

# China Financial Index

SEB Shanghai Branch

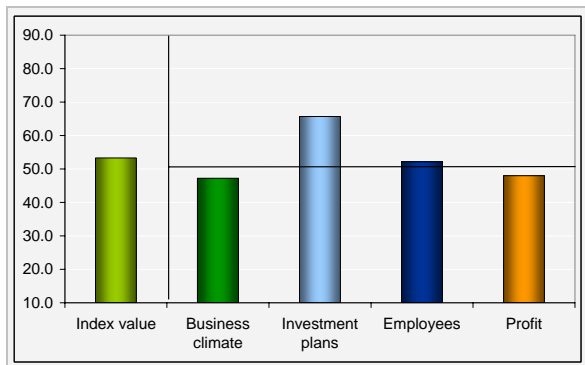
18 March 2009

## Sales and Profits Down in China - but Northern European companies continue to invest

Top managers at Northern European subsidiaries in China are generally pessimistic about the short-term business situation on the Chinese market, as the impact of the global economic downturn is now being felt in the Middle Kingdom. An overwhelming majority see customer demand as the major challenge in 2009, and most expect profits to remain unchanged or drop in the coming 6 months. Downscaling is not on the agenda for 2009, however. Two thirds of companies are planning to invest further in China during the coming 6 months. The number of companies cutting down on staff is equal to the number that are hiring. Only one company is divesting parts of its China business.

**SEB's China Financial Index was valued at 53 in March.** This is the first time this survey has been carried out by SEB in China.

SEB:s China Financial Index



Source: SEB Shanghai

In SEB's China Financial Survey, top-managers at just over 50 subsidiaries of major Nordic and German companies in China were asked about expectations of their own business as well as the macro and financial environment. Across the board, managers are expecting a fairly stable financial environment with falling interest rates, a stable currency and modestly increasing funding needs. While short-term economic data is trending downwards at the moment, major companies have the leverage to endure in China based on expectations that a recovery will happen in the medium term.

### Our conclusions

The global economic crisis is currently impacting on business prospects for North European companies in China. Falling exports combined with slowing domestic demand make companies foresee a worsening business situation. Given a much gloomier outlook in other major economies, however, the global crisis has not changed the view of China as an attractive investment destination, comparatively speaking. Nordic and German companies are sticking to their long-term strategies in China and view the market both as a low-cost manufacturing base and a vast growth market.

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## Confidence Down - but China only growth market 2009

Withered demand from Western economies (China's exports fell by 25.7% in February alone), combined with a drop in domestic sentiment has led to an abrupt fall in Chinese growth rates. GDP growth in Q4 2008 compared to Q4 2007 was only 6.8%, leading to speculation that the actual quarter-on-quarter growth was closer to zero. The exact effects of the government's 4-trillion RMB stimulus plan are still to be seen, but the fact remains that China may very well be the only major growth market left, as Europe, the USA and Japan are all heading for negative growth through 2009. SEB's prognosis is that China's GDP will increase by 4.5% in 2008 and 5.5% in 2010.

### GDP growth

Year-on-year percentage change

	2007	2008	2009	2010
United States	2.0	1.3	-2.6	0.6
Japan	2.4	0.0	-4.2	0.3
<b>China</b>	<b>13.0</b>	<b>9.0</b>	<b>4.5</b>	<b>5.5</b>
Euro zone	2.6	0.9	-2.5	0.0
United Kingdom	3.0	0.7	-3.5	0.3
Russia	8.1	5.6	-3.0	2.0
Sweden	2.5	0.6	-2.4	0.4
Norway	3.1	1.8	-0.7	1.7
Nordic countries	2.9	0.8	-2.2	0.6
Baltic countries	8.6	-0.9	-7.9	-2.8
OECD	2.7	1.0	-2.7	0.4
World economy, PPP	5.2	3.3	-0.7	1.9
World economy, nom	3.9	2.3	-1.4	1.2

Sources: OECD, SEB

Source: SEB, Nordic Outlook, February 2009

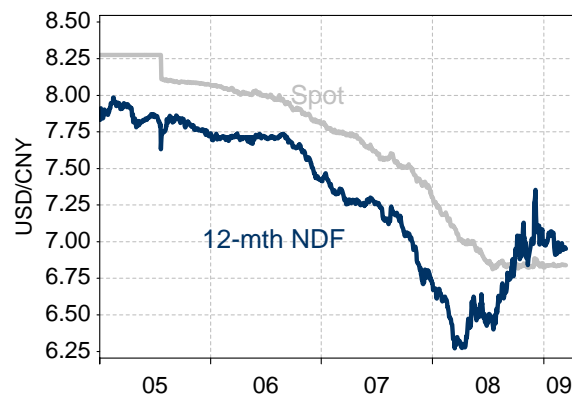
This is probably the rationale behind the "wait and see" and "continued expansion" strategies that Northern European companies seem to have adopted for 2009, in spite of slightly negative profit expectations.

### Hedging common in spite of stable RMB

Two thirds of managers expect the RMB to remain stable against the USD in the coming six months. After China scrapped the 8.27 dollar peg in July 2005, its currency appreciated by 17% against the dollar but has been kept stable at an interval of 6.81 –

6.89 since August last year. During the same period (since Aug 1) the RMB has appreciated by 17% against the EUR. Non-deliverable forward contracts indicate that the RMB will depreciate by around 2% against the US dollar in the coming year.

### USD/CNY Spot & NDF 12-mth



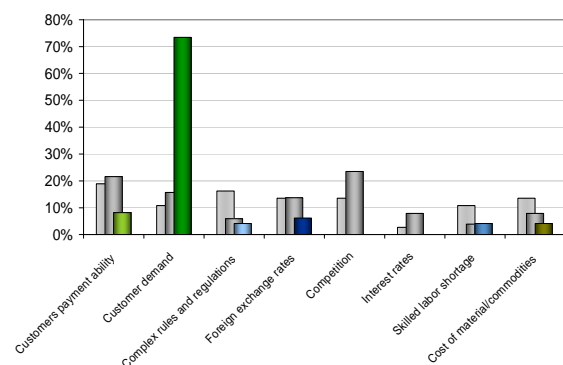
Source: Reuters EcoWin

39% of the China subsidiaries hedge some or most of their foreign currency flows on-shore, whereas 23% hedge through NDF's via their headquarters. Two thirds use the USD as the main trading currency in China.

### Customer Demand the greatest concern

As many as 73% of the respondents see customer demand as their main business concern in 2009. When asked what their second largest concern was, 24% mentioned competition, and 22% said customer payment ability. Although the latter is a constant concern for foreign companies in China, it may also be a further sign that the domestic economic situation is worsening.

### Concerns 2009



Source: SEB. Grey stacks are companies' second and third choices of main concerns the coming 6 months.

## Survey Results

### Information about the Survey

The SEB China Financial Survey is based on input from General Managers and CFO's at just over 50 subsidiaries of large Swedish, Danish, Finnish, Norwegian and German companies. A majority of the companies have a global turnover of over 500 million Euros. The survey is web based and confidential and was carried out during the period March 2 – March 9, 2009.

### Subject: Business Climate / Profit Expectations

Northern European subsidiary managers in China have a fairly negative view of the business climate for the coming six months, at least considering that China has been the fastest growing economy among the larger markets for many years. The number of companies which expect the business climate to be "not very favourable" is 35%, whereas 6% foresee the business to be "very unfavourable". 29% see the business environment as average and another 29% as favourable or very favourable.

Almost half of all managers, or 46%, expect profits to be unchanged in 2009. However, more companies (32%) expect profits to fall than the number expecting profits to increase (22%). As we have no previous data to compare with, it is impossible to see a trend, but based on discussions with clients in China over time, it is obvious that companies have become considerably more pessimistic in the last six months than previously. Apart from falling export figures and lowered domestic demand, many subsidiaries with net exports from China have also been hit by a dramatically stronger RMB during the last 6 months against the Euro and Scandinavian currencies. (See graphs 1 and 3, p. 5)

### Subject: Employee Structure

As demand in China has been faltering, reports of redundancies have been an increasingly common feature in the Chinese media. 24% of Nordic and German companies say that their total employees in China will decrease, but an even higher number, 33%, say they will increase the number of staff in China (of these, 4% even plan significant increases). The percentage of companies retaining the current number of employees is 43%.

(See graph 4 on page 5)

### Subject: Fixed Asset Investment Plans

Out of the companies, as many as 53% will make modest investments in the coming 6 months, and another 14% are planning major investments during the same period. While 31% will make no investments at all, only one company, i.e. 2% of the participants in the survey, is planning minor divestments in China. The figures include green-field investments, expansions as well as acquisitions. Hence, both employment plans and investment plans indicate that companies have either adopted a wait-and-see strategy or a continued expansion strategy in China, betting on a fairly quick recovery in the Chinese economy. As Chinese authorities are rolling out massive fiscal expansion projects to keep up the growth momentum, Northern European companies in China will probably increase the focus on the domestic markets as exports from China continue to drop. (See graph 2 on page 5)

### Subject: Average Outstanding Account Receivables days

In most annual surveys conducted by various chambers of commerce in China over the last 10 years, foreign companies have highlighted payment terms and the issue of actually being paid on time as one of the main challenges in China. Based on this survey, only a small minority of Nordic and German corporates have average outstanding account receivable days of

more than 90 days. One fifth reported less than 30 days, 43% have 30-60 and 29% have an average of 60-90 days. The standard differs between industries. (See graph 5 on page 5)

#### **Subject: Funding Needs**

Two thirds of managers expect funding needs to remain unchanged in 2009, whereas slightly less than a third expect funding needs to increase. Only a few companies foresee a decrease in funding needs. Considering the “wait and see” vs. “continued expansion” attitudes indicated in investment plans and employment structure, this would seem logical. The question did not specify whether needs are for investments or working capital. (See graph 6 on page 5)

#### **Subject: FX and Interest Rates**

Two thirds of managers think that the RMB will remain unchanged against the USD in the coming six months, 24% think it will strengthen and 10% believe that it will depreciate. A stable RMB/USD exchange rate is one of the main reasons as many as 67% of Northern European companies use the USD as their main trading currency in China. 33% use either the EUR or Scandinavian currencies. For the latter, the relevant question is how the USD will develop against the EUR and Scandinavian currencies. Between August 1 last year and March 11 this year, the RMB has appreciated by 18.4% against the EUR, 31.8% against the SEK, 26.4% against the NOK and 17.3% against the DKK. This may be the reason that as many as 39% are now hedging some or most of their FX-flows on the on-shore forward market, and another 24% hedge via their headquarters through NDF-contracts.

Three quarters of managers expect interest rates to fall, and one fourth is expecting rates to remain unchanged in the coming 6 months. No company expects rate hikes. Borrowing and deposit rates are regulated

in China and the Central Bank – the People’s Bank of China – has already lowered rates 5 times since last summer. The one-year borrowing rate as per March 18 is 5.31% and the one-year deposit rate is 2.25%.

(Please see graphs 7 and 8 on page 5 plus graph 9 and 10 on page 6)

#### **Subject: Main Concerns**

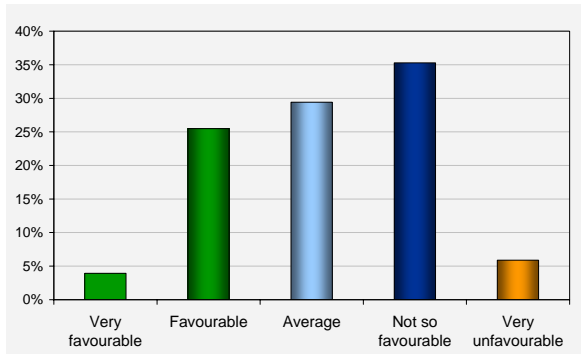
As described above, the major concern at this moment for local management is customer demand, 73% rating it as their main concern and another 16% as their second largest concern. This includes almost all companies. The two second largest concerns are customer payment ability and competition. Both these concerns may increase over the year if more local companies develop liquidity problems. Privately-owned Chinese companies in particular are still having difficulties obtaining bank loans, whereas Chinese banks are expected to increase their lending to government-backed companies drastically during 2009. Increasing competition is a constant concern for foreign companies in China as local companies are generally price aggressive and quickly catch up with foreign technologies.

#### **China Financial Index - Composition**

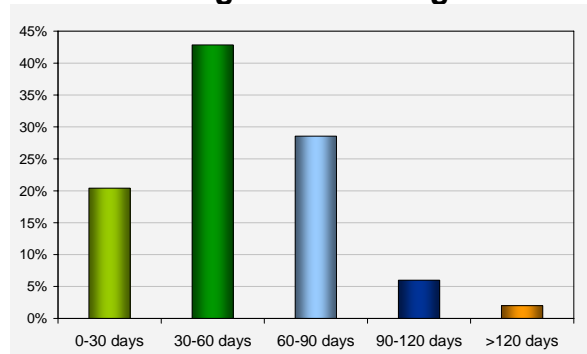
The SEB China Financial Index in March had a value of 53, which is indicating a slightly positive attitude. A value of 50 would indicate a neutral view. The index is based on four components with the following ranking in this survey: General Business Situation - 47, Profit Expectations - 48, Investment Plans - 66, and Employment Plans - 52. (see the graph on page 1)



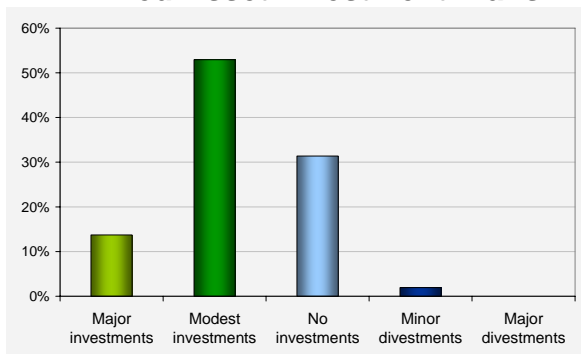
### 1. Business Conditions



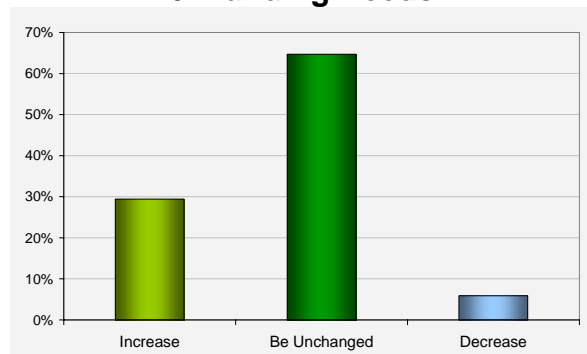
### 5. Average Outstanding A/R



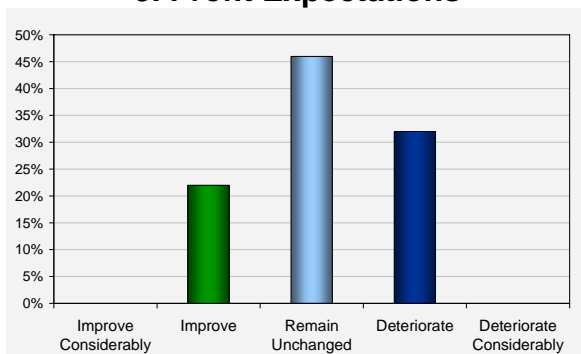
### 2. Fixed Asset Investment Plans



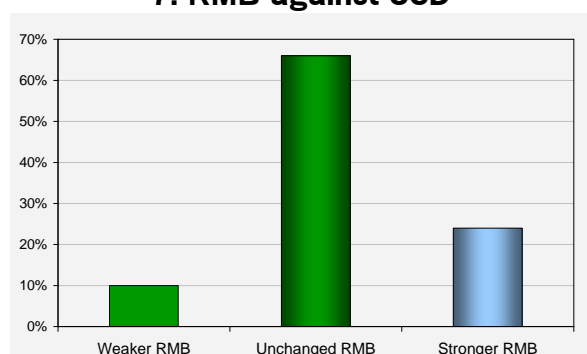
### 6. Funding Needs



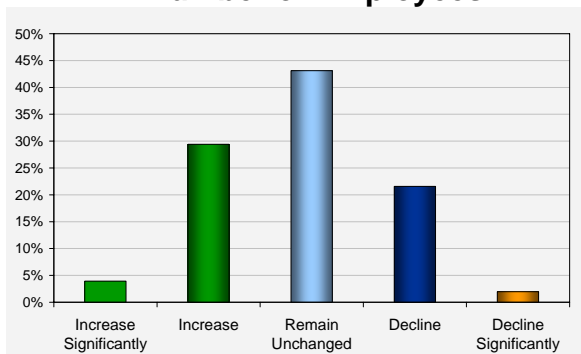
### 3. Profit Expectations



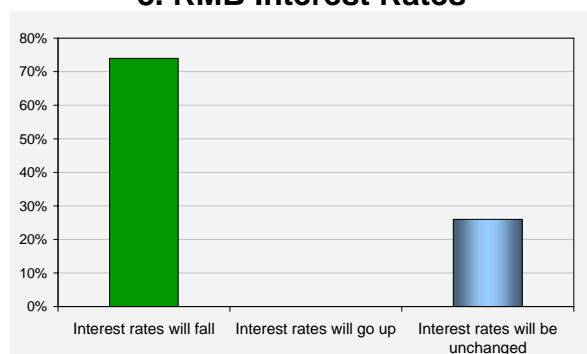
### 7. RMB against USD



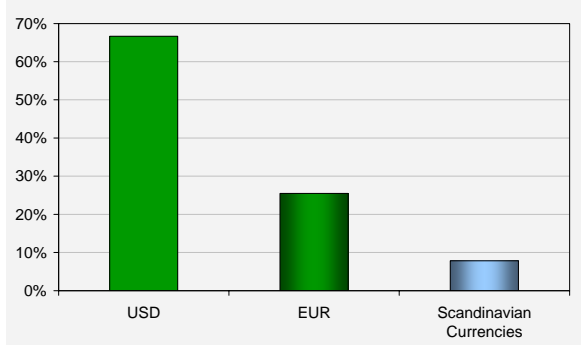
### 4. Number of Employees



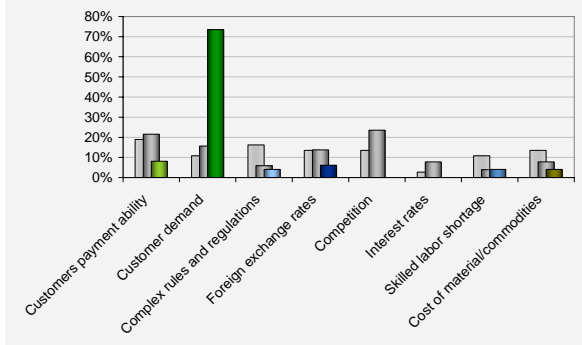
### 8. RMB Interest Rates



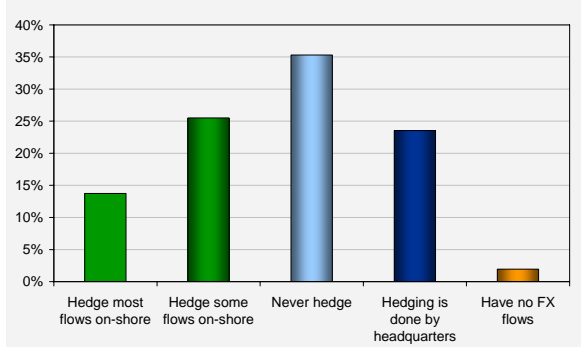
### 9. Main Trading Currency



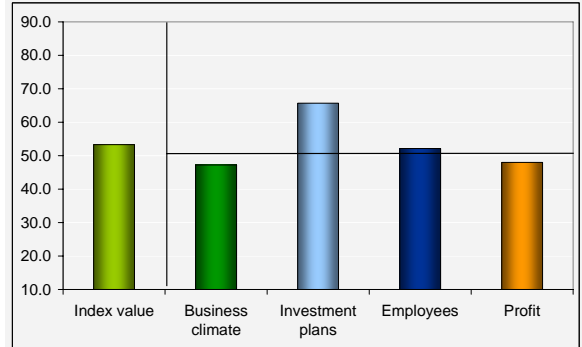
### 11. Main Concerns



### 10. Hedging Strategy



### 12. Main Index



## Financial Data

<b>Macro Data (% changes)</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009 (p)</b>
GDP	10.2	10.7	13.0	9.0	4.5*
CPI	1.8	1.5	4.8	5.9	n/a
Industry Output	11.4	16.6	18.5	12.9	n/a
Exports	28.4	27.2	25.7	17.3	n/a
Imports	17.6	20.0	20.8	18.5	n/a
<b>On-shore deposit rates, major currencies, below 3m USD equivalent</b>					
<b>On-shore interest rates (%)</b>	<b>Current</b>	<b>3M</b>	<b>6M</b>	<b>9M</b>	<b>12M</b>
USD	0.0500	0.4000	1.1000	1.4000	2.0407
EUR	0.1000	0.7500	1.0000	1.1500	1.2500
JPY	0.0001	0.0100	0.0100	0.0100	0.0100
HKD	0.0100	0.8000	1.0000	1.1000	1.1500
<b>RMB Interest Rates (PBOC Regulated)</b>					
<b>PBOC Rate 090318 (%)</b>	<b>&lt; 6M</b>	<b>6M-1Y</b>	<b>1Y-3Y</b>	<b>3Y-5Y</b>	<b>&gt; 5Y</b>
Lending Rates	4.86	5.31	5.4	5.76	5.94
<b>PBOC Rate 090318 (%)</b>	<b>Current</b>	<b>3M</b>	<b>6M</b>	<b>1Y</b>	<b>2Y</b>
Deposit Rates	0.36	1.71	1.98	2.25	2.79
<b>FX Indicative Spot and Forward Rates</b>					
		16/Jun/09	16/Sep/09	16/Dec/09	16/Mar/10
<b>FX</b>	<b>16/Mar</b>	<b>3M</b>	<b>6M</b>	<b>9M</b>	<b>12M</b>
USD/CNY	6.839	6.846	6.848	6.856	6.862
EUR/CNY	8.847	8.861	8.882	8.885	8.918
GBP/CNY	9.621	9.641	9.664	9.685	9.688
JPY/CNY	6.964	6.989	6.994	7.014	7.084
HKD/CNY	0.882	0.884	0.886	0.887	0.888
SEK/CNY	0.806	0.808	0.812	0.813	0.817
DKK/CNY	1.187	1.186	1.187	1.189	1.190
NOK/CNY	1.005	1.002	1.002	1.002	1.004
All indicative rates as per 2009-03-16					
* SEB Forecast, Nordic Outlook February 2009					
For further information please contact SEB Shanghai's Trading Room: stella.peng@seb.se or +86 21 5396 6081					