Experian Business Debt Index (BDI)

Q4 2017

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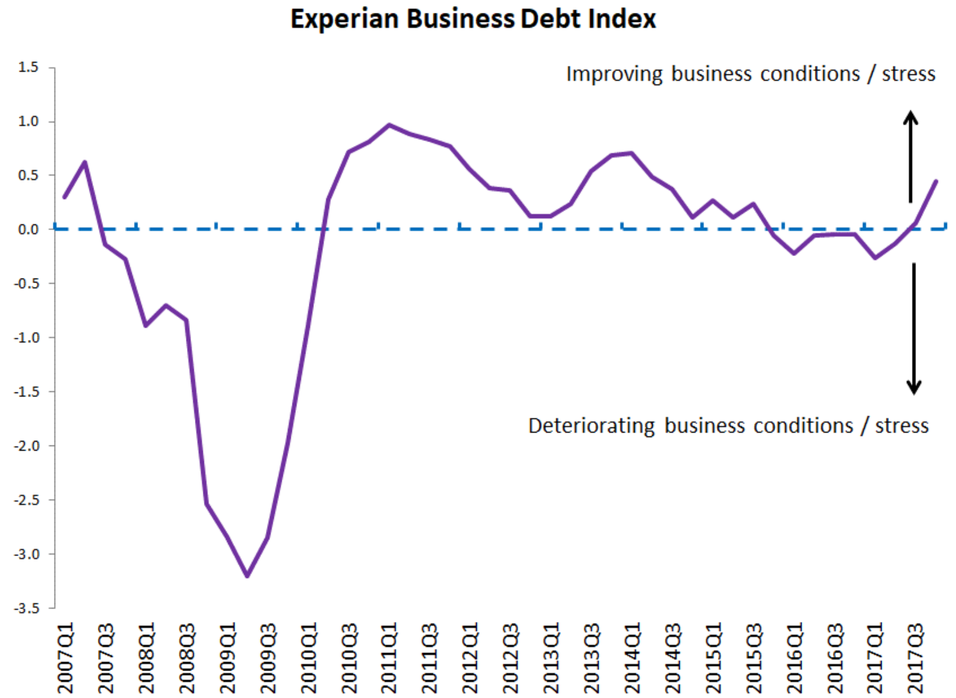
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q4 2017

Signs of improved economic activity reflected in business debt conditions

The Experian Business Debt Index (BDI) improved strongly in Q4 2017, to a reading of 0.443, from 0.059 in Q3 2017. This is the first time the BDI has turned strongly positive since Q3 2015. This is an indication of improving business debt conditions.



	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.042*	-0.260*	-0.129*	0.059*	0.443

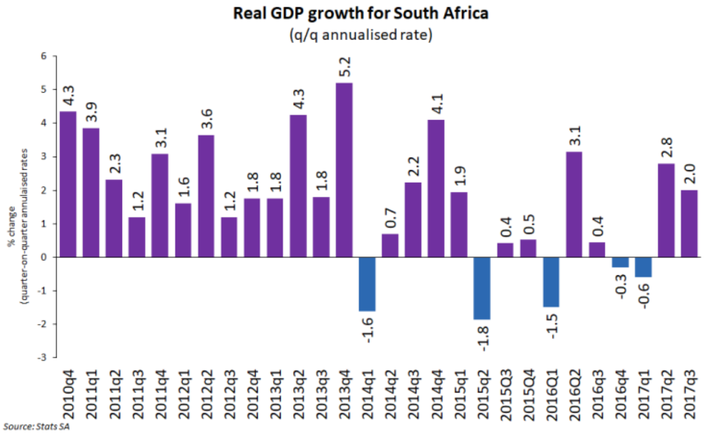
* *Revised*

The Experian Business Debt Index (BDI) improved by its largest margin in four years in Q4 2017. Bear in mind that an index value below 0.0 indicates deteriorating business debt conditions, whilst a positive number indicates an improvement in such conditions. The sharp rise in the BDI, from 0.059 in Q3 2017, to 0.443 in Q4 is the most encouraging sign of a turnaround in the dismal business conditions which have prevailed in the preceding four years. The Q4 2017 BDI was in fact the best such reading in more than three years.

The reasons for the improvement in business debt conditions are largely attributable to a marked turnaround in economic growth for the better both in South Africa and abroad. The recent amelioration in business confidence following the election of Cyril Ramaphosa as ANC president now stands to be followed by a more meaningful and sustained upswing in capital investment. Ironically, to the extent that such investment will begin to use up many of the cash piles built up by corporate South Africa in recent years, it might cause business debt conditions to deteriorate in certain circumstances. Even so, one senses that the boost to economic growth from increased investment will outweigh the weight of bad debts that might arise from insufficiently well-thought-out investment initiatives. It is therefore interesting to note that the latest forecasts for the BDI going forward are not looking for further improvements but rather for a stabilisation in the index at around the 0.4 level in the first two quarters of 2018.

Macroeconomic factors influencing Q4 2017

When the Q3 2017 BDI was presented late last year, the most recent figure released at the time was still significantly negative, at -0.185, even if this figure was less negative than the readings for the preceding two quarters. This figure has now been revised up sharply to a positive 0.059. In addition, last quarter we had predicted that the BDI would move towards the zero mark in the following two quarters, in line with a modest upturn in economic growth.

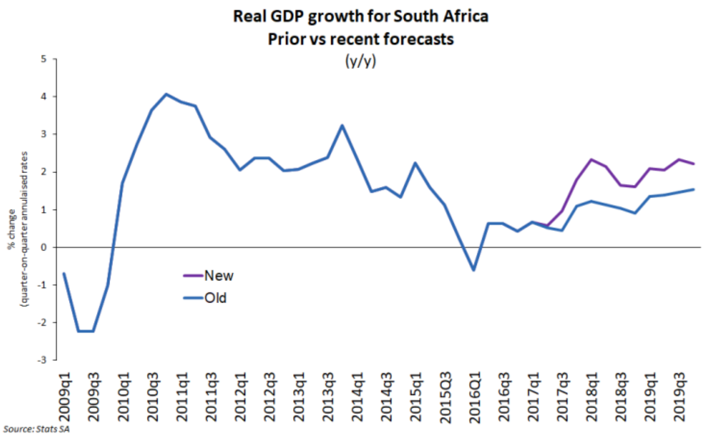


What has now happened is that the Q3 GDP figures for both South Africa and the United States have come in significantly stronger than had been anticipated at the time and forecasts for succeeding quarters have also been revised substantially upwards.

In South Africa's case, the turnaround for the better in economic activity had been developing for several months notwithstanding the decline in business confidence which had occurred over the course of 2017 on the back of two Cabinet reshuffles and subsequent credit ratings downgrades, in most cases to junk status.

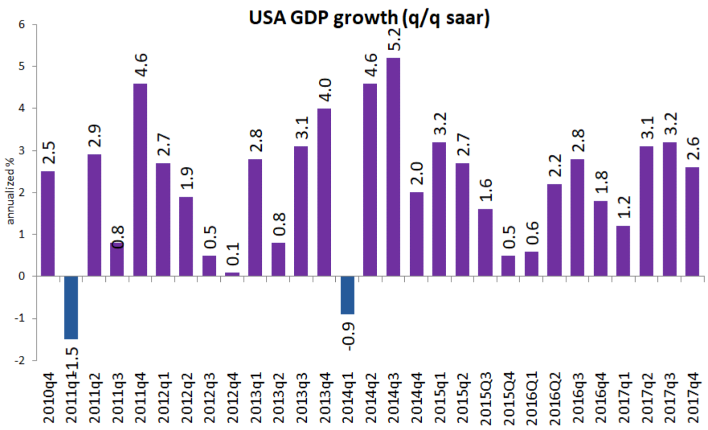
The impact of other variables on the BDI was minor in comparison with that of improved overall growth forecasts.

It was almost as if a disjoint developed between declining business confidence and a gradual return to more positive economic indicators. For example, growth in both mining and manufacturing production moved into significantly positive territory, having been negative for much of 2016. Another important factor driving improved economic growth was emergence from a crippling drought in the preceding two years. As a result, agricultural output almost doubled through the course of 2017 compared with 2016 and the knock-on benefits of this through the rest of the economy were material.



Growth in passenger vehicle sales and retail sales also accelerated quite markedly towards the end of 2017. The underlying driver of this improvement appears to have been the fact that the rand strengthened despite weak business confidence and this contributed towards lower-than-expected inflation which in turn helped to boost the growth in disposable income to levels higher than previously anticipated. The strength of the rand was itself driven by extremely positive risk appetite on global financial markets associated with the continuation of worldwide interest rates at historically low levels and an increase in global liquidity by central banks over a number of years.

The boost provided to commodity prices by the improvement in global economic growth also helped the South African economy to turn a substantial trade deficit a few years ago into a healthy surplus during 2017. The resultant reduction in the current account deficit assisted in alleviating the economy's dependence on foreign capital inflows. The rand benefited as a consequence. Internationally also, the improvement in global economic growth to its best level since the global financial recession implied more favourable export markets for South African goods.



Source: FRED

Whereas GDP growth forecasts for 2017 and 2018 had been set at around 0.6% and 1.0% respectively a few quarters ago, these figures have now been revised upwards to 1.0% and 1.9% respectively. Similarly, whereas US economic growth was expected at barely 2% in 2017, this figure has been revised upwards to 2.5% for both 2017 and 2018.

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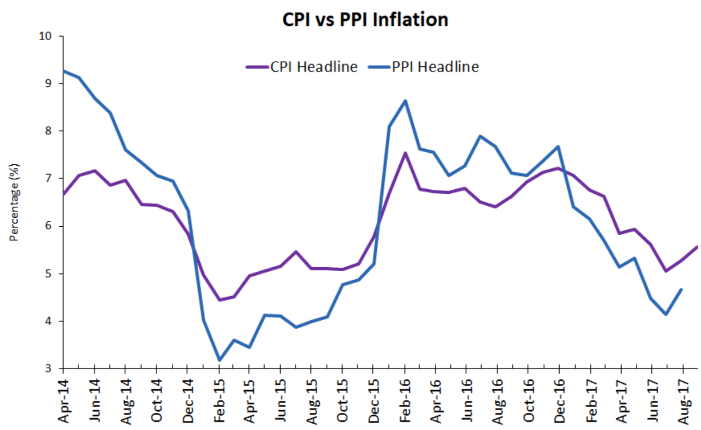
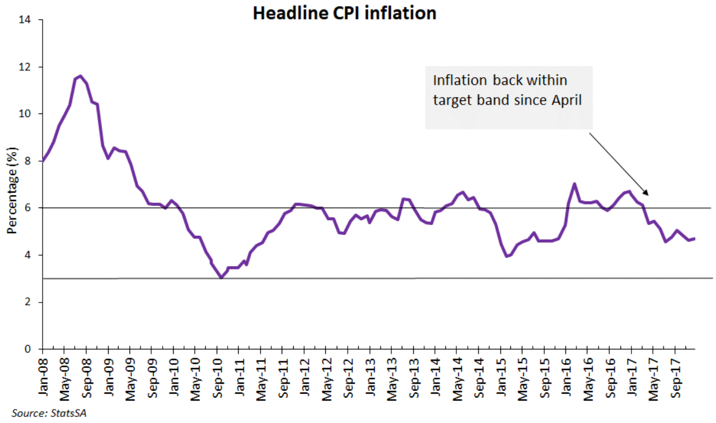
It appears as if the wealth effect of rising financial asset prices resulting from the huge additions of global liquidity into the world's financial markets, finally started flowing into increased consumption and investment in advanced economies. This improvement in turn called forth an upswing in commodity prices and growth in emerging markets as well.

Promises of substantial tax cuts, substantial increases in infrastructural investment spending and wholesale deregulation of the financial system in the US by the newly elected Trump administration, also seemed to help improve business sentiment in that country. However, one should also not ignore the fact that growth in the Eurozone economy increased to its best level in a decade in 2017.



Source: StatsSA

The impact of other variables on the BDI was minor in comparison with that of improved overall growth forecasts. There were only marginal changes in the interest rate differential between South Africa and the United States and between South Africa and short-term interest rates and long-term interest rates. Similarly, there was only a marginal increase in the PPI inflation rate relative to the CPI inflation rate which would normally be construed as implying an increase in business margins



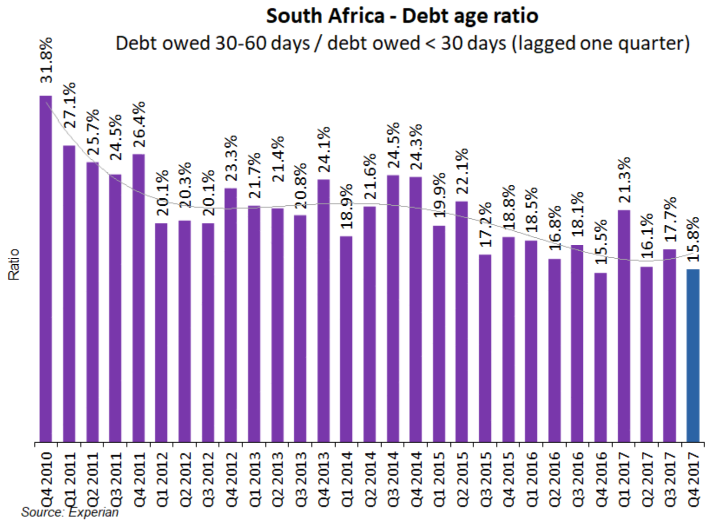
Business debt metrics in Q4 2017

Also contributing towards the improvement in the Q4 2017 BDI, but nowhere near as much as that brought about by higher economic growth forecasts, were the data on outstanding debt of businesses.

Debtors' days

More generally, the average number of outstanding debtors' days declined in Q4 2017 to 46.7, down from 48.7, 48.0 and 47.3 days in the first three quarters of 2017. It became clear that the low level of business confidence continued to contribute towards businesses holding off large-scale capital investment in building up solid cash flows instead.

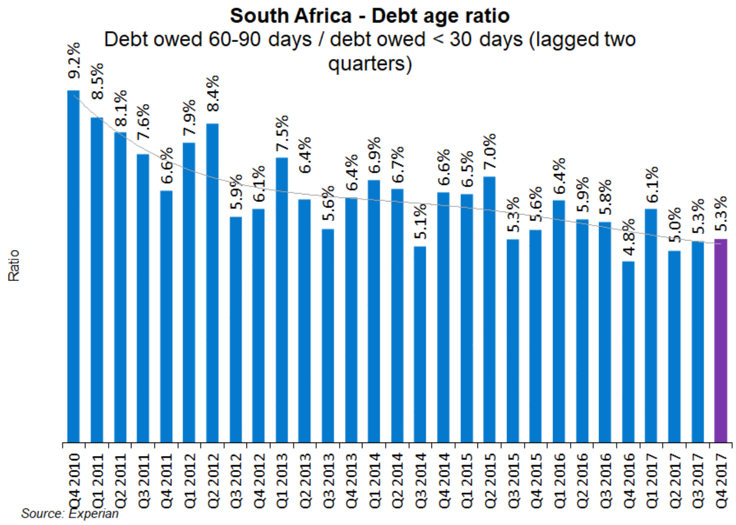
There was indeed a recovery in fixed capital formation in the private sector at an annualised rate of 4.3% in Q3 2017, following several quarters of negative growth in such investment. However, that pickup in private sector investment appears to have been insufficient to use up the cash flows accumulated in earlier years.



Debtors' days' ratio

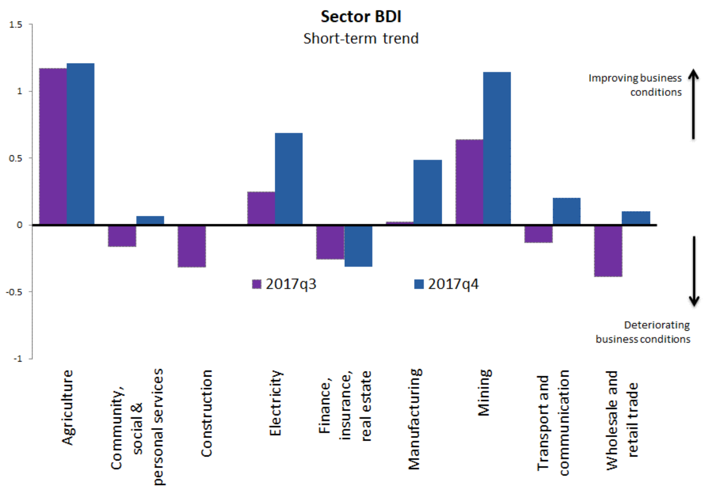
One notes that the ratio of loans outstanding of 30 to 60 days relative to that of less than 30 days (the "30-60 day" ratio) decreased from 17.7% in Q3 2017, to 15.8% in Q4 2017. Aside from Q4 2016, this was the lowest such ratio in a decade. The 30-60 day ratio directly influences the BDI outcome. As such, a continuously improving trend applied upward pressure on the Q4 2017 BDI.

The second ratio impacting the BDI calculation is that of debt owed of 60 to 90 days relative to debts owed of less than 30 days. Colloquially the "60-90 day" or "stress ratio" gives an indication of the long term to shorter term debt outstanding. The implication being that the greater the proportion of outstanding longer-term debt, the greater perceived financial stress of businesses. In the event, the ratio remained unchanged at just 5.3%, relatively low by historical standards, and consequently had little impact on the BDI.



BDI by sector

The improvement in the BDI overall is replicated by a corresponding improvement in the BDIs measured for most sectors of the economy. When the BDI was last measured late last year, only two of the nine economic sectors carried a positive BDI reading.



With the upward revision of economic growth for the second and third quarters carried through into the measurement of the BDI for Q4, the number of sectors recording a positive BDI for Q3 rose to four. Subsequent further improvements in economic growth forecasts have now resulted in the Q4 BDIs for all sectors bar one turning out to be positive.

Mining and agriculture are seeing the best improvements in business debt conditions. However, there have been huge improvements across-the-board with the exception of the financial sector where many smaller companies are labouring under the massive restructuring of the industry that is taking place.

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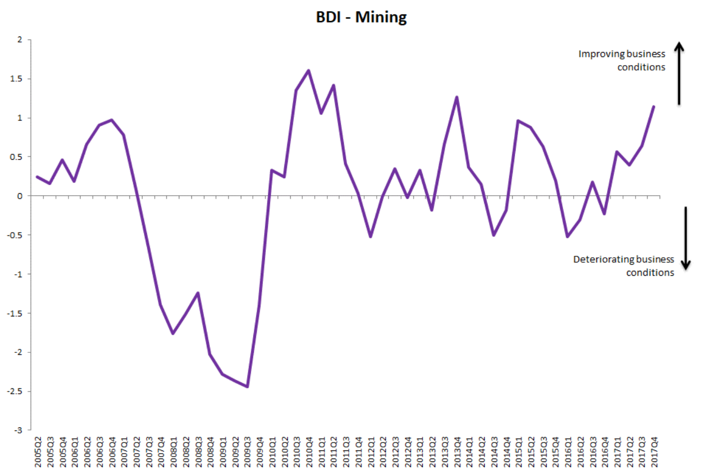
Although there has been a marked improvement in the BDI for the construction industry, the barely positive BDI for this sector illustrates the fact that conditions in construction remain fairly tight in the face of low levels of infrastructural investment.

The BDI reading for community services was also only just positive, with government cutbacks in spending aimed at warding off further credit ratings downgrades contributing towards reasonably tough times amongst public sector employees.

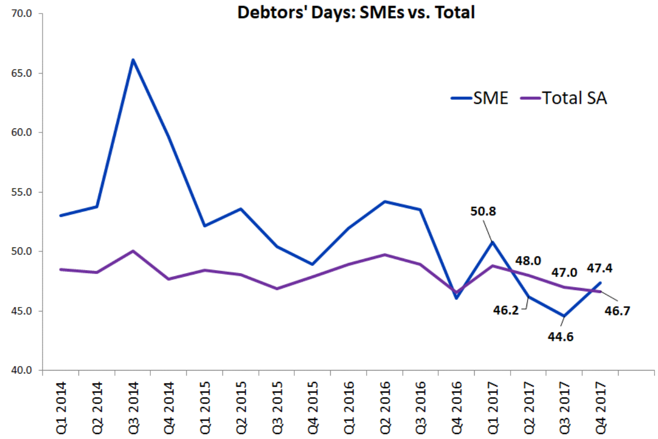


BDI by company size

Finally, there was a fairly stable picture in the business conditions of smaller companies vis-à-vis larger companies in the 4th qtr. The share of small and medium-sized enterprises in total debt increased marginally from 21.1% in Q3 2017, to 21.2% in Q4 2017.

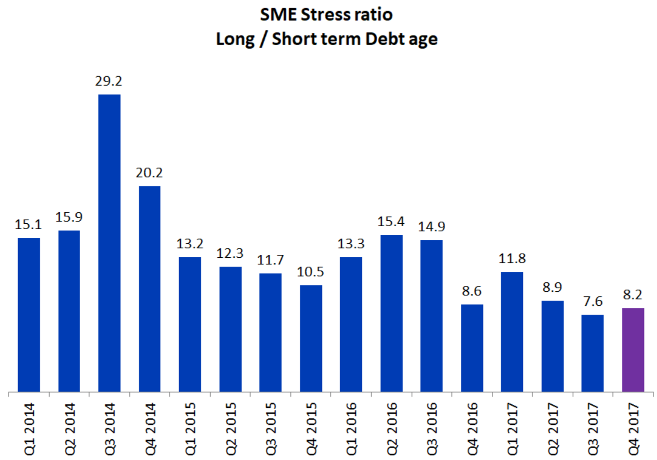
Likewise, the so-called stress ratio, which compares the ratio of long-term debt to short-term debt amongst SMEs, rose marginally from 7.6 in Q3, to 8.2 in Q4. Although raised, this ratio still sits near its lowest level since the data on SMMEs was first captured at the beginning of 2014.

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.



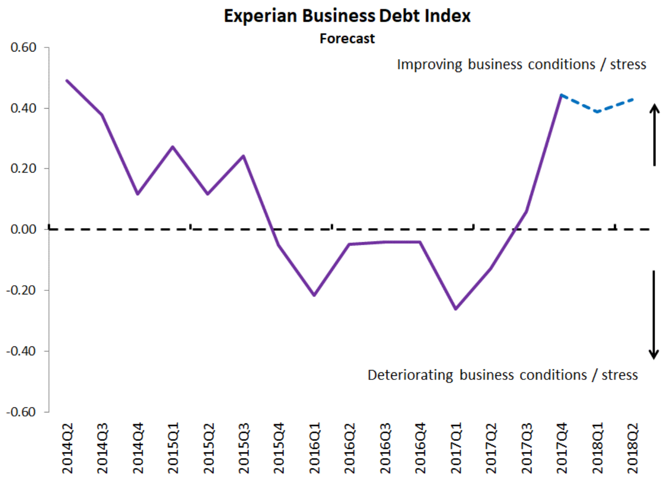
Summary and Outlook

In conclusion, both internationally and domestically there has been a marked change in the business environment for the better and this is starting to be reflected in an improvement in business debt conditions.



Even so, the economic outlook is still constrained by a number of structural impediments to higher economic growth such as poor levels of education, concentration of power in the hands of big business, insufficient attention to development of small businesses, not to mention high levels of state capture and corruption.

Until these issues are overcome, it will be difficult for economic growth to reach its full potential and begin providing scope for a reduction in unemployment. Fortunately, recent developments suggest there is room for optimism to witness a gradual recovery in economic activity henceforth over the next few years. In this regard, it will be imperative for Cyril Ramaphosa to have relatively free rein to dictate economic policy in years to come.



The latest forecasts for the BDI going forward are not looking for further improvements but rather for a stabilisation in the index at around the 0.4 level in the first two quarters of 2018.

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: May 2018

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.