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Why the new way of computing GDP

Shaik Osman Majid

LAST Wednesday, Bank Negara Governor Tan Sri Ali Abul Hassan revealed the much-awaited details of the first quarter performance of the economy: a 1.3 per cent contraction in gross domestic product.

The contraction was not bad news; rather it was good. For since late March, the central bank had been saying the contraction would be in the region of 1.6 per cent.

Indeed, we were later told the performance would be better than expected.

So the smaller contraction is good news to many, including stock market players. It might have been fortuitous, but the Kuala Lumpur Stock Exchange Composite Index did rise over the next two days, breaching the 800-point level on Thursday.

If the market remains buoyant, it is good; otherwise, it only underscores the maxim that the share market doesn't exactly dovetail with the buoyancy of the economy.

But what is the significance of the latest GDP figures? They are little more than economic data, understood perhaps by working economists, some accountants and bankers. The uninitiated want to understand these statistics if only to know whether the country is moving out of recession.

If we are out of the woods and if the good times are imminent, many wage earners will start looking forward to a repeat of the pre-1997 days when annual increments, bonuses and ex-gratia payments were as sure as the monthly salary slips.

From the reports following Bank Negara's announcement, everyone would know that the country is "technically" out of recession. It recorded two months of positive GDP growth in February and March. The momentum is set to be maintained in the second quarter, that is between April and June.

But what exactly is gross domestic product? Many books and economists give their own esoteric versions. The simplest definition is this. It measures the total services and goods produced in a country over a specific period, that is within a year, and now over three months or a quarter.

Goods and services can be exported. When econometrists compute the value of goods and services that flow out of a country, they do not take into consideration intermediate goods that come into the country and are completed and flown away, such as microchip boards and disc-drives.

Only the value of goods and services produced in the country is computed into the GDP. Which is a reason for the use of the word "domestic".

And so, if any uninitiated reader glances at either an economic report or a Bank Negara report, he would be confronted with a pie chart, which with its many coloured schemes depict exports, public consumption (read Government consumption), private consumption, and private and public investments.

The latest pie chart is for last year. Which we all know was a bad year as the economy contracted by 6.7 per cent. What was the position in 1997?

The 1996/97 Economic Report made clear that the per capita income would reach RM11,118. And the GDP was RM292.5 billion.

At this point, readers must note that the GDP is a quantum, expressed in ringgit; real GDP growth or contraction is a percentage improvement or shaving over the previous year's GDP.

Last year, no thanks to the prolonged recession, the GDP shrunk to RM270

billion.

The first quarter figures, however, indicate we may have finally reached the end of the recession. For its own reasons (which will be explained later), the central bank has paraded two indicators.

There is a quarterly 1.6 per cent contraction based on past calculations and a revised figure of 1.3 per cent computed with a different set of indices. Actually it is the latter percentage that is officially used to denote the contraction of the GDP.

Given the new mode of computing GDP contraction and expansion, even the intelligent among the laymen would be scratching their heads to figure out when the country will see again the good times of 1997 and earlier years.

If we analyse the central bank's explanation, it will be apparent that the GDP pie chart has been reconfigured. According to Ali, the new data takes into account the structural changes in the economy. It is based on a wider coverage of industries, totalling 137, compared with 64 in the old configuration of 1978.

The use of the latter database is one reason why GDP figures in the past have been quoted in 1978 prices, even though the current nominal prices have also been cited in each and any economic report for comparison. The base year for the earlier figures was 1978; for the new, it's 1997.

The new data series enables the authorities to rewrite, in a way, economic history. The change in base data is not to present a better picture of the economy.

Rather it gives a more current and reliable account of the state of the economy. For instance, the 6.7 per cent contraction in 1998 has now been revised upwards to 7.5 per cent.

Though Bank Negara did not disclose the actual figures of the 1997 GDP, it did say the magnitude of components was far greater than that which went into the computation of the 1978 base.

It logically follows the recession of 1998 was far greater than anticipated. This is patent in the revised estimates.

The GDP declined by 5.2 per cent and 10.9 per cent in the third and fourth quarters of last year, respectively, instead of the earlier estimates of 6.8 per cent and nine per cent.

It follows that the first quarter contraction is lower. By analogy, if you have savings of RM100 and spend RM5, your savings contract by five per cent. If the savings were RM125 and you spend RM5, you only lose four per cent.

So the country is on renewed footing, at least in computing GDP figures. And the central bank governor is buoyant. He says the first quarter figures mark the end of economic contraction and that the latest indicators point towards positive expansion.

To back his claim, Ali laid out a slew of healthy economy indicators. Manufacturing, which accounts for a third of the GDP posted a big leap. Construction activities have also improved.

Domestic demand for consumer items such as cars and appliances have also risen. Inflation has been capped. It has stabilised at 2.9 per cent in April and May.

All these factors point to a strong recovery. But Bank Negara and even Prime Minister Datuk Seri Dr Mahathir Mohamad would rather stick to the earlier forecast of a one per cent growth in real GDP.

Their caution is well-founded. A country's economy is never solely determined by its own fundamentals nor its prudent management. External factors often change the equation.

But the country could well register three per cent real GDP growth this year. This much has been acknowledged by the governor and international financial analysts. In fact, some of the latter even say five per cent

growth is on the cards.

So, if you factor in these forecasts and if they materialise, the GDP might well swell to more than RM300 billion by the end of 2001. We all might have a per capita income of over RM11,000.

We might have lost four years; but the bountiful future is ours.

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