

China Financial Index

SEB

Surprising business confidence bounce-back

Sales, hiring and profit are all up but flat expansion plans

FRIDAY
30 SEPTEMBER 2016

SEB CHINA FINANCIALS INDEX AT 58.6. Up from 56.2 in March and 57.1 one year ago. **UNEXPECTED RESULTS GIVEN UNDERLYING PROBLEMS.** Slowdown of economy, increasing debt and capital outflows. Results show that our home-market clients are not feeling the bad business climate as much as others. **SERVICE SECTOR MORE OPTIMISTIC BUT MANUFACTURING STILL STRUGGLING.** In terms of hiring, profits, sales and investments the service sector shines brighter than manufacturing. **SALARY LEVELS SIGNIFICANTLY DOWN.** Results indicate and confirm a lower salary growth environment. Still, the service sector sees higher salary growth than manufacturing.

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OVERALL POSITIVE BUSINESS CONFIDENCE BUT INVESTMENTS UNCHANGED

Despite the usual bad news coming out of China these days in terms of the economy, regulations and alarming debt, SEB's China Financial Index is delivering surprisingly optimistic results. Our home-market corporates from the Nordics and Germany are indicating higher expected sales, profit and hiring for the coming six months. However, new investment plans remain flat. Results show that 64% of companies who answered our survey expect order intake to increase during the next 6 months. This is 11% higher than 6 months ago when the previous survey was published. At the same time, the expected growth pace has levelled off from 'increase significantly' to 'increase slightly.' Apparent in this edition is the widening gap between the manufacturing and service sector, with the service sector coming up on top. The question is if China's attempt to turn the economy around to service and consumption-led is actually working? Or is money simply being shuffled into the service sector through higher real estate prices and higher private debt?

ON THE FLIPSIDE OF THE COIN

As the Chinese economy is gradually developing and shifting from a capital-intensive manufacturing economy to more service-oriented, the companies answering our survey also face new challenges. One is intensified competition. In our survey, 23% of respondents say that competition is their main concern in China. This is an increase of 13% from the last survey. The main concern remains customer demand still. 40% of the customers highlight this. We added a new concern in our survey: payment

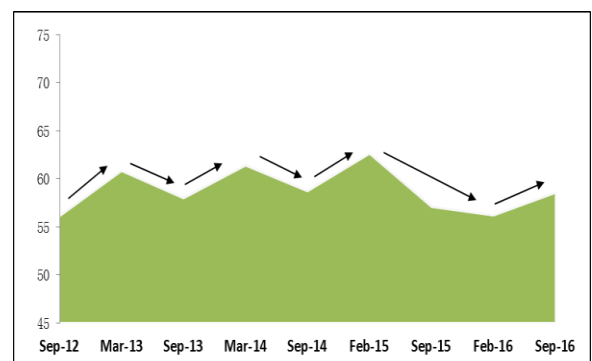
collection. As we increasingly hear from our clients that they are worried about their customers' payment capabilities. 12% of respondents chose this as their main concern.

LOWER SALARY LEVELS

A major finding in this survey is the decreasing salary level, with roughly 4 out of 10 respondents indicating less than 2% salary growth, up from 14% in the last edition. At the same time, 20% are still expecting 7-8% salary increases. Results indicate that it really comes down to industry specifics. Corporates are still mainly concerned with customer demand and competition.

The clear majority of corporates, 73%, still anticipate the RMB to weaken. Over half of the companies (56%) hedge their flows; this portion has steadily increased during the past year.

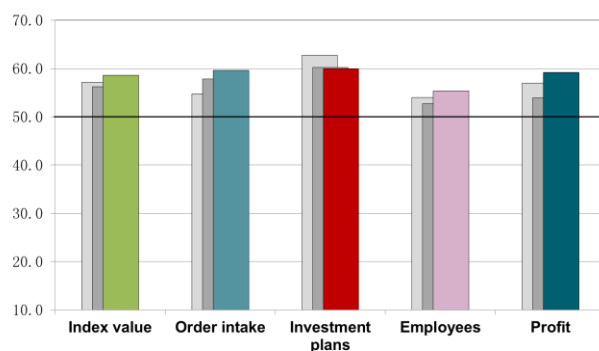
Historical development for SEB's China Financial Index



Time to digest the investments and enjoy returns

Major investments plans are still on hold, which is a trend we have been seeing already in the previous survey. 56% of respondents have no plans to invest. Regarding hiring new staff, 50% expect no changes and 13% are planning to reduce staff.

China Financial Index, September 2016



Source: SEB in Shanghai. The colored stacks are the most recent results. Grey stacks show results in March 2016 and September 2015, respectively.

The findings somewhat follow recently published statistics. The official manufacturer purchasing manager index (PMI) came in at 50.0 in August, down from 50.6 in July, but sharply higher from a year ago. The official services PMI came in at 52.1 in August, up from 51.7 in July. The official GDP growth target range for 2016 is 6.5-7%. SEB's forecast is 6.6% growth. Official statistics are indicating that the service sector is expanding more than manufacturing, which is stagnating.

OUR CONCLUSIONS

As the 'New Normal' is unraveling in China with a declining economy and shift towards sustainable growth, disappointing news has now become the new normal. However, the People's Republic is still a major area for growth for our Nordic and German companies. In discussions with clients, the general attitude is that this is a temporary hiccup and the issues can be fixed. Consumer-, healthcare- and education-driven companies are still seeing strong growth. Manufacturing industries are looking for cost savings, and shifting focus from export-driven strategy to local strategy. Overall, the positive sentiment holds up well among Nordic and German companies who answered this survey. Result shows that China is a patchwork quilt of different economic areas and problems. Looking at averages and statistics can lead to false interpretations. Also, the companies answering this survey are mostly publicly owned, strong counterparties which can withstand headwinds. The lower salary levels are standing out in this survey, with a momentous shift from previous editions. It remains to be seen if this trend continues, there has been

reports of corporates now leaving China due to higher salaries. Only a year and a half ago no one in our survey indicated a salary increase of less than 2%.

Global GDP growth and SEB predictions

Global GDP growth

Year-on-year percentage change

	2015	2016	2017	2018
United States	2.6	1.6	2.4	2.0
Japan	0.5	0.5	0.5	0.5
Germany	1.7	1.7	1.6	1.6
China	6.9	6.6	6.3	6.0
United Kingdom	2.2	1.7	0.9	2.0
Euro zone	1.7	1.6	1.7	1.7
Nordic countries	2.2	2.1	2.0	2.0
Baltic countries	1.8	2.2	2.8	3.1
OECD	2.3	1.7	2.0	2.0
Emerging markets	3.9	4.2	4.7	4.8
World, PPP*	3.1	3.1	3.5	3.6

Source: OECD, SEB

* Purchasing power parities

INCREASED AUTOMATION IN CHINA - FUTURE HIGH-TECH MANUFACTURER OR HIGHER UNEMPLOYMENT?

As salary levels increase in China, the once-competitive edge of cheap labour and being the world's workshop is wearing away. Corporates are increasing the usage of robotic automation, effectively replacing thousands of people through what some have called an automation-driven industrial revolution. Due to this development, the Chinese are now buying more robots than any other nation, even more than high-tech producing countries such as Germany and Japan. The increased automation is derived from several factors, including: the working-age population is decreasing, cost, reliability, precision and a shift in attitude from working along the production line to service-based professions. The government has been promoting the use of robots to replace the labour deficit through subsidies. However, the elephant in the room is undoubtedly increased unemployment. Authorities are counting on benefits from high-tech production balancing the jobs redundancy through policies such as Made in China 2025, which is aimed at improving capabilities and enhancing development of Chinese brands globally. As usual in China, it is an ambitious target and in line with shifting the economy away from production- to service-based. Still, with a slowing economy along with increasing indebtedness and industry overcapacity, the goal remains equally challenging.

Survey Results

INFORMATION ABOUT THE SURVEY

SEB's China Financial Survey was first launched in 2007 and is based on input in this edition from CEOs and CFOs at 52 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 29 until September 11 2016. Introduced in this edition is a donation scheme. We will donate 100 RMB for every answer received to Charyou, a NGO based in Shanghai working in low-carbon lifestyles, youth education, poverty alleviation in remote regions, and caring for the elderly. We will consequently donate 5200 RMB.

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

Survey results are indicating brighter expectations for the coming six months; respondents are seeing increasing sales and profits compared to the previous survey. The majority is expecting significantly or slightly increasing sales, which is almost 20 percentage points higher than one year ago. However, every fifth respondent expects slightly decreasing sales. This is roughly unchanged since the last survey. We can distinguish industry specifics with more manufacturing corporates expecting slightly decreased sales and more corporates in the service industry expecting significantly higher sales.

First introduced one year ago in SEB's China Financial Index, corporates were asked about the comparison in actual sales. This survey asked about results between the first half of this year compared to the second half of last year. Results indicate 61% saw slightly or significantly increased sales, up from 46% in March's edition. At the same time, almost one in three experienced slightly or significantly lower sales figures, which is consistent from the last survey. Profit expectations are mainly unchanged, with 57% expecting profits will improve slightly or significantly. Profit expectations are down from every third corporate to every fourth from last survey. 21% expects profits to stay unchanged. Results are additionally showing that corporates in the service industry are expecting profits to improve more than corporates in the manufacturing industry.

When it comes to inventory, results are virtually unchanged, with every third participant expecting inventory will either increase slightly or significantly.

However, 20% expect slightly lower inventory, which is down from 25%.

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

SUBJECT: Investment/Acquisition plans

Investment plans are essentially unchanged from last edition, with 56% expecting to maintain the same level of investments and acquisitions. Compared to March's survey, a slightly lower number of respondents are looking at making major investments. But modest investments are increasing somewhat. Results are showing a flat or slightly modest picture in terms of investments. As the global economy is recovering and China is slowing down, new business is still crucial for our corporates, but many are also contemplating the situation.

(See graph 5 on page 5)

SUBJECT: Employment and salary

Corporate expectations are overall unchanged from last survey and one year ago regarding expansions in workforce for the coming six months. 37% of respondents are expecting additional hiring and half expects no change in hiring. Roughly one in ten is looking at decreasing staff, down from 22%. We can see that corporates in the manufacturing industry are overall expecting unchanged or even slightly decreasing staffing. On the other hand, more than 70% of responding corporates in the service industry are expecting to make slightly increasing hiring.

As new additions to the workforce are generally unchanged to modest, the salary level in China is shifting. 38% are now expecting salary increases of less than 2%; this is up from 14% in March. This is a major shift in salary development, but at the same time, every fifth respondent is planning to increase salaries by 7-8%, the same share as in the previous edition. Increased salary levels of 3-4% are down to 22% from 41%. Results are confirming the previous slowdown of salary levels, which has been one of the clear trends in this and previous surveys.

(See graph 6 and 8 on page 6)

SUBJECT: Funding needs/Lending attitude

Financing needs for participating corporates are mainly the same as from previous surveys, with almost one in ten expecting increasing borrowing needs. At the same time, the same share expects decreasing borrowing needs, although this up from 2% one year ago. The vast majority, 79%, are expecting their

funding needs as unchanged for the coming six months.

When it comes to banks' lending attitude, the optimistic sentiment has marginally increased in this survey. 44% of all corporates expect lending attitude from their banks to remain slightly or very favorable, which can be compared to 41% six months ago. The largest share, 54%, expects their banks' lending sentiment to stay unchanged. Notably, respondents expecting slightly or very unfavorable lending conditions decreased from 6% to 2%.

(See graph 3 and 4 on page 5)

SUBJECT: FX and RMB usage

In this and previous editions, over half of our responding corporates do hedge their trade exposure. This has been an increasing trend starting two years ago. An increasing number of corporates (44%) choose to hedge offshore through their head office, up from 37% in the last edition. The share of respondents seeing no need for hedging is down from 35% to 29%, perhaps due to increased RMB invoicing. Corporates planning to start hedging is slightly higher (13%) compared to six months ago.

Of the responding corporates, 73% are still expecting the RMB to weaken, most likely due to the currency volatility earlier in the year. This is consistent with similar levels six and twelve months ago. However, the share of corporates expecting the RMB to stay unchanged is up from 14% to 21%, perhaps indicating a stabilisation of the RMB.

With the RMB gradually becoming an international currency, the respondents were asked whether they use RMB as their invoicing currency for imports and exports. 43% already do so, or plan to begin invoicing all their trade in RMB, which is up from 16% six months ago. Corporates planning to use RMB invoicing to some extent is down to 25% from 38%. However, the share of respondents answering that they will not use the RMB decreased from 46% to 33%. Results indicate a greater RMB invoicing and need, which could be partly explained from the recent currency volatility.

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

SUBJECT: Main concerns

For the upcoming six months, 38% of corporates in our survey indicate customer demand as the major concern, compared to 67% in the last survey. Competition is increasingly of concern in this edition, at 23% and up from 10%. Added in this edition of SEB's China Financial Index, we introduced payment collection as an option of concern. This turned out to be of significant importance for the responding corporates, displaying 12%. Payment collection is replacing interest rates. Other important factors include regulations (8%) and labor costs (8%) both up from last edition. Meanwhile, FX rates marginally decrease in importance for the responding subsidiaries.

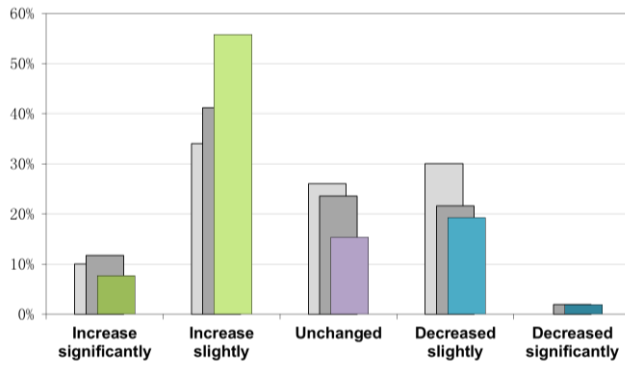
(See graph 11 on page 6)

CHINA FINANCIAL INDEX – COMPOSITION

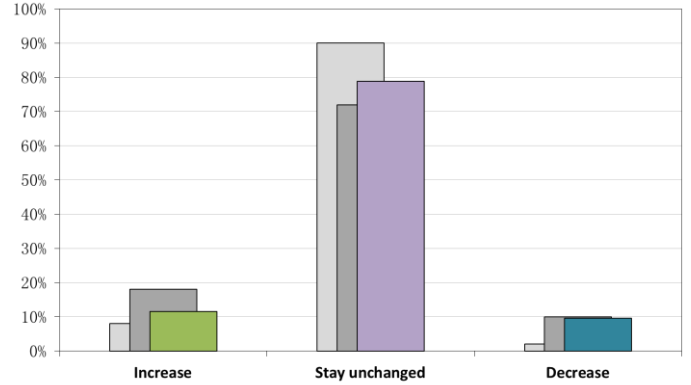
SEB's China Financial Index in September displayed a value of 58.6, indicating an optimistic increase of the business environment compared to previous surveys in March and one year ago.

A value of 50 indicates a neutral view. The index is based on four components, with the following ranking in this survey: Order Intake – 60, Profit Expectations – 59, Investment Plans – 60, and Employment Plans – 55. (See the graph on page 1)

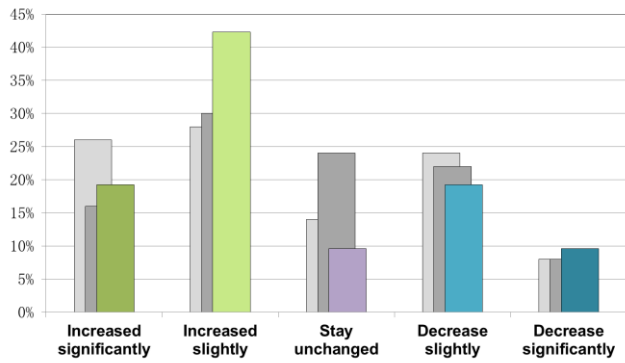
1A. ORDER INTAKE/SALES



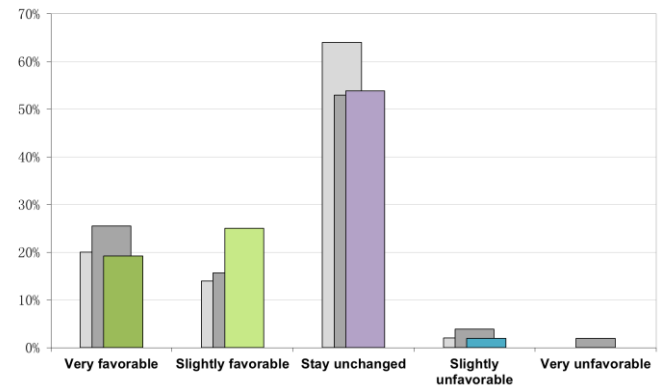
3. FUNDING NEEDS



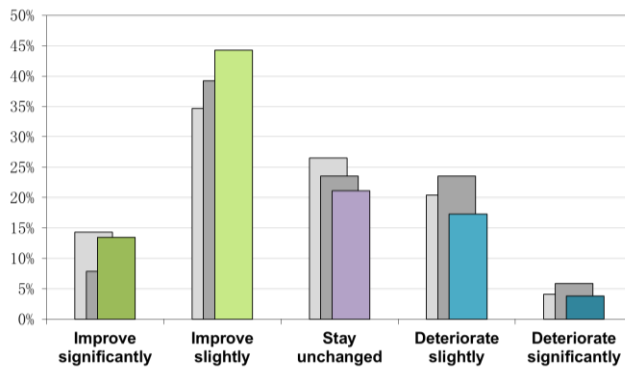
1B. ACTUAL SALES



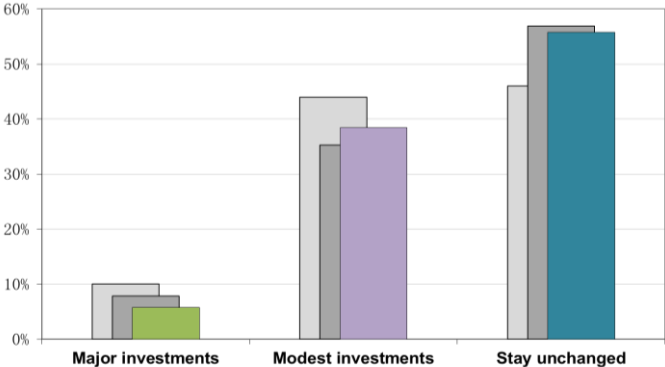
4. LENDING ATTITUDE



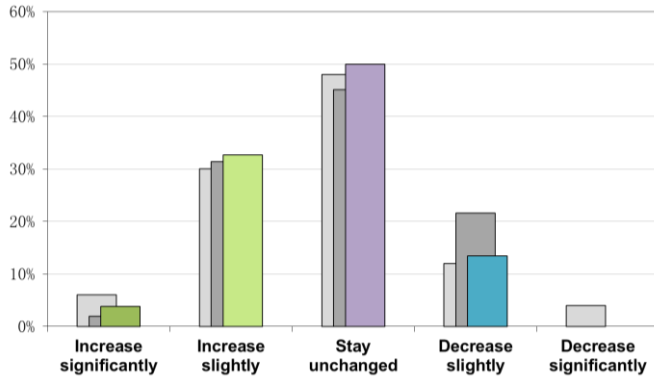
2. PROFIT EXPECTATIONS



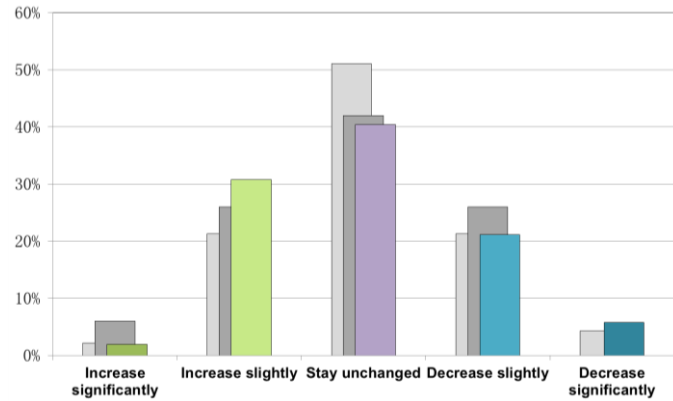
5. INVESTMENT/ACQUISITION PLANS



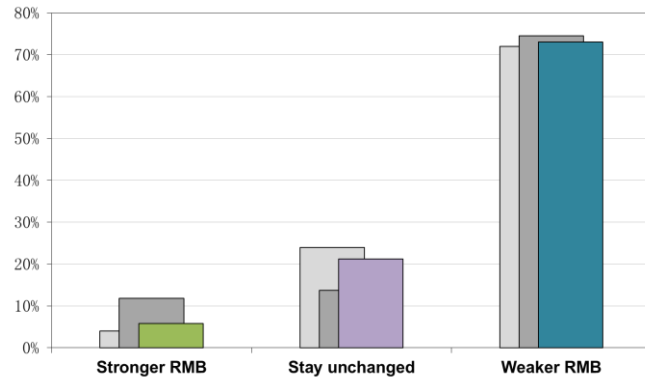
6. NUMBER OF EMPLOYEES



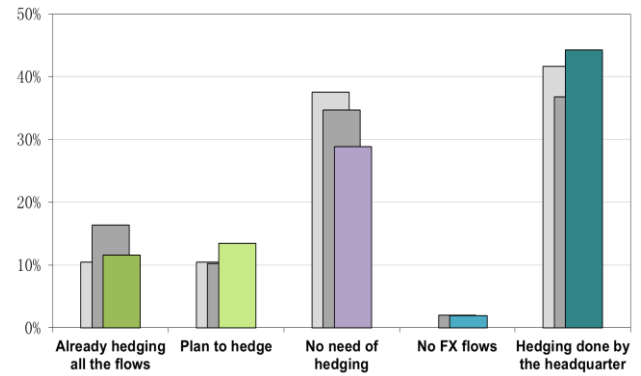
9. INVENTORY EXPECTATIONS



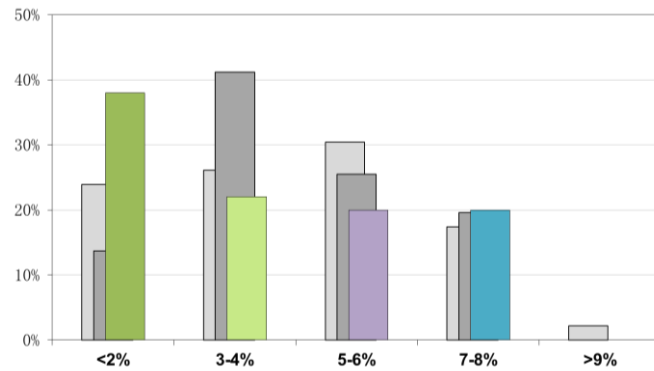
7. RMB EXPECTATIONS*



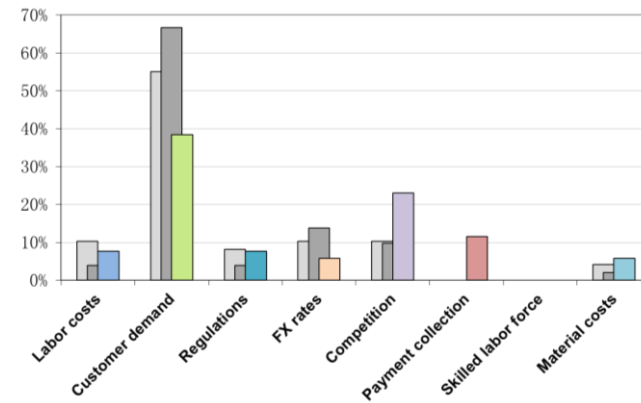
10. HEDGING STRATEGY



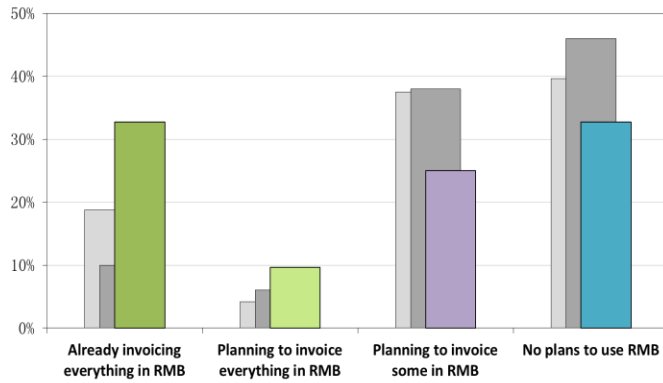
8. AVERAGE SALARY INCREASE



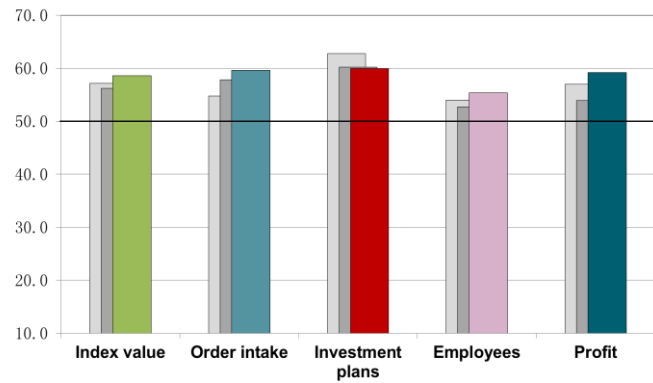
11. MAIN CONCERNS



12. RMB INVOICE



MAIN INDEX



*Source: SEB Shanghai. Grey stacks are indicating companies' answers in the last two surveys in March 2016 and September 2015

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