Business Debt Index

Quarterly Summary

Q3 2019

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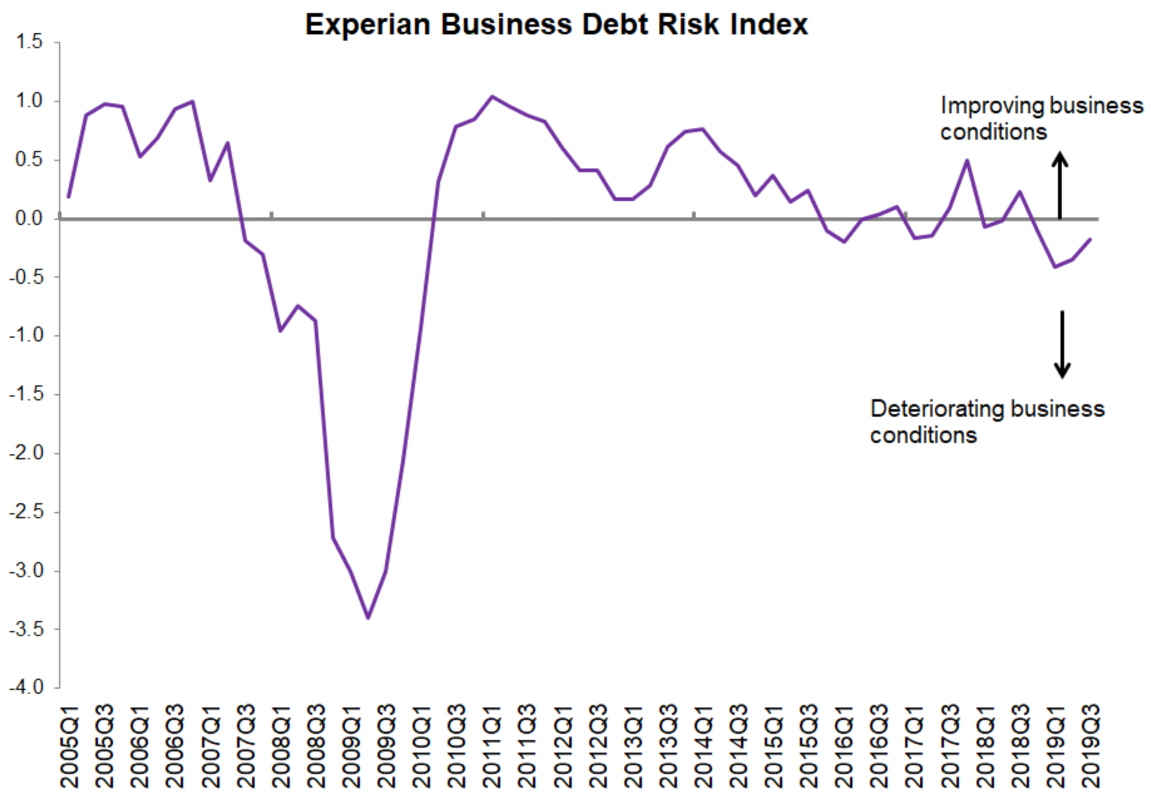
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q3 2019

BDI reflecting business conditions recovered somewhat in the third quarter of 2019

The Experian Business Debt Index (BDI) - which reflects the level of health of businesses in the economy - improved moderately in Q3 from Q2, rising to a reading of -0.18, from -0.35 in Q2.

The fact that the index remained *below* the zero-defining line between improvement and deterioration of business debt conditions, implies that the latter continued to deteriorate in Q3, but much more modestly than in the preceding quarter and for that matter in the quarter before this as well.

It should be emphasised that a positive reading for the BDI reflects improved business debt conditions and a negative figure, a deterioration.



	Q3 2018*	Q4 2018*	Q1 2019*	Q2 2019*	Q3 2019
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.23	-0.10	-0.42	-0.35	-0.18

* *Revised*

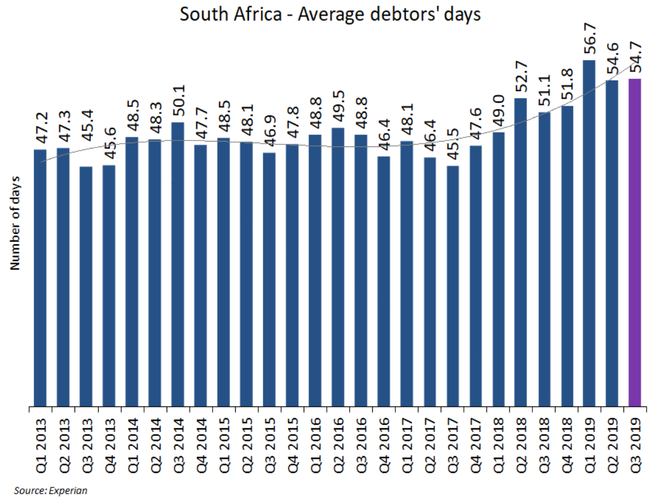
Business debt metrics in Q3 2019

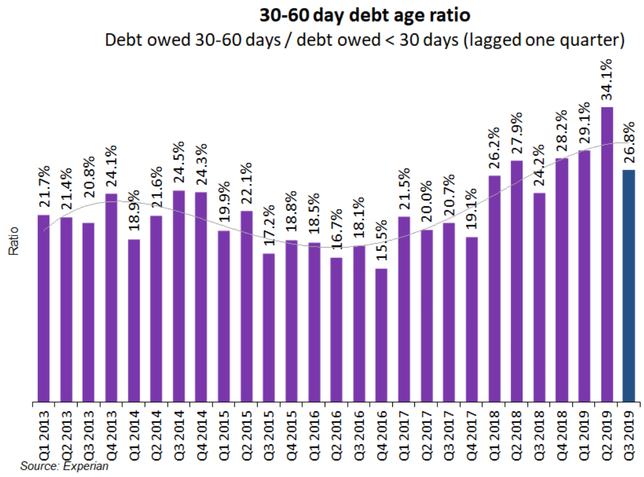
The meaningful improvement in the BDI for Q3 in the latest calculation is attributable largely to the fact that the outstanding debtors' days' data derived by Experian from its client base shows an improvement in relation to Q2.

The average outstanding debtors' days in Q3 remained basically unchanged from the previous quarter (at 54.7 days).

The BDI specifically is calculated according to the **ratio of outstanding debtors' days of 30-to-60 days relative to those of less than 30 days**, as well as the ratio of outstanding debtors' days of 60 to 90 days relative to the number of debts outstanding of less than 30 days.

In the case of the former, there was a drastic reduction in the ratio, lagged by one quarter, from 34.1% in Q2, which itself had jumped from 29.1% in Q1, to just 26.8% in Q3. This is the lowest such ratio in a year. As for the **ratio of debt owed for 60-to-90 days to outstanding debt of less than 30 days**, the ratio plummeted to just 6.9% in Q3, from 11.9% in Q2 and 11.4% in Q1. In fact, the 6.9% value for this ratio in Q3 was the lowest since the end of 2017.





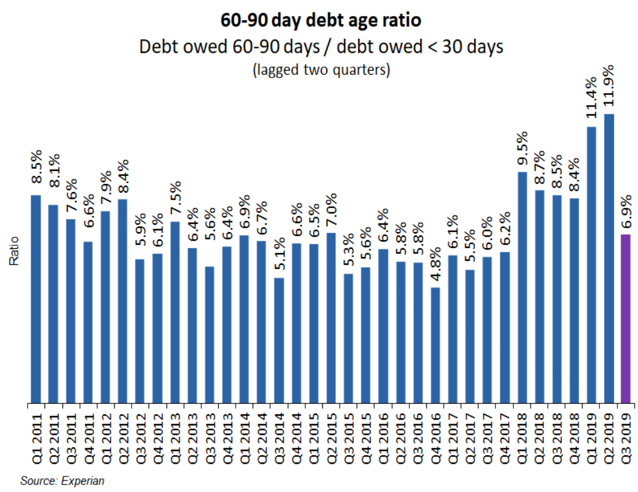
Macroeconomic factors influencing Q3 2019

Improvement in Q3 in the financial stress of businesses and their willingness to repay creditors outweighed the modest deterioration in the macro-economic contributors to the BDI

The effect of this apparent improvement in Q3 in the financial stress of businesses and their willingness to repay creditors, more than outweighed the modest deterioration in the macroeconomic contributors to the BDI, thereby resulting in a marked improvement in the index in Q3.

From a macroeconomic perspective, **US GDP growth** weakened from 2.3% in Q2 to 2.1% y/y in Q3 2019.

In the case of the **South African GDP**, Q3 recorded a slowdown to 0.2%, from 1.0% y/y in Q2 (on a q/q annualised basis growth dropped from 3.2% in Q2 to -0.6%).



Also on the negative front, in terms of the macroeconomic factors affecting the BDI, the **PPI**

inflation rate has fallen sharply **relative to the CPI inflation** rate in recent months. Bearing in mind that a wider differential of PPI relative to CPI inflation is interpreted as offering businesses better profit margins, the fact that the differential contracted so much in Q3, to a level of only 0.4% from 1.8% in Q2, also exerted downward pressure on the BDI.

As for the impact of **interest rate differentials**, there was very little change in the margin between the domestic repo rate and the US Fed Funds rate to have much influence on the BDI. On the other hand, long-term interest rates have risen relative to short-term interest rates domestically and this has traditionally been interpreted as a positive sign for future economic activity. This exerted some upward pressure on the BDI.

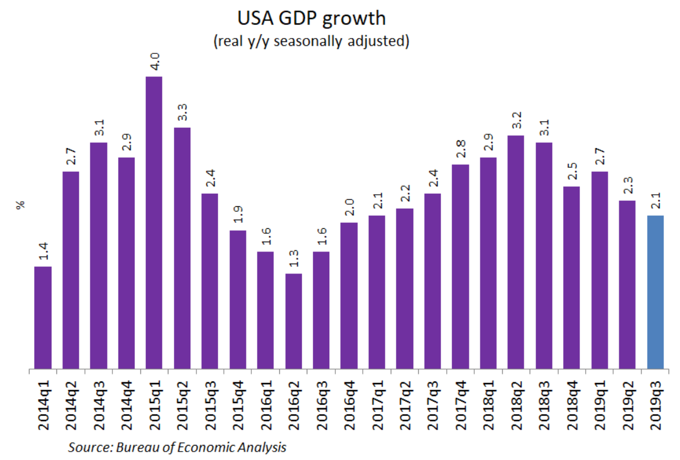
Nonetheless, these changes in macroeconomic variables had a minor (net) impact relative to the improvement in outstanding debtors' days ratios in terms of being the drivers of the uptick in the BDI for Q3.

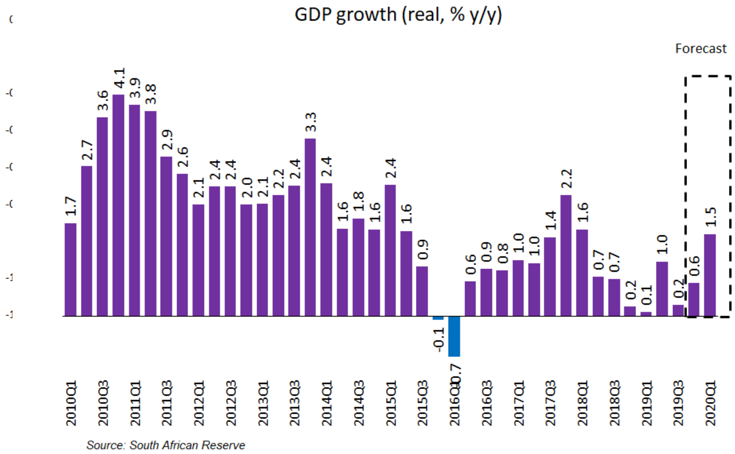
BDI by sector

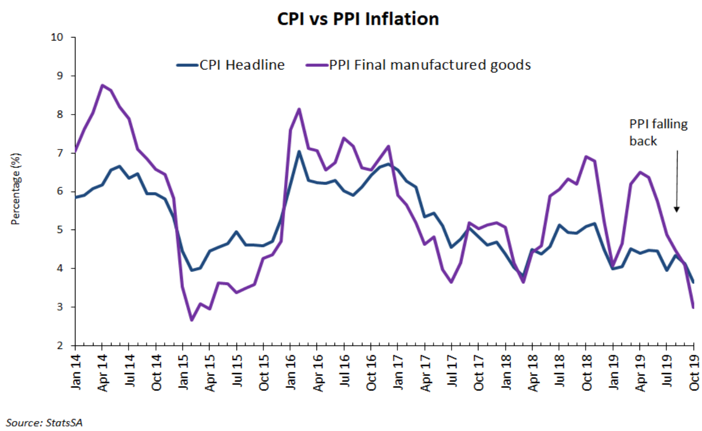
Given the end of load-shedding in Q2 compared with Q1, several of those sectors which were severely negatively impacted upon by load-shedding, are precisely the ones which have led the way towards a recovery in the BDI in Q3. These include mining, construction and electricity.

There have been only minor shifts in the BDIs for agriculture, services, finance and trade, mostly in a downward direction, but only to a minor extent relative to the improvements in the more electricity-intensive and infrastructural-intensive sectors.

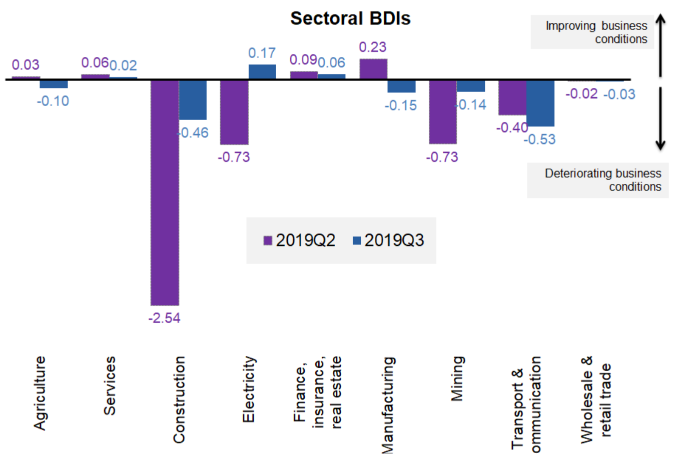
Marked deteriorations were recorded in the manufacturing and transport sectors – which is in line with the disappointing Q3 GDP results of these sectors.







Electricity-intensive and infrastructural-intensive sectors showed most improvement in their Q3 BDIs

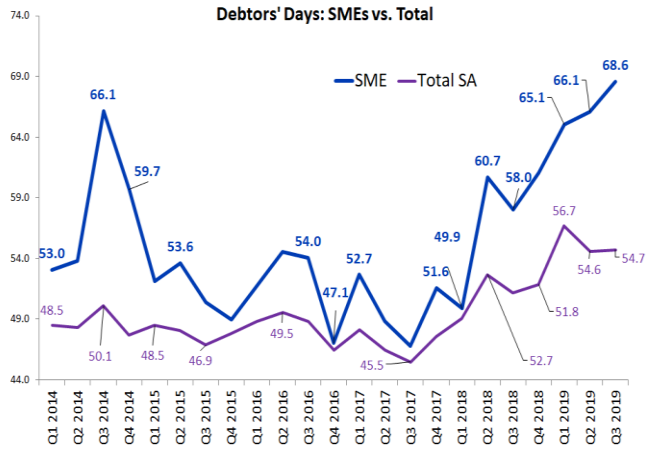


BDI by company size

On the other hand, one of the more dramatic inferences to draw from the latest Experian data is the deterioration in the financial position of SMEs relative to the overall business sector.

Whereas the number of outstanding debtors' days amongst SMEs has shot up from 50.0 at the beginning of 2018, to 65.5 in Q1, 66.1 in Q2 and 68.6 in Q3 of this year, the corresponding increases in outstanding debtors' days amongst all companies in South Africa has been from 49.0 to 54.7 days over the same period, i.e. much less pronounced.

This suggests that the weak state of overall economic activity is impacting far more negatively on small businesses than on the overall business sector. The cumulative lengthy period of suboptimal economic performance is catching up far more acutely on those businesses without the means to see through difficult times over a protracted period.



The financial position of SMEs relative to the overall business sector deteriorated in Q3

Summary and Outlook

Unfortunately, one does not foresee the improvement in the BDI in Q3 being sustained. Based on forecasts of GDP growth domestically and internationally, as well as trends in inflation and interest rates over the next six months, the forecast for the BDI in Q4 is that it will decline, before recovering in Q1 2020. In essence, we do not foresee any major recovery in business debt conditions any time soon.

Overall economic growth remains under pressure domestically – especially in the light of the fact that the latest bout of intensified load-shedding stands a good chance of ensuring that Q4 GDP growth will turn out negative - whilst internationally, growth prospects have also diminished in the face of increased trade tensions between the US and China.

Domestically also, there appear to be huge fiscal constraints building up in the face of the government's need to bail out state-owned enterprises, most importantly Eskom. This is contributing towards raising government expenditure way beyond what was originally planned. On top of this, the government has disappointed in terms of its inability to control the rising trend of the public sector wage bill.

Nevertheless, the president's initiative to convene an Investment Summit each year to try and assist in promoting capital investment, appears to be bearing some fruit. Confidence will only be properly restored in such a way as to attract investment if certainty can be generated in the country's energy security. It is also essential that government give greater policy certainty in the respective key sectors that investors and business keep highlighting.

In conclusion, it is encouraging to see the BDI deterioration somewhat easing from positions seen in Q1 2019.

At the same time, one is cautious about not anticipating a continuation of this improving trend in the short to medium term, both because of domestic fiscal constraints and because of the signs of a slowing global economy.

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 30 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: August 2019

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.