

HSBC Emerging Markets Index Press Release

11 January 2011 (Australia)

HSBC Emerging Markets Index

Emerging market growth quickens in Q4 but inflation threatens sting in the tail for 2011 says HSBC index

Key points

- **HSBC Emerging Markets Index rises to 55.7 in Q4 2010, driven by rebound in manufacturing activity.**
- **Rates of growth fastest in Eastern Europe, India and China.**
- **Input cost inflation hits two-and-half year high amid supply chain bottlenecks.**
- **Both emerging market output and new business rise at markedly faster rates in Q4.**
- **Export order growth quickens but remains slower than Q1 peak.**

Summary

Emerging market growth quickened in the final quarter of 2010, rebounding from a temporary lull in the third quarter and accentuating the growth gap between emerging and developed nations, the HSBC Emerging Markets Index (EMI) shows.

But presenting the key risk to growth in 2011, input cost inflation quickened to the fastest level since Q2 2008, highlighting the rapid build up of inflationary pressures across the emerging world first identified in the HSBC EMI for Q1 2010. Surging inflation reflects higher commodity prices, the impact of loose monetary policy in the United States and low stock holdings at suppliers leading to delivery delays and hiked charges.

The EMI rose to 55.7, from a five quarter low of 54.2 in the preceding quarter, above the long-run series average of 54.7. Nonetheless, the pace of expansion remained slower than rates recorded in Q4 2009 and H1 2010.

The uptick in emerging market growth primarily reflects a rebound in manufacturing activity, as service sector growth held steady in the final quarter. Rates of expansion were almost identical across both sectors.

Stephen King, HSBC's Chief Economist, said: "A strong rebound in emerging markets growth from the temporary lull in the third quarter is a resumption of the long-term trend, driven primarily by a broad-based rebound in manufacturing output. As emerging nations increasingly trade with each other, we could be on the cusp of another economic 'golden age', an emerging market version of the extended period of rapid growth seen in the developed world in the 1950s and 1960s, when tariffs fell and international trade blossomed. If emerging nations can work together to remove the still considerable tariffs between them, we could

witness an explosion of world trade on a truly momentous scale."

"The sting in the tail comes from inflation. Not since the food and energy scares seen in the early months of 2008 have the cost and price components of the EMI touched such worrying levels. Whether policymakers in the emerging world can tame inflation is one of the big issues for investors to confront in 2011. With most emerging nations reluctant to significantly raise interest rates and inflate their currencies, attention will turn to the impact of 'quantitative tightening' measures such as Hong Kong and China's recent attempts to restrict the supply of credit."

Manufacturing output rose across Eastern Europe, with the Czech Republic, Poland and Turkey all recording substantial rates of growth in Q4. Both China and India recorded sharp and accelerated rates of expansion that were the fastest in three quarters. In contrast, manufacturing output growth was only marginal in Taiwan and stagnated in South Korea.

The performance of emerging market manufacturers improved in line with an uptick in new export order growth. Of the big-four emerging markets, India recorded by far the strongest increase in new export business. China recorded modest growth (fastest in three quarters), but falling exports were indicated in Brazil and Russia.

Paul Bloxham, HSBC's Chief Economist in Australia and New Zealand, said: "For Australia the trends in the emerging markets index for the final quarter of 2010 are unquestionably good news. The report shows that emerging market growth accelerated in the final quarter of 2010, with increases in China and India in particular, which is positive for Australian exporters. It also confirms that inflation has been picking up in emerging markets as a result of further upward pressure on commodity prices. While this poses a challenge for policy-makers in the emerging economies, it is beneficial for Australia, particularly in the short run, as it further boosts the incomes of Australian commodity exporters and encourages further investment. More broadly, the emerging markets index continues to show that the centre of gravity of global economic activity is shifting from west to east. This trend bodes well for Australia: a small open economy with a vast stock of raw materials that are in high demand from neighbouring countries in Asia."

In the emerging market service sector, activity growth remained substantial in India, despite easing to a four-quarter low. China also recorded a slowdown in output growth (eight-quarter low). Conversely, Russia saw a strong acceleration in growth and despite quickening to a three-quarter high, Brazilian service sector growth remained modest in Q4.

The key risk to future growth, input cost inflation quickened to the fastest since Q2 2008, when global commodity prices peaked before plummeting amid the fallout from the global financial crisis. The input prices index climbed almost six points from the previous quarter, highlighting the rapid build up of inflationary pressures across the emerging world. Manufacturers felt the brunt of higher purchasing costs in Q4, with input cost inflation hitting a ten-quarter high. Service providers recorded a much slower rise in average input prices than manufacturers, but the pace of inflation was still the fastest since Q3 2008.

The Q4 EMI report includes supplementary analysis on the trends identified by the index throughout 2010. Overall, based on the long-term historical correlation between the EMI and GDP, the EMI points to emerging markets GDP growth of 8% per annum in the final quarter of 2010, down from a 9.6% peak rate in Q1.

Domestic and export demand factors have played important roles in explaining divergent national economic growth trends in 2010. The EMI survey data show how domestic demand has helped prop up emerging market growth rates in 2010 while many developed countries have seen domestic demand hit by high unemployment, public sector spending cuts and deleveraging by indebted households.

In a consistent trend throughout 2010, EMI data illustrate that domestic demand in emerging markets has been boosted relative to the developed world by stronger labour markets. However, there are signs that domestic demand in the developed world may soon start to pick up as a result of improving job market data.

As first identified by the Q4 2009 EMI, drivers of the global economy continue to shift to the East as emerging markets become increasingly dependent on trading links with each other, most notably the south-south trade, as analysed by the Q2 2010 EMI. It is these relationships, repaving the old Silk Road in place of traditional links with the developed world, which offer the potential for an emerging markets golden age over the next decade.

The HSBC EMI is calculated using the long-established PMI data produced by global financial information services company Markit. HSBC announced a partnership in 2009 with Markit to sponsor and produce a number of emerging market PMIs.

The HSBC EMI will be released quarterly and is available via:

www.hsbc.com/emergingmarketsindex

The next HSBC EMI will be released on 7 April 2011.

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For further information, please contact:

HSBC

Paul Bloxham, Chief Economist, Australia and New Zealand
HSBC Bank Australia Limited
Telephone + 61 2 9255 2635
Email paulbloxham@hsbc.com.au

HSBC Media Relations

Kate Epworth, Senior Manager Group
Communications
HSBC Bank Australia Limited
Telephone +61 2 9006 5682
Email kateepworth@hsbc.com.au

Notes to Editors:

The HSBC Emerging Markets Index (EMI) is a weighted composite indicator derived from national Purchasing Managers' Index™ (PMI™) surveys in the emerging markets of Czech Republic, Hong Kong, Israel, Mexico, Poland, Singapore, South Africa, South Korea, Taiwan, Turkey, UAE, Saudi Arabia and the increasingly important BRIC economies of Brazil, Russia, India and China. These surveys collectively track business conditions in over 5,800 reporting companies.

The Purchasing Managers' Index (PMI) surveys on which the EMI is based have become the most closely-watched business surveys in the world, with an unmatched reputation for accurately anticipating official data. The survey data are collected using identical methods in all countries, with survey panels stratified geographically and by International Standard Industrial Classification (ISIC) group, based on contributions to GDP.

Survey responses reflect the change, if any, in the current month compared to the previous month based on data collected mid-month. For each of the indicators, a 'diffusion' index is produced, which reflects the percentage of positive responses plus a half of those responding 'the same'. Diffusion indexes have the properties of leading indicators and are convenient summary measures showing the prevailing direction of change. An index reading above 50 indicates an overall increase in that variable, below 50 an overall decrease. All data are seasonally adjusted.

Data collected at the national level for manufacturing and services are then weighted together according to relative contributions to national or regional GDP to produce indicators at the national whole economy or aggregate emerging market level.

HSBC Holdings plc:

Headquartered in London, HSBC is one of the largest banking and financial services organisations in the world. Its international network comprises some 8,000 offices in 87 countries and territories in Europe; Hong Kong; Rest of Asia-Pacific; the Middle East; North America and Latin America. With assets of US\$2,418 billion at 30 June 2010, HSBC is one of the world's largest banking and financial services organisations. HSBC is marketed worldwide as 'the world's local bank'.

HSBC in Emerging Markets:

- HSBC's birthplace was in Hong Kong and Shanghai in 1865.
- HSBC is the leading international Emerging Markets bank.
- In 1H10, HSBC generated PBT US\$7.0bn in Asia, Latin America, and the Middle East.
- HSBC is the leading international bank in mainland China:
 - in 1H10 HSBC generated PBT of US\$1.28bn in mainland China;
 - 105 outlets in 25 cities;
 - 15 Rural Bank outlets opened.
- HSBC is the largest and most widely represented international bank in the Middle East.
- HSBC has one of the largest networks and the second largest international bank footprint in Latin America (15 countries in the region).
 - 5th largest bank in Mexico in terms of assets and 4th in terms of deposits
 - 6th international bank in terms of assets in Latin America

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- o HSBC Brazil is the 6th largest bank in terms of assets and deposits
- o Euromoney Best Debt House, top player in Debt Capital Markets (Mexico, Latin America, Brazil)

HSBC in Emerging Markets (continued):

- HSBC's Global Banking and Markets strategy is emerging markets-led, financing-focused:
 - o 45% of 1H10's PBT of US\$5.6bn was generated in emerging markets;
 - o won key industry awards including 'Best Global Emerging Markets Bank' from Euromoney.
- HSBC has the largest international Commercial Banking franchise:
 - o 3.5m customers of which 52% are in emerging markets;
 - o In 1H10, 62% of PBT was from emerging markets.

About HSBC's data provider

Markit:

Markit is a leading, global financial information services company with over 1,900 employees. The company provides independent data, valuations and trade processing across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency. Its client base includes the most significant institutional participants in the financial market place. For more information please see www.markit.com

Markit Economics:

Markit Economics is a specialist compiler of business surveys and economic indices, including the Purchasing Managers' Index (PMI) series, which is now available for 26 countries and key regions including the Eurozone and BRIC. The PMIs have become the most closely watched business surveys in the world, favoured by central banks, financial markets and business decision makers for their ability to provide up-to-date, accurate and often unique monthly indicators of economic trends.

Chris Williamson, Chief Economist

Telephone + 44 20 7260 2329

E-mail chris.williamson@markit.com

Caroline Lumley, Corporate Communications

Telephone +44 20 7260 2047

E-mail caroline.lumley@markit.com

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