BUSINESS DEBT INDEX
Quarterly Summary | Q1 2020

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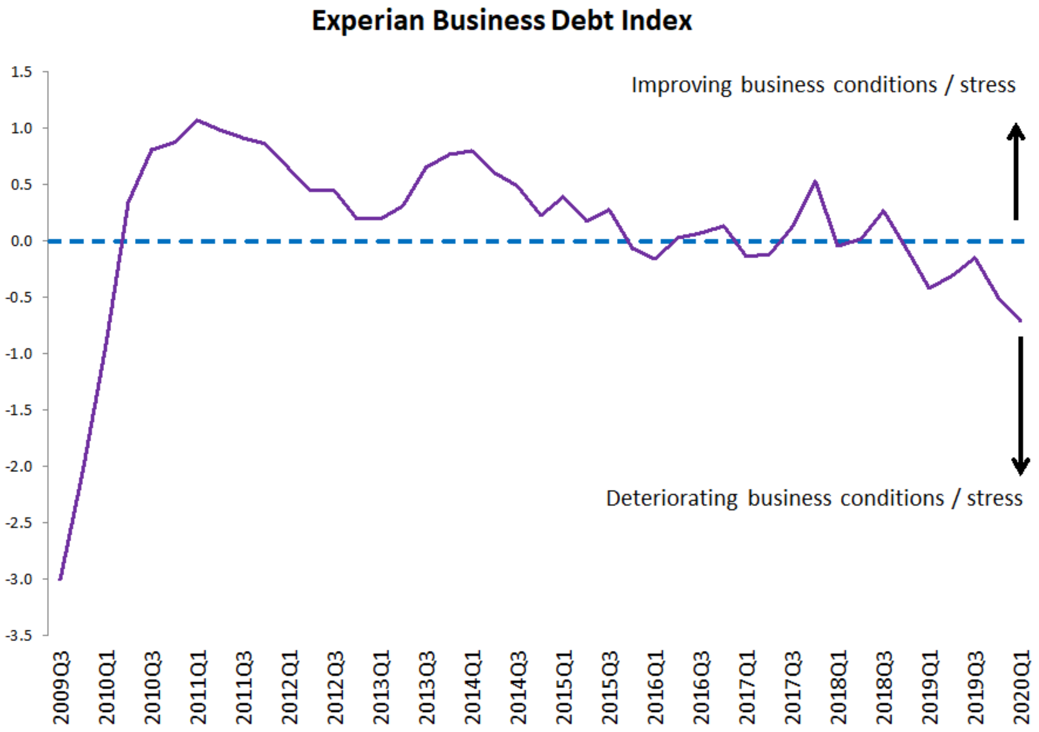
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2020

Deepening economic recession confirmed by a sharp decline in business debt conditions in the first quarter of 2020

The Experian Business Debt Index (BDI) declined sharply in Q1 to -0.741, from -0.499 in Q4 2019. The Q1 2020 reading was the lowest level for the BDI since 2010, following the global financial recession.

On the basis that negative readings for the BDI imply deteriorating business debt conditions, the dip in the BDI marks a significant worsening in business debt conditions in Q1. This contrasts with the hope expressed last quarter of a possible slight improvement in the rate of deterioration.

* *Revised*



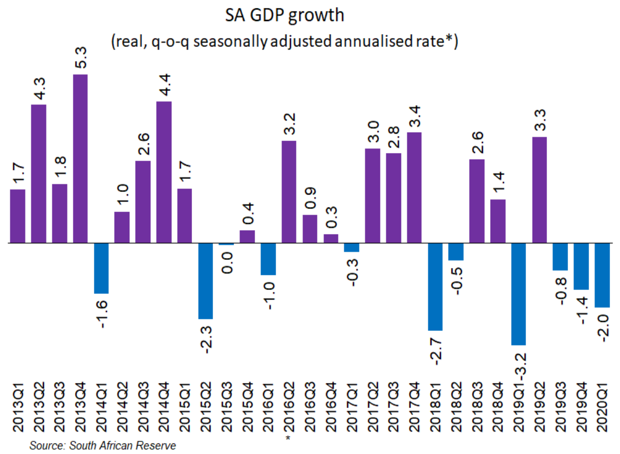
	Q1 2019*	Q2 2019*	Q3 2019*	Q4 2019	Q1 2020*
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.42	-0.30	-0.15	-0.50	-0.71

Macroeconomic factors influencing Q1 2020

Both macroeconomic factors and data relating to the state of business debt in South Africa, had an impact in bringing about a deterioration in the BDI in Q1. Without a doubt, the onset of the COVID-19 epidemic and its impact on economic activity as a result of the need to embark upon social distancing and lockdowns played a role both in respect of macroeconomic factors and business debt. From a macroeconomic perspective, the decline in economic growth in Q1 was not yet devastating because domestically, the introduction of social distancing only occurred during the course of March and the lockdown itself commenced only on March 27th. In other words, these debilitating economic measures took effect over only a small portion of the quarter. Even so, they undoubtedly did depress economic activity as evidenced by the declines in a series of economic indicators during that month, including new vehicle sales, tourist arrivals and manufacturing and mining output.

Through much of Q1, an interruption of supply chains became evident on imports of equipment and components from East Asia as a result of lockdowns effected in some of these countries, most notably China, with a resultant disruption to domestic manufacturing and mining activities. In the event, mining output contracted by -21.5% on a q/q annualised basis, and manufacturing output by -8.5%.

These were the principal contributors to the -2.0% q/q annualised contraction in **GDP** in Q1, which extended the declining trend of GDP from the -0.8% and -1.4% declines recorded in Q3 and Q4 of 2019 respectively. In summary, the recession deepened in Q1.



There were of course other contributing factors to this, including a general loss of business confidence in the wake of renewed unexpected load-shedding towards the end of 2019 and growing recognition of the sharp worsening of the domestic fiscal situation. This was subsequently manifested to some extent in the 2020 Budget, delivered towards the end of February, but culminated in a long-feared downgrade in South Africa's credit rating towards the end of March by Moody's credit rating agency. Moody's had been the last of the three main credit ratings agencies to keep South Africa's credit rating at investment-grade. The downgrade to junk status in the country's credit rating at the end of March meant that all three credit ratings agencies now rated the country's debt at a sub-investment grade or what is commonly known as junk level. In anticipation of this event, selling off South African government bonds gained substantial momentum.

The fiscal deterioration emanated from a massive shortfall in growth of government revenue compared with what had been expected, a function of the dramatic decline in economic growth compared with previous forecasts.

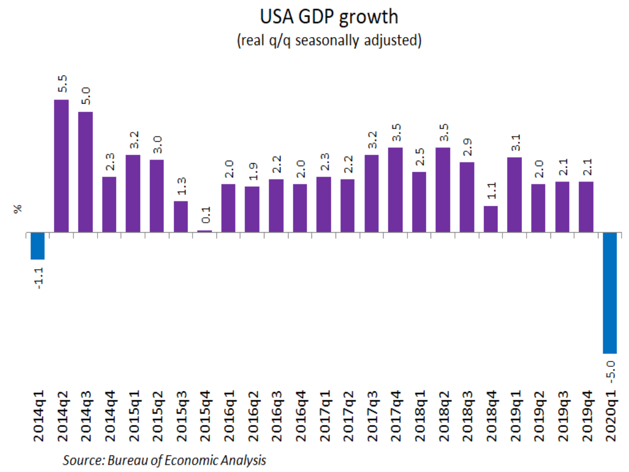
As the prospect of deepening economic depression gained momentum towards the end of March, so too did business confidence deteriorate further in anticipation of a potentially substantial additional increase in the country's budget deficit and associated public debt-to-GDP ratio to levels undreamed of merely a few months earlier.

A sharp -1.0% reduction in the repo rate in mid-March came too late to have any positive impact in limiting the decline in economic growth in Q1. Indeed, were it not for a spirit of panic pre-emptive buying of nondurable consumer goods during March ahead of the lockdown expected to be introduced at the time, growth in GDP would have been considerably weaker even than the -2.0% recorded.

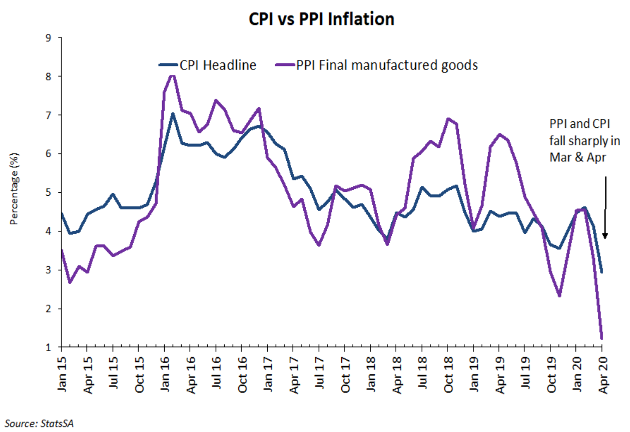
An additional factor mitigating against a further deterioration in growth in Q1, was a sharp 27.8% improvement in agricultural output, following good rains during the summer. This had an especially beneficial impact on maize and fruit crops.

In terms of contributing towards reducing the BDI in Q1 from a macroeconomic perspective, it was not only the fall in domestic growth that was the primary influence.

Part of the decline in domestic growth was linked to a general falloff in global economic growth, especially in March, as the impact of the COVID-19 pandemic started wreaking havoc with the world's major economies as well. Most importantly, **US** q/q seasonally-adjusted **GDP** growth fell off massively from a positive 2.1% in Q4 2019, to -5% in Q1 2020.

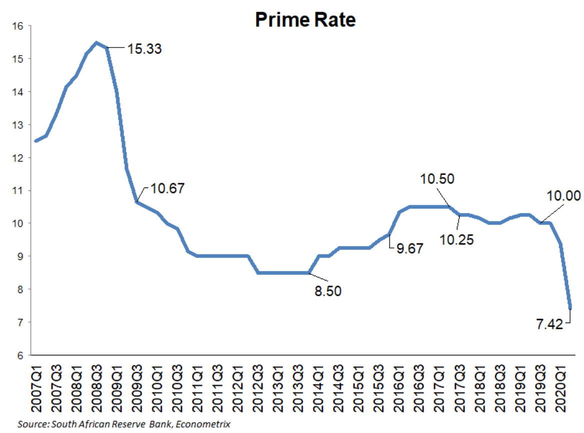


The interruption of supply chains globally, together with increased social distancing and lockdowns in all countries, started having a major negative impact and filtered through into interrupting South Africa's own international trade. Without a doubt, the declines in domestic and global GDP growth were the dominant negative macroeconomic factors contributing towards the downward trend of the BDI in Q1. Ironically, the other variables influencing the BDI from an economic perspective all had a positive impact in limiting the deterioration in the index, but not to any marked extent.



The increase in the **PPI** inflation rate, from an average of 2.9% in Q4 2019, to 4.1% in Q1 2020, was slightly greater than the corresponding increase in the **CPI** inflation rate, from 3.8% to 4.4%. The interpretation thereof is that profit margins of businesses generally improved modestly in Q1 compared with Q4 of last year.

The difference between short and long-term interest rates is also used conventionally as a proxy for economic prospects. Whilst domestic short-term interest rates fell quite sharply in March specifically, helping to boost short-term economic prospects, long-term interest rates also remained fairly depressed for most of the quarter before rising strongly in late March specifically in line with a general sell-off in global financial markets and a rise in risk aversion towards emerging markets and risky assets.



The increase in long-term interest rates in late March was not sufficient, however, to have a major impact on the average Q1 level of long-term interest rates. Short-term interest rates were also reduced internationally, but less so than that of domestic short-term interest rates. Accordingly, domestic financing requirements became slightly cheaper.

Business debt metrics in Q1 2020

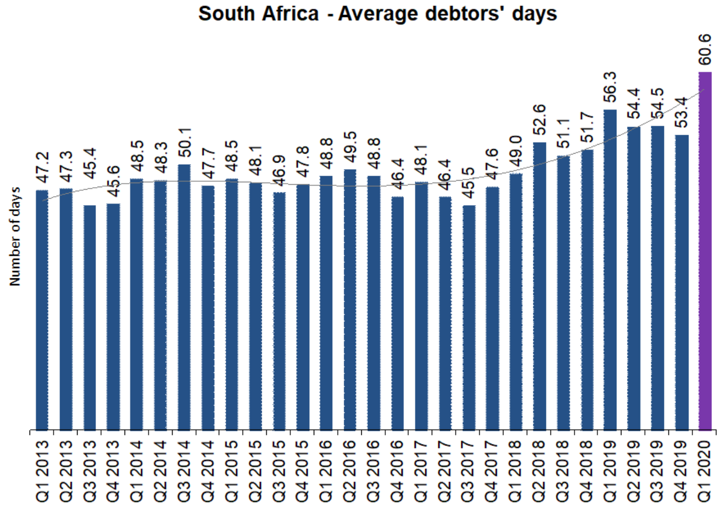
Despite the negative impact on the Q1 BDI from lower economic growth domestically and internationally, the other main influence was a marked deterioration in business debt conditions.

The average level of outstanding debtors' days shot up to its highest over the past decade, at 60.6 in Q1, up dramatically from 53.4 days in Q4 2019 and a recent low point of 45.5 days in Q3 2017.

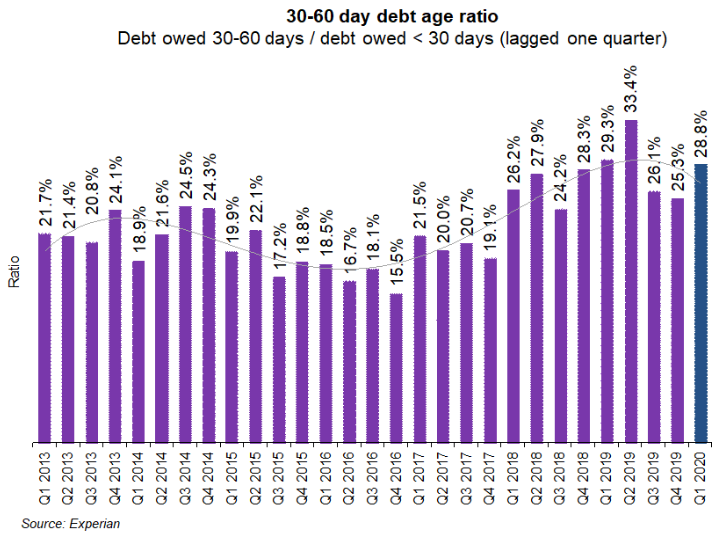
The increase in debtors' days extended a rising trend that has been in place for the last 3½ years, but the jump in Q1 2020 was particularly sharp. One suspects that the cumulative effect of declining economic growth for an extended period of two years finally took its toll on the ability of businesses to survive without holding back on debt payments.

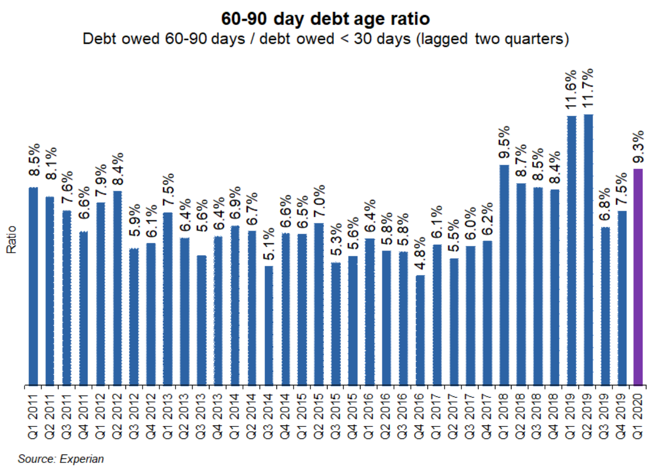
In addition, the negative impact of social distancing and ultimately the lockdown in late March must have also played some role in compelling businesses, afflicted by these developments, to hold back on paying off debtors. Specifically related to the BDI calculation, the 30- 60 days ratio[1] increased to 28.8% in Q1 2020, from 25.3% in Q4 2019 and 26.1% in Q3 2019.

The **60-90 day ratio**[2], rose to 9.3% in Q1, from 7.5% in Q4 and 6.8% in Q3 of last year.



Negative debt metrics added to the negative impact of macroeconomic factors on the overall BDI in Q1





[1] *The ratio of outstanding debt owed of 30 to 60 days relative to that owed of less than 30 days lagged by one quarter*

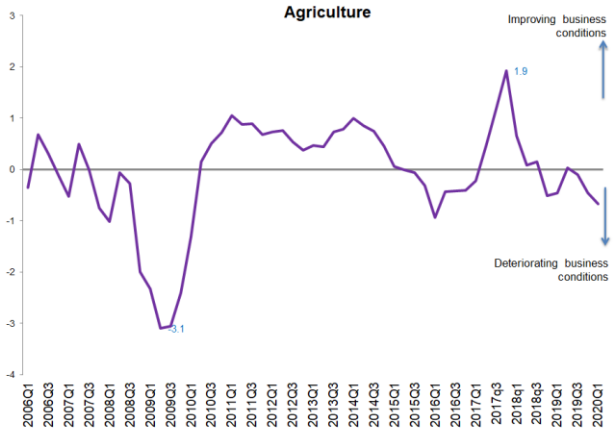
[2] *Outstanding debt owed of 60 to 90 days relative to debt owed of less than 30 days lagged by two quarters*

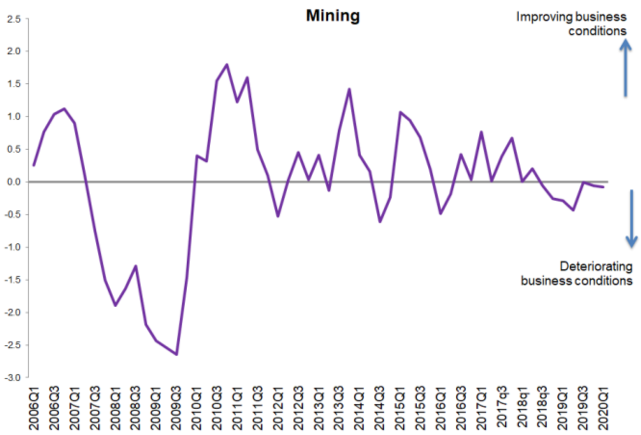
BDI by sector

From a sectoral perspective, the BDI calculations reflected an improvement in the case of electricity, manufacturing, transport and communication, the retail trade and accommodation sectors, construction and financial services.

In contrast, the BDI for agriculture and mining deteriorated.

These impacts were counterintuitive given that in Q1, it was the agricultural sector that outperformed all the other sectors with regard to GDP, while manufacturing, electricity and construction all recorded declines in output.





The relatively favourable performances of the BDI in these sectors is therefore more a lagged function of the relative improvement in the debt situation derived from a positive performance in the South African economy in Q2 of last year.

Severe deterioration in business conditions was reported in the agricultural sectors

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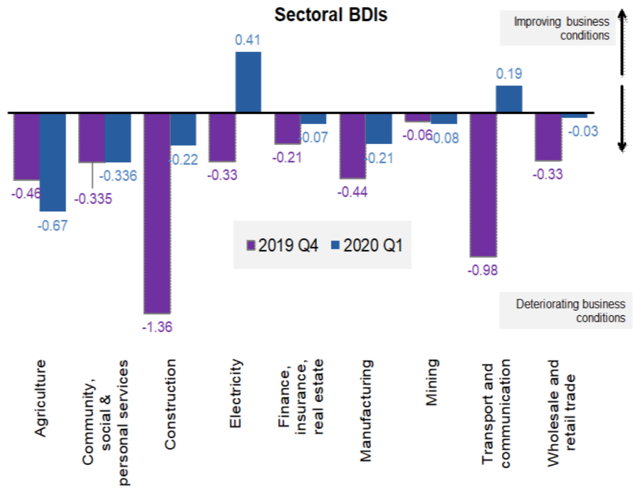
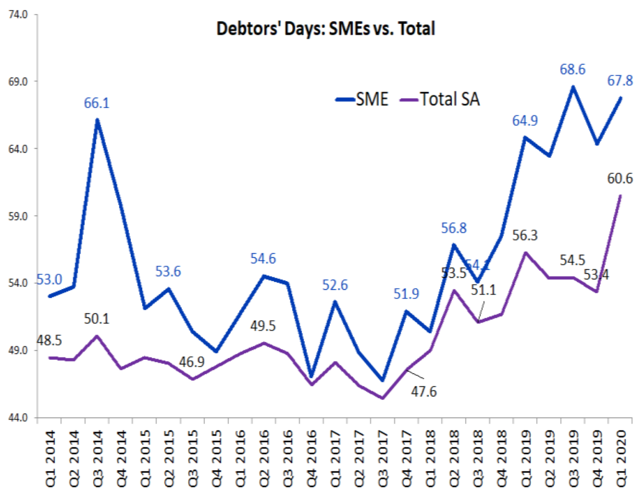


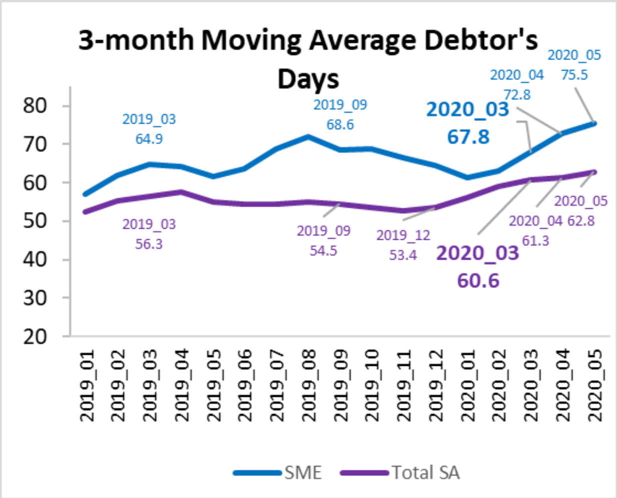
BDI by company size

Also counterintuitive is the smaller deterioration in the number of outstanding debtors' days in respect of SMEs compared with larger companies in Q1 2020.

However, analyses into the Q2 2020 data that has been submitted to bureau thus far, does indicate that the



(expected) more severe impact was felt by SMEs during April and May.



This aligns with findings from surveys of the relative impact of the lockdown on small versus bigger businesses in April and May, which suggested that the bulk of the adverse impact financially fell on small rather than bigger businesses. This appears to have been preceded by the opposite trend with respect to the overall sample as the broader global slowdown impacted more on larger businesses due to general supply chain and demand impacts.

Summary and Outlook

In many respects, the BDI for Q1 2020 is to some extent of academic importance only. It is commonly known that the lockdown - which commenced in late March and has been with us in varying forms ever since then - has had a devastating effect on both the domestic and international economies.

Economic growth forecasts both here and abroad have been revised down quite dramatically and to an extent not seen for almost a century. General market predictions estimates that domestic economic growth will decline by between 10% to 20% on a year-on-year basis in Q2, compared with the -2% growth recorded in Q1. For the year as a whole, official forecasts by the Reserve Bank, National Treasury, IMF and World Bank, are in the region of -7% for the South African economy. Internationally also, the forecast for world economic growth for 2020 has been revised downwards equally sharply, from a positive 3.3% that prevailed in February, to -4.8% currently.

The macroeconomic inputs into the calculation of the BDI are therefore going to endure by far the biggest downward pressure experienced since this business debt index was conceived.

One imagines that the data relating to outstanding debtors' days will equally see a bigger increase than anything hitherto imagined.

One is already aware from responses to surveys conducted by Statistics South Africa that many businesses, especially smaller ones, have shut down operations, at least partially and in some cases permanently, as a result of the adverse impact of the lockdown. On both fronts, therefore, macroeconomic and business debt-related, one should expect the BDI to plunge in Q2. Thereafter, one is likely to see some recovery based on the lifting of lockdown levels to a less restrictive dispensation in Q3.

There is still enormous uncertainty regarding the future path of infections with the COVID-19 virus. Most recent evidence suggests that the virus is spreading at an escalating rate in South Africa as well as in many overseas countries as well. Development of a vaccine would undoubtedly improve business confidence enormously, but such an outcome is not foreseen during the course of 2020 specifically and in all likelihood will only emerge during the course of 2021.

In the intervening period, business debt conditions are likely to be considerably worse than anything experienced in the memory of most people alive.

Explanatory notes regarding the Experian Business Debt Index

What is the Experian Business Debt Index?

The Experian Business Debt Index (BDI) is an indicator of the overall health of businesses, as well as the South African economy. It measures the relative ability for business to pay its outstanding suppliers/creditors (i.e. amounts owed to other businesses) on time and tracks macro-economic indicators that can impact on the ability of companies to pay their creditors.

A number of debtors and macro-economic variables are combined into a single indicator of business debt stress.
In other words, the BDI is a reflection of the overall health of businesses and the position of debt settlement between businesses in the economy.

How to interpret the index

The Experian BDI, as an indicator of the overall health of businesses, measures the relative ability of businesses to pay their outstanding creditors on time. It also incorporates trends in macroeconomic indicators, insofar as these impact on the ability of companies to pay their creditors. The index is constructed around a mean value of zero.
Values above zero indicate less business debt stress and values below zero indicate business debt stress.
Given the underlying data of the index, relative higher levels of debt indicate a weakening in the ability to pay outstanding creditors. Higher interest rates result in higher borrowing costs and an increase in business stress. Relatively higher production costs vs consumer costs decrease operating margins of business, while higher domestic and international growth could result in a better trading environment for businesses.

Measured by using principle components

The Experian Business Debt Index (BDI) is constructed using principal components analysis. This is similar to the St. Louis Fed's Financial Stress Index (STLFSI) and the Kansas City Fed's FSI (KCFSI) in the USA. The principal components analysis is a statistical method that is used to extract factors responsible for the co-movement of a group of variables. As such, it is assumed that business stress is the primary factor influencing the co-movement and by extracting the principal components, it is possible to build an index with a useful economic interpretation.

Variables included

The Experian Business Debt Index is made up of Experian business debtors' data and public domain data. Variables include the following:

- 30 – 60 debtor days' ratio (debt compared to initial amount invoiced 30 days ago);
- 60 – 90 debtor days' ratio (debt compared to initial amount invoiced 60 days ago);
- South Africa consumer inflation and producer inflation spread;
- Interest rate spread (Repo vs US Federal Fund rates);
- Interest rate spread (R157 vs Repo);
- Real SA GDP (year-on-year percentage change);
- Real US GDP (year-on-year percentage change).

No provision is made for any leads or lags in any of the variables.

Methodology used to construct the index

The index is constructed by first demeaning the individual indices - subtracting the index value from the index average and dividing it by the sample standard deviation (SD). The indices can now be expressed in the same units. Next, the method of principal components is used to calculate the coefficients of the variables in the EBSI. These coefficients are scaled so that the standard deviation of the index is 1. Lastly, each of the indices is multiplied by its respective adjusted coefficient.

When the index is updated quarterly, the values of the Experian Business Debt Index can change. This can occur either through a change in the coefficients (an updated re-estimation) or because of a change in the actual values of the variables in the sample. Because the data are demeaned and standardised, the value of the original sample will change as the sample mean and sample standard deviation of the underlying variables change.

About Experian

We are the leading global information services company, providing data and analytical tools to our clients around the world. We help businesses to manage credit risk, prevent fraud, target marketing offers and automate decision making. We also help people to check their credit report and credit score and protect against identity theft. In 2016, for the third year running, we were named one of the "World's Most Innovative Companies" by Forbes magazine.

We employ approximately 17,000 people in 37 countries and our corporate headquarters are in Dublin, Ireland, with operational headquarters in Nottingham, UK; California, US; and São Paulo, Brazil.

To find out more about our company, please visit http://www.experianplc.com or watch our documentary, 'Inside Experian'.

About Econometrix

Econometrix is South Africa's largest independent macro-economic consultancy based in Johannesburg. We are privately owned and therefore totally independent of any official organisation or pressure groups. Econometrix – which has a successful track record of more than 35 years - is committed to on-going research and analysis of economic fundamentals thereby ensuring a sound basis for future business decisions. These services are provided through a range of complementary products to more than 150 South African and international organisations.

Our approach is to empower our clients with quality decision support intelligence and assistance regarding the economic and financial environment, and assist them in their strategic and financial planning processes. Our in-depth analysis of economic fundamentals aims to assist our clients in commanding the economic environment and in identifying opportunities and risks.

Contact details

Analysis – Econometrix	+27 11 483 1421	ilsef@econometrix.co.za
Enquiries – Experian South Africa	+27 11 799 3400	taryn.stanojevic@experian.com

Next release date for the BDI: August 2020

For more detailed analysis on the debt stress by sector, Experian publishes the *Business Debt Overview* report. Please contact Taryn Stanojevic at Experian for more information.