Business Debt Index

Quarterly Summary - Q4 2022

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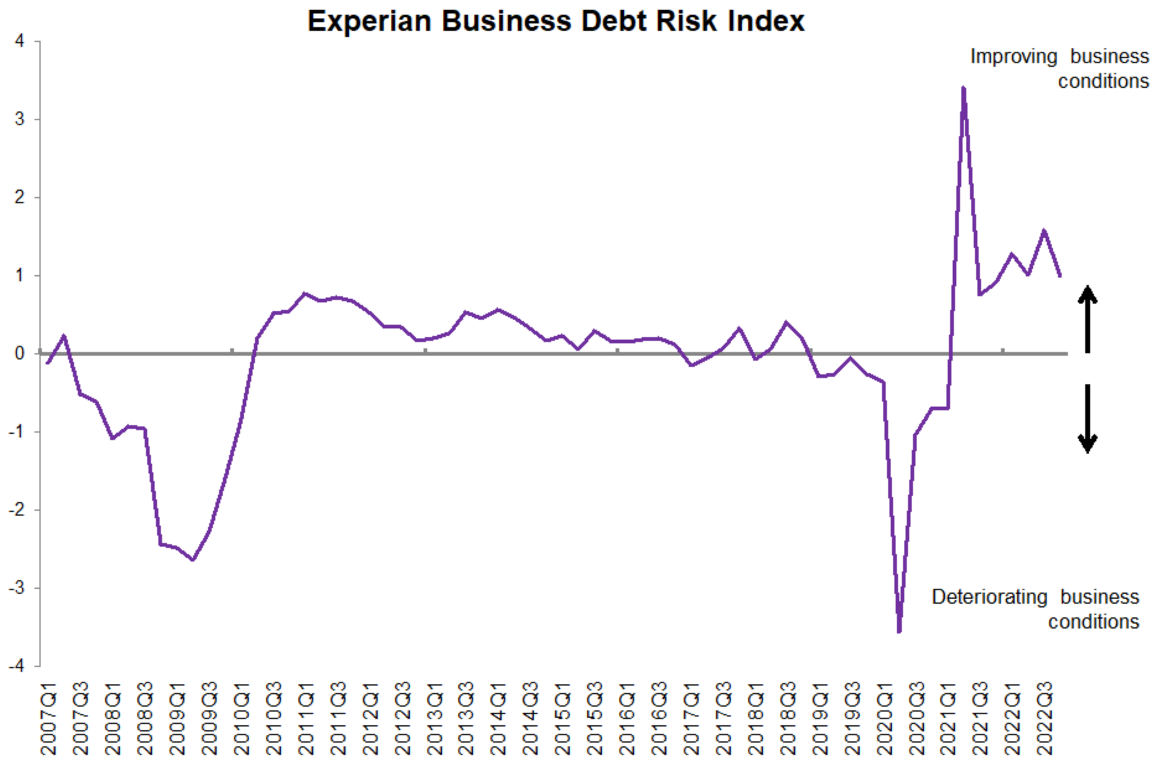
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q4 2022

An expected decline in Experian BDI in Q4 on the back of slower GDP growth

The Experian Business Debt Index unsurprisingly declined sharply to a reading of 0.996 in Q4 2022 from 1.591 in Q3. The decrease in the BDI in Q4 was much greater than had been anticipated.



	Q4 2021*	Q1 2022*	Q2 2022*	Q3 2022*	Q4 2022
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.919	1.276	1.009	1.591	0.996

** Revised*

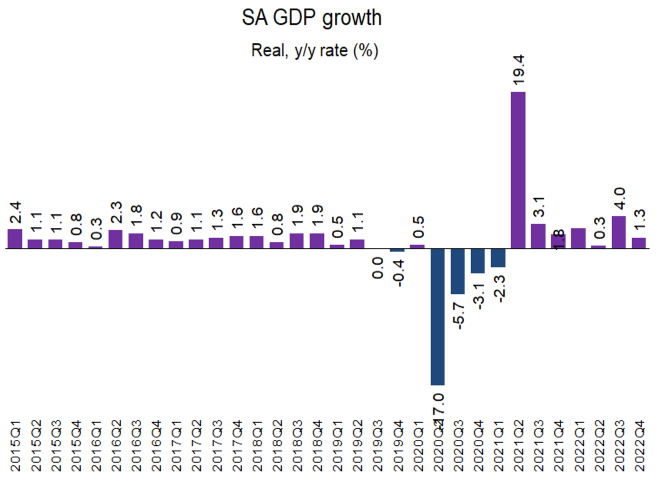
Macroeconomic factors influencing Q4 2022

Two factors dominated in producing this negative outcome.

First and foremost, the level of electricity load-shedding intensified sharply in Q4, with the predominant level of load-shedding moving to Stage IV in Q4 from Stage II in Q3.

This was very disruptive to domestic economic activity across a broad front, manifested in the deterioration in q-o-q GDP growth from 1.8% in Q3 to -1.3% in Q4.

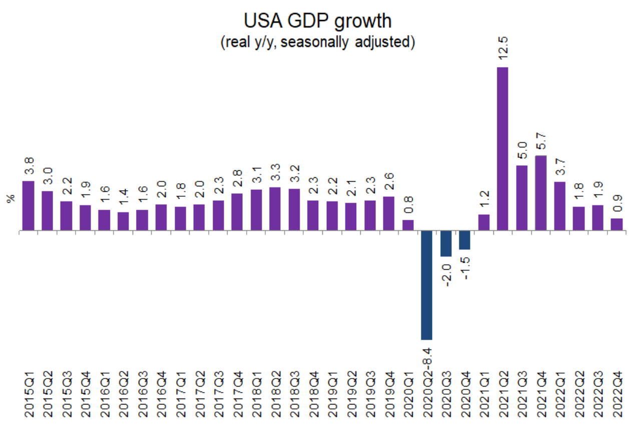
On a y-o-y basis, growth diminished from 4.0% in Q3 to 1.3% in Q4.



Source: South African Reserve Bank

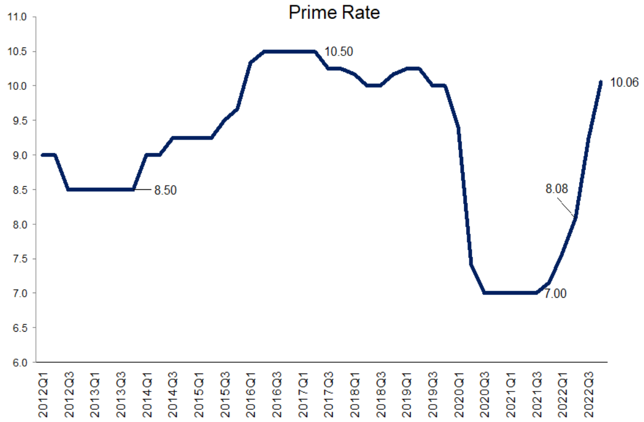
Also contributing towards this deterioration in growth in Q4 was a two-week strike at Transnet in October, which negatively affected the country's ability to export raw materials. This added to the negative impact on exports arising from a decline in commodity prices linked to reduced global economic growth expectations.

The reduction in international growth, reflected for purposes of the calculation of the BDI by the slump in US GDP growth from 1.9% in Q3 to 0.9% in Q4, emanated



Source: Bureau of Economic Analysis

from the unprecedented steepness of the increase in interest rates through 2022 aimed at quelling inflationary pressures.



Source: South African Reserve Bank

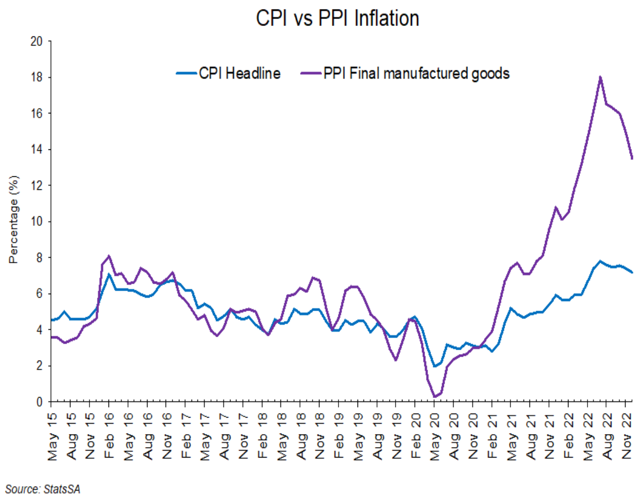
Indeed, higher interest rates and uncomfortably high inflation derived from sharp increases in food and fuel prices, partially linked to the war in Ukraine, as well as supply-side pressures resulting from disruptions to supply chains in the wake of Covid-19 restrictions in the previous two years, were also a partial contributor towards the reduction in domestic economic growth.

However, the increase in US interest rates was even steeper than that of domestic interest rates, resulting in a diminution in the differential between the two.

This helped temper slightly the extent of the decline in the BDI by reducing the relative cost of borrowing from abroad to assist in promoting business in domestic operations.

On the other hand, the modest reduction in the differential between South African long-term and short-term interest rates due to the latter increasing by slightly more than the former contributed marginally to the decline in the BDI given that the magnitude of this differential is seen as a signal of potential strength in economic activity.

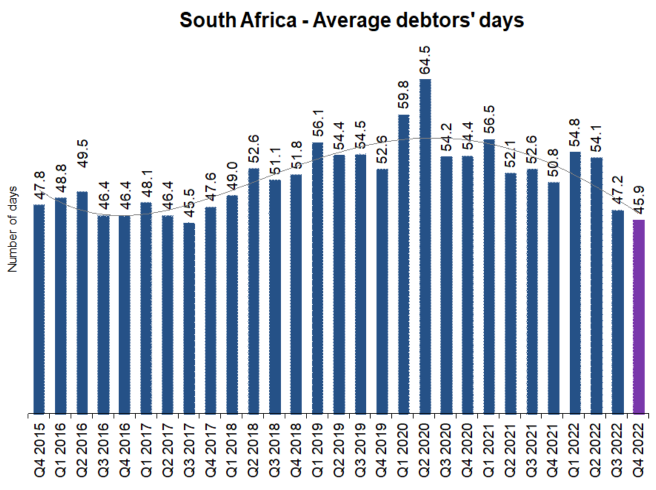
Finally, also contributing from a macroeconomic point of view to the decline in the BDI was the contraction in the differential between the PPI inflation rate and the CPI inflation rate from 9.3% in Q3 to 7.4% in Q4. This can imply a contraction in the margins for doing business in South Africa.



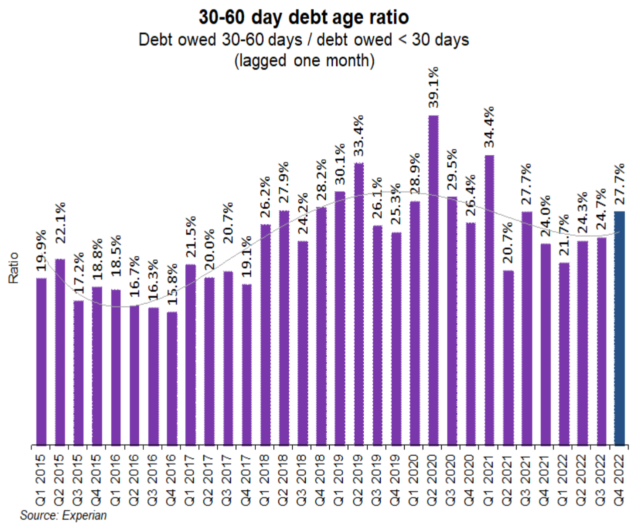
Business debt metrics in Q4 2022

The decline in the BDI in Q4 was not entirely driven only by macroeconomic factors.

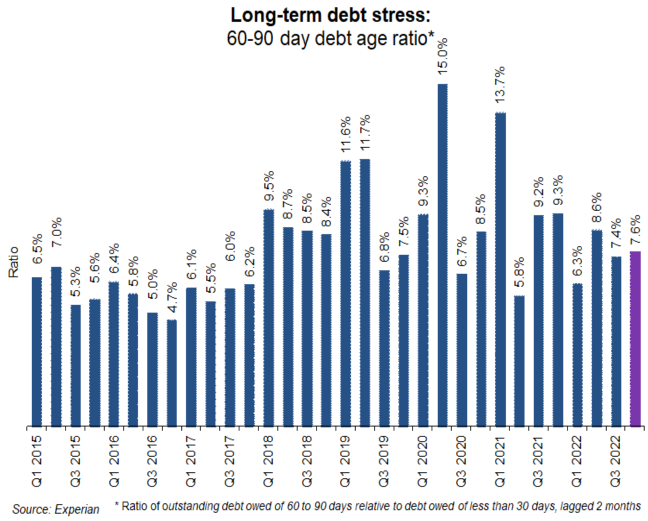
The final three months of 2022 also witnessed a slight deterioration in the alacrity with which businesses were prepared to pay off their debts, mainly because of the increased strain on doing business emanating from the weak overall business environment.



The **30 to 60 days ratio**[1] increased from 24.7% in Q3 to 27.7% in Q4.



Similarly, the **60 to 90 ratio**[2] as a percentage of those outstanding for less than 30 days edged upwards from 7.4% to 7.6%.



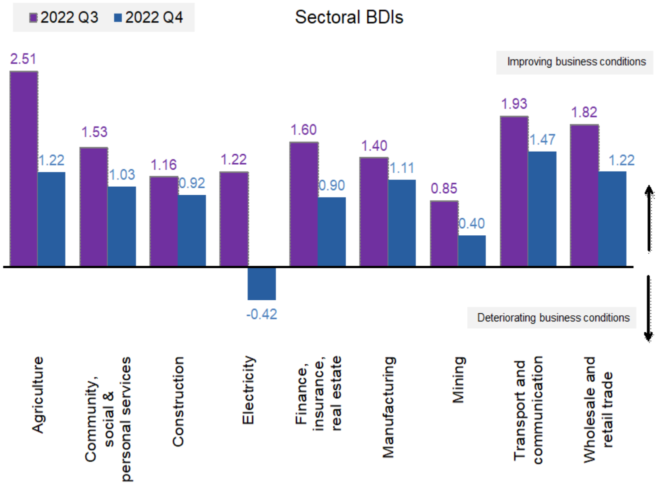
By historical standards, these debt ratios were still relatively low. They did not reflect any major financial deterioration, but they contributed modestly to the decline in the BDI.

[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*

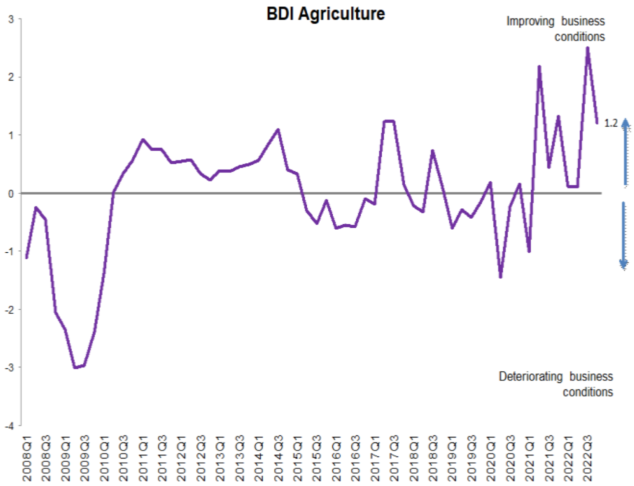
BDI by sector

From a sectoral perspective, there was a universal decline in BDI across all sectors. The steepest decline of all, not surprisingly given the increased intensity of load-shedding, was in the electricity sector.



Whereas the BDI in all other sectors remained positive, even if down substantially compared with Q3, the electricity sector BDI was the exception, declining steeply into negative territory.

The other sector which declined steeply was the agricultural sector, on the back of a dramatic slowdown

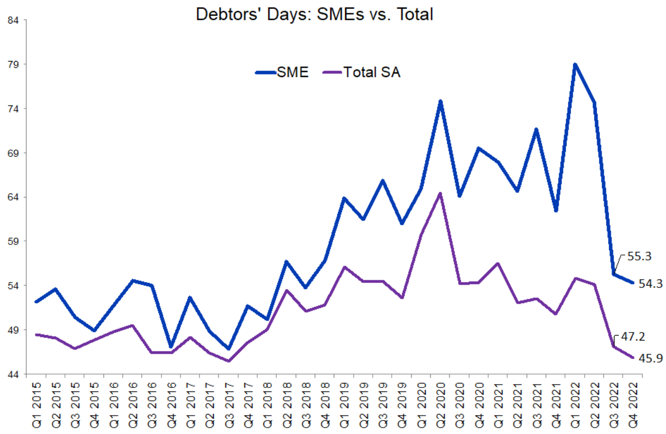


in the sector's growth, with q-o-q growth plunging from an extremely high 30.5% in Q3 to a negative -3.3% in Q4.

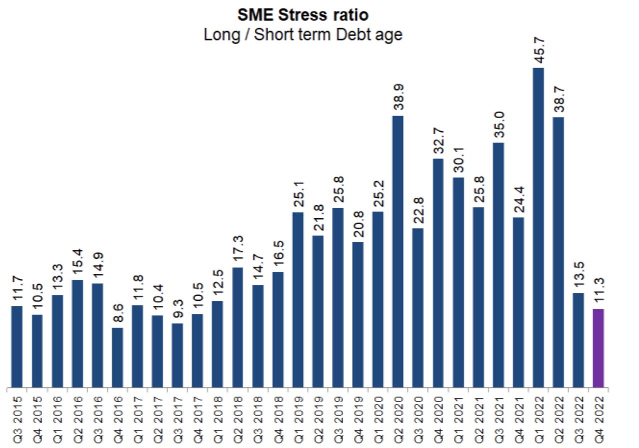
The consistent way the BDI for all sectors declined in Q4 illustrates how the negative effects of intensified load-shedding filtered through across a broad band of activities in the economy.

BDI by company size

Encouragingly, the number of outstanding debtors' days amongst SMEs stood out in contrast with so many other patterns of stress experienced in Q4 from load-shedding, declining slightly to 54.3 in Q4 from 55.3 in Q3.



The level of outstanding debtors days amongst SMEs in Q4 was the lowest in four years. Similarly, the SME stress ratio[3], comparing long-term to short-term debt of SMEs, also fell to its lowest level in four years, at 11.3%, down from 13.5% in Q3 and a peak of 45.7% in Q1 of 2022.



This provides solace that the pace of deterioration in financial conditions in the small business sector has been fairly modest in recent times, notwithstanding the negative effects of intensified load-shedding.

This points to some element of resilience within the economy's private sector that stands as a bulwark against a much more serious collapse of the entire economy in the face of the energy shortage.

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

It is the one factor that provides hope that the South African economy can withstand the onslaught of a lack of energy and an inability to improve the infrastructural base through which services can be delivered.

It is almost as if the private sector is succeeding in creating a viable environment in which to survive and thrive, notwithstanding the enormous challenges faced with the decline in the effectiveness of state-owned enterprises.

Outlook

Unfortunately, one anticipates that there will be a further substantial decrease in the BDI as we project the index during 2023. A sharp decline is expected for Q1 2023; this could be followed by further declines in ensuing quarters this year as the country battles to keep the lights on.

Load-shedding has intensified further, with outages at Stage VI more frequent during Q1 2023.

In addition, interest rates have been raised further in recent months, with the repo rate having been hiked by 50 bpts in November 2022 and by a further 25 bpts in January 2023. Probably, March will witness yet another increase of at least 25bpts. Cumulatively over the past 16 months, the repo rate has been raised by 4% from its 3.5% low prevailing between May 2020 and November 2021.

Subdued economic growth linked to load-shedding and the deterioration in the country's infrastructure more generally also stands to contribute towards difficulty in raising government revenue to fund government expenditure, carrying the risk of a deterioration in the country's fiscal metrics, with the concomitant threat of an accelerated increase in the trajectory of public debt-to-GDP ratio.

Although the 2023 Budget tried to portray a fiscally responsible stance, the growth assumptions underlying revenue projections may have been too optimistic. The fiscus may also come under pressure from public sector trade unions for higher wage awards than those incorporated into the Budget.

Adding to one's pessimism regarding the outlook for the BDI, is the likelihood that global economic activity might slide further in the wake of the steep rise in interest rates in many parts of the world.

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 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: June 2023

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.