# Payment Behavior Index (PBI) shows deteriorating conditions

## February 24, 2016

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### **Executive summary**

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- Euler Hermes' Payment Behavior Index (PBI) fell by 6.4 points over the past year, indicating a higher incidence of past due receivables, also consistent with slower GDP growth in Q4 2015 vs. Q4 2014.
- Nationwide bankruptcies are expected to rise by 3% in 2016 after six straight years of declines.

#### U.S. **Payment** behavior among businesses continues to deteriorate

The Euler Hermes Payment Behavior Index (PBI) fell 6.4 points from 67.2 to 60.8 over the past four quarters ending in Q4-15 (Figure 1). The deterioration in payment behavior indicates an increase in the amount of late payments to businesses. The PBI is developed using Euler Hermes' proprietary past due information from policyholders about unpaid accounts receivables by their buyers. A PBI above 50 indicates payment behavior better than average and below 50 worse than average. Although the PBI is still above 50, it has fallen markedly over the past four quarters indicating that buyers are starting to encounter financial stress due to a weak economy. As a broad indicator of business conditions, the PBI is highly correlated to GDP growth; therefore Euler Hermes expects to see continued tepid GDP growth of 2.3% in 2016.

# Financial conditions, shrinking profits contributing to slow payment and bankruptcies

The Federal Reserve raised the target Fed Funds interest rate for the first time in over 11 years in December 2015 (Figure 2). However financial markets had been anticipating the move for some time, and as a result financial conditions began to tighten well before the actual increase. One measure of tightening financial conditions is the net percentage of bankers who are widening the interest rate spreads on their loans, as represented by the blue line in Figure 2.

5% GDP (R) PBI (L) 4% 3% 2%

1%

0%

Q4-15

Figure 1: Payment Behavior Index (PBI) vs. GDP

Source: IHS, BEA, Euler Hermes

Q1-15

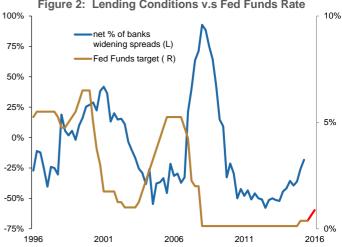
Q4-14

Figure 2: Lending Conditions v.s Fed Funds Rate net % of banks widening spreads (L) 75% Fed Funds target (R) 50% 25% 5% 0% -50%

Q2-15

Q3-15

Sources: IHS, Federal Reserve, Euler Hermes



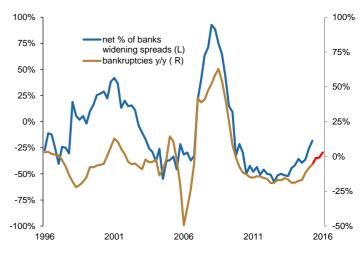
Looking ahead, the most likely scenario for 2016 is that the Fed will raise rates 1-2 times more this year, although it's possible they won't raise at all. Regardless of the pace of Fed hikes, bank lending conditions are quite likely to continue tightening, making it more difficult and expensive for businesses to get credit and fund their operations.

These tighter lending conditions have already contributed to the increase in slow payment: If a business cannot get funding from banks, it will effectively get funding by paying its bills more slowly. After a certain point, the business will stop paying its bills altogether and declare bankruptcy.

In fact as shown in Figure 3, tightening lending historically conditions have been highly correlated with increases in nationwide bankruptcies. Furthermore, real corporate investment is slowing, and real corporate profits are actually shrinking (Figure 4) putting additional pressure on businesses. combination of expensive credit and falling profits is quite likely to make bankruptcies rise, and Euler Hermes expects to see bankruptcies increase by 3% in 2016 after six straight years of declines. In fact the decaying payment behavior as shown by Euler Hermes' Payment Behavior Index is a strong harbinger of the coming increase in bankruptcies.

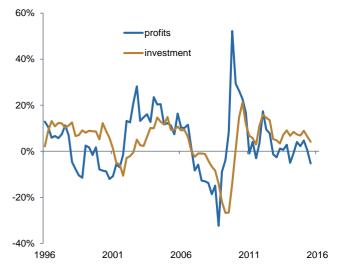
Some sectors are showing marked deterioration in late payments. For example, metals and machinery companies are facing severe financial stress due to a combination of factors including weak global demand, plummeting orders for pipe and machinery from oil drillers, and a strong dollar which makes exports less competitive, and which causes a flood of cheap imports that are difficult to compete against. Commodities producers are also under severe stress from the collapse in commodity prices. In 2016 we expect to see continued anemic global demand, low commodity prices, weak machinery orders, and even though the dollar has fallen a bit in the past few weeks, we do not expect it to fall enough to boost exports or lessen competition from cheap imports. Conversely, the food sector is showing incremental improvement, and strength in auto sales has resulted in significant reductions in late payments as well. We expect to see continued strength in auto sales in 2016, boosted by cheap gasoline prices and a still ageing fleet.

Figure 3: Nationwide Bankruptcies vs. Lending Conditions



Sources: IHS, Federal Reserve, US Courts, Euler Hermes

Figure 4: Real Corporate Profits and Investment, y/y



Sources: IHS, BEA, Euler Hermes

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