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Making sense of market data

The information necessary to understand the recession is available, but unlocking its meaning poses a significant challenge

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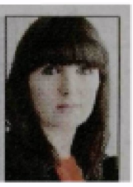

In an economic environment where sentiment is king, how do consumers' perceptions affect the shape of the market? Market data and statistics are omniscient in today's media, with acres of column inches dedicated to the latest number-crunching on the state of our economy. But do consumers really understand the reams of data coming their way? Or is the muddle of numbers all a bit hard to grasp?

Behavioural economists are trying to bridge the gap between the available economic data and consumer understanding by developing new models that challenge the more traditional measures of what's going on in the economy.

"Traditional economic models assume we are rational. But it turns out that may not be so, as we change our minds a lot. So the reality is there are behavioural elements to those aspects of life that economic models try to capture. Behavioural economics is a science that is growing, and is tweaking many financial and economic models," said Professor John Cotter, a specialist in finance at University College, Dublin (UCD).

Michael Dowling, an economist in Dublin City University's business school, said the whole area of alternative indicators was quite fun. "We are talking about the lipstick indicator – coined by the boss of Estée Lauder when he was surprised to find that lipstick sales rose in recessions, presumably as small comfort purchases – or indicators of people staying indoors rather than going out and spending money, such as television viewing and pizza deliveries," he said.

"There's even a 'hot waitress' indicator – I would guess coined by testosterone-fuelled Wall Street types. In recessionary times you will see better-looking waitresses as restaurant owners have a greater choice of employees to choose from and will be able to pick based on looks that might attract customers into the restaurant."

According to Dowling, such measures may be fun, but they are not useful. "All they do is tell us what we already know: that we are in a recession," he said. "What we want is an indicator that helps us predict what is going to happen in the future."

However, some other alternative indicators have more substance to them. For example, the Harvard MBA indicator tracks the percentage of Harvard MBA graduates from a particular graduating year who take jobs in investment banking and other stock market jobs.

"The idea is that if the recruitment of these top graduates is heavily skewed towards market-sensitive jobs this suggests a bubble forming in the market, on the basis that if everyone goes to work on the stock market, its probably a sign of overconfidence on the part of investment banks," Dowling said.

"We seem to be in a bit of a limbo at the moment. Those old-fashioned fun indicators, like hemlines on skirts, are relics of a simpler era, and we know we will eventually be able to accurately model sentiment and predict population mood cycles and their influence on economic conditions in the near future – but we're not quite there yet," Dowling said.

One area where alternative indicators are becoming increasingly popular is in an attempt to capture the mood, or the happiness levels, of people. "Many of the quirky things like hemlines or lipsticks are more issues of consumer activity and fluctuate in areas where there are more or fewer working women for example so are pretty meaningless," said Colm Harmon, professor of economics at UCD and director of the university's Geary Institute. "The most substantive movement in recent years has been towards a concept of wellbeing.

"We desperately need to measure the mood of the public," Harmon said. "To discuss things like unemployment in the absence of any concept of the mental health impact, for example, is to understate the impact quite substantively."

In a bid to get a handle on how happy we are, behavioural economists are merging quality-of-life statistics with things like commuting time and sunshine hours. However, sometimes the results can be surprising and can require an understanding of the statistics behind the easy-to-digest concept.

For example, Cotter explained that, surprisingly, California and New York had low rankings in a recent happiness index of US states. While these states may be perceived as the happiest and best to live in, he said that this drove more people to move there seeking a better life, only to increase population, thus driving up congestion and property prices.

Crime statistics were also given a high weighting in the happiness index that he cited, meaning that states with big cities were generally deemed less happy than more rural states which had lower crime levels.

Cotter predicted that in the future there would be more of these types of economic indicators, with measures of economic activity working hand in hand with broader measures of sentiment. "People can get the concepts, but what is underneath can be a bit more subtle," Cotter said.

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Dr Ronnie O'Toole, chief economist with National Irish Bank, said that the media and consumers should by all means use quirky examples to explain bigger ideas, but not to the exclusion of official statistics.

"I think that individual examples can absolutely help explain to people what is going on, cutting through economic jargon," he said. "For example, which do you think people will understand best: the Big Mac index [used by the Economist] comparing the price of a Big Mac in various countries, or would they prefer to use the OECD's purchasing power parity statistics? Both try and do the same thing, though the Big Mac index is obviously much easier to understand."

However, O'Toole warned that people needed to be careful about assuming that "very specific, 'homey' examples" applied across the board. "For example, we expect emigration at a time of recession, and when we find examples we believe that the proposition has been proved. In reality, the Central Statistics Office figures show that, while foreign nationals have been leaving, net emigration among Irish citizens has not been a major feature of this downturn," O'Toole said.

Instead of using quirky or alternative indicators of economic activity, Harmon said the revolution in economics is more about how we gather and use data. "For example, the British Food Survey now gives folks scanners so that they can keep a record of what they buy and eat - meaning for any individual you have their spend, but also the complete nutrient profile," he said. "We know what folks from different income levels are eating - or rather what nutrients they are taking in. That is the sort of thing economists need to design things like so-called 'fat taxes'."

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Big Mac prices give an insight into purchasing power in different countries