

Survey Evidence on the Rationality of Business Expectations: Implications from the Malaysian Agricultural Sector

Shirly Siew-Ling Wong¹, Chin-Hong Pua² and
Shazali Abu Mansor³

*Department of Economics, Faculty of Economics and Business,
Universiti Malaysia Sarawak, 94300 Kota Samarahan, Sarawak, Malaysia.*

¹shirlywong87@hotmail.com, ²chpuah@feb.unimas.my, ³mshazali@feb.unimas.my

Abstract

The rational expectations hypothesis (REH) serves as an appealing mechanism in forming expectations compared to that of extrapolative or adaptive frameworks because of its consistency with the basic principles of maximizing behavior. This argument is particularly true as the basic idea of REH maintains that expectations in an uncertain world are formed under assumptions where no systematic errors and information are fully utilized. However, empirical findings from the present study showed diverse evidence of rationality in business operational forecasts formed by Malaysian agriculture firms, as capital expenditure expectations were found to be irrational but gross revenue expectations were supportive of the REH proposition. This implies that the survey of business forecasts may not work well in reflecting the true business outlook, specifically in value-related operational forecasts, which in turn would directly influence investment decisions as well as the capital budgeting process.

Keywords: Rational Expectations Hypothesis, Unbiasedness Test, Non-serial Correlation Test, Weak-form Efficiency Test

JEL Classification: C12, C22, C83, D84, L81

1. Introduction

Decision making and future planning are crucial parts of business and economics, and expectations play a prominent role in generating informed presumptions for future outlooks. In an increasingly dynamic business climate surrounded by economic risk, uncertainty, and imperfect information, it is certainly less than sensible to expect firms to generate precisely correct business expectations. Instead, at the least, business forecasts must reflect the profit maximizing behavior of typical business players under a well-defined economic system with information incorporated efficiently. Under such circumstances, the hypothesis of rationality is theoretically more appealing since the microeconomics assumptions of profit and utility maximizing behaviors are consistent with the basic principles of rational conduct in which people efficiently engage in their economic self-interest by acting rationally in predicting future economic variables. Such assertions are upheld by the notion advocated by neoclassical economists, which maintains that economic agents are assumed to