Nordic Companies in China less optimistic

- But they continue to expand their presence

TUESDAY
6 SEPTEMBER 2011

Fredrik Hähnel
General Manager
SEB Shanghai
+86 21 53966681

THE SEB CHINA FINANCIAL INDEX AT 63.4, down from 70 in March. All indicators are falling in the September survey.

BOTH BUSINESS PROSPECTS AND PROFIT EXPECTATIONS ARE DOWN but companies continue to invest and recruit albeit at a slightly slower pace.

CUSTOMER DEMAND IS THE MAIN CONCERN, followed by labor shortage.

SLIGHT COOLING DOWN IN CHINA

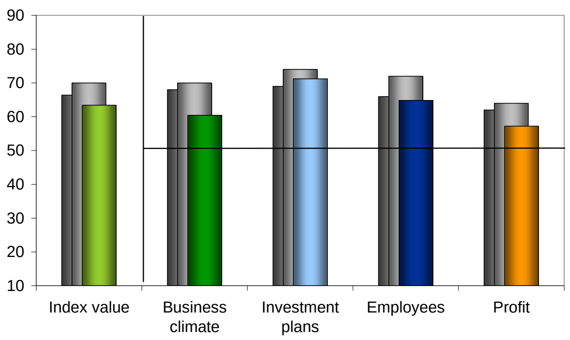
Northern European companies are for the first time since early 2009 less optimistic about business conditions on the Chinese market in the coming six months. Continued monetary tightening and increased global growth fears have started to impact senior managers' view of the China market.

Only 38% expect business conditions to improve and 10% expect a significant improvement, compared to 65% and 18% respectively in our last survey in March.

Profit prospects are also falling with 44% expecting profits to improve (58% in March) and 2% (8% in March) to improve significantly. The number of companies expecting falling profits has doubled from 6% to 12% of respondents.

Companies continue to expand in China however with 57% foreseeing modest investments. Another 24% are planning for significant investments. 70% of companies are planning further recruitments although the number of companies planning significant increases in headcounts has fallen from 22% to 8%.

China Financial Index



Source: SEB Shanghai. Grey stacks show results in March 2011 and September 2010

In SEB's China Financial Survey, senior managers at 50 subsidiaries of major Nordic and German companies in China were asked about their expectations of their own business and the macro and financial environment.

Again, companies worry about falling demand for their products, just like they did after the 2008 financial crisis (See China Financial Survey, March 2009). More than one out of four view falling domestic demand as the main concern. The combination of global growth concerns and China's Central bank continuing to fight inflation and excessive investment with interest rate hikes and slower loan growth, are probably both contributing to the fall in sentiment.

Most economic data, however, indicate that China will be able to avoid a hard landing and that the country's economic prospects continue to be relatively bright in the short term. China's Purchasing Manager's Index (PMI) showed a rebound in August strengthening the view that China's economy is gradually stabilising.

OUR CONCLUSIONS

North European subsidiaries' business confidence in China has clearly tumbled as the country feels the impact of monetary tightening and increased fears of how the global growth outlook may eventually affect China. However, the fall in business confidence has not changed the view of China as an attractive investment destination and Nordic and German companies continue to invest and recruit in China as business prospects, comparatively speaking, are considerably more positive in China than in most other major markets. Apart from continued high investment and recruitment plans, this is further evidenced by high working capital needs among subsidiaries as indicated by respondents in the September survey.

Slightly slower growth…

…BUT STILL HIGHER THAN OTHER MARKETS

China posted 9.5% growth in the second quarter of 2011, down slightly from 9.7% in the first quarter. The role of fixed asset investment remained strong while retail sales experienced its weakest growth in six years. Inflation continues to plague the economy with a CPI of 6.5% in July. China's trade surplus leapt to USD 31,5billion in July thanks to surprisingly strong growth in exports, whereas China's manufacturing activity, measured in the purchasing managers index (PMI) to 50.9 in August, following a two-year low of 50.7 in July. How the current global economic turbulence will eventually filter through to the Chinese economy remains to be seen but the August PMI figures support the view that China's economy is stabilising and that a hard landing scenario can be avoided. SEB forecasts that China will experience 8.4% growth in 2012, well above other major markets.

Global GDP growth

Year-on-year percentage change

	2010	2011	2012	2013
United States	3.0	1.5	1.8	2.7
Japan	4.0	-0.6	2.9	2.2
Germany	3.6	3.0	1.3	1.9
China	10.3	9.2	8.4	8.8
United Kingdom	1.4	1.1	1.6	2.0
Euro zone	1.7	1.7	1.0	1.5
Nordic countries	2.9	2.6	1.9	2.6
Baltic countries	1.4	5.7	3.7	4.4
OECD	**2.9**	**1.7**	**1.8**	**2.1**
Emerging markets	7.4	6.2	5.5	5.8
World, PPP*	5.1	4.0	3.5	3.9
World, nominal	4.4	3.3	2.8	3.2

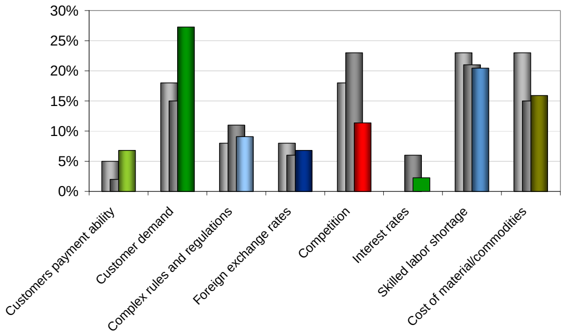
Source: OECD, SEB * Purchasing power parities

CUSTOMER DEMAND, SKILLED LABOR SHORTAGE AND RAW MATERIAL COSTS ARE MAIN CONCERNS

As many as 26% of North European companies view customer demand as their greatest concern and another 14% as their second largest concern for the coming six month. Although it is a strong indicator that demand may be falling in China, it is still far from levels seen in the SEB China Financial Index in March 2009 when as many as 73% of respondents pointed out customer demand as the greatest concern. It is however a trend shift and considerably higher than in the last survey (see comparisons and a longer analysis on page 4). Skilled labor shortage is the second largest worry with 18% identifying it as the main concern, followed by high costs of raw material which is singled out as the largest concern by 14% of respondents in this survey. Competition is identified as the main concern for 10% of the companies. When asked about their second and third largest concerns, another 46% put competition on top of the list. Very few companies mention other issues such as complex regulation, foreign exchange rates or customers' payment ability.

The concerns mentioned in this survey are all logical reasons behind the fall in profits expectations, as it is probably forcing companies to sell at lower margins than they previously had in China. With slowing volumes, increasing labor costs, higher commodity prices than a few years ago and tougher competition from local and international firms, the possibility of keeping up margins is falling.

Picture: Major Concerns in the coming six months



Source: SEB Shanghai, colored stacks show companies choice as major concern, grey stacks show second and third largest concern

THE RMB WILL CONTINUE TO APPRECIATE AND INTEREST RATES GO UP

Inflationary expectations in China may continue. In the first seven months, the CPI rose an annual 5.5%. As China continues its monetary tightening, PBOC has raised it's one year policy rate in five steps to 6.56% and many analysts expect one more hike in 2011, before it remains stable, The RMB reached several new highs against the US dollar in August. Since late June last year, when the appreciation of the RMB against the USD was resumed, the RMB has strengthened by close to 6.5%. A record number of 58% expect interest rates to go up further and 92% (by far the highest in any of our surveys) calculate with an appreciating RMB against the US dollar.

Survey Results

INFORMATION ABOUT THE SURVEY

The SEB China Financial Survey is based on input from CEOs and CFOs at 50 subsidiaries of major Swedish, Danish, Finnish, Norwegian and German companies. Most of the companies have a global turnover of over EUR 500 million. The survey is web- based and confidential and was carried out during the period August 25 – September 2, 2011.

SUBJECT: Business Climate / Profit Expectations

Northern European subsidiary managers in China have a more pessimistic view of the business climate for the coming six months, compared to six months ago. 38% (65% in March) of companies expect business conditions to be favourable over the coming six months and only 10% (18% in March) believe they will be very favourable. 6% of companies think that conditions will be unfavourable while no company believes that conditions will be very unfavorable. Half a year ago, no companies had a negative view and one year ago the figure was 3%.

When asked about profit expectations, 44% expect profits to increase as compared to 58% six months ago, and today only 2% of companies believe profits will improve considerably (compared to 8% in March). 12% expect falling profits (6% in March).

China GDP Growth in H1 2011 reached 9.6% and most figures point at continued strong growth in China during 2011, albeit at a slowing speed. Chinese exports (of which approximately 60% are produced by foreign-invested companies) rose by 20 percent year-on-year in July and the trade surplus rose to nearly USD 31.5 billion. As the global economic outlook looks gloomier, there is a risk that Chinese exports growth may slow down in 2012. Retail sales have continued to show good increases despite rising inflation.

(See graphs 1 and 3, p. 5)

SUBJECT: Employment Structure

North European companies are continuing to recruit in China but the pace has clearly moderated in the past six months. As managers become more bearish of the China market, they are slowing down the speed at which they are increasing staff numbers. 70% are planning to increase staff in China, out of which 8% are planning significant increases (the latter figure was 22% six months ago). A big difference from all previous surveys is that in the September survey, two companies replied that they will actually reduce staff in China. No company has indicated that in previous surveys.

(See graph 4 on page 5)

SUBJECT: Fixed Asset Investment Plans

Around one quarter, or 24%, of companies in this survey are planning for major investments in the coming six months in China, down from 33% in the latest survey in March. 57% are planning for modest investments. 18% are planning no further investments and no company is divesting.

Hence, it is obvious that the strategy to “aggressively expand”, which was prevailing in the previous SEB China Financial Index survey, has now developed into a more careful investment mode among North European companies. China saw some USD 108.7bn in foreign direct investment last year, an increase by 7.4% from the year before and most surveys point in the direction of China continuing to be a prime FDI destination for western companies.

(See graph 2 on page 5)

SUBJECT: Average Outstanding Account Receivables days

Foreign companies often highlight payment terms and the issue of actually being paid on time as one of the main challenges in China. Based on this survey, only a small minority of Nordic and German corporates have average outstanding account receivable days greater than 90, but the number has increased somewhat. 17% of respondents now have 90-120 days average payment terms compared to 12% in the last survey. No companies have over 120 days (4% in the last survey).

(See graph 5 on page 5)

SUBJECT: Funding Needs

Funding needs have decreased slightly among companies. Today, only 52% of managers are expecting funding needs to increase in the coming six months, as compared to 62% six months ago. 48% of managers expect funding needs to remain unchanged, whereas no companies expect funding needs to decrease. Considering that companies continue to invest in China although in a more moderate way, this seems logical. If lower sales volumes and lower investments do indeed become a reality in the near future, both working capital and fixed asset investment financing needs will fall.

(See graph 6 on page 5)

SUBJECT: FX and Interest Rates

The dominant view among managers is that China still needs to continue the monetary tightening that started last autumn. This can be seen from the views of interest rates and the RMB exchange rate. Only 4% of the companies believe that interest rates will fall, whereas 58% believe that rates will go up. 38% expect rates to stay at current levels in the coming six months (six months ago, 12% thought they would be unchanged). Both deposit rates and lending rates are regulated in China and the current lending rate for a 12-month bank loan is 6.56%. The 12-month deposit rate is 3.5%. The Chinese Central Bank, PBOC, has already hiked rates four times since November, by one percentage point in total, and considering that inflation, measured as CPI, has gone up from 4.9% in December 2010 to 6.5% July 2011, there is room for more tightening going forward. At current levels, deposit rates are highly negative in real terms. Although the government will move cautiously, most economists expect further tightening of the Chinese economy before year-end.

Almost all managers expect the RMB to continue appreciating against the US dollar after the RMB finally started to move in July last year. 92% expect the RMB to appreciate over the coming six months compared to 82% in September. 6% still believe that the RMB will be stable against the US dollar. A fairly stable RMB/USD exchange rate is one of the main reasons why many companies have traditionally invoiced their China trade in USD, but the trend seems to have changed in the last six months. As many as 28% of respondents now use the Euro as their main currency. This is up from 22% a year ago. 11% use one of the Scandinavian currencies. An interesting question in coming surveys will be to see how many companies will start to use the RMB as their cross border settlement currency, as China has started to allow that.

Between August 31, 2010 and August 31, 2011, the RMB appreciated by 5.6% against the USD, and depreciated by 4.9% against the EUR, 6.8% against the NOK, 4.9% against the DKK and 7.8% against the SEK. The fact that so many companies are expecting the RMB to start moving against the USD this year may be one reason why as many as 46% are hedging some or most of their FX flows on the on-shore forward market and another 18% are hedging via their head offices through NDF-contracts or the CNH market.

(Please see graphs 7 and 8 on page 5 plus graphs 9 and 10 on page 6)

SUBJECT: Main Concerns

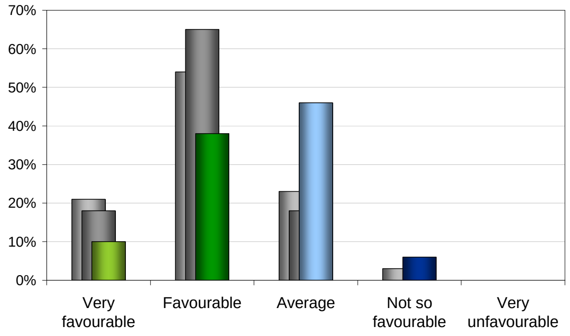
Customer demand is yet again the the major concern for local management. Now 27% mention it as their main concern and another 18% say it is their second largest concern. Skilled labor shortage is also a top concern (mentioned by 20% as the main concern and 8% as the second largest concern) as well as raw material costs (16% and 15% respectively). Competition was the main concern a year ago but is now only mentioned by 11% of companies as a main concern.

(See graph 11 on page 5)

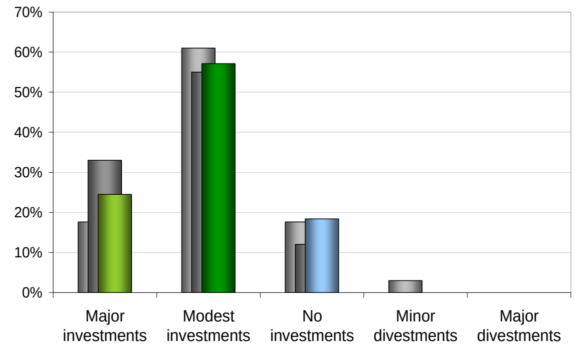
CHINA FINANCIAL INDEX – COMPOSITION

The SEB China Financial Index in September had a value of 63.4, indicating a positive attitude. A value of 50 would indicate a neutral view. The index is based on four components with the following ranking in this survey: General Business Situation – 60, Profit Expectations – 57, Investment Plans – 71, and Employment Plans – 65. (see the graph on page 1)

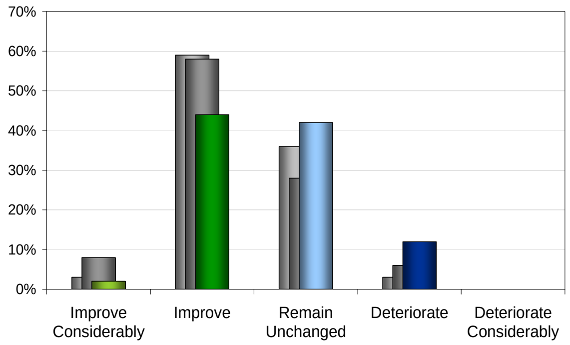
1. BUSINESS CONDITIONS



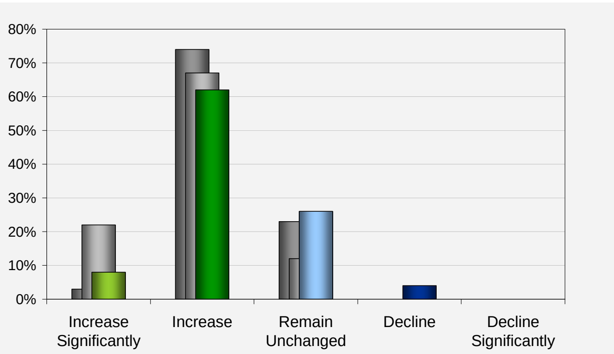
2. FIXED ASSET INVESTMENT PLANS



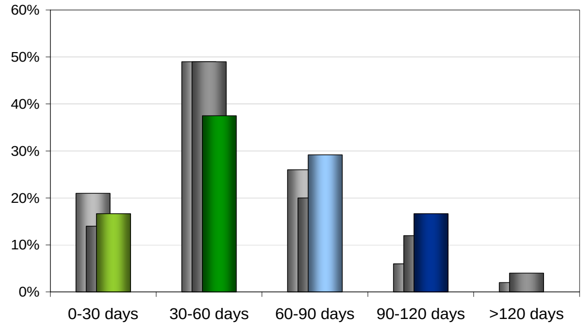
3. PROFIT EXPECTATIONS



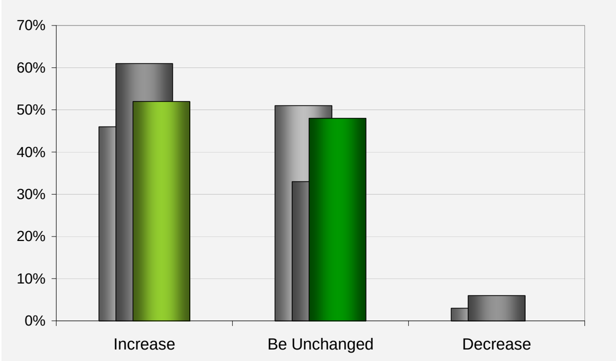
4. NUMBER OF EMPLOYEES



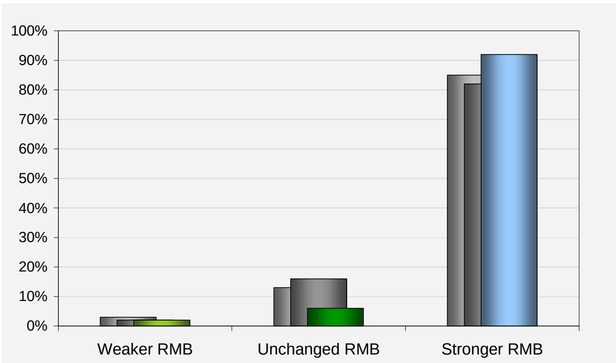
5. AVERAGE OUTSTANDING A/R



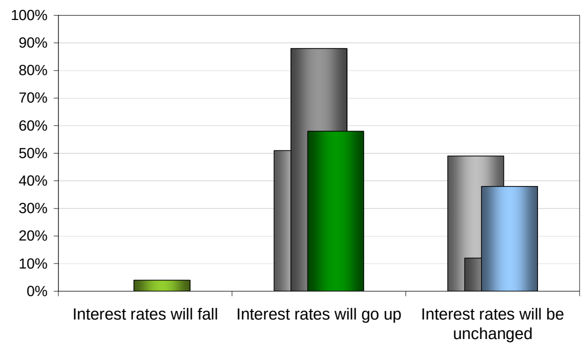
6. FUNDING NEEDS



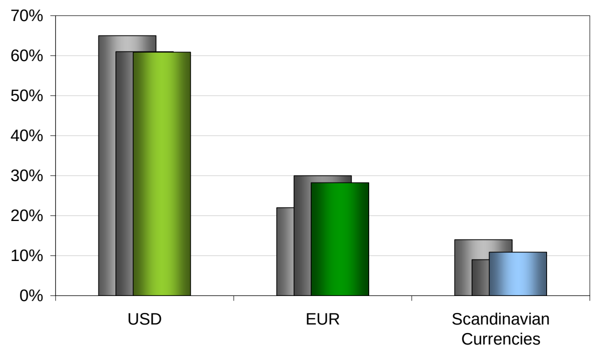
7. RMB AGAINST USD



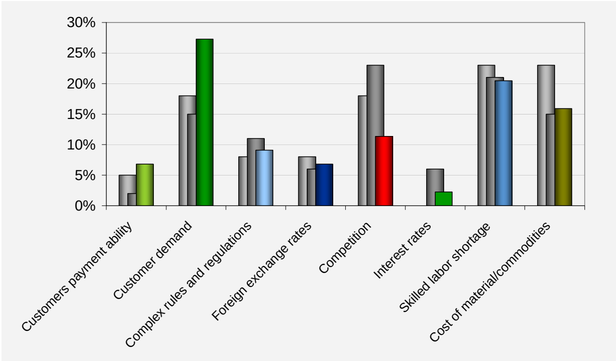
8. RMB INTEREST RATES



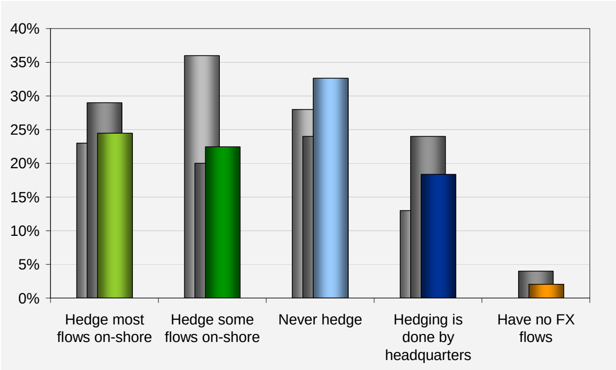
9. MAIN TRADING CURRENCY



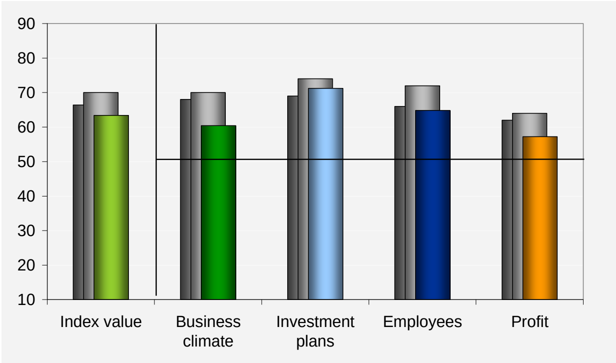
11. MAIN CONCERNS



10. HEDGING STRATEGY



12. MAIN INDEX



Source: SEB Shanghai. Grey stacks are indicating companies' answers in the last two surveys in March 2011 and September 2010

IMPORTANT: THIS STATEMENT AFFECTS YOUR RIGHTS