Experian Business Debt Index (BDI)

Q2 2017

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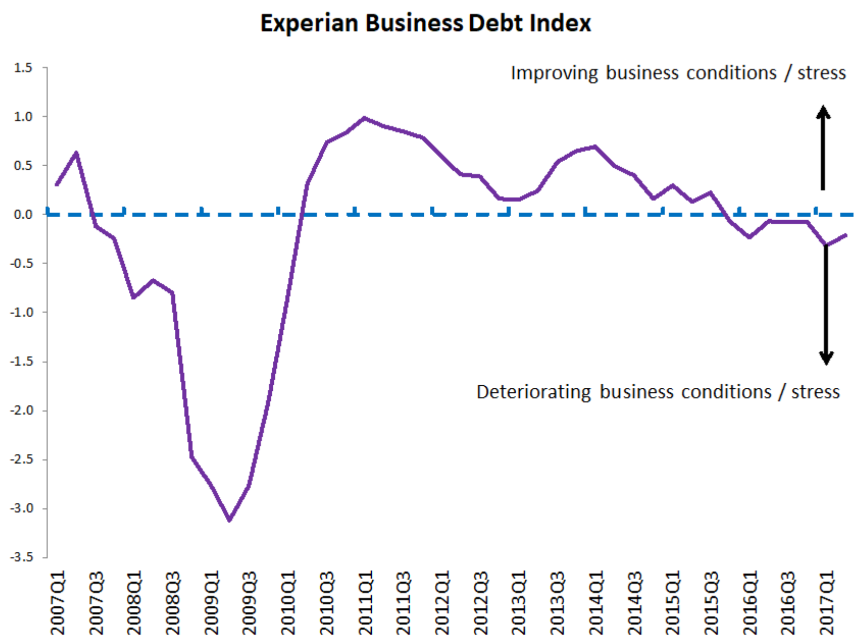
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q2 2017

Business debt conditions still holding up despite recession

The Experian Business Debt Index (BDI) rose moderately in the second quarter of 2017 compared with the first quarter. The BDI rose to a reading of -0.218 for the second quarter, from -0.317 for the first quarter. The fact that the BDI remained negative suggests that business debt conditions continued to deteriorate in the second quarter, but at a slower pace than in the first quarter.



	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.073*	-0.080*	-0.080*	-0.317*	-0.218

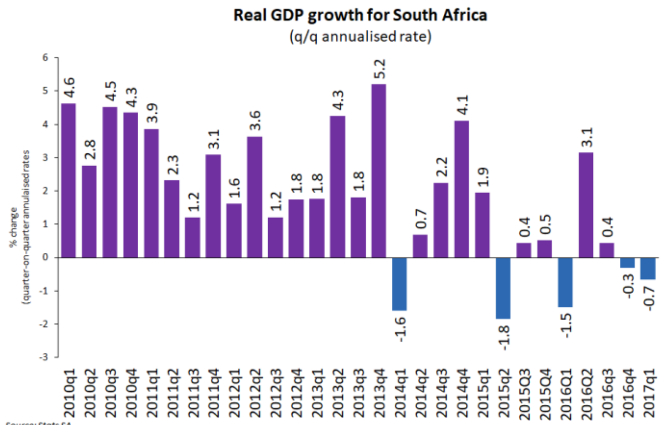
* *Revised*

Much of the improvement in the second quarter BDI can be ascribed to the fact that the first quarter BDI had to be revised down sharply due to the fact that the actual growth of domestic GDP in the first quarter came in substantially weaker than had been forecast. General expectation had been for Q1 2017 GDP to reflect an improvement compared with the -0.3% q/q growth recorded in Q4 2016. In the event, q/q growth came in at -0.7%, forcing a substantial revision to the Q1 2017 BDI.

Nevertheless, the second quarter results indicate some slight improvement in business conditions on the back of lower inflation, a stronger currency and an improved economic outlook, with growth expected to have rebounded back into positive territory. Overall, despite the weak economy, businesses are maintaining a fairly stable financial position. The still negative BDI is representative of structural issues facing the economy, most notably continued low business confidence and a difficult operating environment, compounded by volatile policy-making and an uncertain economic outlook.

Macroeconomic factors influencing Q2

Optimism about a recovery in the first quarter had been based on good rains falling in the summer rainfall regions of the country, which augured well for agricultural production. In addition, monthly figures for mining output in the first three months of the year had reflected a substantial improvement compared with the dreadful performance of the sector in 2016. Furthermore, inflation declined by more than anticipated, providing a potential boost to consumers' disposable income.

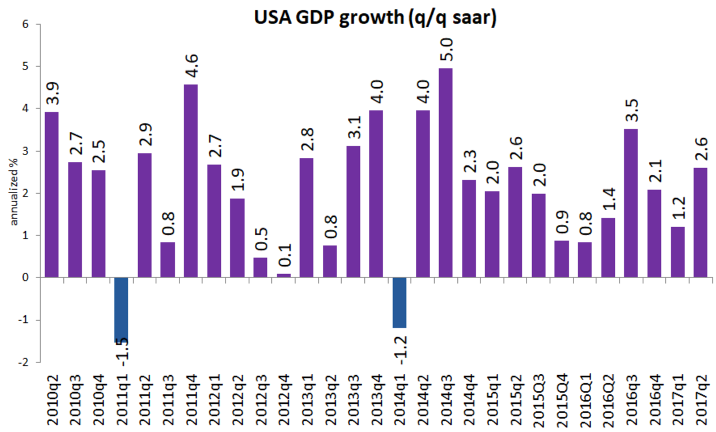


Source: Stats SA

Contrary to these expectations, the actual Q1 2017 GDP figure came in even weaker than the Q4 2016 figure, at -0.7% q/q from -0.3% previously. Negative q/q growth was recorded for two successive quarters, leading to the South African economy being officially classified as in a technical recession, a far worse outcome than hoped for. As a result, the BDI had to be revised downwards to -0.317 for the first quarter of 2017 from the marginally negative reading of -0.081 published last quarter.

What took most analysts by surprise was the fact that nearly all sectors of the economy posted negative q/q growth in GDP in Q1 2017, way below the worst expectations and something not experienced since the global financial crisis in 2008/09. The downward revision of the BDI for the first quarter was also exacerbated to some extent by the fact that, in none other than the US itself, Q1 2017 GDP surprised on the downside.

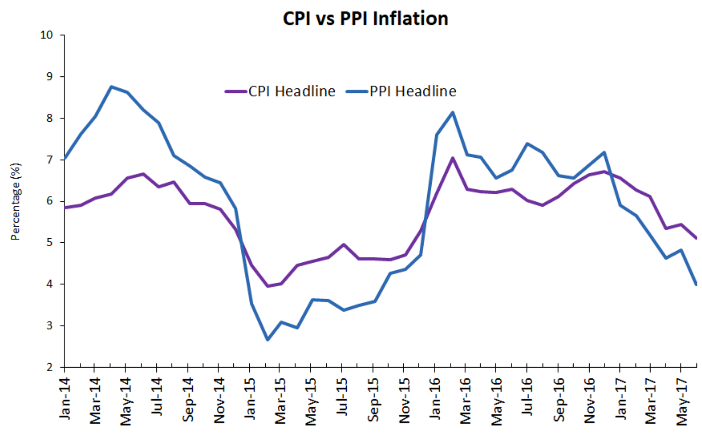
Economic data relating to the second quarter have thus far fortunately been fairly positive, endorsing the view that Q2 2017 GDP growth will record a recovery back into positive territory. Reserve Bank Governor Lesetja Kganyago himself alluded to this likelihood in his report at the Bank's AGM in late July. Consequently, as mentioned above, improved domestic GDP growth translates into an uptick in the BDI for the second quarter. This improvement is also helped by a fairly substantial improvement in the GDP growth for the US economy in Q2 2017 at an annualised q/q growth rate of 2.6%, up from the 1.2% downwardly revised figure for the first quarter.



Source: FRED

Working marginally against a more marked improvement in the BDI for the second quarter is the fact that long-term interest rates have declined relative to short-term interest rates and the PPI inflation rate has fallen sharply relative to the CPI inflation rate, pointing to tighter margins in the productive sector of the economy, which are likely to impose some financial strain on the business sector.

Working more strongly against the BDI however were the credit rating downgrades, which (although they remain unchanged) have had a strong role in depressing business confidence and expected economic outlook. Without the capacity to borrow, government spending will falter in line with stimulatory effects on the economy such spending used to have.



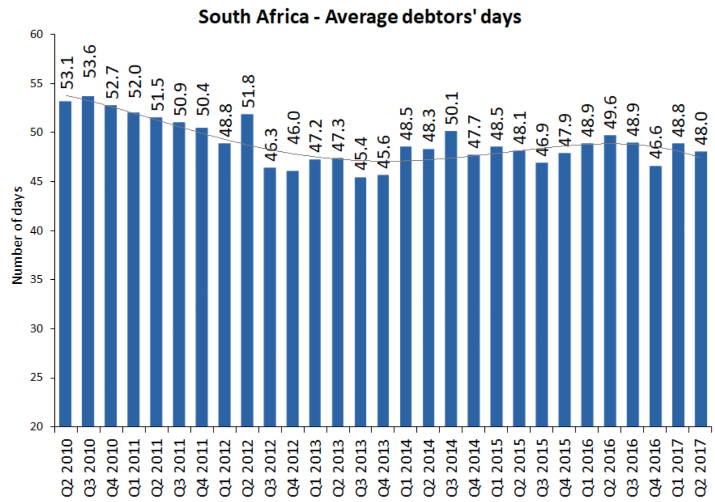
Source: StatsSA

Business debt metrics in Q2 2017

Data inputs relating to outstanding debtors' days of businesses for the second quarter reflected a slight improvement compared with the first quarter. This also assisted in bringing about the improvement in the second quarter BDI.

Debtors' days

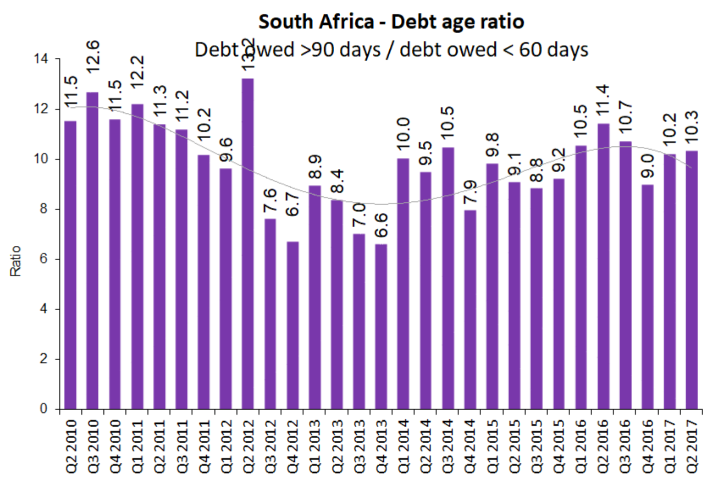
The average number of debtors' days outstanding decreased to 48.0, from 48.8 in the first quarter. The figure remains very much in line with the average recorded over the past three years, suggesting that businesses remain resilient from a financial strain point of view in spite of the weakness of the economy.



Source: Experian

Debtors' days' ratio

In addition, the ratio of outstanding debtors' days in excess of 90 days relative to those outstanding for less than 60 days, remained almost unchanged, inching upwards to 10.3 from 10.2 in the first quarter. Again, there was no great deterioration in the ability of businesses to meet their debt servicing commitments.



Source: Experian

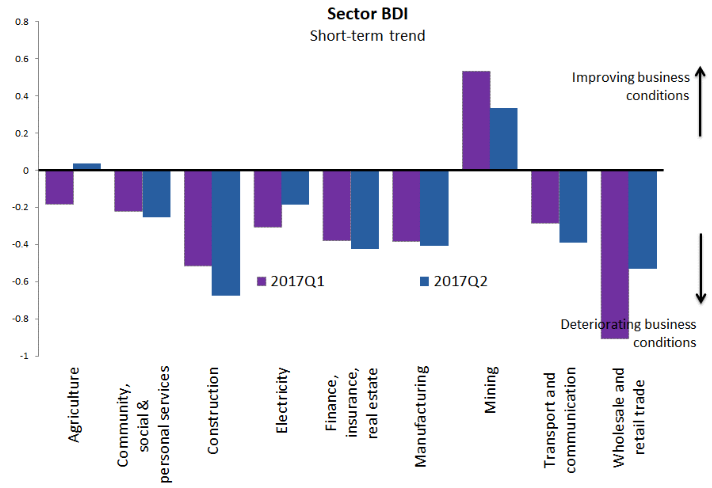
One should reflect on the fact that the country's credit rating was downgraded by two leading credit rating agencies in early April. This may have damaged business confidence, driving companies to consolidate their cash flows by taking on a little more debt in the expectation of a possible sharp decline in short-term economic activity, which in the event, does not appear to have transpired.

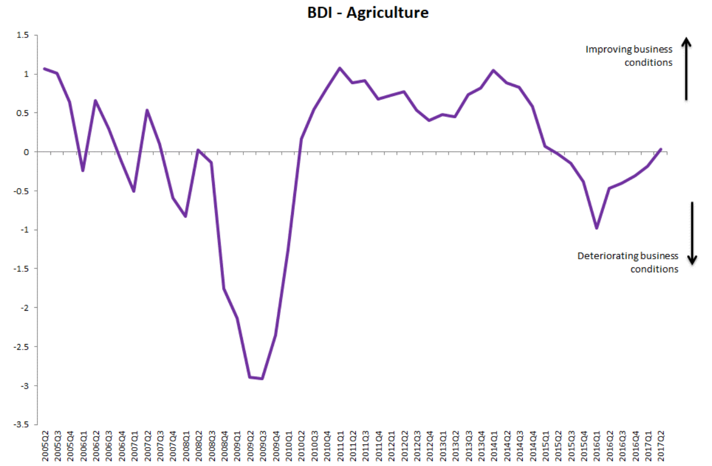
BDI by sector

From a sectoral perspective, the fact that all sectors bar agriculture and mining witnessed negative GDP growth in Q1 2017 played an important role in contributing towards negative BDI outcomes for those sectors. Only in the case of agriculture and mining was the BDI positive in the second quarter.

There was a marked deterioration in respect of transport, presumably linked to strains being experienced in the face of declining levels of activity as businesses refrain from undertaking investment projects. On the other hand, the BDI for the retail sector did not deteriorate at the rate observed in Q1 2017 as a result of some respite to disposable income arising from low inflation and reduced expectations of any interest rate increases.

Business debt conditions in the electricity sector also recorded some improvement, presumably linked to the coming on stream of more electricity generating power as the Medupi and Kusile projects gradually come to be commissioned and renewable energy projects also kick in. Business debt conditions in the financial sector have remained quite negative and are deteriorating further as margins continue coming under severe strain.



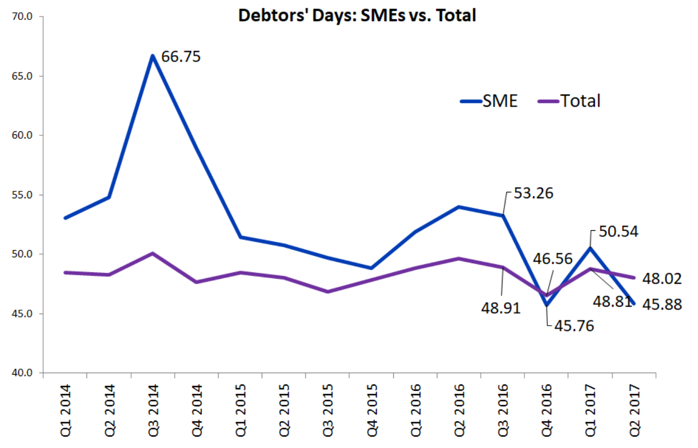


BDI by company size

One of the more surprising outcomes of the latest BDI has been the fairly sharp decline in the number of outstanding debtors' days of SMEs relative to the total.

One would have thought that the SME sector would be taking more strain than other companies in the face of lower economic growth. Contrary to expectations however, the relative improvement in business debt conditions of SMEs is attributable to increased resilience of such companies in tight economic conditions, enhancing their ability to restructure their operations more speedily to adjust for tough conditions.

The number of outstanding debtors' days of SMEs fell from 50.54, to 45.88 in the second quarter. One is encouraged by what appears to be an overall decline in the number of outstanding debtors' days of SMEs over the last three years. They appear to have prepared themselves well for the tough economic times.



Summary and Outlook

Unlike the situation which prevailed three months ago, wherein a further deterioration in the BDI was foreseen, the preliminary forecasts for the BDI outcomes for the third and fourth quarters reflect a further improvement in addition to that reflected for the second quarter.

This improvement is linked to the continuing robust nature of the South African economy in the face of much political turmoil. The short-term economic outlook is being greatly assisted by the maintenance of a relatively strong currency which is driving down forecasts of inflation ever further, heightening the possibility of additional interest rate cuts on top of the one announced in late July.

The manner in which South African businesses have prepared themselves for tough economic times by investing less and building up cash resources, is itself providing a buffer for the economy to withstand the political headwinds.

The short-term economic outlook is being greatly assisted by the maintenance of a relatively strong currency which is driving down forecasts of inflation ever further, heightening the possibility of additional interest rate cuts on top of the one announced in late July.

These factors indicate that the BDI for the third and fourth quarters should reflect further marginal improvements in addition to that reflected for the second quarter. One must remember though, that the Business Debt Index is still the most negative that it has been in the last four years reflecting the recessionary conditions businesses are currently operating in. Thus, any improvement of the BDI which remains below the zero line should be considered as a slower rate of deterioration when compared to Q1 2017 but more so than a year ago.

In such a recessionary environment, businesses have little option but to adopt a conservative approach to managing their finances and reducing risk. This attitude will help insulate them against the ravages of sustained slow growth and ensure their resilience.

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 decreases 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 index is constructed by first demeaning the individual indices - 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. Next, 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 because of a change in the actual values of the variables in the sample. Because the data are demeaned and standardised, the value of the original sample will change as the sample mean and sample standard deviation of the underlying variables change.

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 2016, for the third year running, we were named one of the "World's Most Innovative Companies" by Forbes magazine.

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, 2016, was US$4.6 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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Next release date for the BDI: 15 November 2017

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.