Fall in business confidence in China

Nordic companies less optimistic but continue to invest

TUESDAY
23 SEPTEMBER 2014

SEB CHINA FINANCIAL INDEX AT 58.7, down from 61.4 in March, suggesting business activity has fallen in China.

BUSINESS PROSPECTS FALL, BUT PROFIT EXPECTATIONS HOLDING UP FAIRLY WELL. Investment plans remain high, while plans for new recruitments fell back slightly.

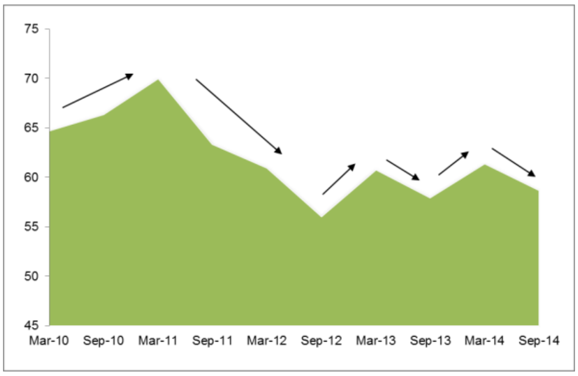
INCREASED CONCERN OVER CUSTOMER DEMAND, further indicating a cool-down of the Chinese market.

Fredrik Hähnel
General Manager
Tony Wang
Markets
SEB Shanghai
+86 21 53966681

SOMEWHAT LOWER DEMAND IN CHINA

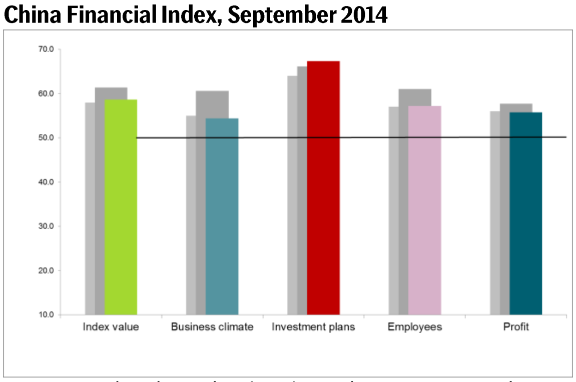
In line with the recent economic data, SEB's China Financial Index shows that Northern European companies have become less optimistic on business conditions in the Chinese market, compared to six months ago. While the survey still indicates further business growth, companies are now less positive on the business climate, despite fairly stable profit expectations. Four of ten continue to expect favourable business conditions. Almost none believe conditions to be very favourable, a downward shift from 11% in the last survey. Close to half of the companies expect profits to increase over the upcoming six months, while 16% expect profit to deteriorate, up from only 6% six months ago.

Historical development for SEB's China Financial Index



Interestingly, the fall in business sentiment has no impact on companies' investment plans: Northern European subsidiaries continue to invest in China. 16% of respondents are planning for significant investments, which is a small increase from the last survey. More than half of respondents (58%) plan modest investments in the coming six months, also up from the last survey. When asked about hiring plans, companies say these have slowed since the last survey. Half of the companies have no plans to increase staff in China in the coming six months. Meanwhile, four out of ten companies are planning to increase headcount. Only 2% are planning for a significant increase, down from 11% in the last survey.

China Financial Index, September 2014



Source: SEB Shanghai. Colored stacks are the most recent results. Grey stacks show results in March 2014 and September 2013, respectively

Compared to prior surveys, more companies today are worried about falling demand for their products, with 43% seeing this subject as their main concern (27% in March and 38% one year ago). Fewer companies this time believe competition is their main concern. Clients' payment ability is the third largest worry, with 10% ranking it their biggest concern.

Plans for salary increases have fallen since the last survey. This time, roughly seven of ten respondents expect salaries to increase by 5-8% in 2015. The number of companies that expect salary increases over 8% has fallen, with only one of 14 saying that this will be the case. Almost one-fifth of respondents, which is three times as many as one year ago, plan for salary increases of 3-4%, when asked about salary increases during 2015. Lower inflation rates in China and less optimism about the business climate in general seem to have a direct effect on salary increases, as these numbers are, on an aggregated level, lower than in our last survey. However, costs continue to increase for companies in China. In discussions with clients active in the manufacturing field, an increasing number of companies mention environmental compliance costs, salary costs and costs for rent, putting pressure on margins.

This survey result is in line with the other data, which indicates that the Chinese economy is decelerating in recent months. The most recent HSBC PMI came out at 50.2. Meanwhile, industrial output for August was the lowest level in six years, showing considerable downside risks to the economy. At the same time, more easing is broadly expected by the market, in order to reach 7.5% GDP growth for 2014. China is trying to make a balancing act between growth and reforms.

OUR CONCLUSIONS
The conclusion is that Nordic and German companies are less positive now than they were in March. The most significant change is that many companies see business climate as less favourable, and more companies see falling customer demand as their main concern. Survey results do not indicate any large changes in expansion plans in China. On the contrary, we see investment plans increasing slightly, although recruitment plans decelerate. Hence, slowing GDP growth and a soft landing of the economy seems to be what North European companies see in their crystal balls. The general belief is that the Chinese government will eventually step in and support the economy with further stimulus and looser monetary policy. Note: as our survey is done every six months, the results of the September survey must be compared with the latest survey in March and do not capture more short-term changes in sentiment.

Target reform or growth?
7.5% GDP GROWTH EXPECTED IN 2014

The world's second largest economy grew by 7.5% year-to-year during second quarter of 2014, a small pick-up from the previous 7.4% in Q2. In a time where accommodative monetary policy is widely used across the globe, China chose to introduce a so-called targeted stimulus, with the intention of injecting credit into certain sectors. The fundamental difference between traditional and targeted stimulus lies in the fact that the Chinese economy has, through years of high growth, built up substantial risks, such as the real estate sector, which accounts for more than 20% of the economy. Hence, to avoid further acceleration of debt and overcapacity across the economy, targeted easing gradually became an important tool for the Chinese government. Meanwhile the stimulus tends to give a short-term boost into the economy. Chinese leaders are looking to carry out structural reforms in order to maintain economic prosperity in the long run. We believe it is easier said than done.

Global GDP growth
Year-on-year percentage change

	2013	2014	2015	2016
United States	2.2	2.2	3.4	3.1
Japan	1.5	1.1	1.2	0.8
Germany	0.1	1.2	1.4	1.8
China	7.7	7.5	7.3	6.9
United Kingdom	1.7	3.1	2.8	2.6
Euro zone	-0.4	0.7	1.1	1.5
Nordic countries	0.6	1.5	2.0	2.2
Baltic countries	2.9	2.1	2.7	3.6
OECD	1.4	1.9	2.5	2.4
Emerging markets	4.8	4.6	5.0	5.1
World, PPP*	**3.3**	**3.4**	**3.9**	**4.0**

Source: OECD, SEB * Purchasing power parities

SEB's main scenario is that China's growth continues to stabilise in the upcoming years. We have raised our GDP forecast for 2014 to 7.5% from 7.4%. At the same time, we expect GDP growth to slow down to 7.3% in 2015 and 6.9% in 2016.

THE MEDIUM OF PAYMENT
Corporates prefer EUR and USD, CNH lags behind

Since the establishment of CNH in 2010, corporate usage of CNH as a medium of payment has been a widely discussed topic. Last year, RMB, or CNH as it is often referred to in the off-shore market, has become among the top 10 most traded currencies according to the Bank of International Settlements (BIS). Meanwhile, the trading volume for CNH has grown significantly in recent years; we see that Northern European companies continue to favour USD and EUR as their main trade currencies. Both combined account for 88% of the companies, meanwhile CNH only applies for 5% and Scandinavian currencies for 7%. However, based on our dialogue with the local subsidiaries, more and more are now considering shifting their payments to CNH due to recent FX volatility in the market.

More than half of the corporates (57%) expect the RMB exchange rate to appreciate against the USD in the coming six months, which is an increase from 49% in the previous survey. So far, RMB has depreciated by 1.7%, partly due to the trading band expansion. However, the average market forecast for USD/CNY remains at 6.0, which is in line with the SEB estimates. We believe volatility in off-shore CNH and economic data from China will increasingly impact the onshore RMB exchange rate.

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 more than EUR 500 million. The survey is web-based and confidential, and was carried out from September 1-12 September, 2014.

SUBJECT: Business Climate/Profit Expectations

Looking ahead, Northern European subsidiary managers have become slightly less optimistic compared to six months ago. Among these companies, 37% believe conditions will be favourable, while only 2% expects conditions to be very favourable (compared to 11% six months ago). The respondents who expect conditions to be not so favourable have increased to 20% from 6% in the last survey. Nevertheless, the majority (41%) still expect the business climate to remain stable in the coming six months.

In terms of profit expectations, slightly fewer believe in improving profits (44%) compared to 45% in March. This time, 16% expect profits to deteriorate, which is an increase from 6% in the previous survey.

The Chinese economy rebounded in the second quarter to 7.5%, after several targeted stimulus engagements from Beijing. SEB readjusted its GDP forecast for 2014 from 7.4% to 7.5%, with further expectations that economy will eventually stabilise to around 6.9% in 2016. Overall, recent Chinese data has been rather mixed: strong trade balance and PMI figures show solid business sentiment, while CPI and industrial output have been a disappointment. The later data is now on the lowest level since financial crisis. Premier Li has in a recent conference reiterated his belief that China would achieve 7.5% GDP growth this year, at the same time emphasizing structural reforms before stimulus.

(See graphs 1 and 3 on page 5)

SUBJECT: Fixed Asset Investment Plans

Compared to the survey in March, fixed asset investment plans among participants have risen. Corporates with major investment plans account now for 16%, which is a small increase from 13% in the last survey. More than half of the companies (58%) are keen to make modest investments in China, compared to 55% six months earlier. On the same note, companies with no investment plans continue to slide, from 43% one year ago to 24%.

In conclusion, foreign corporates remain long-term committed in China, which is seen in their investment behaviour. Many of the clients we talk to have today onshore production and are planning to increase the share of local sales.

(See graph 2 on page 5)

SUBJECT: Employment Structure

Managers of Northern European corporates expect a slower expansion in workforce for the coming six months. Half of the participants believe the number of employees will stay unchanged, an increase from 34% in the last survey. Four of ten will continue to hire, although that is still lower than the 45% in the last survey. Only 2% of corporates plan to expand significantly, compared to 11% in March.

(See graphs 4 on page 5)

SUBJECT: Salary increase

Salary levels in China continue to stabilise in 2014. Only 14% of corporates expect the paycheck level to increase by 9% or higher, compared to 29% six months earlier. As the previous survey, a vast majority (69%) believe a 5-8% increase is more appropriate. Interestingly, 17% of the corporates forsee an increase of 3-4%, which we notice is a rising trend from 6% a year earlier. Our survey also indicates that a shortage of skilled labour is less of a concern today compared to a year ago. This may have dampened the escalating salary trend in China. A stable salary level is an important aspect for foreign companies when doing business in China.

(See graph 5 on page 5 and graph 11 on page 6)

SUBJECT: Funding Needs

Funding needs among Northern European corporates remain stable. 33% of managers expect funding needs to increase, compared to 36% in March. 57% expect the funding situation to stay unchanged. 11% of corporates will have decreasing funding needs compared to six months ago (2%). Deteriorating funding needs may go against our result of a higher investment, although it could be explained by other factors such as self-financing through cash-flow or from the group level.

(See graph 6 on page 5)

SUBJECT: FX and Interest Rates

For the coming six months, the majority of corporate managers (66%) hold a view on the interest rate level, compared to 54% in the last survey. Among them, 43% believe interest rates will rise, which may be a surprise for many, as the recent CPI number for August has slowed down to 2.1%. The inflation target for 2014 is set at 3.5%; lower inflation may attract more expansive policies. The view of a lower interest rate is shared by 23% of all respondents, a rise from the previously 11%.

In terms of exchange rate, 57% of corporates expect the RMB to appreciate during the coming six months, compared to 49% in the last survey. Meanwhile, only 9% believe in a weaker RMB, a view which was shared by 11% six months ago. The conclusion is particularly relevant considering RMB volatility this year. After RMB weakening in the first half of the year, due to the trading band increase, corporates are now again expecting the RMB to strengthen. SEB expect USD/CNY to reach 5.90 by year-end.

Many corporates (35%) are still in favour of hedging some or most of their FX exposure on the onshore market. At the same time, 28% are hedging through their head office via the off-shore market and 35% have no hedging strategy implemented at all. As China aims for full liberalisation of the FX market, a two-way volatility will subsequently increase the needs of import/export flow hedging among corporate managers. What we have seen is that, although the need of hedging may appear obvious, the implementation of the hedging process among local subsidiaries remains in slow phase.

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

SUBJECT: Main Concerns

In this survey, corporate managers have again highlighted client demand as the greatest concern (43%), compared to 27% six months earlier. Both skilled labour shortage (10%) and competition (14%) have decreased in importance, meanwhile client payment ability (12%) and FX rates (10%) have become significant issues for Northern European corporates.

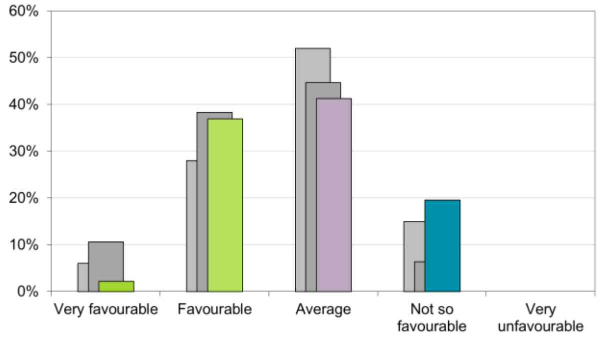
(See graph 11 on page 6)

CHINA FINANCIAL INDEX – COMPOSITION

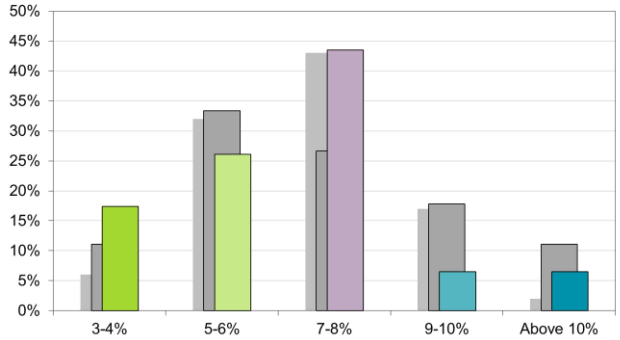
The SEB China Financial Index in September had a value of 58.7, indicating a general positive attitude, albeit a slowdown from the previous survey.

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 Climate – 54, Profit Expectations – 56, Investment Plans – 67, and Employment Plans – 57. (See the graph on page 1)

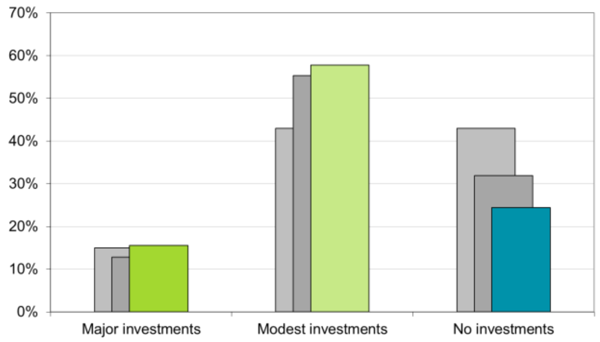
1. BUSINESS CONDITIONS



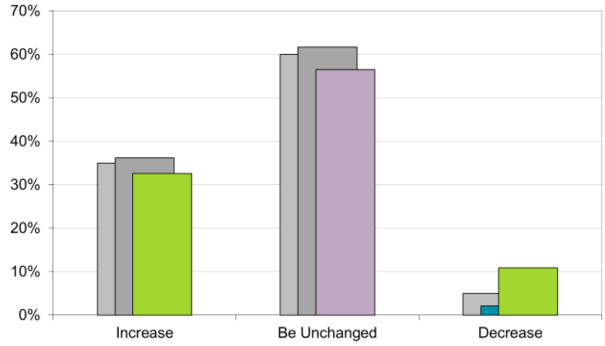
5. AVERAGE SALARY INCREASE



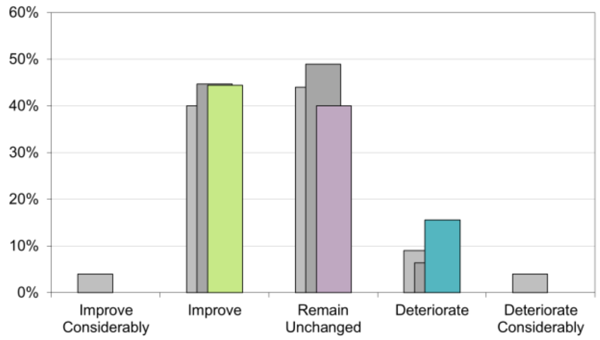
2. FIXED ASSET INVESTMENT PLANS



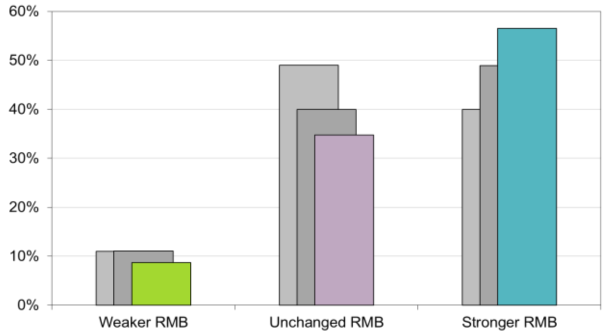
6. FUNDING NEEDS



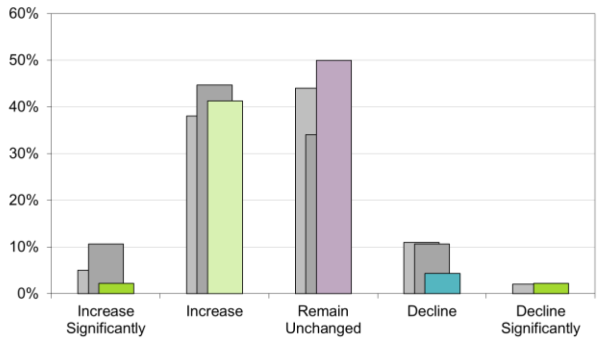
3. PROFIT EXPECTATIONS



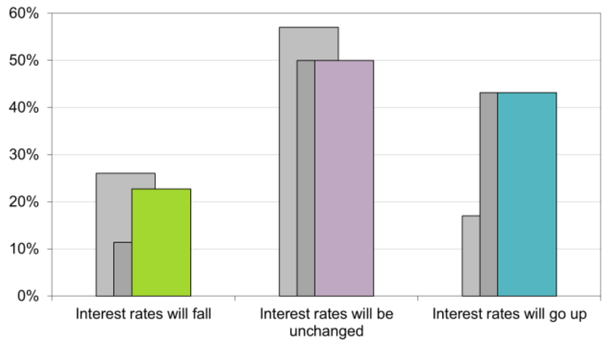
7. RMB AGAINST USD



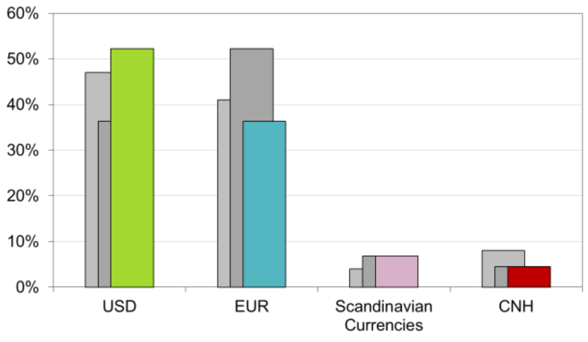
4. NUMBER OF EMPLOYEES



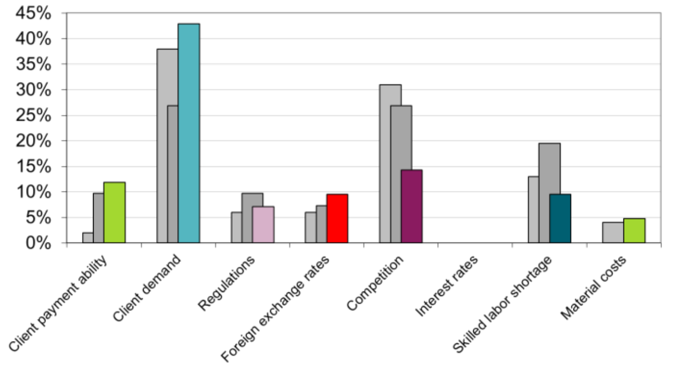
8. RMB INTEREST RATES



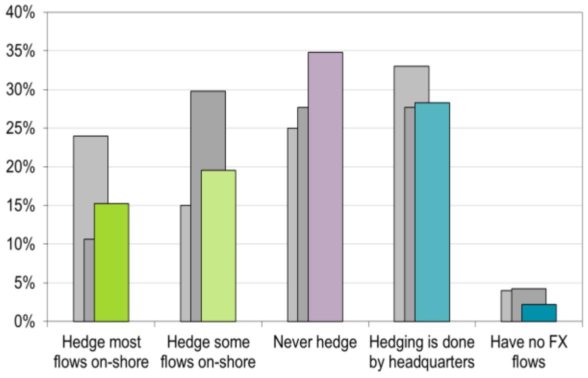
9. MAIN TRADING CURRENCY



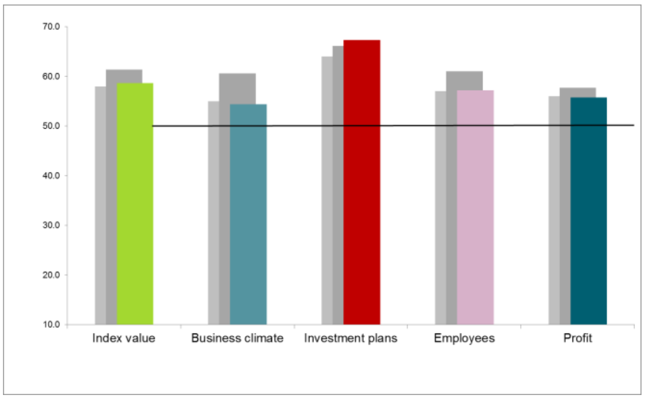
11. MAIN CONCERNS



10. HEDGING STRATEGY



12. MAIN INDEX



Source: SEB Shanghai. Grey stacks are indicating companies' answers in the last two surveys in March 2014 and September 2013