BUSINESS DEBT INDEX
Quarterly Summary | Q3 2020

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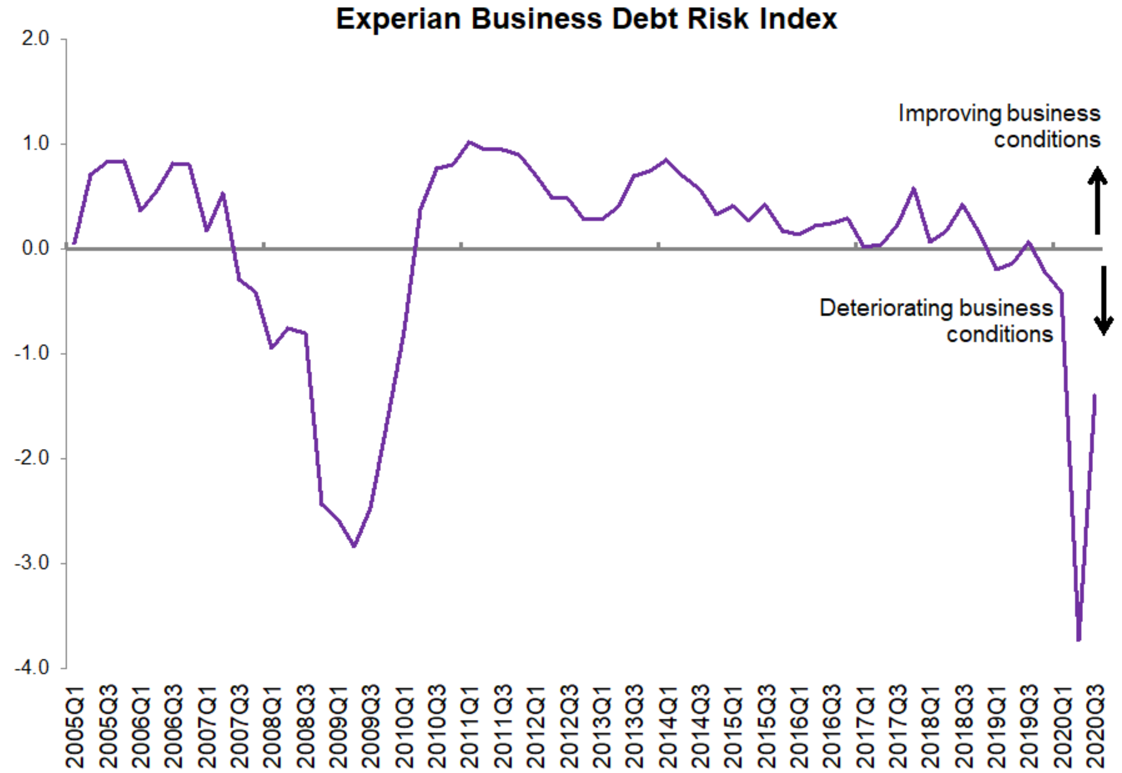
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q3 2020

Significant improvement in BDI for Q3 2020 due to easing of lockdown measures

The Experian Business Debt Index (BDI) - as expected - improved sharply in Q3 from the incredibly heavily depressed level reached in 2020 Q2, easily the worst such measure on record. The BDI shot up from its horrific level of -3.728 in Q2, to -1.402 in Q3.



	Q3 2019*	Q4 2019*	Q1 2020*	Q2 2020*	Q3 2020
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.068	-0.221	-0.412	-3.728	-1.402

** Revised*

Macroeconomic factors influencing Q3 2020

The explanation for the sharp increase in Q3 is straightforward. During Q2, both international and domestic economies were heavily locked down in an effort to quell the spread of the new coronavirus COVID-19. This meant that many sectors saw activity declining by between 50% and 100% through the course of April specifically. From May onwards, some of the lockdown restrictions gradually came to be lifted so that by Q3, far more business activity was being conducted than in Q2.

Domestically, it has been observed that a variety of economic indicators have progressively improved with each and every loosening of lockdown restrictions, as human behaviour and business conditions gradually aspired to return to normality. This was the dominant trend in economic activity and the debt metrics of businesses overall in Q3.

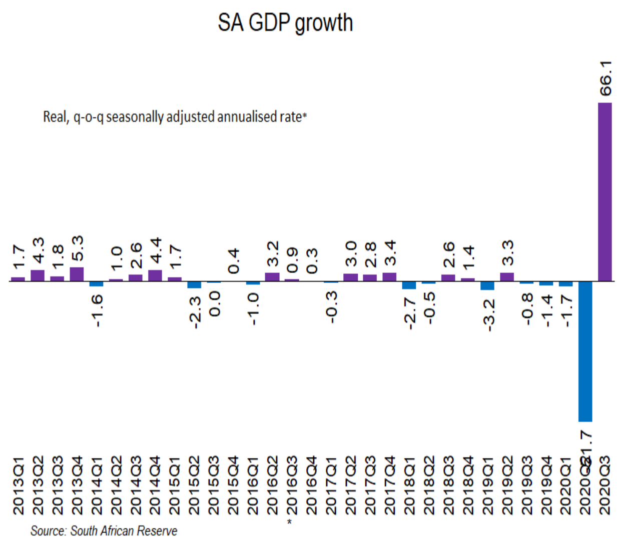
Over and above these factors, businesses and consumers benefited in Q3 from the massive fiscal and monetary stimulus packages introduced. In advanced economies, these stimulus packages were of the order of $10 trillion each, making up a total stimulus of approximately $20 trillion. Of this, between 30% and 40% was injected into the US economy, enabling it to recover quite strongly. Whereas in April, some 22 million jobs were lost in the US, by September around half of these had been regained. The US unemployment rate, which rocketed from 3.5% in February, to 14.5% in April, fell back to just 6.9% in September.

In South Africa, the stimulus packages were not as dramatic. Even so, a good deal of the Q3 recovery emanated from the fact that consumers and businesses alike benefited from the 30% effective reduction in their debt servicing costs as a result of the cut in the prime overdraft rate from 10% at the beginning of the year, to 7% in July.

In addition, from the fiscal side, many of those businesses and consumers who were retrenched or received pay cuts during the strictest phase of lockdown benefited from the Temporary Employee Relief Scheme (TERS) executed by the Unemployment Insurance Fund and introduced by the government to provide some temporary financial relief. Banks were also encouraged to provide temporary interest payment holidays for holders of mortgage advances, car loans and other relevant forms of debt.

Finally, at the lower end of the income spectrum, around six million unemployed persons who were unable to qualify for social grants were assisted in the form of a temporary special social grant.

The combination of all these factors resulted in the South African economy reversing a horrific -51.7% q-o-q annualised growth rate in Q2 into a seemingly astonishing 66.1% pickup in q-o-q seasonally-adjusted and annualised growth in Q3.

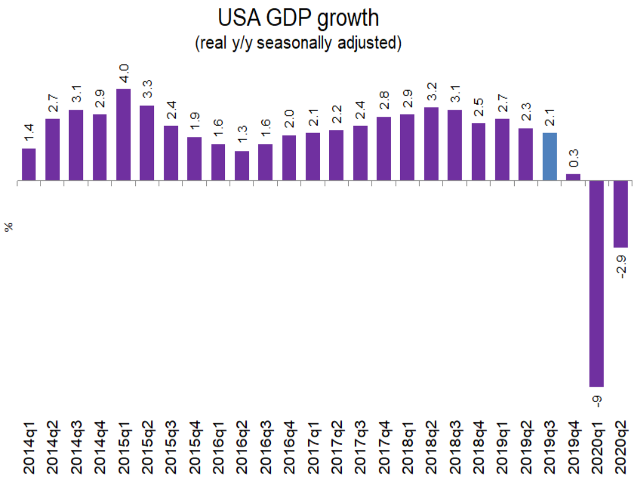


In some ways, it is easier to conceive of the situation by considering y-o-y comparisons. In this context, the economy experienced a -17.5% y-o-y contraction in Q2 and this improved sharply to a - 6.1% contraction in Q3.

Every single one of the 10 sectors of the economy shared in this improvement in economic growth, with those sectors which had experienced the steepest declines during the stringent lockdown of Q2, such as mining, manufacturing, construction, transport and communication, and retail sales and accommodation, recording the biggest proportionate improvements in Q3. There was also an astonishing 201% annualised pickup in exports on the back of higher commodity prices and increasing demand for South African processed goods from China as the latter economy began recovering strongly.

Nonetheless, it is relevant to point out that, as much as economic growth picked up in Q3, even the - 6% y-o-y growth rate recorded during that quarter represented a massive y-o-y hit on economic activity. It was easily the second-worst y-o-y performance of the South African economy after what had been experienced in Q2. It is this y-o-y drastic deterioration that has resulted in the BDI in Q3, at -1.402, still being far worse than the -0.412 reading of the index in Q1 prior to the main onset of the COVID-19 crisis.

In the US, economic growth similarly picked up sharply, from a massive contraction of -9.0% in Q2, to -2.9% in Q3, likewise helped along by a lifting of social restrictions, massive fiscal stimulus and the perpetuation of interest rates at zero levels.

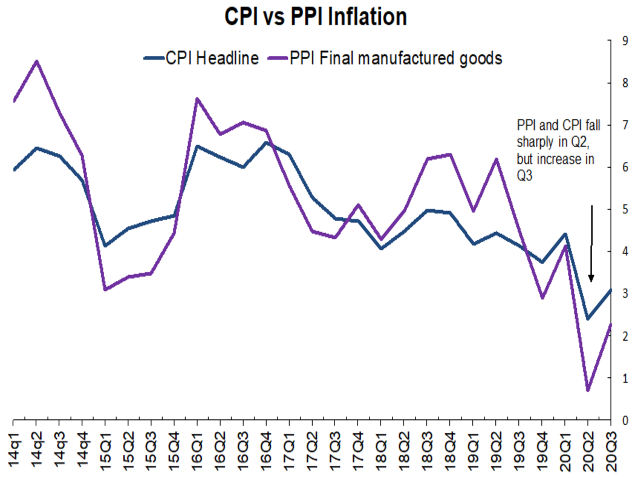


Source: Bureau of Economic Analysis

The other contributors to the macroeconomic factors making up part of the BDI had minor influences compared with the movements in the GDP growth rates of both South Africa and the US. Encouragingly, they also assisted in improving the BDI.

Firstly, the gap between the PPI and CPI inflation rates, which is seen as a proxy for the margins enjoyed by businesses, narrowed from -1.71% in Q2, to -0.99% in Q3. The increase in the PPI relative to the CPI is indicative of the fact that businesses were no longer able to carry on absorbing cost increases emanating from the weakness of the Rand in earlier months and began passing on some of these increases to customers.

There was also a modest reduction in the gap between the repo rate and the US Fed Funds rate, signalling a relative decrease in foreign financing pressures of local businesses.

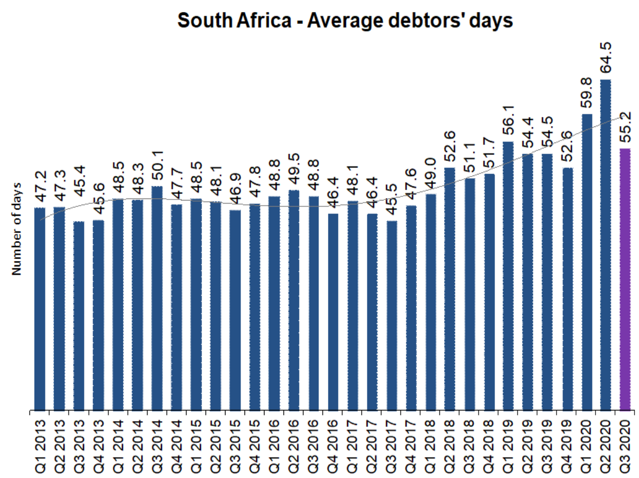


Source: StatsSA

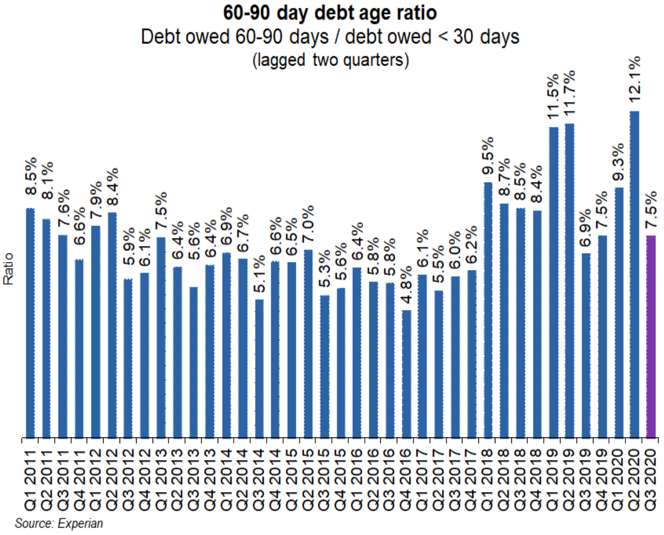
Finally, the gap between short and long-term interest rates domestically widened marginally, which is conventionally interpreted as a sign of a potential improvement in the economic outlook. In the case of the growth indicators and the PPI/CPI relationship, the actual inputs into the BDI were still very negative in Q3, but far less so than in Q2. In the case of the relationship between the repo rate and the US Fed Funds rate, the absolute impact on the BDI remained positive, albeit very modestly so in comparison with the growth indicators.

Business debt metrics in Q3 2020

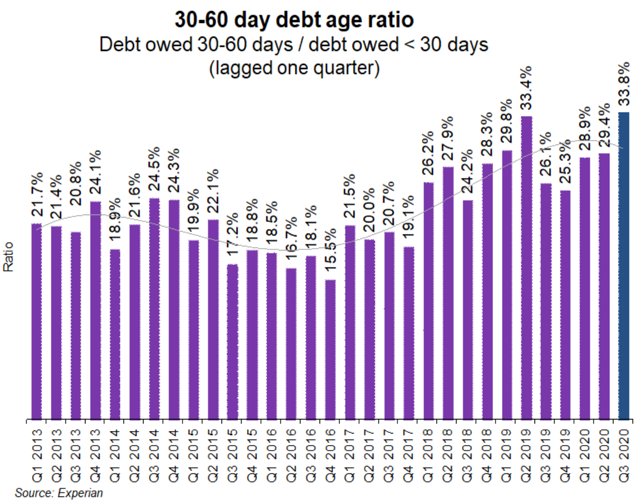
Besides the recovery in economic growth, the other important factor contributing towards the improvement in the BDI in Q3 was the sharp improvement of the data on **outstanding debtors' days** as reflectors of the financial position of businesses. Overall debtors' days outstanding fell dramatically from a decade-long high of 64.5 days in Q2 and 59.8 days in Q1, to just 55.2 days in Q3.



Within this overall picture, the outstandingly positive input came from the **60 to 90 ratio**[1]. The ratio of the longer-term outstanding debt to the shorter-term debt narrowed dramatically from a record 12.1% of companies in Q2 and 9.3% in Q1, to 7.5% in Q3.



The reduction in this ratio outweighed the impact of an increase in **30 to 60 days ratio**[2], which increased from 29.4% in Q2, to 33.8% in Q3. One gains the impression, however, that the dramatic fall in interest rates this year has probably reduced the propensity of companies to try and hold back paying off their debts early as the opportunity to gain additional interest income by doing so has diminished.

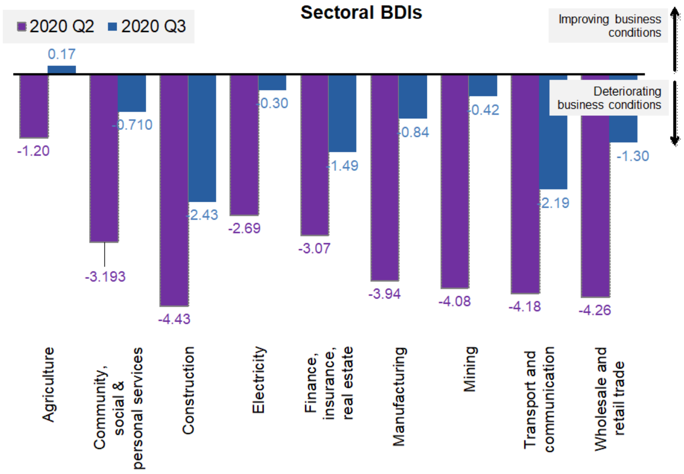


Positive debt metrics buoyed the overall BDI in Q3

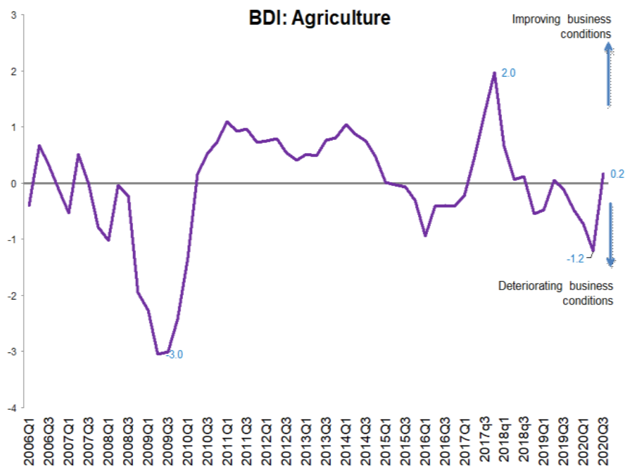
BDI by sector

As mentioned earlier, the breakdown of Q3 growth figures by sector reveals a huge improvement in every single one of the 10 sectors of the economy.

Those that experienced the biggest dip in activity in Q2 were conversely the ones that benefited most in the recovery in Q3. This had the effect of vastly improving the BDI readings for every single sector.



However, only the agricultural sector has seen a move into positive territory for the BDI. This stems from three consecutive quarters of double-digit growth in agricultural output following the excellent harvests recorded this year in the wake of solid rainfall over the 2019/20 summer season.

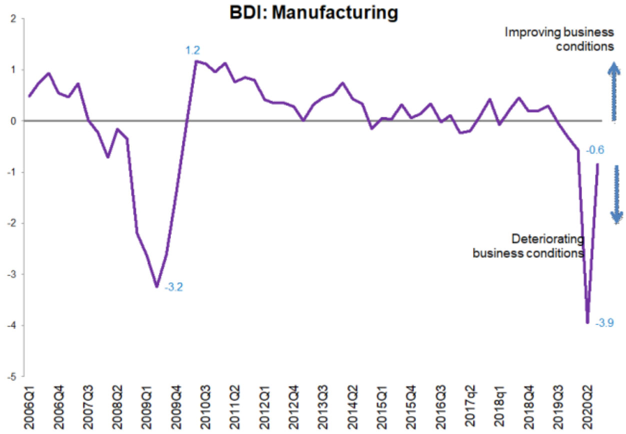


The latest BDI reading improved massively for mining, from -4.08 in Q2, to -0.42 in Q3, with the recovery in manufacturing and wholesale and retail trade and

[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*

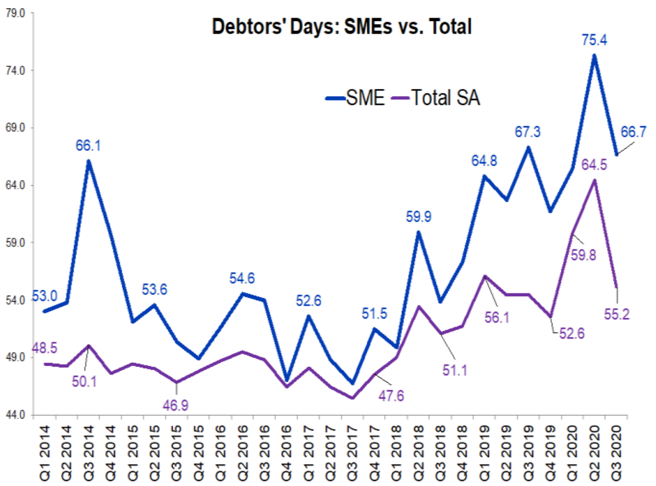
accommodation, not falling behind by much in order of magnitude.



The smallest relative recovery was recorded by the financial and business services sector, but then this sector was nowhere near as badly affected by the stringent lockdown experience in Q2 as most of the other sectors.

An improvement in business conditions of all sectors was reported in Q3

BDI by company size



It is encouraging to note that the improvement in business debt conditions was not confined only to larger companies. The number of outstanding debtors' days of SMEs fell from record levels of 75.4 in Q2, to 66.7 in Q3. Even the latter figure remained extremely high, suggesting that the financial strain being experienced by small businesses remains acute notwithstanding the opening up of the economy in recent months.

However, the SME stress ratio, which is more a function of the relative outstanding debtors' days of SMEs compared with the overall sample, declined steeply, to 26.0% in Q3, from an all-time high of 39.3 in Q2.

Both SMEs and larger businesses showed an improvement in debt conditions in Q3

Summary and Outlook

In conclusion, business debt conditions have improved markedly over the past quarter. Even so, the economy is not out of the woods yet and is still of a significantly smaller size than it was prior to the ravages of the COVID-19 crisis earlier in the year. Whilst continued recovery is foreseen in the year ahead, it is unlikely to be nearly as dramatic as that witnessed in Q3 alone.

Furthermore, it is important to reflect on the fact that economic growth and business debt conditions were deteriorating even prior to the onset of the COVID-19 crisis. This was attributable to structural weaknesses impeding the economy from fulfilling its full potential. Unless those structural weaknesses are effectively addressed in the coming months, one should not expect business debt conditions to move into an improvement phase in absolute terms for a long while to come. The best that one can hope for is that the rate of deterioration in business debt conditions in the short to medium term will simply become much more temperate.

Looking ahead, it is highly unlikely that one will observe a continuation of economic recovery to the extent witnessed in Q3. Most of the lockdown restrictions have been lifted, so the marginal benefit of such developments is petering out. However, there is a short-term risk of the re-introduction of some restrictions on freedom of movement as a result of an acceleration in the rate of

COVID-19 infections domestically. Indeed, such renewed restrictions have been introduced in the Nelson Mandela Bay region most recently and this could be a precursor to such restrictions being extended to other regions of the country should the escalation in infections not be constrained.

Secondly, some of the relief packages such as the TERS, the temporary interest holidays provided by banks and the extra social grants funded by government, are set to mature in coming months.

Thirdly, a sharp escalation in the rate of infections in Europe and North America over the past month or two has compelled some leading countries to reintroduce social restrictions in order to quell the second wave of the coronavirus.

As a consequence, one is likely to see the recovery witnessed abroad, which has indirectly benefited the South African economy, losing some momentum in the coming months. Against this and looking slightly further out, global economic confidence has been buoyed by the expectation of a rollout of newly developed anti-COVID-19 vaccines. The spectre of a return to normality and pre-COVID-19 economic activity is no longer an academic source of hope, but a real one instead.

Global business confidence has also been boosted by the election of Joe Biden as President-elect of the United States, with the concomitant potential benefit of a reduction in trade tensions between the US and other countries, the most important being China. Taking all these factors into account, we see a marginal further improvement in the level of economic growth in Q4 in the South African economy, to -5.9% y-o-y, from the -6.1% growth recorded in Q3.

Likewise in the US, the -2.9% y-o-y growth rate recorded in Q3 will probably improve somewhat to -2.0% in Q4. It should be noted that even projected growth rates remain heavily negative. Consequently, the forecast for the Q4 BDI remains highly negative, but reflects a marginal improvement on the -1.402 BDI reading for Q3.

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.

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Next release date for the BDI: February 2121

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.