Business Debt Index

Quarterly Summary - Q1 2021

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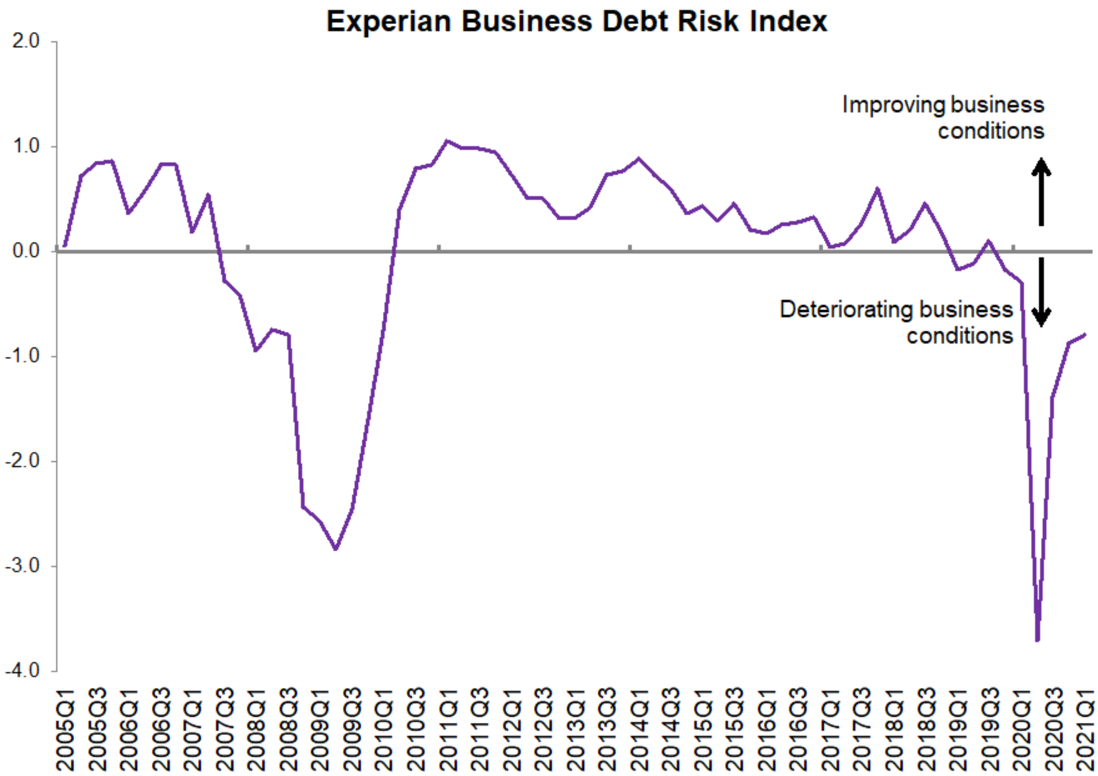
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2021

Continued improvement in BDI for Q1 2021 in line with continuing economic recovery

In line with a continuing economic recovery following the ravages inflicted on economic activity in 2020 by the COVID-19 crisis, the Experian BDI made up further ground in Q1 2021 to a reading of -0.785 from -0.871 in Q4 2020.

A reading below zero implies deteriorating business debt conditions and, as such, the -0.785 reading for Q1 continues to reflect a worsening of the financial position of businesses, although less acute than what was experienced in the preceding three quarters.



	Q1 2020*	Q2 2020*	Q3 2020*	Q4 2020*	Q1 2021
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.288	-3.703	-1.385	-0.871	-0.785

** Revised*

Macroeconomic factors influencing Q1 2021

That the BDI should have improved in Q1 was in line with our expectations last quarter, driven largely by the fact that the recoveries in the world and South African economies continued during the quarter.

Internationally, growth prospects were given a huge boost by the announcement in November 2020 by Pfizer of the development of a vaccine to combat the COVID-19 virus. This speeded up the period over which economic activity was expected to return to a semblance of traditional normality.

Around the same time, Joe Biden was elected to take over the US presidency. Being a Democrat, it was expected that he would embark upon massive fiscal stimulus to lift the US economy further out of recession and to create jobs to be filled by those who had lost employment during the lockdown period of the COVID-19 crisis in April and May last year. In the event, the US has undertaken a major vaccination campaign in which more than half the population has been inoculated to limit the spread of the virus. Simultaneously, the Biden administration did indeed succeed in getting a $1.9tn stimulus package through Congress.

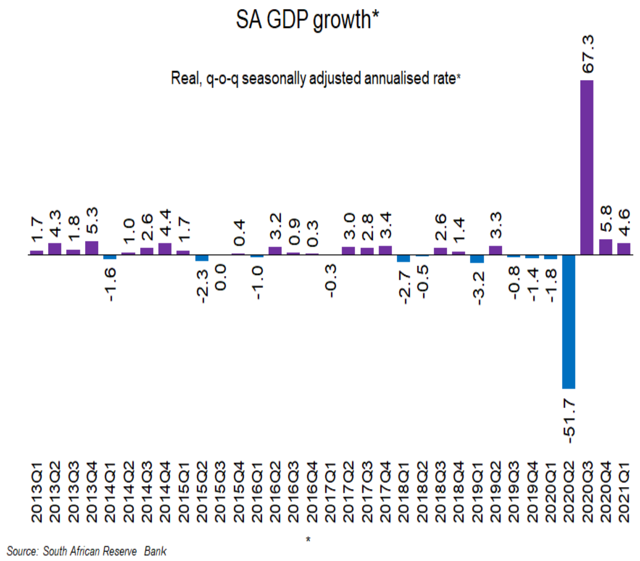
All the while, the US Federal Reserve Board has maintained its policy of pumping $120bn per month into the US financial system through purchases of government and corporate bonds from financial institutions and corporations. Similar fiscal and monetary stimulus has been the order of the day in other advanced economies, whilst the rollout of vaccinations has been pursued in all these countries with vigour. The IMF has revised its forecast for global economic growth in 2021 upwards to a brisk 6.0%.

The net effect of the pickup in global economic prospects has been to lift expectations of demand for food and raw materials around the world. As a consequence, commodity prices have risen across the board.

With South Africa's economy being highly dependent upon the performance of its agricultural and mining sectors, the sharp increase in commodity prices has benefitted the value of the country's exports enormously. The resultant increase in profitability of many of the country's large corporations, especially in the mining sector, has helped to increase tax revenues and this, in turn, has improved somewhat the parlous state of government finances. The knock-on effect of improvements in mining has been felt through the rest of the economy, enhancing the recovery.

As a consequence, the economy has been provided with a significant boost from a rebuilding of inventories that were slashed to the bone last year during the height of the coronavirus crisis.

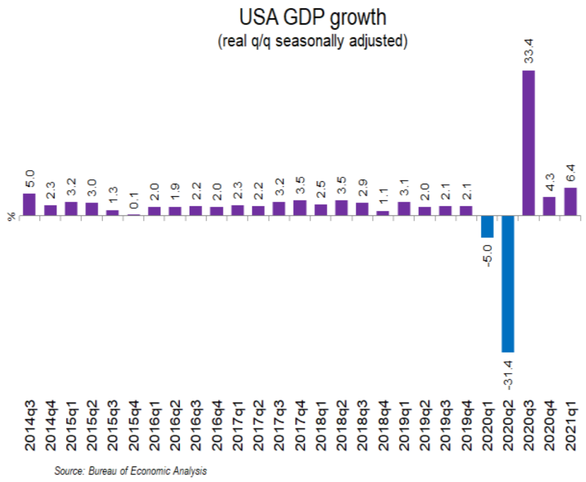
South Africa's GDP increased by 4.6% on a q-o-q seasonally-adjusted basis in Q1, following on from a 5.8% corresponding increase in Q4 2020. Although the Q1 outcome was slightly down on the Q4 2020 outcome, it was still better than expected.



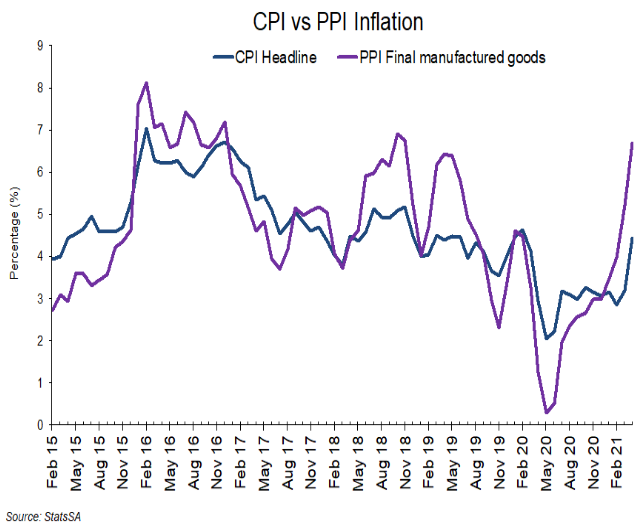
Nonetheless, given the depth of the contraction in economic activity during the hard lockdown in Q2 last year, economic activity had still not returned to levels prior to the COVID-19 crisis.

It is largely for this reason that the BDI still generates a negative reading, implying continued deterioration in business debt conditions. It is just that on a relative basis, this deterioration is diminishing. On a y-o-y basis, South Africa's GDP growth in Q1 was still significantly negative, at -3.2%, but at least this was up from -4.2% in Q4 of 2020 and way up on the -17% growth recorded in Q2 2020. This relative improvement in growth in the domestic economy was the cornerstone around which the BDI picked up in Q1.

Similarly, US GDP rose on a y-o-y basis to a positive 0.4% in Q1 from -2.4% in Q4 2020 (and to 6.4% on a q-o-q seasonally-adjusted basis), also constituting an important positive input into the BDI.



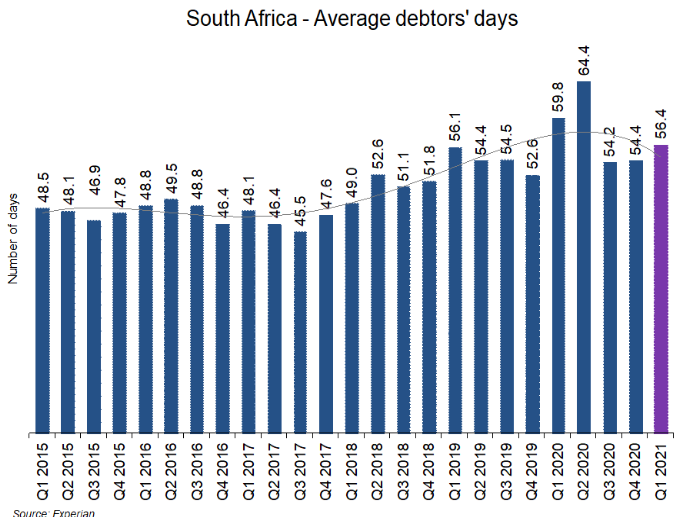
The only other input of significance to have a positive impact on the BDI was the fairly substantial increase in the differential between the PPI and CPI inflation rates, to 1.2% in Q1, from -0.3% in Q4 2020. This implied an increase in the profit margins available to business.



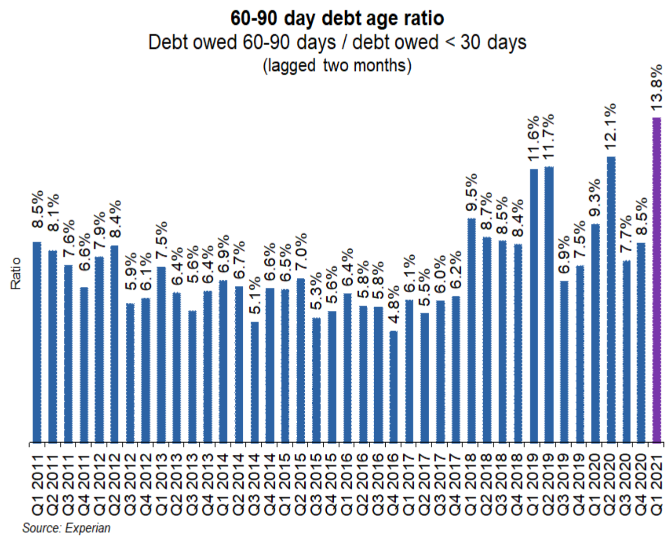
The remaining inputs into the BDI relating to interest rate changes had a negligible effect on the calculation, with interest rates both domestically and internationally largely unchanged at historically low levels.

Business debt metrics in Q1 2021

Despite the sharp improvement in economic growth both domestically and internationally, both of which turned out to be steeper than anticipated, the -0.785 BDI outcome for Q1 was actually slightly inferior to the forecast for the quarter when the Q4 2020 BDI calculation was conducted. This was largely a function of the fact that the Experian data relating to outstanding debtors' days did not improve to the extent that one had anticipated in line with the rest of the economy. On the contrary, the average number of outstanding debtors' days increased to 56.4 in Q1 from 54.4 in Q4 and 54.2 in Q3.

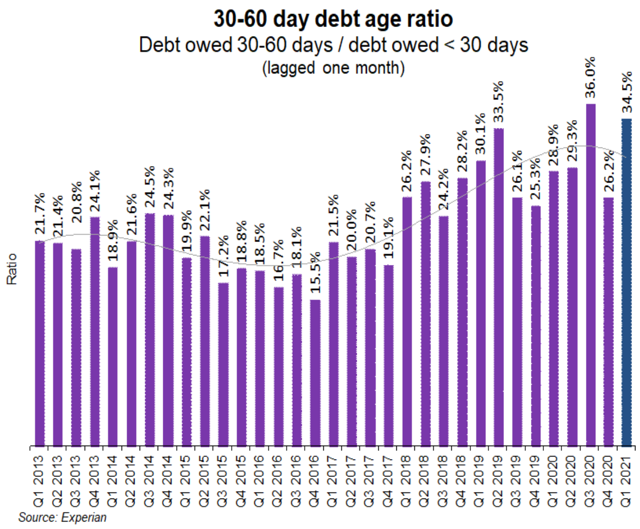


There was an especially steep increase in the **60 to 90 ratio**[1]. This ratio rose to an all-time high of 13.8% in Q1 from 8.5% in Q4 2020 and was even higher than the 12.1% ratio that prevailed during the height of the COVID-19 crisis in Q2 2020.



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

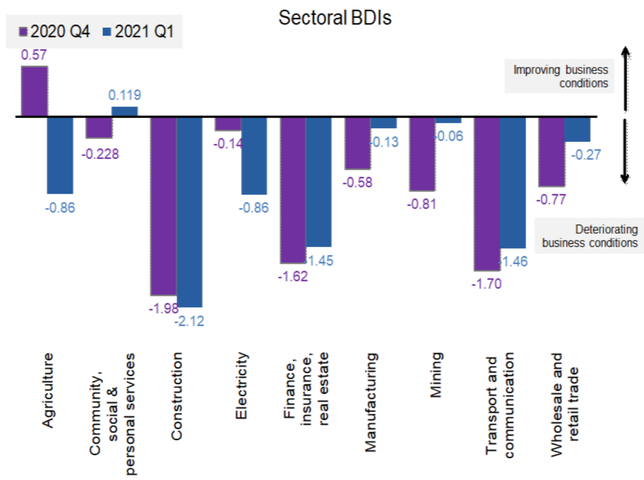
There was also an increase in the **30 to 60 days ratio**[2], but this increase was not quite as dramatic as the former ratio, increasing to 34.5% in Q1, from 26.2% in Q4 2020, but at least this ratio was below the 36.0% peak reached in Q3.



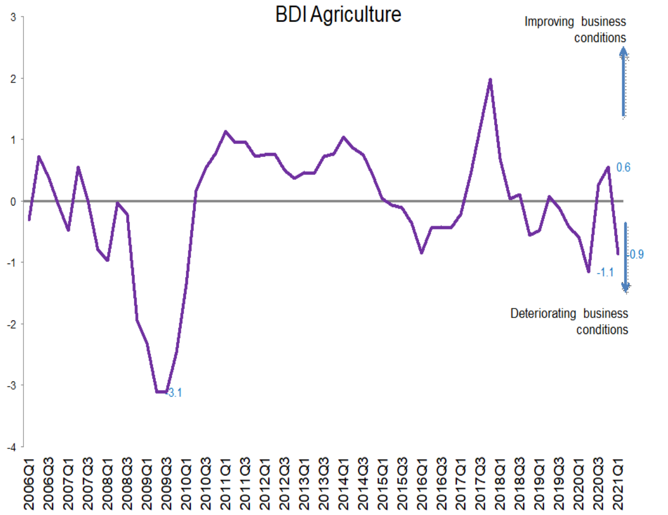
One can only interpret these figures as suggesting that the economic recovery has meant that businesses have been under increasing cash flow pressure to exploit the uptick in activity and, as a consequence, have been compelled to hold back on paying off their debts as rapidly as previously. During the depths of the downturn last year, there was probably a psychological incentive ironically to reduce debts as rapidly as possible.

Nonetheless, to the extent that this increase in outstanding debt feeds into the overall BDI negatively, it neutralised somewhat the benefit to the financial health of businesses caused by the improvement in business conditions.

BDI by sector



The improvement in the BDI in Q1 prevailed across most sectors, with the notable exception of agriculture. To some extent, this can be attributed to the fact that the agricultural sector was the one outstanding sector to experience positive conditions in 2020 and so was not materially adversely affected by the lockdowns introduced to fight the COVID-19 virus.

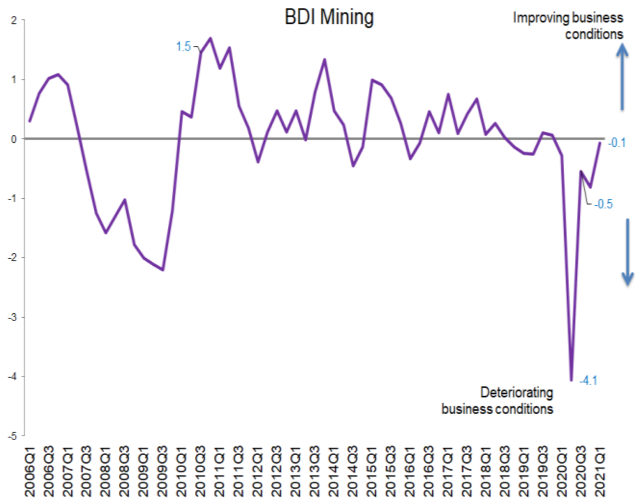


On the contrary, the supply of food to enable people to survive was a cornerstone of the state's economic policy. As a consequence, Q1 economic growth showed a slight decline after successive quarters of buoyancy in 2020. Nonetheless, anecdotal evidence suggests that agricultural conditions remain very favourable, with bumper crops in many different types of produce.

Accordingly, one anticipates that there will be a recovery in the BDI of this sector over the remainder of the year.

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

Amongst other sectors, the outstanding feature was the sharp increase in the BDI of mining in tandem with the recovery in mining output associated with rising mineral prices.



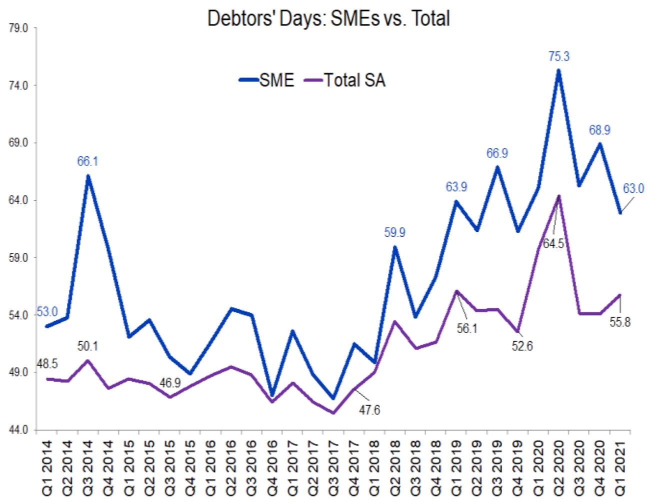
It is also noticeable that the BDI for community and social services recovered to a positive level and constituted the only BDI outcome that was in positive territory, suggesting improving business debt conditions. On the other hand, it is also conspicuous that sectors related to capital investment, such as construction, electricity and, to some extent, even manufacturing, did not recover to the extent that some of the other sectors did in Q1.

Fortunately, the recent announcement by President Ramaphosa to allow companies to generate their own electricity up to 100 MW without having to apply for licences to do so, should instil some confidence that the government is serious about introducing structural reforms that will reverse the declining longer-term trend of South Africa's economic fortunes.

BDI by company size

The latest BDI analysis also suggests some improvement in the relative conditions of the small business sector. The number of outstanding debtors' days in this sector decreased quite sharply from 68.9 in Q4 to 63.0 in Q1. This contrasted with an increase in the overall number of outstanding debtors' days. Similarly, the SME stress ratio fell quite sharply to just 23.1 in Q1 from 31.7 in Q4.

This outcome seems to endorse the suggestion that increase in overall outstanding debtors' days in Q1 was probably more a function of businesses trying to improve their cash flow by withholding payments of debts as they prepare to take advantage of the upturn in business activity which appears to be taking place on a more general level if the relative improvement of the SME stress ratio is anything to go by.



Summary and Outlook

On the positive side, it is logical to expect that in the event of the economic recovery continues to gather momentum, one will see further increases in the BDI. In particular, according to the latest BER Business Confidence Index, domestic business confidence has soared in Q2 to 50 points in Q2 from 35 in Q1.

As revenues of companies are restored, the pressure on cash flows to take advantage of improved conditions is likely to ease. The experience is likely to be particularly beneficial for exporters, especially in the mining, manufacturing and agricultural sectors. There are indeed some risks in the economic outlook both domestically and internationally.

Domestically, the increased incidence of load-shedding might dampen business enthusiasm somewhat, whilst a slow rollout of vaccinations means that South Africa's economy might lag the global experience in deriving the benefit of a return to normal conditions.

Internationally, there has been rising anxiety regarding the possibility of a tightening of monetary policy in the wake of sharp increases in inflation. Central banks have gone out of their way to suggest that they believe the increase in inflation will prove to be a temporary phenomenon and accordingly are in no hurry to raise interest rates.

However, one suspects that such confidence may not prevail indefinitely. It is also important to emphasise that there has as yet not been enough time to assess the efficacy of vaccinations in combating the spread of the coronavirus.

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 36 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: June 2021

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.