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## **MEASURING BUSINESS CYCLE FLUCTUATIONS: AN ALTERNATIVE PRECURSOR TO ECONOMIC CRISES**

***Abstract.** This study constructs a factor-based model of business cycle identification for the Malaysian economy via the dynamic factor approach. Our central focus is to explore a factor-based business cycle indicator (BCI) that can serve as a good gauge for economic crises. The empirical finding is in harmony with the envisaged objective; the constructed BCI produces satisfactory identification of business cycle turning points and statistically outperforms the national-owned composite leading indicator (CLI) in terms of predictive accuracy and forecasting performance. Therefore, we reckon that the constructed BCI can serve to identify the business climate and foretell approaching economic crises in a timely manner.*

***Keywords:** Business cycle indicator, dynamic factor model, turning points, forecasting, Malaysia*

**JEL Classification: C38, C43, C61, E37**

### **Introduction**

Throughout history, getting a good grip on the current and future states of an economy has been a hard core issue for policymakers, investors, businesspeople and even political parties. Despite countries' best endeavours to presage recurring changes or phase shifts across fluctuating business cycles, business cycle identification is typically challenging as the "state of economy" is rather latent and unobservable. Nevertheless, the literature springing from theoretical and methodological developments in the study of business cycles has mounted since the legendary work on indicator construction in the spirit of [Burns and Mitchell](#)