Spring 2022

China Financial Index

May 18, 2022

- The SEB China Financial Index for the spring falls back to **54.9**, dropping from 60.2 in the previous survey, conducted in December, and down from 61.3 posted one year ago
- As China is battling the largest outbreak of Covid-19 since Wuhan, optimism about the outlook, both in and outside Shanghai, is falling as strict lockdown measures put pressure on production capacity and logistics
- The impact of measures makes corporates adjust their budgets, change business plans, and delay or halt investments in China

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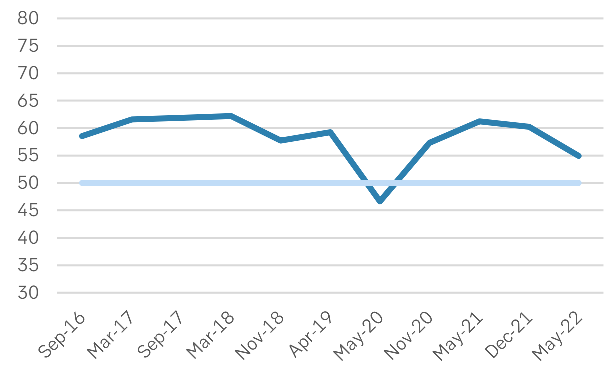
In this Spring edition of the China Financial Index (CFI), the index value decreased to 54.9, based on the survey conducted between 19 April and 11 May. While the overall outlook remains optimistic, this marks the third consecutive decline in the survey set out to measure the views among Northern European corporates doing business in China. As Covid-19 cases surged again in China in the first part of 2022, there is more cautiousness among our corporate client base. Looking back to February 2016, this is the second lowest value recorded, behind the low of 46.6 measured in the survey conducted in May 2020.

Historical trend of the CFI



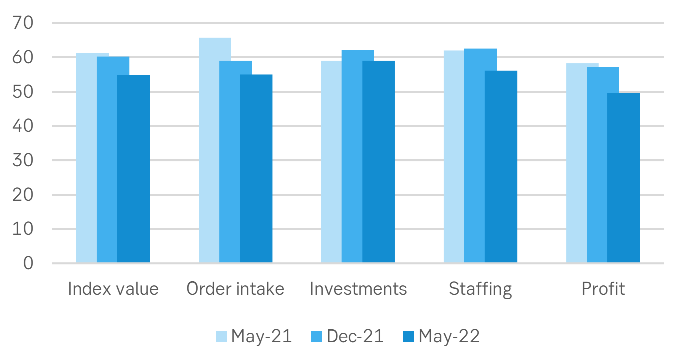
Source: SEB

As China is currently fighting its largest outbreak of Covid-19 since the start of the pandemic, the growth outlook has gradually weakened. Lockdowns and other restrictions are dampening consumer demand and production output, as well as putting further pressure on already restrained local and global supply chains. After two years of keeping Covid-19 largely under control and being able to keep the economy open, the outlook has now gradually turned to lower digits. In Q1, GDP grew more than SEB expected with 4.8% y/y, thanks to a strong start in January and February offsetting lower activity in March.

The Caixin China General Manufacturing PMI for April fell to a 26-month low of 46.0, down from 48.1 in March. The PMI survey also showed the third contraction in factory activity since the beginning of the year, and both output and new orders fell at their second steepest pace since the survey began in early 2004. In dollar terms, exports from China grew 3.9% in April compared to a year earlier, while y/y March data reported 14.7% growth. As China reaffirms its commitment to the "dynamic clearing" Covid policy, it will continue to remain a significant dampener on growth until autumn. SEB's forecast for Chinese GDP growth was recently lowered to 5.0% for 2022 and 5.2% for 2023.

In this spring's survey, all index components decline compared to the previous survey, in line with our expectations. The components falling the most are *Staffing* and *Profit*, dropping from 62.6 to 56.1 and from 57.3 to 49.6 respectively. This is not surprising, as *Order Intake* recorded a large drop in the last survey and, as we argued in the previous report, *Investments* have a more long-term nature than the other components.

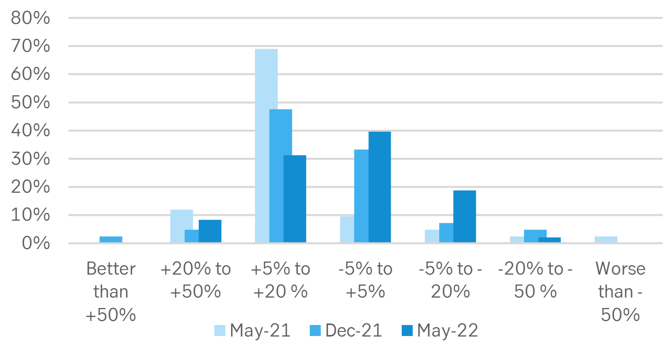
Index values



Source: SEB

As the quick recovery in 2020 becomes more distant and more of the world seems to have come to terms with the pandemic, growth has slowed after a rather strong 2020 and first half of 2021 (at least among our client base). In line with expectations and outlook responses from the last survey, we see that y/y sales for H1 have either flattened or moved more into the -5% to -20% bracket. Yet, 35% are reporting sales growth (not including the +/- 5% bracket). When it comes to the outlook, there is an increase in those expecting sales/order intake to decrease -5% to -20 % over the next six months. Among Shanghai-based corporates, which have been under a strict lockdown since the end of March/beginning of April, 44% expect a -10% to -20 % decrease in sales for the full year 2022 and no one expects a positive financial impact.

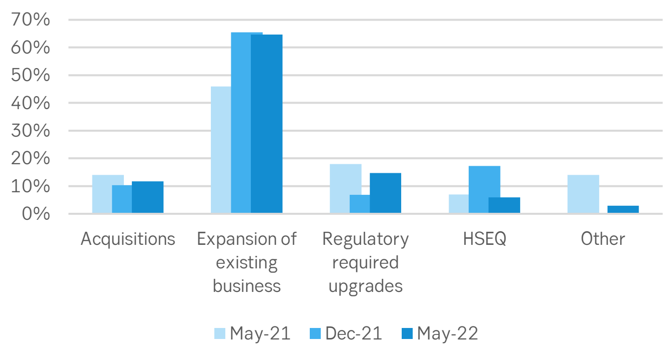
Expected order intake over the next six months



Source: SEB

The investment component falls slightly back, as responses mainly shift from *modest investments* to *unchanged.* Investments continue to be on the agenda. In total, 59% of respondents said that investments will stay unchanged, yet there are 39% that still report either modest or major investments in the coming six months. We may draw some conclusions about this index decrease from our question about the main impact of the resurgence in Covid cases. When asked to list the three main impacts, around 37% replied that they are delaying or halting investments. For the first time since May 2020, there is a mention of divestments. Unless we see a continuation of this in the next survey, we can most likely attribute it to the uncertainties surrounding the epidemic prevention measures and the impact they have on operations.

Nature of investments

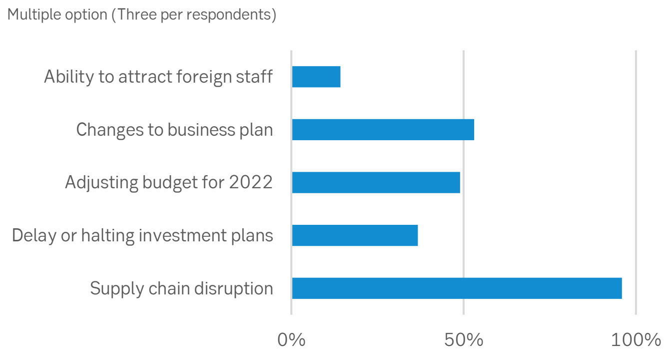


Source: SEB

A vast majority still eye an expansion of their existing business. In total, 65% of the respondents that have investments planned are targeting an expansion of existing business. There is an uptick in responses that are planning regulatory-required upgrades. Whether this is related to new industry regulations or preparatory work to run closed-loop management or other epidemic prevention-related upgrades is unclear. On the staffing side, 10% now report that staffing is expected to slightly decrease over the coming months, but in general there seems to be a more positive/neutral trend among our client base than the overall unemployment numbers. Recent government data from before the lockdown in Shanghai showed a 21-month high of 5.8%.

As China is reaffirming its commitment to the "dynamic clearing" policy, the highly contagious nature of Omicron continues to test the strategy. As mentioned in our previous survey, the policy has had strong support from the population but has evidently had impacts on foreign businesses and the expat population. As the four-day staggered lockdown of Shanghai turned into a lockdown of a more "indefinite" nature, it seems this has trumped the economic costs of the strategy. We asked the respondents to list the three main impacts of the recent resurgence in virus cases and the subsequent restrictions. Almost 100% list disruptions to the supply chain as a main impact. Furthermore, more than 50% are making changes to their business plan, 49% are adjusting their budgets (down), while 37% of respondents are delaying or halting investments in China.

Main impact of the resurgence in Covid-19 cases

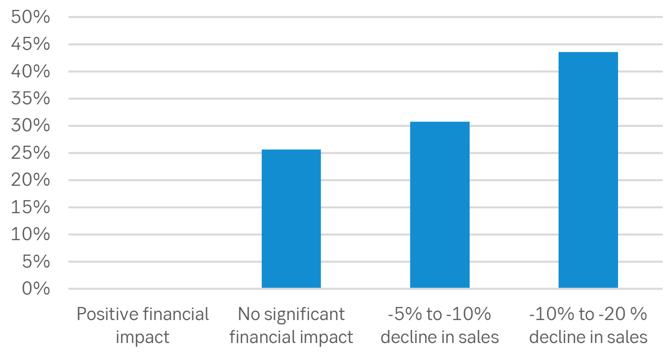


Source: SEB

While industries have been able to operate under so-called *closed loop management,* where staff are able to live and operate in the offices, provided they do not interact with the world outside, this is not a viable long-term solution. Yet, the costs of shutting down production for a long period are also economically challenging. Whether already finding themselves in the situation or planning for possible scenarios, 39% of the survey responds that they will stop operations during a lockdown, 22% would operate under closed loop management, while 33% report that they could run their business fully remotely, with some reporting they could do a mix of closed loop and work from home. Only 7% report that they do not have a plan for this at the time of the survey. It is not expected that a change of strategy will come before the Communist Party's National Congress in the autumn.

Shanghai has taken the spotlight as the main battle arena against the corona virus and is currently going through the most severe lockdown since Wuhan in early 2020. As mentioned previously, there is little optimism about the financial impact of the lockdown in the 2022 figure. Additionally, in a survey targeting the expat population of Shanghai, quoted by Al-Jazeera, 85% of 1,000 respondents said they expect to leave the city within 12 months. The lockdown has accelerated a downward trend, but for foreign (and local) businesses hoping to attract new or replace foreign talent, it might prove more difficult than it was before the lockdowns started.

Expected FY/22 financial impact of lockdown (Shanghai based)

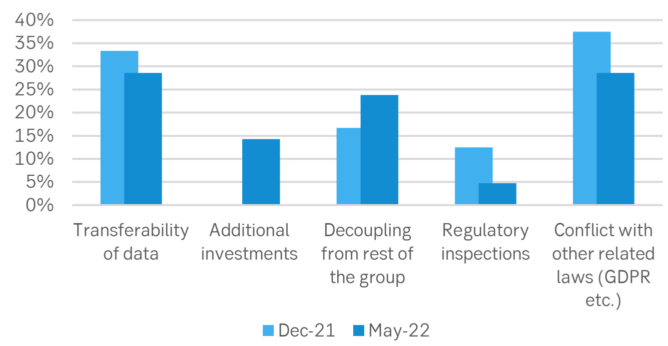


Source: SEB

If we only look at replies from the respondents in Shanghai, the index will fall to an even lower number, 54.2 (vs. 54.9), which is not entirely surprising, given the length and scope of the lockdown. The *Profit* index component among Shanghai-based companies falls as low as 47.6.

On the topic of data and cyber security in China, there is an increase in respondents stating that they are not worried about this, shifting mainly from the *Yes* category. While the resurgence in Covid-19 might have stolen the spotlight, it is interesting to see the changes in the follow-up question, where we asked about the main concern of data and cyber securities. There is a visible shift in responses from *Transferability of Data* and *Conflict with other laws* to *Additional Investments and Decoupling from the Group*. This may suggest that localisation of data infrastructure and a de facto technological decoupling from operations outside of China are being discussed more frequently.

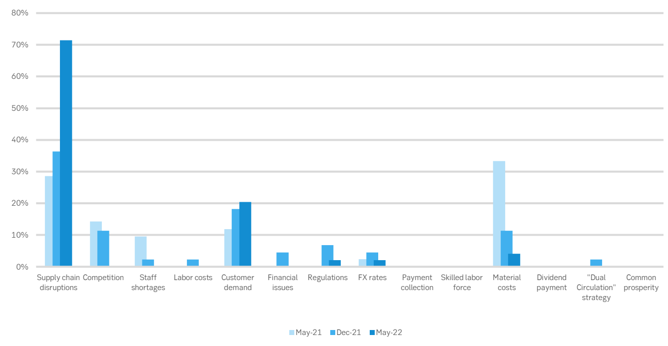
Main concerns related to data and cyber security



Source: SEB

Unsurprisingly, supply-chain disruptions continue to reign as the main concern for corporates over the next six months. A total of 71% ranked *supply-chain* disruptions as the main concern for their operations over the half year. Already congested supply chains have been increasingly stretched due to the Covid-related lockdowns and will spill over to global supply chains and add to inflation. As of the end of April, according to the maritime AI company, Windward, around 20% of container ships globally are stuck in port congestion, with a quarter of them stuck in Chinese ports. Internal movements in China have also proven difficult, as restrictions in cities and across provinces make for challenges moving cargo between the ports and the place of origin/destination, due to epidemic-related restrictions in and outside the closed-loop areas. As for the second and third largest concerns, we see that material costs, regulations, labour costs and payment collections are causing headaches too. Interestingly, payment collection has had limited exposure in this category previously. It is fair to say that this is most likely attributed to the lockdowns, which have also impacted banks' ability to operate, and the subsequent impact it has had on payments. A large number of payments in China are still processed via physical paper applications that, in addition, require a company chop, which might be locked in the operating premises of the company.

What is your main concern over the next six months?



Source: SEB

Our conclusions

The spring 2022 survey of the China Financial Index follows the trend from the previous survey and is also largely in line with similar surveys conducted by various chambers of commerce, business organisations and diplomatic missions. As China battles its largest Covid outbreak since early 2020, the economy has slowed and strict lockdown measures are spilling over to supply chains, not only locally, and putting pressure on forecasts, consequently sending optimism downwards. Yet, commitment to the Chinese market seems to remain and we still clock in on a positive outlook above the neutral index value of 50.

Information about the survey

SEB's China Financial Index was first launched in 2007. In this edition, the index is based on input from CEOs, CFOs or Treasurers at 49 subsidiaries of major Swedish, Finnish, Norwegian, Danish, German, British and Swiss companies. Most of the surveyed companies have a global turnover above EUR 500m. The survey is web-based, confidential and was carried out between 19 April to 11 May 2022.

China Financial Index – composition

SEB's China Financial Index displayed a value of 54.9 in the spring of 2022, indicating a drop in optimism in the business environment compared with the survey in December 2021. A value of 50 indicates a neutral view. The index is based on four components with the following ranking in the survey: Order Intake 55.0, Profit Expectations 49.6, Investment Plans 59.0 and Employment Plans 56.1.

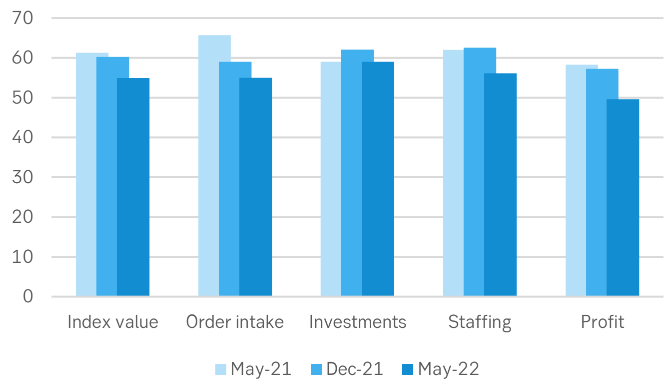
Forecasts, real GDP, % y/y

	2021	2022	2023
China	8.1	**5.0**	**5.2**
India	8.3	**4.3**	**7.5**
Indonesia	3.7	**5.2**	**5.1**
Malaysia	3.7	**6.0**	**4.8**
Philippines	5.7	**6.3**	**6.0**
Singapore	7.9	**4.3**	**3.0**
South Korea	4.0	**2.9**	**2.6**
US	5.7	**2.6**	**1.7**
Eurozone	5.4	**2.1**	**2.8**
Japan	1.6	**2.3**	**1.9**

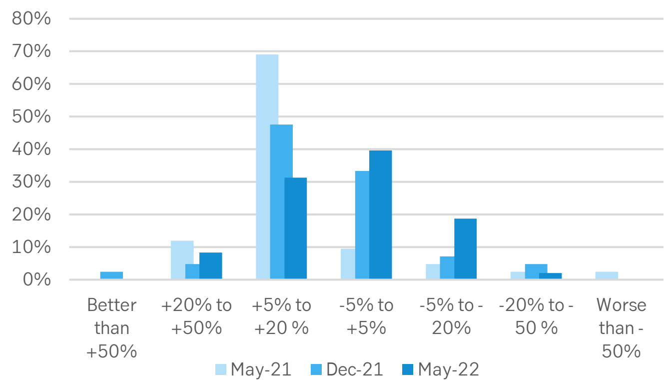
Source: Bloomberg, CEIC, SEB

Please note: The following graphs are all produced by SEB and represent all the questions in the latest China Financial Index as well as historical surveys (if applicable).

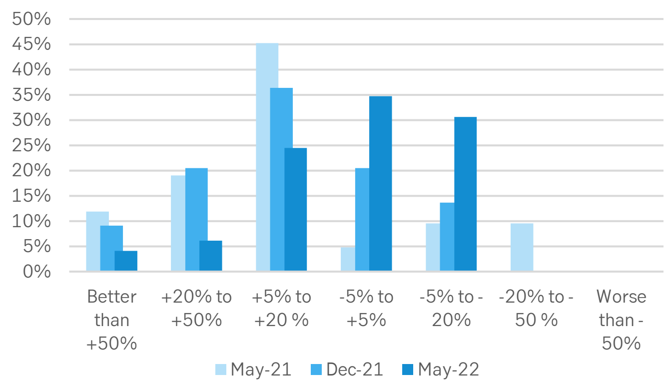
1 – Index values



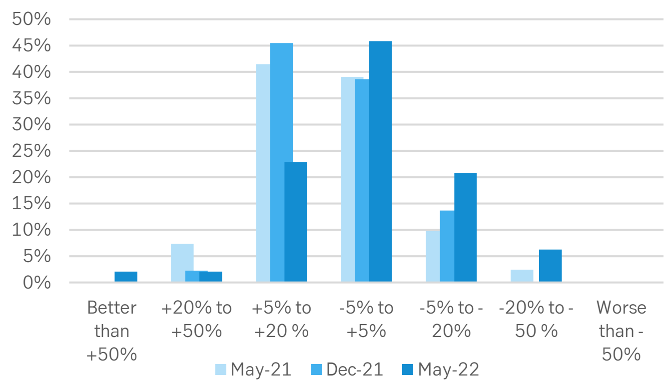
2 – Sales outlook (next six months)



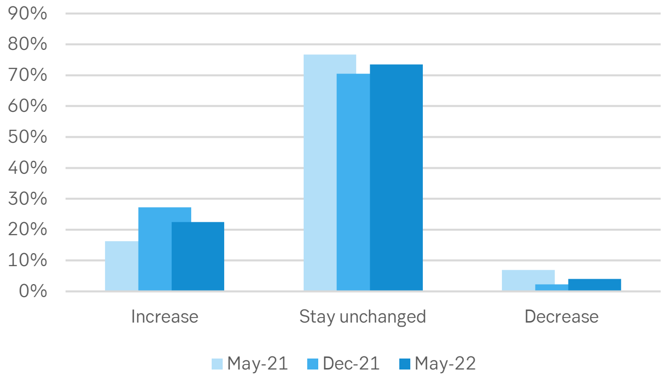
3 – Y/y sales trends (H1/22 vs H1/21)



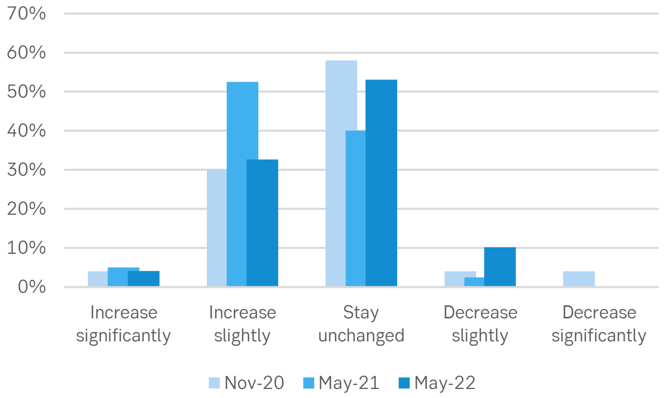
4 – Profit outlook (next six months)



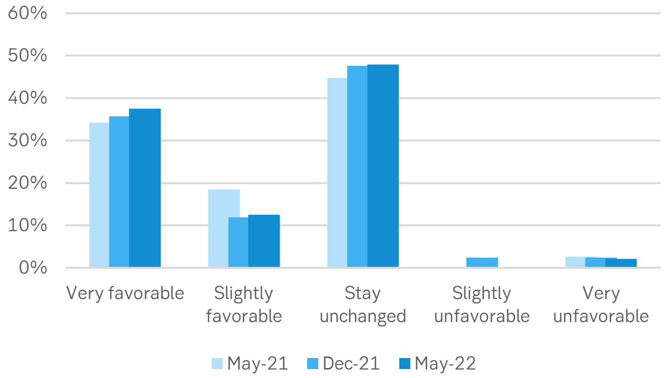
5 – Borrowing outlook



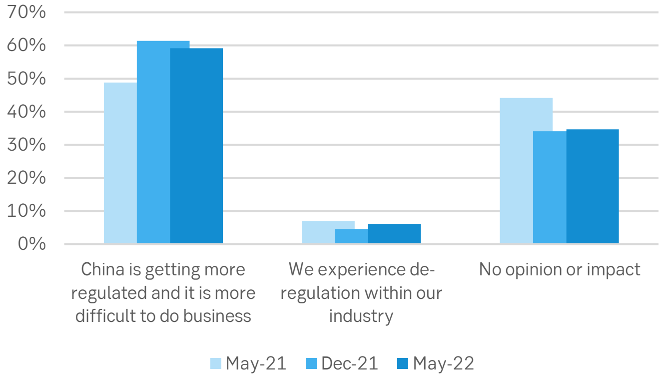
9 – Staffing trends



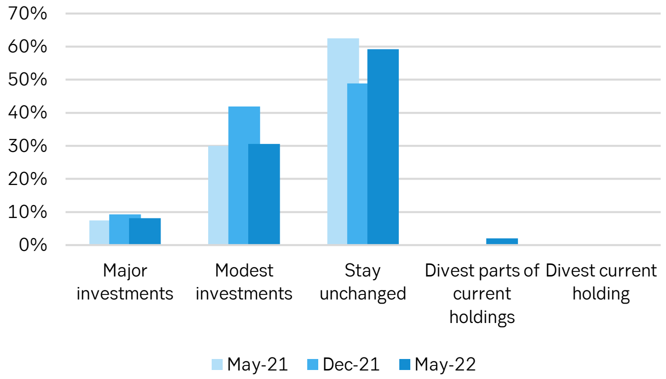
6 – Bank's lending attitude



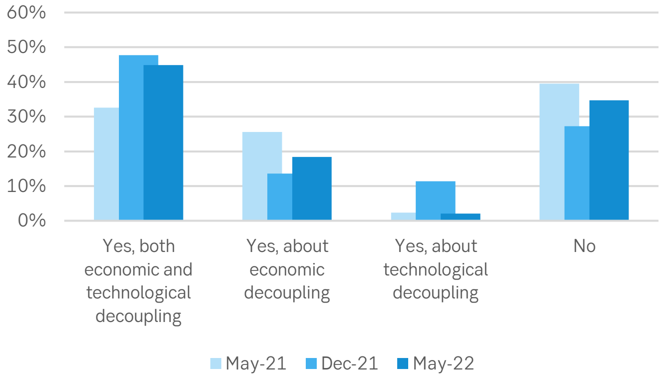
10 – Regulatory trends in China



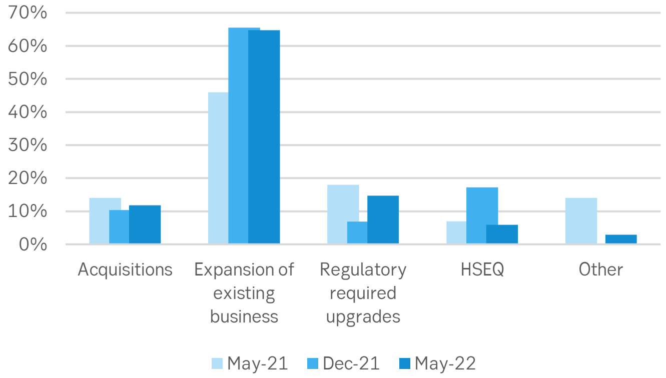
7 – Investment plans



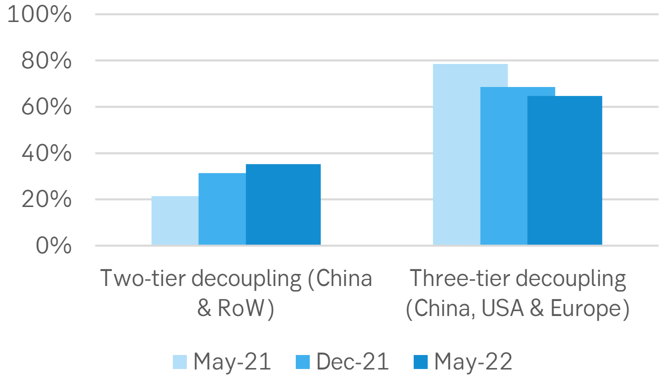
11 – Worried about decoupling?



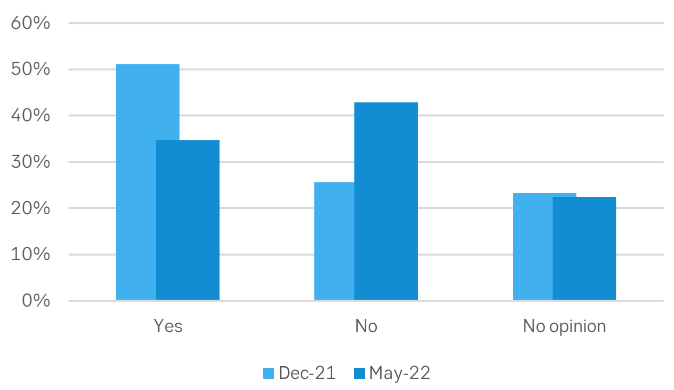
8 – Type of investment



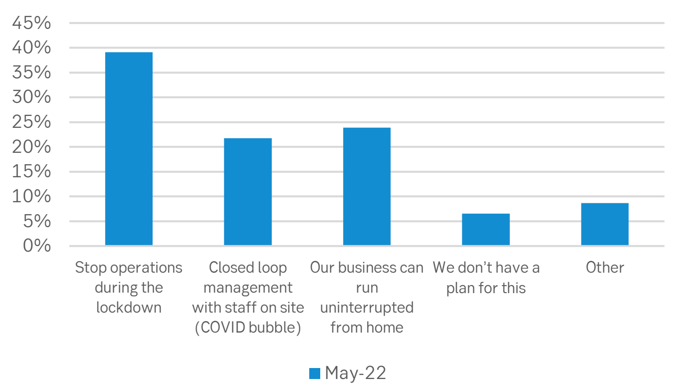
12 – Type of decoupling



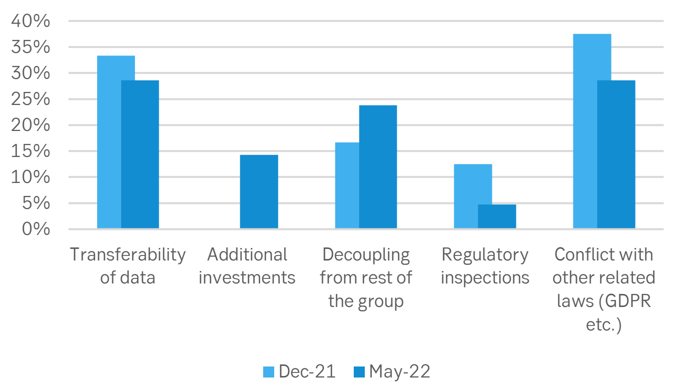
13 – Worried about data/cyber security?



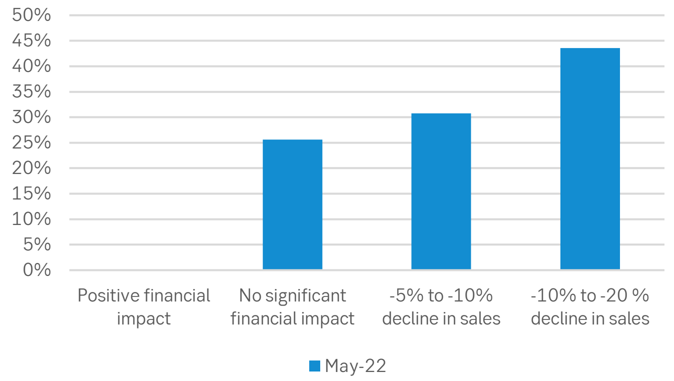
17 – Way of operation during a lockdown



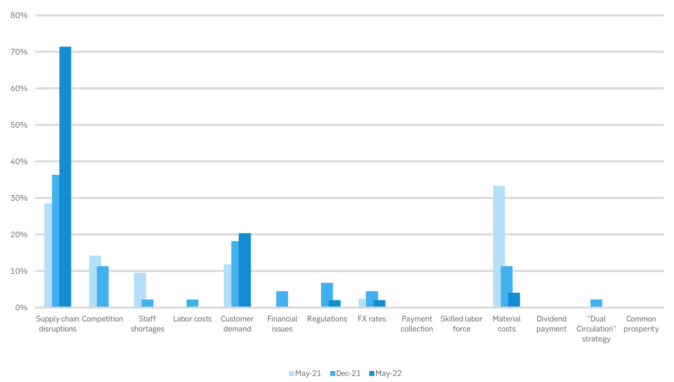
14 – Main concern regarding data/cyber security



18 – FY/22 financial impact on Shanghai-based companies



15 – Main concern over the next six months



16 – Main impact of Covid-19 resurgence

Multiple option (Three per respondents)