Experian Business Debt Index (BDI) Results. Q4 2015

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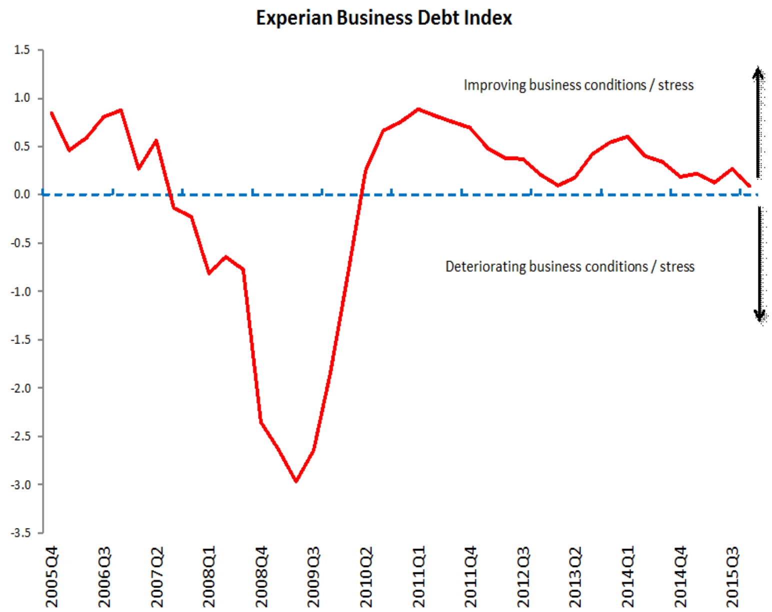
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q4 2015

Financial health of business at its worst since global financial crisis

Chart 1



	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.188*	0.218*	0.128*	0.263*	0.082

* *Revised*

Outcome for Q4 2015

In the midst of the worst economic performance for the South African economy since the global financial crisis of 2008/09, it is not surprising to see the relative financial health of the domestic business sector deteriorating in Q4 2015.

The Experian Business Debt Index (BDI) for Q4 2015 fell to its weakest level since the domestic economic recovery got underway in 2010 following the global financial crisis of 2008/09.

Nonetheless, the index was still marginally positive, suggesting that overall business debt conditions are not yet dire.

The BDI declined to 0.082 in Q4 2015, from 0.263 in Q3 and a recent peak of 0.6 in Q1 2014.

A positive reading implies an improvement in business debt conditions, whilst a negative reading should be interpreted as a deterioration in business debt conditions.

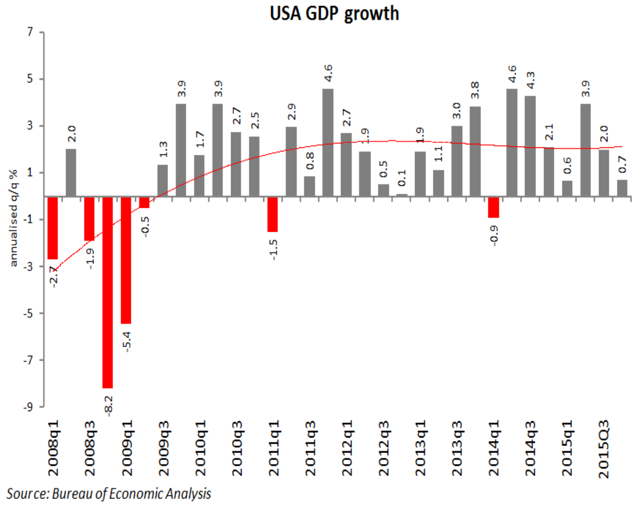
Unfortunately, even though the BDI still gave a marginally positive reading for the last quarter of 2015, the portents for 2016 are not good. One expects that the coming year will see a marked deterioration in business debt conditions.

Macroeconomic factors influencing the Q4 2015 BDI

A number of factors conspired to cause a reduction in the rate of improvement in business debt conditions in Q4.

Most importantly, strains arising from declining economic growth both globally and domestically through 2014 and 2015, were manifest.

Chart 2

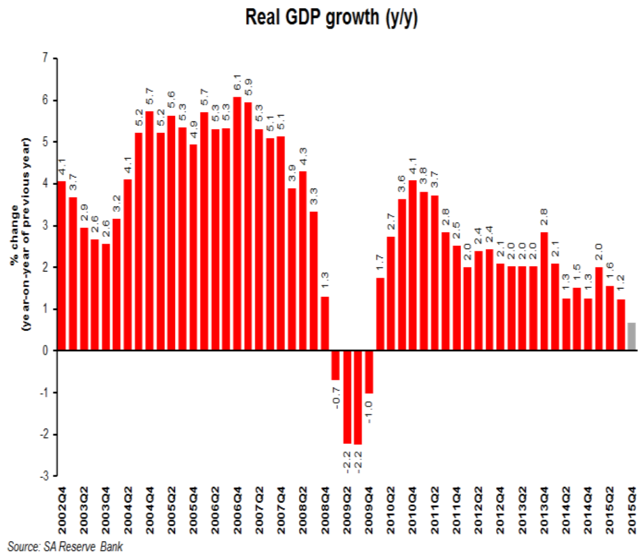


Domestic economic growth slowed, albeit not precipitously, thus preventing the dip in the BDI from being unduly sharp. We estimate that year-on-year growth in GDP declined to 0.6% in Q4 2015, from 2.0% in Q1.

This slowdown in South Africa's economic growth did not, however, occur in isolation.

One of the main causes of the slowdown in the South African economy was the slump in international commodity prices, driven in part by lower global economic growth and in particular a fairly significant slowdown in the Chinese economy.

Chart 3



The combination of these factors caused growth in exports to weaken, facilitating a sustained depreciation in the Rand's exchange rate, in particular against the developed economy currencies, during 2015.

This depreciation reignited inflationary pressures, obliging the Reserve Bank to increase interest rates, albeit by a modest 0.25%, in both July and November.

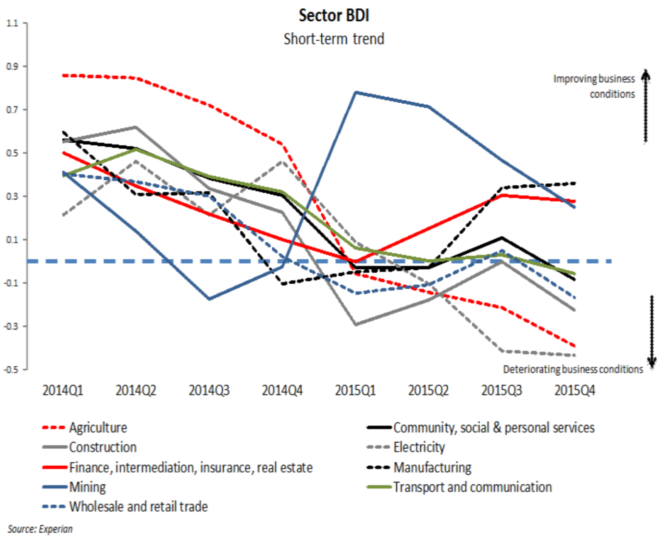
The resultant decrease in the growth of disposable income and increase in debt servicing costs weighed down on the financial prowess of the domestic business community.

This is reflected in the fact that the average number of debtors' days outstanding picked up in Q4 last year.

BDI by sector

The deterioration in business debt conditions in Q4 was fairly broadly distributed across most sectors of the economy, with the only exception being the manufacturing sector, where conditions improved off a low base a year earlier in the aftermath of the metal industries strike.

Chart 4



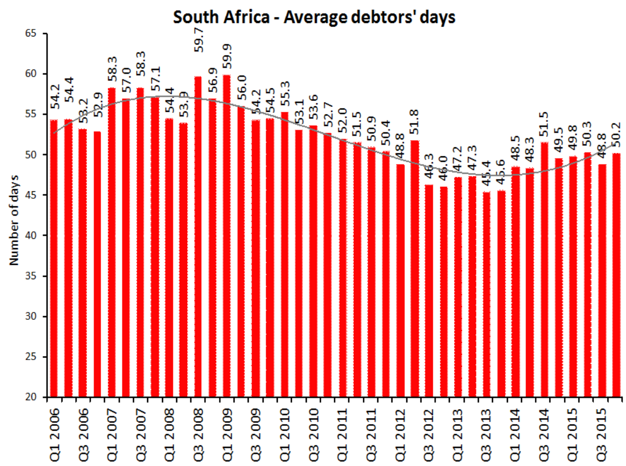
Business debt metrics in Q4 2015

The rise in average number of debtor days in the last quarter of 2015 was not particularly dramatic.

Despite increasing to 50.2 days in Q4 2015 (from 48.8 days in Q3), the 50.2 days average outstanding debtors' days was in fact marginally lower than the 50.3 days corresponding figure for Q2. It was also lower than the 51.5 outstanding debtors' days recorded in Q3 2014 in the immediate aftermath of the platinum mining and metal industries strikes during the first seven months of 2014.

Observation of a rising trend in the average number of debtors' days is only modestly discernible, with the average number of outstanding debtors' days having bottomed at 45.4 in Q3 2013.

Chart 5



The relative deterioration in financial health also becomes apparent if one examines the ratio of outstanding debts of more than 90 days relative to the corresponding outstanding debts of less than 60 days.

This ratio increased to 11.9 in Q4, from 11.1 in Q3, but was still lower than the recent ratio peak of 12.1 recorded in Q3 2014. However, it was significantly higher than the 6.6 low point for this ratio in Q4 2013.

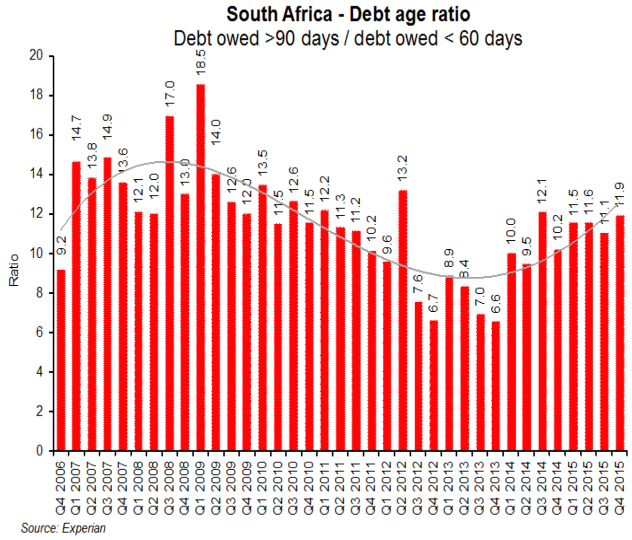
The Q4 2015 ratio contains a sharp increase in the December 2015 value to 13.5 which would point to even further deterioration in the short term.

The deterioration in the category of longer term outstanding debt based on the ratio of outstanding debts of more than 90 days relative to less than 60 days appears visually to be slightly more pronounced than the deterioration reflected by debt outstanding of between 30 and 60 days relative to less than 30 days.

Therefore, whilst the overall debt situation of businesses may not be deteriorating unduly aggressively, there may be a group of companies that is indeed beginning to take a lot of financial strain.

This is evidenced in the debt age ratio for small businesses where a value of 14.94 was recorded in Q4 compared to the 11.9 for the total ratio. Average debtors days of 54 were recorded for small business compared to the 50.2 days for the total BDI Q4 value.

Chart 6



Summary and Outlook

There is a fair chance domestic economic growth will slow further during the course of 2016 mainly because the full effects of drought conditions have not yet been felt. If anything, drought conditions intensified during November and December, laying the ground for what could be a period of double-digit food inflation.

Inflation more generally is also anticipated to rise quite strongly in the wake of the accelerated depreciation of the Rand during December and January.

The currency's collapse during those months rose from the negative sentiment generated by the downgrade South Africa's credit rating and the unstable period in the finance ministry in early December.

The resultant response of the Reserve Bank's Monetary Policy Committee to raise the repo rate by a fairly aggressive 0.5% at its January meeting implies a further increase in debt servicing costs for businesses.

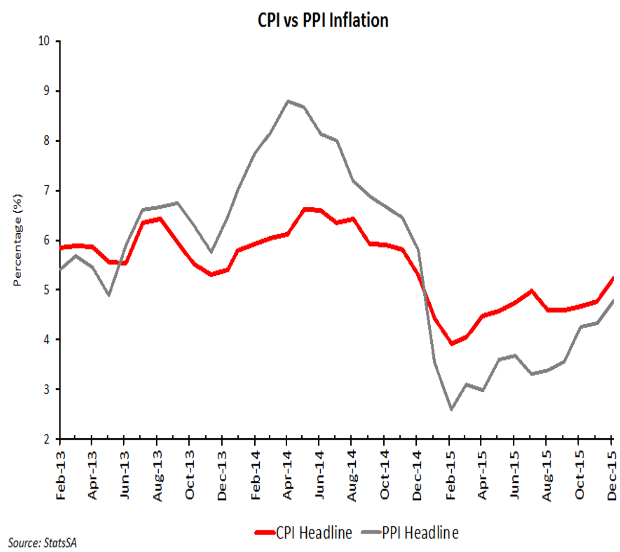
The corresponding increase in capital market yields is also set to raise the cost of government's financing of its budget deficit.

Furthermore, it is likely that the Reserve Bank will be obliged to increase interest rates still further through the course of 2016 in order to assist in persuading foreign investors to deposit funds in the Rand and in so doing prevent a further run on the currency.

Fortunately, there are some mitigating factors. Producer price inflation remained slightly lower than consumer price inflation during Q4 (see chart below); however, it is doubtful whether this situation will persist.

It is expected that producers will start recouping cost increases emanating from the Rand's depreciation to a greater extent than had been the case in 2015 when weak demand conditions squeezed pricing power to a degree that cannot be sustained. Many companies have been protected up until recently by forward cover contracts on their foreign exchange obligations. As these mature, it will be inevitable to see accelerated price increases for imported items.

Chart 7



In conclusion, there has undoubtedly been a relative deterioration in business debt conditions, but the situation is still marginally positive, suggestive of no major collapse in economic activity.

Nonetheless, with inflation and interest rates set to rise in coming months, there is bound to be further noticeable deterioration in the financial health of the business sector through 2016.

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 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, 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: 16 May 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.