BDI Debt Index summary

Q1 2018

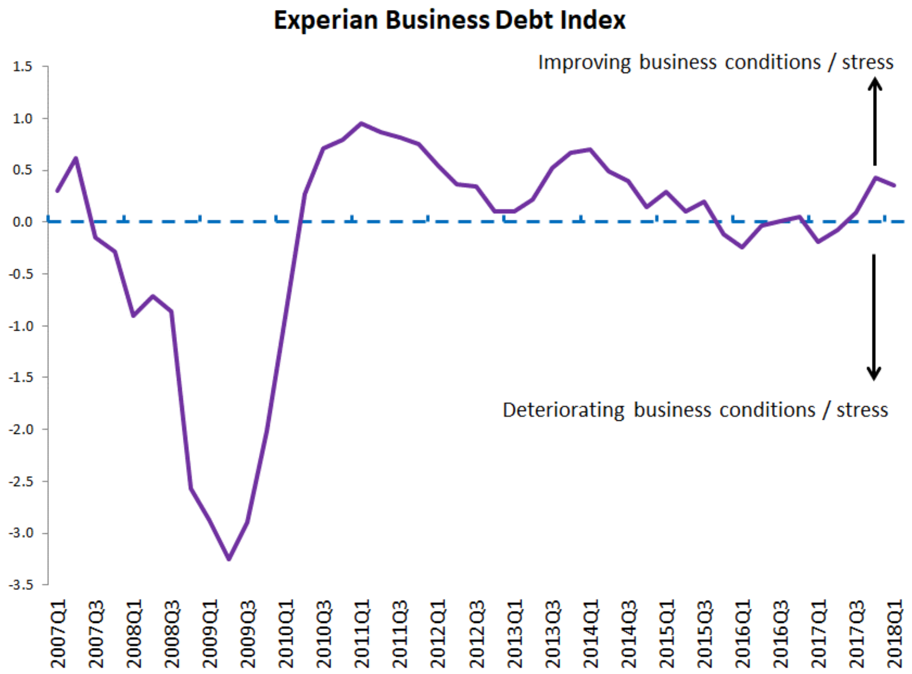
powered by

ECONOMETRIX (PTY) LTD

EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2018

Despite decline, BDI indicates improving business debt conditions

The Experian BDI, which aims to measure the financial conditions of the business sector, showed a slight decline in Q1 2018, at 0.360, compared with 0.430 in Q4 2017. Nonetheless, even at the slightly lower level, the BDI for Q1 2018 remained firmly in the realm of improving business debt conditions, as defined by an outcome that was well above the zero level, which distinguishes between improving and deteriorating business debt conditions.



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Index >0= Improving business conditions <0 = Deteriorating business conditions	**-0.191***	**-0.079***	**0.096***	**0.430***	**0.360**

* *Revised*

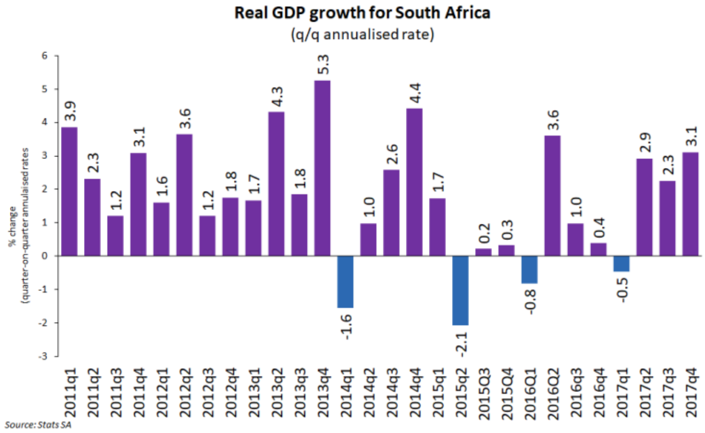
The still substantially positive BDI for Q1 2018 should be seen in the context of the fact that the index had risen sharply and encouragingly in Q4 2017 to its best level (at 0.430) in more than four years, after having been barely positive in Q3 2017, and this in turn had reflected a meaningful improvement from negative levels in the first two quarters of 2017.

In other words, the financial state of business improved meaningfully through the course of 2017 from a deteriorating dispensation, to one of improvement and only fell back modestly in Q1 2018. As it is, the reading for Q1 2018 was the second best such reading in four years (second only to the higher Q4 2017 figure).

The BDI continues to be supported by macroeconomic conditions, largely attributable to a marked turnaround in economic growth for the better both in South Africa and abroad. Unfortunately, the positive impulses from the macroeconomic environment were not replicated by the Experian data on outstanding debtors' days.

Macroeconomic factors influencing Q1 2018

The macroeconomic environment improved in the final quarter of last year following substantial upward revisions by Statistics South Africa of economic growth domestically. These upward revisions occurred for every one of the four quarters in 2017 and assisted in providing upward revisions for the BDI. Internationally, similarly, growth turned out to be stronger than previously anticipated, with the US economy surprising on the upside, recording growth of 2.9% in Q4 2017.

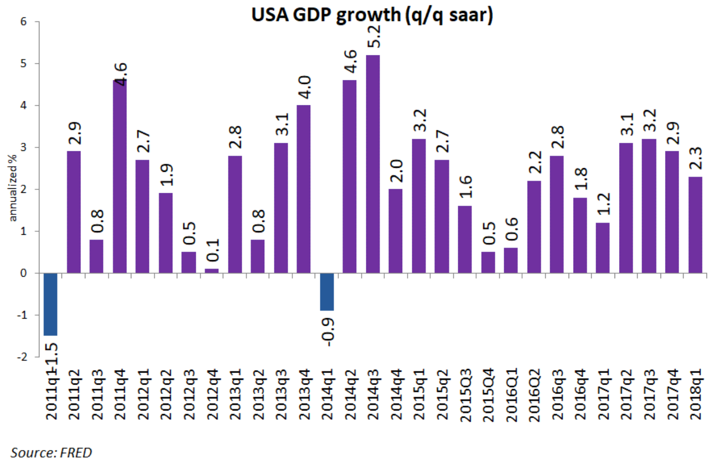


Besides the statistical upward revision of economic growth, growth was boosted late last year by the lagged effects of the ending of drought conditions as well as the sharp recovery in the mining sector following a dismal 2016.

In addition, growth benefited from the fact that inflation turned out to be lower than anticipated on the back of a reduction in food inflation, subdued fuel prices and a rand that posted more substantial appreciation than had been expected. The fall in inflation also helped business debt conditions by inducing an expectation of reduced interest rates, a fact which indeed came to pass subsequently in Q1 2018. Internationally, the pickup in growth came primarily from a better than expected outcome in the US, driven by $1.5 trillion worth of tax cuts by the Trump administration.

The macroeconomic environment improved in the final quarter of last year and assisted in providing upward revisions for the BDI

Another macroeconomic factor which boosted the BDI was the fact that long-term interest rates rose relative to shorter term interest rates. This is usually taken as a classic signal of improved prospects for economic growth. Higher long-term interest rates are meant to be a function of stronger long-term growth prospects which might push up inflation.



The BDI was also boosted by the fact that the PPI inflation rate fell more sharply than the CPI inflation rate, implying improved margins for businesses as a result of the rate of increase in their cost structures declining faster than their revenues.

Business debt metrics in Q1 2018

The positive impulses from the macroeconomic environment were not replicated by the Experian data on outstanding debtors' days in Q1 2018. In the case of both debt age ratios, upward revisions more than neutralised the impact on the BDI of upward revisions to economic growth.

One might also like to think that part of the reason for the extension of the duration before which businesses began to meet their debt commitments in Q1 2018 might have been linked to an improvement in business confidence in the New Year following a change in leadership in the country. Which was perceived by the business sector to enhance the likelihood that the country might begin tackling the structural impediments to higher economic growth more effectively.

Consequently, businesses may have begun committing more working capital to new projects and thus might have become more inclined to delay payment of their existing debts.

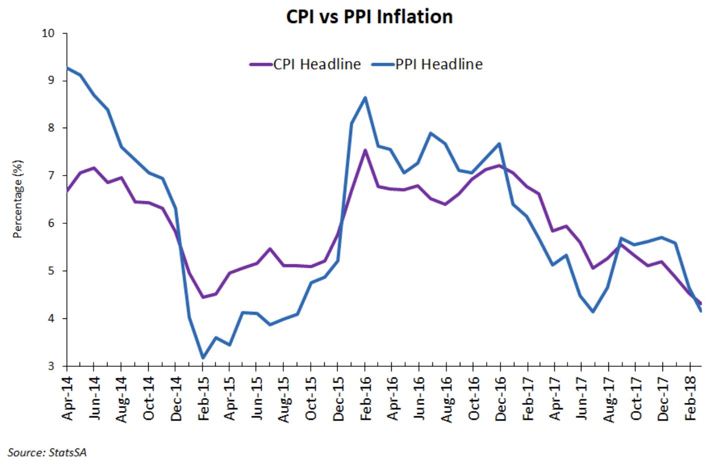
Debtors' days

The average number of debtors' days increased from 48.0 days in Q4 2017, to 50.7 days in Q1 2018. This was the highest number of outstanding debtors' days for any quarter since Q2 2012.

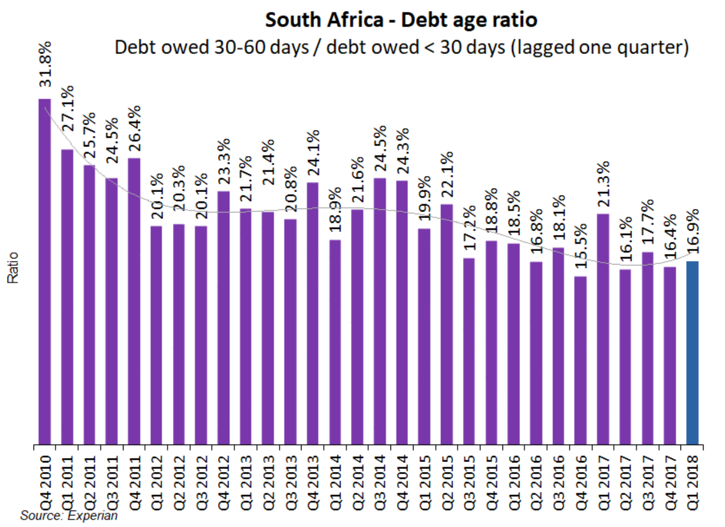
Debt age ratio[1]

There was an especially steep increase in the ratio of debts owed of between 60 and 90 days relative to debts owed of less than 30 days lagged by two quarters, the "60-90 day ratio". This ratio shot up to 6.8% in Q1 2018 from 5.5% in the previous quarter and a low point of 4.8% in Q4 2016.

The increase in outstanding debtors' days was not as severe in the case of shorter term debt. This can be seen in the fact that the ratio of debt owed of for 30 to 60 days relative to that owed for less than 30 days, the "30-60 day ratio", increased only slightly, to 16.9%



Increases in the case of both outstanding debtors' days ratios, more than neutralised the impact on the BDI of upward revisions to economic growth



[1] *Two ratios directly impact the BDI calculation: **1.)** the ratio of loans outstanding of 30 to 60 days relative to that of less than 30 days, lagged by one quarter (the "30-60 day" ratio). **2.)** debt owed of 60 to 90 days relative to debts owed of less than 30 days, lagged by two quarters. Colloquially the "60-90 day ratio".*

in Q1 2018, from 16.4% in Q4 2017. Despite increasing in Q1 2018, this ratio was still lower than the ratios recorded in earlier quarters last year.

BDI by sector

Closer analysis of the BDI by sector reveals that the biggest contributor to the deterioration in overall BDI was sharp declines in the BDI for agriculture and mining.

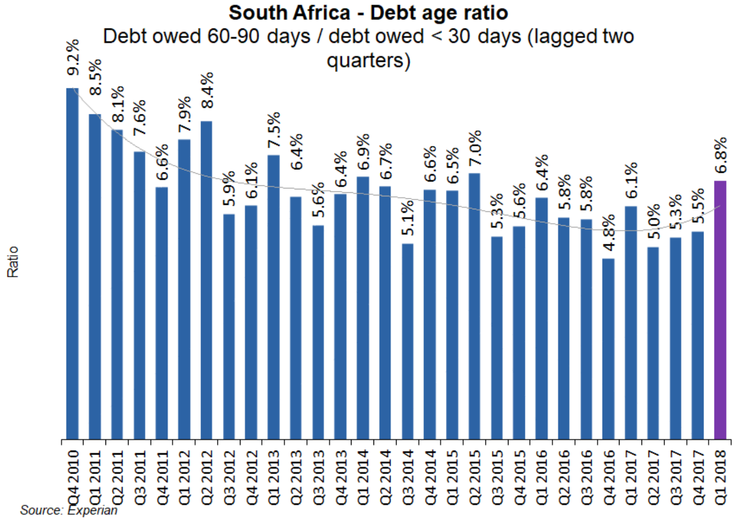
To some extent this is not unexpected. The BDI readings for these two sectors had risen dramatically in earlier quarters following a recovery in production in these sectors over the course of 2017. Statistically, growth in these sectors was bound to subside to more normal levels. After surging to an unprecedented BDI of 1.676 for Q4 2017, the BDI for agriculture plummeted to just 0.427.

Underlying this is the fact that the ratio of outstanding debtors' days of 60 to 90 days relative to those of less than 30 days rocketed from just 7% in Q4 2017 to 18% in Q1 2018. This massive lengthening of the debt profile in the agricultural sector can be a function of two possible factors.

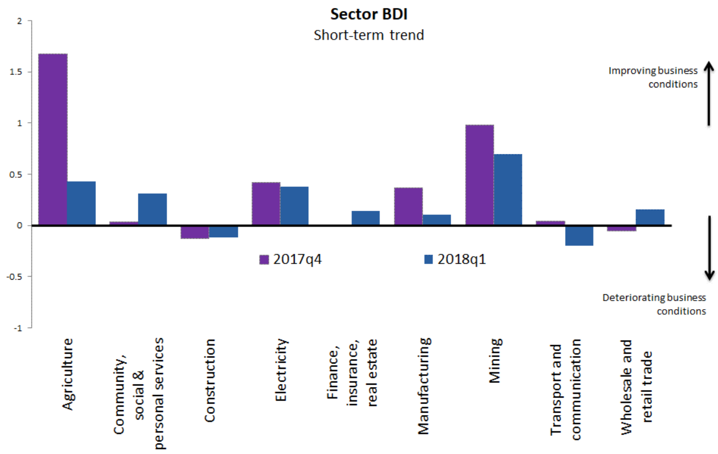
- Firstly, the drought in the Western Cape might have contributed towards financial strain amongst some of the farming communities in that region which may have impacted on the overall figure.
- Secondly and speculatively, there have been anecdotal reports of commercial farmers extending their debts in order to pass the perceived and growing financial risk of land expropriation without compensation to the banking sector and away from themselves.

Be that as it may, the plunge in the agricultural BDI was the single biggest such deterioration recorded in the most recent quarter. There was also a substantial decline in the BDI of mining, but as with the agricultural sector, one must bear in mind that the decline in the BDI in mining also came off a very high base from the previous quarter.

Linked to the slowdown in the improvement in business debt conditions in mining and agriculture was a fairly substantial decline in the BDI for manufacturing and to a lesser extent electricity. The two sectors which

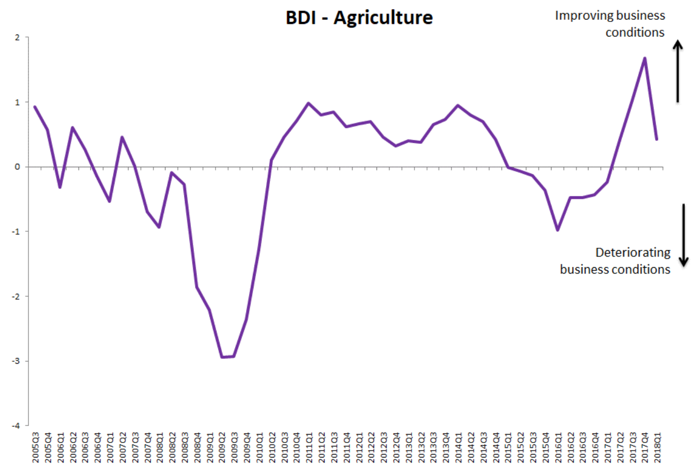


There was an especially steep increase in the "60-90 day ratio". This ratio shot up to 6.8% in Q1 2018, from 5.5% in Q4 2017



reflected a continuing deterioration in business debt conditions were construction and transport and communication, reflecting the parlous financial state of state-owned enterprises and their reluctance to extend themselves financially on investment projects. These tend to be lagging indicators of the overall economy.

On the other hand, the readings for the BDI's of the services sectors improved, with the most notable being in respect of community services. This improvement might be linked to the reduction in the time taken by government departments to make payments for services rendered following criticism regarding the length of time taken to pay in the past which has hampered small businesses. Other services sectors such as community services, finance and the retail trade, also saw significant improvements in their debt profiles. The increase in the BDI for the retail and wholesale trade is also replicated in the astonishingly strong performance of retail sales in Q4 2017.



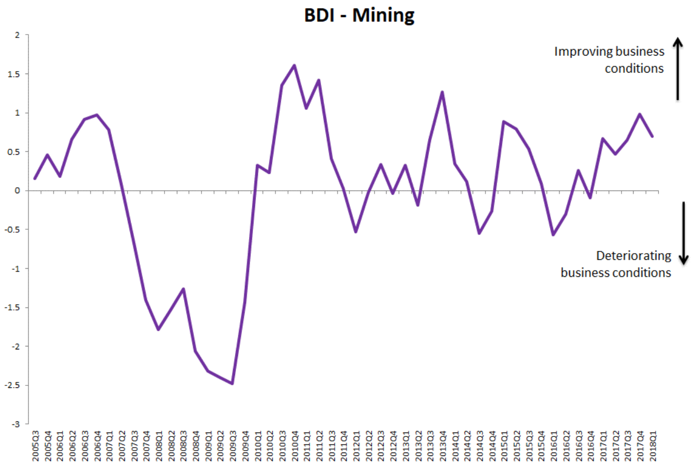
BDI by company size

What encourages one to believe that the most important reason for the slight deterioration in the BDI in Q1 2018 were the sharp decreases in the BDI for agriculture and mining, is the fact that the business debt conditions of SMEs improved relative to the overall business population.

Closer analysis [...] reveals that the biggest contributor to the deterioration in overall BDI was sharp declines in the BDI for agriculture and mining

Companies involved in these two sectors tend to be large. In contrast, the number of outstanding debtors' days for small businesses actually fell to 48.5 Q1 2018, from 50.1 for the overall number of businesses.

This contrasts with the above-mentioned overall increase in the number of outstanding debtors' days, from 48.0, to 50.7. Similarly, the ratio of debts outstanding of less than 60 days compared with debts outstanding of more than 90 days for SME's rose sharply for a second consecutive month, to 11.2%, from 9.6% and 8.0% respectively for the preceding two quarters.



Summary and Outlook

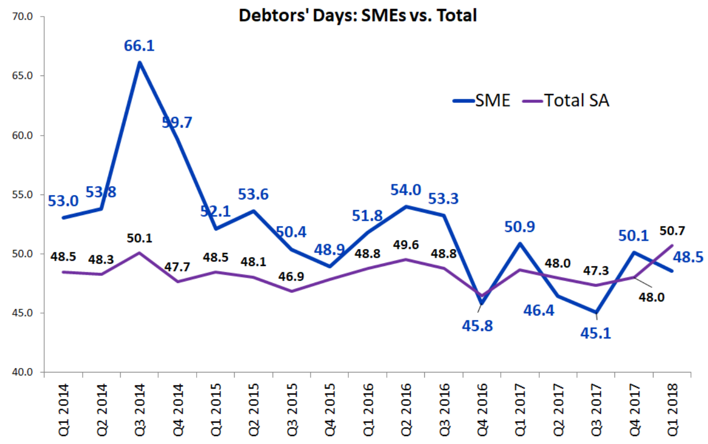
In light of the sharp improvement in business confidence in the New Year, one might have contemplated that the outlook for the BDI would improve still further.

However, this is not the case. Precisely because of the unexpectedly sharp increase in economic growth in the second half of 2017, one is likely to see growth falling back slightly during the initial stages of 2018 for purely statistical reasons linked to comparison against a high base in earlier quarters.

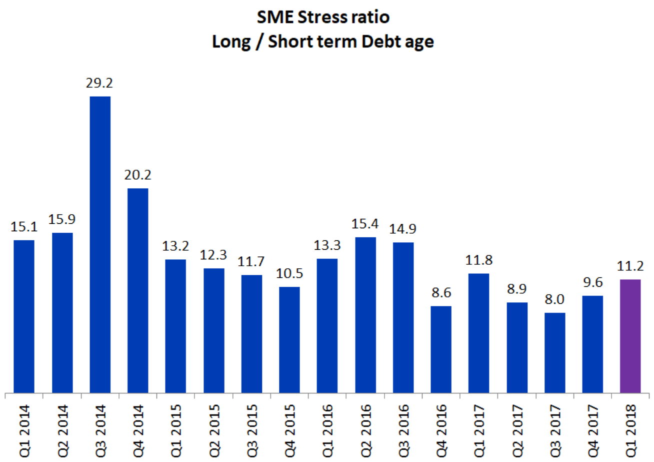
Already we know that US GDP growth fell back to 2.3% in Q1 2018, from 2.9% in Q4 2017. Similarly, initial data on mining, manufacturing and electricity production, as well as retail and wholesale trade sales, point to the likelihood that GDP growth domestically will have dropped back significantly in Q1 2018.

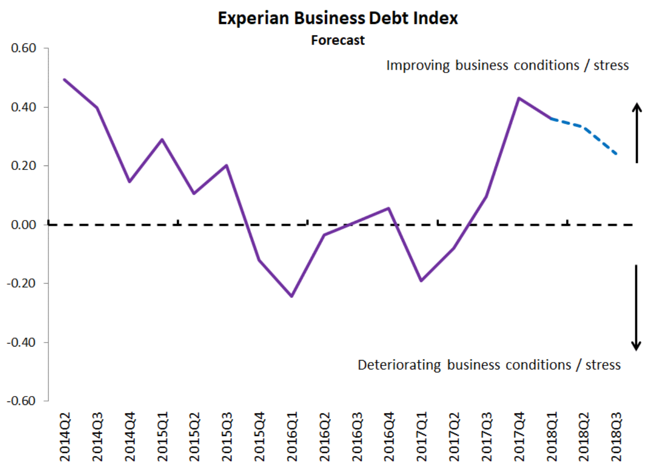
Furthermore, if indeed businesses continue to commit more funding to their operations in an improved political climate, it is conceivable that there will have been pressed to extend the repayments of their debts. In line with these assumptions, our model sees a slight further slowdown in the rate of improvement in business debt conditions for the next two quarters, with the BDI projected to decline from 0.360 in Q1 2018, to 0.332 and 0.243 in the second and third quarters.

It should nonetheless be borne in mind that even the slower figures still reflect improvements in business debt conditions, just not at the frenetic recovery pace seen in Q4 2017. Such a more moderate outlook would also be endorsed by signs of renewed weakness in the rand with potential inflationary pressures, with the latter being exacerbated by an increase in the rate of VAT and the sharp recent escalation in world oil prices. Internationally also, concerns relating to the escalation of protectionism between the world's leading economies, poses a threat to the continuation of faster global economic growth.



The number of outstanding debtors' days for small businesses actually fell to 48.5 Q1 2018, from 50.1 for the overall number of businesses





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 its 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 cost decreases 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 close to 30 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 complimentary 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.

Contact details

Analysis – Econometrix +27 11 483 1421 jefferyd@econometrix.co.za

Enquires – Experian South Africa +27 11 799 3400 taryn.stanojevic@experian.com

Next release date for the BDI: Aug 2018

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.