

NOVEMBER 2006 BENCHMARK REVISIONS TO JAPAN LEADING ECONOMIC INDICATORS

AND RELATED COMPOSITE INDEXES

With the November 2006 release, the composition of the leading index for Japan has been revised. The new measure of the yield spread, one of the current components of the LEI, uses a new interest rate spread in the calculations. The new spread is calculated using the 10-year government bond minus the 3-month interbank rate. The old spread was calculated using the 10-year government bond minus the discount rate. The revision also involves a shift from using the yield spread in the LEI to using the cumulative sum of the yield spread. The primary effect of this revision is to change the way the contribution of the yield spread is calculated.

The monthly contribution calculation is based on monthly changes in each component of a composite index. With the revision, the contribution of the yield spread will be calculated from the value of the yield spread in a given month instead of its change over the previous month. Currently, the yield spread contributes negatively - i.e., reduces the growth rate of the index - to the LEI whenever the spread is declining and this happens before recessions, but at many other times as well. The new measure will contribute negatively to the LEI only when the spread inverts; that is, when the long rate is less than the short rate. The cumulative measure of the yield spread provides a less "noisy" leading indicator, one that better reflects the effect of the yield spread on future economic activity.

This benchmark revision also institutes an old and well-known trend adjustment procedure to the leading index. The trend adjustment is applied over two sample periods: 1965:1 to 1991:12 and 1992:1 to 2005:12. This procedure does not affect the cyclical properties of the LEI, but it offers two advantages:

1. The long-term trend in the LEI will be equated to the trend that is measured by the average growth rate in the coincident index (CEI). Hence, the trend of the LEI will not vary with changes in the composition of the index, i.e. the set of indicators used to calculate it. This will facilitate the interpretation of the indexes as cyclical measures and provide 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.

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 last year and will be incorporated into the LEIs of other countries covered by the TCB's global indicators program.

Detailed descriptions and discussion of the changes will be posted on our web site. Please visit <http://www.conference-board.org/economics/bci> .