Nordic Companies in China less optimistic

- Expansion plans continue but at a slightly slower pace

WEDNESDAY
29 FEBRUARY 2012

SEB'S CHINA FINANCIAL INDEX AT 61, down from 63.4 in September and 70 in March last year, suggesting that business activities have slowed further in China.

BOTH BUSINESS PROSPECTS AND PROFIT EXPECTATIONS HAVE FALLEN and companies slow down slightly on investment plans and recruitments.

CUSTOMER DEMAND IS THE MAIN CONCERN, followed by competition.

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FURTHER FALL IN DEMAND IN CHINA

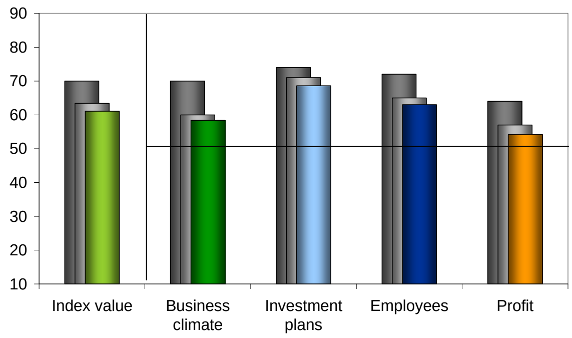
North European companies are slightly less optimistic about business conditions on the Chinese market in the coming six months compared to our previous survey. This is the second time in a row that the index is falling after having reached an all-time-high in March last year.

Still, 47% of the respondents expect business conditions to be favourable but only 5% expect them to be very favourable compared to 10% in September and 18% one year ago. 44% foresee average business conditions and 9% expect them to be unfavourable.

Profit prospects are also falling with 35% expecting profits to improve (44% in September and 58% one year ago) and no companies expect significantly improved profits. 53% forecast unchanged profits.

One quarter of companies are still planning significant investments whereas the number foreseeing modest investments has fallen from 57% to 47%. Recruitment plans have also fallen slightly and 61% (70% in September) are now planning to add further staff.

China Financial Index



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

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

Companies continue to worry about falling demand for their products, with over half of the companies now viewing it as the main concern (53% as compared to 45% in September and 33% a year ago). Competition is the second largest concern among companies. The European debt crisis and global growth concerns combined with fairly tight monetary conditions as China's Central bank continues to fight inflation are both contributing to a fall in sentiment.

Our index is in line with other economic data. However, most analysts believe 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 January strengthening the view that China's economy is gradually stabilizing.

OUR CONCLUSIONS

North European subsidiaries' business confidence in China has tumbled further since September and local managers now feel the impact of monetary tightening and increased fears of how the global growth outlook has started to affect China. However, it should be remembered that the index is still highly positive. The main change since September is that more companies take a neutral view of the market conditions. Very few companies expect deteriorating business prospects and profits and the majority of companies are still planning to expand further in China, albeit at a slower pace than previously.

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GDP grew 9.3% in 2011
SLOWER GROWTH EXPECTED

China's economy grew by 8.9% year-on-year in the fourth quarter of 2011 while full year growth was 9.3%, down from 10.4% the year before. Industrial output growth ended 11% in 2012, down from 13.9% in 2011. Inflation increased to 4.5% in January from 4.1% in December. However, most analysts expect inflation to fall back again and China's policy makers are widely expected to ease monetary conditions further as continued weakness in the country's primary export markets in the US and Europe dampen economic prospects. The Chinese Purchasing Managers Index (PMI) rose to 50.5 in January, up from 50.3 in December and 49.0 in November whereas HSBC's equivalent index fell to 47.4 in February, which is an eight month low. SEB's main scenario is that China can avoid a hard landing and expects GDP to rise by 8.7% in 2012 and 8.9% in 2013.

Global GDP growth

Year-on-year percentage change

	2010	2011	2012	2013
United States	3.0	1.7	2.5	2.5
Japan	4.5	-0.6	1.7	1.2
Germany	3.6	3.0	0.4	1.3
China	10.4	9.3	8.7	8.9
United Kingdom	2.1	0.9	0.3	1.4
Euro zone	1.8	1.5	-0.8	0.7
Nordic countries	2.9	2.5	0.9	1.8
Baltic countries	1.1	6.0	2.0	3.2
OECD	**3.1**	**1.7**	**1.4**	**1.9**
Emerging markets	7.3	6.2	5.7	6.0
World, PPP*	**5.2**	**3.9**	**3.5**	**4.0**
World, nominal	4.5	3.2	2.8	3.3

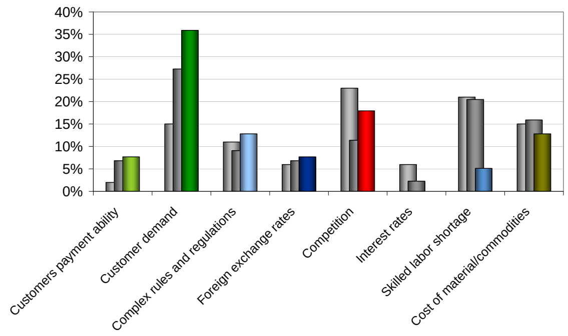
Source: OECD, SEB * Purchasing power parities

FALL IN CUSTOMER DEMAND, MAIN CONCERN

Customer demand is by far the largest concern in this survey, seen by 36% as their greatest concern, compared to 27% six months ago. Another 17% see it as their second largest concern. This is the second consecutive survey where customer demand is increasing as a concern and can be seen as a strong indicator that demand may be falling in China. Competition is the second largest worry with 18% identifying it as the main concern, followed by high costs of raw material and complex rules which are singled out as the largest concern by 13% of respondents in this survey. Very few companies mention other issues such as foreign exchange rates or customers' payment ability.

The concerns mentioned in this survey point in the direction of slowing sales growth and increased competition, which are logical reasons behind the fall in profit expectations, as it is probably forcing companies to sell at lower margins than they previously had in China. With slowing volume growth, 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 refer to earlier surveys.

THE RMB WILL CONTINUE TO APPRECIATE AND INTEREST RATES REMAIN THE SAME

Consumer prices were in a falling trend by the end of 2011 but rose to 4.5% in January year-on-year. As China continues its monetary tightening, PBOC has, since the last China Financial Index was published in September, held its one year policy rate stable at 6.56%. Many analysts expect monetary easing to primarily take place through lower deposit reserve ratios for banks before eventually lowering interest rates. The RMB continued to strengthen during 2011 and has during the last year strengthened by 4% against the USD. As many as 55% of respondents in this survey expect interest rates to remain stable whereas 31% expect them to fall. 70% calculate with a continuous appreciation of the RMB against the US dollar whereas 28% think it will remain stable.

Survey Results

INFORMATION ABOUT THE SURVEY

SEB's 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 2 – 15 February, 2012.

SUBJECT: Business Climate / Profit Expectations

North European subsidiary managers in China continue to be slightly more pessimistic about the business climate for the coming six months, compared to six and 12 months ago. Now, only 5% (10% in September and 18% in March) think that conditions will be very favourable whereas 42% (38% in September and 65% in March) view the business climate as favourable. One year ago, no companies had a negative view whereas the figure has now grown to 9%.

When asked about profit expectations, 35% expect profits to increase as compared to 44% six months ago and 58% 12 months ago. Today 54% expect profits to be unchanged (compared to 42% in September and 58% a year ago). 10% expect falling profits, which is the same as six months ago.

China GDP growth in 2011 reached 9.3% in 2011 but many figures point at a slowdown in China during 2012. However, the PMI rose to 50.5 in January after having fallen in November and December. The IMF warned in January that a dramatic slowdown in Europe would cause Chinese growth to fall by as much as half. More negative reports and falling exports have probably further led to a gloomier sentiment among companies participating in our survey.

(See graphs 1 and 3, p. 5)

SUBJECT: Employment Structure

North European companies are continuing to recruit in China but as manager become more bearish of the China market, they are slowing down the speed at which they are increasing staff numbers. 61% (70% six months ago) are planning to increase staff in China, out of which 12% are planning significant increases. Now 7% of the companies indicate that they will actually reduce staff in China compared to 4% six months ago and no companies one year ago.

(See graph 4 on page 5)

SUBJECT: Fixed Asset Investment Plans

Companies are cutting down slightly on investments. In this survey, one third or 30% answer that they do not plan any further investments as compared to 18% six months ago. The percentage of companies planning modest investments has fallen to 47% from 57% in September whereas one quarter of all companies, or 23%, still continue to plan for major investments, exactly like six months ago.

Hence, the continued falling confidence in the market has now also led to lower investment plans, which was not the case six months ago. China saw some USD 116bn in foreign direct investments last year, an increase by 9.7% from the year before. Most surveys point in the direction of China continuing to be a prime FDI destination for western companies, although this survey is indicating a slowdown among North European 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 and previous surveys, only a small minority of Nordic and German corporates have average outstanding account receivable days greater than 90, but the number has increased somewhat. 13% of respondents now have 90-120 days average payment terms compared to 12% one year ago. No companies have over 120 days.

(See graph 5 on page 5)

SUBJECT: Funding Needs

Funding needs have decreased further among companies. Today, only 35% (52% in September and 62% one year a go) of managers are expecting funding needs to increase in the coming six months. 65% 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 will be moving towards less monetary tightening in the coming six months. This can be seen from the views of interest rates and the RMB exchange rate. As many as 55% of the companies believe that interest rates will remain unchanged (38% in the last survey), whereas 31% (4% in the last survey) believe that rates will go down. Only 14% expect rates to go up in the coming six months. 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, cut bank reserve requirements for big banks in December and February to 20.5%, down from 21.5% but it has kept interest rates stable, Inflation, measured as CPI, fell in the last months of 2011 to 4.1% in December but went up to 4.5% in January this year. Most analysts expect inflation to continue to ease however and expect further monetary policy easing going forward. It should be remembered however that deposit rates are highly negative in real terms.

Over two thirds of managers expect the RMB to continue appreciating against the US dollar after the RMB finally started to move in July last year. 70% expect the RMB to appreciate over the coming six months compared to 92% in September. 28% believe that the RMB will be stable against the US dollar as compared to 6% in September. A fairly stable RMB/USD exchange rate is one of the main reasons why many companies have traditionally invoiced their China trade in USD and this trend has strengthened in the last six months. As many as 71% of respondents now use the USD as their main currency. This is up from 61% six months ago. 5% 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 this.

Between 21 February, 2011 and 20 February, 2012, the RMB appreciated by 4.0% against the USD (from 6.5643 to 6.3009), and appreciated by 7.3% against the EUR, (from 8.9556 to 8.3020), 4.5% against the NOK (from 1.1615 to 1.1084), 7.3% against the DKK (from 1.2067 to 1.1178) and 8.3% against the SEK (from 1.0281 to 0.9424). 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 28% are hedging some or most of their FX flows on the on-shore forward market and another 23% are hedging via their head offices through NDF-contracts or the CNH market.

(See graphs 7 and 8 on page 5, plus graphs 9 and 10 on page 6)

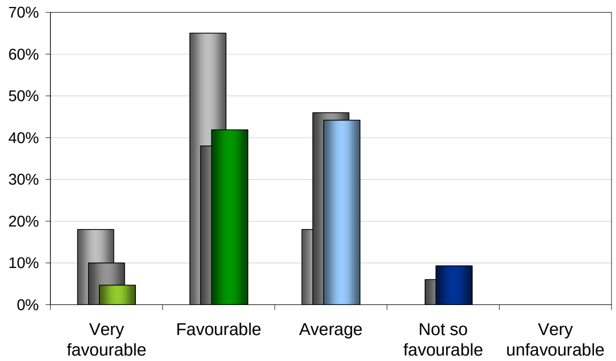
SUBJECT: Main Concerns

Customer demand continues to be the major concern for local management. Now 36% (27% in September and 15% in March last year) mention it as their main concern. Another 17% say it is their second largest concern. Competition is also a top concern (mentioned by 18% as the main concern and 21% as the second largest concern) as well as raw material costs (13% and 14% respectively). Complex rules and regulations are considered to be the fourth largest concern among the choices given in this survey.

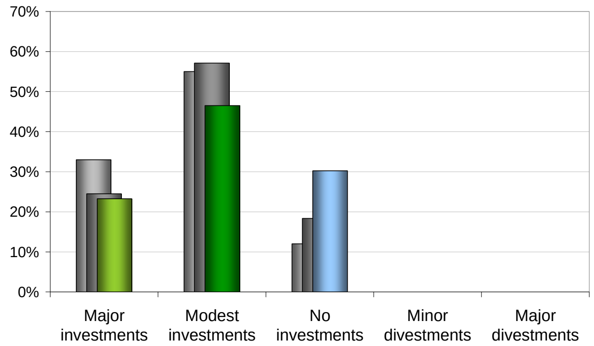
(See graph 11 on page 5)

CHINA FINANCIAL INDEX – COMPOSITION
SEB's China Financial Index in February 2012 had a value of 61 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 – 58, Profit Expectations – 54, Investment Plans – 69, and Employment Plans – 63. (see the graph on page 1)

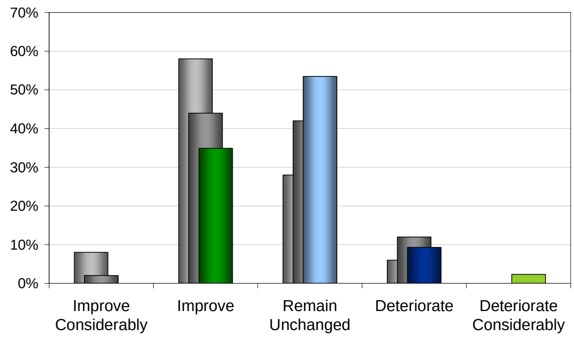
1. BUSINESS CONDITIONS



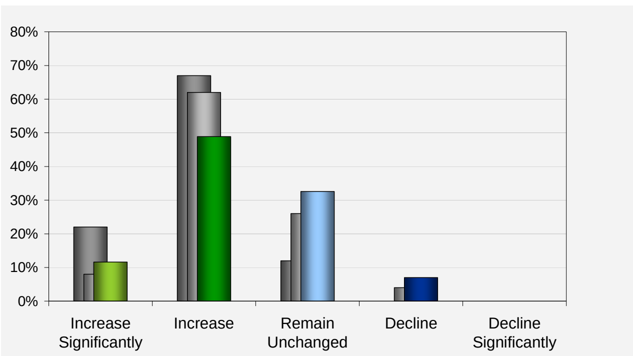
2. FIXED ASSET INVESTMENT PLANS



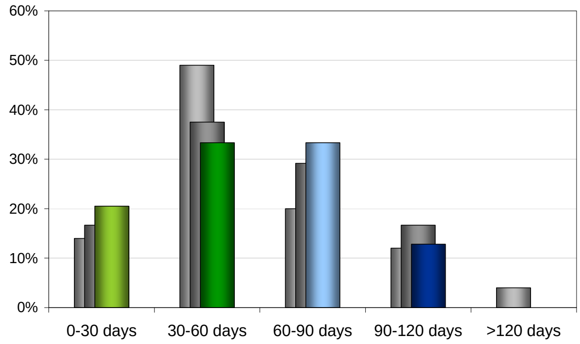
3. PROFIT EXPECTATIONS



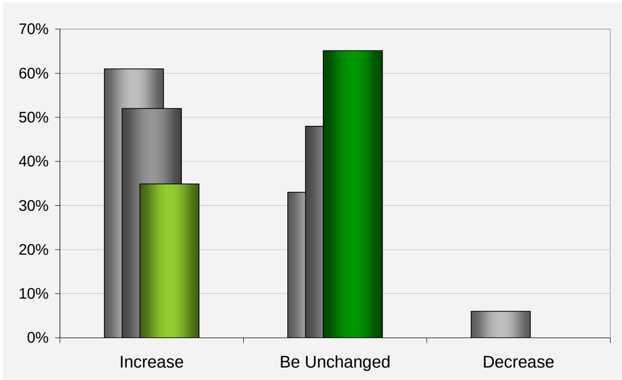
4. NUMBER OF EMPLOYEES



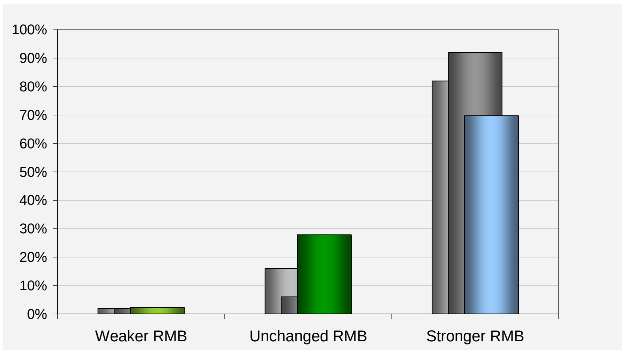
5. AVERAGE OUTSTANDING A/R



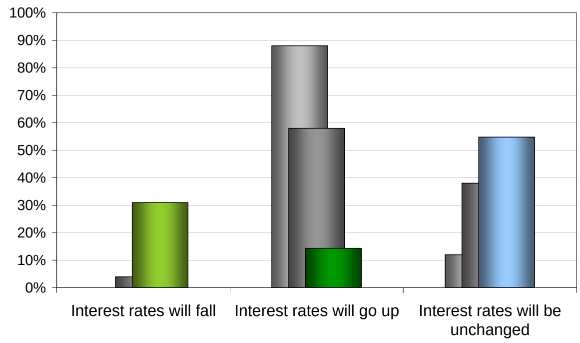
6. FUNDING NEEDS



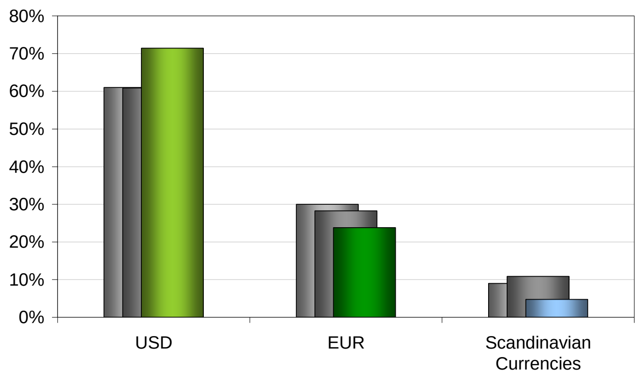
7. RMB AGAINST USD



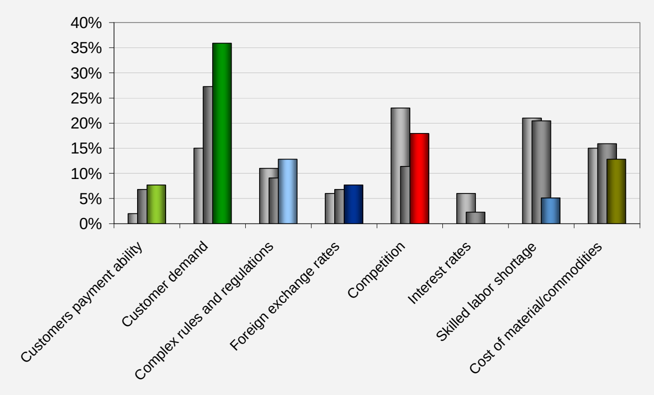
8. RMB INTEREST RATES



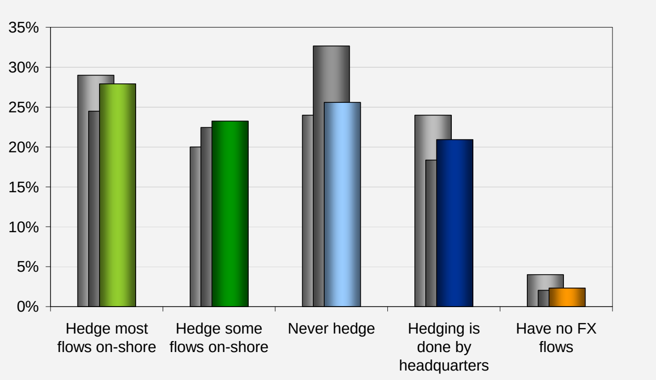
9. MAIN TRADING CURRENCY



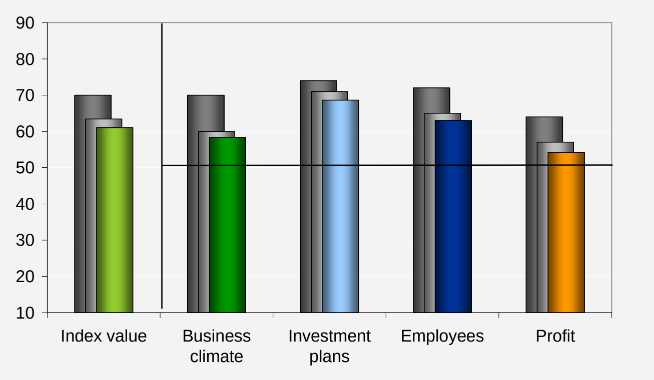
11. MAIN CONCERNS



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

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