

China Financial Index

10 Year
Edition

SEB

Significant uptick in new orders for Nordic companies in China

Sales forecast at multi-year high, recruitments and investments adjusted upwards

WEDNESDAY
15 MARCH 2017

SEB'S CHINA FINANCIAL INDEX AT 61.6. Up from 58.6 in September and 56.2 one year ago. **STRONG SALES INCREASE DESPITE UNCERTAINTIES.** Despite of high leverage, currency volatility and increased regulations. Results continue to show that our home-market clients are optimistic about the Chinese business climate.

MATERIAL COSTS NOW A KEY CONCERN. The concern of material costs surges from low levels previously.

SALARY LEVELS AND HIRING PICKUP. Results surprise by showing increased salaries and hiring. The service sector sees higher staffing growth than manufacturing, as expected.

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SUSTAINED OPTIMISTIC BUSINESS CONFIDENCE

In line with economic data published lately, our clients also see an uptick in the business climate and are optimistic about the coming six months. Will this optimism endure? Regardless, our survey continues to show industry specifics with manufacturing still trailing with the usual problems. On the other hand, the service sector again shows increased confidence. This is hardly surprising anymore, as survey results have been showing this for some time and it follows the restructuring of the greater economy. Generally, profit expectations remain unchanged with a majority expecting slight improvements. Findings are similar to one year ago and may also reflect seasonality.

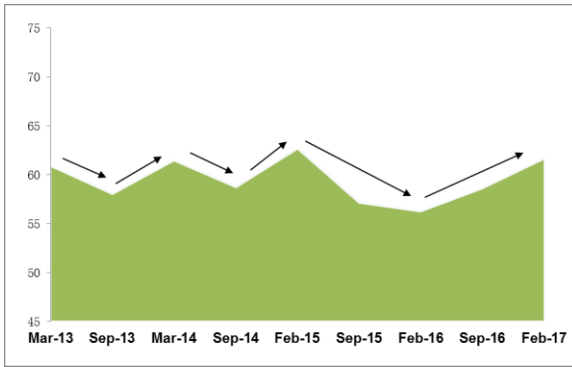
MATERIAL COSTS NOW A CONCERN

A key finding in this edition is the increasing concern of material costs for our corporates. One in four indicated this as their main concern, up from very low levels from the last edition and a year ago. This could perhaps be explained by increasing commodity prices during the last few months, specifically in petroleum, copper and iron ore. Hence sourcing could be contributing to creating profit pressure. However the largest concerns remain customer demand and competition, and have been for many years. Notably in this edition, regulatory concerns stand out as an increasing worry. This is not surprisingly given the increased scrutiny, new approval processes related to cross-border and foreign exchange payments since our last survey.

INCREASING SALARY LEVELS AND HIRING – RISK OF INFLATION

A surprising finding, and opposing the previous survey, is the higher salary levels and hiring. Corporates looking at increasing hiring slightly or significantly is up to 50% from around 30%. At the same time, fewer corporates are looking at decreasing staff. Moreover, our respondents are indicating higher salary growth levels with roughly half saying they will increase salaries by 5-6%, up from one in five. Our survey results of increasing salaries and material costs support the recent data showing higher inflation in China. The inflation rate has been creeping up the last few years, and SEB expects it to average 2.5% in 2017. The official inflation number for China in January was 2.5% and for Shanghai 3.6% (National Bureau of Statistics of China). If inflation pushes up interest rates, that could make debt levels in China difficult to handle – hence financial instability. Referring to SEB Chief Asia Strategist Sean Yokota, the current leverage level in China is definitely a worry, and hard landing risk probability increases with inflation.

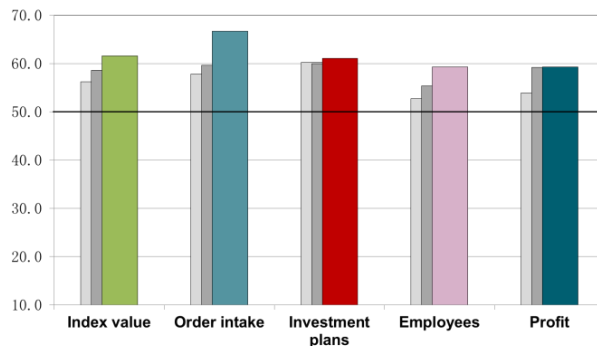
Historical development for SEB's China Financial Index



MODEST INVESTMENTS, WAIT AND SEE

Investments for the coming 6 months increased somewhat, with close to 50% of our responding corporates indicating plans to make new investments, albeit mostly modest. The other half is keeping investments unchanged. No one is expecting to make any divestments. Borrowing needs are also up in this edition, with one in five increasing borrowing. Another thing worth pointing out is the need for hedging, which is significantly down, with almost 50% of respondents indicating no need for hedging their trade exposures. This is slightly surprising, as RMB volatility has increased significantly. There is no evidence in our survey of increasing usage of the RMB, as almost 50% of respondents say they have no plans to use or start using the RMB for invoicing, up from last edition in September.

China Financial Index, March 2017



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

The findings follow recently published statistics. The official manufacturer purchasing manager index (PMI) came in at 51.7 in February, up from 51.0 in January, but much higher compared to a year ago. The official services PMI was 54.2 in February, down from 54.6 in January. The official GDP growth target range for 2017 is around 6.5% down from 6.5-6.7% in 2016. 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

Our responding corporates are still very optimistic about China but the recent uncertainties have somewhat hampered new investments and growth plans. There are some potential signs of increasing inflation as evidenced by higher commodity prices and higher salary growth. In addition material costs are becoming a greater concern. However, companies we speak to continue to hold the view that the Chinese market has high strategic importance, and they remain committed on a long term basis.

Global GDP growth and SEB predictions

Global GDP growth				
Year-on-year percentage change				
	2015	2016	2017	2018
United States	2.6	1.6	2.6	2.6
Japan	1.2	0.9	0.6	0.5
Germany	1.8	1.9	1.8	1.8
China	6.9	6.7	6.6	6.2
United Kingdom	2.2	2.0	1.1	1.2
Euro zone	2.0	1.8	1.8	1.9
Nordic countries	2.3	2.0	2.1	2.1
Baltic countries	2.0	1.8	2.7	3.1
OECD	2.4	1.8	2.1	2.1
Emerging markets	4.0	4.1	4.6	4.8
World, PPP*	3.3	3.1	3.6	3.7

Source: OECD, SEB * Purchasing power parities

MORE CAPITAL CONTROLS, IS CHINA SHUTTING THE BORDER?

Various strict measures marked the end of 2016 with increased regulations of cross-border and foreign exchange related business in China. This is the outcome due to large capital outflows throughout the year including massive outbound M&As and capital flight due to fear of the slowing economy and depreciating currency. This encouraged the authorities to step up controls and stem the capital outflow with new scrutiny, preapprovals and longer processing periods. Hence it is becoming increasingly difficult to move capital out of China; going forward this will impact outbound investments and more importantly confidence towards the greater economy and internationalisation of the RMB. Corporates may be reluctant to invest into the PRC if they cannot get money out of the country. The authorities maintain support for legitimate and compliant overseas investments, but if the downward pressure continues, further tightening is expected. Some say that another large devaluation, as experienced in 2015, could be authorised. As for now,

China appoints new top leaders of the Politburo later in the year, hence keeping the economy and currency stable will be a priority. Reforms and liberalisation are to be put on hold for the time being. This could prove a daunting task with a strengthening greenback and political uncertainty in the US and Europe.

10 YEAR ANNIVERSARY INTERVIEW WITH THE CHINA FINANCIAL INDEX CREATOR – FREDRIK HÄHNEL

- **What was your biggest surprise with the index looking back these 10 years?**
- “The biggest surprise during the past 10 years is that our clients have been so consistently sticking to their China strategy. The mood has gone up and down but very few companies, almost none, ever started to reassess their China strategy or divested or fundamentally changed their expansion plans. Having said that, we have seen a trend among industrial companies to cut down the speed to much more moderate investment plans today than a few years ago.”
- **Looking forwards another 10 years, what do you see the index developing in to?**
- “China will still struggle with overcapacity for many more years to come so I would expect many industrial companies to continue to have slightly lower investment plans, at least in the short term, especially since the strong currency and higher cost base will make it hard for companies to export excess capacity out of China. We also believe many manufacturing companies will try to further increase productivity in the years ahead, as costs in China continue to go up and competition gets fiercer, further trimming staff and investing in automation. For clients in different parts of the consumer goods industry and services, I believe we have another 10 good years of high growth in front of us”.

Survey Results

INFORMATION ABOUT THE SURVEY

SEB's China Financial Index was first launched in 2007 and is based on input in this edition from CEOs and CFOs at 56 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 13 until February 26 2017.

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

Survey results in this edition are showing stronger expectations for the coming six months; respondents continue to see increasing sales which was also observed in the previous edition. Three out of four are expecting significantly or slightly increasing sales, up by 25 percentage points. Noticeably, the number of respondents expecting slightly or significantly decreasing sales is down to less than 10% from 21% previously. Sales are overall slightly more positive compared the last survey and no one indicated significantly decreased sales for the coming six months. We can distinguish industry specifics with more manufacturing corporates expecting decreased sales and corporates in the service industry expecting higher sales. A trend we have seen for a number of years.

The comparison in actual sales for H2-16 to H1-16 indicates that 74% saw slightly or significantly increased sales, up from 61% in September's edition. At the same time, 16% experienced slightly or significantly lower sales figures, which are down from the last survey of 29%. Profit expectations are mainly unchanged, with 61% expecting profits will improve slightly or significantly. Decreasing profit expectations are unchanged to every fourth, indicating slightly or significantly lower profit expectations, consistent with last survey. 21% expect 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. 30% of manufacturing corporates are actually expecting profits to deteriorate slightly or significantly.

When it comes to inventory, results are slightly in favor of an increased inventory; with the majority expecting inventories will either increase slightly or significantly, up from 30%. However, 16% expect slightly lower inventory, which is down from 21%. Inventory levels have stayed relatively unchanged for the last couple of surveys.

(See graphs 1A, 1B, 2 and 9 on page 6 and 7)

SUBJECT: Investment/Acquisition plans

Investment plans are essentially unchanged from last edition, with 54% expecting to maintain the same level of investments and acquisitions. Compared to September's survey, a slightly larger number of respondents are looking at making major investments. Modest investments are unchanged of 38%. Reassuringly for the Chinese economy, none of our responding corporates indicate any divestments. 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 6)

SUBJECT: Employment and salary

Corporate expectations are more positive from the last survey and one year ago regarding expansions in the workforce for the coming six months. 50% of respondents are expecting additional hiring and 41% expect no change, showing a slight increase in hiring. At the same time, roughly one in ten is looking at slightly decreasing staff. We can see that corporates in the manufacturing industry are overall expecting unchanged or even slightly decreasing staffing. On the other hand, more than 60% of responding corporates in the service industry are expecting to make increased hiring. This has also been observed in prior publications.

As new additions to the workforce are slightly increasing, the salary level in China is following suit. 46% are now expecting salary increases of between 5-6%; this is up from 20% in September. This is a significant shift in salary development. At the same time, 13% of respondents are planning to increase salaries by less than 2%, down from roughly 40%. Increased salary levels of 3-4% are up to 29% from 22%. Results are surprising, contradicting the previous findings of decreasing salary levels, which was one of the clear observations in the previous survey.

(See graph 6 and 8 on page 7)

SUBJECT: Funding needs/Lending attitude

Financing needs for participating corporates are slightly up from previous surveys, with almost every fourth expecting increasing borrowing needs. At the same time, 9% expect decreasing borrowing needs, roughly unchanged from one year ago. The vast majority, 68%, see their funding needs as unchanged for the coming six months. The increasing borrowing need is now back at levels we observed in 2015.

When it comes to banks' lending attitude, the optimistic sentiment has marginally decreased in this survey. 34% of all corporates expect lending attitudes from their banks to remain slightly or very favourable, which can be compared to 41% six months ago. The largest share, 61%, expects their banks' lending sentiment to stay unchanged. Notably, respondents expecting slightly or very unfavourable lending

conditions increased from 2% to 6%. This is something we have experienced in previous editions.

(See graph 3 and 4 on page 6)

SUBJECT: FX and RMB usage

Remarkably, in this survey we can detect that less than half of our responding corporates do hedge their trade exposure. This is disputing the previous trend starting two years ago. A decreasing number of corporates (27%) choose to hedge offshore through their head office, down from 44% in the last edition. The share of respondents seeing no need for hedging is up from 29% to 40%, perhaps due to increasing CNY usage. Corporates planning to start hedging is unchanged (13%) compared to six months ago. This is one of the significant discoveries in this edition.

Of the responding corporates, 73% are still expecting the RMB to weaken, most likely due to currency volatility earlier in 2016. This is consistent with similar levels six and twelve months ago. However, the share of corporates expecting the RMB to strengthen is up from 6% to 14%, perhaps indicating a slight appreciation 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. 23% already do so, or plan to begin invoicing all their trade in RMB, which is down from 43% six months ago. Corporates planning to use RMB invoicing to some extent is up to 32% from 25%. However, the share of respondents answering that they will not use the RMB increased from 33% to 45%. Results indicate a surprise compared to previous surveys of lower RMB invoicing and need, which could be partly explained by recent currency volatility and regulations.

(Please see graph 7, 10 and 12 on page 7, 8)

SUBJECT: Main concerns

For the upcoming six months, 32% of corporates in our survey indicate customer demand as the major concern, compared to 38% in the last survey. Competition is still of concern in this edition, at 23%. Added in the previous edition of SEB's China Financial Index, we introduced payment collection as an option of concern. This turned out to be of less importance for the responding corporates, displaying 5% compared to 12%. Another important factor is regulations (13%) up from last edition, which is not surprising given the recent increased regulatory

scrutiny during the last few months. Meanwhile, FX rates marginally decrease in importance for the responding subsidiaries. What stands out in this edition is the concern of material costs which increased to 23% from 6%. This could be explained due to increasing commodity prices

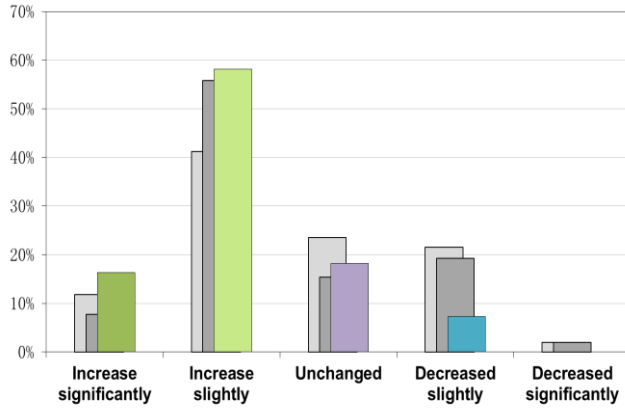
(See graph 11 on page 7)

CHINA FINANCIAL INDEX – COMPOSITION

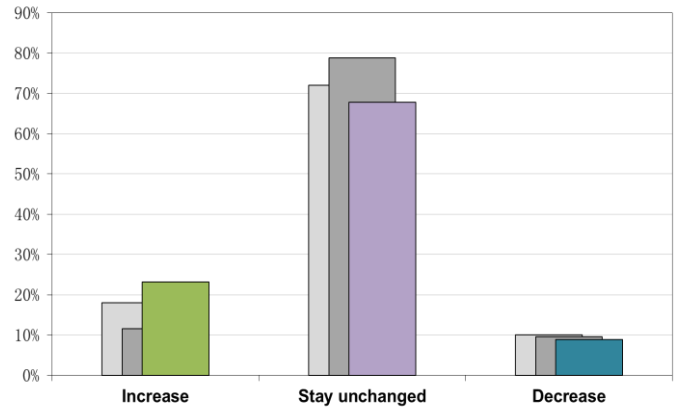
SEB's China Financial Index in March displayed a value of 61.6, indicating an optimistic increase of the business environment compared to previous surveys in September and one year ago.

A value of 50 indicates a neutral view. The index is based on four components, with the following ranking in this survey: Order Intake – 67, Profit Expectations – 59, Investment Plans – 61, and Employment Plans– 59. (See the graph on page 2)

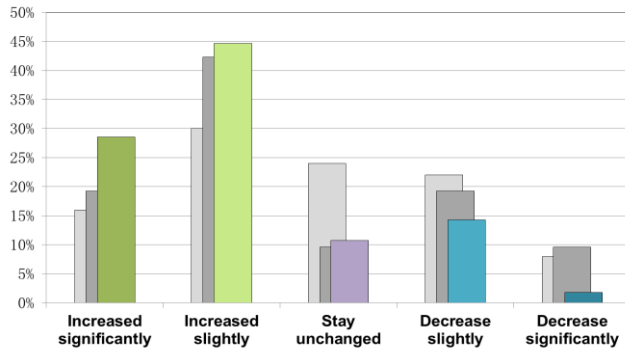
1A. ORDER INTAKE/SALES



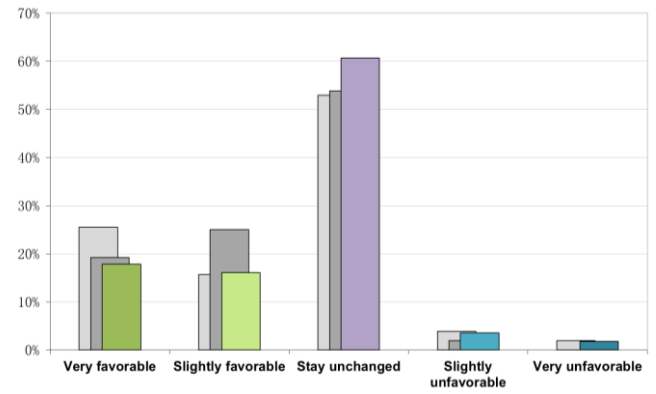
3. FUNDING NEEDS



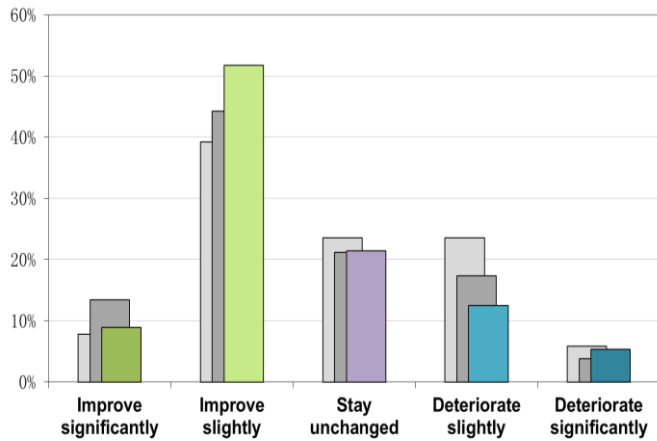
1B. ACTUAL SALES



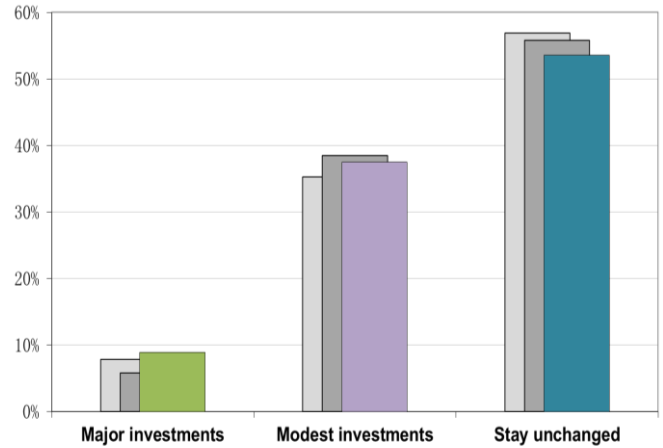
4. LENDING ATTITUDE



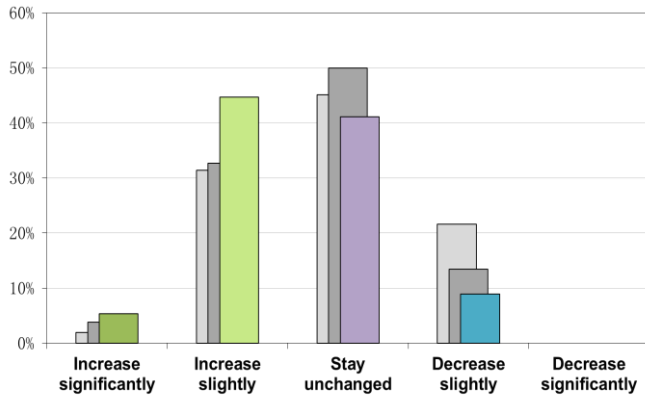
2. PROFIT EXPECTATIONS



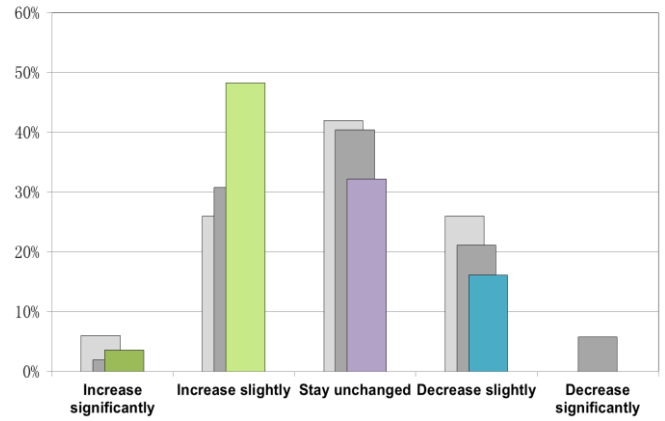
5. INVESTMENT/ACQUISITION PLANS



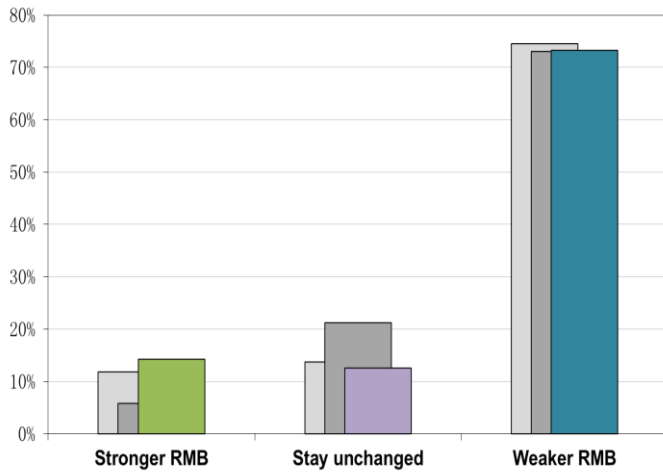
6. NUMBER OF EMPLOYEES



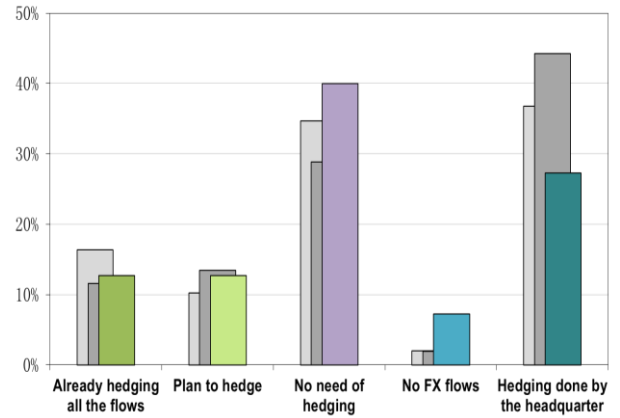
9. INVENTORY EXPECTATIONS



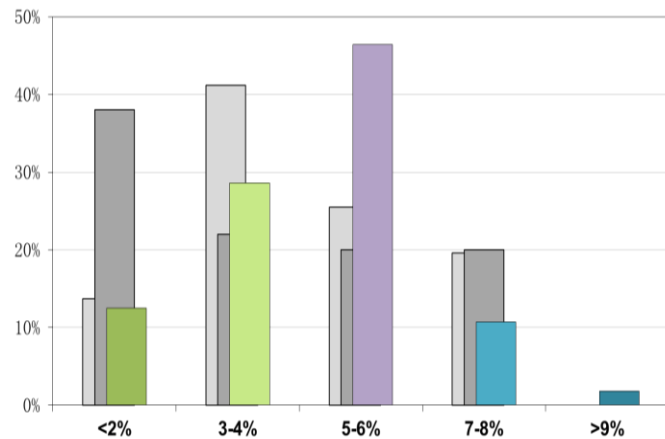
7. RMB EXPECTATIONS*



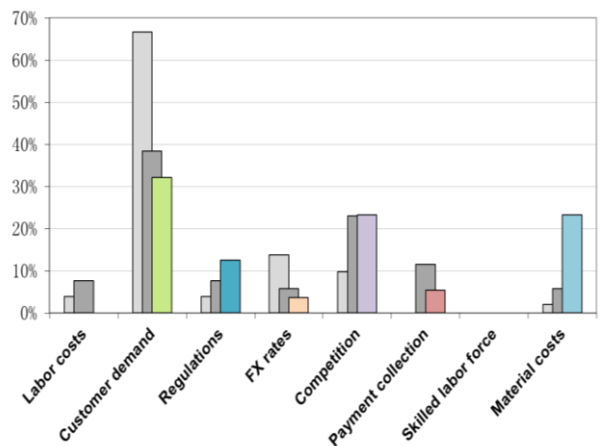
10. HEDGING STRATEGY



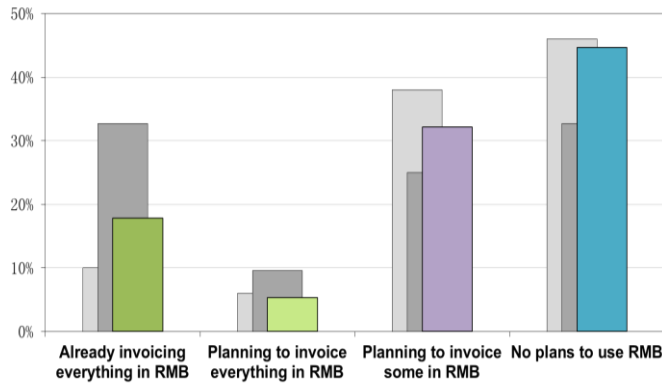
8. AVERAGE SALARY INCREASE



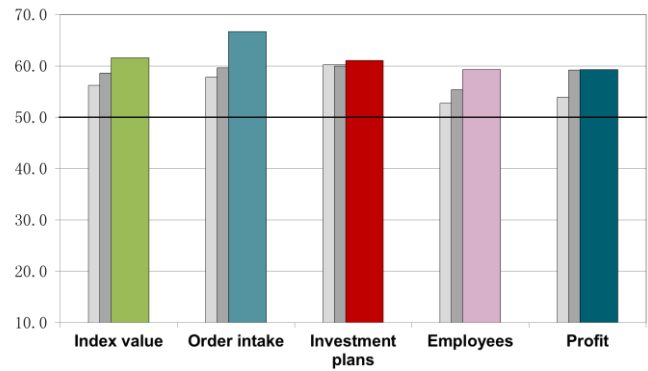
11. MAIN CONCERNS



12. RMB INVOICE



MAIN INDEX



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

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