Further fall in China confidence

- but two of three Nordic companies plan to invest further

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SEB CHINA FINANCIAL INDEX AT 56.1, down from 61.0 in March and 63.4 twelve months ago, suggesting business activity has continued its slowing pace in China.

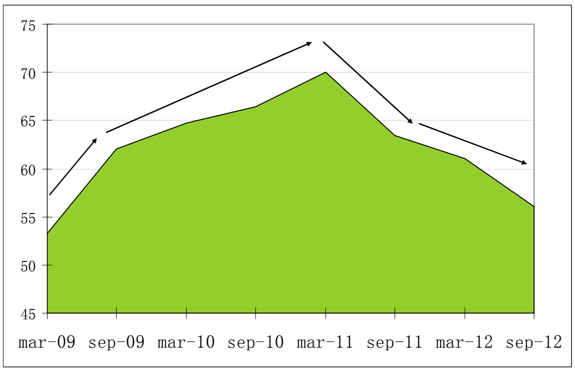
BUSINESS PROSPECTS NOW INDICATE A SMALL CONTRACTION. Profit expectations have also fallen. Companies continue to invest but are cutting recruitment plans.

CUSTOMER DEMAND BY FAR THE MAIN CONCERN

FURTHER FALL IN DEMAND IN CHINA

Northern European companies have become more pessimistic about business conditions in the Chinese market for the coming six months. This is the third consecutive survey where the index has fallen, after reaching an all-time high in March last year. At 56.1, the index is now only slightly higher than in March 2009, just after the financial crisis took hold.

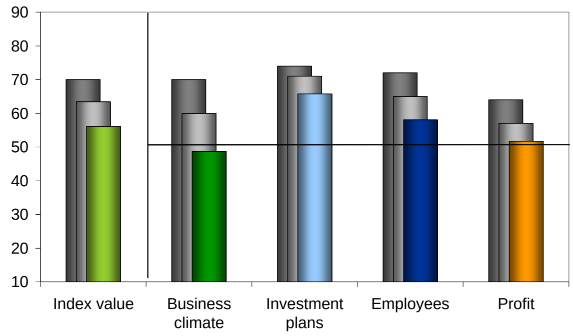
Historical development, China Financial Index



Around one-third of respondents expect business conditions to be favourable, but none expect them to be very favourable compared to 5% in March and 10% one year ago. One-third foresees average business conditions and one-third expects them to be unfavourable. Profit prospects are also falling. Around 30% expect profits to improve (35% in March and 44% one year ago), whereas 17% expect deteriorating profits. Half of the companies forecast unchanged profits.

Companies continue to invest, albeit at a slower pace, with 15% of companies still planning significant investments and 49% foreseeing modest investments. Recruitment plans have fallen. Now, 44% plan to add further staff (vs. 61% in March).

China Financial Index, September 2012



Source: SEB Shanghai. Coloured stacks are the most recent results. Grey stacks show results in March 2012 and September 2011, respectively

Companies continue to worry about falling demand for their products, with 70% now viewing the subject as the main concern (36% in March and 27% a year ago). Other concerns are customer payment ability, skilled labour shortage and cost of material.

Half of respondents expect salaries to increase by 7-8% during 2013, while another one-third expects salaries to increase by 9-10% or more. The fact that costs continue to increase while companies see a fall in the business climate could potentially put pressure on margins for certain companies in the short term.

Our index is in line with other economic data. China's official Purchasing Manager's Index (PMI) showed a continuous downtrend in August, strengthening the view that China's economic activity is slowing further. 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 medium term.

OUR CONCLUSIONS
North European subsidiaries' business confidence in China has tumbled further since March 2012, and local managers now feel the impact of a slowing Chinese economy. However, the index is still positive and still above levels seen right after the financial crisis erupted, when SEB started the index in March 2009. Companies continue to invest in what is still the fastest growing major economy, but the pace has slowed. Based on discussions with clients, we also see a large difference in sentiment among respondents. Industrial companies are in general more pessimistic while companies selling to consumers are more optimistic, reflecting the ongoing rebalancing of the Chinese economy from investment-led to consumption-driven.

GDP growth below 8% in 2012

BUT GROWTH IS EXPECTED TO HOLD UP

China's economy grew by 7.6% year-on-year in the second quarter of 2012. Full-year growth for 2012 is now expected to end at 7.8% and then pick up slightly in 2013. Industrial production remained relatively slow in August (8.9%) while fixed asset investment growth decelerated to 19.1% in the same month. The call for government stimulus similar to the RMB 4trillion package launched in 2009 now seems to be partly answered, with China recently announcing a boost to railway spending and approving 25 subway projects across the country at a value of USD 112billion. But top leadership in Beijing has also denied that spending will be as aggressive as in 2009, as the country tries to rebalance its growth model away from investment-led growth.

Global GDP growth
Year-on-year percentage change

	2011	2012	2013	2014
United States	1.8	2.2	2.2	2.6
Japan	-0.7	2.7	1.5	1.3
Germany	3.1	0.8	1.0	1.5
Euro zone	1.5	-0.4	0.2	0.9
China	9.3	7.8	8.0	8.2
United Kingdom	0.8	-0.4	1.4	1.6
Nordic countries	2.4	1.7	1.9	2.2
Baltic countries	6.2	3.1	3.8	4.4
OECD	**1.8**	**1.4**	**1.7**	**2.1**
Emerging markets	6.2	5.0	5.3	5.8
World, PPP*	**3.9**	**3.3**	**3.6**	**4.1**
World, nominal.	3.2	2.5	2.9	3.3

Source: OECD, SEB * Purchasing power parities

China has lowered its key interest rate on two occasions since our last survey, and further monetary easing is expected, with further deposit reserve ratio cuts for banks and possibly one or more interest rate cuts. However, the third dose of quantitative easing in the United States, or QE3, may increase the risk of inflation in China, complicating monetary policy for the Chinese central bank. SEB's main scenario is that China will avoid a hard landing. We expect GDP to rise by 8% in 2013 and 8.2% in 2014.

CUSTOMER DEMAND THE MAIN CONCERN

Customer demand is by far the largest concern in this survey. 70% say it is their greatest concern compared to 36% six months ago. Another 14% see it as their second largest concern. This is the third survey in a row where customer demand is increasing as a concern. Customer payment ability, skilled labour shortage and cost of material are other worries, followed by competition.

The concerns mentioned in this survey fairly strongly point in the direction of slowing sales growth and increased competition, which are logical reasons behind the fall in profit expectations. These factors are probably forcing companies to sell at lower margins than they previously had in China. With declining volume growth rates, increasing labour costs, higher commodity prices compared to a few years ago and tougher competition from local and international firms, the ability to maintain margins is falling.

RMB LIKELY MORE VOLATILE AND INTEREST RATES MAY BE CUT FURTHER

Consumer prices were in a falling trend during the first half of 2012 but rose to 2.0% in August year-on-year. As China continues its monetary loosening, PBOC has, since the last China Financial Index in March, lowered its one-year policy rate to 6.00%. Many analysts expect monetary easing to primarily take place through lower deposit reserve ratios for banks before possibly further lowering interest rates. The RMB has weakened by 0.5% against the USD in 2012, and the onshore forward market is expecting another 1.6% depreciation to 6.41 against the USD 12 months from now. As many as 72% of respondents in this survey expect interest rates to decrease whereas 26% expect them to remain unchanged. 47% calculate with a stable RMB and 21% think that the RMB will be weaker against the USD.

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 more than EUR 500million. The survey is web-based and confidential, and was carried out from 2 September to 10 September, 2012.

SUBJECT: Business Climate/Profit Expectations

Northern European subsidiary managers in China have become more pessimistic about the business climate for the coming six months, compared to six and 12 months ago. Now, none (5% in March and 10% in September 2011) think that conditions will be very favourable whereas 30% (42% in March and 38% last year) view the business climate as favourable. One year ago, 6% of companies had a negative view whereas the figure has now grown to 32%.

When asked about profit expectations, 30% expect profits to increase compared to 44% 12 months ago. Today, 50% expect profits to be unchanged (compared to 53% in March and 42% a year ago). 19% expect falling profits, which is almost double the amount compared to six months ago (11% in March).

China GDP growth in Q2 2012 reached 7.6%, and almost all economic data point to a slowdown in China in 2012. Furthermore, the official Chinese PMI index dropped to 49.2 in August (from 50.1 in July), indicating contraction in the Chinese economy. This was the lowest level since November 2011. More negative reports and falling exports have probably added to a gloomier sentiment among companies participating in our survey.

(See graphs 1 and 3 on page 5)

SUBJECT: Employment Structure

North European companies are continuing to recruit in China, but the pace has fallen in the past year. As managers become more bearish on 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 this time, two companies said they will actually reduce staff in China. No company has ever indicated that in previous surveys.

(See graph 4 on page 5)

SUBJECT: Fixed Asset Investment Plans

Companies are only indicating a slight slowdown in investments. In this survey, more than one-third, or 36%, answer that they do not plan any further investments compared to 30% six months ago. The percentage of companies planning modest investments has risen to 49% from 47% in March whereas only 15% of all companies still continue to plan for major investments (vs. 23% six months ago).

Hence, continued falling confidence in the market has had some effect on investment plans. However, it is mainly recruitment plans that have fallen (see above), whereas three-quarters of all respondents in fact have modest or significant investment plans. The volume of foreign direct investment (FDI) to China in the first half of 2012 dropped 3% compared to the same period last year.

(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. However, the number has increased somewhat. 18% 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 32% (35% in March and 52% one year a go) of managers are expecting funding needs to increase in the coming six months. 62% 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 continue to move towards monetary easing in the coming six months. This can be seen from the views on interest rates and the RMB exchange rate. As many as 72% (31% in our last survey) believe that interest rates will go down, whereas one of four companies believe that interest rates will remain unchanged (55% in the last survey). Only one company expects rates to go up in the coming six months. The current policy rate for a 12-month bank loan is 6.0%. The 12-month deposit rate is 3.0%. The Chinese central bank cut interest rates twice, in June and July, but kept the deposit reserve ratio for banks unchanged. Inflation, measured as CPI, fell in July of 2012 to 1.8% but went up to 2.0% in August. Most analysts expect inflation to continue to be stable and expect further monetary policy easing.

Only one-third of managers expect the RMB to continue appreciating against the USD over the coming six months compared to 70% in September. 47% believe that the RMB will be stable against the USD as compared to 28% in March. 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 USD as their main currency. 5% use one of the Scandinavian currencies.

Between 2 January, 2012 and 30 August, 2012, the RMB depreciated 0.88% against the USD, 4.1% against the SEK and 3.7% against the NOK. During the same period, the RMB appreciated 2.4% against the EUR and 2.3% against the DKK. The fact that so many companies are unsure of whether the RMB will strengthen or weaken 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 onshore 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

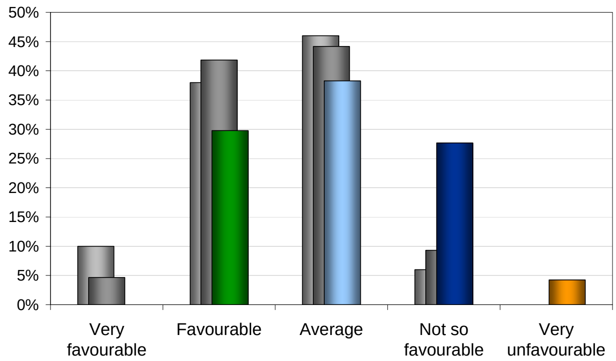
Customer demand seems to have fallen for an absolute majority of the companies and is now a much bigger concern for local management than in previous surveys. Now, 70% (36% in March and 27% in September last year) mention it as their main concern. Another 14% say it is their second largest concern. We have spoken to several of our clients in China over the last few weeks to discuss the economy. The view of the market differs significantly between different industries. Companies selling directly to the Chinese consumer have in general a very positive view of the market, with expected further growth this and next year. On the other hand, manufacturers typically have a much less optimistic view, in particular export-oriented companies or manufacturers selling to infrastructure-related projects. Customers' payment ability, skilled labour shortage and cost of material are also mentioned as concerns (pointed out by 7% each as the main concern).

(See graph 11 on page 5)

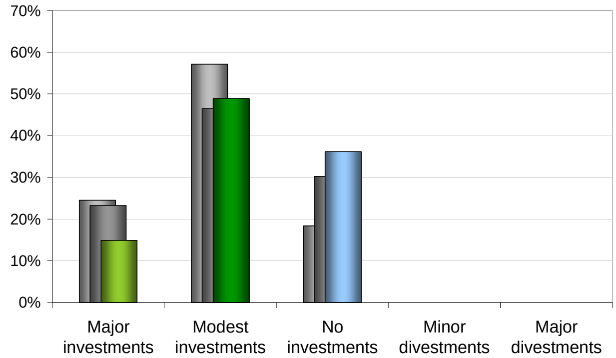
CHINA FINANCIAL INDEX – COMPOSITION

The SEB China Financial Index in September had a value of 56.1, indicating a slightly 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 – 49, Profit Expectations – 52, Investment Plans – 66, and Employment Plans – 58. (See the graph on page 1)

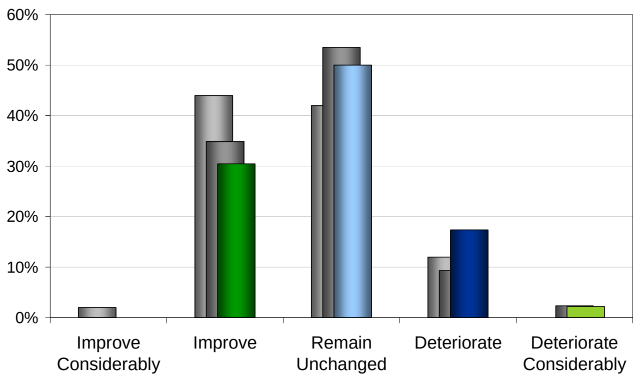
1. BUSINESS CONDITIONS



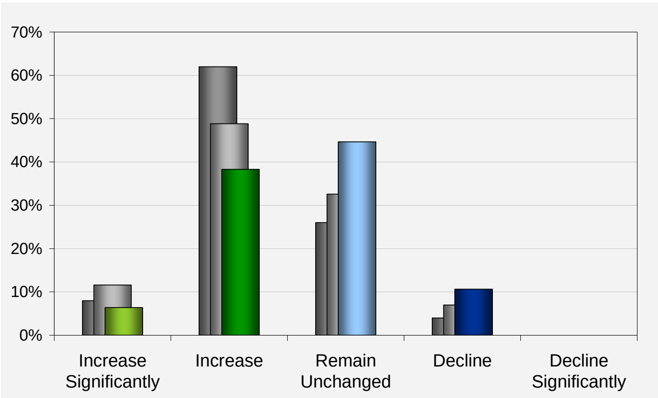
2. FIXED ASSET INVESTMENT PLANS



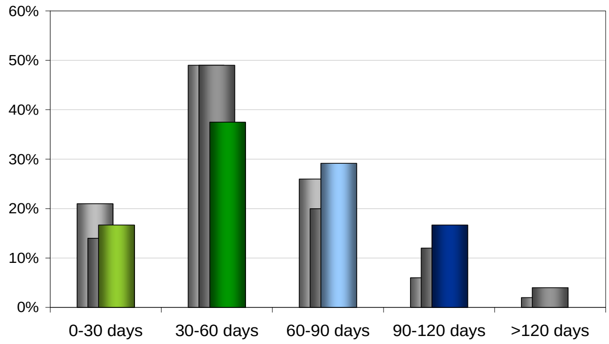
3. PROFIT EXPECTATIONS



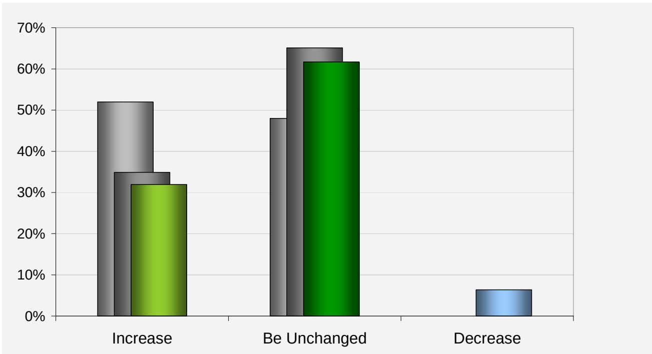
4. NUMBER OF EMPLOYEES



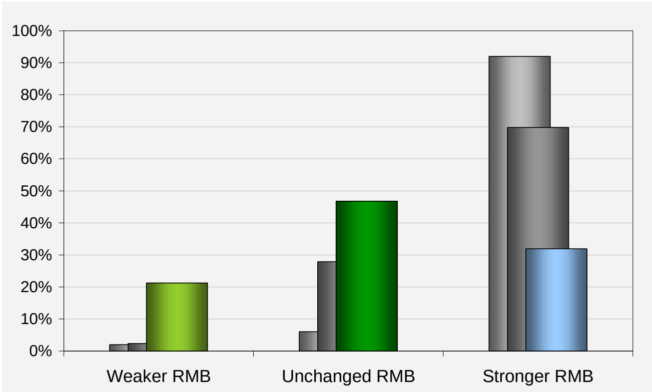
5. AVERAGE OUTSTANDING A/R



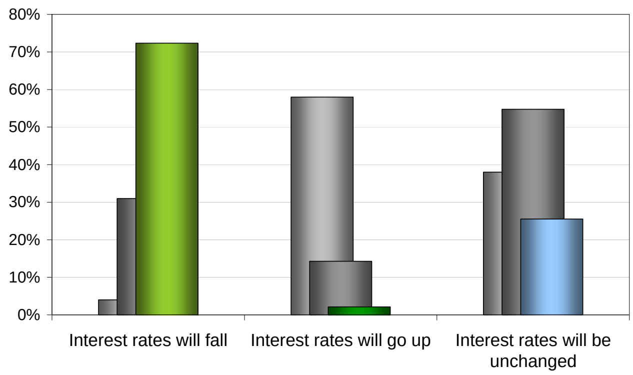
6. FUNDING NEEDS



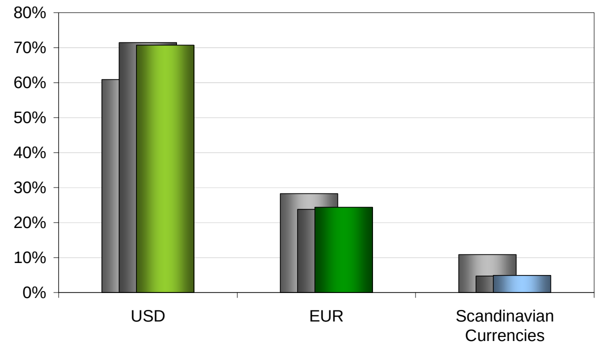
7. RMB AGAINST USD



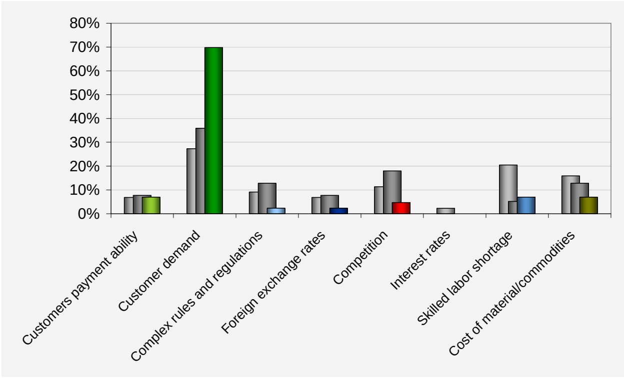
8. RMB INTEREST RATES



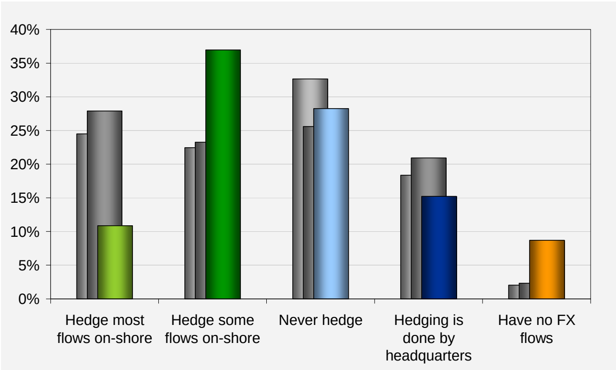
9. MAIN TRADING CURRENCY



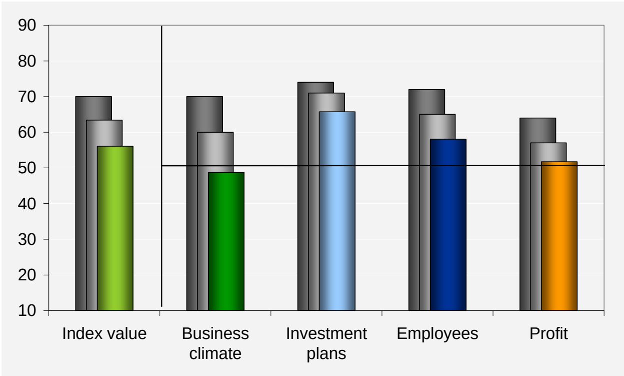
11. MAIN CONCERNS



10. HEDGING STRATEGY



12. MAIN INDEX



Source: SEB Shanghai. Grey stacks are indicating companies' answers in the last two surveys in March 2012 and September 2011