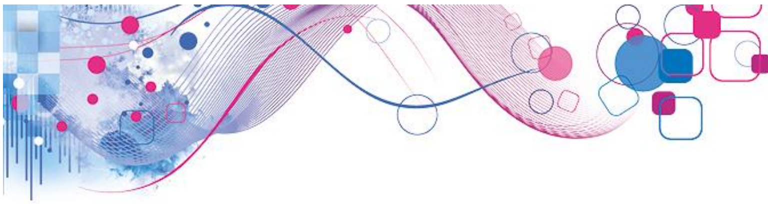

Experian Business Debt Index (BDI)

Q3 2017

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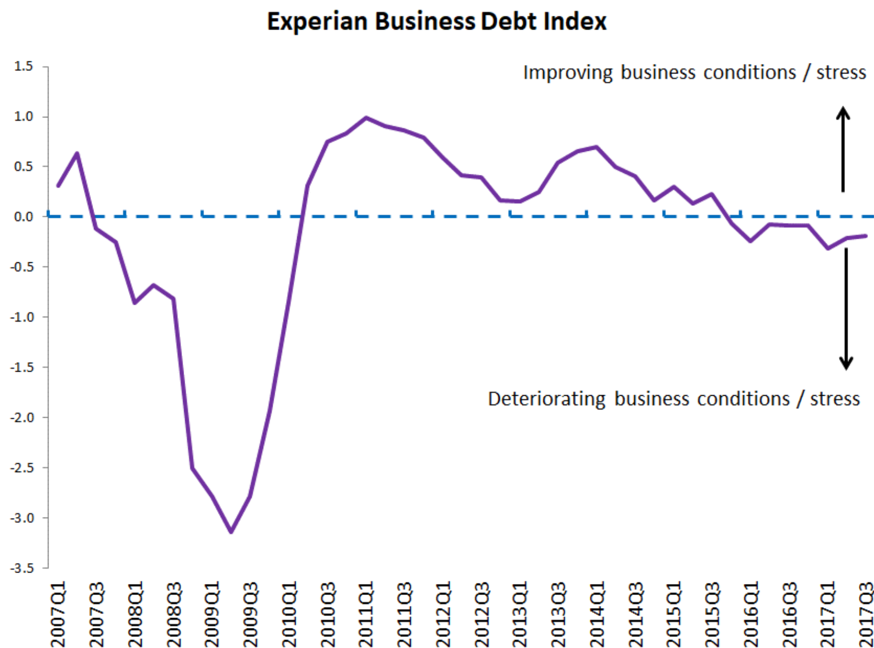
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q3 2017

Business debt conditions remain resilient in weak economy

The Experian Business Debt Index (BDI) rose marginally in Q3 2017, to a reading of -0.185, from -0.206 in Q2 2017. Nonetheless, the fact that the BDI remains negative suggests that business debt conditions continued to deteriorate in Q3 2017, but at a pace which is not particularly severe.



	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.080*	-0.081*	-0.316*	-0.206*	-0.185

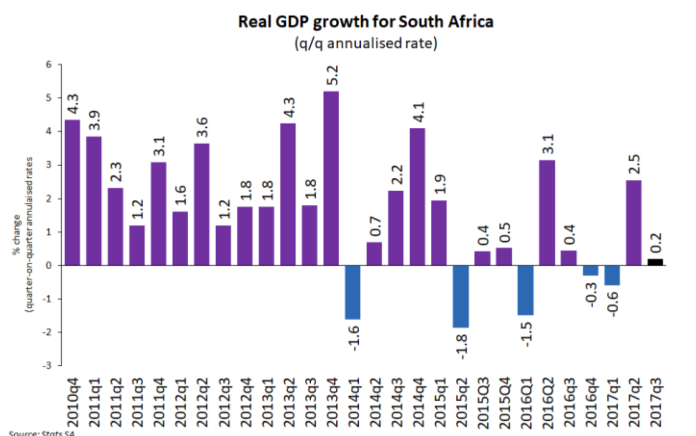
* *Revised*

Despite the threat of further credit ratings downgrades and depressed business confidence, there have been signs of resilient economic activity, with improved growth figures for mining and manufacturing production, as well as retail and car sales. On average, the number of outstanding debtors' days fell moderately for a second successive quarter, to 47.0 days, from 48.0 days in Q2 2017 and 48.8 days in Q1 2017. The 47.0 average outstanding debtors' days in Q3 2017 compares favourably with a corresponding figure of 49.0 days in the same quarter of 2016 - this points to continued financial resilience amongst firms.

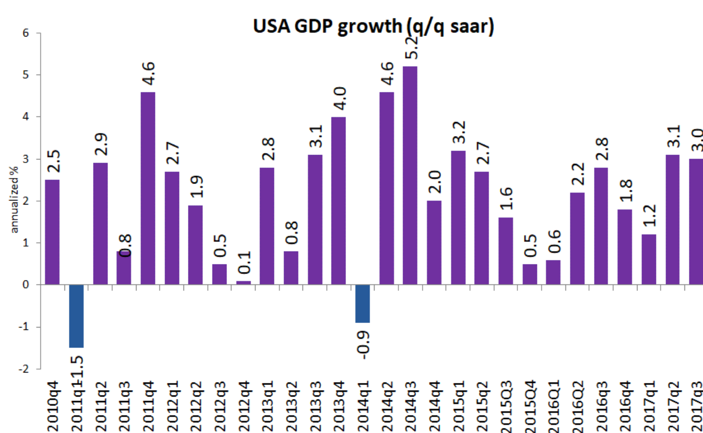
There can be no doubt that the weak state of domestic economic activity continues to hold back any chance of a meaningful improvement in business debt conditions. At the same time, there have been encouraging signs of a gradual bottoming out after a seven-year downward trend in business activity. Macroeconomic factors support a gradual improvement in domestic economic growth which should ensure that the BDI continues to improve over the next two quarters. Even so, the extent of such improvement is likely to be relatively muted in the face of continuing political uncertainty regarding the outcome of the ANC's electoral conference.

Macroeconomic factors influencing Q3 2017

From a negative perspective, the Q3 2017 reading for the BDI remained below zero, indicating continuing deterioration in business debt conditions in the face of lower economic growth and poor business confidence. However, from a positive perspective, the BDI rose marginally, to a reading of -0.185 in Q3 2017, from -0.206 in Q2, which was itself up on the -0.316 Q1 BDI.

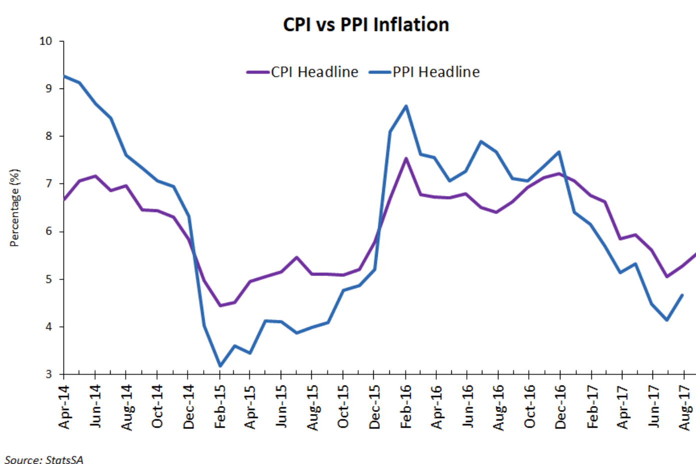


On the whole, the macroeconomic factors feeding the calculation of the BDI did not change dramatically. Even though the q/q seasonally- adjusted growth rate in GDP recovered quite strongly to 2.5% in Q2 2017 from -0.7% in Q1 2017, much of this can be attributed to statistical factors. In particular, the timing of Easter falling into April this year as compared with March last year, had the effect of depressing growth in Q1 2017 and boosting it in Q2, especially in those sectors whose performance tends to benefit from public holidays. In other words, the statistical improvement in GDP growth in Q2 2017 was not based on fundamental factors. The forecasted rate of growth in South Africa's GDP in Q3 2017 (used in the Q3 BDI calculation) remains unchanged, at 0.45% y/y. This brings stability, but is not substantial enough to bring about an improvement in business debt conditions.



Source: FRED

On the other hand, the actual growth in US GDP accelerated slightly, to 2.26% y/y in Q3 2017, up on a forecasted growth rate of 1.80%. Downward pressure to the index came from the fact that the gap between short and longer-term domestic interest rates widened as long-term interest rates rose in line with the gradual weakening of the rand in Q3 2017 and an associated increase in the probability of further credit ratings downgrades. Finally, the gap between the CPI and PPI inflation rates, as an indicator of relative pricing pressures, was virtually unchanged in Q3 2017 compared with Q2.

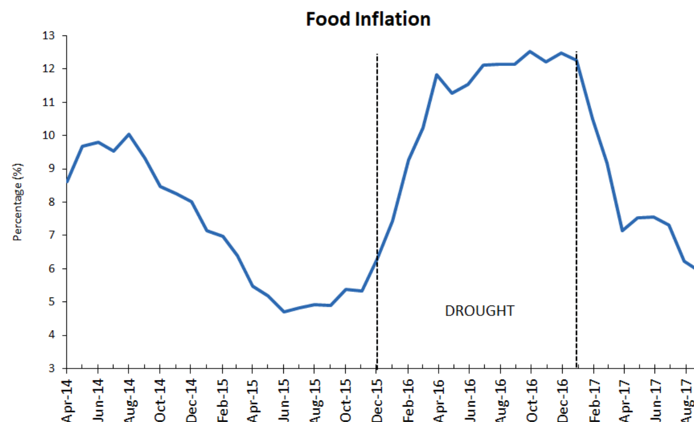


Source: StatsSA

Looking closer at the domestic economy, agricultural conditions have improved with the ending of drought conditions in the north-eastern regions of the country. A resultant decline in agricultural futures prices of staple foodstuffs has brought down food inflation quite sharply, from over 12% in 2016 to around 5% in September

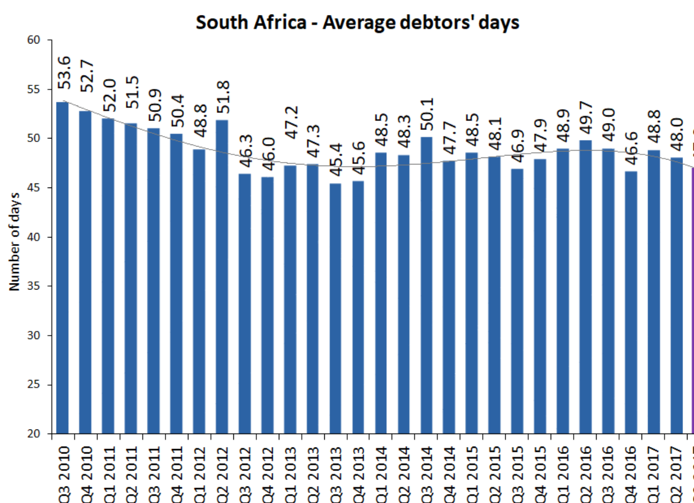
2017. This improvement has coincided with an uptick in mining production in tandem with improved mineral prices. The incidence of industrial action has also remained low in the past couple of years compared with the preceding five years.

The fact that the rand strengthened by some 20% on a trade-weighted basis between early 2016 and Q3 2017 has resulted in a decline in the inflation rate of imported goods and imported inputs into production processes. Lower-than-expected inflation in turn has meant that the disposable income of citizens has been given a lifeline and has meant that interest rates have not risen in the manner previously anticipated. Finally, the improvement in commodity prices has contributed towards a widening of the trade surplus and an associated diminution of the current account deficit, feeding through into still more currency strength.



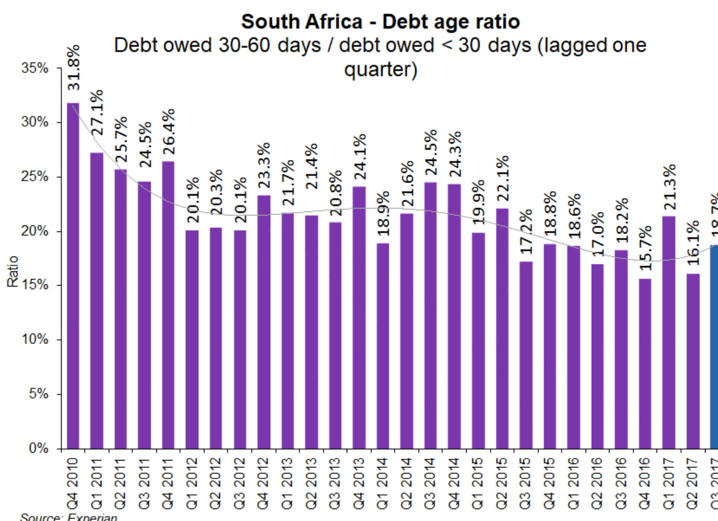
Business debt metrics in Q3 2017

As mentioned, despite the undramatic change in macroeconomic indicators influencing the BDI, the latter unfortunately did not improve to the extent hoped for. This was mainly due to the increase in the ratio of outstanding debtors' days compared with what had been anticipated.



Debtors' days' ratio

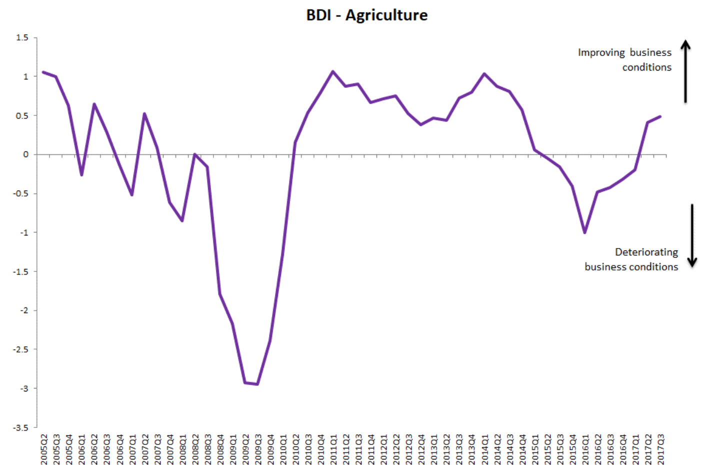
There was an increase in the ratio of outstanding debtors' days of more than 30 days relative to those of less than 30 days. Outstanding debtors' days of between 30 and 60 days accounted for 18.7% of the total number of outstanding debts of less than 30 days in Q3 2017, whereas this percentage had been much lower, at 16.1% in Q2 2017. Similarly, the debt owed of between 60 and 90 days outstanding relative to debts owed of less than 30 days, increased from 5.1% in Q2 2017, to 5.5% in Q3 2017.



These increased ratios indicate an increasing number of businesses (albeit a minority of the overall number of businesses) have been taking strain in these difficult economic conditions and have been compelled to delay paying off their debts. In this way providing downward pressure on the overall index and underlying the narrative of some continued deterioration in business debt conditions.

BDI by sector

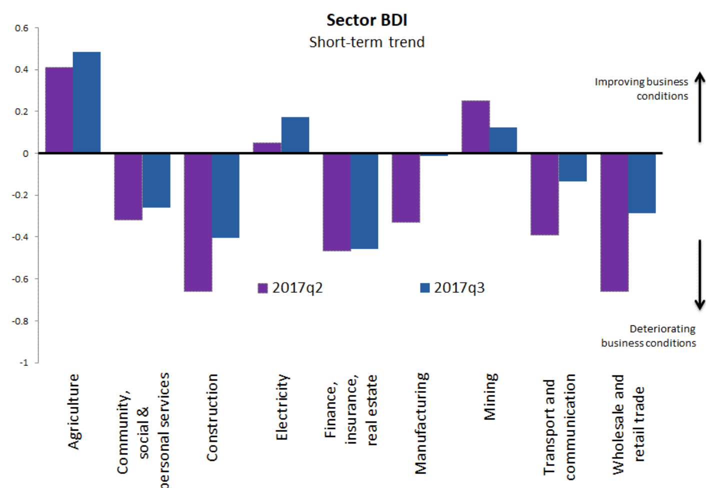
Some encouragement can be drawn from the fact that the improvement (represented by more positive BDI) in the rate of deterioration in business debt conditions is applicable to the overwhelming majority of sectors within the economy. Of the nine sectors in which the BDI is measured, only mining reflected a declining BDI in Q3 2017 compared with Q2. Some of this decline can be attributable to the fact that the recovery in the BDI in the mining sector in Q1 had been very strong and so the BDI for mining has come off a high base.



However, despite the slowdown in the rate of deterioration of most sectors, only three of the nine sectors recorded a positive BDI in Q3 2017, namely, agriculture, mining and electricity. All three of these sectors reflect improving business debt conditions on account of the fact that 2016 had been a difficult year for them.

After strong improvement in the BDI of construction, the finance sector represented the lowest BDI value, this is a function of two effects, the first being that the construction of BDI values penalises those sectors which are underperforming their historical averages. In the case of finance this is acutely accurate as the current average growth in the financial sector falls well short of its generally outperforming growth in prior years.

Secondly there is certainly a situation manifesting itself where smaller financial firms are taking strain. As the economy tightens, the industry is consolidating around the larger firms and excluding the smaller suppliers and service providers in the sector. This is to the detriment of the overall economy and simply exacerbates the concentrated monopoly power that many commentators and government rails against.



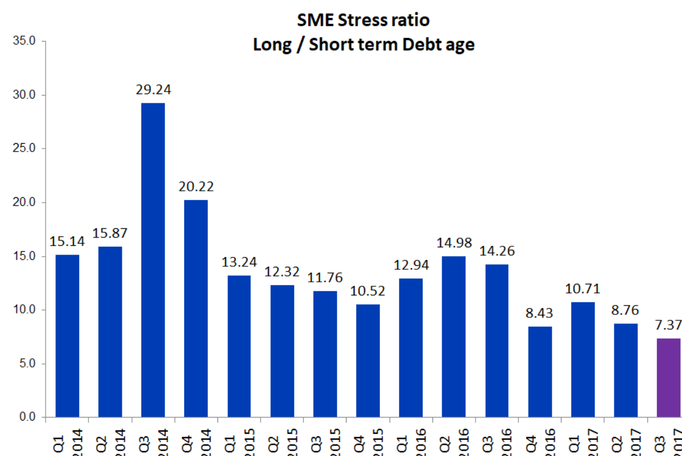
BDI by company size

Finally, also providing a somewhat counterintuitive outcome, the average number of outstanding debtors' days of SMEs fell further below that of the overall business community in Q3 2017. The average number of outstanding debtors' days of SMEs declined from 50.4 days in Q1 and 46.0 days in Q2, to just 44.3 days in Q3. This compares with the much smaller rate of

decline in overall debtors' days from 48.8 in Q1, to 47.0 in Q3.

In addition, the so-called stress ratio, which compares the ratio of long-term debt to short-term debt amongst SMEs, declined from 10.71 in Q1, to just 7.37 in Q3, its lowest level since the data on SMMEs was first captured at the beginning of 2014.

One explanation for this is that in the earlier stages of the economic downturn, many SMEs folded and the remaining SMEs still operating have succeeded in consolidating their balance sheets, enabling them to survive a low-growth environment even more effectively than the overall universe of companies. Put simply, it is possible that many of those SMEs who stood to fail have already failed, so that the balance is now reflecting a more solid financial state.



Summary and Outlook

In conclusion, business debt conditions remain under pressure, but do not seem to be deteriorating markedly. The narrative of businesses having prepared for a prolonged period of sluggish economic growth by building up solid cash balances and refraining from using these up through aggressive investment programmes, remains in place. In turn, this is helping to prevent the overall economy from posting a much steeper decline in business conditions notwithstanding the huge political headwinds to which the economy has been subjected and is likely to continue experiencing.

Structural impediments to higher economic growth in South Africa remain in place and it remains to be seen whether new political leadership will be able to bring about the structural reforms needed to boost economic growth and government revenues on a sustainable basis.

Furthermore, the international investor confidence was impacted by the evidence provided in the Medium-Term Budget Policy Statement (MTBPS) of a likely sharp increase in the public debt to GDP ratio, from its current level around 50% of GDP, to over 60% in the next three years.

Economic growth is likely to come in positive but weak, creating ongoing pressure on the ability of many businesses to pay their debts timeously. For these reasons, it is likely that the BDI will remain negative even if slightly better in Q4 2017 and Q1 2018 than in Q2 and Q3 2017, implying a continuation of the deterioration in business debt conditions, even if marginal.

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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 Experian BDI, as an indicator of the overall health of businesses, 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. 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: February 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.