

June 3, 2021

## Continued positive outlook on doing business in China

- The SEB China Financial Index for the spring stands at a strong **61.3**, bringing confidence back to pre-COVID-19 pandemic and trade war levels. The index is up from an all-time low of 46.6 one year ago and 57.3 in November 2020. This underpins foreign companies' confidence and the positive outlook on the recovery of the world's second largest economy.
- While close to 50% of respondents were no longer experiencing any effects of the COVID-19 pandemic, 37% were still experiencing negative effects.
- An increasing number of respondents had a positive view on sales development for the next six months. However, the profit outlook does not report the same shift in positive answers, as material costs become the main concern for the next six months on the back of a surge in commodity and shipping costs.

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**In this Spring 2021 edition of the China Financial Index (CFI), the index value climbs to 61.3 based on the survey conducted between 7 May and 21 May.** This underpins the strong recovery in the Chinese economy following the Chinese government's strong containment efforts in 2020. The CFI has risen further from 53.4 in November 2020 and from the negative survey of 46.6 a year ago. This brings the CFI back to levels not recorded since early 2018. The Chinese economy closed the books of 2020 with real GDP growth of 2.3%, the only major economy to report growth in 2020.

### Historical development of the CFI

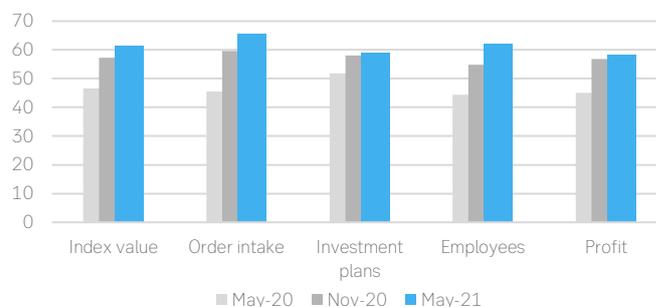


Source: SEB

As the world emerges from lockdowns and closed borders, we expect Chinese exports to continue supporting the economy through 2021. Given developed countries' access to vaccines and subsequent high coverage as a percentage of the population, we expect developed markets to recover and reopen more quickly than emerging markets. We find this supportive of Chinese export growth, as alternative emerging market suppliers still find themselves grappling with the virus. SEB's forecasts for Chinese GDP growth are 9.0% in 2021 and 5.3% in 2021.

We see a positive read across most questions posted in the survey and see that economic activity and growth have largely picked up pace among our corporate client base. Albeit we note some developments in certain questions that suggest more focus is being put on regulation and worries about external geopolitical developments.

### Index values



Source: SEB

### Is COVID-19 capping upside to the positive development? We

see in the survey that around 37% of respondents reported that they are still experiencing negative effects from the COVID-19 pandemic. While there are base effects in the year-on-year sales development, we see that there is a strong positive development in the profit outlook for the next six months supporting the recent performance and the recovery sentiment. Thus, the response on COVID-19 pandemic effects might imply that travel restrictions and demand outside of China is still affecting export and project execution, thus limiting the upside potential. In total, 81% of respondents forecast positive profit development between +5% and +50% for the next six months, with the main bracket being +5% to +20%, representing 69% of the total response.

While companies are relatively positive on sales growth, we see that the profitability outlook is almost flat compared with the survey in November. We see two probable culprits for this development: (a) competition and (b) input costs. After a period with low economic growth across the board, market intelligence suggests to us that many corporates are gradually facing tough price competition and need to sacrifice margin to maintain volumes and market shares. We expect the recent surge in raw material and shipping costs to affect margins in the short term.

**YTD development of selected commodities** (n=100, 04 Jan 2021)

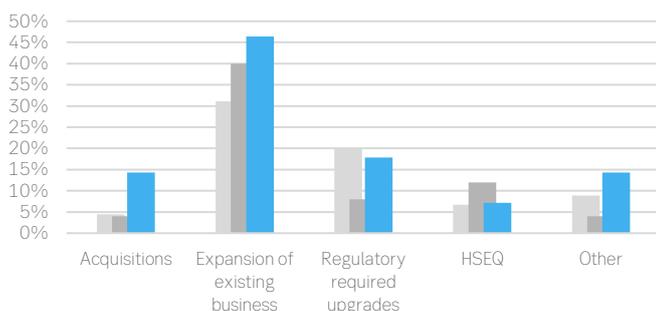


Source: Bloomberg

We also see that *material costs* have taken the top position as corporates' main concern over the next six months, as well as being the second largest concern. While this category was of some concern one year ago as supply chains were disrupted, the category is making a rather strong comeback. In total, 33% of respondents cited it as their main concern together with *supply chain* (29%). On the back of rising commodity and container/shipping costs, we do not see this development in profitability outlook as too surprising.

**Investment plans look set to remain flat.** The investment index is still lower than before the Covid-19 pandemic but still showing a small gain from 58 to 59 in the most recent survey. This is the second survey in a row after 'Divestments' was recorded for the first time that shows corporates either planning to invest or keeping the business as is. A total of 63% of respondents expect investments to remain unchanged. While it is small, there is a slight uptick in companies expecting *Major investments* (up from 4% to 8%). We note that China overtook the USA as the largest receiver of FDI in 2021 and we plan to monitor this index closely, as it lags the other categories in recovery.

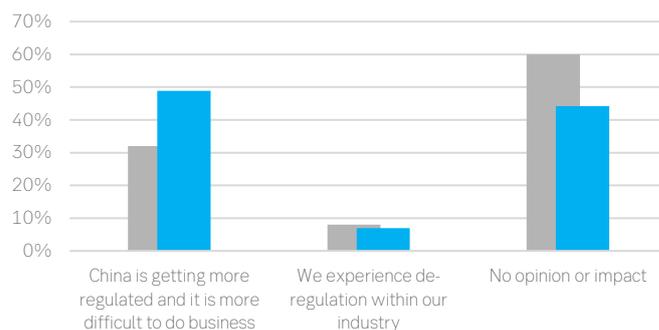
**Nature of investments**



Source: SEB

**Expansions still take the number one spot when it comes to investments.** Of the respondents, 61% reported that they planned either expansion of existing business or acquisitions. We have noted recently that several of our clients are looking at M&A activity in China. Another notable increase is the increase in investments that are "upgrades required by regulations". The number of respondents reporting this has jumped from 8% to 18%. While the type of upgrade is not known to us, we also see parallels in this response to our question about perceived regulatory focus, where there is an increase in answers stating that China is becoming more regulated and increasingly more difficult in which to do business.

**How do you perceive regulatory changes in China?**

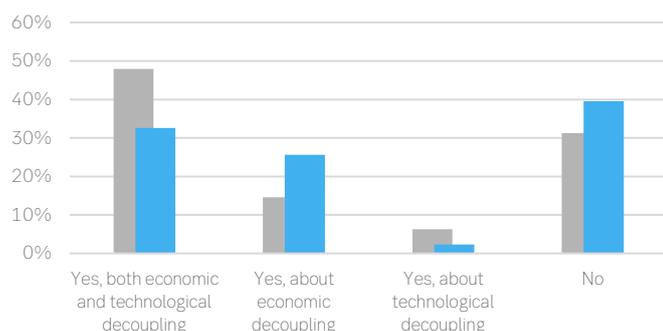


Source: SEB

With China and the US now, to a larger extent, considering each other as rivals rather than strategic partners, this does have an impact on the business climate in China as European MNCs try to find their place in a deglobalizing world, as the two markets are largely trying to insulate sensitive industries and sectors from each other. Consequently, *decoupling* has established itself as a topic in the business community in China. Interestingly, the number of respondents that are not concerned about decoupling has increased from 31% to 40%. While it is still a relatively new topic that could be confusing and difficult to grasp, among those that are concerned about decoupling there is a strong shift from both economic and technological decoupling to only economic decoupling. In this Spring survey, the number of respondents worried about both economic and technological decoupling fell from 48% to 33%.

A [report](#) from the EU Chamber of Commerce in China (EUCCC) points to global supply chains being multi-tiered and reliant on technology from both the US and China, so that companies that would like to integrate the best of both are being forced to operate with either dual systems that include separate supply chains and R&D for China and the RoW or with a flexible architecture where everything that could be supplied in a 'neutral' manner could be supplied to both, while the rest is being developed separately. Either way, the costs of this are considerable and are likely to lead to less investment, fewer jobs, higher costs and fewer choices for end-consumers – a no-win situation, in our view.

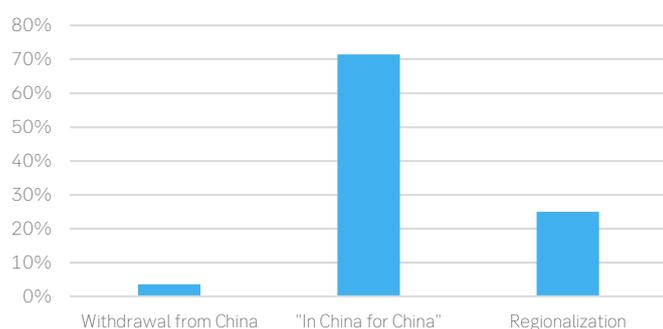
## Are you worried about decoupling?



Source: SEB

**'China-for-China' seems to be the preferred route among those worried about decoupling.** Along with the question about what type of decoupling corporates are worried about, we asked about what potential strategies the companies are exploring to prepare themselves better for decoupling. A total of 71% of respondents are exploring an 'in China for China' strategy, with only a minor share replying that they are exploring withdrawal from China (4%). These would normally be companies with China representing a small part of global sales where the costs of adapting to the new reality outweigh both the investment and possibly the growth potential.

## Strategies explored to tackle decoupling

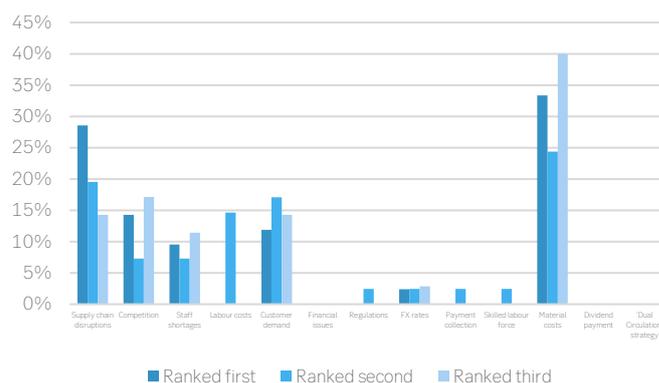


Source: SEB

**Regardless, we still see a commitment to China in terms of both investments (above) and staffing.** The decrease in staffing one year ago was an expected one but we now see that 53% of respondents are expecting staffing to increase over the next six months with close to zero expectations of decreased staffing, impacting this index contributor positively upwards from 54.8 to 62.

**While the development in the survey is positive, it is also a 'steady state' development without large surprises.** As northern European companies are largely present in China due to the local market access, events outside of China seem to weigh little on the outlook on doing business in China. The main concerns probably weigh more on the cost side (and are possibly still attributed to the Covid-19 pandemic?) rather than the operational issues of doing business in China. Material costs are the main concern for corporates over the next six months, so it may be that margins are taking a hit to preserve market share and volumes. This is followed by supply chains, which we know are stretched when you look at both container and bulk prices out of China given the strong export surplus China has had through 2020 and into 2021.

## Main concern for the next six months



Source: SEB

## Our conclusions

The recovery continues and it is clear in this Spring 2021 edition that northern European corporates are positive on the outlook on doing business in China. Helped by strong containment efforts by the Chinese government, economic activity is continuing to pick up and the companies are reporting good growth numbers. As vaccination outside of China increases, we are slowly returning to a 'normal' world, at the same time as there are changes to how the world's two largest economies see themselves in relation to each other. Dealing with decoupling is likely to continue to be on the agenda for corporates and should be a topic addressed by corporate headquarters sooner rather than later, to assess the impact on their Chinese operations. On the back of a strong GDP print in Q1 of 18.3% y/y, SEB raised its full year forecast to 9.0%, so we expect northern European corporates to take part of continued economic growth through the rest of 2021.

## Information about the survey

SEB's China Financial Index first launched in 2007 and is based on input, in this edition from CEOs, CFOs or Treasurers at 57 subsidiaries of major Swedish, Finnish, Norwegian, Danish, German, British and Swiss 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 7 May to 21 May 2021.

## China Financial Index – composition

SEB's China Financial Index in the Spring of 2021 displayed a value of 61.3, indicating a continued rebound in optimism in the business environment compared with the surveys in November and April 2020. A value of 50 indicates a neutral view. The index is based on four components with the following ranking in the survey: Order Intake 65.7, Profit Expectations 58.3, Investment Plans 59.0 and Employment Plans 62.0.

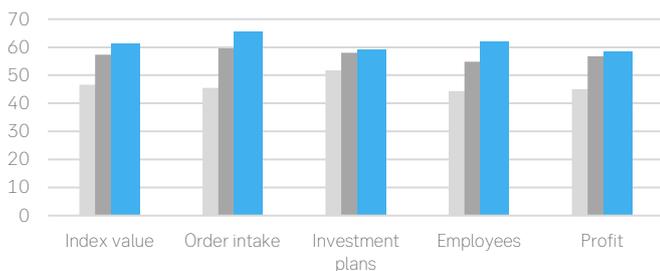
**Forecasts – Real GDP, % y/y**

	2020	2021	2022
China	2.3	9.0	5.3
India	-7.1	10.1	7.2
Indonesia	-2.0	4.4	4.7
Malaysia	-5.6	5.7	5.5
Philippines	-9.4	7.5	6.1
Singapore	-5.4	5.9	4.0
South Korea	-0.9	3.4	2.8
US	-3.5	6.5	4.0
Eurozone	-6.7	3.0	5.1
Japan	-4.9	2.1	0.7

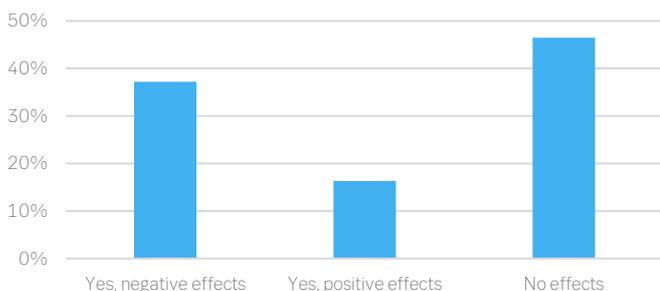
Source: Bloomberg, CEIC, SEB

**Please note:** The below graphs are all produced by SEB and represent all the questions in the 2021 China Financial Index. Grey stacks indicate companies' answers in the past two surveys, in April 2020 and November 2020.

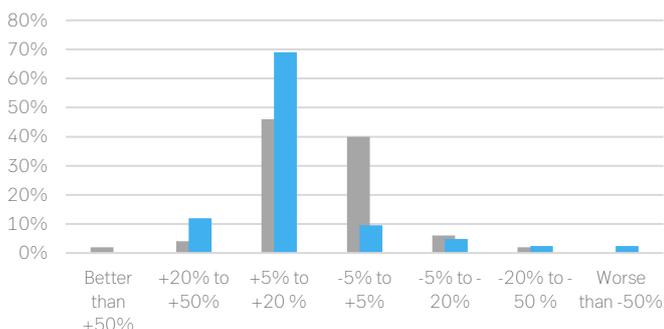
**1 – Index values**



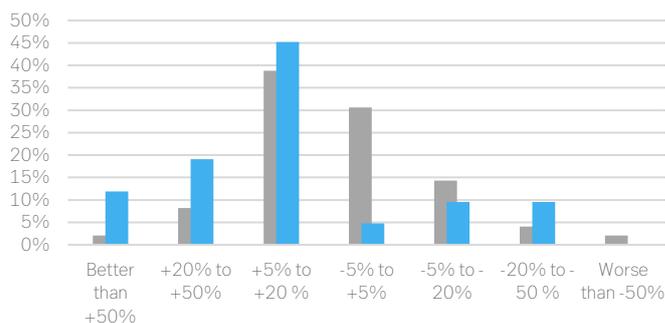
**2 – COVID-19 effects**



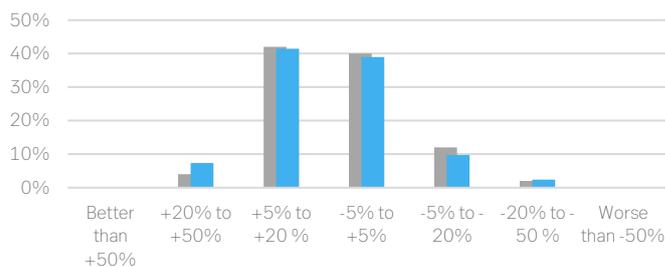
**3 – Sales outlook (next six months)**



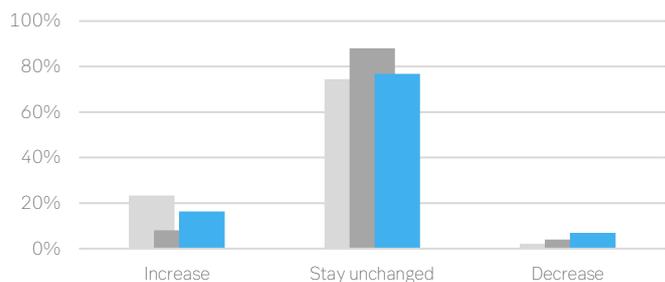
**4 – Y/y sales development (H1/21 vs H1/20)**



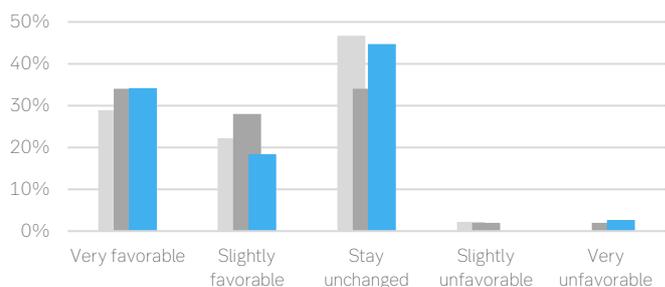
**5 – Profit outlook (next six months)**



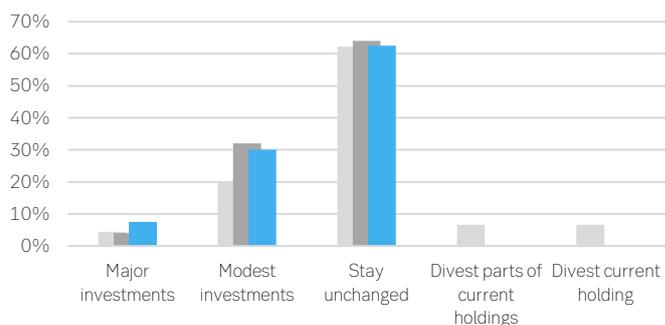
**6 – Borrowing outlook**



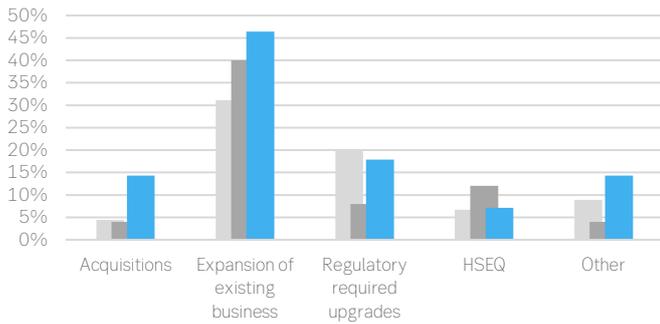
**7 – Bank's lending attitude**



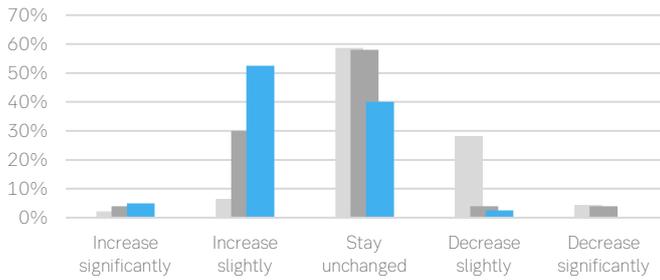
**8 – Investment plans**



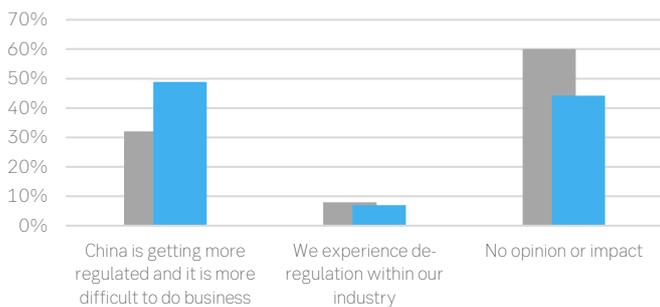
**9 – Type of investment**



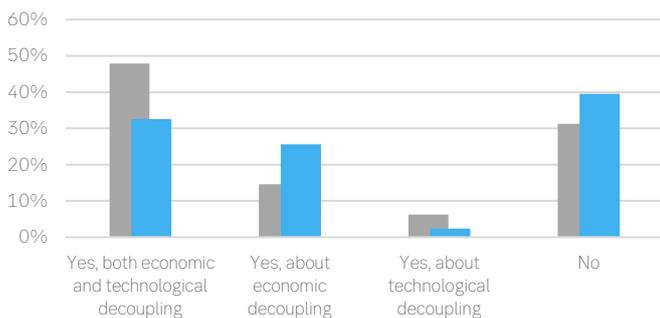
**10 – Staffing development**



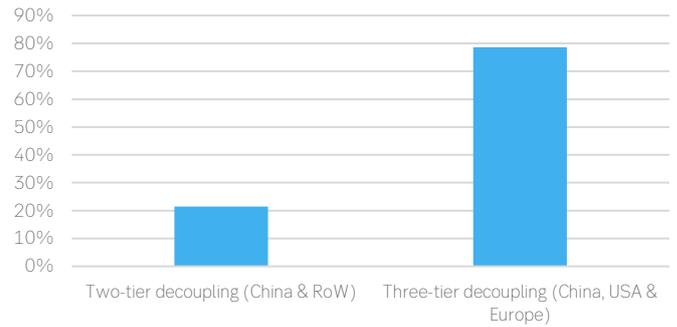
**11 – Regulatory development in China**



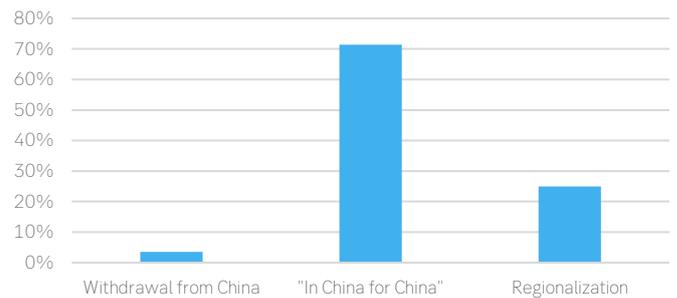
**12 – Worried about decoupling?**



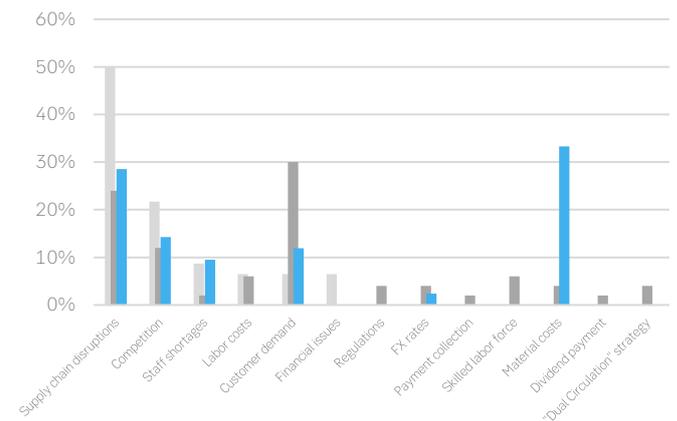
**13 – Type of decoupling**



**14 – Potential decoupling strategy**



**15 – Main concern**



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