Experian Business Debt Index (BDI) Results. Q2 2015

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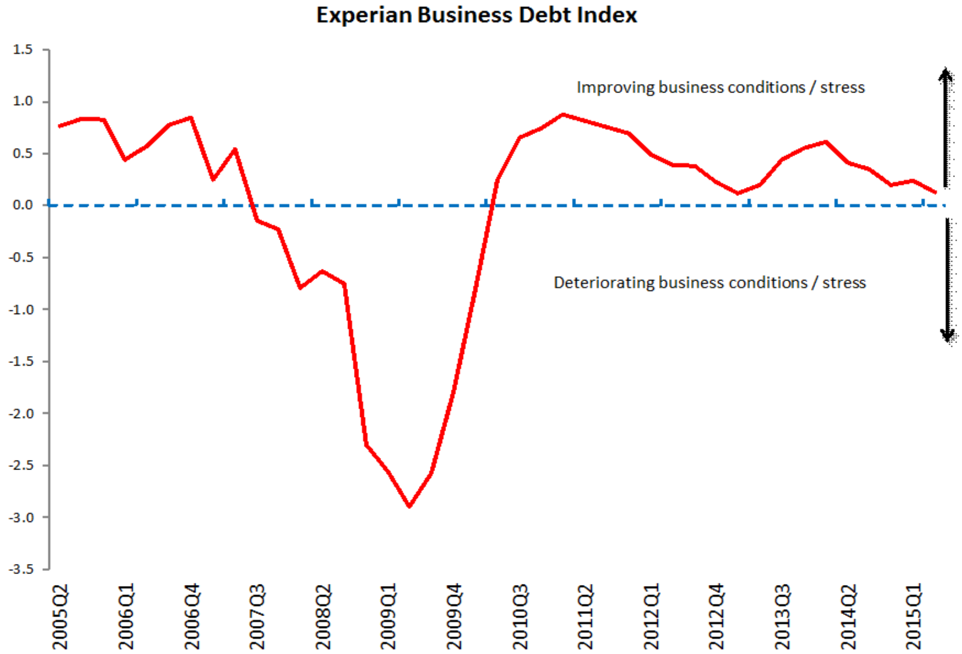
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q2 2015

Declining trend in financial health of businesses continues in Q2 2015, with the BDI falling close to 0

Chart 1



	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.408*	0.344*	0.200*	0.237*	0.127

* *Revised*

Introduction

Amidst a declining economic growth rate and falling business confidence, the South African economy has been characterised by relatively healthy financial conditions in the business sector overall.

For a number of years now, the financial health of businesses has been solid and improving. Part of this has been attributable to the recognition on the part of business people that structural factors inherent in the South African economy, together with the dampening long-term growth implications of the global financial crisis seven years ago, would limit the growth of the domestic economy.

Accordingly, they have refrained from aggressive capital investment beyond what is absolutely necessary and have instead ensured stability in their balance sheets to cope with difficult economic circumstances. Nowhere had the improvement in the financial health of the business sector been reflected better than in the average number of outstanding debtor days, which declined from a peak of 59.9 in the 1st quarter of 2009, to a low point of 45.4 days in the 3rd quarter of 2013.

Nonetheless, the steady overall deterioration of the domestic and international growth environments has been such that in recent times one has detected ever less improvement in the financial health of businesses.

This has been reflected in the declining trend of the Experian Business Debt Index over the past year. Although the index has remained above the zero level

- which distinguishes between improving and deteriorating financial health - it has steadily fallen to the point where it is now quite close to zero.

Outcome for Q2 2015

In the 2nd quarter of 2015, the Experian Business Debt Index (BDI) declined to 0.127, from 0.237 in the 1st quarter and a recent peak of 0.608 in the 1st quarter of 2014. Although the Q2 reading has remained above the 0.0 level, which distinguishes between improving and deteriorating business debt conditions, the reading was the lowest since the financial crisis in 2009 when the index reached negative levels (with the exception of 2013 Q1).

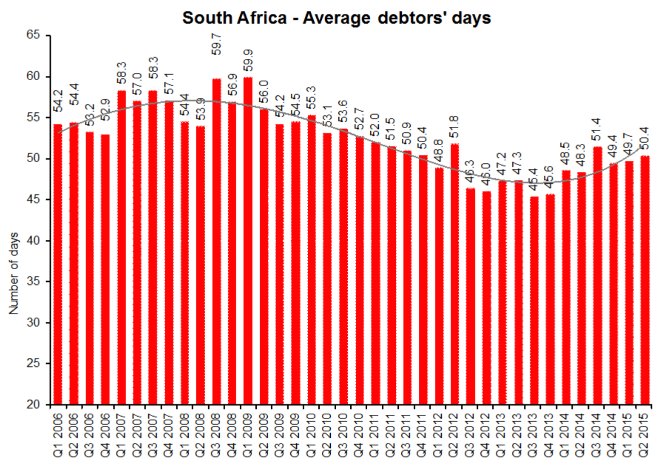
In other words, the rate of improvement in business debt conditions has indeed diminished significantly in line with worsening economic conditions both domestically and abroad.

Business debt metrics in Q2 2015

This relative deterioration has gone hand-in-hand with a gradual increase in the number of outstanding debtor days from the 43.6 days for October 2013 to 51.4 days in May.

Although June witnessed a countervailing reduction, to 49.2 days, the average number of outstanding debtor days in the 2nd quarter of 2015, of 50.4, was the highest in the past two years and was moderately greater than the 49.7 average outstanding debtor days in the 1st quarter.

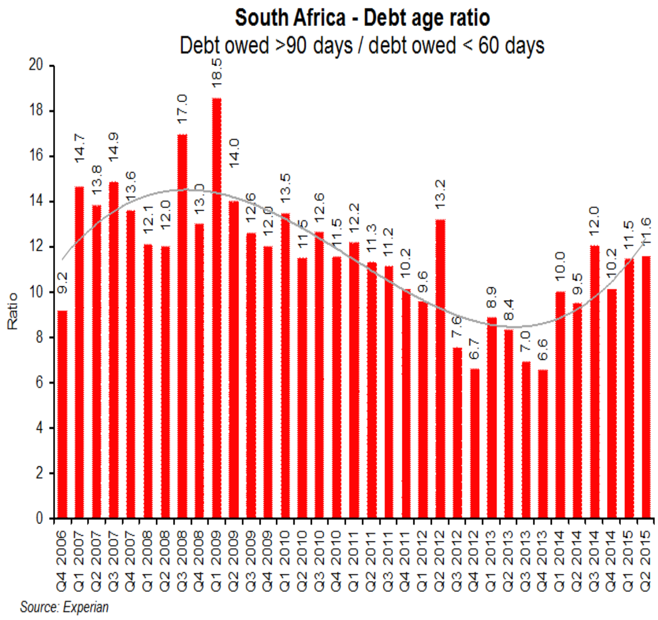
Chart 2



There were other corresponding metrics reflecting a gradual slowdown in the rate of improvement of business finances. The share of debts outstanding of 30 to 60 days as a percentage of those outstanding for less than 30 days rose to 19.7% in the 2nd quarter, from 16.9% in the 1st quarter.

Similarly, the number of debts outstanding for more than 90 days relative to those outstanding for less than 60 days increased to 11.6% in the 2nd quarter of 2015, from 11.5% in the 1st quarter and a mere 6.6% in the fourth quarter of 2013.

Chart 3



While the 19.7% and 11.6% figures for these ratio measurements of financial health were admittedly respectively still significantly lower than the 40% and 14% ratios which typically prevailed prior to the global financial crisis, the deteriorating trend is undeniable.

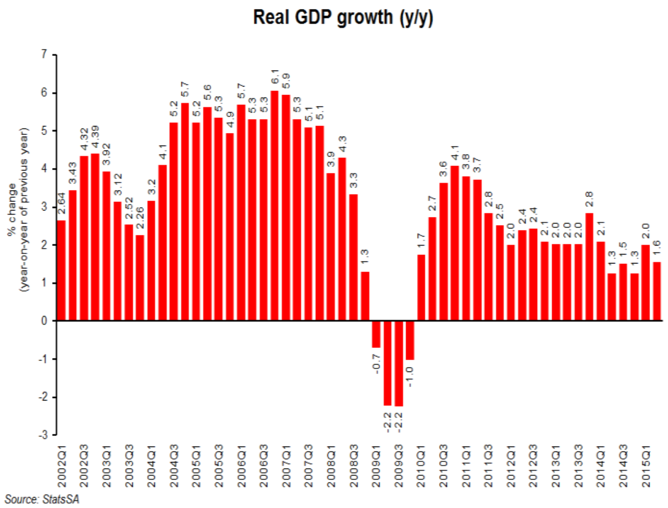
Macroeconomic factors influencing the Q2 2015 BDI

In calculating the BDI, however, we go beyond just limiting the assessment of the financial health of businesses.

The index is made up of a combination of metrics directly relating to alacrity in repaying debt and a series of macroeconomic measurements imputed to reflect financial conditions in the business sector.

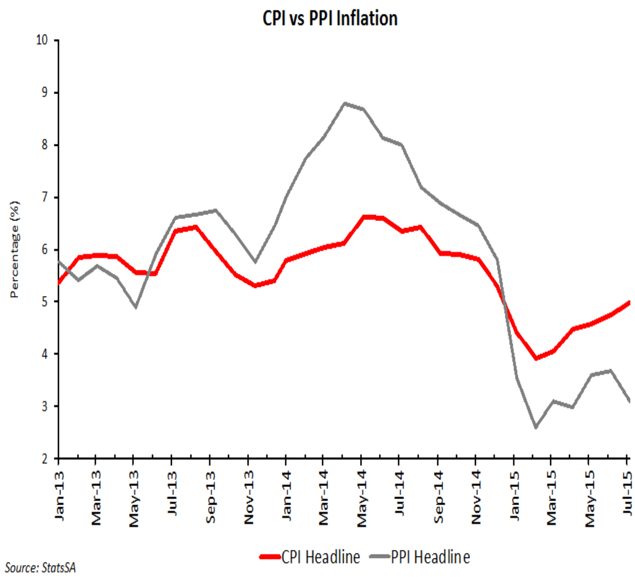
In this regard, there was a definite deterioration in the overall macroeconomic environment in the 2nd quarter. Obviously, most notable as determinants of the overall macroeconomic environment are global and domestic economic growth rates. Both declined perceptibly in the 2nd quarter, with that of the domestic economy particularly steep, down to 1.6% on a year-on-year basis, from 2.0% in the 1st quarter (on a q/q seasonally adjusted annualised basis growth fell to -1.3%, from 1.3% in the 1st quarter).

Chart 4



The tightness of the economic environment was also reflected in the widening disparity between consumer price inflation and producer price inflation. The latter remained considerably lower than the former, indicating the extent of the pressure on pricing power within weak demand conditions in the economy.

Chart 5

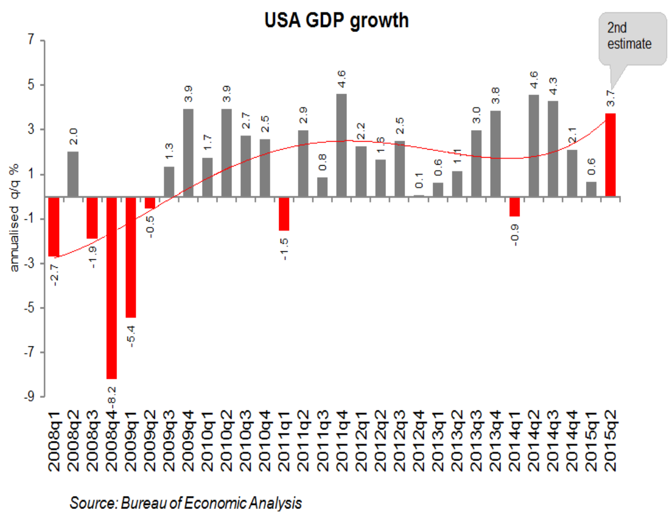


The only factor which ostensibly pointed to an improvement was the widening discrepancy between short and long-term interest rates. Normally when long-term interest rates rise relative to short-term interest rates, this represents an indication of relative strength in the economy that tends to ignite inflationary pressures and the expectation that interest rates will rise in the longer term because of improving economic conditions.

However, in the 2nd quarter the rise in long-term interest rates was brought about more by fears of inflation increasing due to currency depreciation than due to any expectations of significant improvements in the longer term growth outlook.

Interestingly, the same kind of macro-economic impulse improvement emanated from the US economy, where q/q seasonally adjusted annualised GDP growth also rose in the 2nd quarter of this year, compared to a plunge in growth in the world's largest economy in the 1st quarter to 0.6% (Chart 3).

Chart 6



BDI by sector

Five of the sectors for which the BDI was measured posted some improvement and four deteriorated, but there were no major swings.

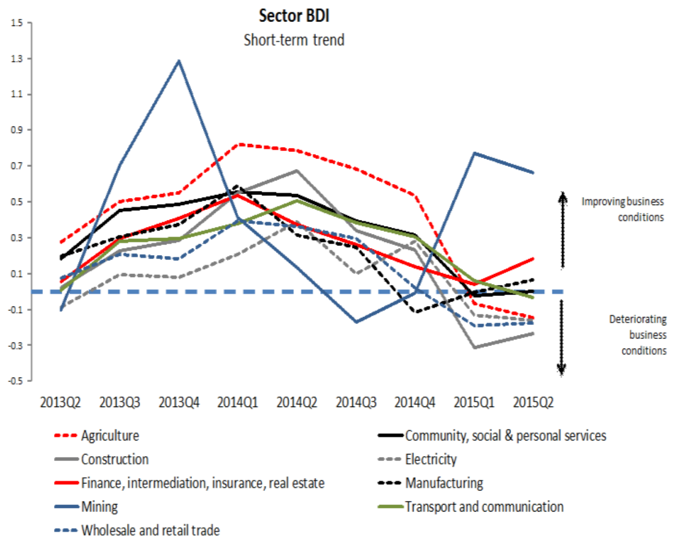
The dramatic recovery in the BDI for the mining sector following the ending of the series of strikes in the mining and manufacturing sectors in the first three quarters of 2014 began to fade in the second quarter of 2015.

Given the intensification of drought conditions, it is no wonder that the agricultural sector saw a faster deterioration in financial conditions. The same applied to the wholesale, retail, accommodation and restaurants sector, presumably driven mainly by the

sharp falloff in foreign tourism associated with the Ebola scare and the installation of tighter visa requirements for foreigners. Increased loadshedding and reduced demand for electricity saw this sector also recording a deterioration.

However, on the positive side, there were marginal improvements in financial conditions in manufacturing, transport, communications, community and social services, as well as financial and business services.

Chart 7



Outlook

Unfortunately the deteriorating trend of the BDI can be expected to continue during the second half of the year. Especially given the financial turmoil of recent weeks associated with scares about declining Chinese economic growth, the domestic business environment is bound to feel after-effects. Slower Chinese economic growth is depressing demand for raw materials which has resulted in lower commodity prices, which is bound to put downward pressure on the margins of resource companies, compelling them to reduce investment still further.

The knock-on effects of this are bound to reverberate through manufacturing and to a lesser extent other sectors of the economy. In addition, continuing disgruntlement with lack of implementation of the country's National Development Plan, which was aimed at addressing structural weaknesses in the economy, has, if anything, escalated more recently.

Under these circumstances, one fears that the 2nd quarter of 2015 might turn out to have been the last such quarter in which there may have been an overall improvement in financial conditions of businesses.

Our preliminary forecasts for the BDI project negative levels in the coming two quarters.

In conclusion, even the relative health of the business sector is set to gradually give way to poorer financial conditions on the back of the inability of the global and domestic economies to gain any traction.

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 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 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 way the index is constructed is first to demean the individual indices by 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. Secondly, 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 as a result of the change in the actual values of the variables in the original sample. This happens because the data are demeaned and standardised and as a result the value of the original sample will change as the sample mean and sample standard deviation of the variables changes.

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 2015, we were named by *Forbes* magazine as one of the 'World's Most Innovative Companies'.

We employ approximately 17,000 people in 38 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, 2015, was US$4.8 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.

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To be added to the mailing list for the quarterly BDI release please email Taryn.Stanojevic@experian.co.za.

Next release date for the BDI: 2 December 2015

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.