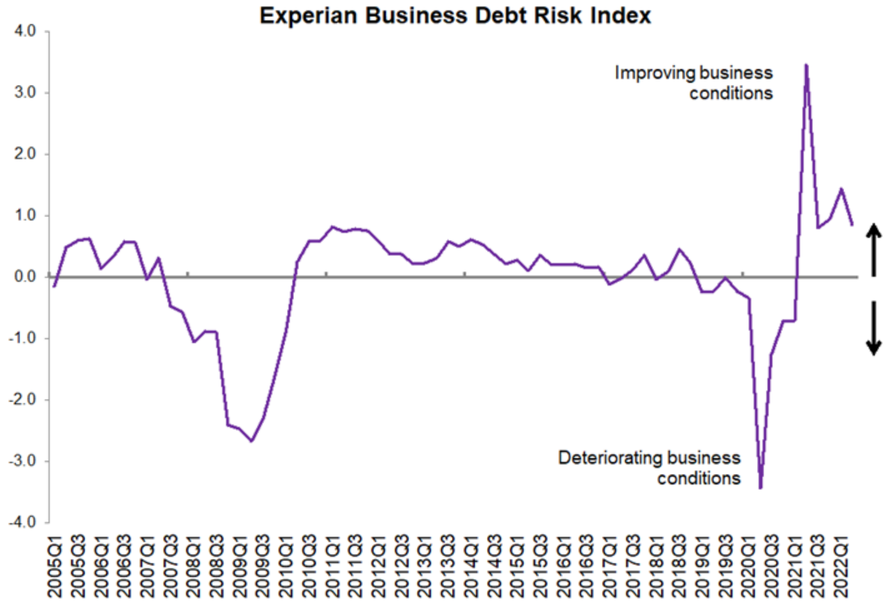
News release

Decline in SA business debt conditions in Q2 – Experian data

Prudent debt management advised in tough economic climate

Johannesburg, 03 November 2022 – There has been a decline in business debt conditions in Q2, with this downward trajectory likely to continue in the coming quarters, according to new insight from Experian South Africa.

As expected, the Experian Business Debt Index (BDI) declined in Q2 from Q1 2022, due to lower economic growth in South Africa and abroad, decreasing from a reading of 1.438 in Q1 to 0.856 in Q2.



	Q2 2021*	Q3 2021*	Q4 2021*	Q1 2022*	Q2 2022
Index >0= Improving business conditions <0 = Deteriorating business conditions	3.462	0.803	0.946	1.438	0.856

** Revised*

Macroeconomic factors influencing Q2 2022

South Africa's year-on-year GDP growth declined from a downwardly revised 2.7% in Q1 to 0.5% in Q2. The principal reason for this outcome was the intensification of electricity load-shedding in June, which aggravated the slump in economic growth in Q2 compared with what had been expected.

Jaco van Jaarsveldt, Head of Commercial Strategy and Innovation at Experian Africa said: "Other factors that contributed to the decline in the Q2 BDI were the floods in KwaZulu-Natal and the impact of the steep 0.5% repo rate increase at the May MPC meeting – at that time, it represented the biggest repo rate hike in more than a decade. The war in Ukraine added to inflationary pressures in terms of the surge in oil and other energy prices arising from sanctions imposed upon Russia and a countervailing withholding of supplies of these goods to the West. In addition, an interruption of food commodity exports from Ukraine also caused food prices to rise."

Ironically, heightened inflationary pressures in supply chains contributed to a perceived increase in the margins of businesses reflected in the rise in the domestic producer price index (PPI) inflation rate to levels even steeper than those of the consumer price index (CPI) inflation rate.

The PPI inflation rate rose well into double-digit levels, leaving the differential between PPI inflation and CPI at more than 8%, providing a nice cushion to the business community, which may have assisted in tempering the deterioration in financial conditions caused by higher interest rates.

Business debt metrics in Q2 2022

While economic growth decreased by more than anticipated and was the overriding reason for the lower-than-expected BDI outcome, there was also significant deterioration in the debt age ratios derived by Experian.

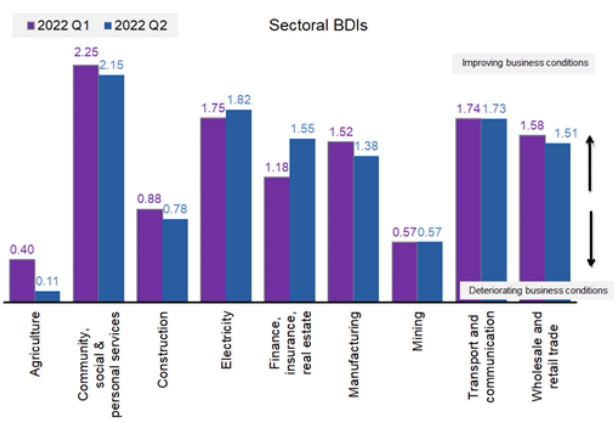
In particular, the 30–60-day ratio almost doubled, from a four-year low of 19.0% in Q1 to 36.8% in Q2. The latter was, in fact, the second highest such lengthening of outstanding debts over the past decade. Similarly, the 60 to 90 ratio doubled from 5.7% in Q1 to 11.9% in Q2.

"We suspect that the realisation that interest rates domestically were set to increase sharply, created a tendency for debtors to withhold paying off their debts as rapidly as had been the case previously. Also, with the kind of disruption to economic activity caused by the floods and the load-shedding in Q2, businesses may have felt compelled to replenish cash flows by withholding the repayment of loans as rapidly as had been the case," said van Jaarsveldt.

BDI by sector

The sectoral breakdown of BDI had relatively minor changes, primarily linked to the GDP performance in Q2 of each of the sectors.

Only two sectors recorded changes in BDI of more than 0.10, namely 'agriculture' in a downward direction and 'finance, insurance, and real estate' in an upward direction. In other words, in seven of the sectors, the BDI barely changed.

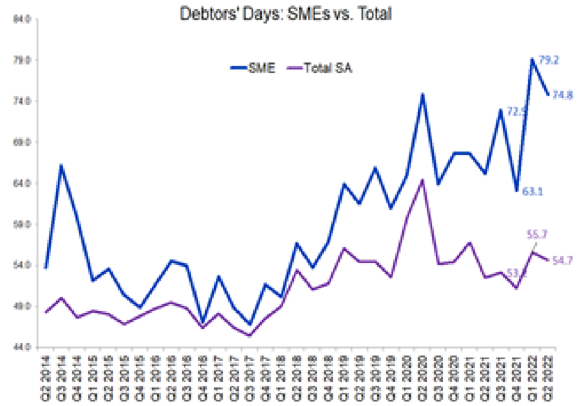


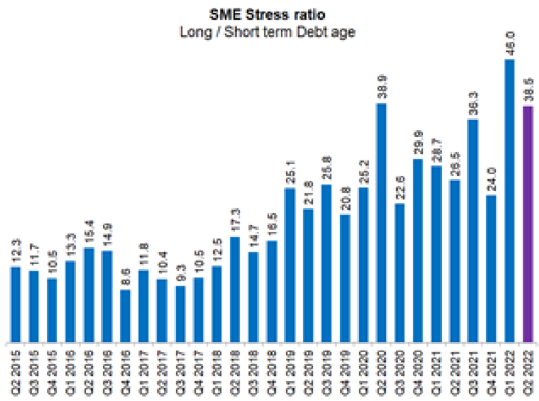
Moreover, the BDI in every single sector remained positive. However, agriculture was negatively affected by the floods in KwaZulu-Natal and the disruptions to harbour facilities for exporting such products. The impact was not dramatic though and the BDI remained above the 0 level.

BDI by company size

Given the deterioration in the outstanding debtors' days ratios derived by Experian, there was a marginal improvement in the extent to which small business debt conditions fared relative to larger businesses.

The SME stress ratio declined from 46.0% in Q1, a previous all-time high, to 38.5% in Q2. By historical standards, the SME stress ratio is still very high and, in fact, the third highest for any quarter on record. However, it failed to deteriorate as one might have anticipated in the wake of the floods in KwaZulu-Natal.





Projected recovery in BDI in Q3

The forecast for the BDI in Q3 is a limited rebound in the index. However, this is largely predicated on the anticipation of some recovery, albeit mild, in the economic growth rate domestically to 1.22% from Q2's 0.60%. The extent of this BDI improvement forecast is, however, tempered by the fact that US economic growth is expected to have dipped further in Q3 on the back of rising US interest rates to temper inflation.

On the other hand, the BDI forecast will benefit from the fact that the differential between the US and domestic interest rates will have narrowed significantly, thereby reducing the relative cost of overseas finance.

Unfortunately, looking beyond Q3, the signs for a sustained recovery in the BDI are unlikely. The impact of further steep increases in domestic interest rates of 1.5% cumulatively in Q3, following hikes of 0.75% in the repo rate at each of the July and September MPC meetings, is only likely to be felt in subsequent quarters.

Businesses are thus advised to manage their debt prudently especially as the coming quarters are expected to become tougher as consumer distress intensifies and demand decreases, thus adding further strain to business debt stress levels. To navigate this challenging environment, organisations should favour more conservative financial management practices that focusses on strong cash flow management," concludes Van Jaarsveldt.

[1082 words]

ENDS

Notes to the editor:

* Debtors' days is a metric of time measuring the average outstanding period (in days) that businesses take to repay their debt. A higher debtors' day value points to an environment where firms are taking longer to repay their outstanding debt obligations.

The Experian Business Debt Index is an indicator of the overall health of businesses, as well as the South African economy. It 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.

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. Higher interest rates result in higher borrowing costs and an increase in business stress. Relatively higher production costs vs consumer costs decrease operating margins of business, while higher domestic and international growth could result in a better trading environment for businesses.

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 the business stress is the primary factor influencing the co-movement and by extracting the principal components, it is possible to build and index with a useful economic interpretation.

For a more detailed analysis of business debt stress, Experian releases a Business Debt Overview report. The Business Debt Overview report constitutes of three main sections: The Business Debt Stress Index, a macro-economic overview and a sectoral debt analysis.

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