JULY 2007 BENCHMARK REVISIONS TO UK LEADING ECONOMIC INDICATORS
AND RELATED COMPOSITE INDEXES

July 13, 2007 release of the UK LEADING ECONOMIC INDICATORS AND RELATED COMPOSITE INDEXES, incorporates benchmark revisions to the composite indexes bringing them up-to-date with revisions in the source data and updating the standardization factors used in their calculation. This is a maintenance procedure typically done once a year, which usually does not change the cyclical properties of the indexes and has, as expected, relatively small effects. The comparison charts of pre and post benchmarked Leading and Coincident Indexes are illustrated on page 3.

These revisions to the composite indexes updated the standardization factors used in their calculations, and all historical values for the two composite indexes were revised at this time to reflect the changes. (Under normal circumstances, updates to the leading and coincident indexes only incorporate revisions to data over the past six months.) The component factors are inversely related to the standard deviation of the month-to-month changes in each component. They are used to equalize the volatility of the contribution from each component and are “normalized” to sum to 1.

The factors for the leading index were calculated using 1977-2005 as the sample period for measuring volatility. Separate sets of factors were the 1975-1977 period, the 1974-1975 period, as well as the 1970-1974 period. The factors for the coincident index were calculated using 1992-2005 as the sample period; separate sets of factors were the 1978-1992 period and the 1970-1978 period. These multiple sample periods are the result of different starting dates for the component data. When one or more components are missing, the other factors are adjusted proportionately to ensure that their total continues to sum to 1. The standardization factors for the most recent sample period are available on our web site and in our press releases.

In addition to benchmark revisions, this month’s release incorporates further major revisions to the composite index of leading economic indicators (LEI): 1) a new component, interest rate spread, is used in the composition of the LEI, 2) the LEI methodology incorporates a trend adjustment, and 3) another discontinued component, new orders for engineering industries, is omitted.

With this revision, the contribution of the yield spread will be calculated from the value of the yield spread in a given month. The interest rate spread is calculated using a long term interest rate less a short term interest rate. The new measure of the yield spread contributes negatively to the LEI only when the spread inverts; that is, when the long rate is less than the short rate. Because of data constraints, the long term interest rate for 10 year bonds is constructed from three different series. From 1/1975 to 12/1983, the data used is Long term Government Bond Yield obtained from the IMF International Financial Statistics. From 1/1984 to 11/1993, the data used is the series of 10 year par gross redemption yields on British Government Securities (recently discontinued).
obtained from the Bank of England. From 12/1993 to present, the data used is the series on nominal par yields also obtained from the Bank of England. Throughout these three periods, the short rate used is the official bank rate from the Bank of England.

This month’s revision also institutes an old and well-known trend adjustment procedure to the leading index. This procedure does not affect the cyclical properties of the LEI, but it offers two advantages facilitating the interpretation and use of the LEI.

1. The long-term trend in the LEI will be "fixed" as the procedure equates the trend in the LEI to the trend that is measured by the average growth rate in the coincident index (CEI). This means that the trend of the LEI will not vary with changes in the composition of the index or set of indicators used to calculate it. This facilitates the interpretation of the indexes as cyclical measures and provides a more consistent framework for their use.

2. The trend adjustment makes the growth of the leading index more similar to that of the coincident index. In turn, the levels of these indexes are more meaningful since the coincident index is a measure of current economic activity. While the composite indexes are mainly used to indicate directional changes in aggregate economic activity, many users also regard them as measures of the level of economic activity. The trend adjustment facilitates this use.

The trend adjustment factor for the leading index is -0.0594, calculated over the 1970-2005 period.

These changes are the result of research at The Conference Board (TCB) and regular consultations with its Business Cycle Indicators Advisory Panel and other experts. The Conference Board continuously monitors the behavior and performance of the composite indexes and their components and makes changes from time to time. This revision is consistent with long-standing TCB policy to make changes to the indexes when research indicates substantial improvements are possible. Because of these revisions, the composite indexes and their monthly changes are no longer directly comparable with previous releases. Similar methodological changes were introduced into the US LEI recently and will be incorporated into the LEIs of other countries covered by the TCB's global indicators program.

For more information visit our web site at http://www.conference-board.org/economics/bci/methodology.cfm