Wayfields Partners

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Checking the pulse of the Economy

Economic & Finance

INTRODUCTION

I recently visited the hospital for a routine check-up, on advice, because I seldom visit the doctor's. I asked questions about the meaning of the numbers, in a chatty manner, as the nurse checked my pressure, examined my weight and took my pulse. As she held my wrist it occurred to me what I had read some time ago in the financial dictionary, Investopedia that as an investor "it is important to keep your finger on the pulse of the economy, and ***indicators*** are an important way to do that".

In studying the human anatomy in biology, generally, we learn about how the human body systems interrelate with each other to ensure an organism functions normally. The brain, for instance, receives information from other body systems with several other complex interplays, at least to the layman. These interplays are constantly ongoing to ensure proper functioning of the body. Similarly, the reality of an economy appears to emerge as a result of the interactions both between and among finance & economic ***indicators*** which, sometimes, can be complex hence the use of assumptions to simplify our understanding.

Some of the key ***indicators*** include interest rates, inflation, Gross Domestic Product (GDP), exchange rate, taxation, deficits, consumer activity (demand & supply) among several others. They are displayed as ratios, percentages, absolute figures and indices. For example, the monetary policy rate (MPR) set by the Bank of Ghana (BoG) is currently 16%.

SOME BACKGROUND

Economics and Finance are taught as separate courses. In many ways in the real world, however, they are actually interrelated disciplines.

The key ***indicators*** that drive or influence an economy, a market or an industry like the capital market industry are mainly finance and economics in nature. And their indicators work together, for good or bad, just like the interplay of body systems in humans.

Whereas economics provides investors with the big picture tools like inflation, demand & supply and GDP in understanding and analyzing markets and companies to forecast growth; we learn that finance helps to break it all down by focusing on analyzing prices, sharing risks, valuing and projecting cash flow, calculating the fair value of investment products and using the financial markets to ensure better investment decision making.

Whenever you hear about time value of money (TVM) which may affect the return on your investment (ROE); and the cost of capital or interest expense which is likely to increase the cost of running your business, just know that it is the discipline of finance presenting itself to you in more practical ways!

OVERVIEW OF THE FINANCIAL MARKET

Thus, the purpose of a financial market is to set prices and raise funds by transferring money and sharing risks for governments, companies, SME's, and individuals.

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Although there are many components to a financial market, two of the most commonly used are the money market (for **short term funds** for operating expenses and working capital) and the capital market (for **long term funds** including equity and bonds for capital improvements or for large scale projects). The money market provides an avenue for low risk investors whereas the capital market provides an avenue for investors with an appetite for relatively higher risk.

Ultimately, the financial sector can be likened to ***the backbone that connects all sectors of an economy***. With the help of ***indicators***, it plays a major role in directing needed capital through financial institutions and the Ghana Stock Exchange, towards various sectors of the economy for productive business ventures.

LEADING & LAGGING INDICATORS

Clearly, the broad economy is a complex set of moving parts made up of acting and reacting or leading and lagging ***indicators.*** Whereas leading indicators like consumer confidence and retail sales, considered in aggregate, help to predict changes in the economy, lagging indicators like GDP confirm long-term trends, but they do not predict them.

When the Ghana Cedi depreciates against the US Dollar this feeds into the **import dependent** economy as high prices of goods and services. This translates into increased prices of fuel and related products which form a major component of household consumption.

Notably, with the interplay of leading and lagging ***indicators*** time delays, *or time lags economists call it*, of weeks, months and years are inevitable when policymakers try to recognize, diagnose and fix macroeconomic issues. And this presents one main challenge identified in the use of the indicators, which is the uncertainty associated with expected timing and the desired impact of policy prescriptions!

THE IMPORTANCE OF THE INDICATORS

We have established that as an investor or player in the industry keeping your finger on the pulse of the economy gives you an idea of its health - ***and of the continued health of your investments***. With the help of leading indicators you are able to adjust your expectations and strategies.

Policy makers are able to implement sound monetary or fiscal policy for the good of all. Also, business people are able to anticipate, and accordingly position themselves for economic conditions that will affect their sales and revenues.

Ultimately, your ability to project the direction of government policy will help you to position yourself and reap maximum benefits. Internationally, capturing early warning signals of potential financial or banking sector shocks has become increasingly important since the outbreak of the global financial crisis in 2007.

CONCLUSION

Nowadays, the state of the economy is something that is constantly being discussed. This only goes to emphasis its importance largely due to the extent to which the consequences, good or bad, of the health of the economy has on our daily lives.

As we go about our daily lives purchasing goods and services not necessarily intending to consume today but to create wealth for the future, or to run our businesses, we need to keep checking the pulse of the economy through the use of the ***indicators*** to enable us make the right decisions.

I am pleased to inform you that I walked away from the hospital with a clean bill of health!

This article was first published on 23 January, 2017 in the Business & Financial Time (B&FT) newspaper, Ghana.

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Sources: Investopedia, BoG, Ghana Stock Exchange, The Economist, CFI