ECONOMIC AND FINANCIAL INDICATORS - A Tool for Investment Decisions

Introduction

Economic and financial indicators are the bedrock of making a thorough investment assessment as well as making sound judgment concerning the various areas of investments. Economic and financial indicators are also a source of ignition to the growth of every economy.

Economic indicators can have a huge impact on the market; therefore, knowing how to interpret and analyze them is important for all investors. They help us understand the past and current economic stance so as to predict an expectation of the future for our investments. A battery of these indicators includes Inflation, Exchange Rates, Interest Rates, GDP Changes, Money Supply, Employment and Unemployment Rates.

What are Economic and Financial Indicitors?

These are statistics used to measure current conditions as well as to forecast financial or economic trends. Indicators are used extensively in technical analysis to predict changes in stock trends or price patterns. In fundamental analysis, economic indicators that quantify current economic and industry conditions are used to provide insight into the future profitability potential of economies and companies alike.

In an economic context, an indicator could be a measure such as the unemployment rate, which can be used to predict future economic trends. Common general economic indicators are the interest rates, Gross Domestic Product (GDP), the consumer price index (CPI) among others. For the purpose of this article five of these indicators will be discussed. These indicators are GDP, CPI, Stock Market Index (GSE-CI and GSE-FSI), and Interest Rates. These indicators affect investments at all levels and sectors of the economy and must be well understood so as to make the best investment decisions.
**Ghana Stock Exchange Composite Index (GSE-CI)**

An index is a statistical measure of the changes in a portfolio of stocks representing a portion of the overall market. The Stock market index is a measure of investor sentiment. It is often viewed as a barometer of business and consumer confidence regarding the future. A high and/or rising index may point to a robust growth of business, investment and consumer spending in the near future while a low and/or falling index may signal sluggish spending.

It is usually difficult to track every single security trading in the country. To get around this, a smaller sample of the market is taken to represent the entire market. Thus, just as politicians use political surveys to gauge the sentiment of the population, investors use indexes to track the performance of the stock market.

The calculation of the GSE Composite Index (GSE-CI) is based on the volume weighted average closing price of all listed stocks. All ordinary shares listed on GSE are included in the GSE-CI at total market capitalization, with the exception of shares listed on other markets. The GSE-CI is a market capitalization weighted index, i.e. each constituent is given weight according to its market capitalization. The base date for the GSE-CI is December 31, 2010 and the base index value is 1000. The index reflects investor sentiment of the economy and influences their behavior.

Ideally, a change in the price of an index represents an exactly proportional change in the stocks included in the index. Most indexes weigh companies based on market capitalization. If a company's market cap is S1, 000,000 and the value of all stocks in the index is S100, 000,000, then the company would be worth 1% of the index.

**Association of Ghana Industries (AGI) Business Barometer Index**

The Association of Ghana Industries Business Barometer (BB) shows trends in the development of the Ghanaian economy. It was developed out of the previous Business Climate Survey (BCS) and conducted quarterly basis to measure the level of confidence in the business environment and forecast short-term business trends. The applied methodology follows international best practice and asks only 4 simple questions which can be answered instantly by CEOs. These are weighted in accordance with company size and sector contribution towards GDP.

The AGI simply expresses the state of the business environment and is calculated out of “current” business disposition and “expectations” for the future. Further the AGI always identifies the most pressing challenges facing the business community and analyses challenges of the economy based on the various sectors.
**Real Gross Domestic Product (GDP)**

The gross domestic product (GDP) is the godfather of the indicator world. Real GDP is one indicator that says the most about the health of the economy and the advance release will almost always move markets. It is by far the most followed, discussed and digested indicator out there - useful for economists, analysts, investors and policy makers. As an aggregate measure of total economic production for a country, GDP represents the market value of all goods and services produced by the economy during the period measured.

Further, GDP is the monetary value of all the finished goods and services produced within a country's borders in a specific time period usually calculated on an annual basis. It includes all of private and public consumption, government purchases, private inventories, paid-in construction costs and the foreign trade balance (exports are added, imports are subtracted).

The formula for calculating GDP is shown and explained below:

\[ GDP = C + G + I + NX \]

Where:

"C" is equal to all private consumption, or consumer spending, in a nation's economy

"G" is the sum of government spending

"I" is the sum of all the country's businesses spending on capital

"NX" is the nation's total net exports, calculated as total exports minus total imports. (\(NX = \text{Exports} - \text{Imports}\))

**Consumer Price Index (CPI)**

The CPI is an index designed to measure the change in price of a fixed market basket of goods and services. The market basket of goods and services is representative of the purchases of a typical urban consumer. The index is intended to measure pure price change only; attempts are made to remove changes in price resulting from changes in quality. The rate of change of the CPI is one of the key measures of inflation for the economy. Changes in CPI are used to assess price changes associated with the cost of living.

Interpreting this index is fairly simple. A rising rate means inflation, but economists usually predict an acceptable change of between 1% to 2%. Anything higher means there has been
significant inflation and as a result, consumers' purchasing power decreases. The core rate is one of the most important indicators for analyzing the CPI because it excludes volatile costs like energy to provide better inflation picture. Information on changes in CPI can be received from the monthly publication of the Ghana Statistical Service.

**Interest Rates**

Interest rate is defined as the amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets. Interest rates are typically noted on an annual basis, known as the annual percentage rate (APR). The assets borrowed could include, cash, consumer goods, large assets, such as a vehicle or building. Interest is essentially a rental, or leasing charge to the borrower, for the use of the asset.

In the case of a large asset, like a vehicle or building, the interest rate is sometimes known as the “lease rate”. When the borrower is a low risk party, they will usually be charged a low interest rate; if the borrower is considered high risk, the interest rate may be higher.

In Ghana, interest rates charged by traditional banks are indexed to the Government of Ghana treasury security rates, normally the 91 day bill. They affect borrowing and lending decisions, determine expenditure and productions patterns, as well as the level of trade and investments.

**Consumer Confidence Index (CCI)**

The CCI is a unique indicator, formed from survey results of more than 5,000 households and designed to gauge the relative financial health, spending power and confidence of the average consumer.

There are three separate headline figures, the first measurement is how people feel currently (Index of Consumer Sentiment), the second is how people feel the general economy is moving (Current Economic Conditions), and the third is how people project the performance of the economy in the next six months (Index of Consumer Expectations).

The Consumer Sentiment Index is a component of the Conference Board’s template of economic indicators. Historically, changes in this index have tracked the leading edge of the business cycle well.

**The Effect of Consumer Confidence Index on the Economy:**

Consumer confidence is important to the economy because it is a major indicator that drives economic growth. The Consumer Confidence Index is a lagging indicator, which means it follows
economic trends. It lags because most people don’t really feel that the economy has changed until after it actually has. The Consumer Confidence Index is usually evaluated by stock market analysts and investors in order to have an idea of whether consumer spending will continue to drive the economy. The stock market can move dramatically on the day the Index is published. However, this only happens when there is a lot of uncertainty about the economy.

The Effect of Consumer Confidence Index on Individuals:

If the Consumer Confidence Index is moving upwards, it means that stocks will probably go higher. If Consumer Confidence is too high, then the excessive demand could trigger inflation, which could lead to a rise in interest rates.

Despite the importance of the Consumer Confidence index, it is worth noting that the CCI is highly subjective, and the results should be interpreted as such. People can use a popular indicator such as gas prices to project economic conditions, moreover because there are no real data coupled with the fact that gas prices may only represent about 5% of people’s expenditure thus this cannot be a basis for an entire economic outlook.

Conclusion

An investors’ knowledge and comprehension of economic indicators cannot be overemphasized; this understanding will help investors make fair predictions concerning the future of their investments since a company's earnings and future prospects depend largely on the overall business and economic climate. Moreover, no matter how strong a company's fundamental is, if the economy is down, the performance of a company will inevitably be affected somewhat.

Therefore, as an investor, it is important for you to understand the macro picture of the economy, not just the sector/industries or stock/company that you want to invest in. A stock market investor must use the indicators to gauge the prevailing economic condition, to enable him to trade profitably and avoid potential losses.

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