages are calculated for each of the series to help smooth out the month-to-month changes. Then (symmetric) per cent changes are calculated and adjustments are made to equalize the volatility of each of the series so the more volatile ones do not have a disproportionate influence on the final index. The changes in each of the individual series are combined (with equal weighting) and used to calculate the index with a base year of 1996.

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