# Experian Business Debt Index (BDI) Results

# Q1 2016


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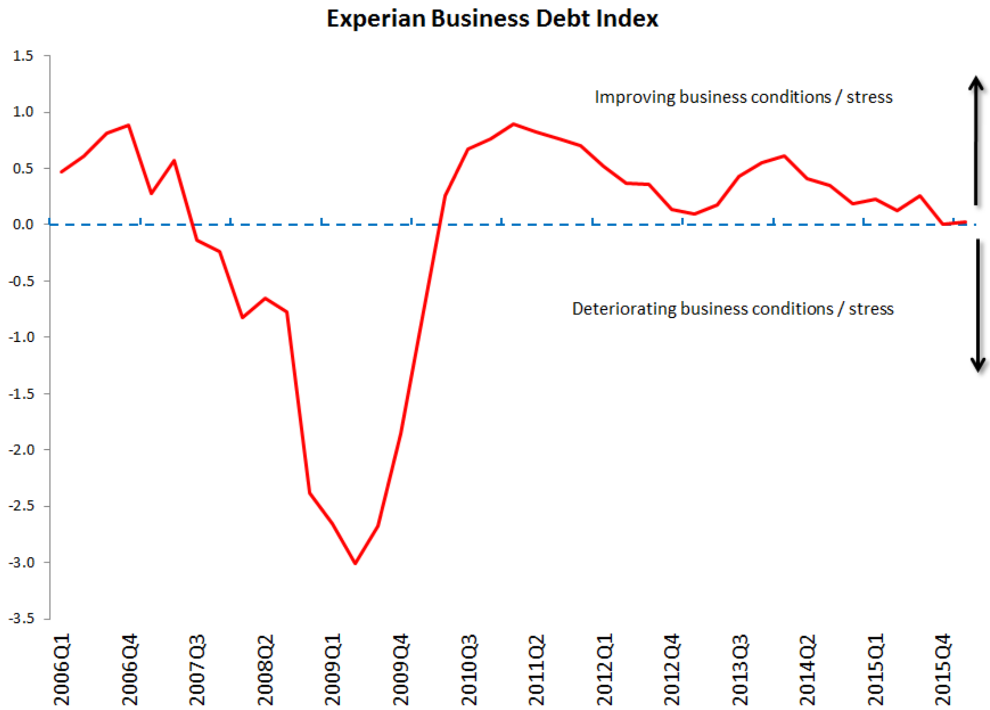
# EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2016

*Stressed business debt conditions remain for economy sailing close to recessionary conditions*

**Chart 1**




| | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 |
|---|---|---|---|---|---|
| **Index**<br>>0= Improving business conditions<br><0 = Deteriorating business conditions | 0.229* | 0.125* | 0.256* | 0.005* | 0.028 |

* *Revised*

## Outcome for Q1 2016

Contrary to our expectation in the last quarter that the BDI would probably fall below the zero level, which distinguishes between improvement and deterioration in business debt conditions, the BDI actually edged slightly upwards in Q1 2016, to 0.028 from 0.005 (revised) in Q4 2015.

The BDI for Q4 2015 had been the weakest reading since the negative readings recorded in 2009 at the time of the global financial recession.

Nonetheless, there is no sign of the downward trend in the BDI of the past three years showing any major increase in momentum. This is mainly due to a number of macroeconomic indicators that appear to be in the process of bottoming out.

## Macroeconomic factors influencing the Q1 2016 BDI

The South African economy has only just managed to escape from recession, with barely positive growth of 0.6% being recorded in Q4 of 2015 and expected growth unlikely to have been much better than this in Q1 2016.

Much of this sluggishness can be ascribed to domestic factors.

In particular, a loss of business confidence over the past year has weighed down on investment spending.

Linked to this, certain key political developments contributed towards driving the Rand down sharply to exceptionally low levels. This was to an extent totally unforeseen.

This depreciation has resulted in an increase in inflationary pressures which have compelled the Reserve Bank to raise interest rates by 1% between November last year and March this year. This has placed considerable financial strain on both individuals and businesses.

No doubt there have also been other factors beyond the control of the authorities that have contributed towards the fall in the Rand, the rise in inflation and interest rates and a loss of business confidence.

Domestically, the severity of the 2015/16 drought should not be underestimated. Drought has also contributed towards increased inflation by virtue of the shortage of food supplies.

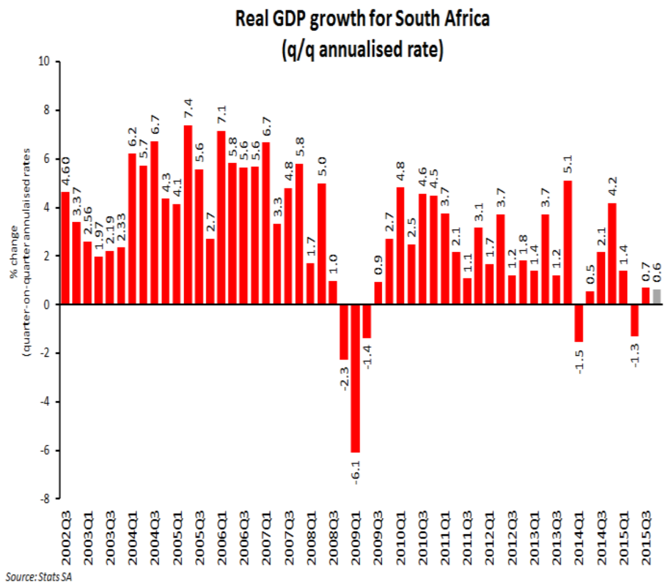
Internationally, the plunge in commodity prices through 2015 has sapped the export revenues of economies reliant on exports for growth, such as South Africa.

Commodity prices have also contributed towards a loss of confidence more generally amongst international investors towards emerging markets, with large-scale sales of bonds and other financial assets belonging to such markets.

Indeed, many would argue that this, more than domestic factors, was the main reason for the Rand's precipitous fall through most of 2015 through to January 2016.

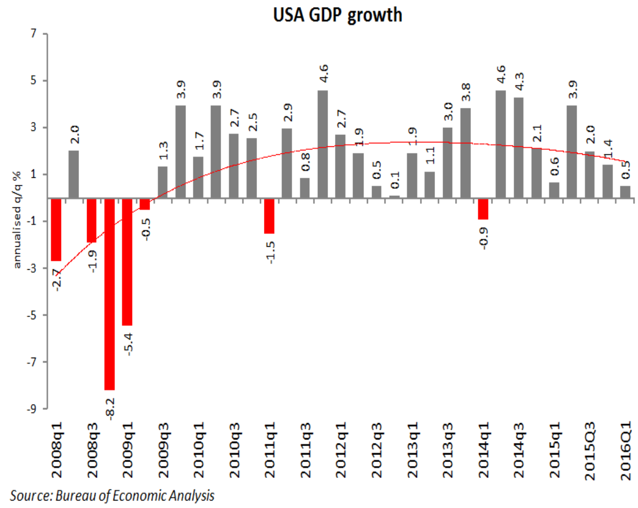
Despite all these headwinds against economic growth, there have been indications that the economy is not collapsing, even if it is not growing at more than a very pedestrian pace.

**Chart 2**



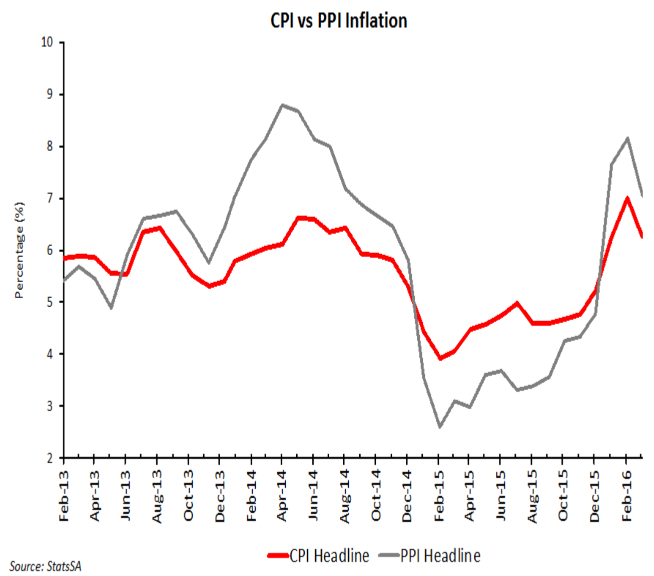

Growth in US GDP dipped slightly in Q1 2016 from the final quarter of 2015, whilst domestically it may have followed the same pattern.

**Chart 3**




The rate of increase in producer prices has accelerated relative to that of consumer prices, implying that many manufacturing businesses have been trying to claw back margin following the precipitous depreciation of the Rand last year by raising their prices faster than before.

**Chart 4**




*Source: StatsSA*

The fact that long-term interest rates remain significantly higher than short-term interest rates is also a sign of optimism that longer-term economic growth prospects remain more upbeat than shorter-term ones, although the gap between the two narrowed ever so slightly in this past quarter.

One also notes that domestic interest rates have risen relative to foreign interest rates, which ought to be of assistance in attracting foreign capital into South Africa at the margin, helping to stabilise the Rand and reducing the extent to which interest rates need to carry on rising.

Much of the fact that the South African economy has not been collapsing can be ascribed to businesses building up substantial cash reserves instead of spending heavily on capital projects, which are insulating them against the ravages of sustained slow growth.

The level of liquidations and insolvencies remains quite low, whilst growth in summonses and judgements for bad debt has also shown no major upward spike. This may arise from the fact that businesses in trouble are increasingly resorting to business rescue rather than closing shop.

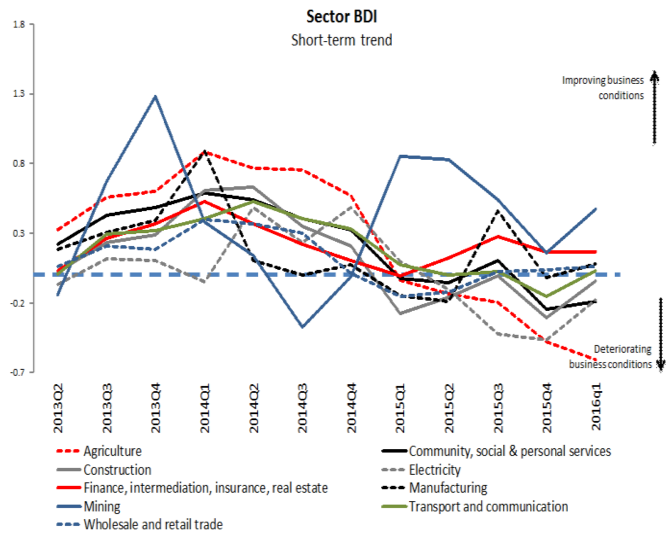
## BDI by sector

The BDI of five sectors were in positive territory in Q1 (i.e. experiencing an improvement in business conditions): transport and communication, mining, finance and business services, wholesale and retail trade and accommodation and the manufacturing.

The BDI of the following four sectors were in negative territory (i.e. experiencing deteriorating business conditions): construction, services, electricity and agriculture.

The agricultural sector specifically has been deteriorating significantly due to the impact of the crippling drought.

**Chart 5**



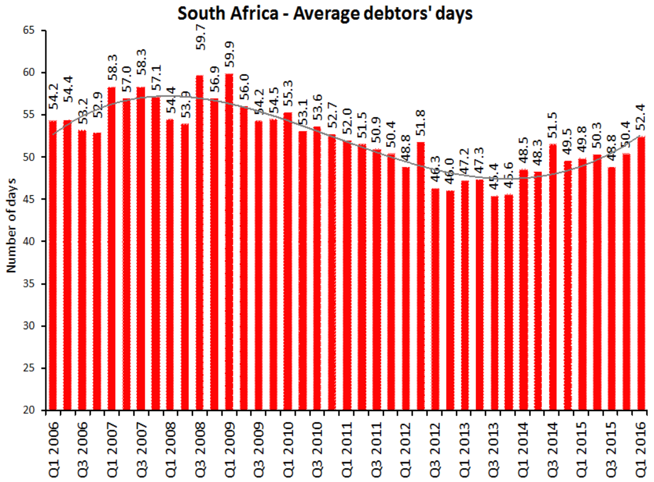

## Business debt metrics in Q1 2016

The average number of outstanding debtors' days for the overall economy rose in Q1 2016 for the second consecutive time, to 52.4 days, from 50.4 days in the final quarter of 2015 and 48.8 days in Q3 last year.

Indeed, the 52.4 average outstanding debtors' days in Q1 of this year were the highest such number since Q3 2010.

However, within this figure there was a substantial divergence between the trends of shorter-term debts outstanding as opposed to longer-term ones.

**Chart 6**



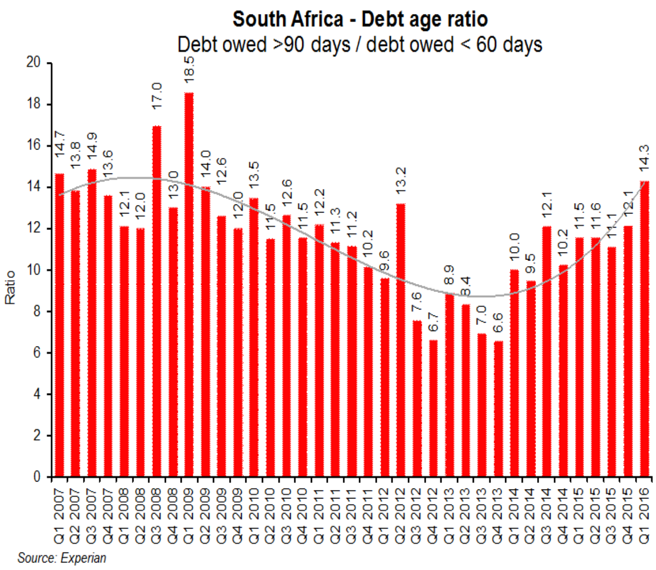

If one looks at the ratio of debts outstanding of between 30 and 60 days relative to those of less than 30 days, the ratio remained unchanged in Q1 2016 compared with Q4 2015, at 15.9.

Apart from the slightly lower Q3 2015 figure of 14.9, this was the lowest such short-term ratio of outstanding debtors' days in the past decade.

It compares, for example, with the fact that the ratio during the global financial recession was in the region of 35 to 40.

On the other hand, the ratio of debts owed of more than 90 days relative to debts owed of less than 60 days shot up to 14.3 in Q1 2016 from 11.1 and 12.1 in the final two quarters of 2015 respectively.

**Chart 7**




The 14.3 ratio recorded in Q1 of this year was in fact the highest such ratio since the global financial recession in Q1 of 2009.

These figures suggest that for the majority of businesses, balance sheets remain relatively healthy, but there is an increasing number of businesses, albeit a minority, that are coming under acute strain in the low growth and rising interest rate environment.

One might have thought that this divide would be reflected in terms of the divergence in outstanding debtors' days' trends between small businesses and larger ones.

This is interestingly not the situation. The average number of outstanding debtors' days of small and medium-sized enterprises barely rose in Q1 of 2016, rising to an average of 57.03 days from 57.01 days in Q4 of 2015.

This contrasts with the fairly significant increase in the number of outstanding debtors' days overall, from 50.4 to 52.4.

Even though the number of outstanding debtors' days of SMEs is higher than the overall, its trend has not been rising as steeply as is the case with all businesses, large and small, taken together.

## Summary and Outlook

There is likely to be a continuation of a situation in which some companies are really suffering due to the weak economic climate, but others are succeeding in generating a shell of protection against low growth.

There are some tentative signs which suggest that the worst in terms of a loss of business confidence is coming to an end.

Decisions taken by the judiciary to reinforce respect for key institutions and stronger action against corrupt attempts in the political realm, together with a revival in commodity prices since February and an increase in risk appetite towards emerging markets associated with this, have seen significant gains being made in the Rand since its January lows.

In turn, this has tempered somewhat the fear of further substantial increases in inflation and interest rates.

Apprehension that leading credit ratings agencies are set to downgrade the credit rating on South African government bonds to junk status, has receded slightly. Strong commitment on the part of National Treasury towards fiscal consolidation in its Budget embodied in its budgeted decline in the fiscal deficit over the next three years, has also helped to strengthen the case for no further downgrades.

Over and above these institutional factors, is the fact that the drought is unlikely to last forever and the economy is therefore set to recover somewhat during 2017.

All these possible positive factors are reflected in our preliminary forecast of the BDI for the next quarter, which shows that the BDI will remain close to the zero level (albeit deteriorating slightly), even though the economy keeps sailing close to recessionary 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 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.

## Contact details

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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 2016

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.