Slightly lower confidence in China

Nordic companies less bullish. Expansion plans slightly lower.

WEDNESDAY
11 SEPTEMBER 2013

SEB CHINA FINANCIAL INDEX AT 58, higher than a year ago but down from 60.8 in March, suggesting business activity has fallen back somewhat in China.
BUSINESS PROSPECTS AND PROFIT EXPECTATIONS DOWN. Expansion plans remain high although investment plans and further recruitments are slightly lower than the last survey.
SHARP INCREASE IN CONCERN OVER COMPETITION, although customer demand is still the major concern. Lack of skilled labour also a key worry.

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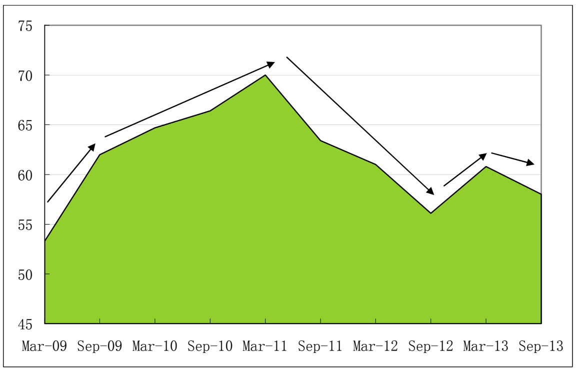
DEMAND FALLING SOMEWHAT IN CHINA

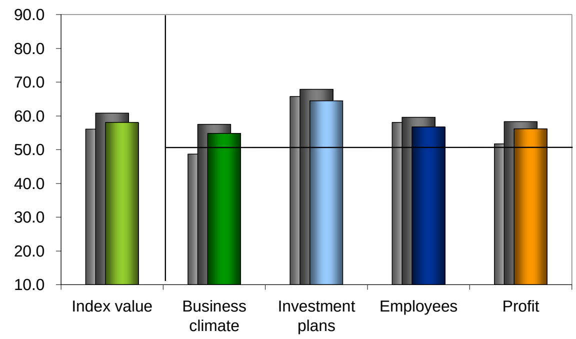
Northern European companies still have an optimistic view of business conditions in the Chinese market in the coming six months, but optimism has fallen compared to March. The last survey broke a string of three consecutive surveys with falling optimism, but the index has now turned downward again. Profit expectations have also eased in our latest survey, and remain far below the peak in March 2011.

Historical development, China Financial Index



Around one-third of respondents expect business conditions to be favourable compared to roughly half of the respondents six months ago. Some 15% see business conditions as unfavourable compared to 10% six months ago. The remaining 50% expect business conditions to be “average”. Profit prospects are slightly down. 44% of respondents expect profits to improve (48% in March), and equally many forecast unchanged profits. Only a small number of companies expect deteriorating profits. Six out of ten companies continue to invest while the number of companies not planning further investments has increased somewhat from three out of ten in the last survey to four out of ten this time. 15% of companies are still planning significant investments, just as in the previous survey. Recruitment plans are fairly stable. Four out ten companies plan to add further staff. One out of ten plans to decrease the number of staff, while almost half of the companies plan to keep the number of employees in China unchanged.

China Financial Index, September 2013



Source: SEB Shanghai. Colored stacks are the most recent results. Grey stacks show results in March 2013 and September 2012, respectively

Fewer companies worry about falling demand for their products in this survey, with 38% now viewing the subject as the main concern (44% in September). However, the percentage of companies viewing competition as the largest concern has doubled from 15% six months ago to 30% in this survey.

Plans for salary increases have fallen since the last survey. Now, only two out of ten respondents expect salaries to increase by 9-10% or higher during 2014, while four out of ten companies expect salaries to increase by 7-8%. Three out of ten companies expect salary increases to be below 4%. Lower inflation rates in China and less top-line growth seem to have had an effect on salary changes, as these numbers are considerably lower than in our last survey. However, costs continue to increase for companies in China at the same time as many investors see a cooling in the business climate. This could potentially pressure margins for certain companies in the short term and may be the reason companies have slightly lower expectations on profits in this survey compared to the last one.

Our index is not completely in line with other data which have pointed to a rebound in the last couple of months. For example, China's official Purchasing Managers' Index (PMI) hit a 16-month high in August. On the other hand, as our index is only done on a six-month basis, it does not reflect short-term changes in business conditions. GDP figures for Q2 were lower than Q1 while many other indications published in July and August indicate that the economy is in the midst of a mild recovery.

OUR CONCLUSIONS

What we see in the September survey is by no means a dramatic change from the last survey. Differences are minor and the index is still higher than it was one year ago. Should other economic data published in the near term continue to improve, we will probably see an improvement in our index as well. The fact that six out of ten companies continue to invest is also proof that there is no significant change in the long-term view that China is an important growth market. Having said that, all four sub-indexes "business climate", "profit expectations", "investment plans" and "recruitment plans" have fallen slightly, and the index is far from levels seen in 2011, when companies had a very optimistic view of China. Since then, GDP growth has had a falling trend for nine quarters out of ten. Based on discussions with clients, we can see that industrial companies are in general less optimistic while companies selling to consumers are more upbeat, reflecting the ongoing rebalancing of the Chinese economy from investment-led to consumption-driven.

Modest recovery

AROUND 8% GDP GROWTH EXPECTED 2013

China's economy grew by 7.5% in the second quarter of 2013 compared to the same quarter 2012. This was a slight deceleration from 7.7% in the first quarter. China's PMI has been fairly stable at just above 50 in the last three quarters but showed an increase in August. The Markit/HSBC equivalent index declined during the summer but rose in August to 50.1. China FDI has surged in the first seven months of 2013, up 7.1% from the same period in 2012. Chinese exports and imports also accelerated faster than expected in August, up by 7.2% and 7% respectively on a year-to-year basis. Economists and international newspapers are increasingly concerned with credit quality in the Chinese banking system, as well as growth of the shadow banking sector. Total credit growth for the first six months of 2013 was around 20% while economic growth has continued to fall, raising concerns that the quality in the allocation of capital has continued to deteriorate.

Global GDP growth

Year-on-year percentage change

	2012	2013	2014	2015
United States	2.8	1.6	3.3	3.7
Japan	2.0	1.9	1.4	1.0
Germany	0.7	0.5	1.7	2.0
China	7.8	7.5	7.4	7.0
United Kingdom	0.2	1.5	2.3	2.6
Euro zone	-0.6	-0.5	0.8	1.7
Nordic countries	1.2	0.8	2.4	2.5
Baltic countries	4.2	2.9	3.8	4.4
OECD	**1.5**	**1.2**	**2.4**	**2.8**
Emerging markets	**4.9**	**4.8**	**5.3**	**5.4**
World, PPP	**3.4**	**3.2**	**4.0**	**4.2**
World, nominal	2.7	2.5	3.2	3.5

Source: OECD, SEB

SEB's main scenario is that China's growth will remain strong, and we expect GDP to rise by 7.4% in 2013 and 7.0% in 2014.

COMPETITION INCREASINGLY A CONCERN

Customer demand is still the largest concern in our last survey, with 38% saying it was their greatest concern and another 23% saying it is their second largest concern. The second biggest worry is competition, mentioned by 31% as the largest concern and 28% as their second largest concern. The third largest concern was on skilled labour shortage.

The number of companies mentioning competition as their largest concern has doubled since the last survey, reaching a record high.

USD STILL MAIN CROSS-BORDER CURRENCY

But EUR more common than previously

Although the Chinese government is trying to bolster the use of RMB for trade and investment purposes in and out of China, North European companies continue to use foreign currencies as their main cross-border currency. Less than 10% use the RMB, or CNH as it is often referred to outside China. When asked which currency is the preferred one for cross-border business, 47% mention USD as their main currency. This is a fall from around 63% in our previous survey and 70% one year ago. 41% now say that EUR is their main currency. Only 4% say Scandinavian currencies, which is unchanged from previously.

Half of the companies expect the RMB exchange rate to be stable against the USD in the coming six months and 40% count on an appreciation. More companies than previously (11%) believe the RMB will weaken against the dollar. Over half the companies think interest rates will remain unchanged. 26% expect a falling rate and 17% think rates will go up.

The RMB has appreciated by 1.77% against the USD so far in 2013 whereas the onshore forward market is expecting a 1.5% depreciation to 6.21 against the USD, as indicated by the 12-month forward rate. In 2013, most analysts expect a further moderate appreciation of the RMB.

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 26 August - 5 September, 2013.

SUBJECT: Business Climate/Profit Expectations

Northern European subsidiary managers in China have become slightly less optimistic about the business climate for the coming six months, compared to six months ago. Now, 28% (48% in March 2013) think that conditions will be favourable and 6% expect conditions to be very favourable. 52% expect business conditions to be average (42% in the last survey) while the number of companies with a negative view has increased. Six months ago, 10% of companies had a negative view whereas the figure has gone up to 15%.

When asked about profit expectations, 44% expect profits to increase compared to 48% in March. 44% expect profits to be unchanged (compared to 46% in March). 12% expect falling profits, which is higher than the number compared to six months ago (6% in March).

China's GDP growth in Q2 2013 reached 7.5%, but most economic data point to a modest rebound in China in 2013. The official Chinese PMI index came in at 51.0 in August (it was 50.3 in July), indicating a small expansion in the Chinese economy. However, this is still a lower figure than trend in China. If more positive reports and expanding exports continue to improve in coming months, this will probably add to slightly more positive sentiment among companies in our next survey.

(See graphs 1 and 3 on page 5)

SUBJECT: Employment Structure

North European companies continue to recruit in China, but the picture is mixed. 43% are planning to increase staff in China, compared to 56% six months ago. However, 5% of the companies are planning significant staff increases, up from 0% in our last survey. 13% of respondents will actually reduce staff in China compared to 8% in the last survey.

(See graph 4 on page 5)

SUBJECT: Fixed Asset Investment Plans

Investment plans among North European companies remain solid, albeit at a slightly slower pace. In this survey, 43% say that they are planning for modest investments in the coming six months (60% in the last survey) while another 15% plan for significant investments (same as last survey).

Hence, the deteriorated confidence in the market has already had some effect on investment plans but the changes are fairly small. Both investment plans and recruitment plans point in this direction (see above). The volume of foreign direct investment (FDI) to China in the first seven months of 2013 went up 7.1% 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 5-6% in 2014 while 6% plan 3-4% salary increases. 44% of the companies are planning for salary increases of 7-8%. Another 17% are planning for 9-10%. Only 2% now plan for salary increases over 10%. Hence, the average among all companies is some 7-8% increase, which is lower than the actual previous surveys. Still, with the economy slowing down and inflation fairly low in China, salary increases look high in an international comparison.

(See graph 5 on page 5)

SUBJECT: Funding Needs

Funding needs have remained fairly stable among companies. Today, only 35% (40% in March) of managers are expecting funding needs to increase in the coming six months. 60% of managers expect funding needs to remain unchanged, whereas three companies expect funding needs to decrease. This seems logical, considering that companies are still fairly positive in this survey and also indicate that they continue to invest in China, although in a moderate way. If higher sales volumes and higher investments improve 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 view among managers is that China will continue to not change its current monetary policy in the coming six months. This can be seen from the views on interest rates and the RMB exchange rate. In this survey 26% (13% in our last survey) believe that interest rates will go down, whereas 17% now believe that interest rates will increase (19% in the last survey). As many as 57% 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 increased flexibility for banks to decide on both lending rates and deposit rates was introduced by the central bank during 2012, and further in 2013. This interest rate liberalisation is expected to continue in 2014, possibly with further reform of the deposit rates. The Chinese central bank cut interest rates twice last year, in June and July, but has kept rates stable this year. China's consumer prices (CPI) rose 2.7% in July 2013 as compared to the same month a year earlier while the producer price index dropped 2.3%. Most analysts expect inflation to come back somewhat in 2014, 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, 50%, expect the RMB will be stable against the USD in the coming six months, which is similar to our last survey. 40% expect the RMB to continue appreciating against the USD over the coming six months compared to 50% in September. 10% believe that the RMB will depreciate against the USD, which is slightly higher than in the previous survey. 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 this trend has changed somewhat in the last six months. Now, 47% of respondents use USD as their main cross-border currency as compared to 63% in the previous survey. 41% use the EUR and 8% use the RMB (internationally mostly referred to as CNH) as their main crossborder currency. 4% use one of the Scandinavian currencies, which is unchanged from our previous survey.

An increasing number of companies, now as many as 40%, are hedging some or most of their FX flows on the onshore forward market, and another 33% are hedging via their head offices through NDF contracts or the CNH market. Only 25% refrain from hedging their flows in China, which is the lowest figure since we started the China Financial Index. A more liquid and mature forward market and a more volatile exchange rate are probable reasons why most companies' are today hedging their China flows.

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

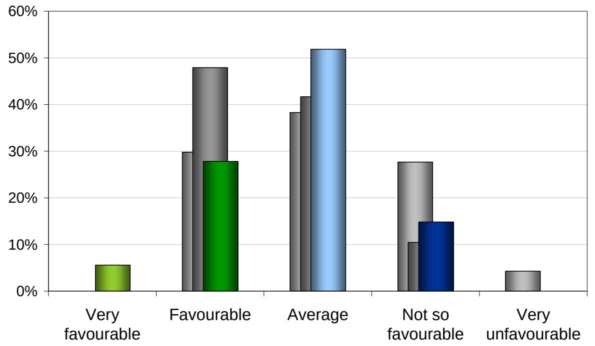
SUBJECT: Main Concerns

Customer demand is still what most companies, or 38%, single out as their main concern in the coming six months while another 23% view it as their second largest concern. However, the largest change from the last survey is that as many as one out of three companies see competition as their main concern. If combining the first and the second largest concern, almost 60% rate competition as a major concern. The third largest concern is skilled labour shortage.

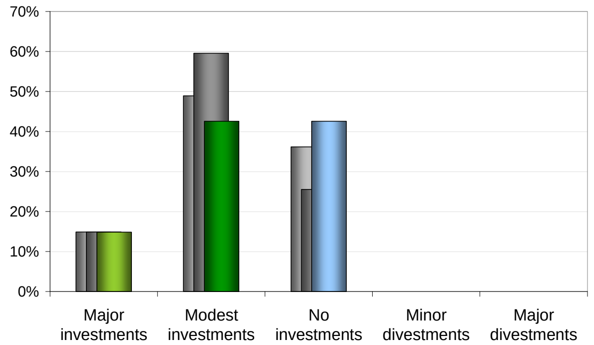
(See graph 11 on page 5)

CHINA FINANCIAL INDEX – COMPOSITION
The SEB China Financial Index in September had a value of 58, 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 – 55, Profit Expectations – 56, Investment Plans – 64, and Employment Plans – 57. (See the graph on page 1)

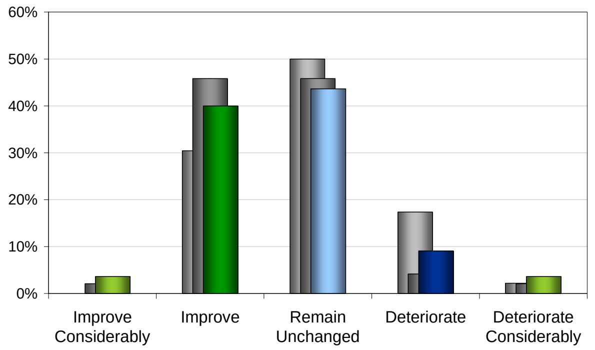
1. BUSINESS CONDITIONS



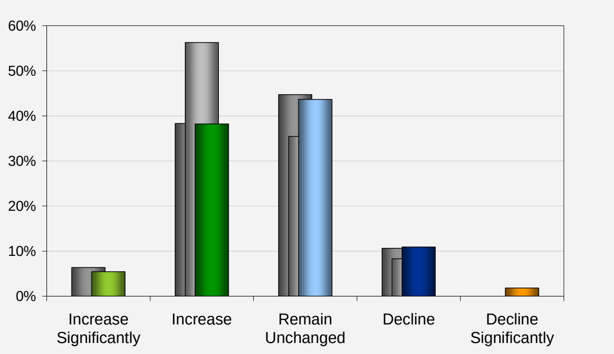
2. FIXED ASSET INVESTMENT PLANS



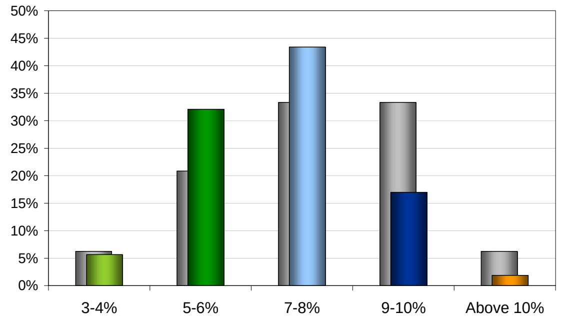
3. PROFIT EXPECTATIONS



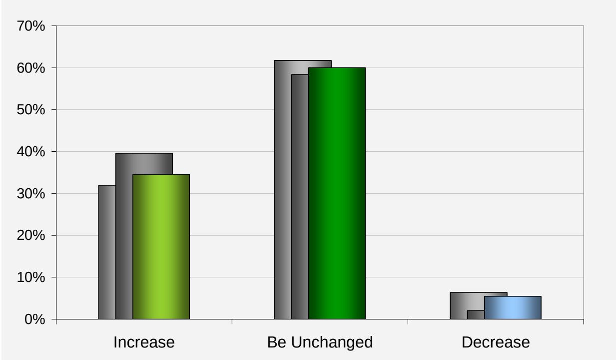
4. NUMBER OF EMPLOYEES



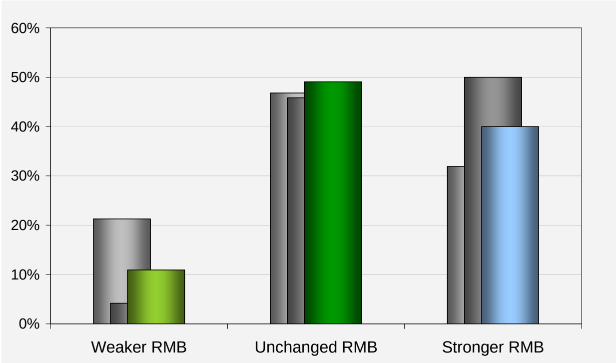
5. AVERAGE SALARY INCREASE



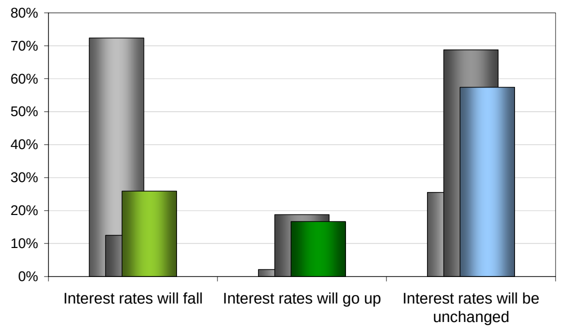
6. FUNDING NEEDS



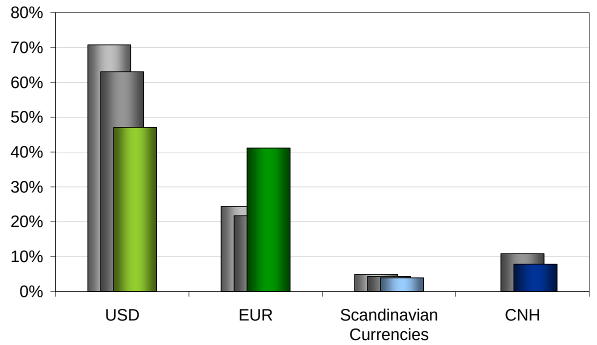
7. RMB AGAINST USD



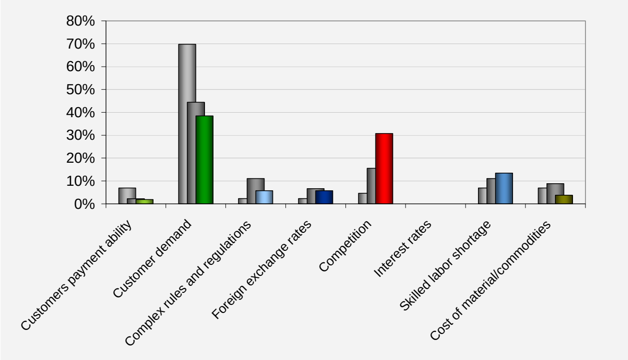
8. RMB INTEREST RATES



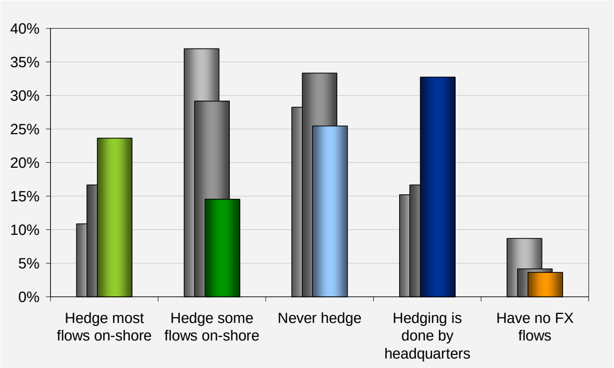
9. MAIN TRADING CURRENCY



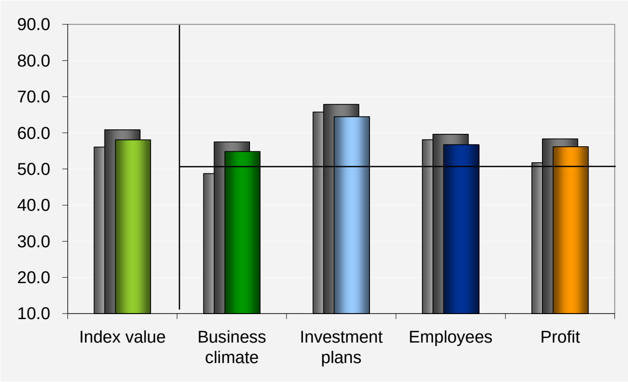
11. MAIN CONCERNS



10. HEDGING STRATEGY



12. MAIN INDEX



Source: SEB Shanghai. Grey stacks are indicating companies' answers in the last two surveys in March 2013 and September 2012