Business Debt Index

Quarterly Summary - Q2 2023

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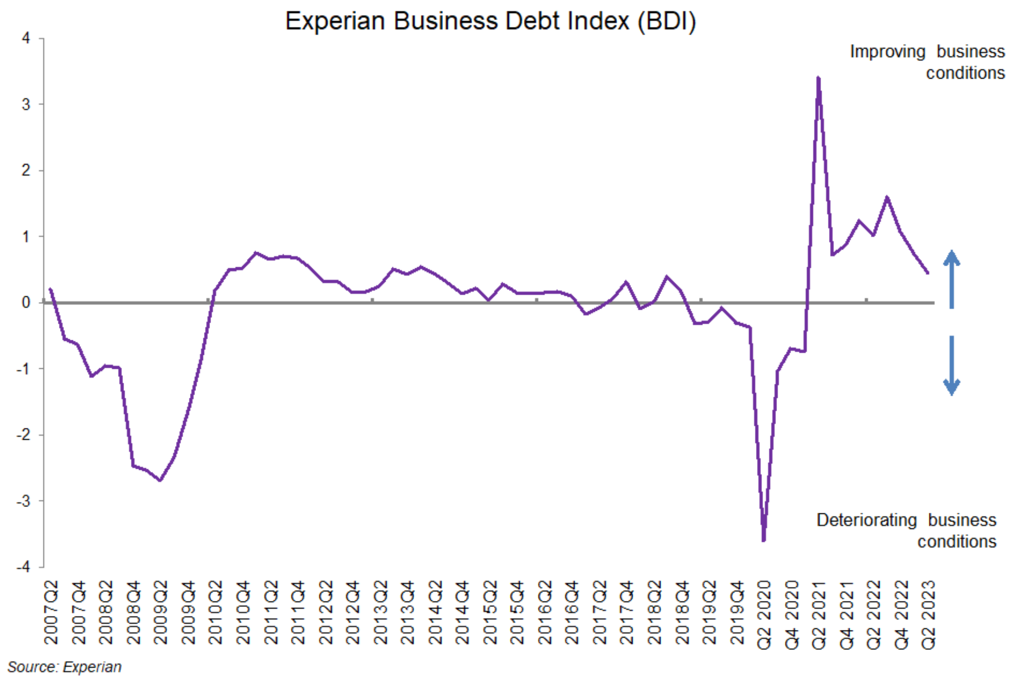
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q2 2023

Expected decline in Experian BDI in Q2 as macroeconomic situation and outstanding debt levels outweigh improved GDP growth

As anticipated in the previous quarter, the Experian Business Debt Index (BDI) declined substantially in Q2; however, the outcome was much better than was expected.

The reading for the BDI fell from a slightly upwardly revised 0.740 (previously reported as having been 0.721) to 0.445 in Q2.



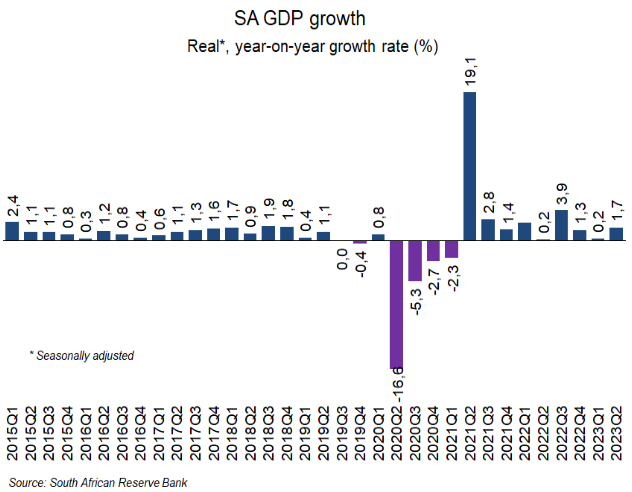
	Q2 2022*	Q3 2022*	Q4 2022*	Q1 2023*	Q2 2023
Index >0= Improving business conditions <0 = Deteriorating business conditions	1,014	1,603	1,083	0,740	0,445

* Revised

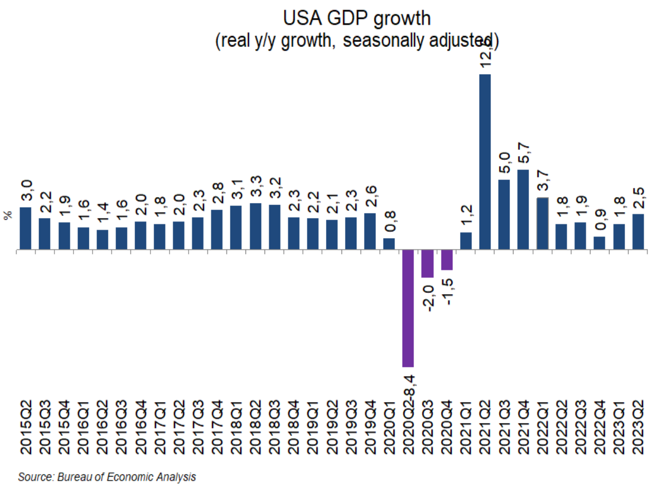
Macroeconomic factors influencing Q2 2023

The main reason for the slightly better outcome than anticipated was a better outcome for Q2 GDP growth in both South Africa and the US than had been assumed in drawing up the forecast for Q2 BDI three months ago.

South Africa's q/q seasonally adjusted GDP growth in Q2 came in at 0.6%, somewhat better than the -0.1% growth for that quarter that had been assumed. On a y/y basis, South Africa's GDP growth rate rose significantly, from 0.2% in Q1 to 1.7% in Q2.



Similarly, US GDP growth also improved from 1.8% in Q1 to 2.5% y/y in Q2.



Domestically, the improvement in GDP growth in Q2 above expectations was attributable to a diminution in the intensity of load-shedding from May onwards and an increase in fixed capital formation in excess consumer spending.

Q/q growth in fixed capital formation rose to 3.9% in Q2, in contrast with the minor 0.3% growth in household consumption expenditure. This trend of fixed investment growing faster than consumer spending has been in place for six consecutive quarters and constitutes an encouraging structural improvement in the economy.

In earlier years, the excess of consumer spending over fixed investment generated an unsustainable scenario in which insufficient resources were being put into ensuring the production of goods and services in the future in relation to what was being demanded.

This pattern has now encouragingly been reversed. In particular, at the heart of the improvement in fixed investment was a marked uptick of investment in machinery and equipment, related to an increase in investment in renewable energy projects, which will hopefully alleviate the electricity shortage in due course.

Over and above these factors, there was a marked increase of 7.9% q/q seasonally adjusted in inventory levels from a record low as a percentage of GDP in previous quarters. This is also indicative of a slight improvement in business sentiment.

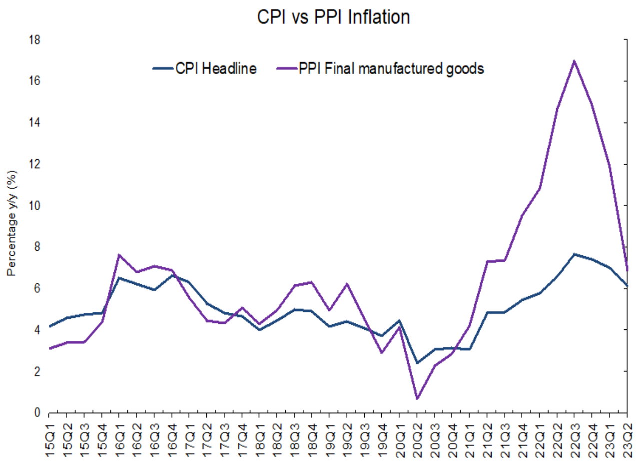
The progressive decline in household consumption expenditure is a function of sharply higher interest rates and a deterioration in consumer confidence.

The positive factors, which generated a smaller decline in the BDI than expected, were insufficient to prevent the overall BDI from declining in Q2.

Other factors related to both the macroeconomic situation and the levels of outstanding debt, as measured by Experian, still outweighed the improved GDP growth outcomes, bringing about a decline in the BDI in Q2.

On the macroeconomic front, the biggest negative was the steep contraction in the differential between the PPI and CPI inflation rates in Q2, to just 0.8% from 4.8% y/y in Q1. This is interpreted as a reflection of a marked diminution in the profit margins of companies and a concomitant increase in their financial stress.

Producing companies were clearly unable to pass on cost increases in the way they had been able to do previously.



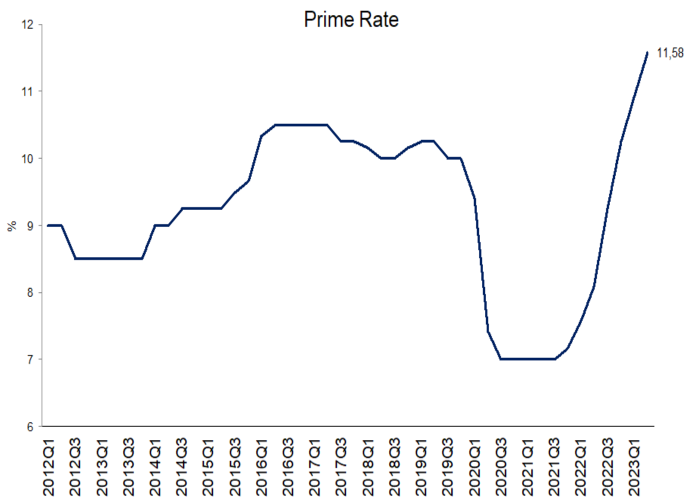
Source: StatsSA

There was also an increase in the margin between domestic and US interest rates to 2.97% in Q2, from 2.69% in Q1, making it more expensive for domestic companies to borrow internationally.

Similarly, the spread between six-month and longer-term interest rates domestically expanded somewhat from 0.84% to 0.92%, rendering longer-term finance slightly more expensive than previously.

The combination of these influences meant that macroeconomic conditions deteriorated from a corporate financial point of view, even though economic growth turned out to be slightly better than anticipated.

At the same time, it is important to note that the BDI remained in positive territory in Q2, indicative not of increased overall financial stress but of a less favourable financial environment than previously.

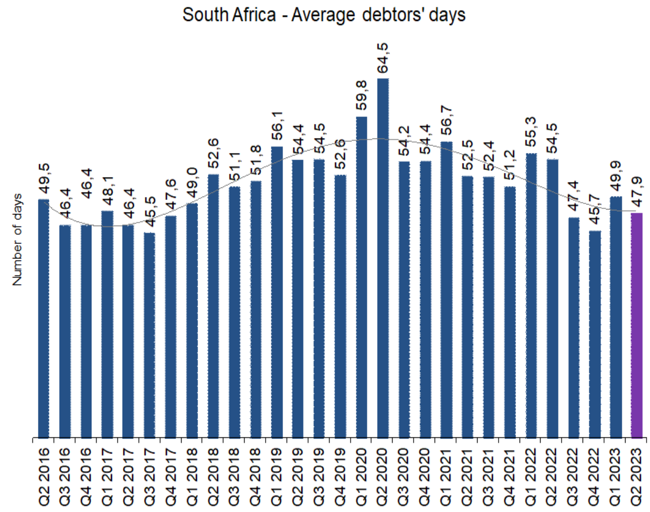


Source: South African Reserve Bank

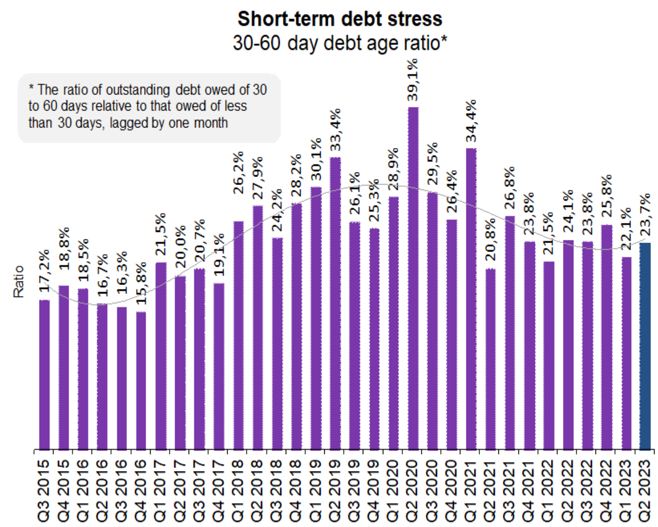
Business debt metrics in Q2 2023

The Experian data on outstanding debt also negatively impacted the BDI for Q2.

Even though the number of outstanding debtors' days on average decreased to 47.9 in Q2 from 49.9 in Q1, the specific ratios relating to outstanding debt, which are applied in the measurement of debt stress, deteriorated slightly.



Specifically, the **30 to 60 days ratio**[1]., increased from 22.1% in Q1 to 23.7% in Q2.

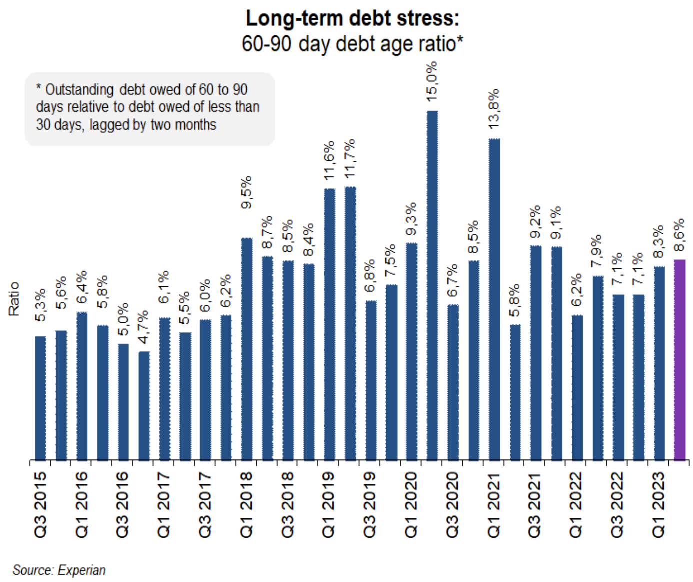


Source: Experian

Similarly, the **60 to 90 ratio**[2]., increased from 8.3% in Q1 to 8.6% in Q2.

[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*

[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*

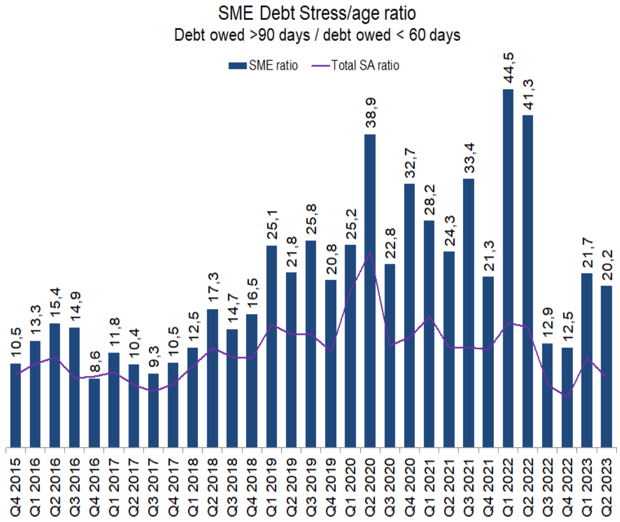


On the positive side, the decrease in average debt age implies some improvement in the number of debtors' days outstanding, but this does not feature in the calculation of the BDI.

The fact that interest rates stabilised by Q2 must have helped to limit the extent of the deterioration in perceived financial stress.

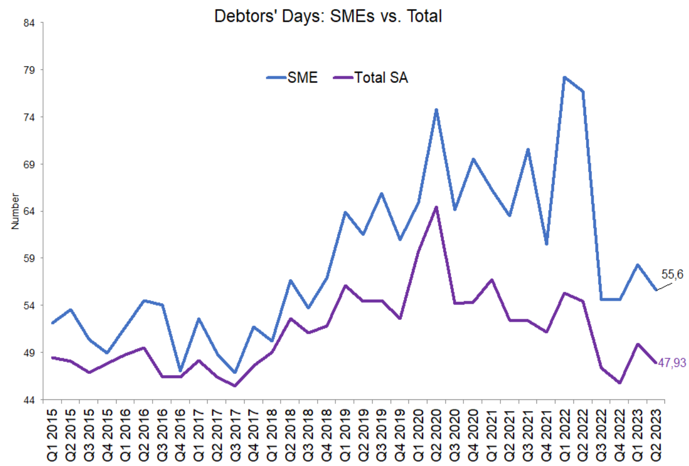
Debtors' Days by company size

The relative stress of SMEs appears to have diminished marginally. The SME debt stress ratio[3] decreased from 21.7% in Q1 to 20.2% in Q2.



The average number of outstanding debtors' days amongst SMEs, at 55.6, was significantly less than its peak at around 66 days a year ago, leaving one to conclude that although financial conditions amongst SMEs remain significantly inferior to that of the overall sample of businesses, the situation in relative terms has not deteriorated markedly.

It reflects some resilience in the overall performance of the South African economy, notwithstanding the enormous headwinds posed by load-shedding and an inadequate rail network system.

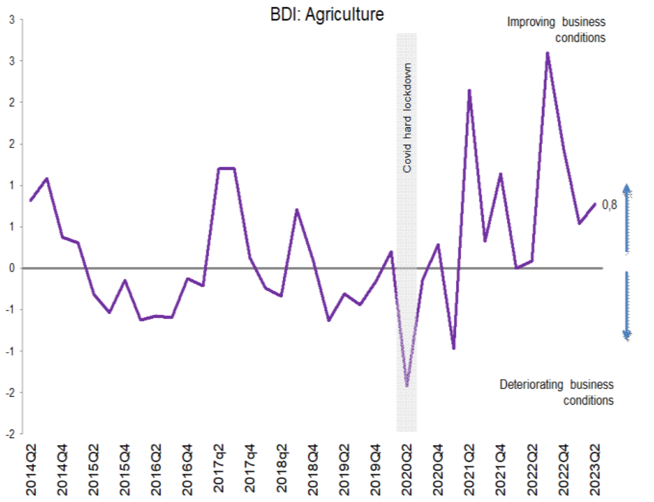


BDI by sector

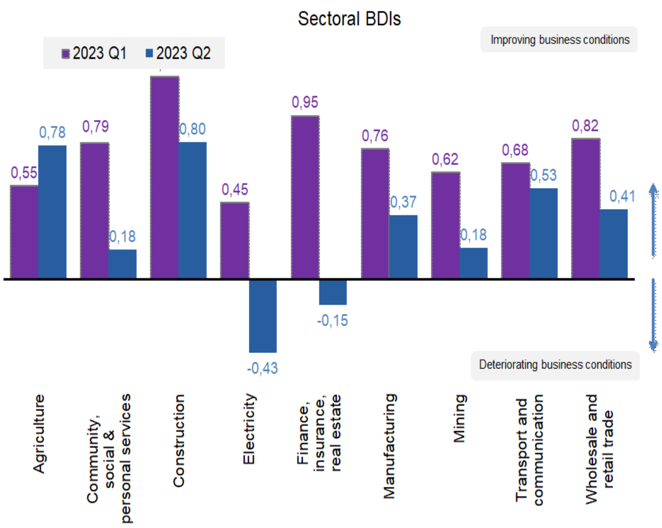
From a sectoral point of view, the outstanding feature of Q2 was the fairly substantial recovery in agricultural output compared with Q1.

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

GDP growth in agriculture recovered from -11.9% in Q1 to a positive 4.2% q/q in Q2. A reduced incidence of load-shedding undoubtedly played a significant role here, allowing for less disruption to irrigation and supply channels in the food sector.



As far as the remainder of the sectors are concerned, everyone experienced a decline, with the BDIs for electricity production and financial services dropping below zero for the first time in years.



Outlook

Unfortunately, the prognosis in the short term is not favourable. The forecast BDI for Q3 reflects a significant further deterioration, this time into negative territory.

US economic growth and that of the world economy as a whole is expected to slow somewhat in the wake of higher interest rates.

Domestic economic growth is also likely to remain sluggish, especially with load-shedding intensifying again and the negative impact of higher interest rates holding back consumers' ability to spend.

Statistical factors are also likely to play a role in comparing against stronger figures historically when calculating growth rates.

More recently also, fuel prices have been resurgent, which is likely to feed into raising food prices faster and causing inflation to rise close to the 6% upper end of the inflation target. This, too, is likely to weigh on disposable income and consumers' capacity to spend.

From a longer-term point of view, the ability of the economy to come through next year's general election without major economic disruption presents a risk.

Fiscally, continuing low growth and declining commodity prices create funding risks for the government by virtue of the reduced tax revenues it collects. The government has granted a substantial pay rise to public servants and is under pressure to extend special social grants; consequently, the budget deficit is threatened with a significant increase that will raise public debt alarmingly and increase the government's debt-servicing costs, squeezing out its ability to spend on more vital social projects.

There is also a threat to government finances posed by the need to keep funding ailing SOEs, most prominent amongst these being Eskom and Transnet.

Optimism rests on progress being made in improving the country's ability to generate electricity through renewable energy and on investments directed at enhancing such possibilities as well as investing in improving the logistical environment, especially the ability to transport goods through rail.

More substantially, fundamental structural impediments to growth, such as corruption and state capture, overregulation, inadequate educational outcomes, insufficient skills to implement infrastructural investment projects and accommodate service delivery, criminal activity and sabotage of initiatives to improve the country's logistical environment and energy availability and the relative weakness of small business, all need to be addressed for the economy to grow faster and, in so doing, improve the financial well-being of the business sector.

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: December 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.