Business Debt Index

Quarterly Summary

Q4 2019

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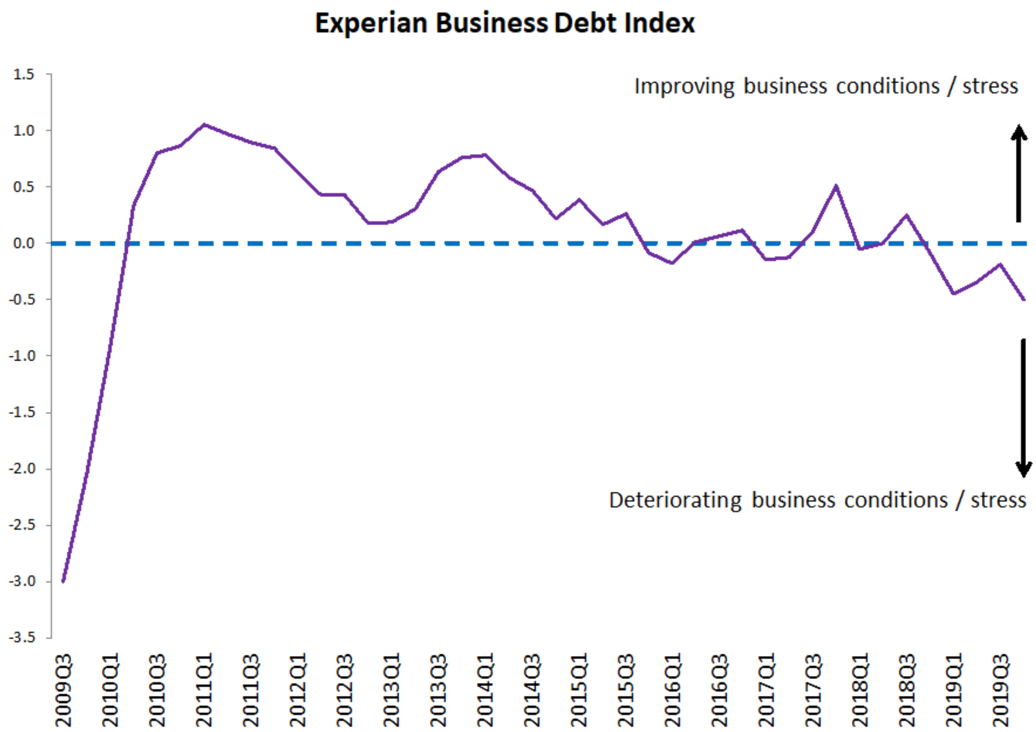
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q4 2019

BDI reflects economic prospects - sharply lower in the fourth quarter of 2019

The Experian Business Debt Index (BDI), which reflects the level of health of businesses in the economy, worsened fairly sharply in Q4 2019 to an index value of -0.51, once again indicative of the fastest pace of deterioration in business debt conditions since the global financial crisis in 2009.

Q4 2019's outcome is disappointing, given that the BDI recorded some improvement in Q2 and Q3. Overall, however, the latest outcome is very much in line with the larger trend in business debt conditions, which has seen the index move relentlessly from positive (improving business debt conditions) to negative (deteriorating business debt conditions) since 2014. The implication is that the financial position of companies in South Africa has likewise worsened.

The Experian BDI quantitatively supports the idea that, in a stagnating domestic economic environment, beset by structural weaknesses and lack of confidence and itself positioned within a broader international environment of slowing growth, business prospects look bleak. Lengthening credit duration, a lack of willingness to invest, a reduction in government's ability to sustain high levels of spending, a loss of competitiveness and a shrinking market are all reflected succinctly in the BDI outcome. Nevertheless, a closer examination does lend some slight optimism that a floor of business resilience has been reached – assuming of course that economic conditions do not deteriorate further.

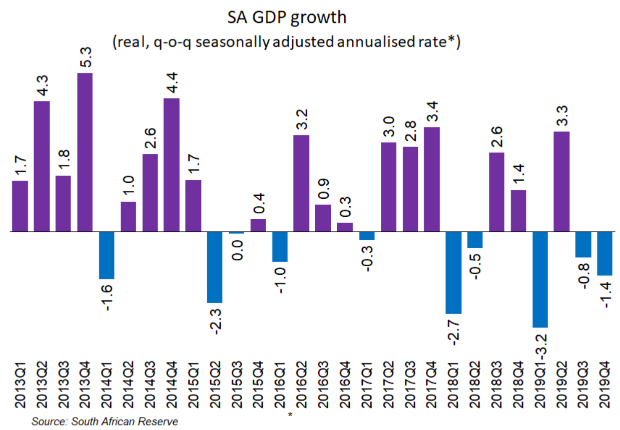


	Q4 2018*	Q1 2019*	Q2 2019*	Q3 2019*	Q4 2019
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.08	-0.45	-0.34	-0.19	-0.51

* *Revised*

Macroeconomic factors influencing Q4 2019

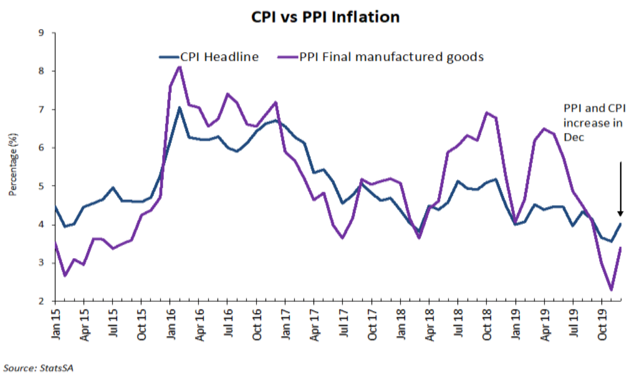
The overall BDI was let down by macroeconomic inputs in Q4 2019, and these formed the principal reason for such a sharp decline in the overall index. Within this, the primary culprit was a substantial slowdown in South Africa's Q4 2019 **GDP growth**.



That a weak growth outcome would occur in the final quarter of the year was largely expected. Business confidence was eroded by a downgrade in the outlook for South Africa's credit ratings by leading credit rating agencies and by industrial action at SAA, which posed a strong threat to its continued existence.

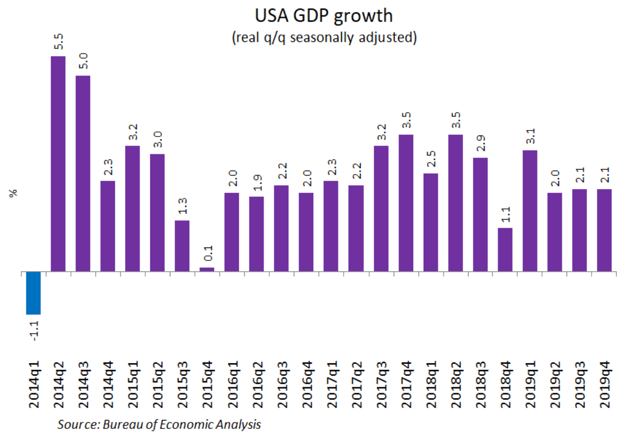
In addition, in December, load-shedding returned unexpectedly with a vengeance. However, it was the severity of the slowdown that was surprising.

Growth came in well below expectations at just -1.4% q/q, confirming fears that the economy fell into a *technical* recession in H2 2019 (after Q3 2019 growth of -0.8%). However, based on many broader metrics, such as living standards, South Africa has seen recessionary conditions for at least the last five years.



In addition, the **PPI inflation rate declined relative to the CPI inflation rate** in Q4, suggesting a squeeze on corporate profit margins.

Countering this domestic pessimism somewhat was a stabilisation in **US GDP** growth at 2.1% q/q, indicative of more stable global economic prospects. Hopes had begun emerging that some agreement would be reached between the US and China over their trading relations.



In addition, there was a slight increase in the **differential between long-term and short-term interest rates**, which is a conventional gauge of longer-term economic prospects, with a larger differential being indicative of a slight improvement forthcoming in economic growth possibilities.

Ultimately GDP data simply confirm the outcome of numerous interlinked processes that must be set in motion today in order to realise growth tomorrow. Of these, fixed capital formation is one of the most important, and Q4 2019's outcome illustrates how South Africa's economic potential continues to be hollowed out. On a q/q seasonally-adjusted and annualised basis, fixed investment growth fell by -10.0% in Q4, following increases of 5.8% and 4.1% in Q2 and Q3 respectively. For 2019 as a whole, fixed capital formation fell by -0.2%, perpetuating a broadly declining trend that has been in evidence for the past four years. This has reflected the growing disillusionment of the private sector in the country's economic prospects. A lack of investment in turn restricts any real potential turnaround in economic growth, even if political and social structural failures are corrected. It also renders the economy ever more dependent upon imports, because of the erosion of domestic productive capacity, which results from declining investment.

Business debt metrics in Q4 2019

Where the macroeconomic elements of the Experian BDI regressed sharply, business debt metrics in the latest quarter offered some slight silvers of optimism.

Average debtors' days, which give a broad indication of outstanding debt conditions, remained relatively stable at 53.9 days in Q4 2019, compared to 54.8 days in Q3 2019. The recent high of 56.6 days in Q1 2019 still stands as having been the highest number of outstanding debtors' days recorded since the global financial recession.

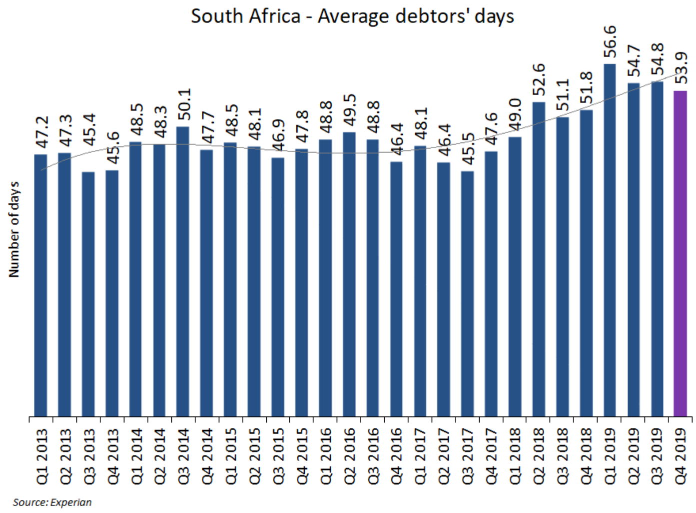
From a debt age perspective, the **outstanding debtors' days in the 30-60 day ratio**[1] improved marginally to 25.5% in Q4 from 26.8% in Q3. This contrasted with a deterioration in the **60-90 day ratio**[2] which rose to 7.5% in Q4 from 7.0% in Q3.

Taking a step back from the quarter-to-quarter volatility paints a fascinating picture. In general, business debt conditions improved solidly after the global financial crisis until the end of 2016. From that point onwards, there has been a steady deterioration.

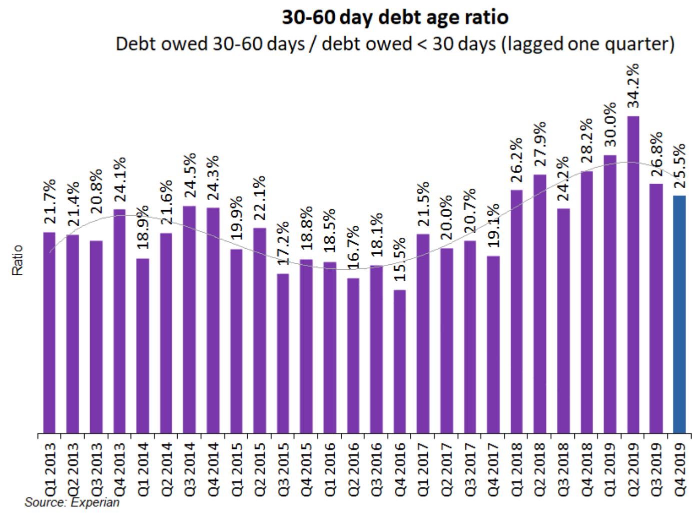
The cumulative effect of weak economic activity extending over several years now has resulted in businesses taking longer to repay their outstanding debt commitments. This is manifested in a lengthening of debt age ratios.

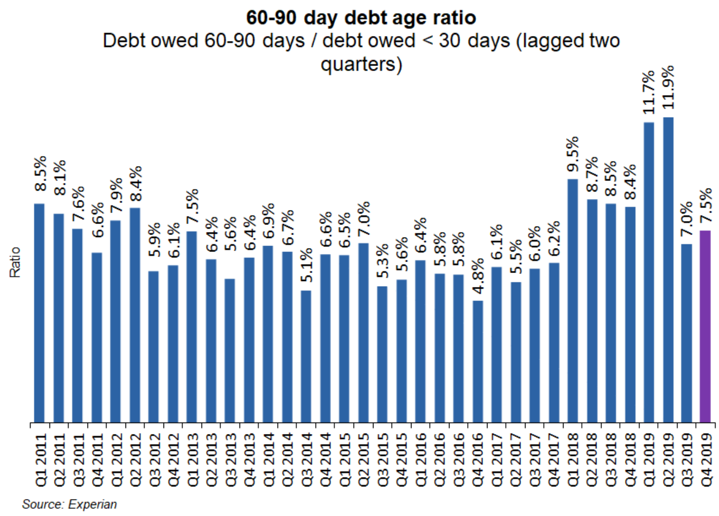
The most recent data suggest that the very worst conditions may have passed. Those businesses that were going to fail have done so already.

The rest seem to be weathering the poor economic conditions; thus some stability or at least a slower rate of deterioration has returned. Overall, however, debt conditions have remained quite weak.



Positive debt metrics counterbalanced the negative impact of macroeconomic factors on the overall BDI in Q4





[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

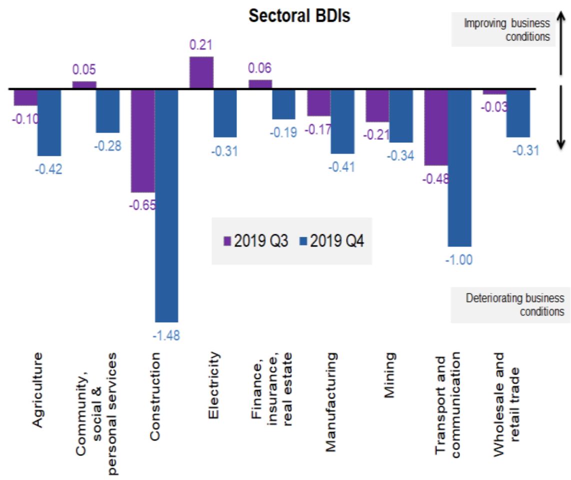
Sectorally there was a unanimous worsening of individual BDI measures. By far the worst outliers are the construction and transport & communication sectors.

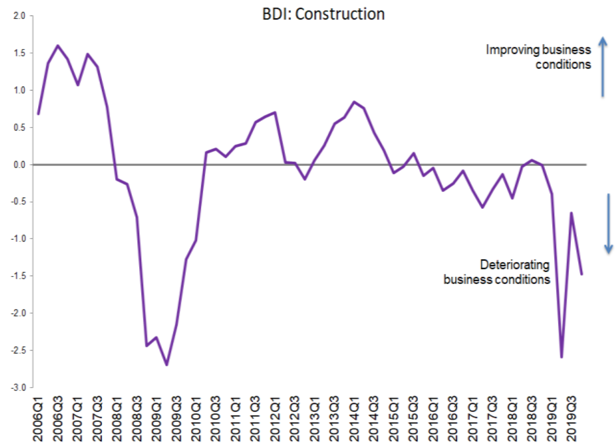
The construction sector's GDP declined for a sixth consecutive quarter, recording q/q annualised growth of -5.9% in Q4, up marginally from Q3's -6.9%: a visible victim of the cutback in investment by both the public and private sectors.

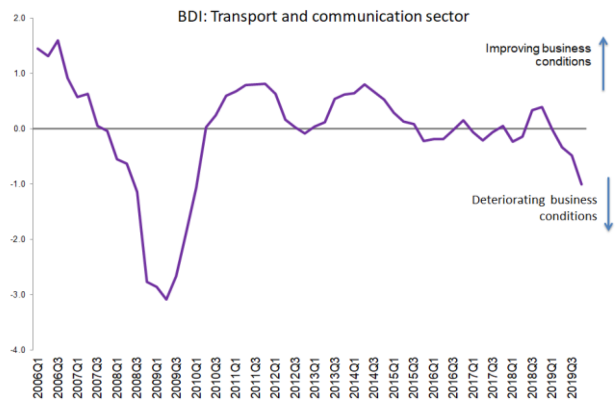
The transport and communication sector's GDP fell for a fourth consecutive quarter, at an accelerated pace of -7.2% q/q in Q4, from -5.4% in Q3. The sector has been hit hard by declines in transport demand for basic metals and fabricated metal products which have certainly been heavily constrained by slowing global growth, a bleak demand outlook from China, and some domestic policy developments which have resulted in the closure most recently of ArcelorMittal's Saldanha steel plant.

In contrast, the most positive BDI measures were recorded in the finance, real estate and business services as well as the community services (a proxy for government) sectors. Neither of these two sectors is fundamentally productive in the way of agriculture, mining and manufacturing, for example. The government sector is by definition entirely reliant on the economic surpluses generated by the other sectors of the economy. Nor is either sector much use in absorbing the massive, restless, unskilled unemployed population whose numbers pose a very real risk to the very concept of a democratic society.

Severe deterioration in business conditions was reported in the construction and transport sectors

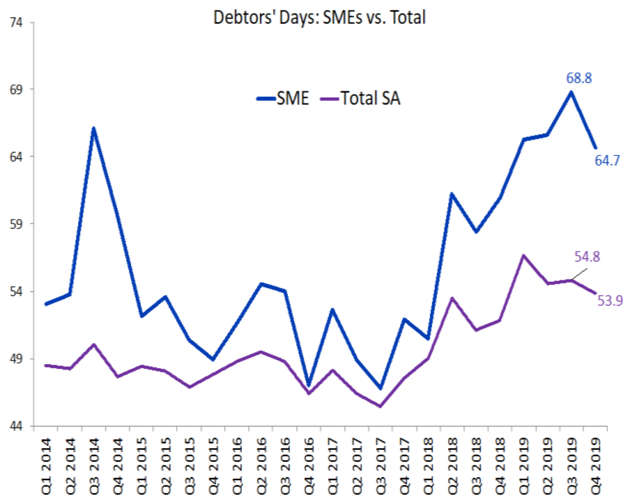






BDI by company size

Again, there were slivers of optimism when looking at business debt conditions across company size. Where the average overall debtors' days fell as discussed, those of SMEs fell far more sharply, from an elevated 68.8 days in Q3 2019 to 64.7 days in Q4 2019.



As mentioned, at face value, this is heartening. SMEs are carrying the bigger brunt of difficult economic conditions, but at least these no longer seem to be deteriorating. A more critical eye may however point to the fact that SMEs are failing far more rapidly than larger firms, reducing the sample size and stimulating an apparent recovery in outstanding debtors' days. This is evidenced by the fact that those SMEs still in business continue to exhibit a significantly lengthened credit duration compared with the overall sample of companies.

Summary and Outlook

It is reassuring that the Experian BDI appears to be accurately reflecting the deteriorating business environment. Unfortunately, given the recent proliferation of load-shedding and more importantly, the spread of the coronavirus with its destructive implications for business activity, it is likely that the deteriorating trend of the BDI will continue and indeed deepen to the point where the index plumbs new all-time lows. The BDI for Q4 largely reflected a weak business environment that existed even before the onset of the coronavirus. The latter has impacted upon the world economy quite dramatically. Interruptions to supply chains around the world are set to reduce production. Furthermore, the disruption to transport and tourism, together with responses by governments to quarantine large sections of society, are bound to reduce demand for goods and services materially. Businesses are likely to suffer severe cash flow problems in the wake of reduced revenues, in some instances amounting to the lion's share of total revenue generated. The resultant negative impact on company earnings has resulted in an unprecedented sharp sell-off in financial asset prices, with a concomitant threat to global liquidity. Under the circumstances, it is virtually certain that bad debts amongst businesses both internationally and in South Africa itself, will rise in coming months. The only solace one can draw from this situation is that South Africa will not be alone in experiencing these pressures and challenges.

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 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

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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.