Business Debt Index

Quarterly Summary - Q2 2022

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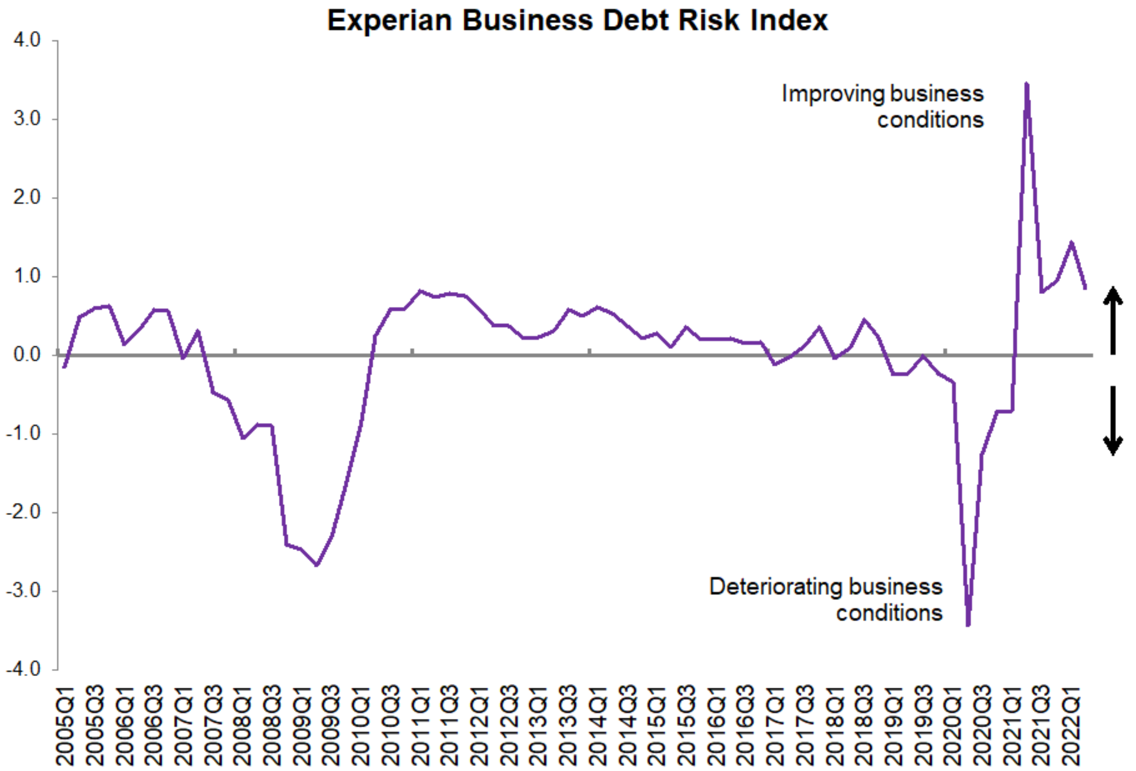
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q2 2022

Expected deterioration in Experian BDI in Q2

As expected, the BDI declined in Q2 of 2022 due to lower economic growth in South Africa and abroad. The BDI declined from a reading of 1.438 in Q1 to 0.856 in Q2.

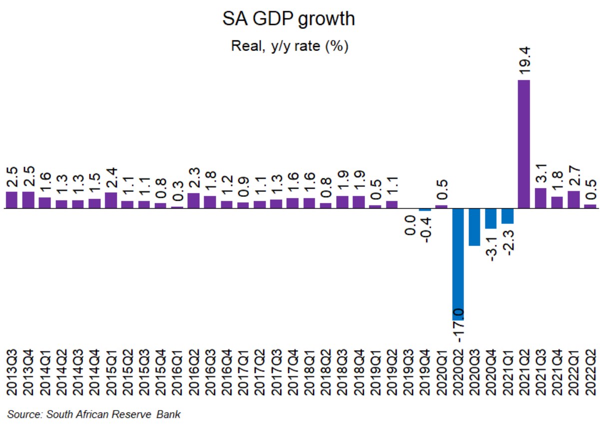


	Q2 2021*	Q3 2021*	Q4 2021*	Q1 2022*	Q2 2022
Index >0= Improving business conditions <0 = Deteriorating business conditions	3.462	0.803	0.946	1.438	0.856

** Revised*

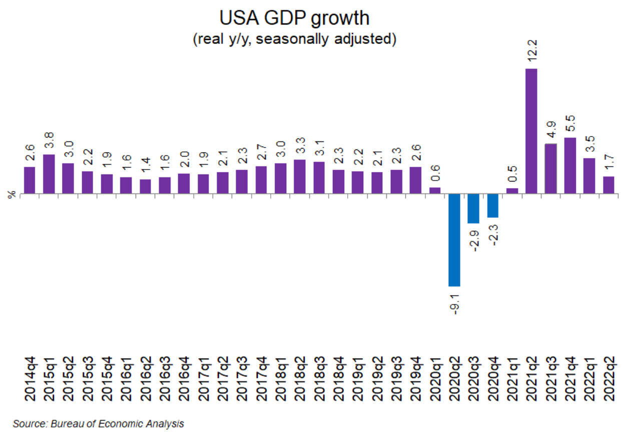
Macroeconomic factors influencing Q2 2022

From a macroeconomic perspective, South Africa's y/y GDP growth declined from a downwardly revised 2.7% in Q1 to 0.5% in Q2.



The principal reason for this outcome was the intensification of electricity load-shedding in June, which aggravated the slump in economic growth in Q2 compared with what had been expected.

Other factors contributing to reduced growth in Q2 had already been factored into the original forecast for Q2 BDI were the floods in KwaZulu-Natal and the impact of the steep 0.5% repo rate increase at the May MPC meeting: at that time, it represented the biggest repo rate hike in more than a decade.



In the US, economic growth slowed somewhat in Q2 to 1.7% y/y, from 3.5% in Q1. However, inflation shot up to a 40-year high of 9.1% in June on the back of supply shortages emanating from the COVID-19 outbreak of the last two years and strong demand for a variety of goods and services in the wake of a return to normality following the end of social distancing and lockdowns.

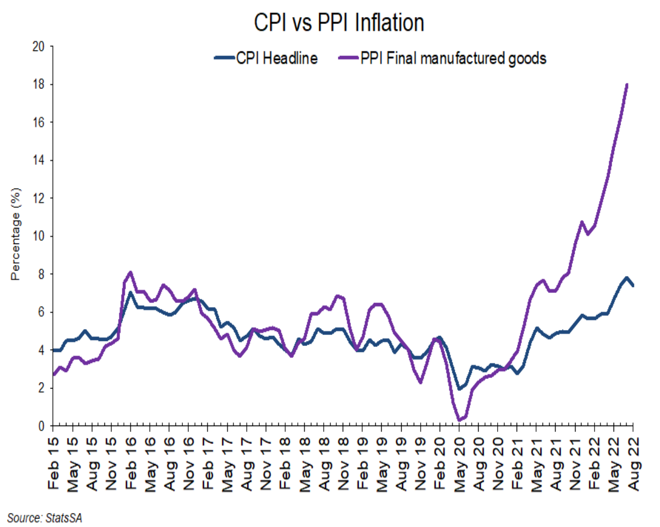
The war in Ukraine added to inflationary pressures in terms of the surge in oil and other energy prices arising from sanctions imposed upon Russia and a countervailing withholding of supplies of these goods to the west.

In addition, an interruption of food commodity exports from Ukraine also caused food prices to rise. Even though growth in wages and salaries accelerated in the face of a relative increase in labour shortages, this was insufficient to prevent an erosion of disposable income that impacted negatively on the US growth outcome.

In this instance, similar factors prevailed, if anything, in an intensified form in Europe, Japan and other countries to render the slowdown in US economic growth a good proxy for what was happening in Q2 throughout the rest of the world.

From a different angle, global economic growth prospects were negatively affected by indications that the world's leading central banks were determined to dampen inflationary pressures by raising interest rates sharply from the extraordinarily low levels that had prevailed in the preceding decade and by sucking out liquidity from the world economy by replacing the erstwhile policy of quantitative easing with quantitative tightening.

Ironically, heightened inflationary pressures in supply chains contributed to a perceived increase in the margins of business companies reflected in the rise in the domestic PPI inflation rate to levels even steeper than those of the CPI inflation rate.



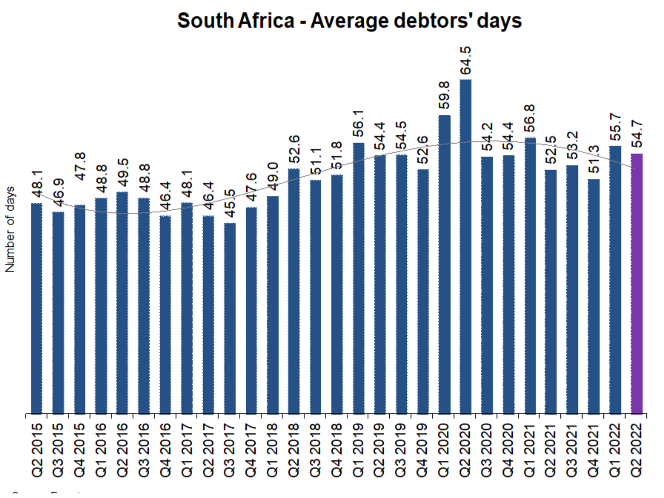
The PPI inflation rate rose well into double-digit levels, leaving the differential between PPI inflation and CPI at more than 8%, providing a nice cushion to the business community, which may have assisted in tempering the deterioration in financial conditions caused by higher interest rates.

There was also some slight respite in borrowing costs domestically by virtue of the differential between domestic and US interest rates declining somewhat. However, a rise in longer-term interest rates that exceeded the rise in short-term interest rates is also interpreted as favouring economic growth prospects domestically.

However, the combination of these other factors that enhanced the BDI was minor compared with the impact of the overall slowdown in economic growth both domestically and abroad.

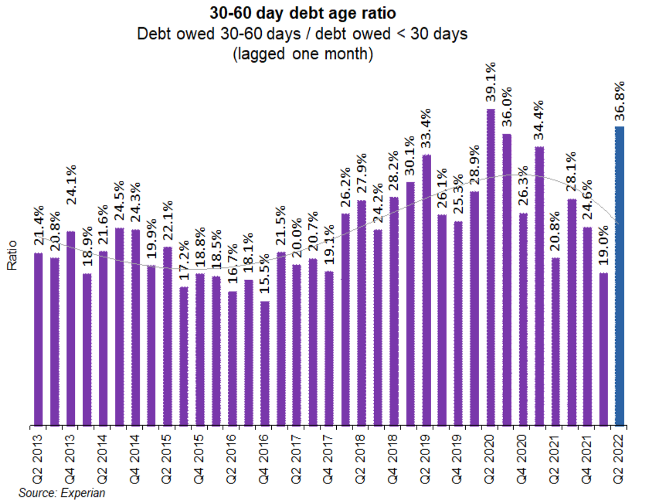
Business debt metrics in Q2 2022

While economic growth decreased by more than anticipated and was the dominant reason for the lower-than-expected BDI outcome, there was also significant deterioration in the debt age ratios derived by Experian.

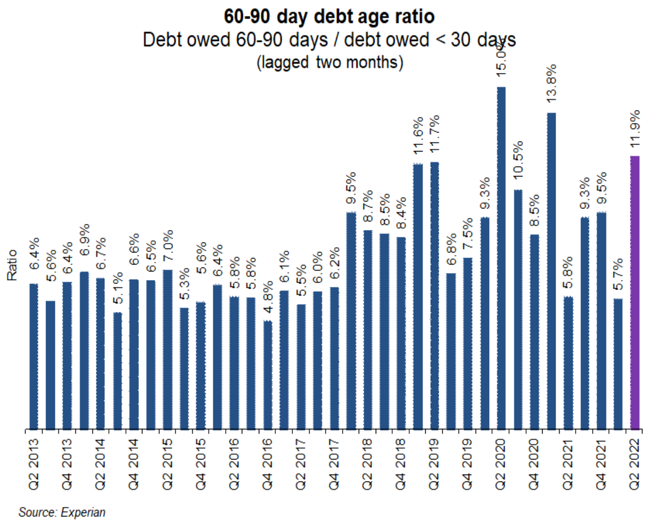


Despite a slight improvement in average debtors' days in Q2 to 54.7, a stronger set of negative impulses on the Q2 BDI emanated from Experian data showing sharp increases in the debt age ratios.

In particular, the **30 to 60 days ratio**[1] almost doubled, from a four-year low of 19.0% in Q1 to 36.8% in Q2. The latter was, in fact, the second highest such lengthening of outstanding debts over the past decade.



Similarly, the **60 to 90 ratio**[2] doubled from 5.7% in Q1 to 11.9% in Q2. One can only imagine that the realisation that interest rates domestically were no longer going to be benign, but set to increase sharply, created a tendency for debtors to withhold paying off their debts as rapidly as had been the case previously.



In addition, with the kind of disruption to economic activity caused by the floods and the load-shedding in Q2, businesses will have felt compelled to replenish cash flows by withholding the repayment of loans as rapidly as had been the case.

At the same time, the extent of the turnaround in this situation from Q1 was so dramatic that one is left to

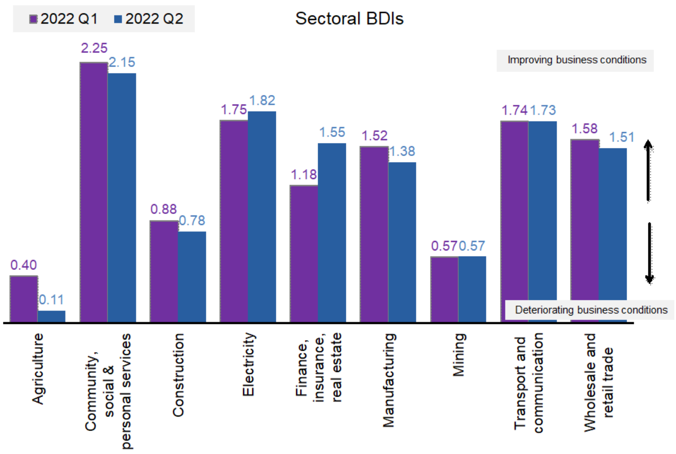
[1] *The ratio of outstanding debt owed of 30 to 60 days relative to that owed of less than 30 days lagged by one month*

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

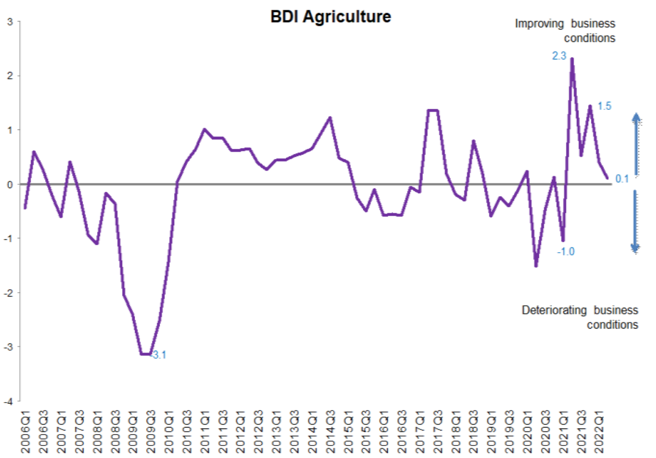
question why the alacrity of repaying debt witnessed in Q1 had been so intense.

BDI by sector

The sectoral breakdown of BDI is somewhat unremarkable with relatively minor changes, primarily linked to the GDP performance in Q2 of each of the sectors.



Only two sectors recorded changes in BDI of more than 0.10, namely agriculture in a downward direction and finance, insurance and real estate in an upward direction. In other words, in eight of the sectors, the BDI barely changed.

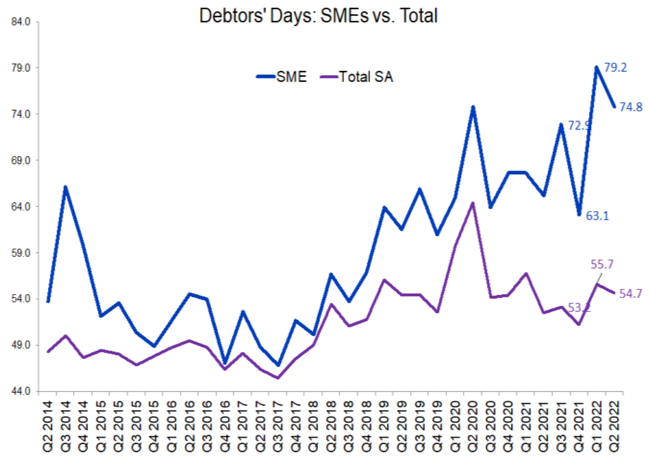


Furthermore, the BDI in every single sector remained positive. However, agriculture was negatively affected by the floods in KwaZulu-Natal and the disruptions to harbour facilities for exporting such products.

Even here, the impact was not dramatic, and the BDI remained above the 0.0 level, which determines the difference between improving and deteriorating business debt conditions.

BDI by company size

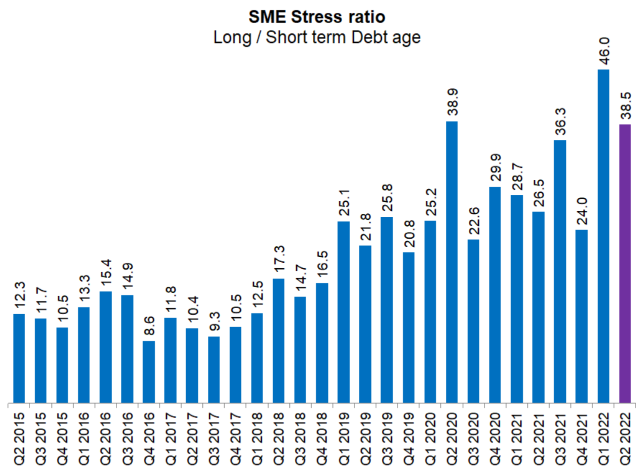
Finally, and somewhat ironically, given the deterioration in the outstanding debtors' days ratios derived by Experian, there was a marginal improvement in the



extent to which small business debt conditions fared relative to larger businesses.

The SME stress ratio[3] declined from 46.0% in Q1, an erstwhile all-time high, to 38.5% in Q2.

By historical standards, the SME stress ratio is still very high and, in fact, the third highest for any quarter on record. However, it failed to deteriorate as one might have anticipated in the wake of the floods in KwaZulu-Natal.



[3] *The ratio of outstanding debt owed by SMEs of 90 to 120+ days relative to that owed of less than 60 days*

Outlook

Looking forward to Q3, the forecast BDI is for a bit of a rebound in the index. However, this is largely predicated on the anticipation of some recovery, albeit mild, in the economic growth rate domestically to 1.22% from Q2's miserable 0.60%.

One must remember that the impact of the KwaZulu-Natal floods will have faded in Q3. In addition, Q3 data for this year are being compared against Q3 data for last year, which had incorporated the debilitating effects of widespread looting and unrest, generating a sharp dip in growth in that quarter a year ago.

The extent of this BDI improvement forecast is, however, tempered by the fact that US economic growth is expected to have dipped further in Q3 on the back of rising US interest rates to temper inflation.

On the other hand, the BDI forecast for Q3 benefits from the fact that the differential between the US and domestic interest rates will have narrowed significantly, thereby reducing the relative cost of overseas finance.

In addition, the differential between PPI and CPI has expanded further in recent months, providing even more breathing space for domestic producers regarding their margins. Even though the domestic economy has taken strain under continued intensified load-shedding, it is by no means collapsing either.

Unfortunately, looking beyond Q3, the portents for a sustained recovery in the BDI are not good. The impact of further steep increases in domestic interest rates of 1.5% cumulatively in Q3, following hikes of 0.75% in the repo rate at each of the July and September MPC meetings, is only likely to be felt in subsequent quarters.

Although inflation domestically appears to have peaked, the extent to which it will decline over the coming year is probably secondary to the extent to which the impact of higher interest rates will be felt. The spectre of intense load-shedding continuing for a few more years to come has been basically endorsed by comments made by President Ramaphosa.

More importantly, globally, the tightening of monetary policy is threatening to be such as to encourage the onset of a worldwide recession, which could be fairly severe.

Financial asset prices have come under the most significant downward pressure in decades due to the drying up of global liquidity. This could bring about a further fall in commodity prices and associated export revenues for South Africa.

In turn, this could erode tax revenues, exacerbating the fiscal challenges faced, especially in respect of providing continued grants to beleaguered impoverished sections of society.

Ultimately, the only solution to overcoming these pressures is for the South African government to undertake appropriate structural reforms. These should focus on education, employment creation, sustainable energy through renewable energy projects, and improved investment policies that support infrastructure rejuvenation (such as rail and harbour networks). These reforms and policies would set South Africa apart on the continent, thus making the country an investment destination of choice.

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 and the South African economy. It measures the relative ability of business to pay its outstanding suppliers/creditors (i.e., amounts owed to other businesses) on time and tracks macroeconomic indicators that can impact the ability of companies to pay their creditors.

Several debtors and macroeconomic 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 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 increased business stress. Relatively higher production costs vs. consumer costs decrease business operating margins, 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 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. It is possible to build an index with a useful economic interpretation by extracting the principal components.

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's 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 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 the 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 reports 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 learn 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 macroeconomic 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 ongoing 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 identifying opportunities and risks.

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Next release date for the BDI: December 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.