Business Debt Index

Quarterly Summary - Q2 2021

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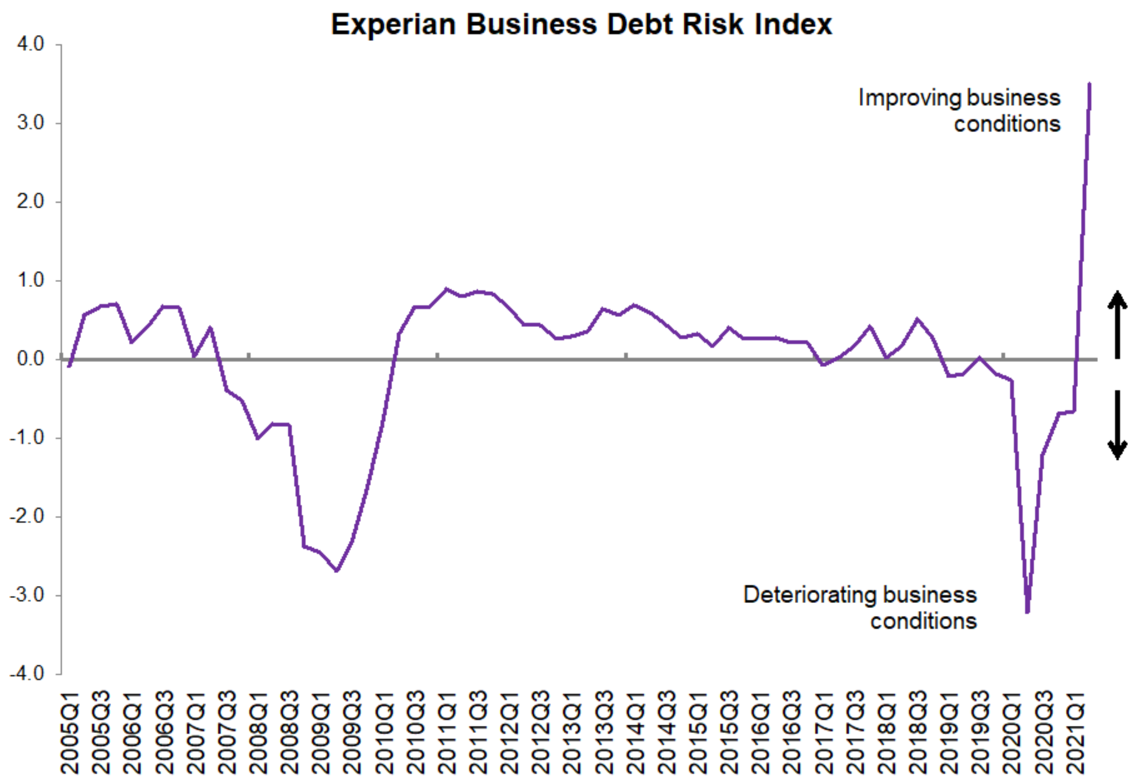
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q2 2021

Continued improvement in BDI for Q2 2021 in line with sustained economic recovery

The Experian Business Debt Index (BDI) improved in Q2 quite dramatically to a record high of 3.50, from a negative -0.661 in Q1 2021. This took the index to a positive reading for the first time since Q4 2018, which reflects a return to improving business debt conditions. It also represented the fourth consecutive quarter of improvement in the BDI, from an all-time low of -3.216 in Q2 2020.



	Q2 2020*	Q3 2020*	Q4 2020*	Q1 2021	Q2 2021
Index >0= Improving business conditions <0 = Deteriorating business conditions	-3.216	-1.210	-0.693	-0.661	3.500

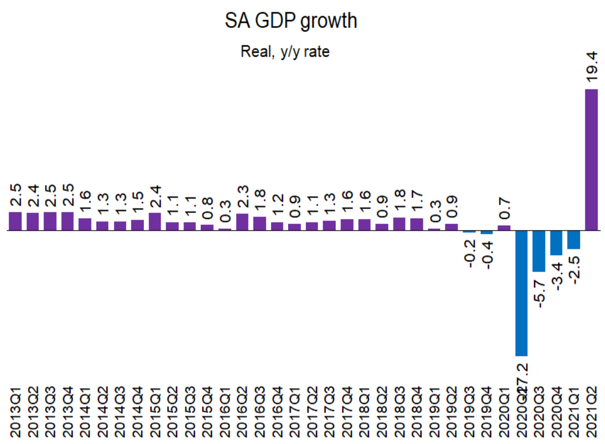
** Revised*

Macroeconomic factors influencing Q2 2021

The rise in the BDI in Q2 was greater than anticipated and attributable to three main factors.

Firstly, there was a revision by Statistics South Africa of the base upon which GDP is calculated from the use of 2010 prices to 2015 prices. This resulted in a significant revision of historical GDP data. As a consequence, the Q4 2020 BDI has been revised upwards to -0.693 from -0.871 previously and the Q1 2021 value for the index has similarly been revised upwards to -0.661, from -0.785 previously.

More importantly, the Q2 GDP growth rate came in at an effective annualised rate of 4.9%. On a y/y basis, GDP growth for Q2 domestically now comes in at a massive 19.4%, well above the -2.5% corresponding growth in Q1. It largely reflects the comparison of an economy that was recovering well in Q2 of 2021 against extremely depressed conditions under strict lockdown in Q2 of 2020.

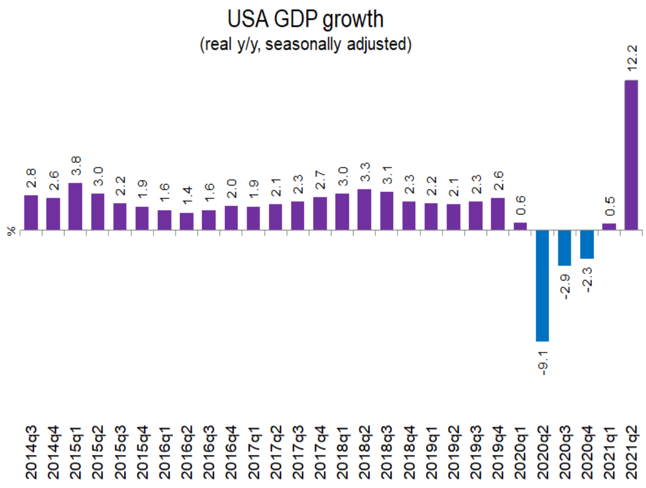


Source: South African Reserve Bank

Secondly, the Q2 GDP growth rate came in higher than anticipated also because of a sharp increase in exports resulting from a significant improvement in international commodity prices. With more than half of South Africa's exports being attributable to the sale of mining and agricultural products, the balance of trade recorded a dramatic annualised increase of more than 4% of GDP.

The improvement in exports associated with higher commodity prices was a function of a surge in global economic activity, especially in the US and Europe, associated with a semblance of a return to normal economic activity following the widespread rollout of vaccines in these regions. Extremely expansionary fiscal and monetary policy, much of it directed at providing consumers with relief from the ravages of lockdown, also contributed towards the unexpectedly steep acceleration of global economic growth and the resultant strong increase in commodity prices. Disruptions to international and domestic supply lines in the face of a sudden surge in demand exacerbated the shortage in the supply of inputs into both manufacturing and the extraction of certain commodities. This also had an impact on pushing up commodity prices.

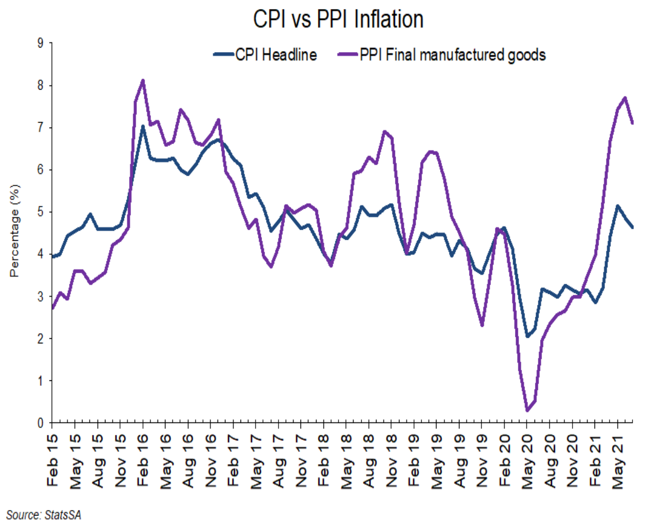
In the event, US GDP for Q2, as was the case with South Africa, came in stronger than had been anticipated three months ago, with y/y growth surging from 0.5% in Q1 to 12.2% in Q2.



Source: Bureau of Economic Analysis

Whilst other factors are contributing towards the measurement of the BDI, their contribution to the improvement in the index in Q2 was negligible. There was virtually no change in the differential between the repo rate and foreign interest rates and absolutely no change in the spread between short and long-term interest rates.

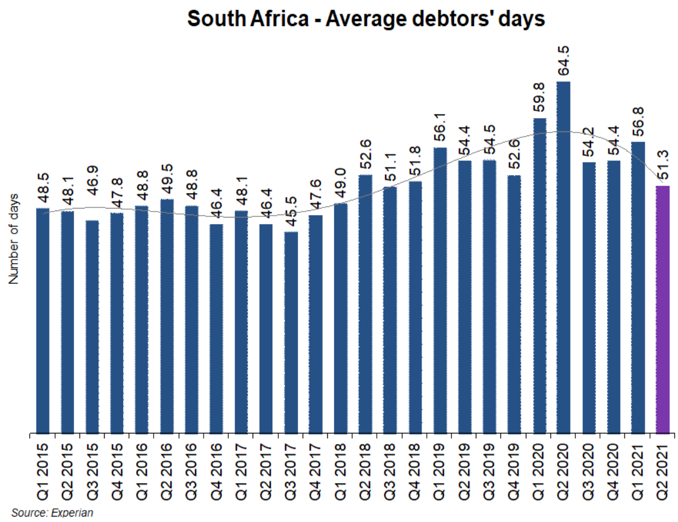
Only in the case of the difference between the PPI and CPI inflation rates, which increased from 1.2% in Q1 to 2.5% in Q2, was there a positive contribution to the BDI. The fact that the PPI rose relative to the CPI inflation rate suggests that the margins of companies improved during Q2. Indeed, this might have been one of the factors contributing towards the substantial improvement in outstanding debtors' days in Q2.



Business debt metrics in Q2 2021

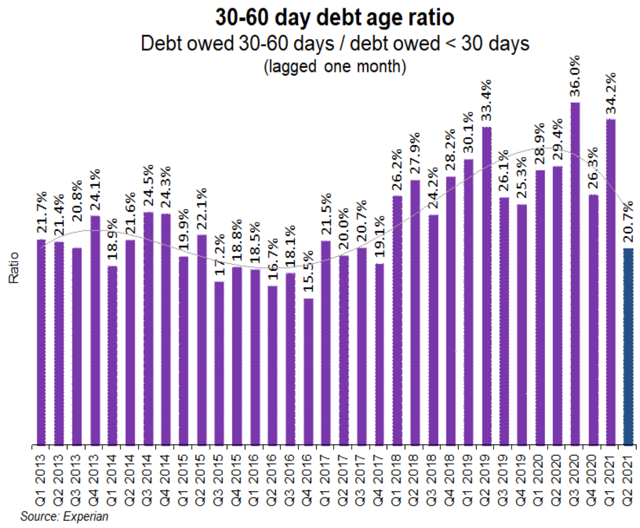
The third main factor underlying the better-than-expected outcome for the Q2 BDI emanated from a far better-than-anticipated outcome in terms of outstanding debtors' days within the domestic business as measured from Experian's client base.

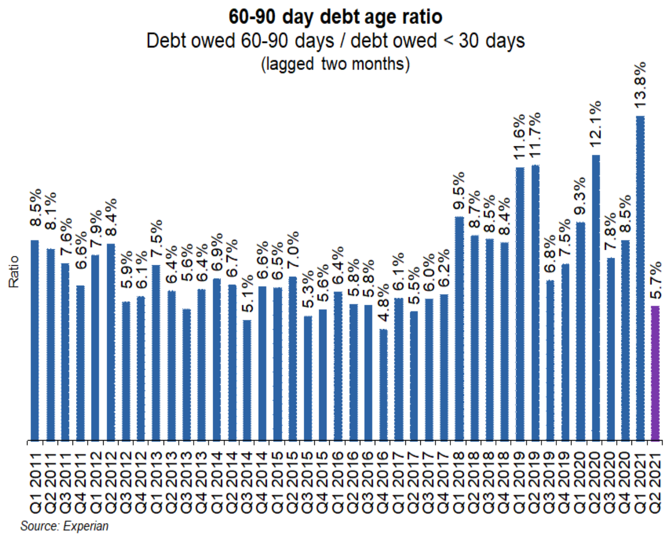
The number of outstanding debtors' days fell steeply, from an upwardly revised 56.8 in Q1 (previously reported as having been 56.4) to 51.3 in Q2, the lowest such level since Q3 2018.



More specifically for the measurement of the BDI, the **60 to 90 ratio**[1] fell dramatically from a record 13.8% in Q1 to just 5.7% in Q2, the lowest such level in four years.

Similarly, the **30 to 60 days ratio**[2] declined from 34.2% in Q1 to just 20.7% in Q2, also the lowest such level in almost four years. The sharp improvement in the metrics regarding debt owed was influenced by the fact that many consumers and businesses have not been spending as much as they were doing prior to the onset of the COVID-19 crisis. With many people working from home rather than going to the office, significant savings in transport costs have been incurred.





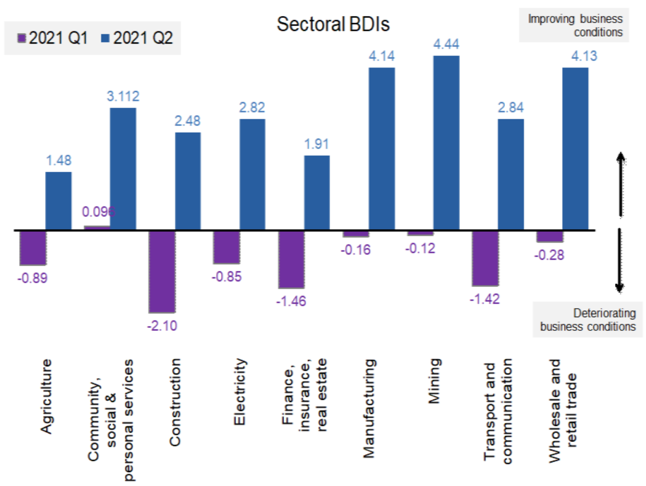
Furthermore, due to the fear of contracting the coronavirus, expenditure on travel, both business and leisure, has been curtailed, as too has been the reluctance to spend at restaurants and other entertainment facilities. Together with the fact that domestic interest rates have remained at 50-year lows for 15 months, a vast improvement in the financial position of both businesses and consumers has ensued. In regard to the latter, it should be borne in mind that due to the high level of inequality in the country, the lion's share of expenditure emanates from a fairly small proportion of the population, largely drawn from the middle class. This segment of the population has not

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

[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*

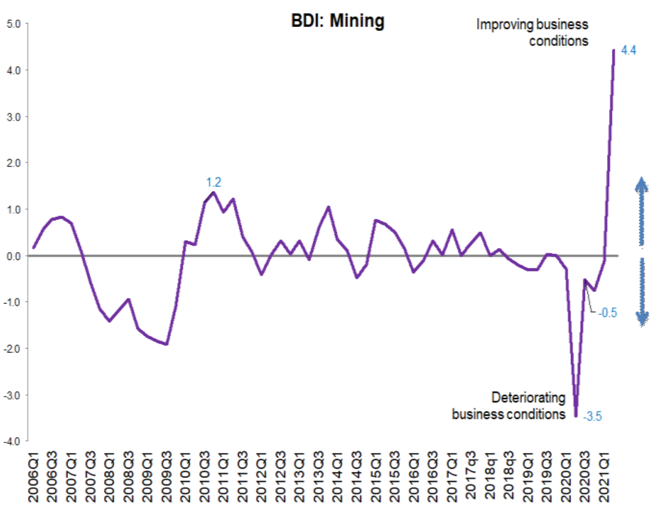
suffered anywhere near to the same extent from the disruption to business activity as the working class and those informally employed. Consequently, business and consumer spending has not been as depressed as had been anticipated.

BDI by sector

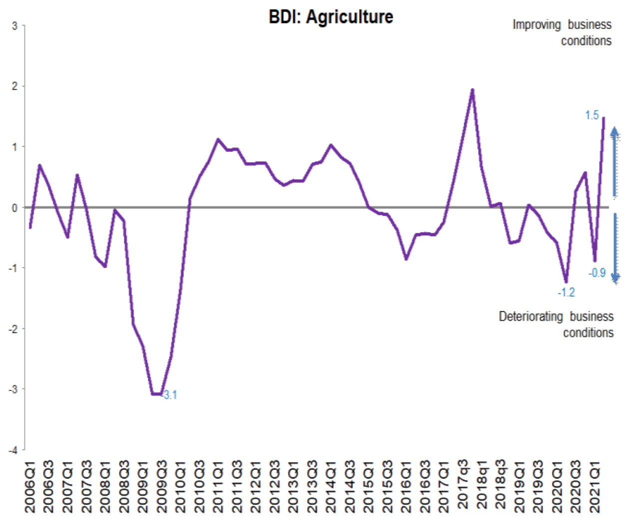


Sectoral analysis of the BDI reflects virtually no difference in the patterns displayed by the different sectors of the economy. In all cases, there was a steep increase between Q1 and Q2. The only minor exception to note is that in the case of community, social and personal services, the BDI increased from an already positive reading in Q1 to a much more positive level in Q2. In all the other sectors, the BDI moved from negative to substantially positive.

The highest BDI reading was in respect of mining, followed closely by the retail and wholesale trade and accommodation sector and the manufacturing sector, all with readings above 4.0. The lowest readings were in respect of agriculture at 1.48 and financial and business

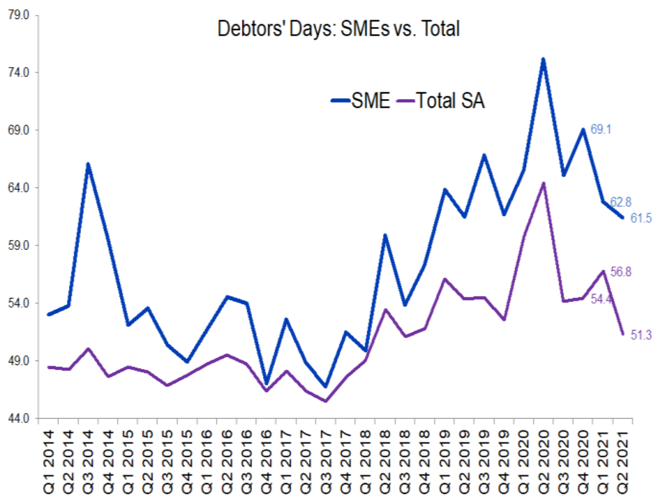


services at 1.91. Even these index values are quite high by historical standards.



BDI by company size

The consistency with which the BDI shot up in Q2 is also reflected in the relationship in the debt experience of small businesses relative to the overall sample of companies. In the case of SMEs, the number of outstanding debtors' days declined to 61.5 from 62.8 in the previous quarter and 69.1 in Q4 2020. This resulted in the SME stress ratio declining from 23.8 in Q1 to 22.0 in Q2 which was the lowest stress ratio since the onset of the coronavirus contagion at the beginning of 2020. In other words, the improvement in business debt conditions in Q2 transcends the relative size of companies.



Summary and Outlook

Looking forward, however, it is likely that the BDI for Q3 will post a sharp decline from the elevated reading in Q2 (but still remain in positive territory). There are three main reasons for this relative pessimism.

- Firstly, the social unrest and looting experienced in early July and the damage this inflicted on business activity and consumer spending did not form part of the calculation of Q2 BDI. Its impact will only emerge in subsequent quarters. The direct impact of reduced spending and interruptions to supply chains will come to weigh down on Q3 GDP growth, whilst in subsequent quarters, business investment stands to take a knock as a result of reduced confidence generated by the events of July. The concern regarding the longer-term growth outlook is the insufficient appropriate measures being undertaken by government to implement urgently needed policies relating to solving the following structural constraints: infrastructural investment, energy security, the cost of digital communication, the inefficiency of SOEs, addressing state capture, and poor education outcomes.
- Secondly, from an international perspective, the resurgence of COVID-19 infections due to the contagion of the Delta variant has resulted in increased apprehension to embark upon normal social activities such as travel, holidays and restaurants. It looks to be depressing global economic activity compared with what was being experienced in Q2. This has resulted in a mild falloff in commodity prices which is likely to work through towards adding to downward pressure on domestic economic activity in Q3 compared with Q2.
- Thirdly, a substantial increase in inflation to its highest level in more than a decade resulting from supply shortages associated with disruption to conventional supply chains in the face of the unexpectedly strong resurgence in economic activity in Q2 has contributed towards eroding disposable income compared with what had been anticipated.

Finally, it is important to note that statistical distortions are playing an important role in similarly altering many indicators of economic activity as a result of the depth of the economic downturn experienced during the hard lockdown of Q2 2020. Distorted y/y data for Q2 2021, compared to an extremely depressed base figure in Q2 2020, means that for many indicators, Q2 2021 will show up as a sharp increase to be followed by a countervailing decrease in growth in Q3 2021.

In conclusion, encouragement can be drawn from the substantial improvement in business debt conditions in Q2 associated both with the change in behaviour of individuals and businesses since the onset of the COVID-19 crisis, as well as the strong upswing in global economic conditions that have helped exports. However, in the wake of the social unrest experienced in July, as well as the renewed spike in infections which seems to be weighing down on global business activity, one expects business debt conditions to show a slower improvement in coming quarters, even if not to a degree that is in any way cause for alarm.

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 37 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: Dec 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.