January 2008 Benchmark Revisions to Australia Leading Economic Indicators and Related Composite Indexes

This month's release of The Conference Board's Australia Leading Economic Indicators and Related Composite Indexes incorporates benchmark revisions to the composite indexes. The composition of both the coincident (CEI) and leading economic indexes (LEI) for Australia were revised and methodological changes were made to the LEI effective with this release.

The unemployment rate is no longer used as a component of the CEI because it is a trendless variable with cyclical timing that is more lagging than coincident relative to business cycle turning points in the level of economic activity. The CEI is now composed of the four remaining components; namely, household disposable income, industrial production, retail trade, and employed persons. With the benchmark revision, the CEI begins in 1960, compared to 1950 previously, to make it consistent with the beginning date for the LEI.

The medium-term government bond yield was omitted as a component of the LEI. In addition, a new measure of the yield spread was implemented. The yield spread is now determined using the 10-year government bond yield and the Reserve Bank of Australia policy rate, which replaces the 3-month bill rate as the short rate. This revision also involves a shift from using the yield spread in the LEI to using the cumulative sum of the yield spread. 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 implements an old and well-known trend adjustment to the leading index, based on the average growth rate in the CEI. This procedure does not affect the cyclical properties of the LEI, but it offers two advantages: With this procedure, the trend in 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. The trend adjustment also makes the growth of the LEI more similar to that of the CEI, and makes the levels of the indexes more meaningful. 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 average growth rate of the CEI is calculated and applied to the LEI over two sample periods: January 1960 to December 1973 and January 1974 to December 2006. The trend adjustment factors are 0.31 and 0.15, respectively.

Finally, the revisions bring the history of the composite indexes up-to-date with data revisions in their existing components and update the standardization factors used in the calculations. 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.

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. 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. Because of these revisions, the composite indexes and their monthly changes are no longer directly comparable with previous releases.

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