Box Article

Clocking in on Business Sentiments: The RES' Business Climate Clock

Executive Summary

- The Business Climate Clock is a useful surveillance tool, offering timely insights that allow BNM to gauge changes in business sentiments.
- Such insights are useful for identifying turning points as well as sector-specific challenges and opportunities, allowing BNM to make informed policy decisions.
- The Business Climate Clock showed that in 2024, business sentiments improved across sectors, driven by better global demand, strong construction activities, and a rebound in tourism, among other factors.

Introduction

In today's fast-paced and complex economic landscape, near-term real-time insights on economic conditions and business sentiments have become indispensable for central banks to gain an understanding of ground-level dynamics. For Bank Negara Malaysia (BNM), the Regional Economic Surveillance (RES) team has been instrumental in gathering feedback directly from industry players, synthesising qualitative data to enhance BNM's economic outlook assessments. This has been proven to be particularly useful during times of heightened uncertainty.

[1] Northern (Penang, Kedah, Perlis, Perak), Southern (Johor and Melaka), Central (Klang Valley and Negeri Sembilan), East Coast (Terengganu, Kelantan and Pahang), Sabah and Sarawak.

BNM analyses business sentiments and obtains crucial insights in identifying turning points in the economy using the BCC

Present in six regions[1] across the country, the RES team conducts a minimum of 120 engagements with a broad spectrum of industry players, business and trade chambers as well as Government agencies every two months. Each cycle coincides with BNM's Monetary Policy Committee (MPC) meetings throughout the year. The team asks firms on the latest developments of key variables such as revenue, investment, inventory, costs, prices, hiring and financing conditions vis-à-vis the corresponding period a year ago, as well as the expected changes in these variables one quarter ahead.

Aggregating such firm-level insights, the RES team analyses fluctuations in business sentiments with a view to identify potential turning points in the economy. This approach is facilitated through an internal tool called the Business Climate Clock (BCC), which helps to visualise and track these trends over time. This article aims to feature how BNM utilises such tool to better assess economic trends to inform appropriate policy responses. The first part of the article outlines the interpretation of the BCC, followed by a chronological assessment on how business sentiments have evolved in recent years, especially through the pandemic. The last part of the article assesses the usefulness of the BCC in relation to identifying turning points in Malaysia's GDP growth.

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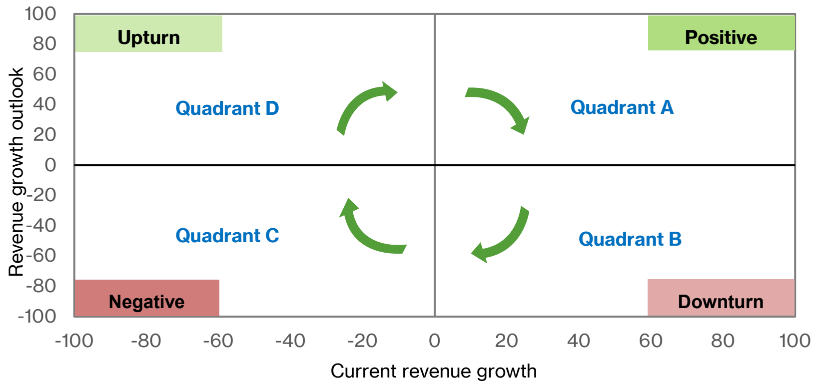
The BCC visualises the state of economy using a situation-expectation graph

While the usage of business surveys is not uncommon, when it comes to graphic representation of survey results, it is rather typical to chart survey responses to respective questions against time. Drawing inspiration from the Ifo (Institute for Economic Research, University of Munich),[2] the BCC seeks to visualise and analyse the state of economy using a situation-expectation graph. This is done by plotting the net balance[3] of firms' current business situation on the X-axis (i.e. current revenue growth) against their business expectations on the Y-axis (i.e. revenue growth outlook in the next quarter) at any given time.

Chart 1: Idealised Representation of a Typical BCC



Note: Firms' revenue growth is chosen as an indicator of business situation and expectation as it can provide valuable insights into overall demand conditions and economic outlook.

There are four quadrants to a BCC diagram, each representing the four distinct stages of climate in a business cycle: positive, downturn, negative, and upturn (Chart 1). If the judgments of firms regarding their current business situation and future expectations are net positive on balance, business climate is in the 'positive' quadrant (A). If the future expectation indicator turns negative, but current business situation is still positive, then a 'downturn' sets in (B). When both current business situation and future expectations are net negative, business climate is in the 'negative' quadrant (C). Lastly, if the net current business situation is negative, but the future expectation indicator turns positive, then the business climate is in the 'upturn' quadrant (D).

Typically, the BCC moves in a clockwise direction across the quadrants. This pattern is attributed to the fact that the business expectation indicator (Y-axis) should lead the business situation indicator (X-axis). In other words, what firms expect in the next three months during this cycle of engagement would eventually come to pass in the next cycle of engagement. Nevertheless, such relationship may not hold true in the event of shocks, where there may be deviations from the typical clockwise rotation.

[2] See Abberger, K. and Nierhaus, W. (2008) for more information on Ifo's Business Cycle Clock. Other countries and organisations have also introduced various versions of such graphical representations, including Business Cycle Tracer by Netherland Statistics and Statistics Denmark, respectively. However, the Ifo's Business Cycle Clock was found to be most relevant for this exercise given its selected indicators are available from RES' engagements (i.e., business situation and business expectations indicators). Please see Appendix for more information.

[3] Net balance refers to the difference between the percentage of firms citing higher revenue and the percentage of firms citing lower revenue.

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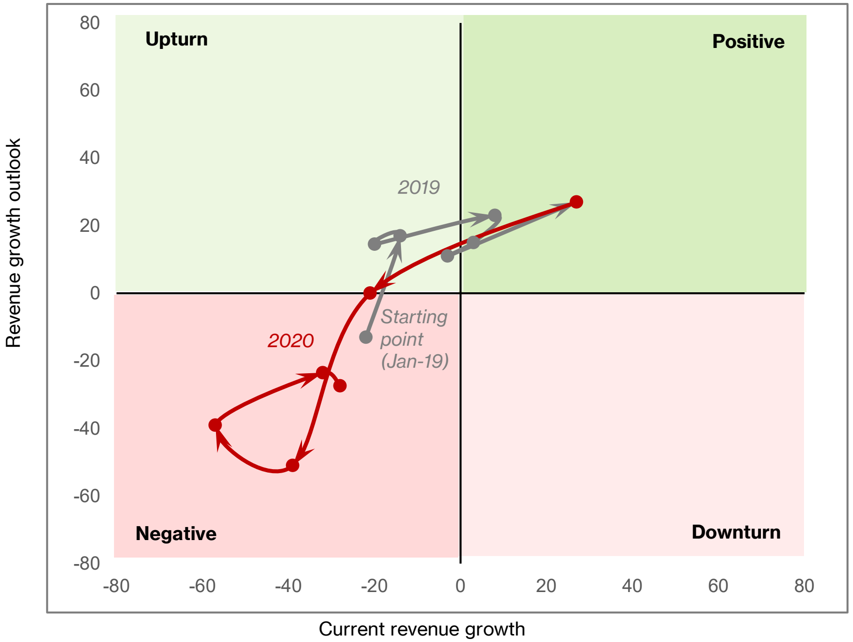
The RES' BCC tracked how business sentiments deteriorated as the world was enveloped by the pandemic

Chart 2: Business Climate Clock (2019-20)
Net balance



Note: The 6 markers for each year represent the 6 MPC cycles throughout the year (January, March, May, July, September and November).
Source: RES engagements

Interview insights from firms are used to identify key factors and recurring themes that influence business sentiments. These qualitative insights provide detailed explanations of the changes observed in the BCC.

The COVID-19 years: A shock to the system

At the beginning of 2019, business sentiments among firms in Malaysia were negative considering prevailing uncertainties stemming from tensions in US-China trade relations and to a certain extent, concerns on policy continuity due to a change in the Malaysian Government in 2018 (Chart 2). However, as the year progressed, a gradual recovery in business sentiments emerged. This recovery was supported by renewed consumer demand. Additionally, strong external demand in trade supported the E&E and primary-related sectors.

This progress, however, was suddenly disrupted by the onset of the COVID-19 pandemic in early 2020. Before other timely indicators were able to capture the impact of the outbreak, firms' sentiments had abruptly turned negative during engagements in January and February 2020 (i.e. March 2020 MPC cycle). Wholesalers, retailers, and hospitality sectors saw declining revenue amid reduced tourist arrivals. Export-oriented firms, which were initially optimistic, grew pessimistic amid delivery delays following lockdowns in certain parts of China. In March 2020, sentiments worsened after the imposition of Movement Control Order (MCO) in Malaysia, which severely disrupted operations and led to a sharp decline in consumer demand. During this period, most firms were focusing on survival and resilience as they were forced to adapt to the new normal. By year-end, most firms were bracing for prolonged disruptions.

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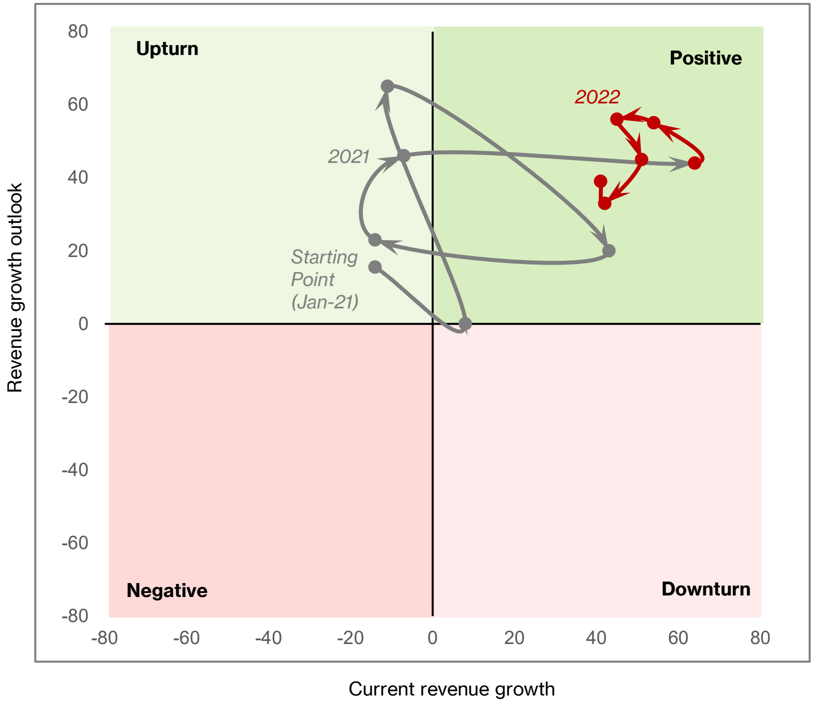
Inconsistent shifts in business sentiments in 2021, followed by stable optimism in 2022

Chart 3: Business Climate Clock (2021-22)
Net balance



Source: RES engagements

[4] There were varying degrees and timelines of movement restrictions across different states throughout 2021. For example, several states reinstated MCO in January 2021, though some transitioned to a less strict Conditional MCO (CMCO) by March 2021. However, a full MCO (FMCO) was imposed mid-year, followed by the launch of a four-phase national recovery plan starting June 2021 to help the country emerge from the pandemic.

A bumpy recovery post-COVID-19

In 2021, business sentiments moved between the 'upturn', 'downturn' and 'positive' quadrants erratically (Chart 3). This reflected an uneven and unpredictable economic recovery post-pandemic. Firms had to deal with residual pandemic challenges, including supply chain issues and operational restrictions. Domestically, retailers and food operators initially benefited from a pent-up demand, evidenced by growth in off-premise and online sales, yet faced unpredictability due to intermittent MCOs[4] as COVID-19 cases spiked again. Meanwhile, export-oriented firms were optimistic amid strong external demand in segments like consumer electronics. Nonetheless, this was not enough to offset negative sentiments among domestic players, resulting in a negative net balance for current revenue growth for most of 2021.

By 2022, with the pandemic in full retreat, positive sentiments across sectors strengthened due to easing restrictions, improved supply chains, border reopenings and stronger global demand. High-touch and consumer-oriented sectors noted a clear recovery through increased foot traffic. Consumer spending was also bolstered by digital offerings, expanded cashless transactions and policy stimulus such as the special EPF withdrawals and the vehicle sales tax exemption. Collectively, these factors underscored a gradual return in demand, with digital adaptation, supply chain diversification, and improved operational resilience as critical drivers for sustained optimism. All these positive sentiments were reflected in firms' improved current business situation and near-term outlook.

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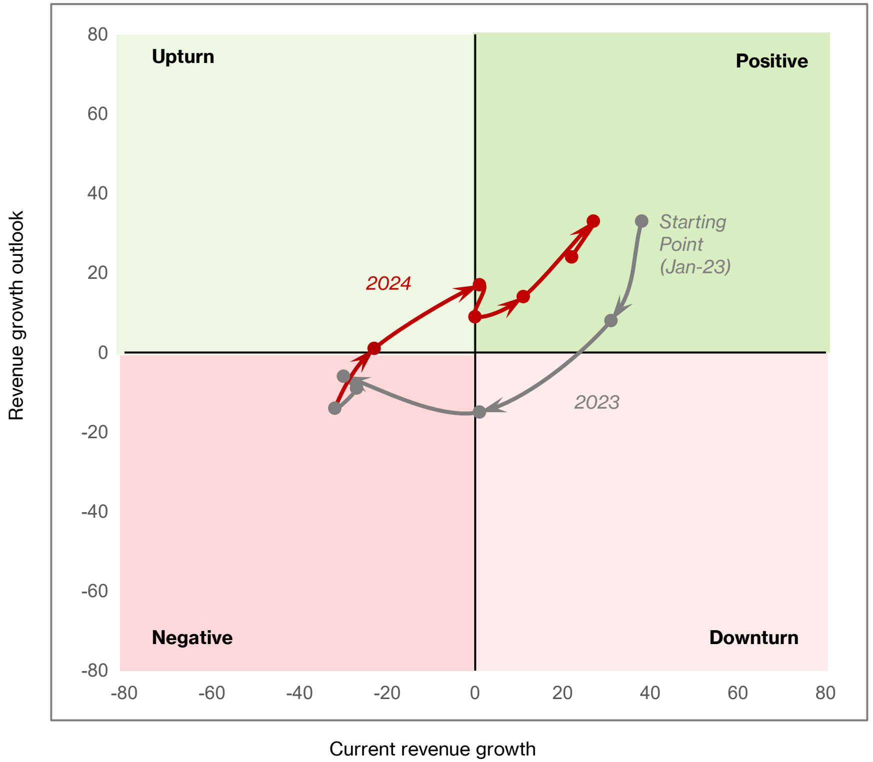
Firms became more cautious in 2023 before sentiments rebounded in 2024

Chart 4: Business Climate Clock (2023-24)
Net balance



Source: RES engagements

From challenges to resilience

While the post-pandemic boom continued to contribute towards positive sentiments in early 2023, insights from firms suggested that the optimism in 1Q 2023 would not last. The BCC started to signal a decline in growth momentum for the next quarter and moved to the 'downturn' quadrant in May 2023 (Chart 4). This shift was largely due to the impact of high cost of living on consumer purchasing power. A subdued 2Q 2023 GDP growth performance later confirmed this trend. In 2H 2023, the BCC further deteriorated into the 'negative' quadrant, as a slowdown in global growth and trade also affected export-oriented firms, including the E&E sub-sector, which experienced a delayed and uneven recovery. Additionally, the weakening ringgit also created cost-related uncertainties, particularly for firms that relied heavily on imports.

Entering 2024, sentiments moved to the 'upturn' quadrant, before becoming more positive in 2H 2024. Business confidence was lifted by better global demand, stronger construction activities, and a more broad-based recovery in the E&E industry. Government policies such as the EPF Flexible Account withdrawals and the civil servant salary revision also bolstered optimism among firms to a certain extent. Additionally, labour market had recovered to pre-pandemic levels, supporting operations in more affected sectors, especially construction and palm oil. The ongoing tourism recovery also boosted firms' confidence as growth was supported by higher tourist receipts. Such positive sentiments were reflected in improved economic growth outcomes in 2024 thus far.

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From Business Climate Clock to an Index

Beyond the insightful graphical narratives presented by the BCC , it is essential to assess whether the BCC accurately and reliably reflects the underlying economic realities. To achieve this, the Business Climate Index (BCI) was calculated using a geometric mean[5] of the net balances of the 'current revenue growth' and 'revenue growth outlook' indicators:

$$BCI = \sqrt{[(\text{Net Balance of Current Revenue Growth} + 100) * (\text{Net Balance of Revenue Growth Outlook} + 100)]} - 100$$

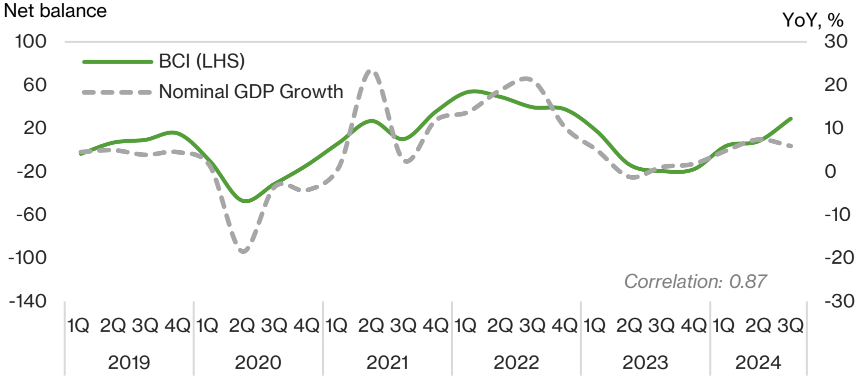
The results revealed a strong correlation between the BCI and GDP growth, with a stronger correlation for nominal GDP growth than real GDP growth (Chart 5), possibly due to price effects. During periods of elevated costs and price pressures (e.g. mid-2021 to mid-2022), firms reported higher revenue growth because price increases enhanced sales value despite stable sales volume.

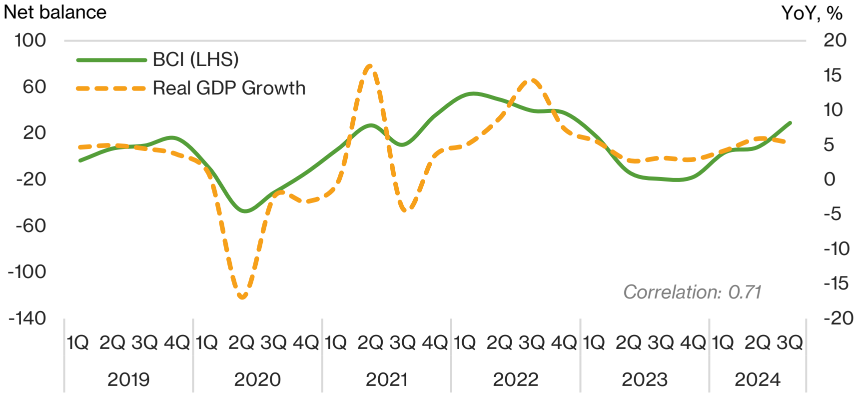
During the pandemic period between 1Q 2020 and 1Q 2022, the BCI was mostly able to capture the downturns and upturns of the economy. However, given its qualitative nature, it was not able to fully capture the magnitude of the troughs and peaks. Compared to GDP growth, the BCI also did not peak in 3Q 2022 or decline in 3Q 2024, likely reflecting the limits of BCI in capturing the magnitude of impact from one-off policy shocks or unexpected events such as the special EPF withdrawal facility and commodity disruptions respectively.

[5] This methodology was also employed by the Ifo for their Business Cycle Clock. Geometric mean leads to a certain smoothing of the extreme values. This may be relevant if the number of observations in the survey is rather small. As the net balances range from -100 to 100, they are initially augmented by 100 in order to obtain real values in the root expression. By subsequently subtracting 100 at the end, these terms nullify each other once more.

Insights from firms correlate well with actual economic output

Chart 5: Comparing BCI with Nominal and Real GDP Growth





Note: The BCC information is obtained every two months, leading to six observations a year. For months without observations, the figure is proxied by taking an average of the previous and following months. Then, this monthly data is aggregated to get the quarterly BCI.
Source: RES engagements and Department of Statistics, Malaysia

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Navigating Uncertainty: The Value of the BCC and BCI

Both the BCC and BCI offer timely and a more nuanced understanding of economic trends and projections, which help to better inform BNM's policy decisions. While the BCI is a coincident indicator, it is still able to provide leading properties due to its availability two months in advance of actual GDP releases. Of significance is its utility in identifying turning points, especially during periods of uncertainty.

For example, the sudden and widespread disruption caused by the pandemic had posed an unprecedented challenge for economic forecasting. Supply chains were disrupted, consumer behaviour changed significantly, while most industries were either temporarily shut down or had to quickly adapt to new standard operating procedures (SOPs). At such critical juncture, insights from the RES team helped to bridge data gaps by providing timely, forward-looking and qualitative information.

In addition to supporting economic assessments for monetary policy, firm-level insights also contribute to BNM's policy formulation and advocacy. Relevant ground-level insights on potential risks and opportunities to the economy are also often communicated through various platforms.[6]

[6] For more information, please refer to the Feature Article titled 'Taking the Pulse of the Economy During the Pandemic' in Bank Negara Malaysia's Annual Report 2021.

Summary

BNM actively engages with the business community to gather critical insights into the economic landscape, enhancing its understanding of current business conditions and outlook. These engagements inform policy decisions and strategic initiatives. A key development in this effort is the Business Climate Clock and Business Climate Index, which offer timely insights that allow BNM to gauge changes in firms' sentiments. By leveraging on these tools, BNM can detect turning points in the economy, as well as identify industry-specific challenges and opportunities. Moving forward, BNM is committed to continuously enhance the quality of responses to ensure a sample that is representative of the economy. BNM will also continue to foster stronger collaboration and trust with the business community and ensure that informed decision-making guides our approach to navigating changes in the Malaysian economic environment.

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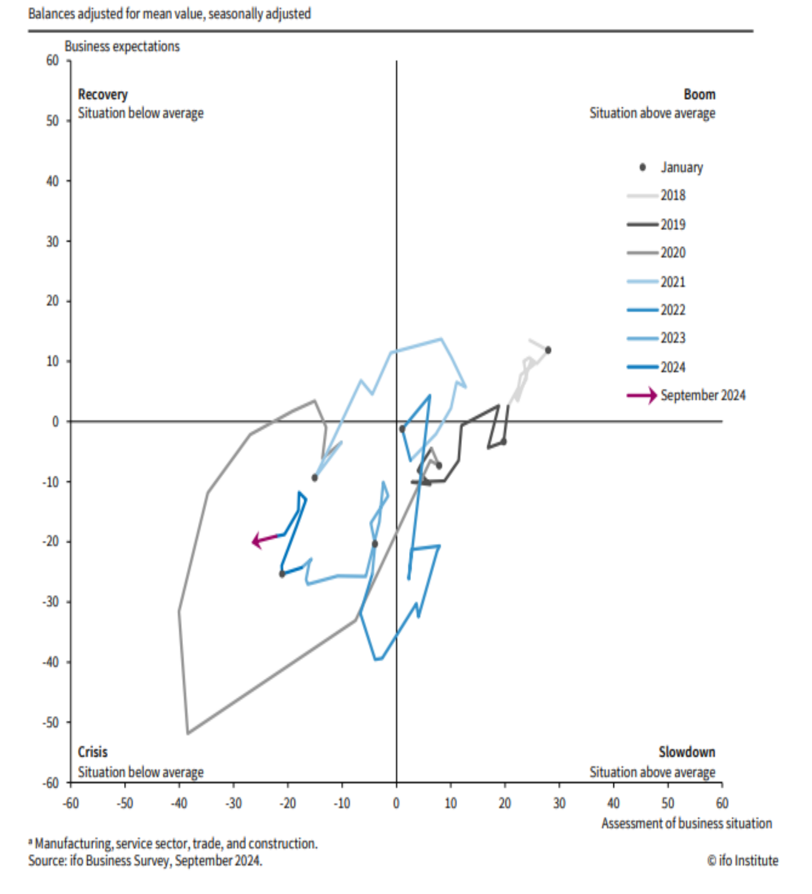
Appendix: Understanding the Ifo's Business Cycle Clock – Origins and Evolution

In 1993, the cyclical relationship between two components of the Ifo Business Survey in Germany – business situation and expectations – was presented for the first time in the form of a four-quadrant business cycle scheme. The quadrants are labelled with four different phases of activity, namely 'recovery', 'boom', 'slowdown', and 'crisis'.

The results on business situation and expectations are obtained from ~9,000 monthly responses from businesses in the manufacturing, services, trade and construction sectors. Firms are asked to describe their current business situation as 'good', 'satisfactory' or 'poor', and their business expectations for the next six months as 'more favourable', 'unchanged', or 'less favourable'. The net balance value of the current business situation is the difference in percentage shares of the responses 'good' and 'poor', while the net balance value of business expectations is the difference in percentage shares of the responses 'more favourable' and 'less favourable'.

The aim of the Business Cycle Clock is to visualise the development of economic activity and its dynamics in a timely manner. Chart 6 shows the evolution of Germany's economic activity from 2018 to 2024, portrayed using the Ifo Business Cycle Clock.[7]

Chart 6: The Ifo Business Cycle Clock in Germany



[7] For more information, please refer to the Ifo institute website at www.ifo.de.

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