News release

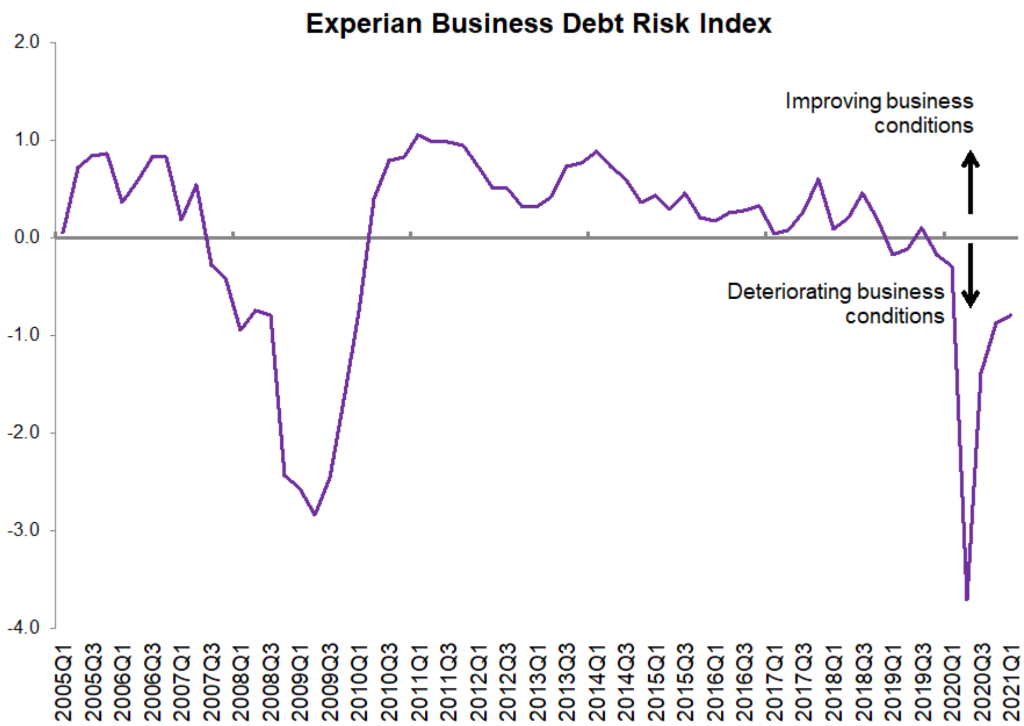
Business debt conditions show signs of improvement in Q1 – Experian data

Johannesburg, 24 June 2021 – Business conditions are moving in the right direction as the economy recovers from the effects of the Covid-19 pandemic, according to new insight from Experian South Africa.

Experian's quarterly Business Debt Index (BDI) for quarter one (Q1) 2021, which reflects the level of health of businesses in the economy, made up further ground in the first quarter of 2021 to a reading of -0.785 from -0.871 in the last quarter of 2020.

Jaco van Jaarsveldt, Chief Decision Analytics Officer at Experian Africa said: “The improvement in Q1 was driven largely by the fact that the recoveries in world economies as well as the South African economy continued during the quarter. Internationally, growth prospects were given a huge boost by the announcement in November 2020 by Pfizer of the development of a vaccine to combat the Covid-19 virus. This speeded up the period over which economic activity was expected to return to a semblance of traditional normality. Similarly, around the same time, Joe Biden was elected to take over the US presidency and succeeded in getting a $1.9tn stimulus package through Congress to lift the US economy further out of recession.”

Despite the positive momentum however, a reading below zero implies deteriorating business debt conditions and as such the Q1 reading continues to reflect an overall worsening of the financial positions of businesses, although less acute than what was experienced in the preceding three quarters.



Macroeconomic factors influencing Q1 2021

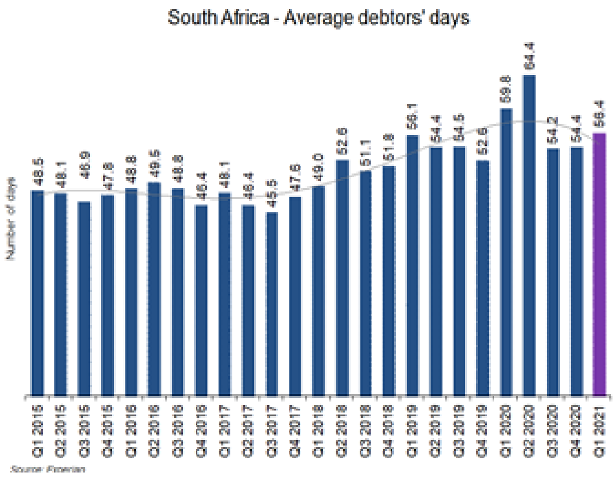
With South Africa's economy being highly dependent upon the performance of its agricultural and mining sectors, the sharp increase in commodity prices has benefitted the value of the country's exports. The knock-on effect of improvements in mining has been felt through the rest of the economy, enhancing the recovery.

Furthermore, South Africa's GDP increased by 4.6% on a q-o-q seasonally adjusted basis in Q1, following on from a 5.8% corresponding increase in Q4 2020. Although the Q1 outcome was slightly down on the Q4 2020 outcome, it was still better than expected. Nonetheless, given the depth of the contraction in economic activity during the hard lockdown in Q2 last year, economic activity had still not returned to levels prior to the COVID-19 crisis.

“It is largely for this reason that the BDI still generates a negative reading. On a y-o-y basis, South Africa's GDP growth in Q1 was still negative, at -3.2%, but at least this was up from -4.2% in Q4 of 2020 and significantly up on the -17% growth recorded in Q2 2020. This relative improvement in growth in the domestic economy was the cornerstone around which the BDI picked up in Q1,” added van Jaarsveldt.

Business debt metrics in Q1 2021

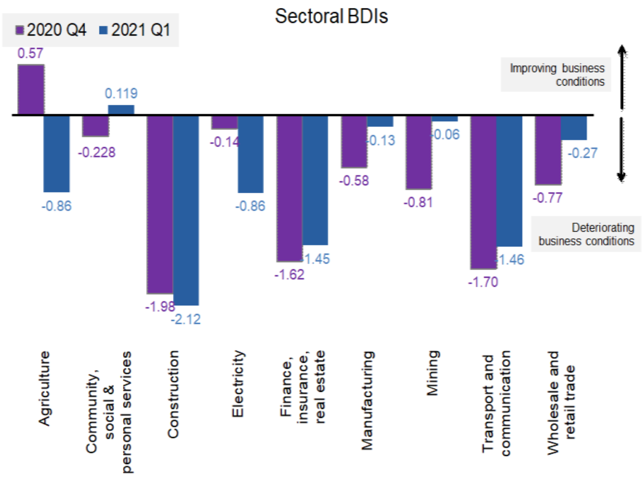
Experian data relating to outstanding debtors’ days did not improve to the extent that one had anticipated in line with the rest of the economy. On the contrary, the average number of outstanding debtors’ days increased to 56.4 in Q1 from 54.4 in Q4 and 54.2 in Q3.



“These figures suggest that the economic recovery has meant that businesses have been under increasing cash flow pressure to exploit the uptick in activity by using available cash to increase stock holding and, as a consequence, have been compelled to hold back on paying off their debts as rapidly as previously. During the depths of the downturn last year, there was probably an ironic psychological incentive to reduce debts as rapidly as possible while demand and thus need for additional stock was low,” added van Jaarsveldt.

The improvement in the BDI in Q1 prevailed across most sectors, with the notable exception of agriculture. To some extent, this can be attributed to the fact that the agricultural sector was the one outstanding sector to experience positive conditions in 2020 and so was not materially adversely affected by the lockdowns introduced to fight the COVID-19 virus. Consequently, Q1 economic activity showed a slight decline after successive quarters of buoyancy in 2020.

Among other sectors, the outstanding feature was the sharp increase in the BDI of mining in tandem with the recovery in mining output associated with rising mineral prices. While still marginally negative, demand for raw materials to support the strong international infrastructure spend mandates and increased consumer demand due to stimulus packages, has supported the South African mining sector.



Positive outlook

As economic recovery continues to gather momentum, one is likely to see further increases in the BDI. According to the latest BER Business Confidence Index, domestic business confidence has soared in Q2 to 50 points in Q2 from 35 in Q1. Whether the BDI will return to a positive level only time will tell, with predominantly positive international economic trends driving the current improvements. With the local economy still significantly smaller than last year the same time and consumers continuing to struggle with their financial burdens, it is difficult to see demand increasing at the same rate as we have noticed internationally. Thus, while short term indicators are positive on the back of improved trading conditions as Covid pressures ease, overall South African economic fundamentals remain poor and thus a long-term recovery is unlikely unless these fundamentals are addressed.

“As revenues of companies are expected to improve in the short term, the pressure on cash flows to take advantage of improved conditions is likely to ease. The experience is likely to be particularly beneficial for exporters, especially in the mining, manufacturing and agricultural sectors. However, there are some risks in the economic outlook both domestically with the increased incidence of load-shedding and internationally with rising anxiety regarding the possibility of a tightening of monetary policy in the wake of sharp increases in inflation. As such the advice to all businesses, especially small businesses dependent on sustainable cash flows is to balance additional stock acquisition with sustained debt payments to ensure that they build a sustainable long-term business,” concluded van Jaarsveldt.

[992 words]

*****ENDS*****

Notes to the editor:

* Debtors' days is a metric of time measuring the average outstanding period (in days) that businesses take to repay their debt. A higher debtors' day value points to an environment where firms are taking longer to repay their outstanding debt obligations.

The Experian Business Debt Index is an indicator of the overall health of businesses, as well as the South African economy. It 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.

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. 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.

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 the business stress is the primary factor influencing the co-movement and by extracting the principal components, it is possible to build and index with a useful economic interpretation.

For a more detailed analysis of business debt stress, Experian releases a Business Debt Overview report. The Business Debt Overview report constitutes of three main sections: The Business Debt Stress Index, a macro-economic overview and a sectoral debt analysis.

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