Business Debt Index

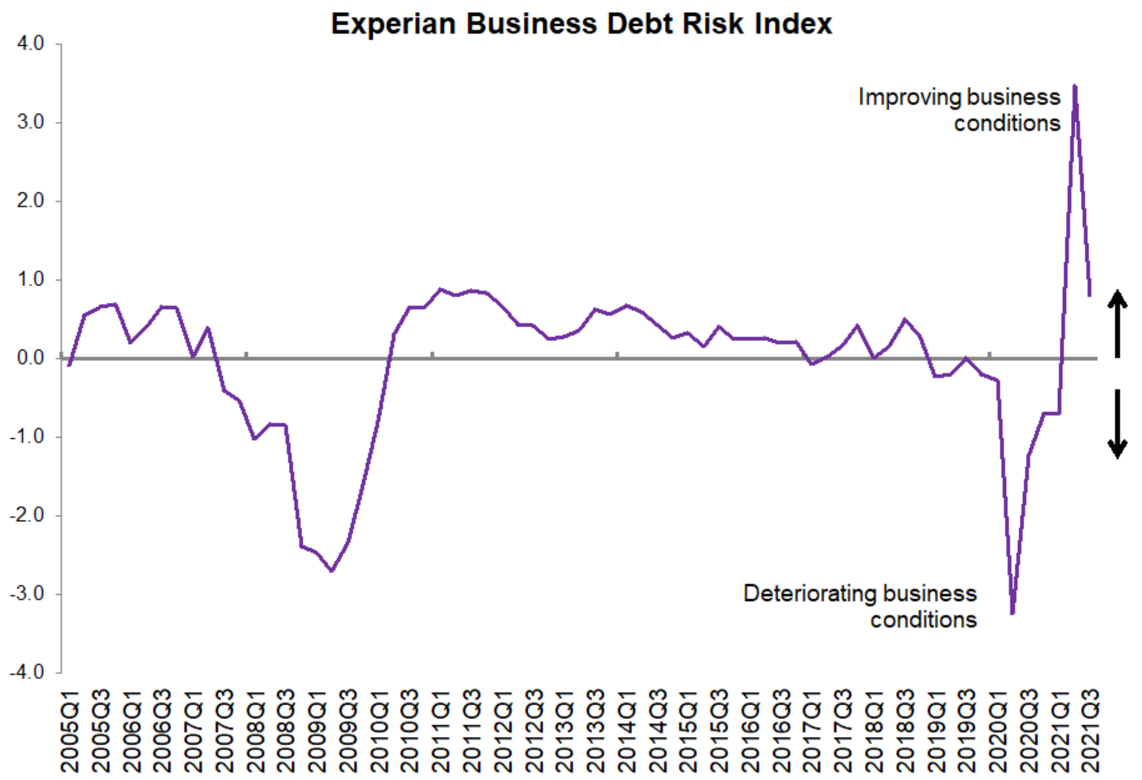
Quarterly Summary - Q3 2021

Powered by ECONOMETRIX (PTY) LTD

EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q3 2021

Moderation in Q3 BDI in line with contraction in economic growth

The Experian Business Debt Index declined sharply in Q3, to a reading of 0.808, from an all-time peak of 3.476 in Q2. It is important to bear in mind that even the 0.808 reading of Q3 is still quite positive, reflecting improving business debt conditions.



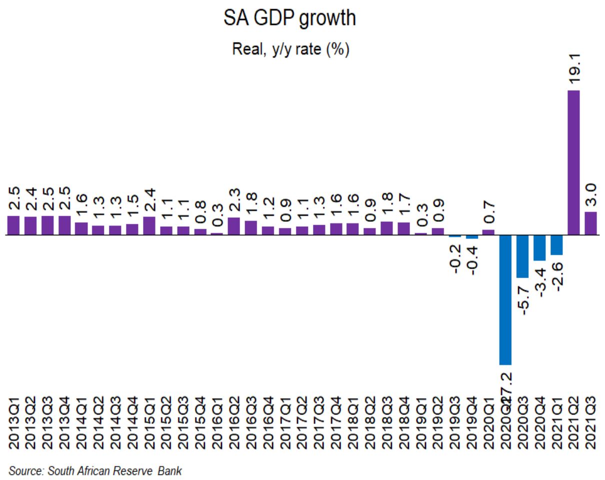
	Q3 2020*	Q4 2020*	Q1 2021*	Q2 2021*	Q3 2020
Index >0= Improving business conditions <0 = Deteriorating business conditions	-1.229	-0.710	-0.695	3.476	0.808

** Revised*

Macroeconomic factors influencing Q3 2021

The decline was fully expected for two main reasons.

- Firstly, statistical factors played a huge role in the volatility of this index, as has been the case with several other economic indicators. This volatility has arisen from the fact that the economy contracted massively, by -17.5% y/y, in Q2 2020 as a result of the strict lockdowns introduced at the time to quell the outbreak of the initial phase of the COVID-19 pandemic. This meant that comparisons drawn between Q2 of 2021 and Q2 of 2020 reflected a massive countervailing increase of 19.1% y/y. With the economy opening up in Q3 of 2020, growth in the economy became far less negative, implying that y/y comparisons against Q3 2020 did not reveal anywhere near as much of an improvement as was the case with the preceding quarter. In fact, y/y growth in Q3 of 2021 fell back all the way to 3.0%, dragging the BDI down commensurately sharply.

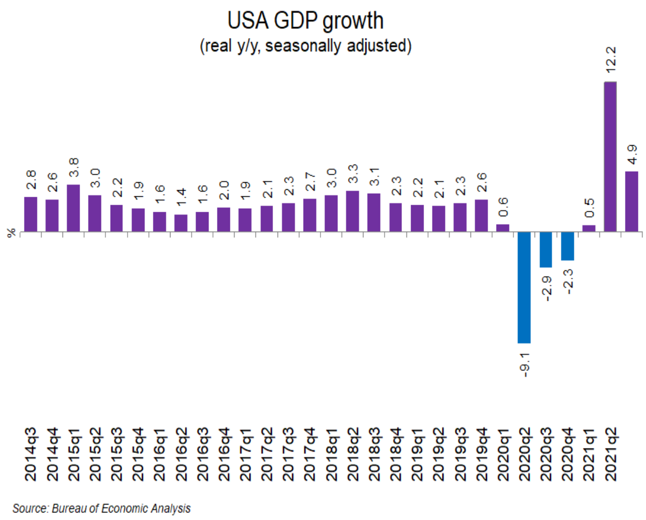


- Secondly, over and above the statistical impact, Q3 2021 GDP growth was also severely depressed by an outbreak of looting and social unrest in KwaZulu-Natal and parts of Gauteng in July. There was significant destruction of businesses and retail stores, as well as disruptions to logistics through the blockage of ports and national road supply pipelines. The situation was exacerbated two weeks later by a cyber-attack on Transnet's digital network, which added further to supply chain disruptions.

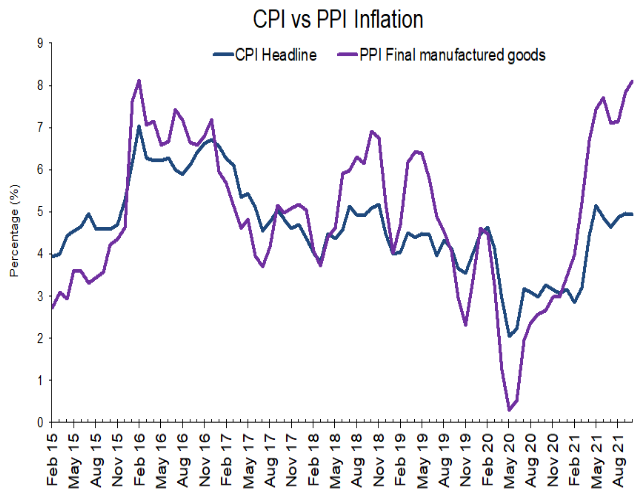
  The ravages of the social unrest in July turned out to be more damaging than anticipated. This was also reflected in the release of Q3 Quarterly Labour Force Survey data which showed a massive 660,000 jobs were lost during the quarter. Whilst it was a known fact that many businesses were destroyed and jobs rendered redundant as a consequence, the magnitude of the job destruction turned out to have been even greater than anticipated.

Reasons for the sharp decline in growth in Q3 were not limited to domestic economic influences alone. Globally too, economies began losing the boom momentum of the year's first two quarters. This boom had been driven by unprecedented massive fiscal and monetary stimulus aimed at providing relief to households and businesses negatively affected by the lockdowns associated with COVID-19. In addition, the successful development of vaccines earlier than anticipated towards the end of 2020 to fight the virus resulted in a sharp upswing in expenditure on travel, leisure, restaurants and similar services, which had been largely dormant during the crisis. However, the onset of Q3 was associated with dissipation of the impact of the relief packages and renewed concerns about the spread of the COVID-19 virus by virtue of the mutation towards the vicious Delta variant, which began inflicting renewed hardship on families as well as new moves to clamp down on free social activity.

US GDP, which had recorded y/y growth of 12.2% and 4.9% respectively in the first two quarters of 2021, fell back further to 3.0% in Q3. The slackening off in global economic growth in turn also resulted in some tailing off of the earlier rising trend of commodity prices and South Africa's erstwhile burgeoning trade surplus.



The other macroeconomic contributors to the BDI had only minor influences on the index. There was a slight reduction in the difference between the PPI and CPI inflation rates. This differential is used as a proxy for the profit margins of businesses. Both PPI and CPI inflation rates increased, but the former by slightly less than the latter. There was no change whatsoever in the difference between short and long-term interest rates domestically to have any influence on the BDI.

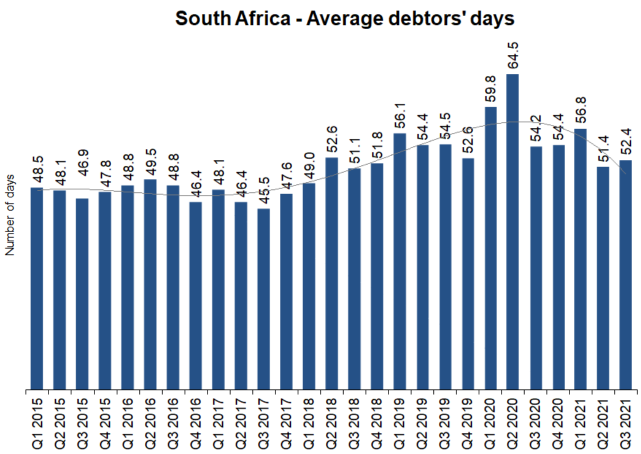


Source: StatsSA

The only marginally positive factor was the rise in the domestic repo rate by 0.25% in September, which helped raise the difference between domestic and foreign short-term interest rates, thereby reducing the relative cost of foreign debt for businesses.

Business debt metrics in Q3 2021

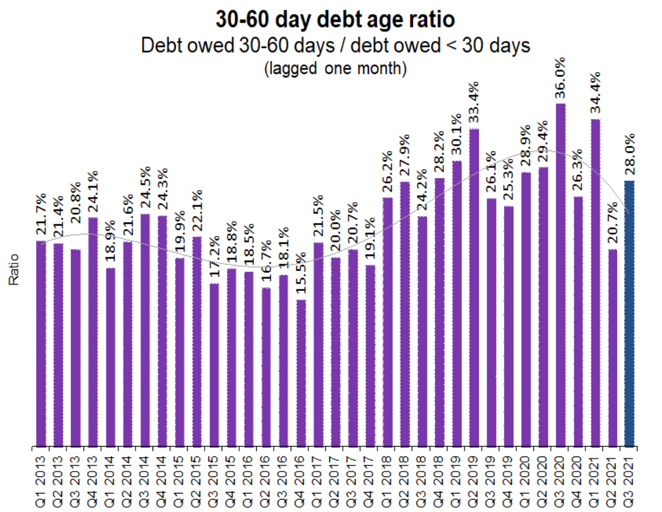
Interestingly, the debtors' days data collected by Experian, which supplement the macroeconomic data in influencing the BDI, followed the same negative pattern in Q3.



Source: Experian

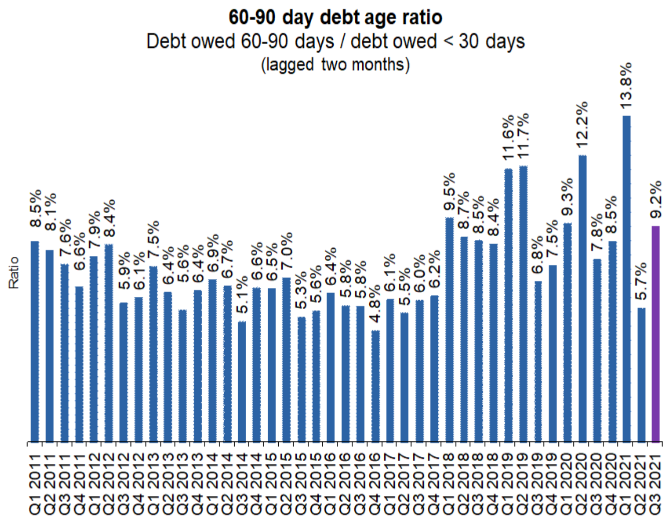
The average number of outstanding debtors days, which had fallen sharply from 56.8 in Q1 to 51.4 in Q2, increased slightly to 52.4 in Q3.

More specifically, those metrics used to determine the BDI deteriorated more significantly in Q3 than the overall average did. The **30 to 60 days ratio**[1] increased to 28.0% in Q3, from 20.7% in Q2. Although the 28.0% ratio for Q3 was sharply down on the 36.0% peak immediately after the hard lockdown a year ago, the increase recorded over Q3 was nonetheless quite significant.



Source: Experian

Similarly, the **60 to 90 ratio**[2] increased from 5.7% in Q2 to 9.2% in Q3. One suspects that the damage to businesses inflicted by the social unrest in July and the subsequent disruption to supply chains as a result of the Transnet cyber-attack had an important role to play in the deterioration of the ability of businesses to meet their debt commitments.

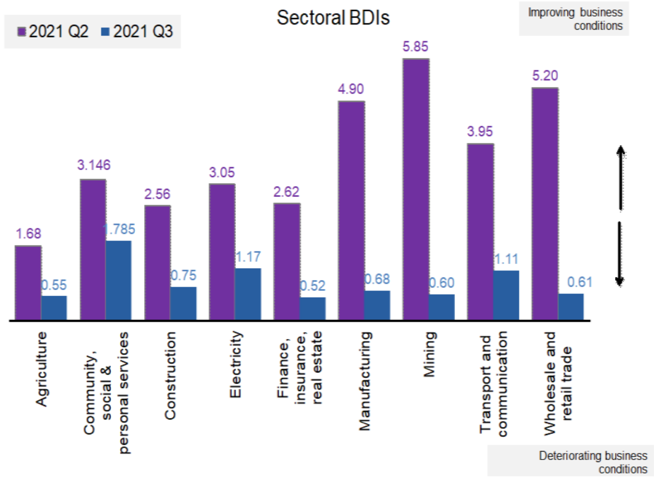


Source: Experian

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

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

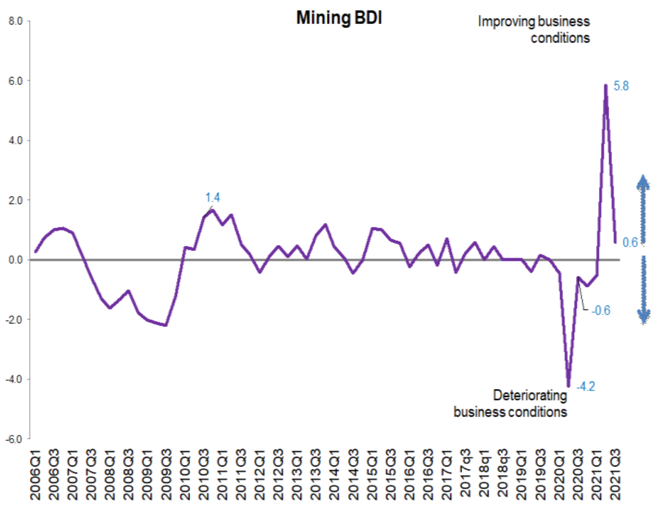
BDI by sector



The steep decline in the overall BDI is also spread amongst each and every sector. There are variances in the extent to which different sectors performed in Q3, but all suffered a deterioration in growth to some degree.

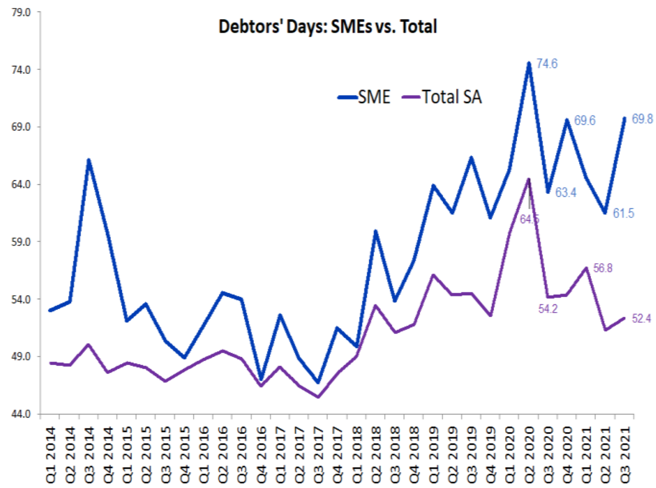
Encouragingly, however, each sectoral BDI still gave a positive reading in Q3, suggesting that overall, even if business debt conditions may not have improved in the manner in which they did in Q2, they did not deteriorate unduly.

The highest BDI reading was in respect of the services, electricity and transport sectors. The lowest readings were in respect of agriculture and the mining sectors.



BDI by company size

The adverse impact of the July looting spree on small businesses specifically is similarly reflected in the dramatic increase in the stress ratio of SMEs, from 22.2% in Q2 to 31.8% in Q3. Compared with the overall increase in outstanding debtors days from 51.4 in Q2 to 52.4 in Q3 for businesses tracked by Experian, the corresponding increase in debtors days of SMEs was much steeper, from 61.5 to 69.8. It is estimated that some 50,000 small businesses were compelled to close down over this period.



Outlook

Looking ahead, the BDI is expected to decline further in Q4. Even though the quarter has not been immersed in the same type of social unrest as that experienced in Q3, the recovery from the social unrest has been less pronounced than one might have hoped as a consequence of renewed electricity load shedding. More than anything, however, Q4 economic growth on a y/y basis is likely to show a further decline for purely statistical reasons related to the phenomenon of comparison against a rising base of activity in Q4 a year ago.

Globally likewise, the loss of momentum of economic activity due to the petering out of the impact of fiscal relief measures, coupled with renewed concerns regarding a new variant outbreak of COVID-19 and its consequences, is also likely to contribute towards depressing the BDI for Q4 when this is released in three months' time.

There is also growing pressure for central banks globally to tighten monetary policy and to end quantitative easing in the face of the sharpest increases in inflation in more than 30 years. Taking into account all these developments, one anticipates that the Q4 BDI will decline, but still remain in positive territory in Q3.

On the positive side, one is not talking about a major deterioration in business debt conditions, just a further slowdown in the rate at which such conditions become easier.

A more significant concern relates to the sluggish growth for the South African economy anticipated from 2022 and beyond in the absence of appropriate structural reforms required to address the weaknesses which contributed towards weak economic growth even prior to the COVID-19 crisis. In the short term, 2021 will have provided some respite with growth picking up off a very low base.

The more serious concern is that in the absence of measures being implemented to rectify weaknesses such as insufficient infrastructural investment, electricity supply shortages, inefficiencies and the running of SOEs, the high cost of broadband spectrum, poor education outcomes and a labour market that is unfriendly towards business, economic growth will resume its sluggishness of the past decade and with this one could well see further deterioration in business debt conditions.

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 40 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 2022

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.