Lower business confidence in China - but mixed outlook

Less than half of companies expect growing sales in the next six months

WEDNESDAY
23 SEPTEMBER 2015

SEB CHINA FINANCIAL INDEX AT 57.1, down from 62.6 in February but only slightly lower than one year ago.

SALES HELD UP RELATIVELY WELL IN THE FIRST SIX MONTHS. But corporates are expecting tougher times for the remainder of the year.

INVESTMENT PLANS RELATIVELY UNCHANGED, BUT SALARY INCREASES FALL SHARPLY. More companies than previously cut down on staff.

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

MIXED PICTURE in china. A number of recently published data point to slower growth in China. China's manufacturing sector is shrinking, exports are falling, the stock market has crashed and the RMB was devalued. Reading newspapers and reports from around the globe, it is easy to get the impression that the authorities have lost control and that the economy is on the brink of freefall.

However, the results of SEB's latest China Financial Index survey provide a more balanced, albeit mixed, picture of reality as experienced by Northern European companies doing business in China.

NEW QUESTION

In this survey, we added one question, asking clients how their sales figures turned out for the first six months of this year compared to the same period last year. It turns out that over half saw an increase in sales income. In fact, every fourth company said it saw a significant sales increase in the first half of the year. The more worrying news is that every third company saw a decrease in sales.

"In fact, every fourth company said it saw a significant sales increase in the first half of the year. The more worrying news is that every third company saw a decrease in sales."

This clearly reflects the spread of our client base in China, where consumer good-oriented companies see a growing market while industrial companies mostly see flat or decreasing sales.

Looking ahead, some managers at Northern European companies in China have become considerably more pessimistic while others, albeit a smaller number of companies compared to the previous survey, are as optimistic as ever. Every third company is now expecting lower order intake in the coming six months – a higher number than we have ever seen before in our index survey. Only one out of ten companies expects significant increases in order intake, and roughly one-third of companies expect order intake to improve slightly. One of four companies thinks order intake will remain the same. Still, half of the companies expect profits to increase while one of four companies expects profits to fall. For the first time ever, two companies in our survey answered that they expect profits to deteriorate significantly.

"For the first time ever, two companies in our survey answered that they expect profits to deteriorate significantly."

When asked about main concerns looking ahead, over half now say their key concern is a fall in demand. This is followed by ten percent pointing out FX rates, competition and labour costs, respectively, as their main concern.

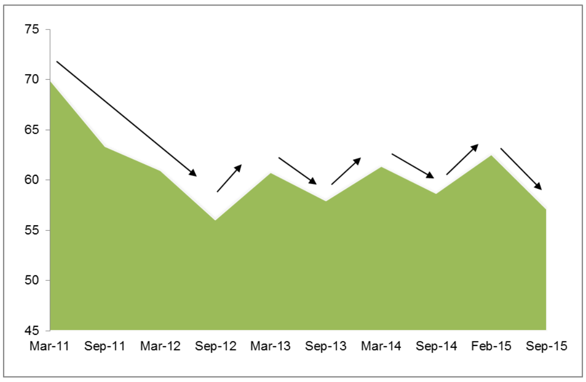
By far the largest trend change in this survey as compared to earlier surveys is that expectations on salary increases now fall dramatically among companies.

"By far the largest trend change in this survey as compared to earlier surveys is that expectations on salary increases now fall dramatically among companies."

One of four companies now answers that salary increases will be 1-2% when adjusted for 2016. One of four companies says the increase will be 3-4% and one-third expects the increase to be 5-6%.

When asked the exact same question at the beginning of 2014, three of ten companies budgeted for a salary increase of over 9%. Today that figure has fallen to only four percent of respondents. Or to make an even more recent comparison: Six months ago, half of all respondents said salary increases would be 7-8% or higher. Today, only one out of five companies has that view.

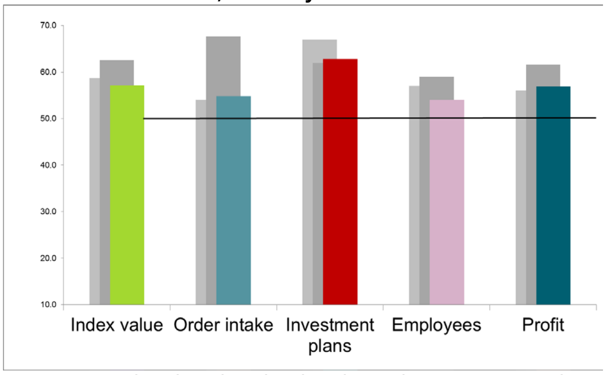
Historical development for SEB's China Financial Index



Interestingly, the fall in business sentiment does not translate into any significant change in investment plans. Ten percent of respondents still plan for significant investments in the coming six months, while over forty percent plan for modest investments. No company plans to divest in China.

However, more companies than previously plan to reduce staff in China. Twelve percent of respondents say that their number of staff in China will be reduced slightly in the coming six months, while two respondents answer that they will reduce staff significantly. Still, half of respondents will keep the number of staff unchanged while every third company plans to add staff, and another six percent plans to add a significant number of staff in China in the near future.

China Financial Index, February 2015



Source: SEB in Shanghai. The colored stacks are the most recent results. Grey stacks show results in January 2015 and September 2014, respectively.

This survey result is partly in line with other data published recently, which indicates that the Chinese economy has decelerated in recent months. The Caixin manufacturing PMI dropped to a 15-month low of 47.8 in July and fell further to 47.3 in August. A number below 50 represents contraction. The Caixin Service PMI is still in positive territory but fell from 53.8 in July to 52.5 in August. China's imports in RMB terms fell 14.3% in August compared to a year before, while exports dropped 6.1%, after tumbling 8.9% in the previous month.

China's industrial profit has continued to decline in recent months and fell 2.9 percent year-on-year in July. Weak domestic demand and a continuous fall in factory gate prices, which have suffered 42 consecutive months of decline, were probably the main reasons.

OUR CONCLUSIONS

The result of this survey confirms two important conclusions: First of all, in line with other indexes, our survey shows that economic activity in China is falling and prospects look gloomier than six months ago. On the other hand, a second equally important conclusion is that things do not look as bad as the media currently portrays. Yes, one-third of our clients responded that they saw declining sales in the first six months. That is a worrying sign that cannot be ignored. But we have known this. Industrial companies in China have seen a decline coming for quite some time, and many of them are acting in segments of the Chinese's economy that do not seem to be growing at the moment. But the fact remains that over half of our clients say their sales increased this year, and almost as many expect the order books to develop well for the remainder of the year. The golden years of rapid growth may be over for certain industrial companies in China, but for a very large number of companies selling consumer goods, professional services, medical equipment etc. sales seem to hold up well. If anything, these companies are investing more in China. For these and all other companies out there, the potential to work on cost structure and keep up profitability is not to be underestimated in an environment where salary increases seem to be falling dramatically.

Global GDP growth and SEB predictions

Global GDP growth

Year-on-year percentage change

	2014	2015	2016	2017
United States	2.4	2.4	3.1	2.6
Japan	-0.1	0.8	1.3	1.0
Germany	1.6	1.9	2.3	2.0
China	7.4	6.8	6.5	6.3
United Kingdom	3.0	2.7	2.5	2.5
Euro zone	0.8	1.6	2.1	2.0
Nordic countries	1.6	1.8	2.1	2.1
Baltic countries	2.6	2.2	2.7	3.4
OECD	1.9	2.2	2.6	2.4
Emerging markets	4.7	4.1	4.7	5.0
World, PPP*	**3.4**	**3.2**	**3.8**	**3.9**

Source: OECD, SEB

* Purchasing power parities

Survey Results

INFORMATION ABOUT THE SURVEY

SEB's China Financial Index 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 August 26-September 9, 2015.

SUBJECT: Order intake/Profit expectations/Inventory/Actual sales

Looking six months ahead, managers of Northern European subsidiaries have become considerably more pessimistic compared to previous surveys. Over half of the respondents expect sales to stay unchanged or decrease slightly. At the same time, only one-tenth believe in continued strong order intake, down from 16% in the previous survey. One-third expects a slight increase, also down from 60% six months earlier.

New for this survey, corporates were asked how the actual sales went for the first half year, compared to a year ago. Interestingly, over half of the respondents saw a slight or significant increase in sales, which goes in line with positive sales expectations from the previous surveys.

In terms of profit expectations, one of four believes in slight or significantly lower profits, which is more than the previous two surveys. At the same time, 14% expect significant improvement in profits, which may reflect the fact that a few selected industries outperform during the current market environment.

When it comes to the inventory situation, fewer than before, 23%, believe inventories will either increase slightly or significantly. The result is a decrease from 40% from the previous survey. However, half of the respondents expect it to remain unchanged.

(See graphs 1A, 1B, 2 and 9 on page 5 and 6)

SUBJECT: Investment/Acquisition plans

Similar to the last survey, almost half of the respondents believe current plans will remain unchanged. More corporates, one of ten, are looking for major investments, versus 6% a half-year ago. However, the general investment appetite has decrease slightly compared to a year ago when 74% said they were planning to invest further, compared to 54% today. With that said, at a time when the global economy remains uncertain, China operations continue to be prioritised among the Northern European corporates.

(See graph 5 on page 5)

SUBJECT: Employment and salary

Compared to one year ago, fewer corporates are expecting an expansion in their workforce for the coming six months. The corporates who are keen to hire have decreased from 51% to 36% since the past survey. Meanwhile 16% are actually looking into cutting down on workforce, which is twice as many compared to the last survey. A slight majority plans to stay unchanged for the coming six months.

As hiring sentiment slows down, salary levels in China also continue to stabilise, according to this survey. Half of respondents believe salaries will increase 4% or less, while one of three expects an increase of 5-6%. Fewer than ever (19%) anticipate an average increase of more than 7%, which can be compared to 47% six months ago and 57% a year ago. The slowdown of salary levels is one of the clearest trends in our report.

(See graph 6 and 8 on page 6)

SUBJECT: Funding needs/Lending attitude

Similar to the last survey, financing needs among Northern European corporates continue to decrease. Only one of ten expects increasing borrowing needs, a sharp fall from one of four and one of three, respectively, in the previous two surveys. The vast majority, 90% of respondents, are keen to stay unchanged when it comes to their funding situation.

When it comes to the banks' lending attitude, optimistic sentiment has somewhat slowed down during this survey. 34% of all corporates expect the lending attitude from their banks to remain slightly or very favourable, which can be compared to 49% six months ago. The lion's share, 64%, expects their banks' lending sentiment to stay unchanged.

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

SUBJECT: FX and RMB usage

In this survey, over half of all Northern European subsidiaries hedge their trade exposure today. More corporates (42%) choose to hedge offshore by their head office, compared to 35% six months earlier. Interestingly, despite the recent devaluation by the Chinese central bank, 38% of all managers see no need of hedging. Due to the recent devaluation by PBOC, over 70% now expect further weakening of RMB going forward, which is a sharp shift from 9% a year ago.

With RMB gradually becoming an international currency, the managers of Northern European subsidiaries were asked whether they use RMB as their invoicing currency for import and export. While 23% already do so, or plan to invoice all their trade in RMB, 38% are planning to use RMB invoicing to some extent. This is a trend we expect to increase going forward.

(Please see graph 7, 10 and 12 on page 6, 7)

SUBJECT: Main concerns

For the upcoming six months, customer demand remains the greatest concern (55%), compared to 47% and 42% for the past two surveys. Other important factors include FX rates (10%), competition (10%) and labour cost (10%). Meanwhile, material costs and skilled labour force decreases in importance for Northern European subsidiaries

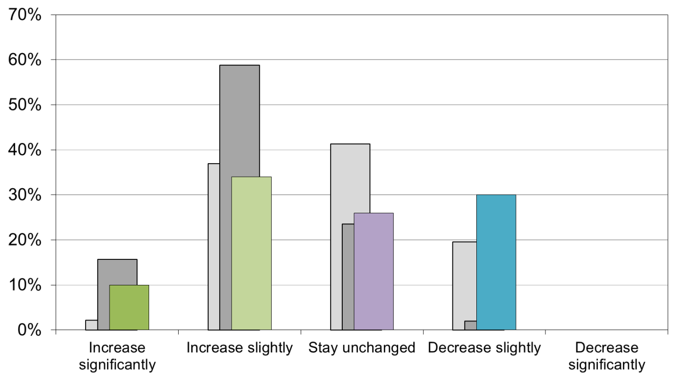
(See graph 11 on page 6)

CHINA FINANCIAL INDEX – COMPOSITION

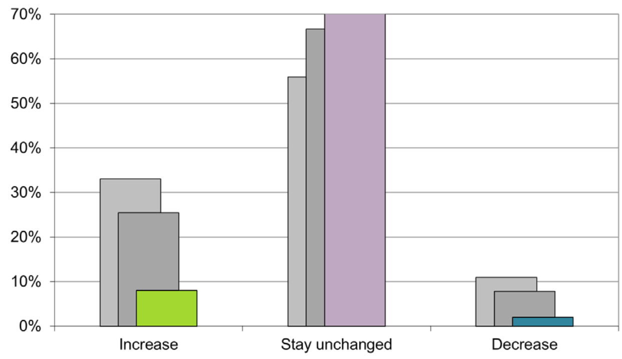
SEB's China Financial Index in September had a value of 57.1, indicating a rather sharp slowdown of the business environment compared to previous surveys in February and one year ago.

A value of 50 indicates a neutral view. The index is based on four components, with the following ranking in this survey: Order Intake – 55, Profit Expectations – 57, Investment Plans – 63, and Employment Plans– 54. (See the graph on page 1)

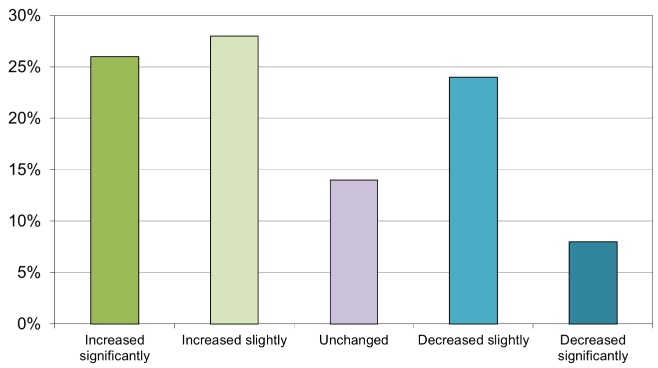
1A. ORDER INTAKE/SALES



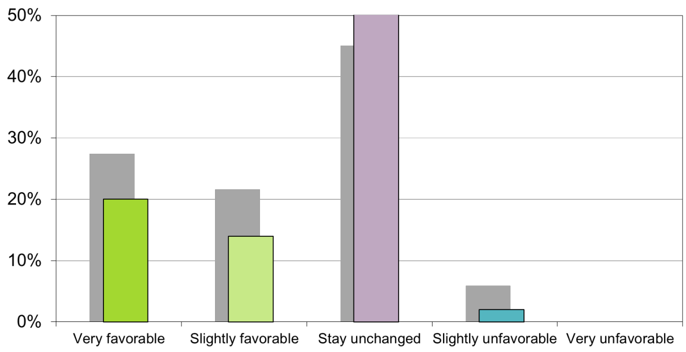
3. FUNDING NEEDS



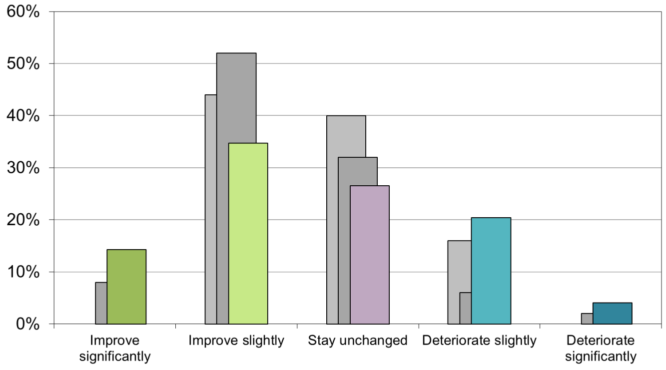
1B. ACTUAL SALES



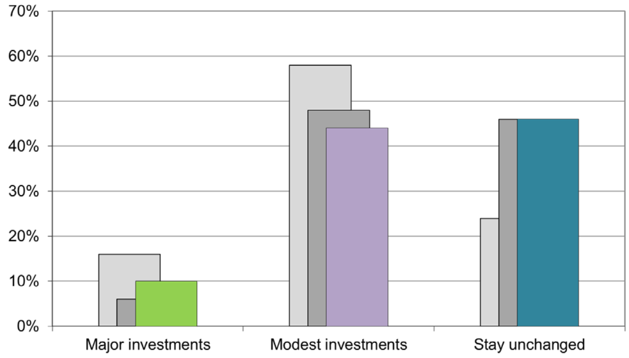
4. LENDING ATTITUDE



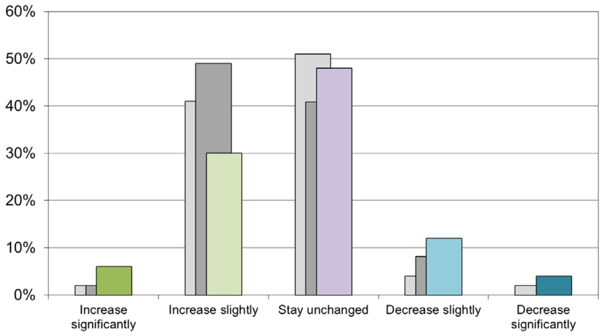
2. PROFIT EXPECTATIONS



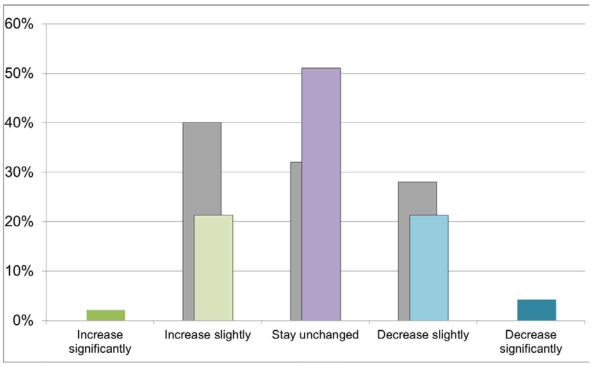
5. INVESTMENT/ACQUISITION PLANS



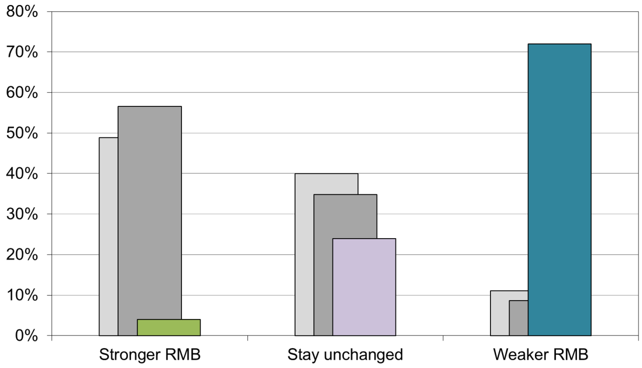
6. NUMBER OF EMPLOYEES



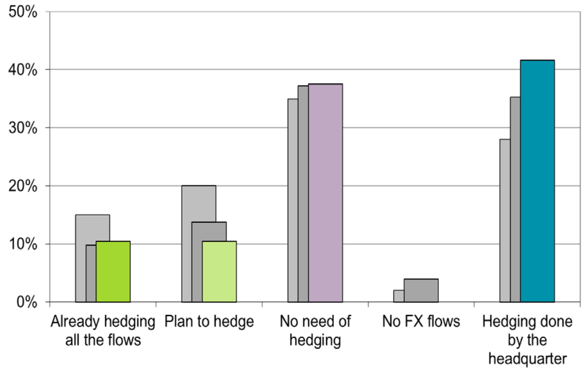
9. INVENTORY EXPECTATIONS



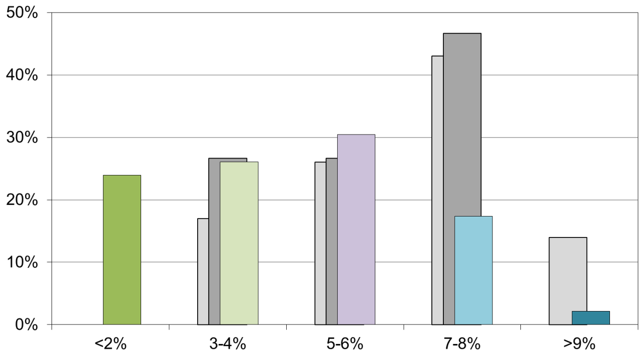
7. RMB EXPECTATIONS*



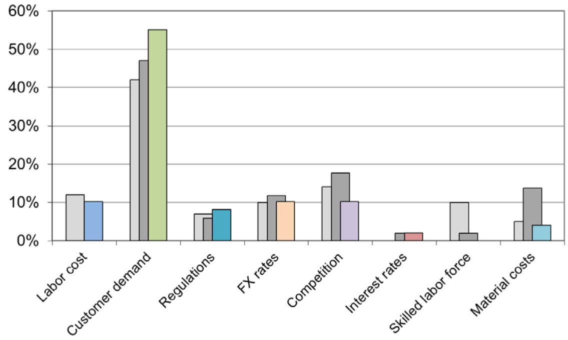
10. HEDGING STRATEGY



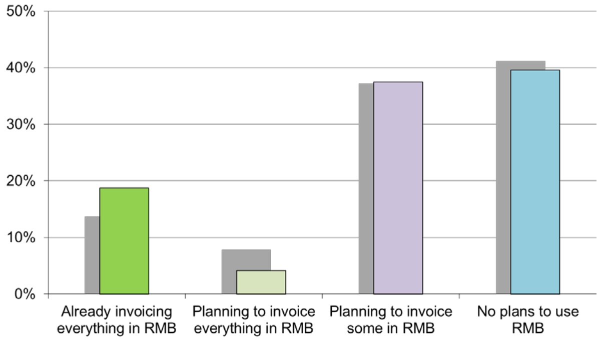
8. AVERAGE SALARY INCREASE



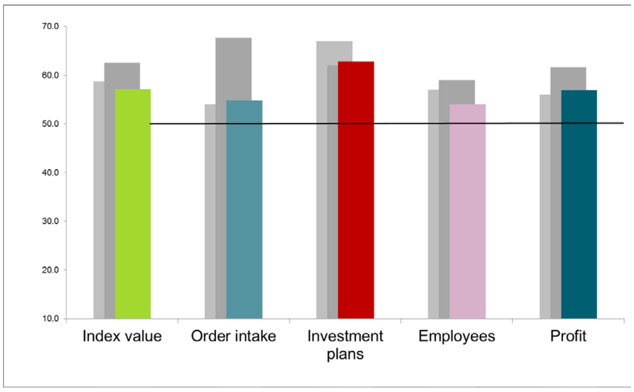
11. MAIN CONCERNS



12. RMB INVOICE



MAIN INDEX



Source: SEB Shanghai. Grey stacks are indicating companies' answers in the last two surveys in February 2015 and September 2014
**Grey stacks are indicating answers in the last two surveys in*

IMPORTANT: THIS STATEMENT AFFECTS YOUR RIGHTS

This Report is produced by Skandinaviska Enskilda Banken AB (publ) for institutional investors only. Information and opinions contained within this document are given in good faith and are based on sources believed reliable. We do not represent that they are accurate or complete. No liability is accepted for any direct or indirect or consequential loss resulting from reliance on this document. Changes may be made to opinions or information contained herein without notice. Any US person wishing to obtain further information about this report should contact the New York branch of the Bank, which has distributed this report in the US. Skandinaviska Enskilda Banken AB (publ) is a member of the London Stock Exchange. It is regulated by the Securities and Futures Authority for the conduct of investment business in the UK.