Experian Business Debt Index (BDI) Results. Q4 2016

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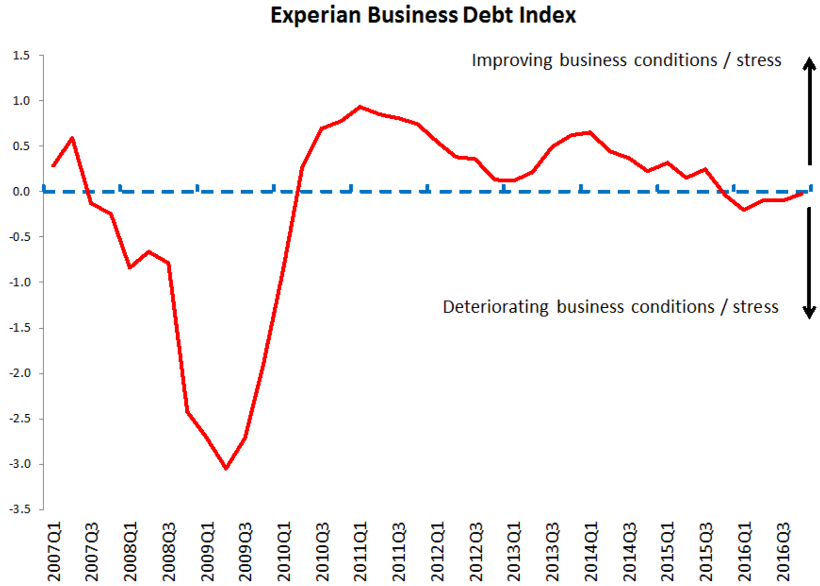
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q4 2016

Persistent horizontal movement of BDI in negative territory points to continued stressed business conditions

Chart 1



	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.036*	-0.208*	-0.107*	-0.098*	-0.034

* *Revised*

Outcome for Q4 2016

The Experian Business Debt Index (BDI) improved marginally in Q4 2016, to a reading of -0.0341, from a marginally revised -0.0983 in Q3. (A reading below zero indicates a deterioration in the financial position of businesses, whereas a positive reading implies an improvement). The fact that the figure was still marginally negative is indicative of a minor further deterioration in business debt conditions in Q4, but by no means anything to be alarmed about.

On the contrary, our initial forecasts of what the BDI will do during the first half of 2017, is one of a slight improvement in the index back into positive territory in line with a stabilisation and gradual turnaround in the past six years' gradual slide in the economy's performance. On the positive side, the fact that the BDI is only marginally negative is encouraging because it suggests that the overall economy is unlikely to go into recession with business debt challenges on the whole surprisingly benign. On the other hand, the reading is weak enough to preclude the likelihood of any large-scale capital investment taking place whereby businesses use up spare cash resources for such investment in such a way as to boost sustainable growth.

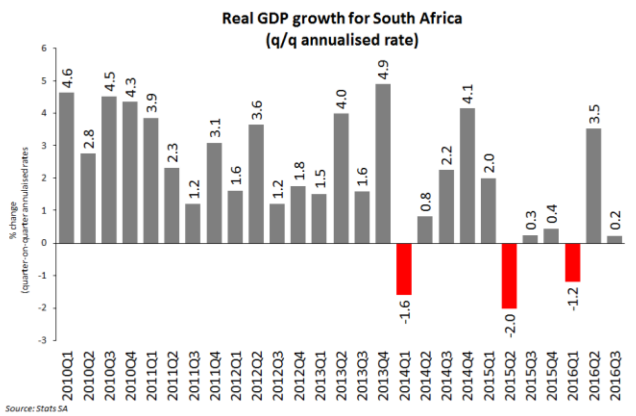
Macroeconomic factors influencing the Q4 2016 BDI

Unfortunately, international economic growth did recede slightly in Q4 2016, whilst domestic economic growth is likely to have been stagnant. There was also no significant improvement in the differential between short and longer term interest rates which is used as a proxy for assessing expectations of future business conditions.

Moreover, the difference between the PPI and CPI inflation rates, which can be used as a proxy for profit margins, deteriorated slightly, suggesting a marginally tighter environment for businesses, in which they have struggled to pass on cost increases. There was also no change in the ratio between domestic and foreign interest rates which might have led one to believe that financial conditions to borrow money locally rather than from foreign operations, had improved materially.

There are a number of reasons why one should expect a modest amelioration in business debt conditions. Firstly, good rains have fallen in North eastern regions of the country, thereby alleviating drought conditions. The resultant recovery in agriculture on its own ought to make a significant contribution to boosting economic activity more generally. Besides the stimulus to agricultural output directly, it presages a fall in food inflation in due course which should assist in boosting disposable income.

Chart 2

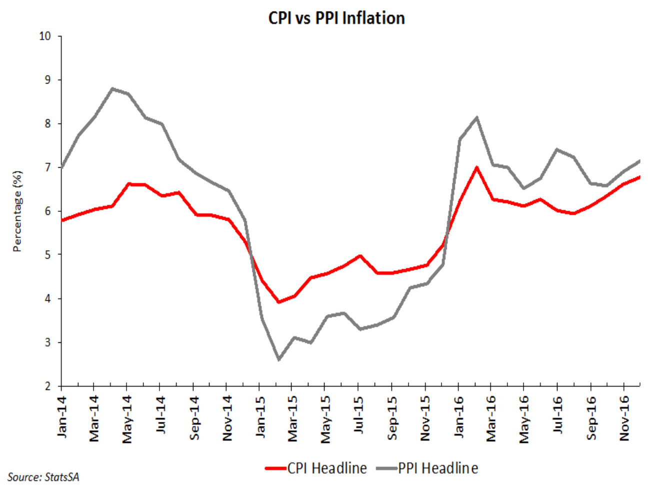


Secondly, electricity supply constraints are a thing of the past. Electricity demand has been sluggish due to slow activity in electricity intensive mining and metal processing operations associated with a switch in the direction of Chinese economic policy away from investment towards consumption.

In addition, demand for electricity has declined partly due to increased usage of other energy sources by businesses and consumers in response to sharp electricity tariff increases over the past decade. On the supply side, a number of units of the new Medupi and Kusile power stations, as well as the four units of the Ingula hydroelectric scheme, have been commissioned, whilst new sources of electricity from renewable energy projects have also become available.

Thirdly, the high spate of industrial action, which characterised the South African economic environment in recent years, has toned down in the face of low growth and the fear of job losses.

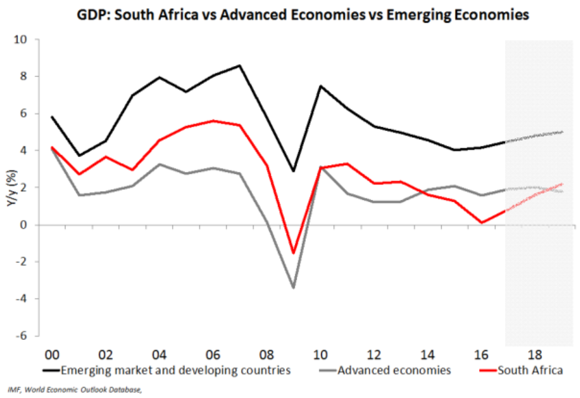
Chart 3



From a financial perspective, consumers as well as businesses will receive some respite from the fact that the Rand has strengthened substantially over the past year and as a consequence inflation is turning out to be lower than had been anticipated a year ago.

Further hikes in interest rates beyond those which took place in March 2016, therefore also became unnecessary, in the process easing the burden of debt on the business sector. Finally, commodity prices have rebounded over the past year following their precipitous declines in 2014 and 2015, assisting in boosting export revenues and making imports more expensive. As a result, the balance of trade has been improving markedly.

Chart 4



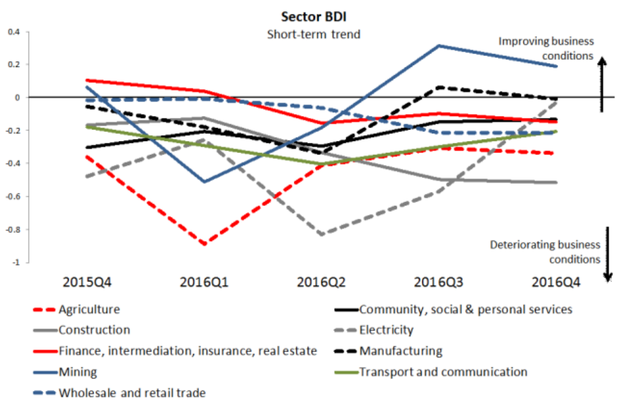
BDI by sector

In the same way as the improvement in the BDI in Q4 over Q3 was fairly marginal, one finds that in the case of most of the individual sectors of the economy, the changes from one quarter to the next in business debt conditions were also fairly small.

There were marginal improvements in the case of community services and transport, whilst there were equally marginal deteriorations in business debt conditions in agriculture, construction, finance, manufacturing and mining.

In agriculture, clearly, the lagged impact of the ravages of the drought, had not yet evaporated in Q4 2016, whilst businesses in mining and manufacturing, although recovering slightly compared with previous quarters, were probably still reeling from the downturn in the previous two years.

Chart 5



Business debt conditions in the retail sector remained unchanged at slightly negative. The single exception with regard to changes in business debt conditions lies with the electricity sector which recorded a marked improvement in line with the easing off of electricity supply constraints referred to earlier. Even here, however, the BDI remained in negative territory, albeit ever so marginally.

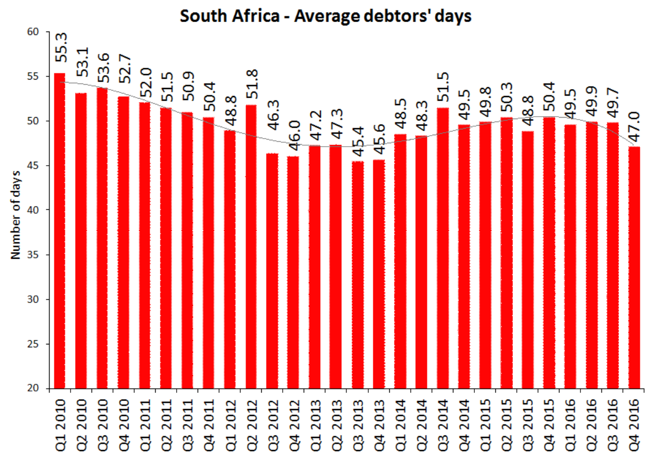
Only in the case of mining, was there a positive reading for the BDI and this is because conditions here reflected in a situation where one was seeing a substantial recovery from an extremely depressed situation in the preceding two years.

Business debt metrics in Q4 2016

The above-mentioned slight improvement in the financial environment has in turn been reflected in a decline in outstanding debtors' days of businesses. In Q4 2016, the average number of outstanding debtors' days declined to 47.0, from 49.7 in Q3 and 49.9 in Q2.

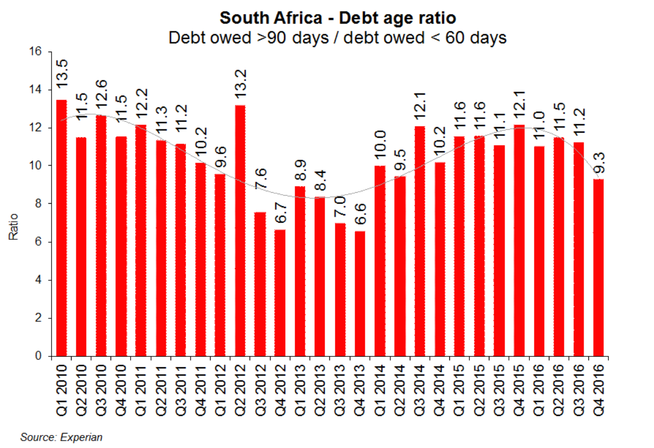
Indeed, the 47.0 average outstanding debtors' days in the Q4 2016 was the lowest average for any quarter since the Q4 2013, i.e. the lowest in three years. It is too early to call a downward trend, but in the context of a longer term history which saw average outstanding debtors' days of between 55 and 60 days in the wake of the global financial recession, encouragement can be drawn with regard to business' ability to survive in the current weak economic environment.

Chart 6



Furthermore, one is particularly encouraged by the fact that the ratio of outstanding debtors' days of more than 90 days to outstanding debtors' days of less than 60 days, declined quite sharply in Q4 2016, to 9.3, from levels between 11.0 and 12.1 in the preceding seven quarters. There was also a reduction in the ratio of debt owed of between 30 and 60 days to debt owed of less than 30 days lagged by one quarter.

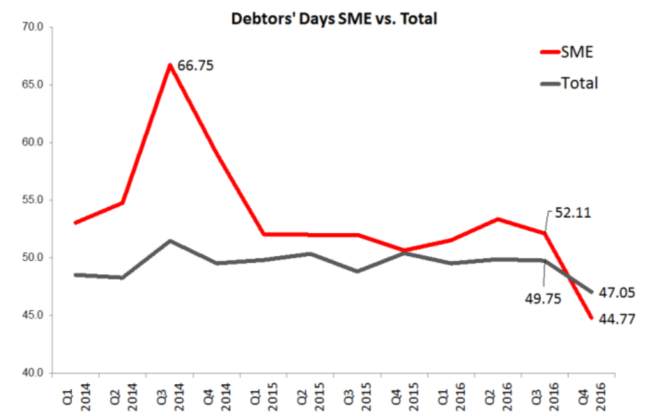
Chart 7



The BDI, however, is comprised not only of data on the number of debtors' days outstanding, but also of macroeconomic variables. Had the BDI depended solely on the number of debtors' days outstanding, it would have shown a much bigger improvement in Q4 2016.

One of the curious additional findings was the steep decline in the average outstanding debtors' days of small and medium-sized enterprises (SMEs) relative to all business. The average debtors' days of small businesses, which had been substantially higher than the overall average in Q3, viz. 52.1 versus 49.8, fell steeply in Q4, to 44.8 debtors' days, which was a level well below the 47.0 of the overall population.

Chart 8



One would have thought that in the wake of difficult economic conditions, the ratio between outstanding debtors' days of small businesses relative to the total would have increased rather than decreased.

Is it is conceivable that small businesses managed to access finance more easily in Q4 2016, in order to meet their financial commitments in such a way that they were able to pay off existing loans in return for new sources of finance. This premise is also supported by the fact that the SME stress ratio, i.e. the ratio between the age of their longer term debt and the shorter term debt, decreased substantially, from 13.5 in Q3 2016, to 7.8 in Q4. If this premise is correct, however, then it implies that the apparent improvement in the business debt conditions of SMEs, will come to be reversed in future quarters.

Summary and Outlook

In conclusion, business debt conditions are not great, but nor are they disastrous. If indeed economic activity improves moderately in 2017 as is currently foreseen, this is likely to be accompanied by a slight amelioration of the debt conditions of businesses through the economy more generally in the coming year.

Expected volatility within the international and domestic political environments in the short term are expected to have negative knock-on effects on business confidence. Fortunately, it would appear as though businesses locally have prepared themselves for such volatility by ensuring relatively solid balance sheets. The current BDI level tells us that business is not facing significantly adverse business conditions and they ought to be able to survive such an environment, barring any substantial downside deterioration.

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.

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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: 10 May 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.