Continued fall in business confidence in China

Sales hold up well but profit expectations and expansion plans are lower

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SEB CHINA FINANCIAL INDEX AT 56.2, down from 57.1 in September and 62.6 one year ago. **ALMOST HALF OF COMPANIES SAW INCREASED SALES IN THE LAST SIX MONTHS.** Half of respondents also foresee increased sales going forward while profits will likely fall. **INVESTMENT PLANS ARE ADJUSTED DOWN.** More than half of respondents will not make further investments, every fifth company cuts staff and salary increases fall further.

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SALES HOLD UP WELL BUT INVESTMENTS ARE DOWN IN CHINA

The world continues to worry about the health of the Chinese economy. Factory activity, as measured by China's official manufacturing purchase managers' index slid to 49 in February, equalling its weakest point since February 2009, just after the global financial crises broke out. Nordic and German companies, covered by SEB's China Financial Index survey, confirm that picture, but views continue to diverge between companies.

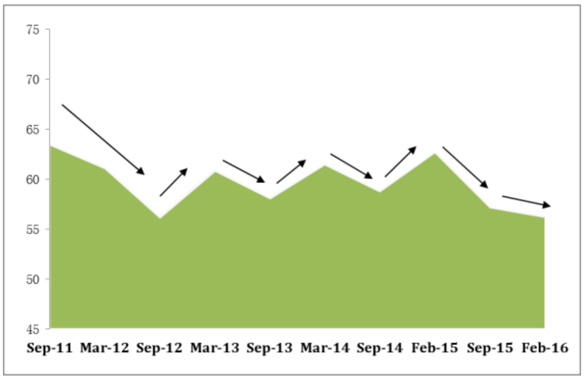
First the bright spots: 15% of the companies covered by our survey say they saw significant sales increases in the last six month. Another 30% saw modest sales increases. Adding the two figures up, almost every second company experienced an improving top line in the last four months of 2015 and the first two of 2016. Looking ahead, half of the companies expect sales to continue rising. Salary increases have almost collapsed from a year ago as well, which may not necessarily be good for the economy but puts less pressure on cost increases for foreign investors now that business prospects look far less certain than a year or two ago.

The less rosy picture: 30% of the companies now say they expect profits to deteriorate in the coming six months. Although, fewer companies - around 25% believe sales will continue falling. And roughly one-third of companies continue to add staff and invest further, although the expansions are mainly modest. Interestingly, we are observing generally lower production costs due to lower commodity prices and salary expectations. This indicates overcapacity in China.

The major trend in this survey is that more companies than in any previous survey plan to put a halt to investments for the time being. Almost 60% have no plans for further investments and one in five companies plan to reduce staff. Only one company in our survey has plans to increase staff significantly in the next six months.

This downward development is reflected in salary increases, which continue to collapse from earlier high levels. More than half of the companies expect less than 4% in salary increases. This differs from one year ago, when half of the respondents said they would increase salaries by 7-8%.

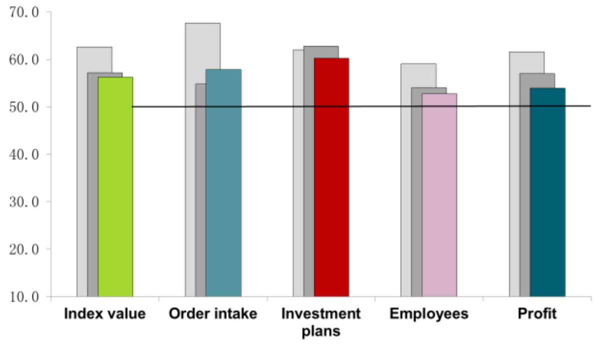
Historical development for SEB's China Financial Index



The biggest concern in this survey is customer demand, with a record of almost 70% singling this out as their main concern, reflecting a cool down of the market and poor economic visibility. The second largest concern, far behind customer demand, is FX risks, which is natural considering the volatility in markets during the second half of 2015, with the RMB weakening against the US dollar. Competition is considered the third largest concern.

Almost 8 out of 10 companies expect the RMB to depreciate further in the coming six months and six out of 10 companies either hedge or plan to hedge their currency risks in China either locally or, as is more common, from global treasury at the head office.

China Financial Index, February 2016



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

This survey result is partly in line with other data published recently. Apart from the official manufacturer purchasing manager index (PMI) mentioned above, the independent Caixin manufacturing PMI fell 0.4 percentage points to 48 in February, marking 12 straight months of contraction, with staff numbers falling at their sharpest pace since January 2009. The official services PMI came in at 52.7 for February, down from 53.5 the month before. Chinese exports fell 11.2 percent in January while imports fell a staggering 18.8%, leaving China with a record trade surplus. China's official goal for the economy is 6.5-7% in 2016. SEB's forecast is 6.5% growth.

OUR CONCLUSIONS

As the general slowdown continues along with a rebalancing of the Chinese economy - the same sentiment applies among Nordic and German companies in the country. In discussions with clients, we continue to get very different views of the market depending on who we talk to. Clients in industries such as cement, steel or shipping typically have a darker view of the near future, with massive overcapacity plaguing the sectors along with sharp decreases in profits. The same companies have fundamentally changed their investment plans. They plan 1-2% salary increases and reductions in the number of staff. The manufacturer of consumer goods or seller of services, on the other hand, continues expanding, adding staff and preparing for further sales increases.

The uptick in expected order intake, albeit small, is the brightest spot in the survey, and it remains to be seen if this will continue during 2016, leading to more expansive investment plans in the latter part of the year. As half of the companies saw increased sales in the last six months, there is reason to be optimistic. But the fact remains that investment plans and plans to add new staff have trended lower for several years now if we look back at index values since the peak in 2011. This is partly a natural development when an economy goes from overheating to a more sustainable growth. The market outside China continues to debate whether China's economy will face a hard landing or if the slowdown will be gradual. There is nothing in our survey pointing to a dramatic hard landing scenario when asking managers of companies operating in China.

Global GDP growth and SEB predictions

Global GDP growth

Year-on-year percentage change

	2014	2015	2016	2017
United States	2.4	2.4	2.4	2.7
Japan	-0.1	0.6	1.0	0.5
Germany	1.6	1.7	1.9	2.0
China	7.3	6.9	6.5	6.0
United Kingdom	2.9	2.2	2.2	2.4
Euro zone	0.9	1.5	1.9	2.0
Nordic countries	1.6	2.1	2.2	2.1
Baltic countries	2.8	1.9	2.7	3.2
OECD	2.0	2.1	2.2	2.4
Emerging markets	4.7	4.0	4.3	4.7
World, PPP*	**3.5**	**3.1**	**3.4**	**3.8**

Source: OECD, SEB * Purchasing power parities

Overcapacity, layoffs and heavy manufacturing

Based on the survey results and recent published statistics, the overcapacity problem remains severe. Basically it is from a combination of stimulus decisions taken after 2007 when the crisis hit the global economy, and from lower commodity prices and inefficient production. The worst industries affected are metals, mining, shipping, cement and chemicals. This issue is recognized. The recently published highlights from the 5 –year plan mention ways to support employment. This is an important priority when solving overcapacity. Additionally we expect initiatives to consolidate industries with excess capacity, and we think there is a need for write-offs. China needs to manage its production output by price and profitability instead of volumes as it has done in the past. This will be difficult with the slowing economy and accompanying potential unemployment. Unemployment has been one of the key focus areas of policymakers and acted as stability for growth, which could cause disruption if altered.

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 February 16-28, 2016.

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

Looking six months ahead, managers of Northern European subsidiaries have become slightly more optimistic compared to previous surveys. Over half of the respondents expect sales to increase slightly or significantly. At the same time, roughly one in four believes in unchanged sales. Additionally 22% believe in slightly decreased sales, down from 30% in September 2015,

As first introduced in the previous edition of SEB's China Financial Index, corporates were asked how actual sales went for the last six months, compared to a year ago. Results show a decrease in respondent's sales from nearly half having slight or significant <u>increase</u> in September towards <u>unchanged</u> (24%) or slightly <u>decreased</u> (22%) in this edition.

In terms of profit expectations, one in three believes in slight or significantly <u>lower</u> profits, which is more than the previous two surveys. At the same time, 39% expect <u>slight</u> improvement in profits, which may reflect the fact that various industries perform differently in the current market.

When it comes to inventory, results indicate an increase from 23% to 32% in respondents believing inventory will either increase slightly or significantly. The result is a decrease from 40% from the previous survey a year ago. However, one in four expects a slight decrease in inventory; this is up from one in five.

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

SUBJECT: Investment/Acquisition plans

More than half believe in unchanged investments and acquisition plans, a sharp increase from the last two surveys. Compared to the last edition, a slightly lower number of respondents are looking at making major investments. This is also confirmed in modest investments, which are also down from 44% to 35%. This is in line with general investment appetite decreasing slightly compared to a year ago, from 54% to 43%. Although in a time when the global economy remains uncertain, new business in China continues to be prioritised among Northern European and German 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 prone to hire have decreased from 51% to 33% since a year ago but only slightly lower since the September edition of 36%. Meanwhile 22% are actually looking into decreasing their workforce. Nearly half expect no change in hiring for the coming six months.

As the hiring sentiment slows down, the salary level in China also follows suit, according to this survey. More than half of the respondents believe salaries will increase 4% or less, while one in four expects an increase of 5-6%. Fewer than ever (20%) anticipates an average increase of more than 7%, which can be compared to 47% a year ago. The slowdown of salary increase levels has been one of the clear trends in our report, which continues since the last edition.

(See graph 6 and 8 on page 6)

SUBJECT: Funding needs/Lending attitude

Financing needs among the Northern European corporates both increased and decreased from the previous edition. Roughly one in five expects increasing borrowing needs, a surge from one in ten. However 12% believe in decreasing borrowing needs, which is up from 2%. The vast majority, 71% of the respondents, are keen to stay unchanged when it comes to their funding situation.

When it comes to banks' lending attitude, the optimistic sentiment has somewhat increased during this survey. 41% of all corporates expects lending attitude from their banks to remain slightly or very favorable, which can be compared to 34% six months ago. The largest share, 53%, expects their banks' lending sentiment to stay unchanged. Notably, respondents believing in slightly or very unfavorable lending conditions increased from 2% to 6%.

(See graph 3 and 4 on page 5)

SUBJECT: FX and RMB usage

In this survey, over half of all Northern European subsidiaries do hedge their trade exposure today. Fewer corporates (37%) choose to hedge offshore by their head office, compared to 42% six months earlier. Interestingly, despite the recent market uncertainty and intervention by the Chinese central bank, 35% of all managers see no need for hedging. The share of respondents planning to hedge is unchanged at 10%. Due to the recent market distress, over 75% now expect further weakening of the RMB going forward, which is a sharp increase from 9% in the September 2015 edition.

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 16% already do so, or plan to begin invoicing all their trade in RMB, 38% are planning to use RMB invoicing to some extent, which is unchanged from the last survey. However, the share of respondents answering to not use the RMB increased from 40% to 46%. This could partly be explained from the recent market uncertainty.

(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 (67%), compared to 55% and 47%, for the past two surveys. Other important factors include FX rates (14%) and competition (10%). Meanwhile, material costs and regulations decrease in importance for the Northern European Subsidiaries

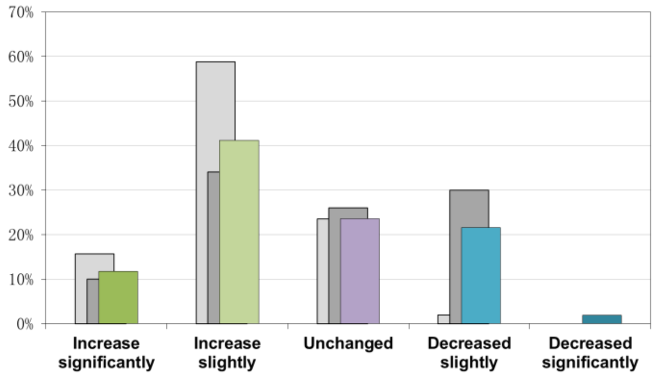
(See graph 11 on page 6)

CHINA FINANCIAL INDEX – COMPOSITION

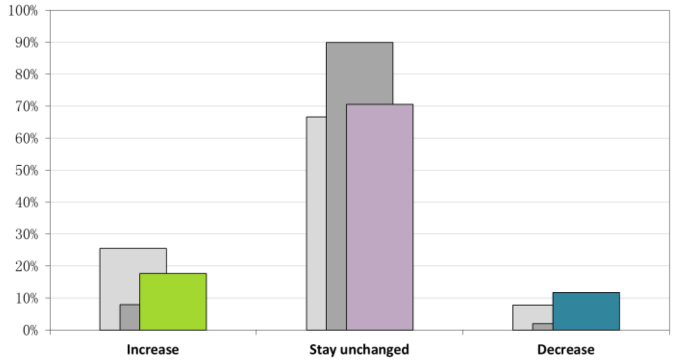
SEB's China Financial Index in February had a value of 56.2, indicating a rather sharp slowdown of the business environment compared to previous surveys in January and one year ago.

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)

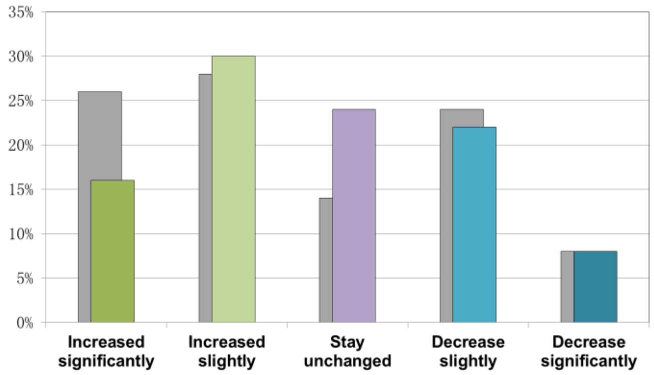
1A. ORDER INTAKE/SALES



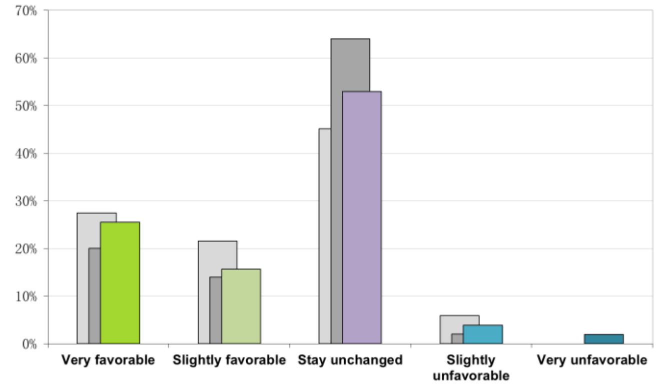
3. FUNDING NEEDS



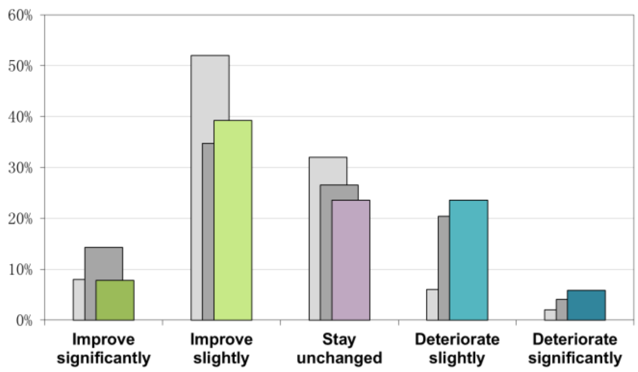
1B. ACTUAL SALES



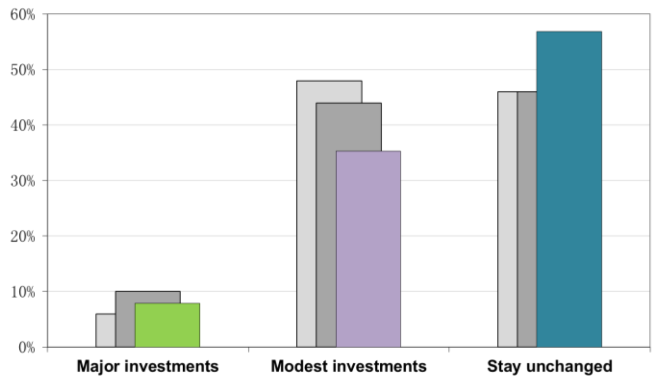
4. LENDING ATTITUDE



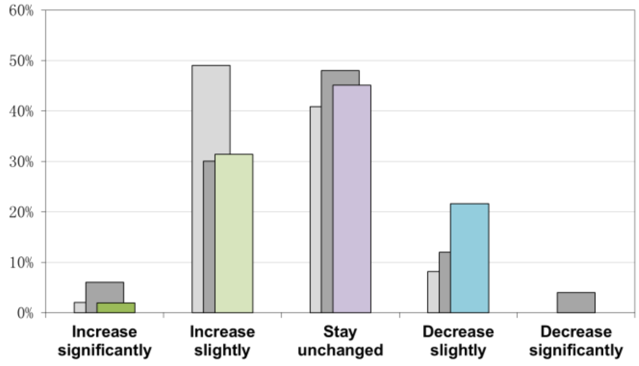
2. PROFIT EXPECTATIONS



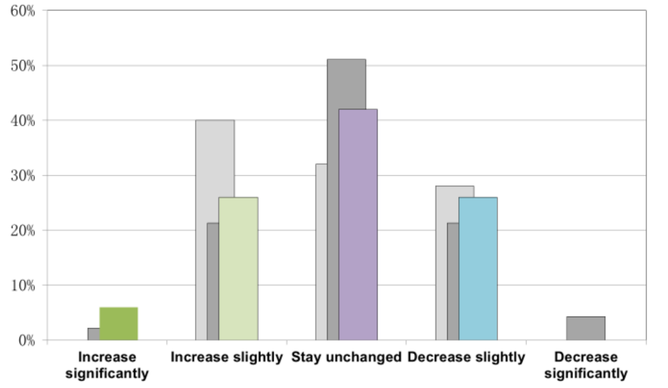
5. INVESTMENT/ACQUISITION PLANS



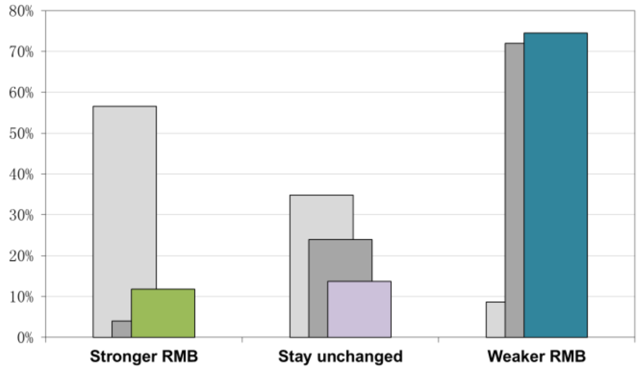
6. NUMBER OF EMPLOYEES



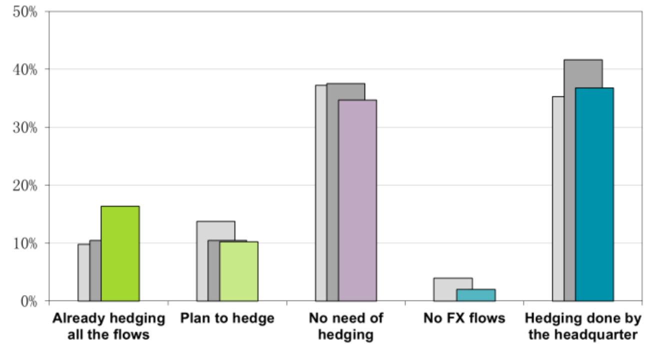
9. INVENTORY EXPECTATIONS



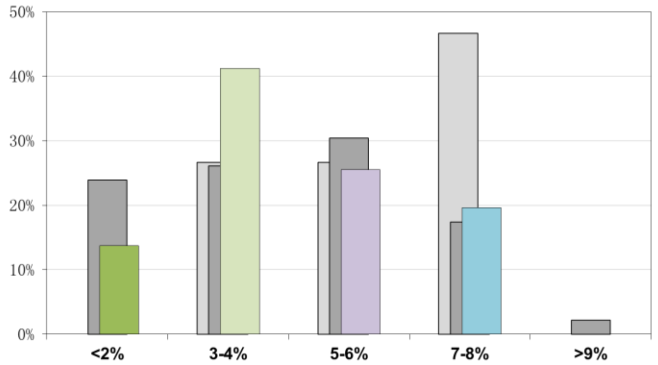
7. RMB EXPECTATIONS*



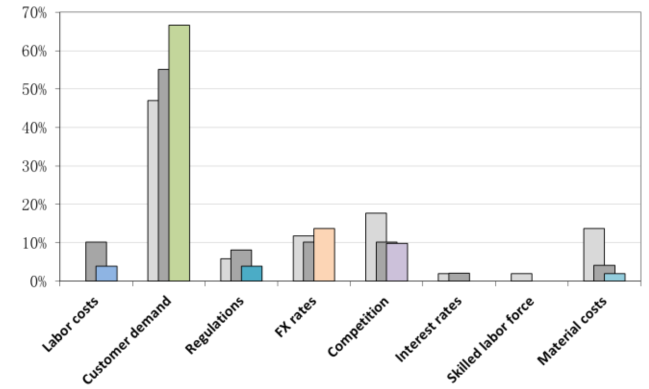
10. HEDGING STRATEGY



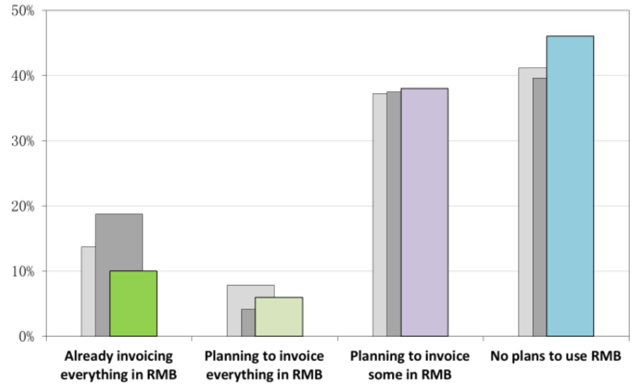
8. AVERAGE SALARY INCREASE



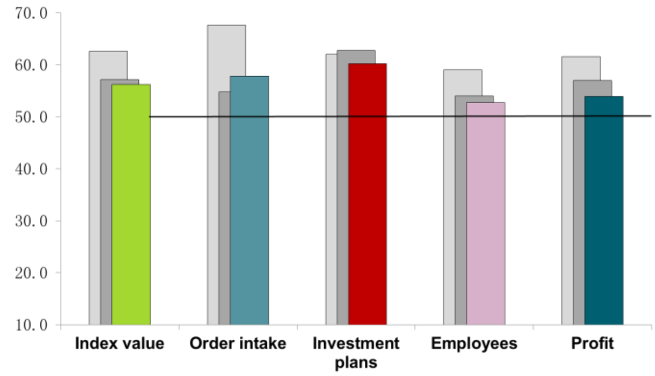
11. MAIN CONCERNS



12. RMB INVOICE



MAIN INDEX



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