HSBC Emerging Markets Index Q2 2012

Emerging market growth rate abates in Q2 on manufacturing weakness combined with below-trend service sector growth

Key points

- **HSBC Emerging Markets Index eases to 53.0 in Q2 2012 on manufacturing weakness**
- **Two-speed growth picture emerges with Brazil and China lagging India and Russia**
- **Service sector solid, but business activity sub-par as China outperforms other BRIC markets**
- **Cost and price inflation moderating for manufacturers, robust for service providers**
- **Economic uncertainty limits jobs growth across emerging markets**

Summary

Emerging market growth abated slightly in Q2 as a solid performance from the services sector was offset by only modest growth in manufacturing, the HSBC Emerging Markets Index (EMI) shows.

The EMI slipped to 53.0, from 53.6 in Q1. The service sector is still expanding at a moderate rate, although has slowed from the pace seen this time last year. The level of activity in the manufacturing sector is broadly stable as demand from Western economies remains lacklustre.

Among the big-four emerging markets, a two-speed growth picture was evident as expansions were slower in Brazil and China compared with India and Russia. Brazilian activity growth weakened again having looked more promising earlier in the year and China recorded only modest growth. In both cases, manufacturing underperformance was the principal drag on activity.

Global demand for goods produced by emerging market manufacturers continued to weaken in Q2, with new export business decreasing for a second successive quarter. Brazil and China saw new export orders decline in contrast to rises seen for India, Russia, Turkey and South Korea.

Service sector activity grew at a sub-par rate in the second quarter, with the overall expansion among the weakest recorded in the past three years. This reflected slower growth in Brazil (weakest in three quarters), India and Russia (slowest since Q1 2011). China meanwhile recorded a solid expansion that was the strongest in one-and-a-half years.

Murat Ulgen, HSBC's Chief Economist for Central and Eastern Europe and sub-Saharan Africa, said: *"Despite a deceleration, emerging economies remain resilient to yet another false dawn in the developed world. The deepening of the eurozone crisis, disappointing U.S. activity and a slowdown in non-eurozone countries has seen developed growth figures revised down yet again. However, this quarter there is a visible slowdown in the emerging giants comprising the majority of the BRICs, exacerbating a year-long pattern of below-trend growth rates for the emerging world.*

"The manufacturing sector remains the greatest drag on activity, which still remains considerably below pre-crisis levels despite an improvement on the first quarter of 2012. Flat growth for new orders and a contraction in new export orders in manufacturing attest to the global economic challenges. Despite being slightly lower in the second quarter, service sector growth has proved its resiliency by outpacing the manufacturing sector for more than a year now, albeit at markedly lower levels to pre-crisis averages. Current levels of business activity are responsible for a lack of confidence in employment conditions, with the first job-shedding in the Chinese economy since the global crisis a particular concern.

"Softer growth and inflation outlook offers room for policymakers to stimulate growth. China and Brazil are leading in this regard and we would expect further action around policy rates, reserve requirements and fiscal policy. The protracted nature of the eurozone crisis will continue to pose strong headwinds for the emerging economies with financial deleveraging and export trade channels providing powerful undercurrents dragging down economic performance of emerging markets. That said, emerging market growth remains resilient in the face of excessive external uncertainties and with plenty of ammunition at their disposal to deploy, they are set to stay on the right track."

Looking ahead, emerging market service providers remain confident about the one-year business outlook, with the degree of optimism the highest in two years. However, the extent of positive sentiment remains lower than in any quarter prior to the onset of the financial crisis. Of the big-four emerging markets, service sector optimism was strongest in Brazil and India.

As commodities and crude oil prices continued to fall, the EMI revealed a further moderation in input price inflation for manufacturers, which they largely passed on to customers in response to weak demand conditions. Service providers, in contrast, saw a stronger rise in input prices than in Q1 and continued to hike selling prices, extending the current period of higher charges to 12 quarters.

With new business growth remaining muted in Q2 and against a backdrop of increased global economic uncertainty emanating from the euro area debt crisis, emerging market companies remained hesitant with regards to hiring in both manufacturing (renewed decline) and services (muted levels of job creation). China was the only one of the big-four emerging markets to record a decline in employment overall, with the fall the first in 13 quarters.

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 is released quarterly and is available via:

www.hsbc.com/emergingmarketsindex

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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.

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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 32 countries and also for key regions including the Eurozone. 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.

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