

BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

INTERPRETING THE BUSINESS CONDITIONS INDEX

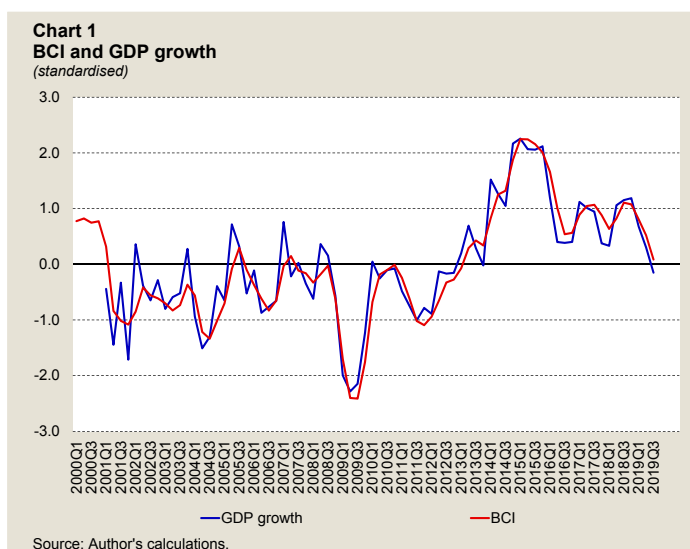
INTERPRETING THE BUSINESS CONDITIONS INDEX¹

The BCI is a concise summary of current economic conditions in Malta. It aims to be a simple indicator of business conditions, and its usefulness stems from its timeliness as it is available on a monthly frequency basis compared to other indicators such as the gross domestic product (GDP), which are produced on a quarterly basis.

As discussed in Ellul (2016),² and further updated in Ellul (2018),³ the average value of the BCI is zero. A zero value is consistent with average business conditions. Positive values imply better-than-average conditions, and conversely for negative values. This behaviour follows from the BCI's nature as a standardised variable.⁴ For example the average growth in GDP in Malta since 2001 stands at 3.9%.⁵ A GDP growth rate of around 4.0% would be broadly consistent with a BCI value of 0.0. This rate is high when compared with long run averages of other developed economies.

Once GDP growth is standardised, it becomes closely tracked by the BCI (see Chart 1). Thus, for example, while the published growth rate of GDP stands at 3.4% in the third quarter of 2019 (2019Q3), when standardised this becomes -0.2. This means that GDP growth in that quarter, while still strong, even when compared to other developed economies, is slightly below the average value of GDP growth calculated from 2001 onwards (see Chart 2). Therefore, while GDP growth has remained consistently well above zero, in recent quarters rates are gradually easing towards, and below their long run average growth rate. The BCI is following a similar trend and is hence shifting towards negative territory.

However, it is important to consider that the average value of zero in the BCI refers to an economy growing at around 4.0%. Thus, a negative BCI value should not be interpreted as negative GDP



¹ Prepared by Reuben Ellul. The author is a *Principal Economist* within the Bank's Economic Analysis Department.

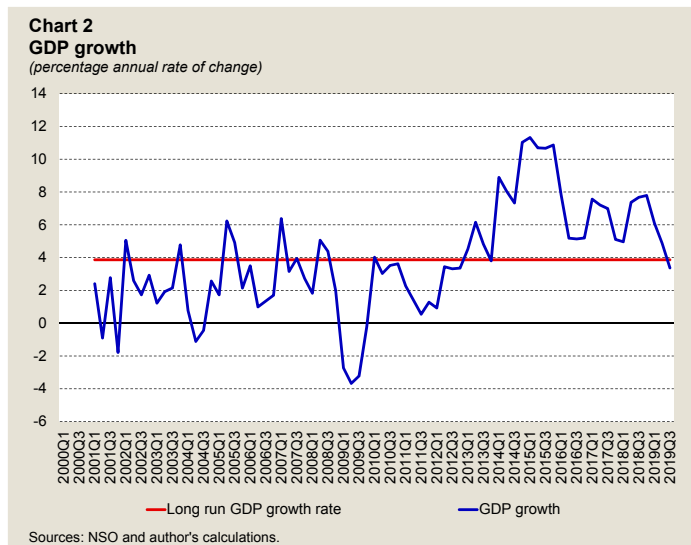
² Ellul, R. (2016). "A real-time measure of business conditions in Malta," WP-04-2016, Central Bank of Malta *Working Paper*, December 2016.

³ Ellul, R. (2018). "Updates to the BCI," Central Bank of Malta.

⁴ Standardisation is a rescaling process to facilitate comparisons of different series and implies the removal of the average value from a series, and its division by the series' standard deviation. Standardised variables have an average value of zero and a standard deviation of 1.0.

⁵ Measured as annual growth in chain-linked volumes, as per National Statistics Office *Release NR199/2019*. Obviously, this figure is subject to change due to both new observations as well as revisions to past data.

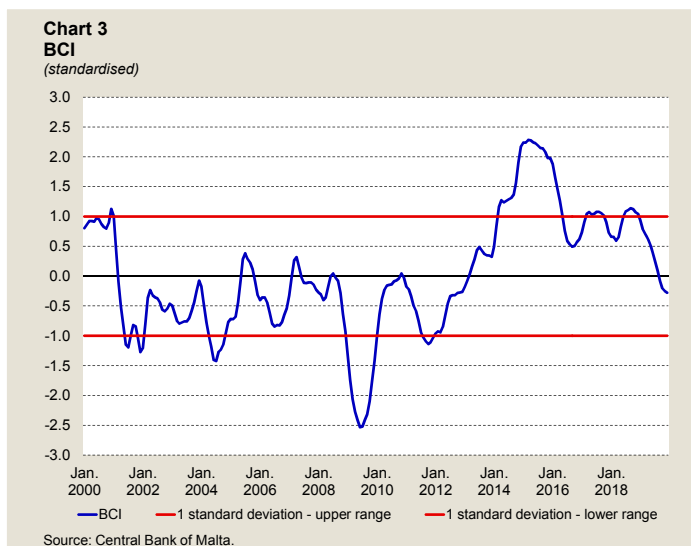
growth. In fact, while the BCI was negative in 29 instances between 2001Q1 and 2019Q3, official GDP growth was below zero only eight times. Special care should be made to interpret the BCI figure as a comparison of current economic conditions with respect to long run averages, and not as a measure in absolute terms of how much or whether the economy is growing.



Moreover, those same long run average economic conditions are themselves liable to change, given the nature of revisions in Maltese national accounts data (Grech, 2018).⁶

In order to facilitate the interpretation of the BCI, and to continue improving transparency, the range enclosing one standard deviation on either side of the mean will also start to be shown in the Bank's publications (see Chart 3). When the BCI falls repeatedly below the lower band, one would be able to conclude that those episodes constitute periods of significantly below normal economic activity.

With this addition, it is apparent that while the BCI is slightly below average economic conditions, it is significantly above the lower confidence level. This is consistent with the normalisation in GDP growth rates in evidence over recent quarters, which while remaining high in absolute terms, have slowed down from the high rates seen in 2014 and 2015. The BCI was consistently below the lower confidence level only in 2001, 2004, 2009 and 2011.



⁶ Grech, O. (2018). "An Analysis of Revisions to Maltese GDP Data," *Research Bulletin* 2018, Central Bank of Malta, pp. 27-34.