Experian Business Debt Index (BDI) Results. Q3 2016

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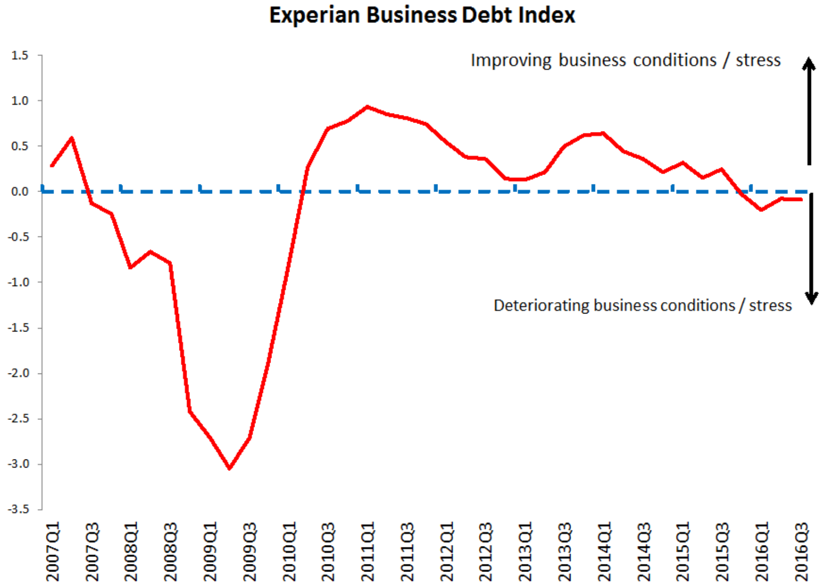
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q3 2016

Experian's BDI Q3 2016 reflects SA businesses' resilience in low-growth environment

Chart 1



	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.242*	-0.033*	-0.206*	-0.086*	-0.088

* *Revised*

Outcome for Q3 2016

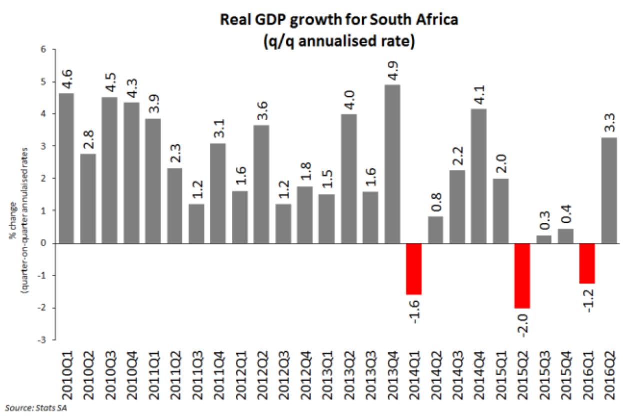
The Experian Business Debt Index (BDI) remained more or less unchanged in Q3 2016 at a reading of -0.0888, compared with -0.0859 in Q2. (A reading below zero indicates a deterioration in the financial position of businesses, whereas a positive reading implies an improvement). In this context, the Q3 BDI suggests that the finances of businesses are indeed deteriorating, but only marginally so.

It suggests that the rate of deterioration in business debt conditions has become less pronounced in the past six months after having deteriorated fairly significantly earlier in the year. There appears to be a certain resilience brought about by adequate preparation on the part of businesses to endure a low growth environment. Encouragement can be drawn from the fact that the rate of deterioration in business conditions is far from as severe as it was during the period 2007 to 2010 either side of the global financial crisis when the BDI declined to -3.0 and worse.

Macroeconomic factors influencing the Q3 2016 BDI

The fact that the BDI has been able to remain only marginally negative for so long represents a certain element of resilience within the business sector which ought to assist in preventing the economy from plunging into full-scale recession.

Chart 2



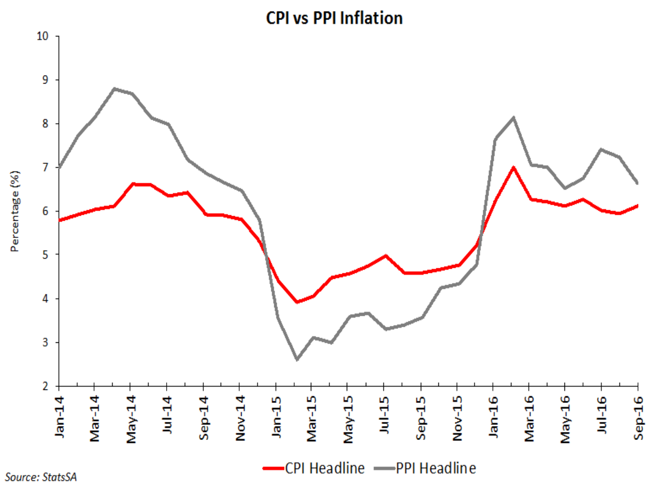
There are several reasons for some optimism that in fact the economy is forming a base from which it might gradually improve through 2017 and 2018.

Part of the reason for the relatively poor performance in Q1 is the fact that that quarter incorporated a spate of public holidays towards the end of March, which resulted in many workers taking just three working days leave in order to ensure a ten day holiday away from the workplace. The mining and manufacturing sectors were particularly adversely affected by this resulting in a sharp dip in the BDI for those sectors during that quarter. Conversely, no such major statistical distortions were evident in Q2 and Q3.

Secondly, meteorologists argue that the drought conditions which have affected the economy more severely than many have given them credit for, should dissipate over the coming year.

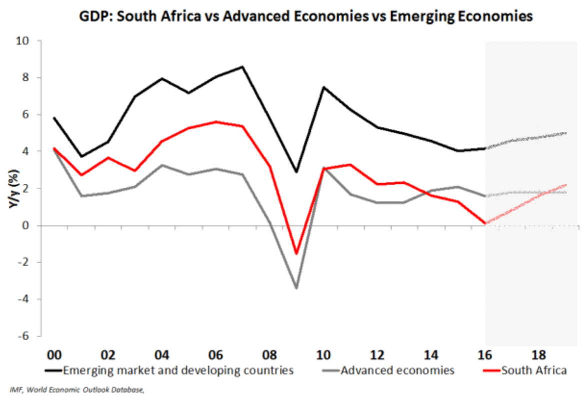
More importantly from a macroeconomic perspective, inflation has turned out to be significantly lower than expected earlier in the year, partly because of some recovery in the exchange rate.

Chart 3



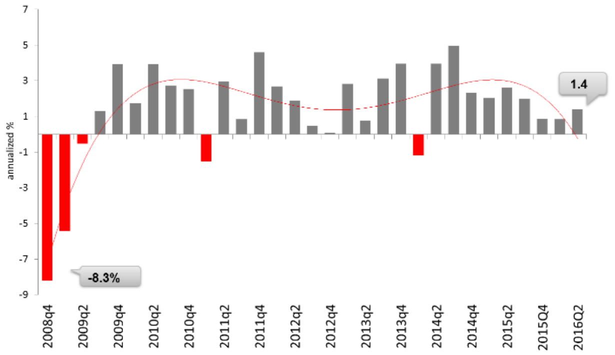
Nonetheless, the lower than previously anticipated inflation rate, which should pave the way for interest rates to remain unchanged rather than to increase, should assist consumers over the coming year. Furthermore, with the exchange rate still at a fairly weak level on purchasing power terms and with costs rising at a much slower pace than had been the case on previous occasions, following severe currency depreciation, exporters should have a wonderful opportunity to capitalise on the enhanced competitiveness of their offerings. More generally related to the BDI, the fact that businesses have by and large been able to maintain relatively firm balance sheets, ought to prevent a spiral of declining economic activity.

Chart 4



Indeed, forecasts of the BDI over the next few quarters see it gradually turning positive by Q1 2017. Such an improvement is unlikely to be dramatic, but sufficient to see economic growth improving from its current level of just above zero. Endorsement for this view has also been gleaned from the upturn in the Reserve Bank's business cycle indicator in August to its best level in over a year. Other factors supportive of this relative improvement include the fact that global economic activity appears to be holding up, albeit at rather tepid levels. This positive growth in part has been exemplified by the pickup in US GDP growth to 2.9% in Q3 from 1.2% in Q2.

Chart 5



Source: Bureau of Economic Analysis

This slight pickup in US growth, together with stabilisation of Chinese growth, have been sufficient to assist commodity prices to rally from their lows at the beginning of the year. In turn, this has also provided support for investment into emerging markets such as South Africa which have helped to bring about a recovery in the exchange rate sufficient to tame inflationary pressures. Of course, the subjugation of some of these inflationary pressures has had the countervailing effect of putting some downward pressure on profit margins of businesses, as reflected by the manner in which PPI inflation has fallen back in recent months relative to CPI inflation. Downward pressures on inflation have also resulted in the gap between short and long term interest rate to decline somewhat, which is normally seen to be reflective of impending margin pressures and subdued economic growth.

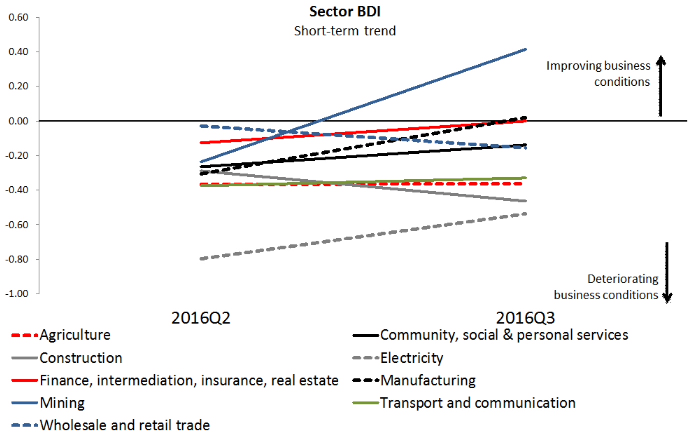
The point is that the caution instilled within businesses from the current economic environment has been such as to ensure that they have battened down the hatches to enable them to survive a period of low growth.

BDI by sector

From a sectoral perspective, one notes a huge improvement in the BDI for the mining sector in Q3, helped along by the recovery in commodity prices and the containment of cost increases. The other sector which had been extremely weak during the first half of the year, viz. manufacturing, also experienced a significant recovery in business debt conditions in Q3.

The data reinforce the manner in which these sectors had been depressed by the spate of public holidays and lower commodity prices in Q1. In tandem with the recovery in mining and manufacturing, business conditions in the electricity sector also showed a diminution in the rate of deterioration.

Chart 6



The agricultural sector has also not seen any significant improvement, which is understandable given that the expected rainfall to end the drought has not yet occurred.

On the negative side, one notes a moderate deterioration in business conditions in the retail sector, which is not surprising. Caution in the face of vulnerability to retrenchment has induced reluctance to take on credit to spend on big-ticket items. In addition, inflation, especially of durable goods, has risen in the past year as a result of the severe currency depreciation of 2015, whilst prices of food have also accelerated as a result of the drought, putting a strain on businesses in the food and other retail industries.

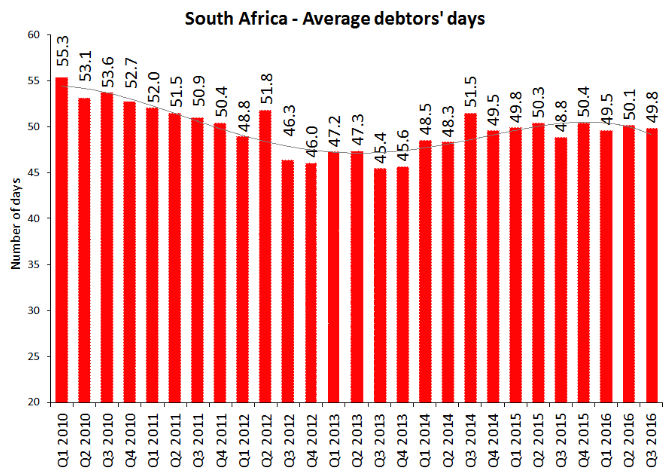
Unfortunately, reflecting the impact of low business confidence in reducing private sector capital investment, business conditions in the construction sector have deteriorated markedly whilst a similar rate of deterioration as before prevails in the transport sector.

Understandably, the decline in the number of outstanding debtor days in the SME sector in Q3 compared with Q2, has not been as marked as with debtors days for all businesses. This suggests that the small business sector is taking more financial strain relatively speaking in the current weak economic environment than big businesses.

Business debt metrics in Q3 2016

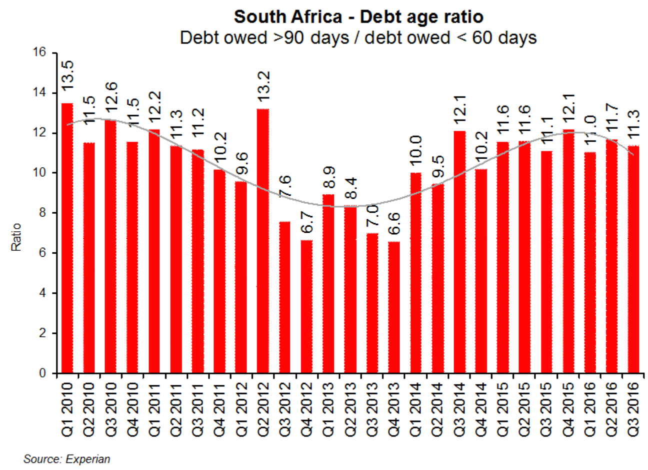
Relative soundness in corporate balance sheets is reflected in the fact that the number of outstanding debtors days actually diminished slightly in August and September, to 49.1 and 48.6 days respectively, from 51.2 and 51.7 days in June and July.

Chart 7



September's average level of outstanding debtors days was at its lowest level since March. For Q3 as a whole, outstanding debtors days declined to 49.8 from 50.1 in Q2. Although these figures are somewhat higher than the 45.4 quarterly low point for outstanding debtors days in Q2 2013, they compare favourably with figures of between 55 and 60 days debtors days outstanding in 2009 and early 2010 following the global financial recession. This picture coincides with the deterioration in the BDI between 2013 and the present, but also reflects the fact that the current BDI is significantly stronger than it was at the beginning of the decade.

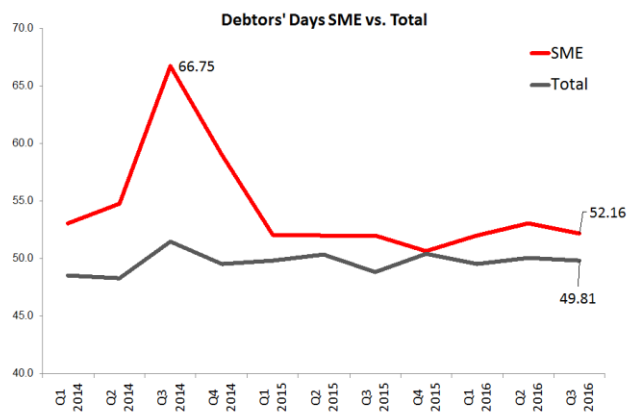
Chart 8



Looking at the ratio of long term to short term debt, the trend of a slowly increasing ratio (i.e of debt owed greater than 90 days increasing while debt owed less than 60 days decreasing) has stabilised somewhat. This aligns with the idea that the ability to repay debts is not deteriorating further and businesses are stabilising their financial position.

The same holds when looking at discrepancies between small and medium sized enterprises (SMEs) and the rest of the business population. Although SMEs continue to experience higher debtor days, Q3 2016 brought a stabilisation (in line with a stable BDI) implying that conditions are not worsening significantly for smaller firms.

Chart 9



Summary and Outlook

In conclusion, the financial position of the business sector continues to deteriorate, but only modestly. There appears to be a certain resilience brought about by adequate preparation on the part of businesses to endure a low growth environment. In turn, this might generate a platform from which modest economic recovery can occur over the next few years.

Obviously, such a recovery can be expedited with the assistance of more fundamental structural improvements to remove significant impediments to better business conditions. This includes the need for more effective outcomes in education and skills development, less adversarial labour relations, a less constrictive regulatory environment, a more intensive build-up of innovation and entrepreneurial activity, and a rise in the relative importance of small business.

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 2016, 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, 2016, 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.

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.