

China Financial Index

SEB

Higher business confidence in China despite downturn

Nordic companies more optimistic despite slowing Chinese economy

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9 FEBRUARY 2015

SEB CHINA FINANCIAL INDEX AT 62.6, up from 58.7 in September, suggesting increasing optimism for 2015 in China.

SALES FORECASTS RISE, AND PROFIT EXPECTATIONS ARE UP. But investment plans fall back slightly.

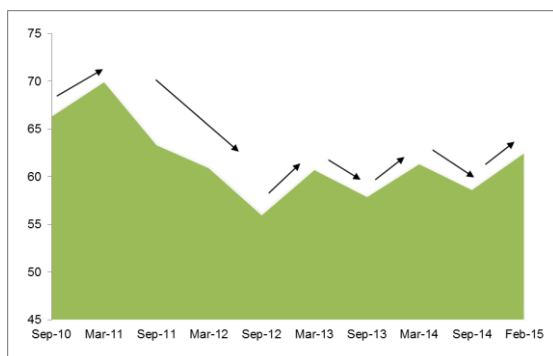
CONCERN OVER CUSTOMER DEMAND THE HIGHEST RISK TO FORECASTS, followed by worry over competition, raw material prices and foreign exchange rates.

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OPTIMISTIC SALES FORECASTS IN CHINA

Contrary to most recent economic data, SEB's China Financial Index shows that Northern European companies have high expectations on sales growth in China the coming six months. While GDP figures point to a further slowdown in the economy, three out of four respondents in our survey think that sales will go up in the first half of 2015, with around 15% expecting sales to increase significantly. Slightly more than half of respondents expect profits to increase while one-third think that profits will remain the same. Less than 10% see profits falling in 2015.

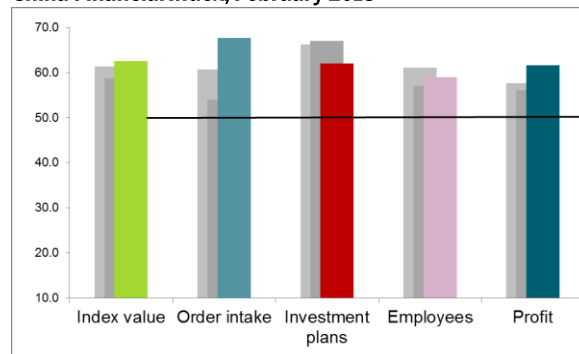
Historical development for SEB's China Financial Index



Interestingly, the improvement in business sentiment does not translate into increased investment plans. On the contrary, almost half of respondents have no investment plans for the coming six months while an equal number plan for modest investments. Only 5% of companies are planning for significant investments in this survey, which is down from 16% six months

ago. Similarly, around half of the companies are planning for modest increases of new staff, while slightly less than half do not plan for further hires. Almost no company plans for significant headcount increase at the beginning of 2015. This is a fall from previous surveys.

China Financial Index, February 2015



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

More companies are worried that a fall in demand could potentially ruin the positive view they have of 2015, with almost half of respondents pointing this issue out as the top risk factor. Fewer companies this time (less than 20%) believe competition is their main concern. Material costs and foreign currency rates are the third and fourth largest worries, respectively.

Plans for salary increases have changed since the last survey. This time, almost no company expects salaries to increase by 9-10% or more. Half of the respondents

believe that salary increases will average around 7-8%. Almost one-third expect salaries to increase by 5-6%, and approximately the same number of companies plan for salary increases of 3-4%.

Lower inflation rates in China continue to push down salary increases, but that seems only to have a limited effect in 2015. However, in discussions with clients active in the manufacturing field, we do see an increasing cost focus and plans to increase salaries at a lower rate in the coming years.

This survey result differs from other data published recently, which indicates that the Chinese economy is decelerating in recent months. The most recent official PMI came out at 49.8, which was the first time the index fell below 50 since September 2012. Industrial profits for December were also down by 8%. On the same note, other indicators such as industrial production, exports and retail sales have surprised on the upside. In general, there continue to be considerable downside risks to the Chinese economy, and it is widely expected that China will support the economy with an increasingly accommodative monetary policy in 2015.

OUR CONCLUSIONS

We believe seasonality is partly the reason respondents in this survey are more positive than companies in other surveys. We guess it is in the DNA of every business leader to predict higher sales and profits when asked about the subject in January. It remains to be seen if predictions will be adjusted down as we move into the Year of the Sheep. It may turn out that Northern European companies are too optimistic when predicting the coming six months, as official PMI figures are rather downbeat at the moment. In a global perspective, with many markets struggling with growth, we can feel satisfied if China delivers around 7% growth in 2015. Unlike previous years, the corporate landscape will likely be more diversified, with certain industries continuously plagued by overcapacity and falling margins while others continue to grow at double-digit speed. We should also expect to see China's top leadership get a bit more trigger-happy if the slowdown continues, with more interest rate cuts and liquidity to stimulate the economy. A pickup in infrastructure projects could also be expected if the downturn becomes too sharp.

Target reform or growth? 7.0% GDP GROWTH EXPECTED IN 2015

The world's second largest economy grew by 7.3% year-to-year during the fourth quarter of 2014, taking full-year growth to 7.4% in 2014. The contribution to

GDP growth from consumption increased to 51.2%, which was three percentage points higher than in 2013. This means we are seeing a rebalancing of the Chinese economy in line with what the government has aimed for: away from investment and in favour of consumption. Exports also developed positively by the end of the year, growing by 9.7% in December year-on-year.

However, purchase managers' indices for manufacturing are not pointing to a clear rebound. On the contrary, both HSBC's index, which came in at 49.7 in December, and China's official index, which fell to 49.8 in the same month, point to a contraction in economic activity. A slumping property sector continues to weigh on domestic demand, and gradual monetary and fiscal policy easing can be expected as we enter the new lunar year in February. Our main scenario is that China's growth continues to stabilise in the upcoming years. We have lowered our GDP forecast for 2015 to 7.0% from the previous 7.3%. At the same time, we expect GDP growth to slow down to 6.7% in 2016.

Global GDP growth

Year-on-year percentage change

	2013	2014	2015	2016
United States	2.2	2.3	3.4	3.1
Japan	1.5	0.4	0.9	1.1
Germany	0.1	1.3	1.2	1.6
China	7.7	7.4	7.0	6.7
United Kingdom	1.7	3.1	2.8	2.5
Euro zone	-0.5	0.9	0.9	1.3
Nordic countries	0.6	1.5	1.8	2.1
Baltic countries	3.1	2.4	2.6	3.3
OECD	1.4	1.9	2.4	2.4
Emerging markets	4.8	4.7	4.8	4.9
World, PPP*	3.3	3.5	3.8	3.9

Source: OECD, SEB * Purchasing power parities

THE MEDIUM OF PAYMENT

What is your RMB strategy?

Since the establishment of CNH in 2010, we have asked corporates whether they use CNH as a medium of payments. Despite massive media attention and efforts by the Chinese government, CNH only accounted for 5% of payments when we asked our clients six months ago. Meanwhile, according to recent data by SWIFT, the Chinese RMB has just become a top-five payment currency in the world, surpassing the Canadian and Australian dollar and only lagging behind the US dollar, euro, British pound and Japanese yen in terms of volume. This can be

compared to two years ago, when RMB was ranked 13th behind Scandinavian currencies such as the Swedish krona.

Since then, China has established RMB clearing banks in 13 countries and signed currency swaps with 28 countries worth more than 3 trillion RMB. In terms of the onshore capital markets, the Shanghai-Hong Kong stock connect scheme and a widening currency trading band also function as a stepping stone for the RMB to become the next major medium of payment. Ahead of this report, we chose to again ask our corporate clients about their RMB strategy for their import and export flows. This time, over 14% say they are invoicing everything in RMB, with an additional 45% planning to invoice part or all of their trades in RMB in the future. Given the recent rise of volatility in numerous currencies, the shift towards RMB settlement may help China-related businesses avoid potential currency risks and margin squeeze, and it may also create a platform for making RMB a reserve currency.

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 surveyed companies have a global turnover of more than EUR 500m. The survey is web-based and confidential, and was carried out from January 13- 28, 2015.

SUBJECT: Order intake/Profit expectations/Inventory

For the upcoming six months, managers of Northern European subsidiaries have become slightly more optimistic compared to the last survey. Among these companies, 75% believe sales will increase slightly or significantly. Meanwhile, almost one-fourth believe order books will be unchanged. The number of respondents who expect sales to decrease has dropped to 2% from 20% in the previous survey. However, compared to a year ago, the change is rather limited. Note: we have tweaked the subject question theme from 'business condition' to 'order book', which likely creates variation in survey results.

In terms of profit expectations, six of ten believe in improved profits, compared to 44% in September. Meanwhile, 8% expect slightly or significantly lower

profits, which is a small increase compared to one year ago.

New for this survey, 40% of managers expect inventory status to increase in the coming six month, while 32% believe it will stay unchanged and only 28% see it dropping.

(See graphs 1, 3 and 6 on page 5)

SUBJECT: Investment/Acquisition plans

Compared to the last survey, investment and acquisition plans among participants have decreased. Almost 46% believe current plans will remain unchanged, which is almost double from the September survey. Only 6% are planning for major investment, compared to 16% six months earlier. Nearly half are keen to make modest investments, which is the lowest level in more than a year.

In general, despite long-term commitment to business in China, many foreign corporates have less appetite to make major investments in the upcoming six months. This may derive from macroeconomic factors or increasing focus on cost-efficiency among Northern European corporates' Chinese subsidiaries.

(See graph 2 on page 5)

SUBJECT: Employment and salary

Compared to the one year ago, fewer corporates are expecting an expansion in their workforce for the coming six months. Having said that, more than half of the managers (51%) are still hiring more personnel, while 8% are cutting down on workforce and one of four expect unchanged hiring.

In terms of salary levels in China, Northern European subsidiaries continue to focus on costs. Most corporates (54%) believe salaries will increase between 3-6%, while 47% expect an increase of 7-8%. No respondent this time anticipates an average increase of more than 9%, which can be compared to 14% six months ago and 29% one year ago. As in our previous surveys, concern over skilled labour continues to decline. This may be due to salary level stabilisation.

(See graph 4 on page 5, graph 7 and 11 on page 6)

SUBJECT: Funding needs/Lending attitude

In this survey, fewer corporates are in need of financing from banks. Only a quarter of companies need to increase funding, compared to 36% one year earlier. 8% are expecting to decrease borrowing, which is a slight increase from 2% in March 2014. Chinese subsidiaries have remained relatively cash-positive the past years, which may support future expansion without bank involvement. A lower investment appetite may also explain lower financing needs.

Also new for this year, we chose to ask how companies view their banks' willingness to lend; a near majority of Northern European corporate managers believe bank lending attitudes to be favorable (22%) or very favourable (27%). Only 6% believe in a slightly unfavourable condition. In general, accommodative policy from China has made it easier for corporates to borrow from banks. This is particularly true for subsidiaries of Northern European companies.

(See graph 5 on page 5 and 10 on page 6)

SUBJECT: FX and RMB usage

Many corporates (24%) are still in favour of hedging some or most of their FX exposure on the onshore market. Compared to previous surveys, more corporates (35%) are now hedging their exposure offshore by their head offices. 37% remains unhedged for the time being. Increased volatility has no doubt increased interest in and awareness of the principles of hedging; meanwhile, implementation may take longer than many think and may need to involve head offices.

As RMB increasingly becomes an international currency, we asked our corporates whether they use RMB as their invoicing currency for import and export. Interestingly, 22% already do so, or plan to begin invoicing all their trade in RMB. Meanwhile, 37% are planning to use RMB invoicing to some extent. This is a trend we expect to increase going forward.

(Please see graph 8 and 9 on page 6)

SUBJECT: Main concerns

Similar to the last survey, corporate managers have again highlighted client demand as their greatest concern (47%), compared to 42% six months earlier. Both skilled labour shortage (2%) and customer payment ability (0%) have decreased in importance, while material cost (14%), FX rates (12%) and competition (18%) have become significant issues for Northern European corporates.

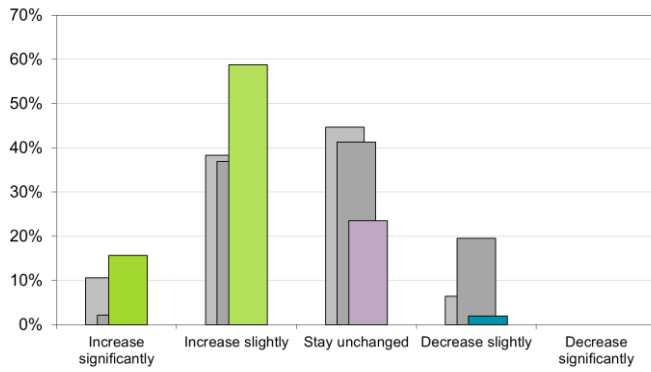
(See graph 11 on page 6)

CHINA FINANCIAL INDEX – COMPOSITION

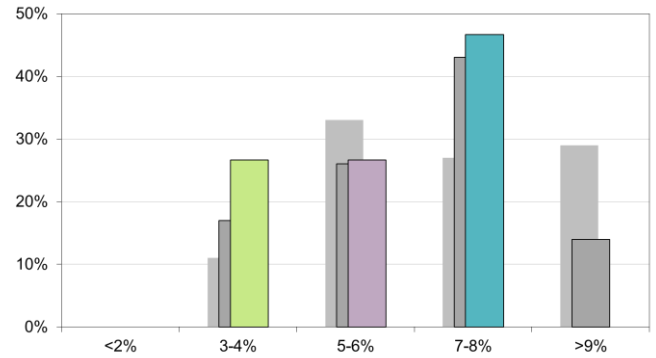
SEB's China Financial Index in February had a value of 62.6, indicating a gradual improvement of attitude compared to previous surveys in September and one year ago.

A value of 50 indicates a neutral view. The index is based on four components, with the following ranking in this survey: Order Intake – 68, Profit Expectations – 62, Investment Plans – 62, and Employment Plans – 59. (See the graph on page 1)

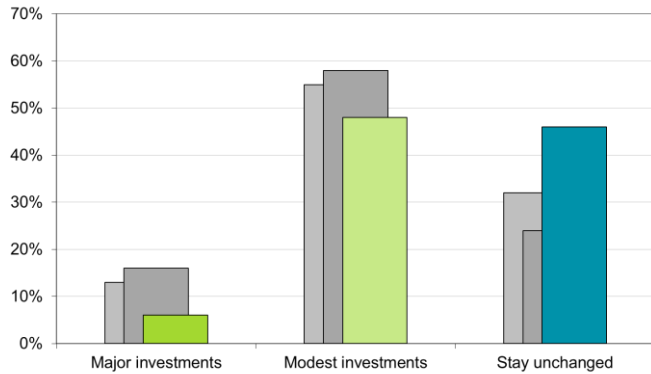
1. ORDER INTAKE/SALES



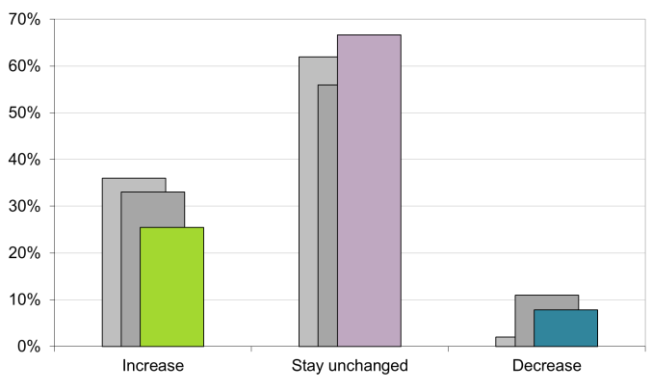
4. AVERAGE SALARY INCREASE



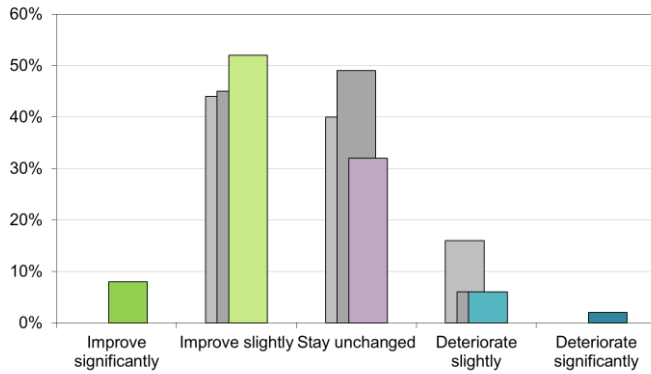
2. INVESTMENT/ACQUISITION PLANS



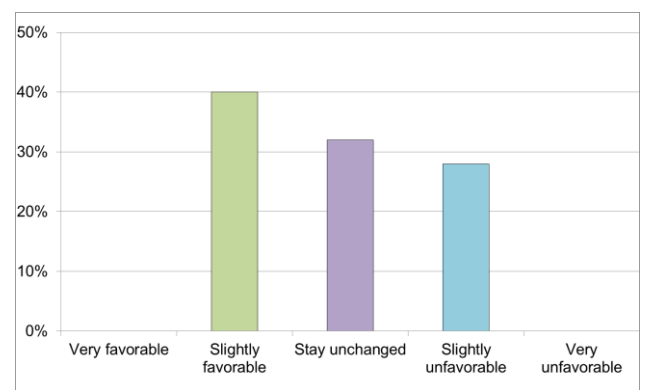
5. FUNDING NEEDS



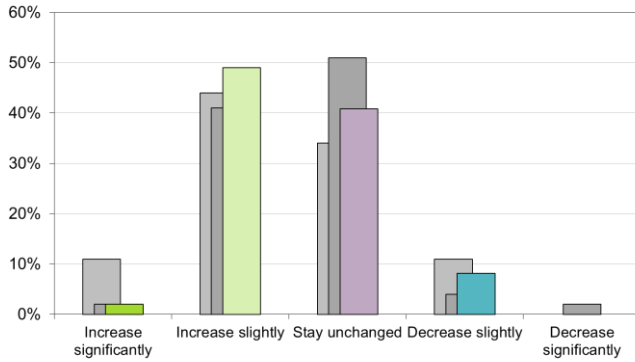
3. PROFIT EXPECTATIONS



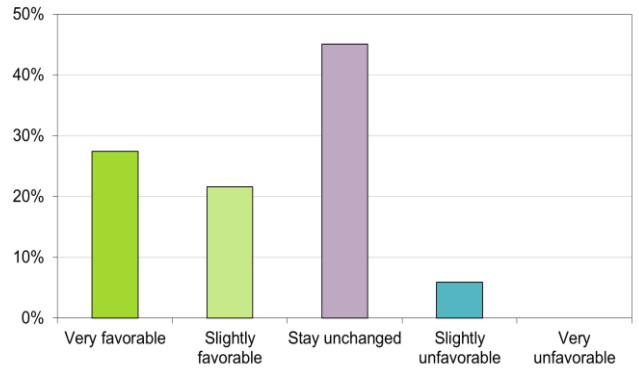
6. INVENTORY EXPECTATIONS



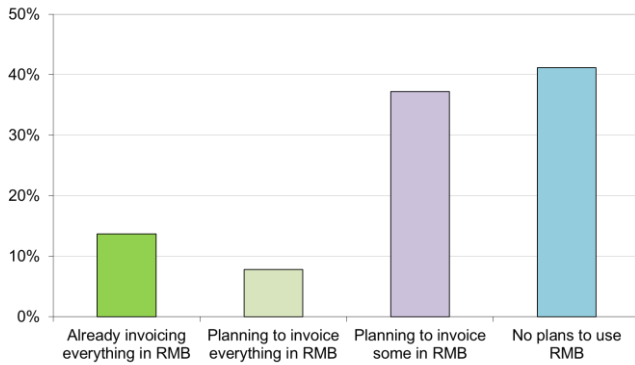
7. NUMBER OF EMPLOYEES



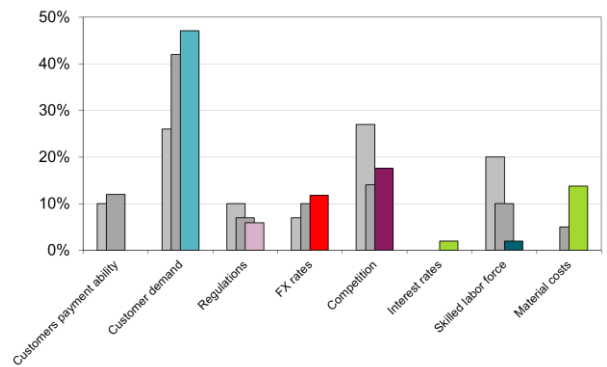
10. LENDING ATTITUDE



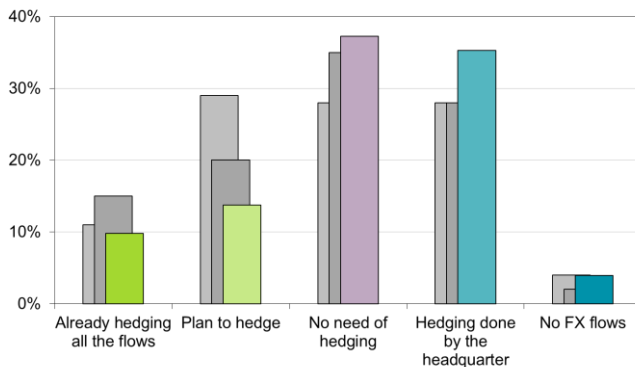
8. RMB USAGE INVOICING



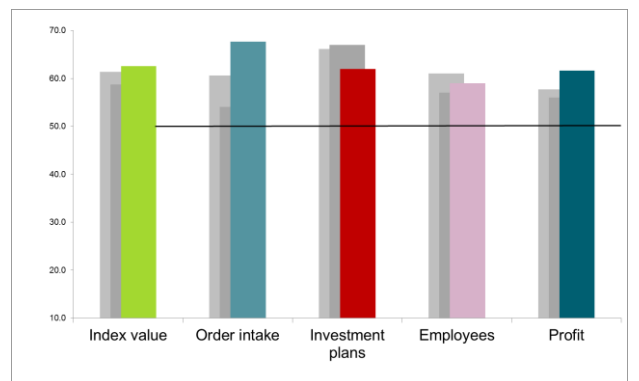
11. MAIN CONCERNS



9. HEDGING STRATEGY



12. MAIN INDEX



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

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