Business Debt Index

Quarterly Summary - Q1 2022

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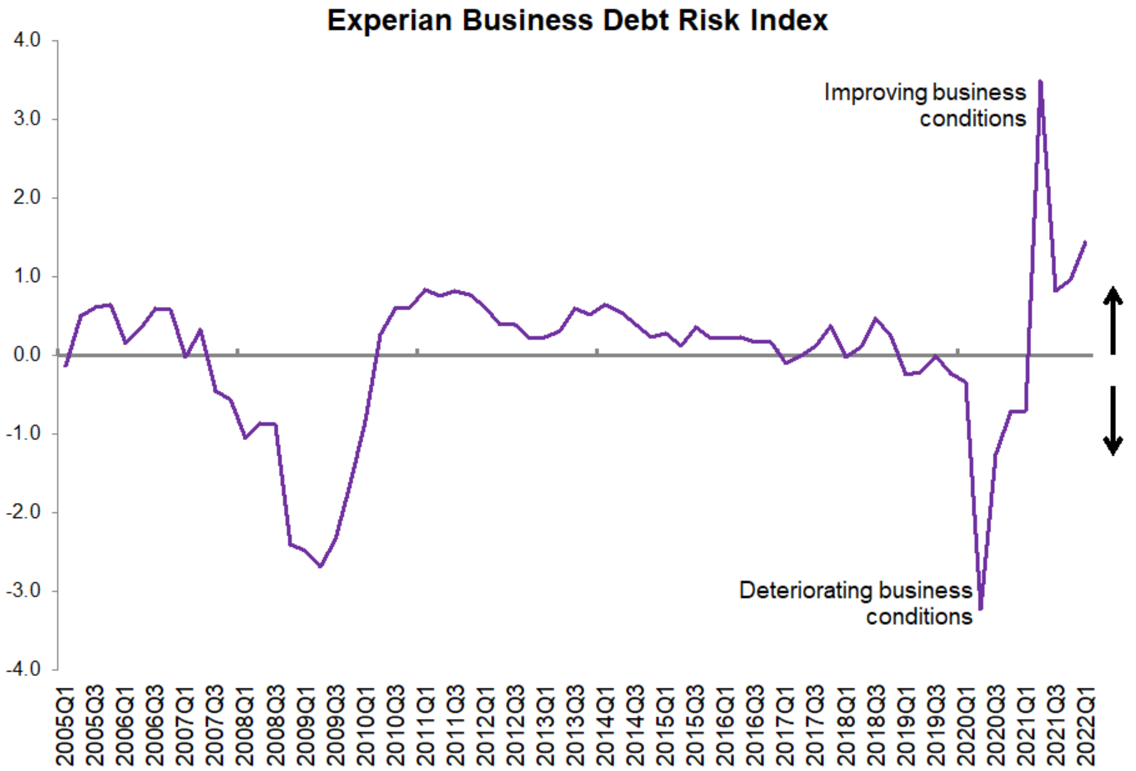
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2022

Solid improvement in Experian BDI in Q1, but likely to decline from here onwards

The Experian business debt index recorded a solid improvement in Q1 from Q4 2021, rising to 1.435 from an upwardly revised 0.970.

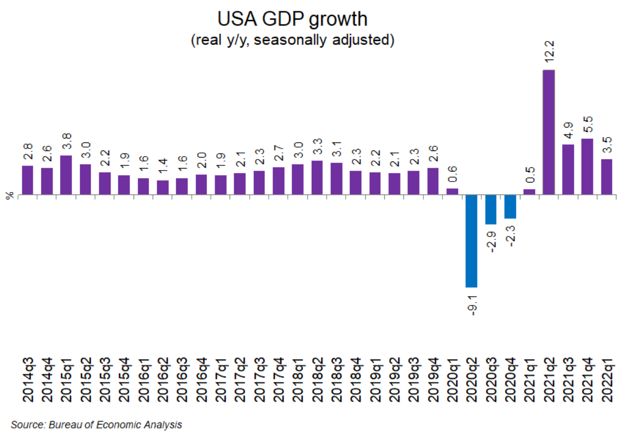


	Q1 2021*	Q2 2021*	Q3 2021*	Q4 2021*	Q1 2022
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.700	3.491	0.819	0.970	1.435

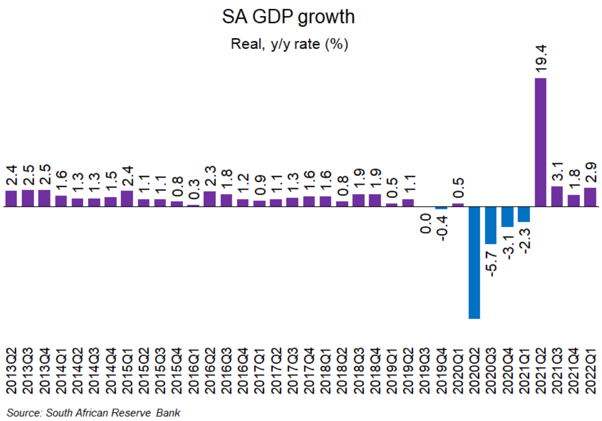
** Revised*

Macroeconomic factors influencing Q1 2022

The principal contributors to the improvement in the Q1 BDI were a pickup in domestic and US economic growth during that quarter.



Domestically, the adverse effects of the looting and unrest experienced in Q3 of 2021 continued to fade during Q1 of 2022.



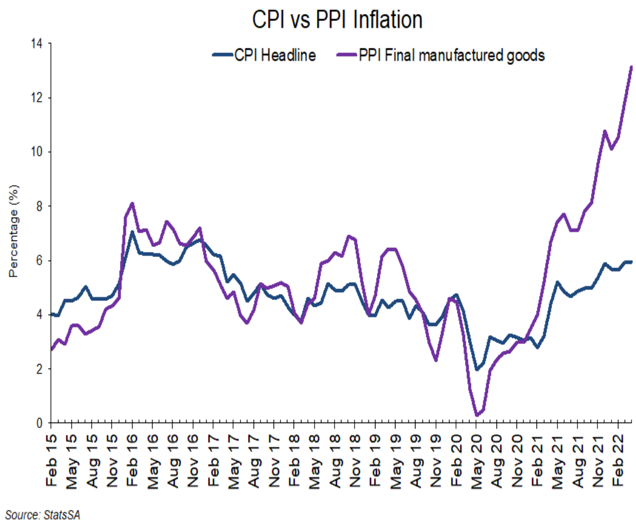
In addition, commodity prices remained elevated in Q1 this year, supported by supply-side shortages globally caused by disruptions to supply chains emanating from lockdowns introduced to fight off the omicron variant of COVID-19.

During that time, the Russian invasion of Ukraine exacerbated such shortages. Furthermore, the reintroduction of hard lockdowns in several Chinese cities extended supply disruptions, especially concerning fossil fuels and food commodities.

Domestic interest rates continued at levels well below those that prevailed before the onset of COVID-19; this gave support to retail sales, as did the increased health of personal balance sheets.

In turn, US economic growth continued to benefit from the lagged effects of the massive and unprecedented fiscal and monetary stimulus introduced in the preceding 18 months to provide relief to beleaguered consumers and businesses negatively affected by lockdowns and other restrictions associated with COVID-19.

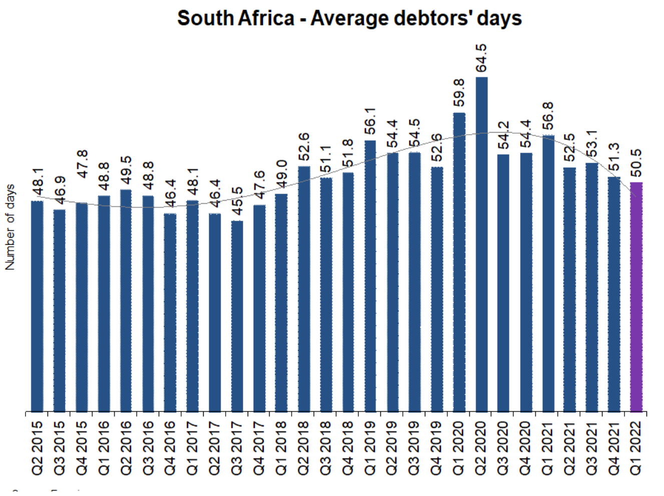
Other factors also contributed to an improvement in the Q1 2020 BDI. The escalation of disruptions to supply chains resulted in the domestic PPI inflation rate rising sharply relative to the CPI inflationary rate. It reflected an increase in the ability of producers to recoup increased costs emanating from higher input prices by passing on such cost increases to retailers and other distributors. In addition, the differential between short- and longer-term interest rates increased moderately as the latter rose in response to domestic and international inflationary pressures.



Although the interest rate differential between the South African (repo rate) and the US (fed funds rate) narrowed slightly, the order of magnitude of this differential was minor compared with other factors used in calculating the BDI.

Business debt metrics in Q1 2022

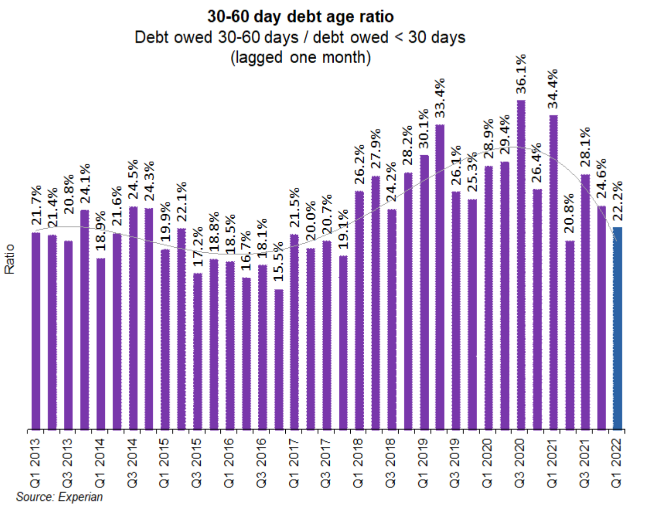
The improvement in the BDI in Q1 2022 was not, however, confined to domestic macroeconomic factors alone. Experian data on outstanding debtors' days also had a significantly positive impact.



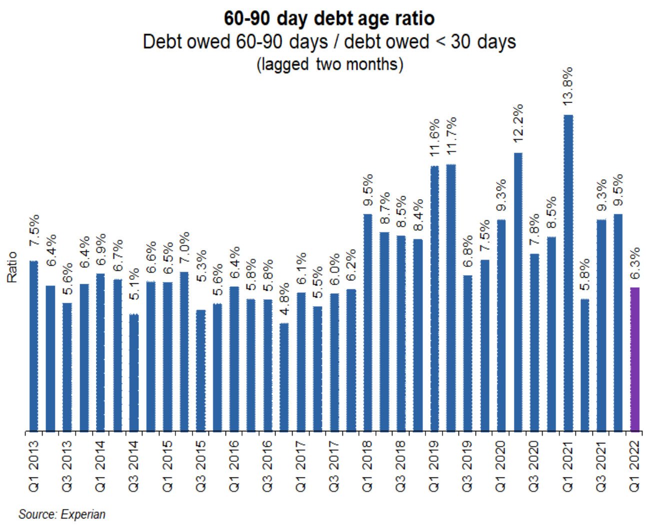
Overall, the declining trend of outstanding debtors' days continued into Q1 of 2022, declining to 50.5 days from 51.1 in Q4 2021 and 53.1 in Q3 2021.

Outstanding debtors' days have diminished quite sharply from the 64.5 days outstanding recorded at the height of the hard lockdown in Q2 of 2020.

In terms of the measurement of the BDI, the first factor taken into account in respect of this variable is the **30 to 60 days ratio**[1]. This ratio declined to 22.2% in Q1 of 2022, from 24.6% in Q4 2021 and 28.1% in Q3 of 2022.



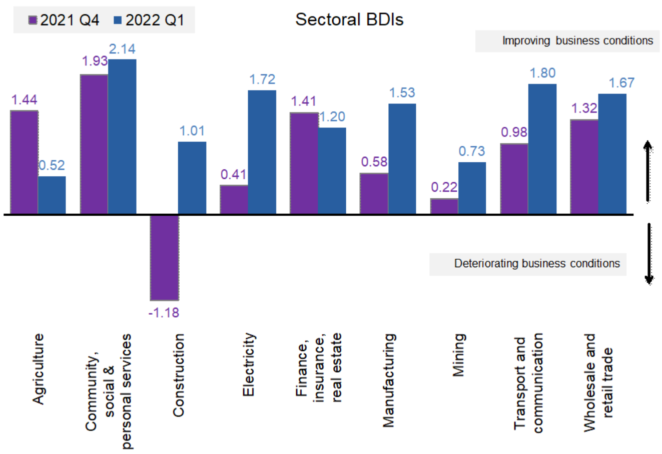
Similarly, the **60 to 90 ratio**[2] declined quite sharply to 6.3% in Q1 of 2022, from 9.5% in Q4 of 2021 and 9.3% in Q3 of that year. These compare with a peak of 13.8% in Q4 of 2020, illustrating the progressive improvement in business debt conditions over the past 18 months, interrupted by the social unrest in Q3 of 2021.



Without a doubt, the ability of borrowers to benefit from the reduced debt-servicing costs following the 30% reduction in domestic interest rates in the first half of 2020 contributed to this improvement.

BDI by sector

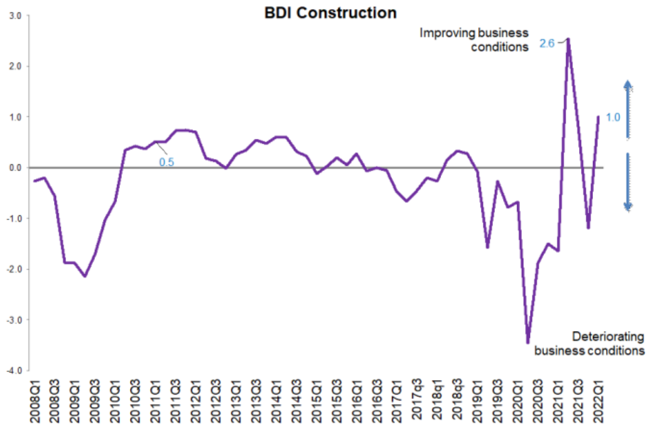
The improvement in the Q1 BDI was transmitted through most sectors of the economy. Every one of the nine sectors recorded a positive BDI in Q1 of 2022, reflecting improved financial health.



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

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

The one sector that had seen business debt conditions deteriorating in Q4 of 2021, viz. construction, saw positive business debt conditions returning in Q1 this year.

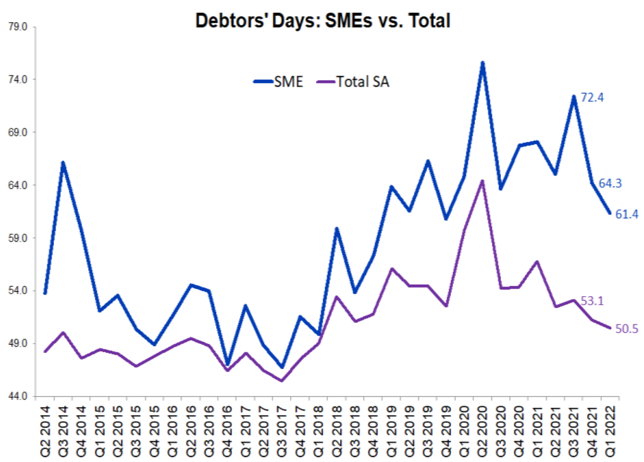


Only in the case of agriculture and financial services did the BDI reading deteriorate from extremely strong to modestly strong in Q1 of this year. This, in turn, was a function of a comparison against a strong base for the previous quarter.

There were particularly impressive increases in the BDI in respect of manufacturing and, associated with this, electricity. These improvements reflect a return to normal conditions following the devastation of industrial activity caused in KwaZulu-Natal in Q3 2021 by the social and political unrest at the time.

BDI by company size

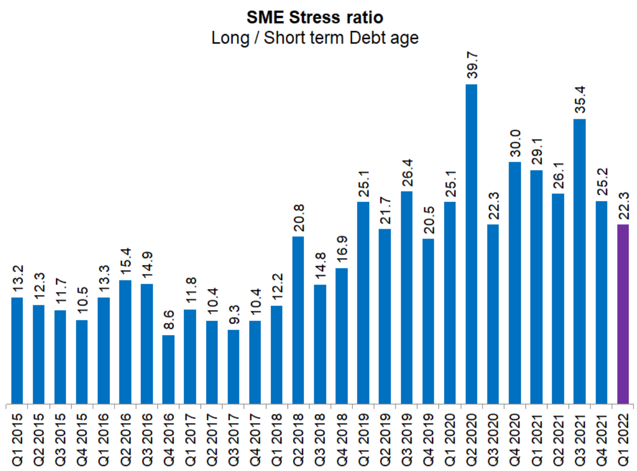
Improved business debt conditions were also reflected, irrespective of the size of the companies. Outstanding debtors' days of SMEs declined to 61.4 in Q1 of 2022, from 64.3 in Q4 of 2021 (itself revised sharply downwards from 71.1 as reported three months ago) and 72.4 in Q3 of 2021 at the height of the looting spree.



SMEs are still reflecting a lot more strain than larger companies, as reflected by comparison of the 61.4 days outstanding in respect of SMEs in Q1 relative to the 50.4 days outstanding for the whole sample of companies for which Experian has data.

However, the fact is that the number of outstanding debtors' days of SMEs has fallen to its lowest level in three years.

Similarly, the so-called SME stress ratio, the number of SMEs with outstanding debts of less than 60 days relative to those with debts outstanding of more than 90 days, fell to 22.3% in Q1 of 2022, from 35.4 and 25.2 outstanding debtors' days respectively for Q3 and Q4 of 2021. This ratio was also the lowest since Q4 of 2019.



Outlook

Unfortunately, the improvement in business debt conditions identified in Q1 of 2022 is likely to be conclusively reversed in Q2 and probably in subsequent quarters as well.

- Domestically, one has already received data on mining and manufacturing activity for April, reflecting a significant decline compared with earlier months this year. An intensification of electricity load-shedding and strike activity in both sectors appear to have impacted negatively on output.
- Secondly, the heavy rains and flooding that occurred in KwaZulu-Natal during April are likely to have inflicted damage on several businesses in the region, especially those involved in manufacturing, sugarcane farming, and importing or exporting through Durban harbour, which was severely

damaged. For example, it is known that the Toyota factory in Prospecton, close to Durban harbour, was badly flooded, and around 8000 new vehicles had to be written off.

- Thirdly, Q2 is likely to witness the adverse impact of the 0.75% cumulative increase in the repo rate between November and March and the additional 0.50% rate hike in May. In this regard, it is also logical to expect that consumers and businesses will be very aware of the likelihood that interest rates will increase further over the remainder of the year in the wake of rising inflation, especially in food and fuel prices. In any case, consumers are likely to see an erosion in their disposable incomes due to the escalation in such prices exceeding the rate of increase in wages and salaries by a substantial proportion.

The adverse impact on business debt conditions is unlikely to be confined to domestic factors alone. Internationally, the continuation of the Ukrainian war without any apparent signs of an end threatens to sustain shortages of vital industrial materials and food commodities. Supply disruptions caused by intensified lockdowns in China to eliminate the spread of COVID-19 are likely to add upward pressure on prices.

In turn, the likelihood of sustained high inflation is set to drive leading central banks worldwide to continue raising interest rates more steeply than had been imagined hitherto. Falling asset prices emanating from the more aggressive tightening of monetary policy and added moves to reverse the increases in global liquidity brought about by two years of quantitative easing are likely to exacerbate the pessimistic mood of middle-class consumers.

A flattening of yield curves in several countries, especially advanced economies, raises the spectre of global recessionary conditions in 2023.

This is unlikely to leave South Africa's economy unscathed. Even though, in the short term, the economy is being insulated from the worst effects of global developments due to commodity prices remaining high by historical standards, one cannot rely on these prices staying this high during a possible sharp downturn in global economic conditions.

Anxiety also abounds concerning the ability of governments to finance the moves to a just transition towards cleaner energy that is being sought by international institutions. The capacity of governments whose public debt levels are already at record highs to embark upon further fiscal expansion to counteract recessionary trends is severely limited.

On the contrary, with long-term interest rates rising sharply, the insulation provided for debt-servicing costs by a sustained period of record-low long-term interest rates is rapidly fading.

It is therefore not surprising that the forecast for the BDI is for it to drop back slightly in Q2. In fact, the risks to such a forecast are definitely on the downside. The mitigating factor is that South Africa might not be as badly affected as several other countries by such a downturn, especially because it is benefitting from the massive increase in international coal prices and the country is one of the five biggest coal exporters in the world.

Nonetheless, even here, the economy cannot reap the full benefit of higher commodity prices because of infrastructural bottlenecks in the country's rail and port networks, preventing the economy from fully exploiting this commodity export bonanza.

Although the government has maintained its determination to address structural weaknesses of the economy with appropriate reforms to improve the country's longer-term economic growth performance, evidence of implementation of such reforms has not materialised to the extent one would have liked to see.

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.

Experian plc is listed on the London Stock Exchange (EXPN) and is a constituent of the FTSE 100 index. Total revenue for the year ended March 31, 2016, was US$4.6 billion.

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 38 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.

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Next release date for the BDI: September 2022

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.