BUSINESS DEBT INDEX

Quarterly Summary | Q4 2020

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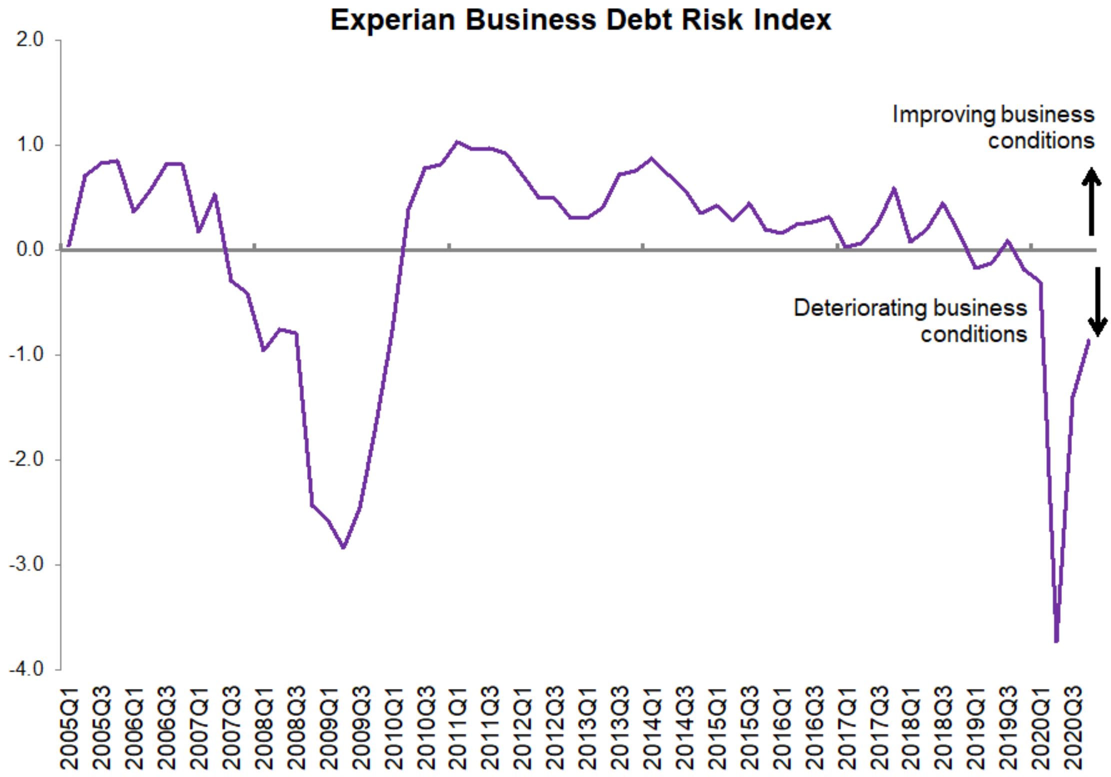
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q4 2020

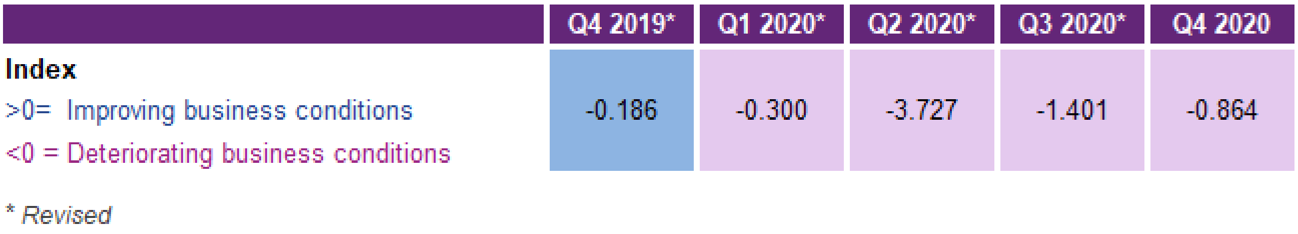
Continued improvement in BDI for Q4 2020 due to easing of lockdown measures

The Experian Business Debt Index (BDI) improved for a second consecutive month in Q4 of 2020, to -0.864, from -1.401 in Q3 and a horrific -3.727 in Q2.

Even though the Q4 BDI was quite substantially up on the previous two quarters, it was still well below any reading for the BDI recorded since the aftermath of the global financial crisis in 2009/10.

A reading below zero implies deteriorating business debt conditions and, as such, the -0.864 reading for Q4 continues to reflect a significant worsening of the financial position of businesses, even if less acute than what was experienced in the preceding two quarters.





	Q4 2019*	Q1 2020*	Q2 2020*	Q3 2020*	Q4 2020
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.186	-0.300	-3.727	-1.401	-0.864

** Revised*

Macroeconomic factors influencing Q4 2020

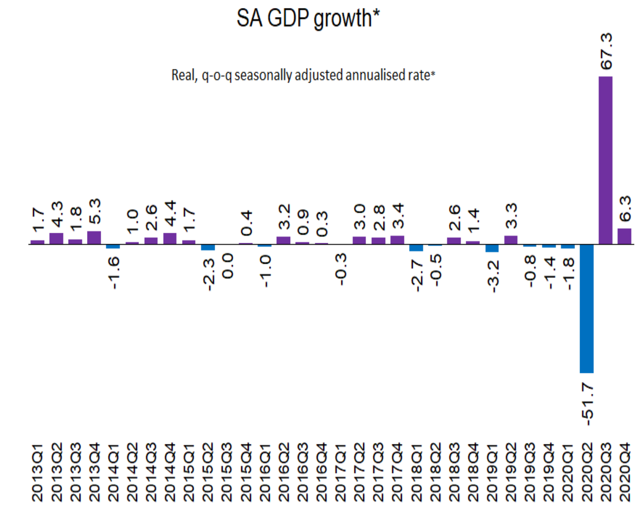
Essentially, the economy was already in recession before the onset of the COVID-19 crisis and this is reflected in the fact that negative readings for the BDI were already being recorded in the second half of 2019 and Q1 of 2020.

The extraordinarily stringent lockdown of the economy between late March and May 2020, forming part of level 5 which was aimed at staving off the spread of the coronavirus, caused virtually half of the economy to shut down at the time. It is no wonder that the BDI collapsed in Q2 of 2020 to -3.727, its lowest level ever. The huge improvement in Q3, albeit still with a substantially negative reading, reflected a relative diminution in business debt stress during that quarter.

Many restrictions on economic activity came to be progressively lifted and several businesses were able to resume operations that had been shut down during levels 5 and 4 of the lockdown. What the further improvement in Q4 signifies is a progressive further improvement, relatively speaking, in business debt conditions following a lifting of still more restrictions.

Towards the end of August, interprovincial travel was once again freed up and from the beginning of October, international travel, under certain stringent conditions, was also allowed for the first time in more than six months. In addition, social distancing restrictions on restaurants and hospitality establishments were eased, as too were the restrictions on the sale of alcoholic drinks. Although some of these restrictions were reimposed in mid-December and strengthened further in late December, the impact on the economy's Q4 performance did not really have time to filter through and is only likely to have manifested itself in Q1 of 2021.

In the event, Q4 GDP exceeded expectations, recording q/q annualised growth of 6.3%, on top of the extraordinarily steep recovery growth rate of 67.3% in Q3. Contributing to the better-than-expected Q4 growth rate domestically was not only the further lifting of local lockdown restrictions, but also a better-than-expected global economic outcome.



Source: South African Reserve Bank

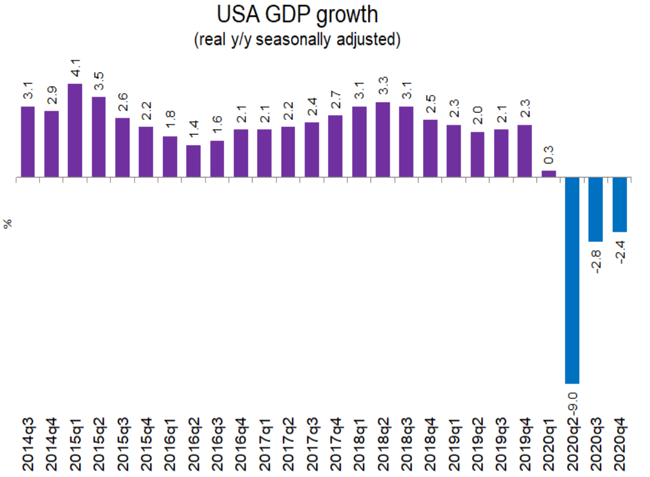
Firstly, East Asian economies began building growth momentum quite strongly as they had not been as negatively affected by the COVID-19 crisis as Western economies. South Africa's manufacturing exports benefitted from this. Furthermore, strong demand for metals and minerals which South Africa produces resulted in a firmly rising trend in the Dollar prices of these commodities, enhancing South Africa's trade performance.

Secondly, the earlier-than-anticipated announcement of the development of vaccines to fight the COVID-19 virus surprised businesses and brought the timeframe for a return to a semblance of more normal economic activity globally forward.

Thirdly, the election of Joe Biden as president of the United States encouraged the belief that the US government would embark upon massive fiscal stimulus to replace the stimulus that had been introduced at the beginning of the COVID-19 crisis almost a year ago and which was about to lapse.

These developments resulted in the Q4 BDI coming in significantly stronger than had been anticipated. Whilst it had been expected that the BDI would show some further improvement in Q4, the better-than-expected domestic and foreign GDP outcomes for Q4 resulted in the improvement in the BDI for Q4 turning out to be substantially stronger than what had been forecast. Specifically, the y-o-y GDP growth rate domestically for Q4 was published as -4.1%, which was significantly less negative than the -5.9% growth rate for Q4 that had been expected and considerably better than the -6.2% Q3 growth rate.

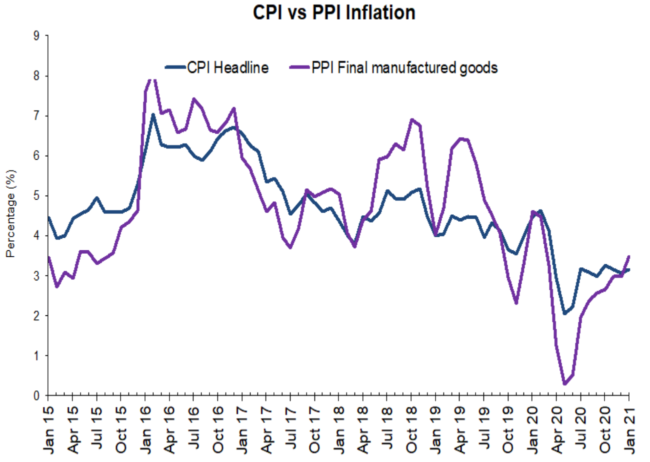
Also in respect of US GDP growth, the Q4 figure, at -2.4% q/q annualised, was materially stronger than the -2.9% growth recorded in Q3.



Source: Bureau of Economic Analysis

These significantly better-than-expected growth outcomes for both the South African and US economies were the main drivers for the materially improved Q4 BDI figure compared with Q3.

There was an additional positive macroeconomic input, namely the sharp rise of the South African PPI relative to the CPI in Q4. The differential between the two narrowed to -0.27%, from -0.82% in Q3, signifying a marked improvement in perceived profit margins of businesses.



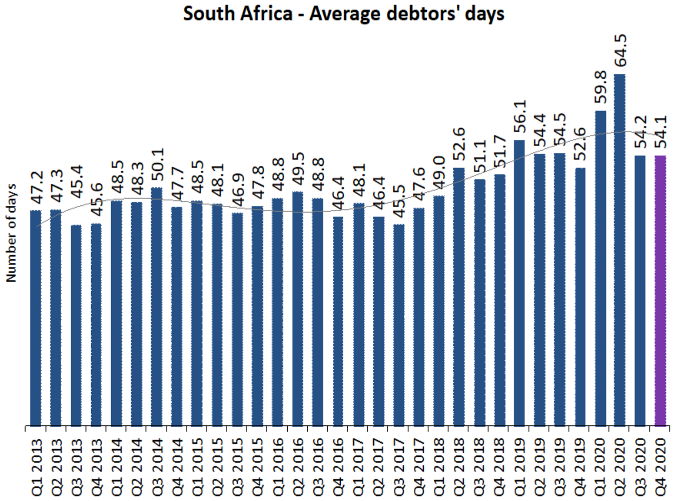
Source: StatsSA

On the negative side, the gap between short-term and long-term interest rates (i.e. between the R208 bond yields and the repo rate) narrowed slightly to 0.10%, from 0.23% in Q3, but this impact was marginal compared with the positive impulses from the growth and inflation factors. There was virtually no change in the relationship between domestic and US short-term interest rates, which remained at 3.41% and therefore had little impact on the BDI.

Business debt metrics in Q4 2020

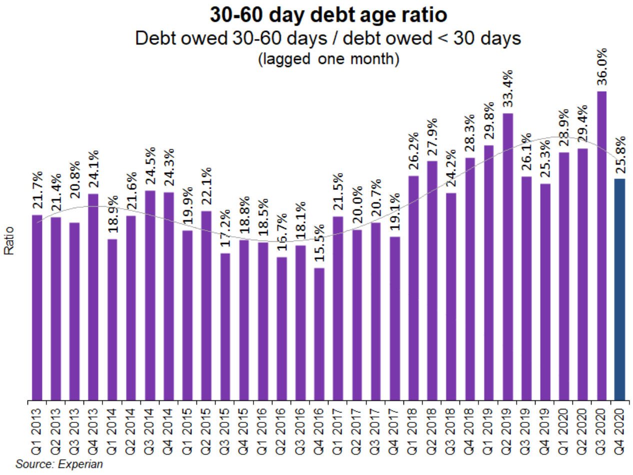
By and large, the debtor day inputs from Experian into the BDI also had a positive influence.

Overall, the number of outstanding debtors' days on average declined marginally to 54.1 in Q4 from 54.2 in Q3, with both these figures being sharply down on the 59.8 of Q1 and the 64.5 outstanding debtors' days of Q2. Relatively speaking, this suggested an improvement in the financial position of businesses in terms of their alacrity to repay debtors.



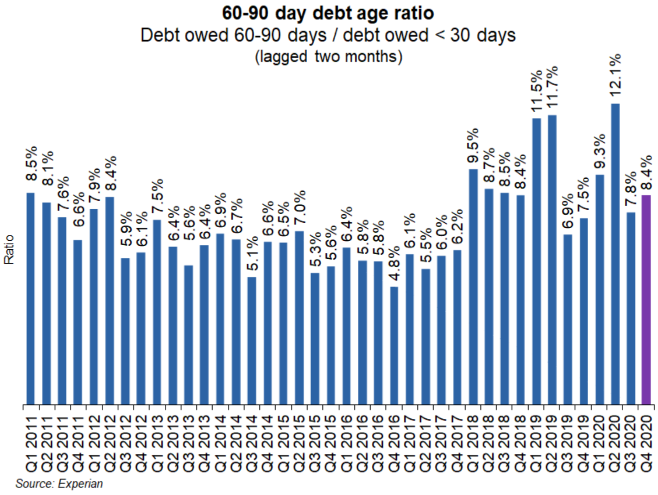
In terms of the measurement of the BDI specifically, a significantly positive impulse was provided by the decline in the **30 to 60 days ratio**[1], from 36.0% to 25.8%.

[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*



Source: Experian

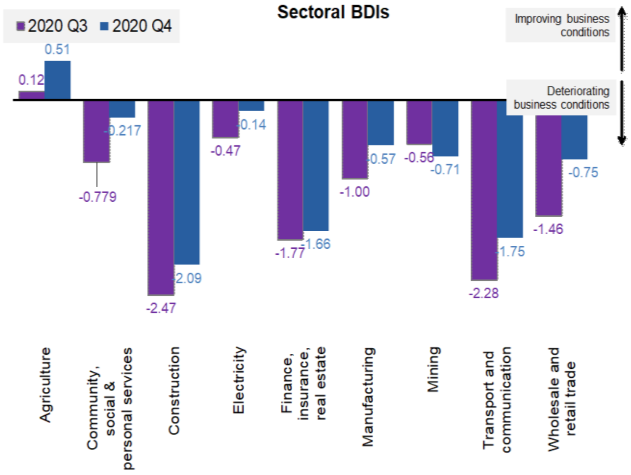
Although the **60 to 90 ratio**[2]increased slightly to 8.4% in Q4 from 7.8% in Q3, both figures were sharply down on the 12.1% ratio that prevailed in Q2. The pickup in the ratio of 60 to 90 days relative to less than 30 days was, however, nowhere sufficient to neutralise the positive impact on the BDI of the steep decline in the ratio of outstanding debtors' days of 30 to 60 days relative to debt owed of less than 30 days.



Source: Experian

In summary, there was a material improvement in the implied business debt conditions based on the Experian data on the number of outstanding debtors' days owed. This finding complemented the finding from the macroeconomic inputs into generating a substantial diminution in the rate of deterioration of business debt conditions in Q4 relative to Q3, with both of these having reflected a vastly improved relative situation compared with Q2.

BDI by sector

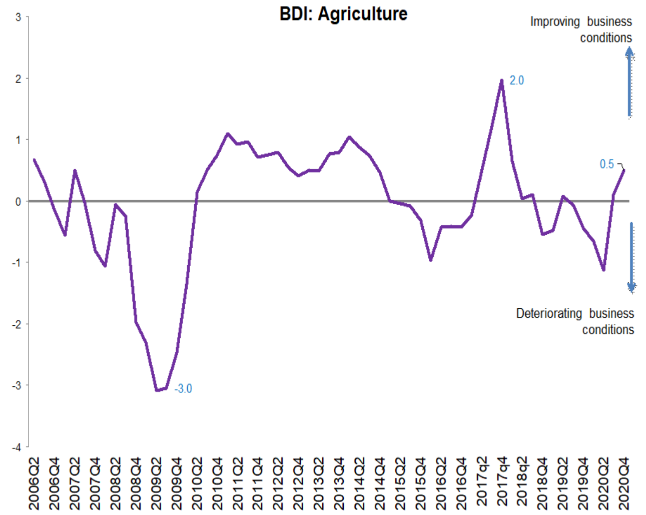


From a sectoral perspective, the improvement in business debt conditions seen in Q4 was reflected by almost all sectors except for mining.

A contraction in mining output during Q4 clearly held back the relative improvement in debt conditions in this sector.

On the other hand, the improvement in business debt conditions in all the other sectors is a reflection of the positive impact of the lifting of further lockdown restrictions that had knock-on effects in most areas of economic activity.

Notwithstanding the improvement in the BDIs of most sectors, it was really only the agricultural sector that recorded a positive BDI in Q4, in the same way as it had done in Q3. This is a direct reflection of the fact that the agricultural sector was the only one in the entire economy that recorded positive growth through the course of 2020. At no stage was there a ban on sales of

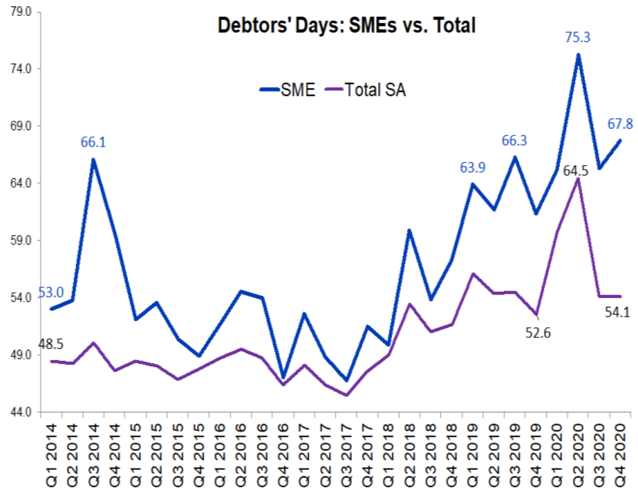


[2] *Outstanding debt owed of 60 to 90 days relative to debt owed of less than 30 days lagged by two months*

food during the COVID-19 crisis. Furthermore, climatic conditions were very favourable for substantial crops in most areas of agriculture in South Africa in 2020. This stands to continue to 2021 following fairly widespread rains during the summer rainfall season just elapsed.

BDI by company size

The one area where there was a relative deterioration in performance in Q4 was in respect of SMEs. The average number of outstanding debtors' days increased from 64.5 to 67.8 between Q3 and Q4 whereas the average for the overall sample actually declined marginally from 54.2 to 54.1. The SME stress ratio as a consequence increased to 30.3 from 24.1 between the two quarters.



Whilst this stress ratio was still significantly below the peak level of 39.2 seen in Q2, it was nonetheless still the second-highest on record. The inference to draw from this is that the relative improvement in business debt conditions experienced in Q4 was weighted towards larger businesses rather than smaller ones.

In particular towards the end of December, the renewed tightening of restrictions, especially on travel to the coast for the December holidays, probably impacted proportionately far more on smaller businesses dependent on holiday travel than on the overall business situation in the country. Hopefully, the lifting of these restrictions from February onwards might see a relative improvement in the overall performance of small businesses.

Even so, a general conclusion to draw regarding the damage inflicted on business by the COVID-19 crisis is that poorer sections of society and smaller businesses suffered more than the middle and upper-income groups and larger businesses. Inequality was exacerbated by the virus. Job losses and salary cuts were proportionately far more evident in the lesser-educated working-class and informal segments of the economy than in the more skilled and educated segments of society where jobs are by and large been retained and income enhanced by an accelerated build-up of wealth on the back of higher asset prices generated from the massive injections of liquidity by the world's leading central banks.

Summary and Outlook

Looking ahead, the model sees a further slight improvement in the BDI in Q1 of 2021, although still in negative territory. This is based on expectations of a further improvement in the global economy associated with the accelerated vaccination of populations in developed economies and the massive further fiscal stimulus provided by governments, most notably the United States.

Domestically, there is likely to be additional impetus for growth derived from the substantial relaxation of lockdown restrictions introduced on 1 February 2021 by the government in response to a fairly dramatic fallback in the rate of COVID-19 infections. Restrictions on trade in alcoholic drinks were removed and there were substantial increases in the number of people allowed to gather at funerals, church services and political rallies.

Even so, it is important to reflect on the fact that, with the BDI still below the zero-level, the level of business debt conditions is still deteriorating at a reasonably brisk pace, even if this is vastly less pronounced than it was a few months ago.

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.