SEB

Press release

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SEB's China Financial Index: lower growth in China. Reduced profit expectations, but expansion plans unaffected.

Northern European companies have a less positive view on the business climate. SEB's China Financial Index in September falls to 58.7 from 61.4 in March. Fewer companies have a positive view on the business climate, with profit expectations lower compared to the previous survey. Recruitment plans are cut, while investment plans increase slightly in this survey.

China's economy continues to grow faster than other large economies, but a fresh string of data shows that growth is currently losing steam. GDP growth increased to 7.5% in the second quarter compared to 7.4% in the first quarter of 2014, but industrial production figures as well as imports and monetary growth in August point in the direction of lower economic activity. Top managers of Nordic and German subsidiaries in China confirm the picture of a less vibrant economy in SEB's latest China Financial Index. Four of ten companies have a positive view of business conditions while approximately an equal amount of companies have a neutral view. One of five companies now have a negative view of the business climate, and almost no companies have a *very* positive view. Still, almost half of the respondents expect increasing profits in terms of their Chinese subsidiaries, while four of ten companies do not expect changes. Around 15% expect profits to fall in the coming six months, which is an increase from the last survey. Expansion plans are only marginally affected: more than seven out of ten companies plan for further investments while there are fewer companies that plan no investments. Recruitment plans fall slightly, but four of ten companies will continue to add employees in China.

More companies than previously, four out of ten, view lower customer demand as the largest concern in this survey. Fewer companies view competition as the major concern while more companies than earlier worry about customers' payment ability and foreign exchange risks.

"On an aggregated level, we see that companies are less optimistic than in the last survey, and that is consistent with economic statistics the last couple of weeks. Meanwhile, we see large variations between industries among our clients in China. For example, companies that are selling to the automotive and railway industries, and companies selling directly to end-consumers, talk about very strong sales figures for the first six months, and there are no indications that it will change in the short term. Companies in the steel, pulp & paper and shipping industries, on the other hand, continue to struggle with overcapacity and weak sales figures," says **Fredrik Hähnel**, Head of SEB in Shanghai and author of the report.

Even if the Chinese economy grew faster than other leading economies, there are a number of risks for further deceleration in growth. Industrial production fell to 6.9% in August, the lowest figure in six years, and China's official purchasing manager's index fell to 51.1 in August from 51.7 in July. Inflation has also continued to fall. The Chinese government has so far preferred to launch smaller stimulus packages towards specific industries to avoid further imbalances in the economy. Meanwhile, analysts expect more aggressive stimulus packages and a looser monterary policy to avoid a further fall in growth. More Reserve Requirement Ratio (RRR) cuts for banks may be needed in order to make banks more willing to extend loans, and should inflation fall further, one should not exclude the possibility of an interest rate cut in 2015.

"Companies seem to be sticking to a fairly positive scenario for China. While overall foreign direct investment (FDI) into China fell in the last couple of months, companies in this survey say they will continue to invest in line with earlier plans. Some companies go so far as to increase investment plans, which we find a bit surprising. Recruitment plans fall slightly, but all in all, North European companies continue to invest in China," Fredrik Hähnel continues.

Four out of ten companies view a fall in customer demand as the biggest concern, which is higher than in the last survey (March 2014). Fewer companies than perviously view competition as the main worry, but more companies are concerned about customer payment ability and foreign exchange rate risks. Seven out of ten companies plan for salary increases of 5-8% while one in five plan for 3-4% salary increases. Only 14% expect salary increases to be 9-10%, which is considerably lower than in previous surveys.

"It is an obvious trend in this survey that companies now try to push down salary increases for the next year. It is also interesting to see so many companies worrying about getting paid in China, which is further confirmed by a number of our customers recently reporting that they increasingly receive bankers acceptance drafts as payments. China's central bank, the PBOC, has increased the band within which the renminbi can move against the US dollar daily, and it even let the currency weaken against the dollar earlier in the year. This has led to a larger focus on foreign exchange risks, which we also see among our clients who hedge their foreign exchange exposures," says Fredrik Hähnel.

Almost six out of ten companies expect the renminbi to strengthen against the US dollar in the coming six months while 35% think the exchange rate will be stable. Four out of ten companies believe interest rates will go up, while half of respondents anticipate that rates will remain the same.

This is the twelfth edition of SEB's China Financial Index, a unique semi-annual survey. The purpose is to mirror changes in expectations among North European companies in China in order to facilitate understanding of economic and financial development in the country. The survey was carried out September 1-12, 2014, and includes a total of 12 questions related to business climate, investment plans, recruitment plans and views on currencies and interest rates. An index level over 50 signals overall positive sentiment. The full report can be downloaded from: www.sebgroup.com\press.

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