Experian Business Debt Index (BDI) Results. Q1 2015

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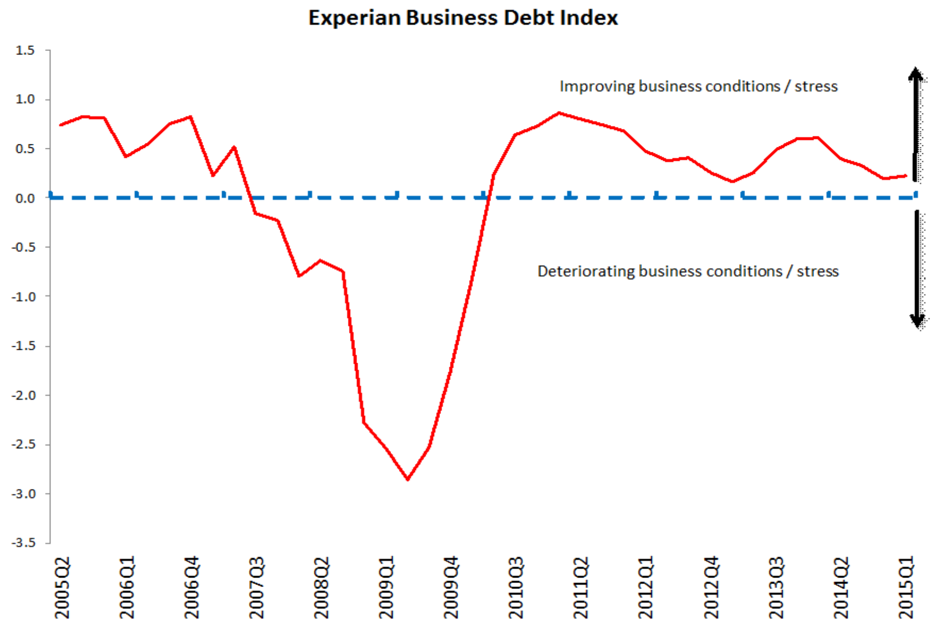
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2015

Debt stress among businesses improves slightly in Q1 2015, but at a very slow rate

Chart 1



	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.61*	0.39*	0.33*	0.20*	0.23

* *Revised*

Outcome for Q1 2015

The Experian Business Debt Index (BDI) improved marginally in the 1st qtr of 2015 compared with the 4th qtr of 2014, to a reading of 0.23, from 0.20 respectively. Both these readings have remained above the 0.0 level which distinguishes between improving and deteriorating business debt conditions. However, in both cases, the readings were lower than at any stage in the past two years. 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, but not to an extent that has seen overall business debt conditions deteriorating.

Macroeconomic factors influencing the Q1 2015 BDI

The make-up of the BDI suggests that there are significant countervailing influences on the financial health of businesses. Probably the overriding factor to emerge is that the experiences of certain sectors of the economy have diverged dramatically.

Only 2 out of the 9 main sectors of the economy (excluding government) witnessed an improvement in business debt conditions, but such improvement was so dramatic that it managed to outweigh a deterioration in financial conditions in all the other seven sectors.

To some extent this was statistical in nature, with big improvements being recorded in respect of mining and manufacturing, which had stood out as the two sectors to experience dramatic and disruptive industrial relations turmoil in 2014.

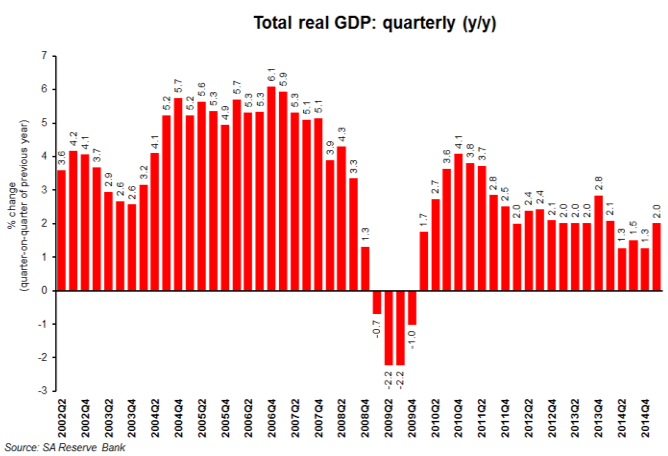
Naturally, the recovery in these two sectors in the 4th qtr of 2014 and the 1st qtr of 2015, following the ending of those strikes, resulted in a big improvement in the debt metrics of these sectors.

On the other hand, a general loss of business confidence in the wake of the mining and manufacturing sectors strikes, only began to penetrate the remainder of the economy in a big way later in the year and into the first part of 2015. The decline in business confidence over that period was also exacerbated by a decision on the part of Eskom to divert electricity outages away from just mining and manufacturing towards all the other sectors of the economy.

From a macroeconomic perspective, the statistical distortion created by the sharp decline in domestic economic growth in the 1st qtr of last year ironically manifested in an improving impulse in the 1st qtr of 2015.

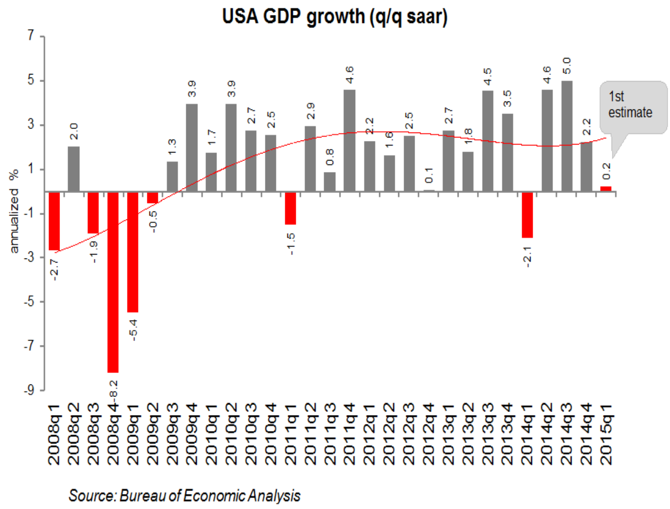
Because of the weak level of economic activity at the beginning of 2014, there was a fairly substantial increase in y-o-y growth in the domestic economy in the 1st qtr of 2015 to 2.0%, compared with just 1.3% in the 4th qtr of 2014 (Chart2).

Chart 2



Interestingly, of the same kind of macroeconomic impulse improvement emanated from the US economy, where y-o-y GDP growth, as opposed to q-o-q growth, also rose in the 1st qtr of this year compared with the final quarter of last year, despite a plunge in q-o-q growth in the world's largest economy in the 1st qtr (Chart 3).

Chart 3

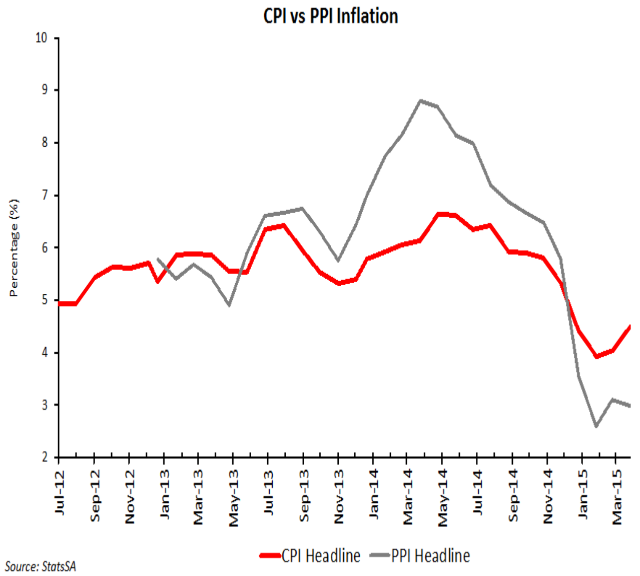


Domestically, a further relatively positive impulse emanated from the continued marked difference between the repo rate and the US Fed Funds rate. The ability of domestic firms to keep borrowing money from abroad at cheaper rates than in the domestic markets, continued to support their ability to finance their debt requirements.

On the other hand, all these positive influences were neutralised by some other negative macroeconomic forces.

- The first of these was the decline in the PPI inflation rate to well below the CPI inflation rate during the 1st qtr of this year (Chart 4). This was the first time this had happened since the global financial recession six years ago. With business confidence declining and with increasingly tight business conditions over the past year, businesses have been finding it increasingly difficult to pass on cost increases to consumers.

Chart 4

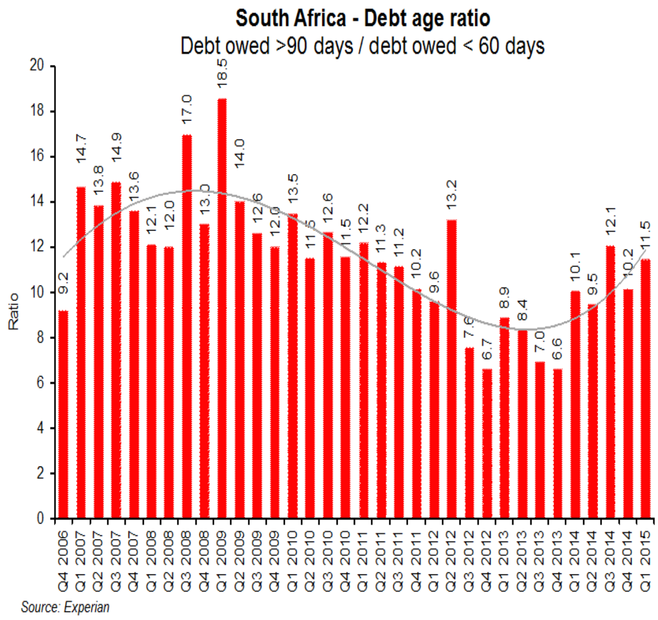


- Another indicator of the strain on pricing within the business sector is manifested by the progressive decline in long-term interest rates relative to short-term interest rates. When long-term interest rates decline, this is seen as an indicator of falling inflationary pressures due to an inability on the part of businesses to price more aggressively. Conversely, the rising trend of short-term interest rates over the past year has increased the costs of servicing debt for businesses in the immediate future.

Just as there was a substantial divergence in the underlying trends in business debt conditions between some sectors, there were also some countervailing trends in the debtors' days profiles of companies.

On the one hand, the ratio between outstanding debts of more than 60 days relative to those of less than 30 days diminished somewhat, to its lowest level in the past decade, whilst on the other hand, the ratio of outstanding debts of more than 90 days relative to debts outstanding of less than 60 days, increased (chart 5). This may suggest that whilst general business conditions remain relatively stable and businesses have enough cash to pay off their debts timeously, there is an increased incidence of a few businesses experiencing significant trauma as a result of the weaker overall state of economic activity. We suspect that this might be the case in particular with small businesses.

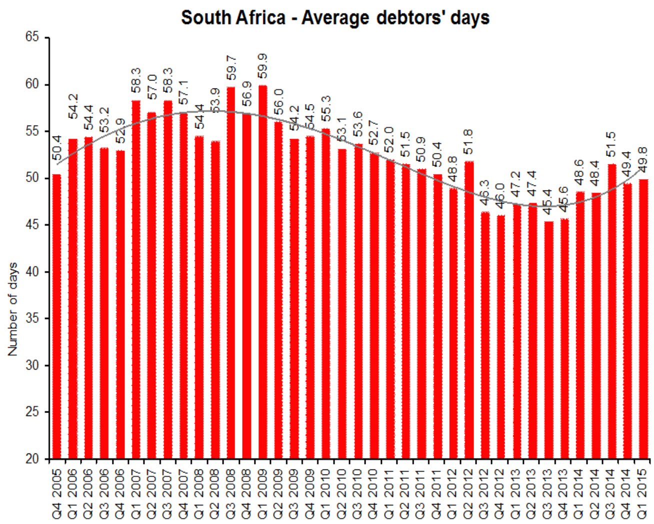
Chart 5



More generally, the average age of all business debts increased slightly, from 49.4 days in the 4th qtr of last year, to 49.8 days in the 1st qtr of this year (Chart 6). However, this is not particularly significant in the longer term scheme of things.

It should be borne in mind that the average age of debtors approached 60 days around five years ago, whilst conversely the 49.8 days average outstanding in the 1st qtr of this year was not that much higher than the low point for this series, of 45.4 debtor days.

Chart 6



Conclusion

In conclusion, the BDI for the 1st qtr continues to paint a picture of an economy that is not about to collapse any time soon even if it is not performing particularly well.

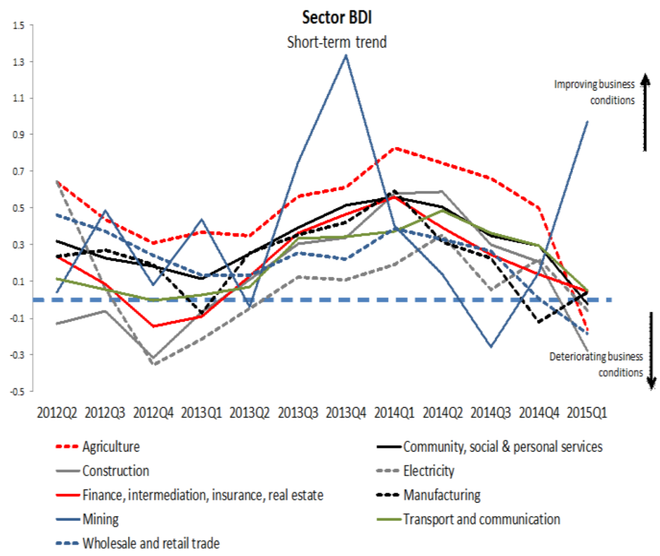
Businesses appear to be continuing to discount a soft growth environment and accordingly are managing their finances on the whole relatively soundly to survive in such conditions. Many are sitting on significant cash balances, refraining from undertaking any more capital investment than is absolutely necessary to keep their businesses operating efficiently.

The positive aspect of such an environment is that the build-up of cash balances is helping businesses to bide their time whilst the economy is seen to be underperforming compared with its true potential. In turn, this should ensure that there is no major downturn in economic activity.

On the other hand, the relative dearth of new investment in capital projects is likely to restrain the country's longer term sustainable growth rate. From a micro-economic perspective one is becoming slightly concerned with the relative deterioration of the business debt indices of sectors other than mining and manufacturing.

The industrial relations turmoil experienced in mining and manufacturing last year, together with disruptions increasingly being caused by electricity outages, are feeding through to affecting businesses in the agricultural and services sectors negatively as well.

Chart 7



We also suspect that business debt conditions are tougher amongst small businesses than in the corporate environment.

Outlook

Nonetheless, our preliminary expectation of the trend of the BDI in coming quarters from a macroeconomic perspective fortunately does not point to any imminent major deterioration, just one of lacklustre growth.

This ties in well with the continuing overall sideways movement in the Reserve Bank's leading indicator of business 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 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 2014, we were named by *Forbes* magazine as one of the 'World's Most Innovative Companies'.

We employ approximately 16,000 people in 39 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 and 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: 9 June 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.