Rebound in China confidence

- Nordic companies more bullish. Profit expectations on the rise.

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5 MARCH 2013

SEB CHINA FINANCIAL INDEX AT 60.8, up from 56.1 in September and close to the 61.0 reading twelve months ago, suggesting business activity has rebounded somewhat in China. **BUSINESS PROSPECTS AND PROFIT EXPECTATIONS RISE**, while expansion plans remain stable, with investment plans and further recruitment slightly up from the last survey.

CUSTOMER DEMAND STILL THE MAJOR CONCERN, although much less so than six months ago. Competition and complex regulation are becoming more worrisome.

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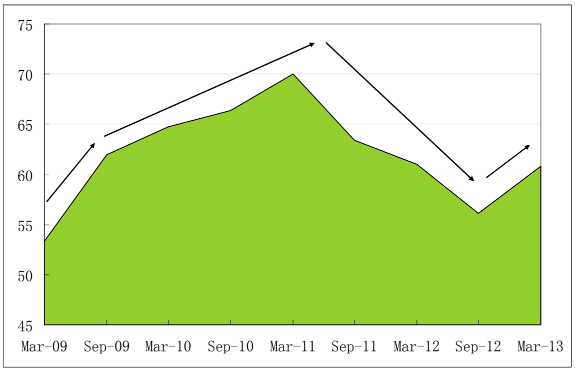
DEMAND IS COMING BACK IN CHINA

Northern European companies have become more optimistic about business conditions in the Chinese market for the coming six months. After three consecutive surveys with falling optimism, the index has now come back to levels seen a year ago. Profit expectations are also rising.

Historical development, China Financial Index

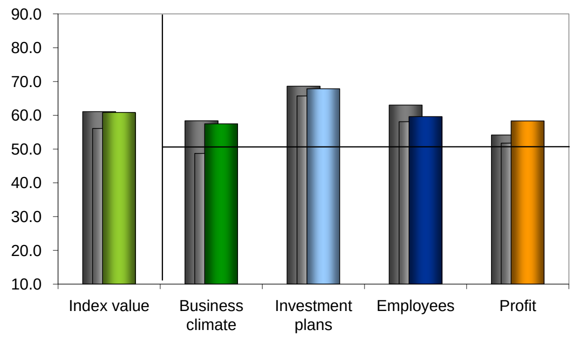


Around half of respondents expect business conditions to be favourable, but none expect them to be very favourable. Only 10% see business conditions as unfavourable compared to 30% six months ago. Four of ten expect "average" business conditions.

PROFITS SEEN ON THE RISE

Profit prospects are also up. Almost half of respondents expect profits to improve (30% in September), and equally many forecast unchanged profits. Only a small number of companies expect deteriorating profits. Three out of four companies continue to invest, which is up from two thirds in our last survey. 15% of companies are still planning significant investments. Recruitment plans are slightly higher. Over half of the companies plan to add further staff, but for the first time since we started the index, no company is increasing staff significantly.

China Financial Index, March 2013



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

Fewer companies worry about falling demand for their products in this survey, with 44% now viewing the subject as the main concern (70% in September). The second-largest concern is now competition.

SALARIES SEEN OUTPACING CPI

Around 40% of respondents expect salaries to increase by 9-10% or higher during 2013, while another one-third expects salaries to increase by 7-8%. Lower inflation rates in China do not seem to have had an effect on salary changes, as these numbers are very similar to our last survey. 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 slightly contradictory to other confidence indexes. China's official Purchasing Managers Index (PMI) showed a continuous uptrend by the end of 2012 and came in at 50.6 in December, but fell slightly

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to 50.4 in January, but its "new orders" sub-index rose to a nine-month high. This is a further indication that the economy is in the midst of a mild recovery.

OUR CONCLUSIONS
North European subsidiaries' business confidence in China has rebounded in the last couple of months. The fact that both sub-indexes "business climate" and "profit expectations" are up, in combination with a sharp fall in concerns about customer demand, indicates that order books are looking better today than six months ago. However, companies seem able to cater to this upswing in demand within previous expansion plans and are not planning to speed up investments in capacity in China. Based on discussions with clients, we also see a large difference in sentiment among respondents. Industrial companies are in general less optimistic while companies selling to consumers are more optimistic, reflecting ongoing rebalancing of the Chinese economy from investment-led to consumption-driven.

MODEST RECOVERY; 8% GDP GROWTH SEEN

China's economy grew by 7.9% in the fourth quarter of 2012 compared to the same quarter 2011. This was the first acceleration in growth in two years and several indicators now point to a recovery, albeit modest, in the Chinese economy. China's official Purchasing Managers Index fell slightly to 50.4 in January, whereas the equivalent HSBC index rose to a two-year high of 52.3 but fell back to 50.4 in February. Chinese exports and imports accelerated faster than expected in January, up by 25% and 14.8% respectively, while foreign direct investment fell for the eighth consecutive month in January, dropping by 7.3% compared to the same month one year ago.

Global GDP growth
Year-on-year percentage change

	2011	2012	2013	2014
United States	1.8	2.2	2.1	2.7
Japan	-0.5	2.0	1.3	1.5
Germany	3.2	0.7	0.6	1.6
China	9.3	7.8	8.1	7.7
United Kingdom	0.9	0.0	1.3	1.5
Euro zone	1.4	-0.5	-0.3	0.9
Nordic countries	2.3	1.0	1.3	2.2
Baltic countries	6.4	4.0	3.4	3.9
OECD	**1.8**	**1.3**	**1.5**	**2.1**
Emerging markets	6.3	5.1	5.5	5.7
World, PPP	**3.8**	**3.3**	**3.7**	**4.1**
World, nominal	3.1	2.6	3.0	3.4

Source:OECD, SEB

Exports will continue to be hampered in 2013 however, due to weak demand from the US and Europe. A very important factor behind the recovery is central or local government infrastructure projects such as water and rail systems that have been fast-tracked to stimulate growth. Credit growth to finance these projects hit a three-year high in January and the beginning of February.

SEB economists' main scenario is that China's growth will remain strong. They expect GDP to rise by 8.1% in 2013 and 7.7% in 2014.

CUSTOMER DEMAND LESS OF A CONCERN

Customer demand was by far the largest concern in our last survey, after having increased three surveys in a row, with 70% saying in September it was their greatest concern. This number had fallen to 44% in February, although 23% mention it as their second-largest concern when asked to rate different concerns. Overall, the second-largest worry is now competition, mentioned by 16% as the largest concern and 33% as their second-largest concern. Other concerns mentioned are complex rules and regulation and skilled labor shortage.

The concerns mentioned in this survey fairly strongly point in the direction of a return in sales growth, as focus turns from worrying over demand for their own products to other concerns. We have seen this pattern – dropping concern over demand followed by sales growth – in previous surveys.

RMB GAINS AS CROSS-BORDER CURRENCY

In line with the Chinese government's plans to bolster the use of RMB for trade and investment purposes in and out of China, North European companies are now slowly changing their invoicing pattern. When asked which currency is the preferred one for cross-border business, 63% still mention USD as their main currency. However, this is a fall from around 70% in our previous surveys. 11% now say that RMB (or CNH, which is what the RMB is usually referred to when traded outside the borders of China) is their main currency. 22% use the euro and only 4% Scandinavian currencies.

Half of the companies expect the RMB exchange rate to be stable against the USD in the coming six months and almost all of the rest expect an appreciation. Two of three companies think the interest rate will remain unchanged, while two out of ten think the interest rate will increase. Only 13% expect a falling rate as compared to 72% six months ago.

The RMB appreciated by 1.2% against the USD in 2012 whereas the onshore forward market is expecting a 1.4% depreciation to 6.34 against the US dollar, as indicated by the 12-month forward rate. In 2013, most analysts expect further moderate RMB appreciation.

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 500 million. The survey is web-based and confidential, and was carried out from 18 February - 22 February, 2013.

SUBJECT: Business Climate/Profit Expectations

Northern European subsidiary managers in China have become more optimistic about the business climate for the coming six months, compared to six months ago. Now, 48% (30% in September 2012) think that conditions will be favourable, although still no companies expect conditions to be very favourable. At the same time, 42% expect business conditions to be average (38% in the last survey) but the number of companies with a negative view has fallen. Six months ago, 28% of companies had a negative view whereas the figure has now fallen to 10%.

When asked about profit expectations, 48% expect profits to increase compared to 30% in September. 46% expect profits to be unchanged (compared to 50% previously). 6% expect falling profits, which is much less than the number six months ago (19% in March).

China's GDP growth in Q4 2012 reached 7.8%, and most economic data point to a modest rebound in China in 2013. Furthermore, the official Chinese PMI index came in at 50.4 in January (it was 49.2 in August, just before our last survey), indicating a small expansion in the Chinese economy. However, this is still a lower figure than trend in China. More positive reports and expanding exports have probably added to a slightly more positive sentiment among companies participating in our survey.

(See graphs 1 and 3 on page 5)

SUBJECT: Employment Structure

More North European companies are planning to recruit in China, but the picture is mixed. 56% are planning to increase staff in China, compared to 38% six months ago. However, no companies are planning significant staff increases, down from 8% in our last survey. Another 8% of respondents will actually reduce staff in China compared to 11% in the last survey.

(See graph 4 on page 5)

SUBJECT: Fixed Asset Investment Plans

Investment plans among North European companies remain solid. In this survey, 65% say that they are planning for modest investments in the coming six months (50% in the last survey) while another 15% plan for significant investments (same as last survey).

Hence, improved confidence in the market has already had some effect on investment plans, but changes are fairly small. Both investment and recruitment plans point in this direction (see above). The volume of foreign direct investment (FDI) into China in January dropped 7.3% compared to the same period last year.

(See graph 2 on page 5)

SUBJECT: Salary increases

Roughly one-third of the companies are planning for salary increases of 7-8% during 2013 and an equal number are planning for 9-10%. Only a few companies are planning for over 10% increases, whereas two out of ten companies are planning for 5-6%. Hence, the average among all companies is an increase of some 8-9%, which is considerably higher than the actual official inflation rate of 2%, indicating continuous fierce competition to keep talent in China.

(See graph 5 on page 5)

SUBJECT: Funding Needs

Funding needs have increased somewhat among companies. Today, 40% (32% in September) of managers are expecting funding needs to increase in the coming six months. 58% of managers expect funding needs to remain unchanged, whereas only one single company expects funding needs to decrease. Considering that companies are more positive in this survey and also indicate that they continue to invest in China, albeit moderately, the funding views seem logical. If higher sales volumes and higher investments do indeed become a reality in the near future, both working capital and fixed-asset investment financing needs will increase further.

(See graph 6 on page 5)

SUBJECT: FX and Interest Rates

The dominant opinion among managers is that China will continue to move from monetary easing to tightening in the coming six months. This can be seen from the views on interest rates and the RMB exchange rate. Only 13% (72% in our last survey) believe that interest rates will go down, whereas 69% now believe that interest rates will increase (26% in the last survey). Only 19% expect the rate to be unchanged 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%, but an increased flexibility for banks to decide on both lending rates and deposit rates was introduced by the central bank during 2012. Interest rate liberalisation is expected to continue in 2013. The Chinese central bank cut interest rates twice last year, in June and July, but kept the deposit reserve ratio for banks unchanged. China's consumer prices, CPI, rose 2% in January 2013 as compared to the same month a year earlier while the producer price index dropped 1.6%. Most analysts expect inflation to come back somewhat in 2013, mainly due to an increase in food prices which have an unusually large impact on CPI in China as compared to developed countries.

Half of managers expect the RMB to continue appreciating against the USD over the coming six months compared to 32% in September. 46% believe that the RMB will be stable against the USD, which is unchanged from the previous survey. A fairly stable RMB/USD exchange rate is one of the main reasons many companies have traditionally invoiced their China trade in USD. However, this trend has changed somewhat in the last six months. Now, 63% of respondents use USD as their main cross-border currency as compared to 71% in the two previous surveys. 11% use the RMB (mostly referred to internationally as CNH) as their main cross-border currency and 22% use the EUR. 4% use one of the Scandinavian currencies.

Between 2 January, 2012 and 31 December, 2012, the RMB appreciated 1.02% against the USD, whereas it depreciated 5.08% against the SEK and 6.60% against the NOK. During the same period, the RMB depreciated 1.02% against the EUR and 0.65% against the DKK. 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 47% are hedging some or most of their FX flows on the onshore forward market and another 17% are hedging via their head offices through NDF contracts or the CNH market. There is no change in companies' hedging behaviours from the last two surveys.

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

SUBJECT: Main Concerns

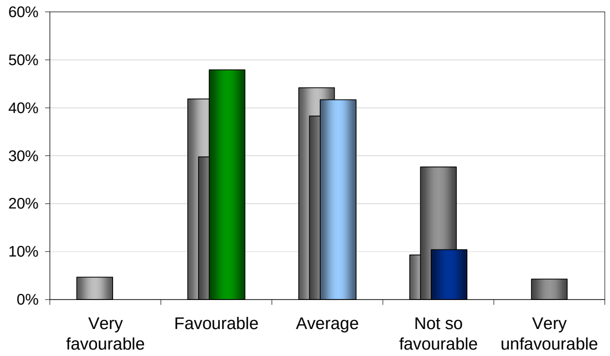
Customer demand seems to have come back for a majority of the companies and is now less of a concern than in the last survey. Now, 44% (70% in September last year) mention it as their main concern. Another 23% say it is their second-largest concern (companies are asked to rate their three largest concerns). 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 Chinese consumers 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. Competition is the second-largest concern according to our survey, with 16% mentioning it as the major concern and another 33% pointing it out as the second-largest concern. Skilled labour shortage, complex rules and regulations and cost of raw material are also mentioned as concerns.

(See graph 11 on page 5)

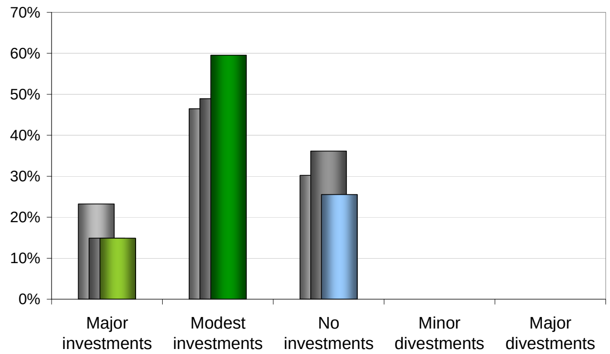
CHINA FINANCIAL INDEX – COMPOSITION

The SEB China Financial Index in March had a value of 60.8, 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 – 58, Investment Plans – 68, and Employment Plans – 60 (see the graph on page 1).

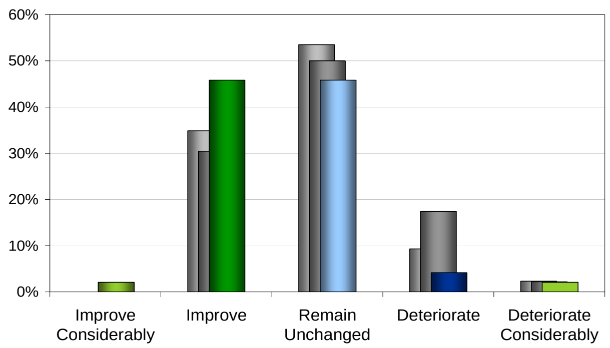
1. BUSINESS CONDITIONS



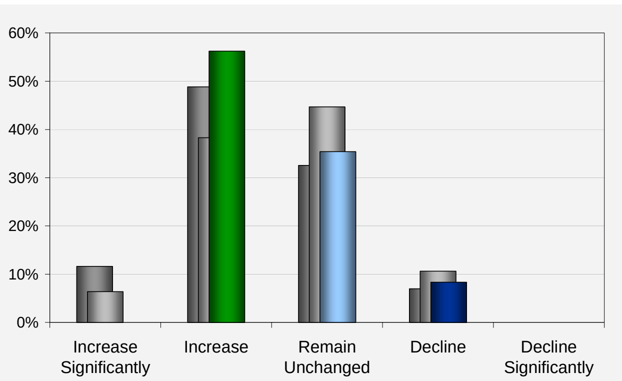
2. FIXED ASSET INVESTMENT PLANS



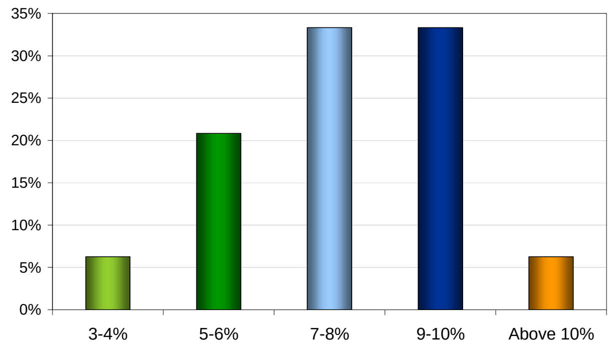
3. PROFIT EXPECTATIONS



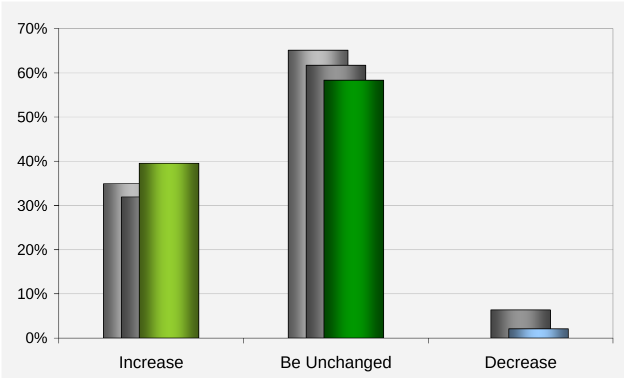
4. NUMBER OF EMPLOYEES



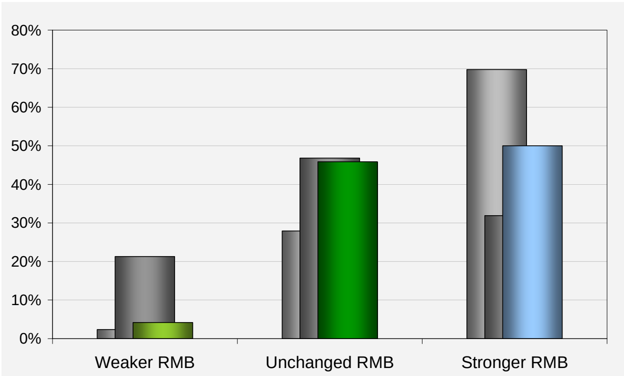
5. AVERAGE SALARY INCREASE



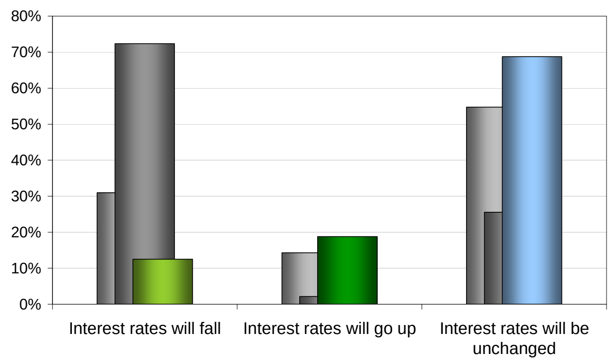
6. FUNDING NEEDS



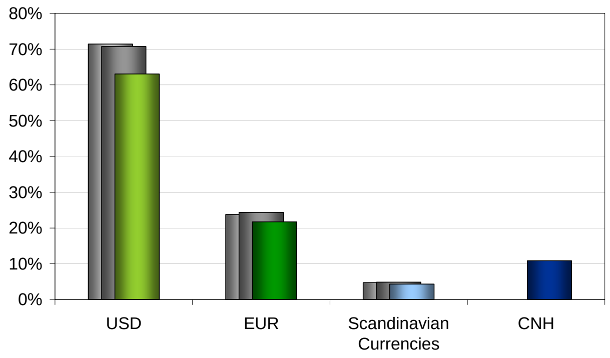
7. RMB AGAINST USD



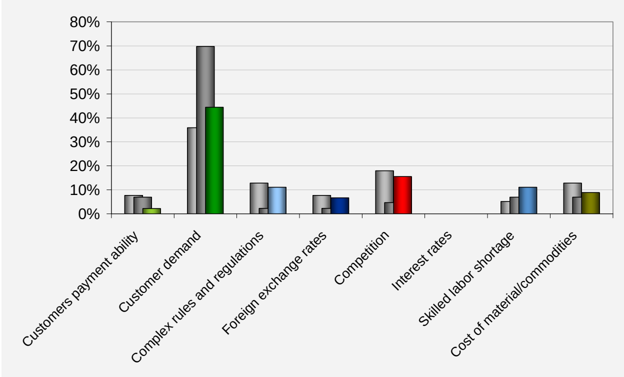
8. RMB INTEREST RATES



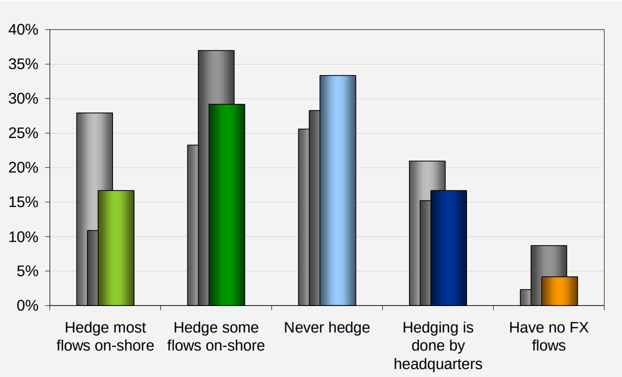
9. MAIN TRADING CURRENCY



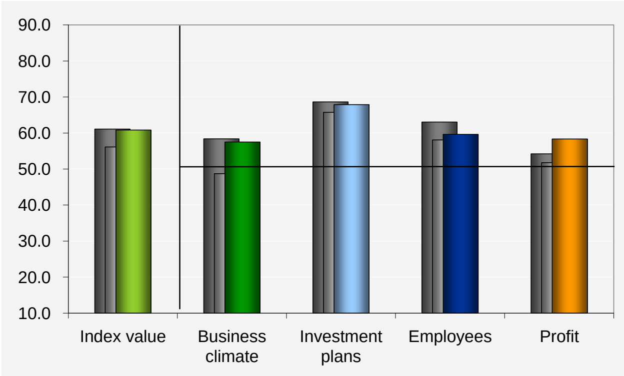
11. MAIN CONCERNS



10. HEDGING STRATEGY



12. MAIN INDEX



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

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