experian

Business Debt Index

Quarterly Summary - Q1 2023

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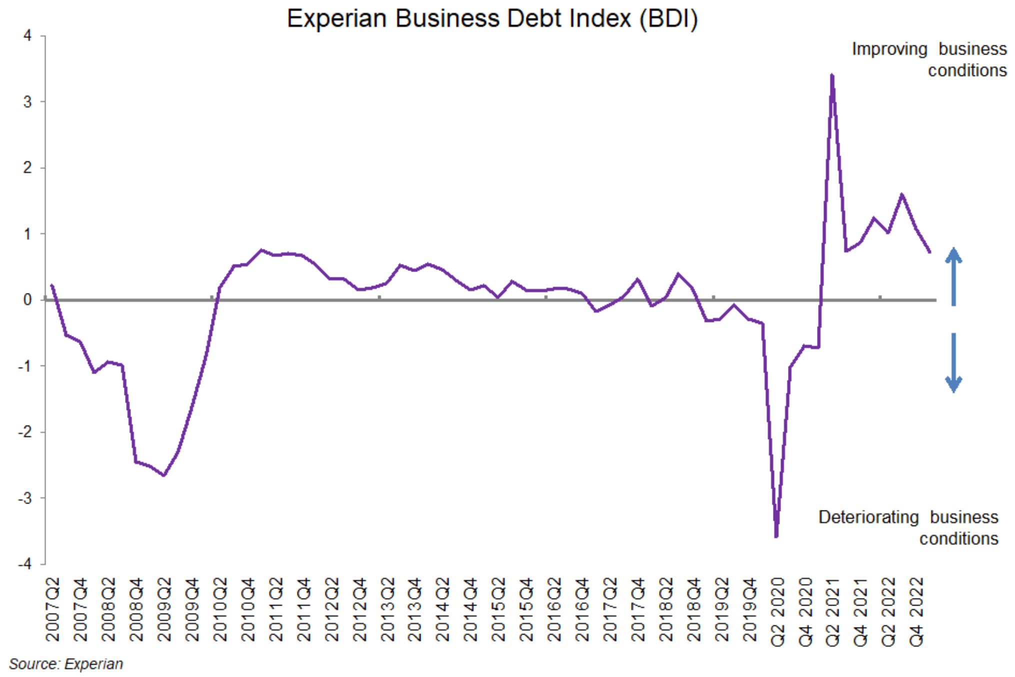
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q1 2023

A better-than-expected outcome in Experian BDI in Q1, on the back of a positive GDP outcome

The Experian Business Debt Index (BDI) for Q1 2023 shows a decline to 0.721 from an upwardly revised 1.086 reading for Q4 2022. The Q1 outcome for the BDI is somewhat better than was expected. The fact that the BDI remains positive (i.e. above the zero level) is an indication of improving business debt conditions. That the Q1 BDI was somewhat better than forecast three months ago is primarily a function of South Africa's economic performance for Q1 turning out to have been a little better than expected.



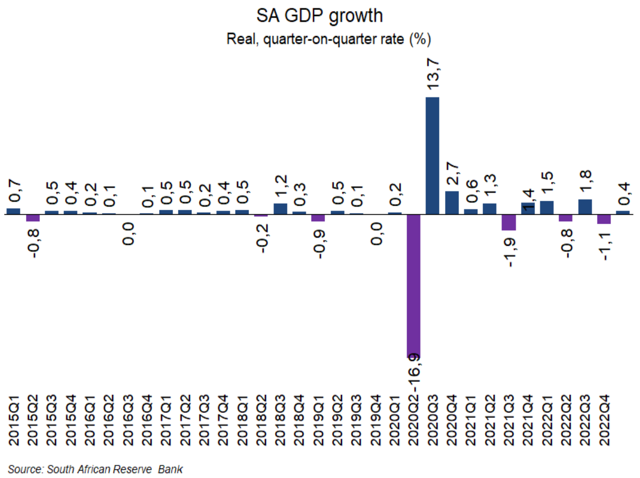
	Q1 2022*	Q2 2022*	Q3 2022*	Q4 2022*	Q1 2023
Index >0= Improving business conditions <0 = Deteriorating business conditions	1,245	1,015	1,602	1,086	0,721

** Revised*

Macroeconomic factors influencing Q1 2023

Three months ago, one had been contemplating an economic scenario of enormous decline due to a significant intensification of load-shedding through Q1. In the event, the impact was not quite as severe as had been perceived.

GDP growth came in at a positive, albeit not sparkling, 0.4% q-o-q. This represented a nice increase from the -1.1% economic contraction experienced in Q4 of 2022 and ensured that the economy had not registered a technical recession, represented by two consecutive quarters of negative growth.



Without a doubt, load-shedding did have some very negative implications, none more so than in the agricultural sector, which contracted by 12.3% q-o-q in Q1, principally because of issues related to load-shedding.

However, it is also apparent from the resilience of mining and manufacturing output in Q1, and positive growth in financial services, transport and retail and wholesale trade, that businesses and consumers are coping with the scourge of load-shedding much better than anticipated.

Purchases of generators and solar panels are clearly helping to diminish the damage caused by a lack of electricity, whilst a fairly reliable programme of load-shedding issued by Eskom enables many to adjust activities to minimise the negative impact.

Economic headwinds were not confined to increased load-shedding alone. Sustained relatively high inflation and an accompanying increase in interest rates to their highest levels in a decade also worked against stronger economic growth.

Nonetheless, consumer spending avoided collapsing, partly because the lion's share of consumer spending is derived from a relatively small proportion of the population whose members continue earning reasonable incomes and can access credit.

To this end, growth in credit extension, especially unsecured lending, grew faster than at any stage in the past decade. Whilst this does have a longer-term downside in terms of the burden of servicing that debt, in the short term, it has been assisting in sustaining spending at previous levels.

The other factor contributing to the economy's resilience has been a noticeable gradual pickup in recent quarters in the level of fixed capital formation. This continued into Q1 of 2023. Much of this is linked to initiatives aimed at enabling businesses to be technologically capacitated when facing the future.

There has been a distinct reversal in recent quarters in the erstwhile declining trend of fixed capital formation to GDP.

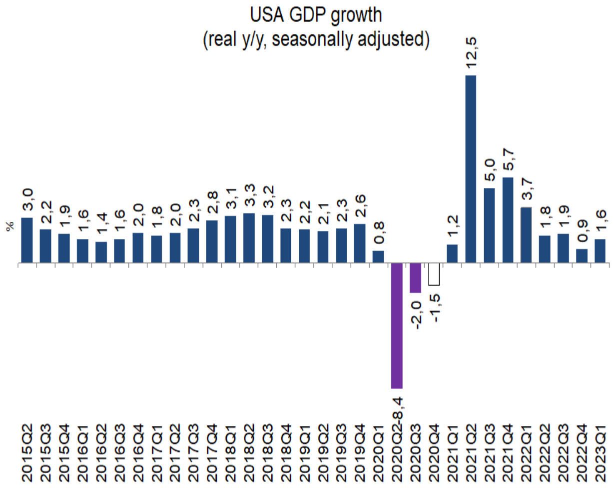
The Q1 BDI was also helped by an improvement in global economic growth, which fed through into the trade and current account deficits turning out to be much smaller than had been feared.

Certain key commodity prices experienced a bit of a revival on the back of improved global growth. It became apparent in the US that the boost from the massive fiscal and monetary stimuli injected into that economy during the Covid crisis continued into the first part of 2023.

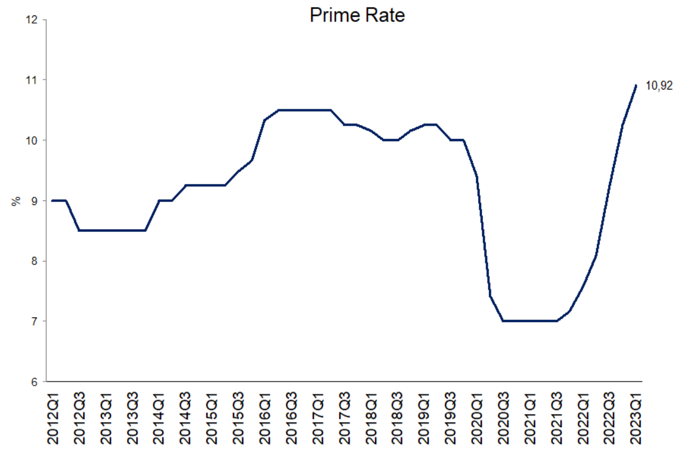
The European economy avoided recession primarily because of the relief derived from a sharp decline in gas and other energy prices.

Meanwhile, China's economy revived on the back of the lifting of extremely severe lockdown restrictions imposed through 2022 to fight Covid.

The surrogate for global growth used in the calculation of the BDI, viz US GDP growth, improved significantly in Q1 of 2023 compared with Q4 of 2022 (see chart below).

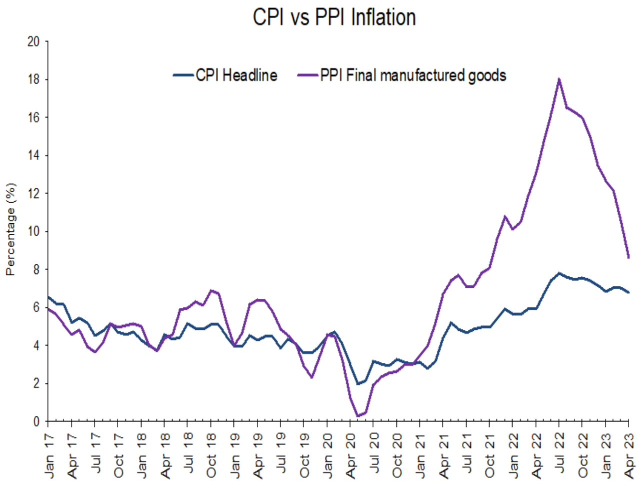


Source: Bureau of Economic Analysis



Source: South African Reserve Bank

Working against a higher value for the Q1 BDI was a sharp diminution in the differential between the domestic PPI and CPI inflation rates, from 7.9% in Q4 of 2022 to 4.8% in Q1 of 2023.



Source: StatsSA

A higher value for the PPI inflation rate relative to the CPI inflation rate is commonly used to reflect the profit margin that businesses are able to extract.

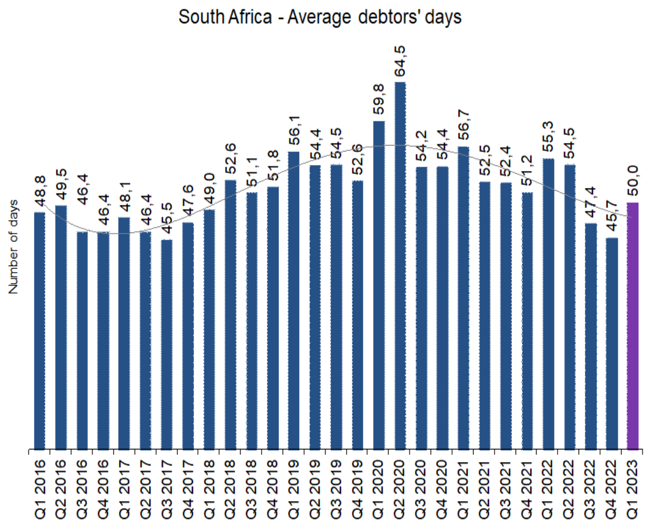
The remaining components of the BDI that might influence its value linked to the relationship between domestic and foreign interest rates and short-term and longer-term domestic interest rates did not play a significant role in determining the Index in Q1.

The changes in these ratios were relatively minor in their impact compared with issues related to South African and US economic growth and the differential between producer and consumer inflation.

Business debt metrics in Q1 2023

The above-mentioned macroeconomic forces influencing the BDI account for 70% of its determination. The remaining 30% are derived from data emanating specifically from Experian relating to the duration of outstanding debtors' days as a reflection of debt stress.

In this regard, the results for Q1 were quite mixed. Superficially, there appeared to be a marked deterioration, as reflected by the average level of outstanding debtors' days rising from 45.7 in Q4 of 2022 to 50.0 in Q1 of 2023.

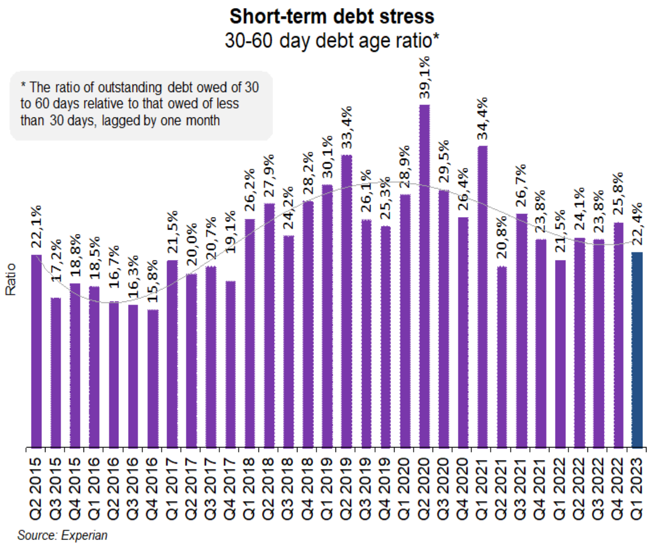


However, disaggregation of these data produced a somewhat different picture.

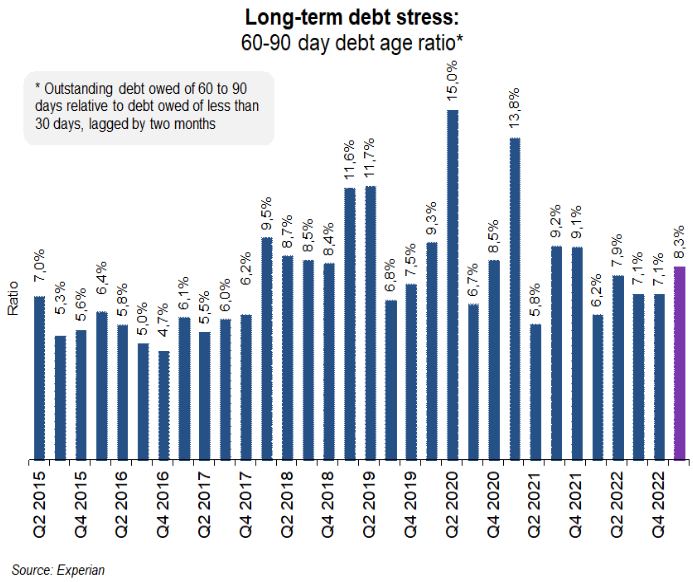
Specifically used in the measurement of the BDI is the **30 to 60 days ratio**[1]. This ratio decreased to 22.4% in Q1

[1] *The ratio of outstanding debt owed of 30 to 60 days relative to that owed of less than 30 days, lagged by one month*

from 25.8% in Q4 of 2022, reflecting a modest improvement.



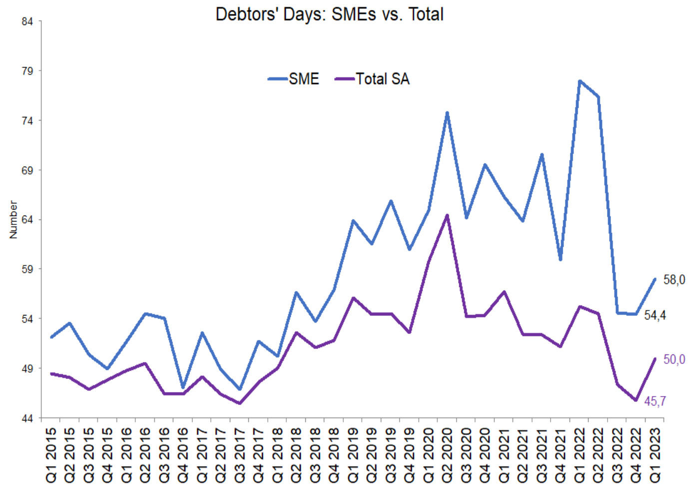
However, this was counterbalanced by a countervailing increase in the **60 to 90 ratio**[2]. The latter ratio deteriorated from 7.1% to 8.3%.



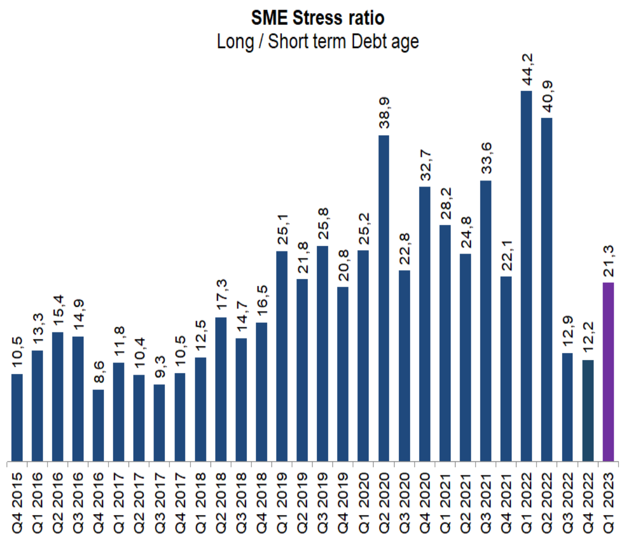
BDI by company size

Overall, these changes are not particularly significant, indicative of, at most, a modest deterioration in the financial health of businesses.

Nonetheless, what does appear to have contributed towards the more substantial increase in overall outstanding debtors' days was a much more significant increase in the number of debtors' days outstanding amongst small businesses, from 54.4 in Q4 of 2022 to 58.0 in Q1 of 2023.



The SME debt stress ratio[3], calculated in the BDI rose sharply to 21.3% in Q1 from 12.2% in Q4. These figures suggest that there has been a much more marked deterioration in the financial health of small businesses than medium and large-size enterprises.



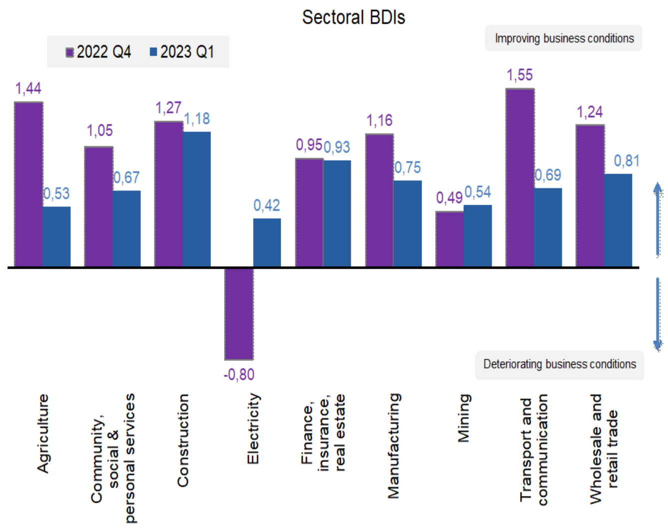
This is not altogether surprising given the difficulty that small businesses have in coping with the expenses required to undertake adjustments in energy procurement to lessen the impact of load-shedding.

[2] *The ratio of outstanding debt owed of 60 to 90 days relative to debt owed of less than 30 days, lagged by two months*

[3] *The ratio of outstanding debt owed by SMEs of 90 to 120+ days relative to that owed of less than 60 days*

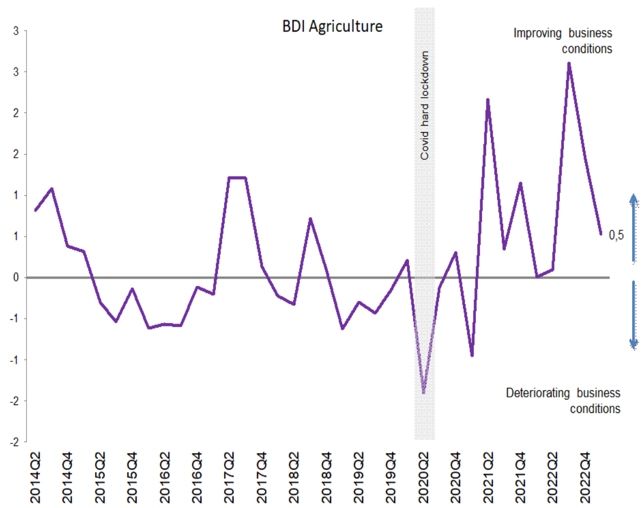
BDI by sector

From a sectoral perspective, the nine main sectors of the South African economy recorded a positive BDI in Q1. However, the trends between the Q4 2022 readings and those of Q1 differed materially between sectors.



On the positive side, there was a fairly significant improvement in the BDI for the electricity sector, which had been negative in Q4 of 2022 but turned markedly positive in Q1. This represented a notable change for the better.

In contrast, the dramatic decline in agricultural output in Q1 due to the effects of load-shedding was reflected in a massive deterioration in the BDI for the agricultural sector.



The BDI for transport and communication also recorded a substantial decline, reflecting the impact of the worsening of the country's rail network.

Less significant, but material nonetheless, were declines in the BDI for manufacturing, retail and community services. These declines were all linked to a deterioration in growth on a y-o-y basis in these sectors, resulting from the increased level of load-shedding in Q1 of this year compared with Q1 of 2022.

The changes in business debt conditions in the remaining sectors were relatively minor.

Outlook

Looking forward, one, unfortunately, sees a continuation of the downward trend in the BDI. The economy may have adapted well to increased load-shedding.

However, one remains concerned that the winter season will be accompanied by a more intense level of load-shedding, even though the opposite may appear to have been the case in the very short term.

There might be a slight boost to GDP growth in Q2 on account of comparison against a level of Q2 growth in 2022 that was severely knocked down by floods in KwaZulu-Natal.

Nonetheless, the combination of increased load-shedding, together with further increases in interest rates in recent months, are likely to erode the level of economic growth over the remainder of the year.

Most recently, one has seen a slight falloff in the more brisk trend of credit extension seen late last year and early into this year.

In addition, one foresees a slowdown in the rate of global economic growth through the remainder of the year in response to the increases in interest rates called upon to quell inflationary pressures.

There has also been growing evidence of a loss of momentum in the recovery of the Chinese economy following the boost provided by the lifting of lockdown restrictions earlier in the year.

On a microeconomic level, one foresees a further substantial reduction in the differential between PPI and CPI inflation, reflecting a growing squeeze on corporate profit margins. For these reasons, the BDI forecasts a decline for Q2.

With all the negative factors and poor infrastructural service delivery dominating the South African economy, one can be grateful that the outcome for the economy has not proved to be still worse than what has transpired.

By now, one might have expected the BDI to be in negative territory. Resilience in the face of anti-growth forces and structural impediments has been surprising.

On the positive side, one can begin looking forward to an increase in electricity availability towards the end of this year and through 2024.

Most economic forecasts look to some improvement for 2024 on the assumption of reduced load-shedding. Some of the units at Kusile and Koeberg power stations that have been shut this year for maintenance work should come on stream late this year or early next year.

In addition, many of the renewable energy projects that have been planned should begin to yield results in terms of increased electricity generation.

Consequently, there is reason to believe that the BDI might be able to remain in positive territory in the foreseeable future, even if only marginally so.

The real problem is that such a performance is really not good enough from a longer-term perspective in terms of uplifting people's living standards and employment opportunities.

Several structural impediments still stand in the way of improved growth in the longer term. These include corruption and state capture, cadre deployment within the public sector, poor infrastructural development, and a lack of human resources to meet the country's developmental needs.

Addressing these deficiencies is a tall order, especially in an environment in which much of the government's attention will be diverted in the year ahead towards ensuring successful electoral outcomes for its members.

The year 2024 is potentially pivotal in determining whether the declining trend of the South African economy over the long term persists and accelerates or whether changes in the political sphere begin generating an underlying improvement in the country's economic growth.

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 their 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 costs 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 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 more than 40 years - is committed to ongoing research and analysis of economic fundamentals thereby ensuring a sound basis for future business decisions. These services are provided through a range of complementary 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 identifying opportunities and risks.

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Next release date for the BDI: September 2023

For more detailed analysis on the debt stress by sector, Experian publishes the *Business Debt Sectoral Overview* report, please contact Taryn Stanojevic at Experian for more information.