HSBC Holdings plc

China economy

HSBC
The world's local bank

Presentation by Qu Hongbin

Co-Head of Asian Economic Research, Chief China Economist

Forward-looking statements

- **This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in our Interim Report. Past performance cannot be relied on as a guide to future performance.**

This presentation contains non-GAAP financial information. Reconciliation of non-GAAP financial information to the most directly comparable measures under GAAP can be found in HSBC's 2010 Interim Report in the Operating and Financial Review.

Policy tightening works

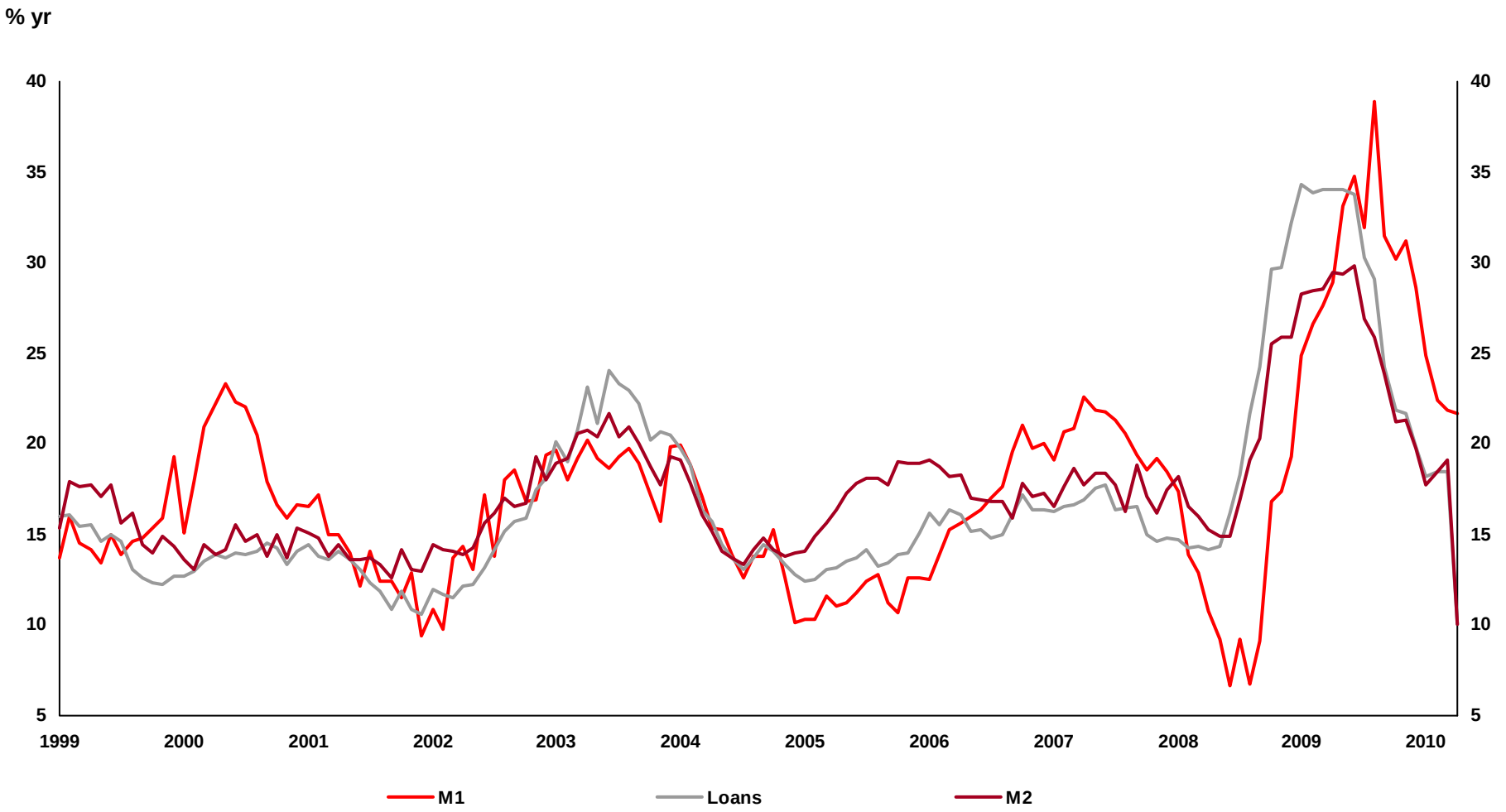
HSBC
The world's local bank

Quantitative tightening works

- **Three reserve ratio hikes**
- **Curbs on new lending (RMB7.5 trillion vs RMB9.6 trillion in 2009)**
- **New rules on local governments' financing vehicles**
- **Property cooling measures**
- **Capacity reduction in energy-intensive sectors**

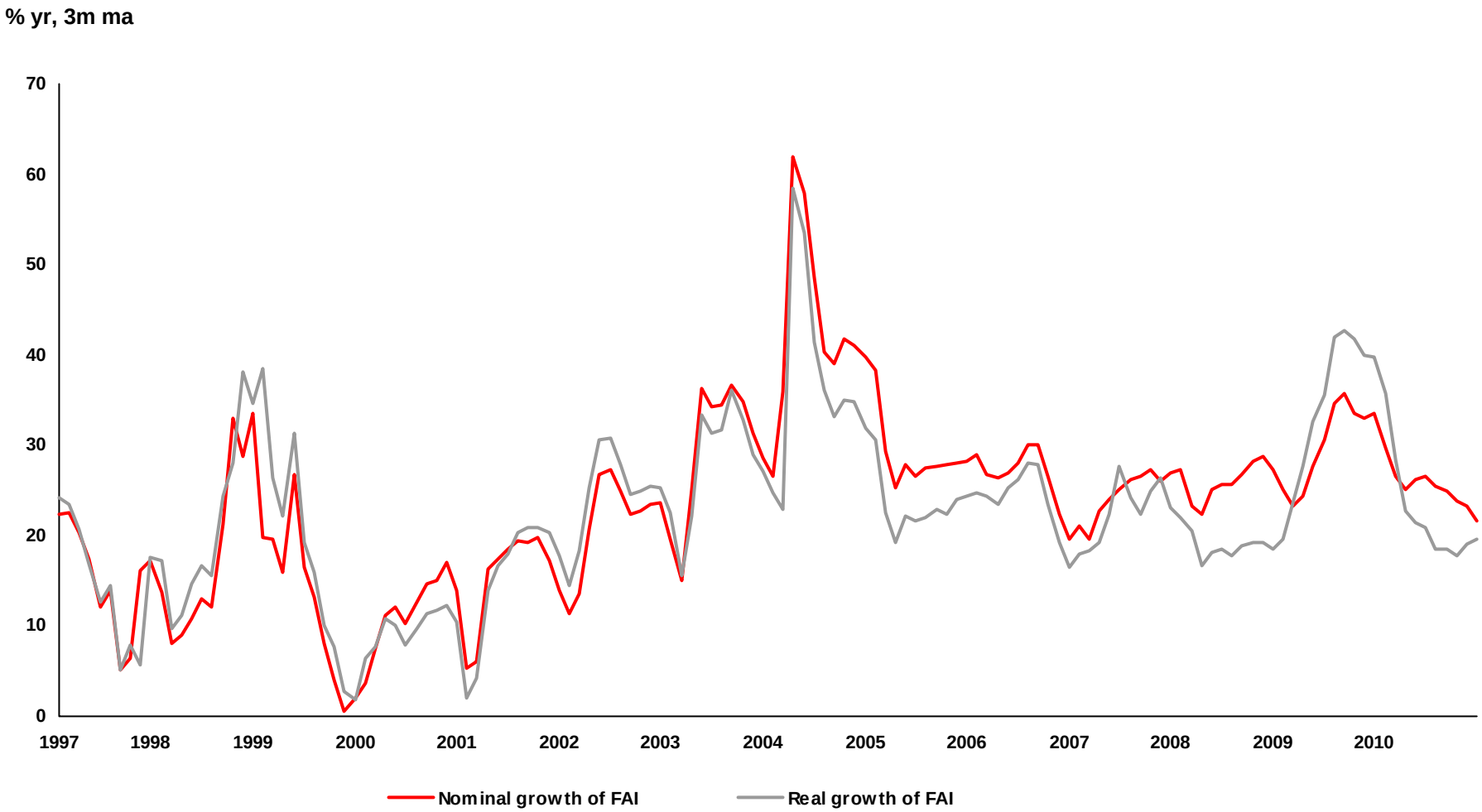
Source: CEIC, HSBC

Credit growth is slowing



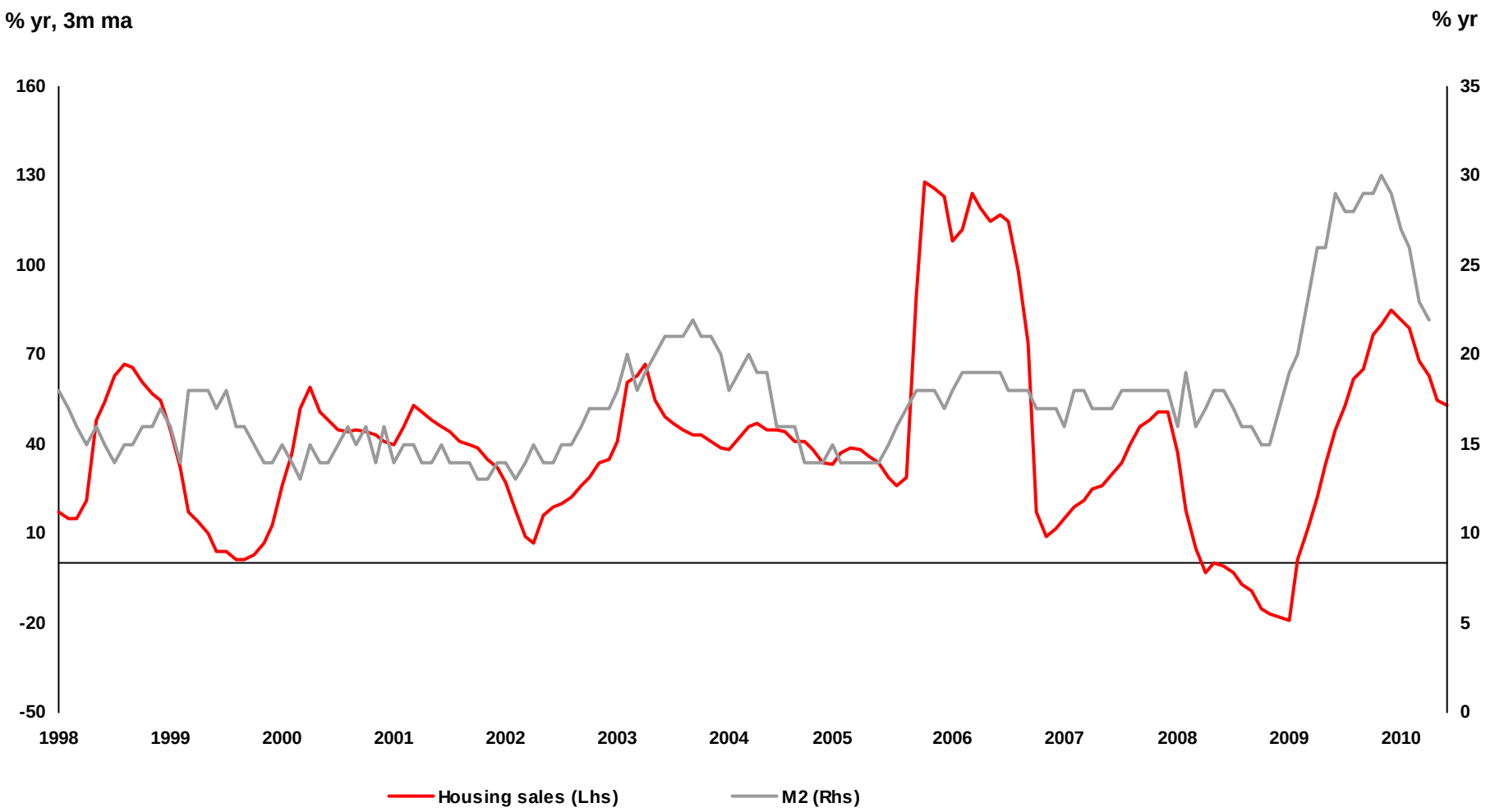
Source: CEIC, HSBC

Infrastructure boom is also cooling…



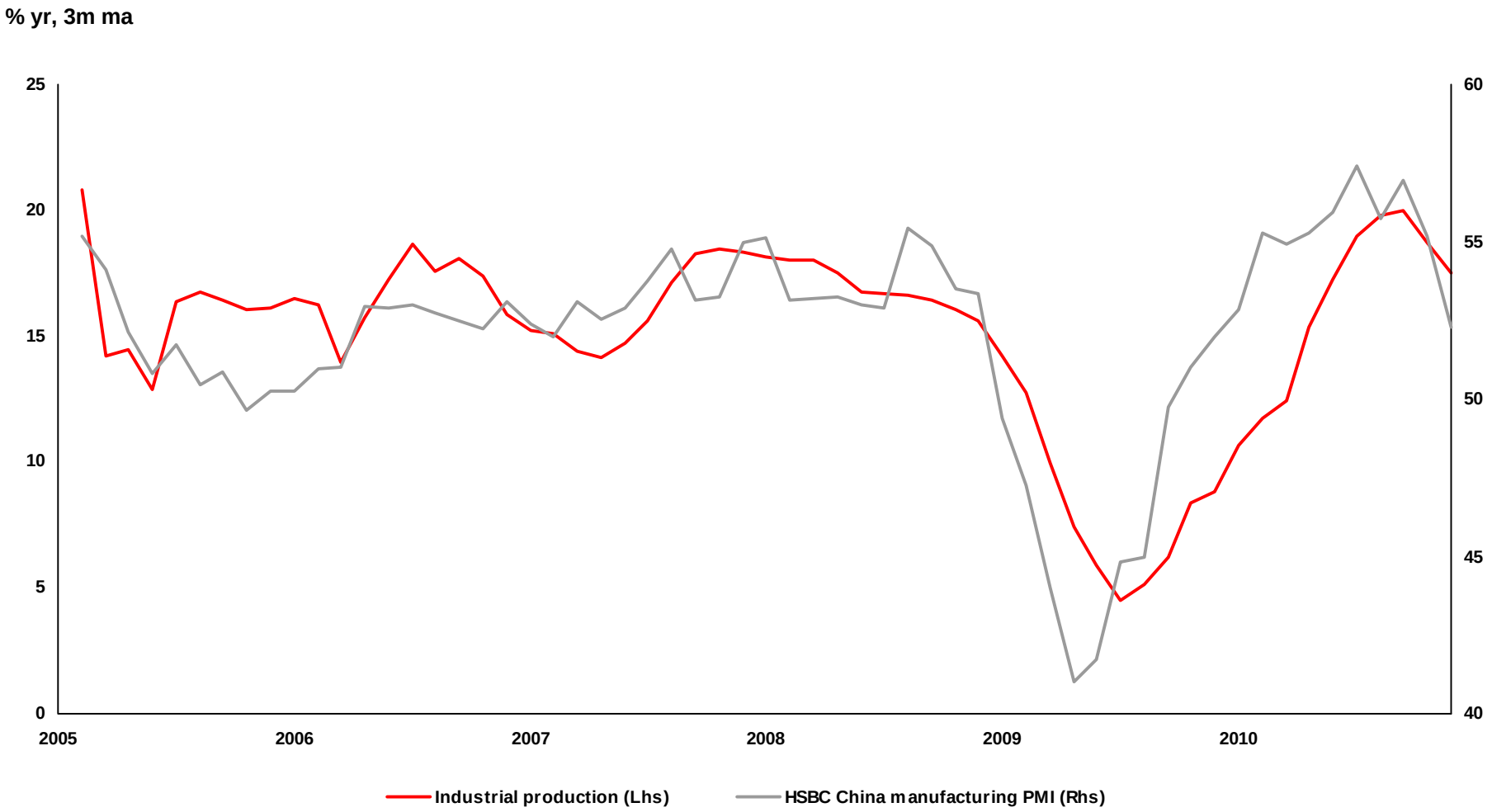
Source: CEIC, HSBC

…so is the overheated property market…



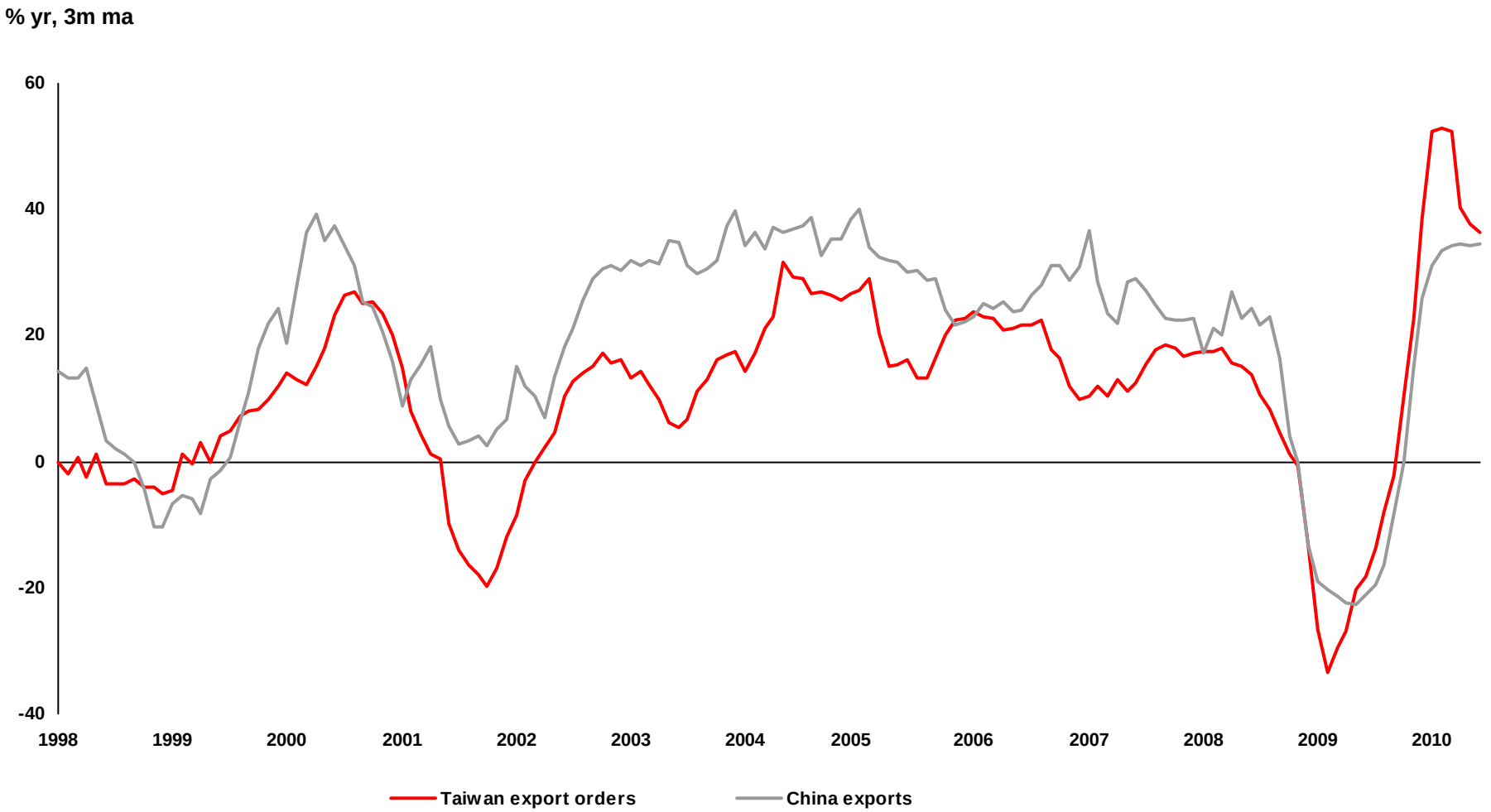
Source: CEIC, HSBC

Industrial production is also moderating…



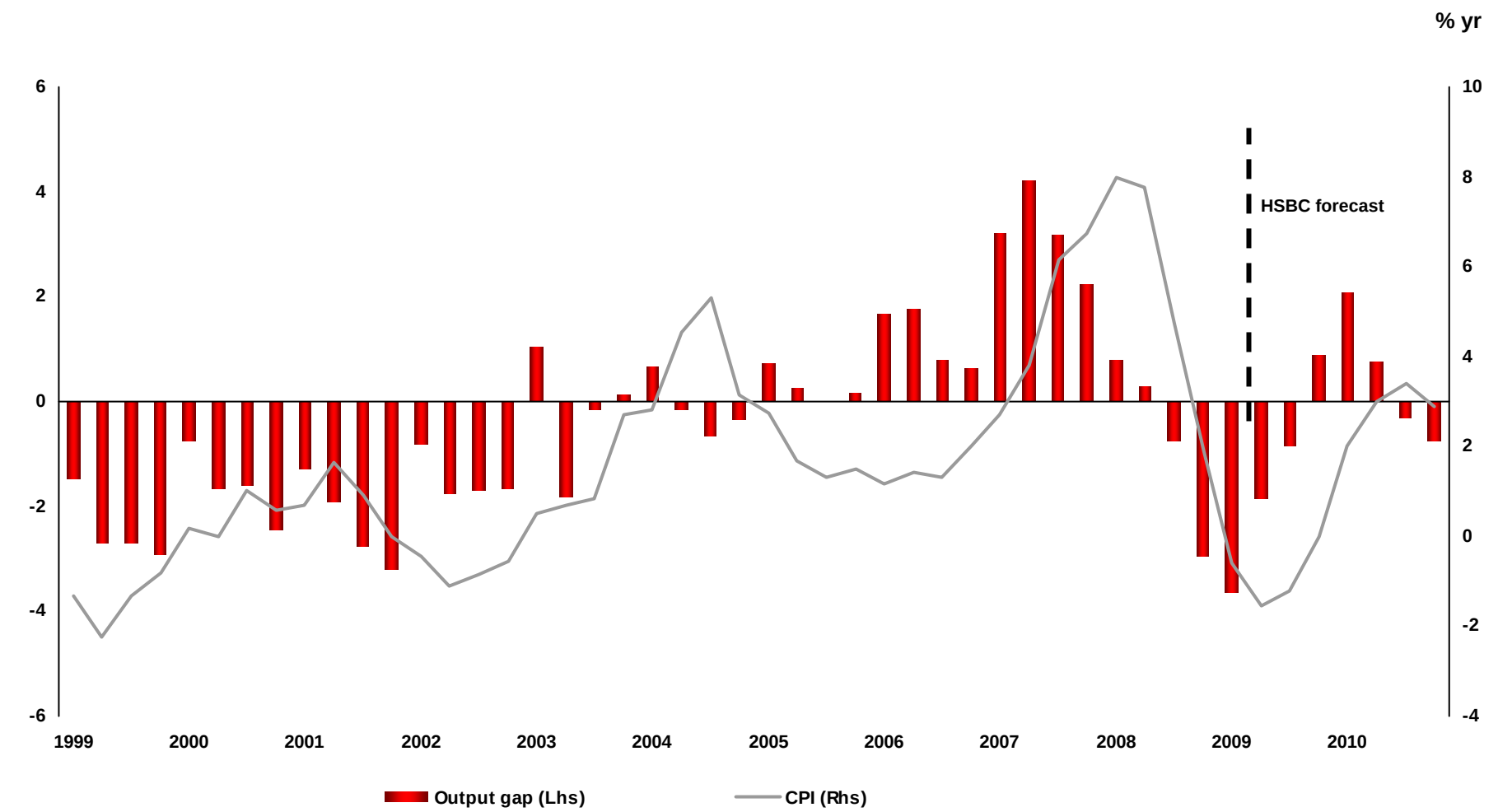
Source: CEIC, Markit, HSBC

…and exports next



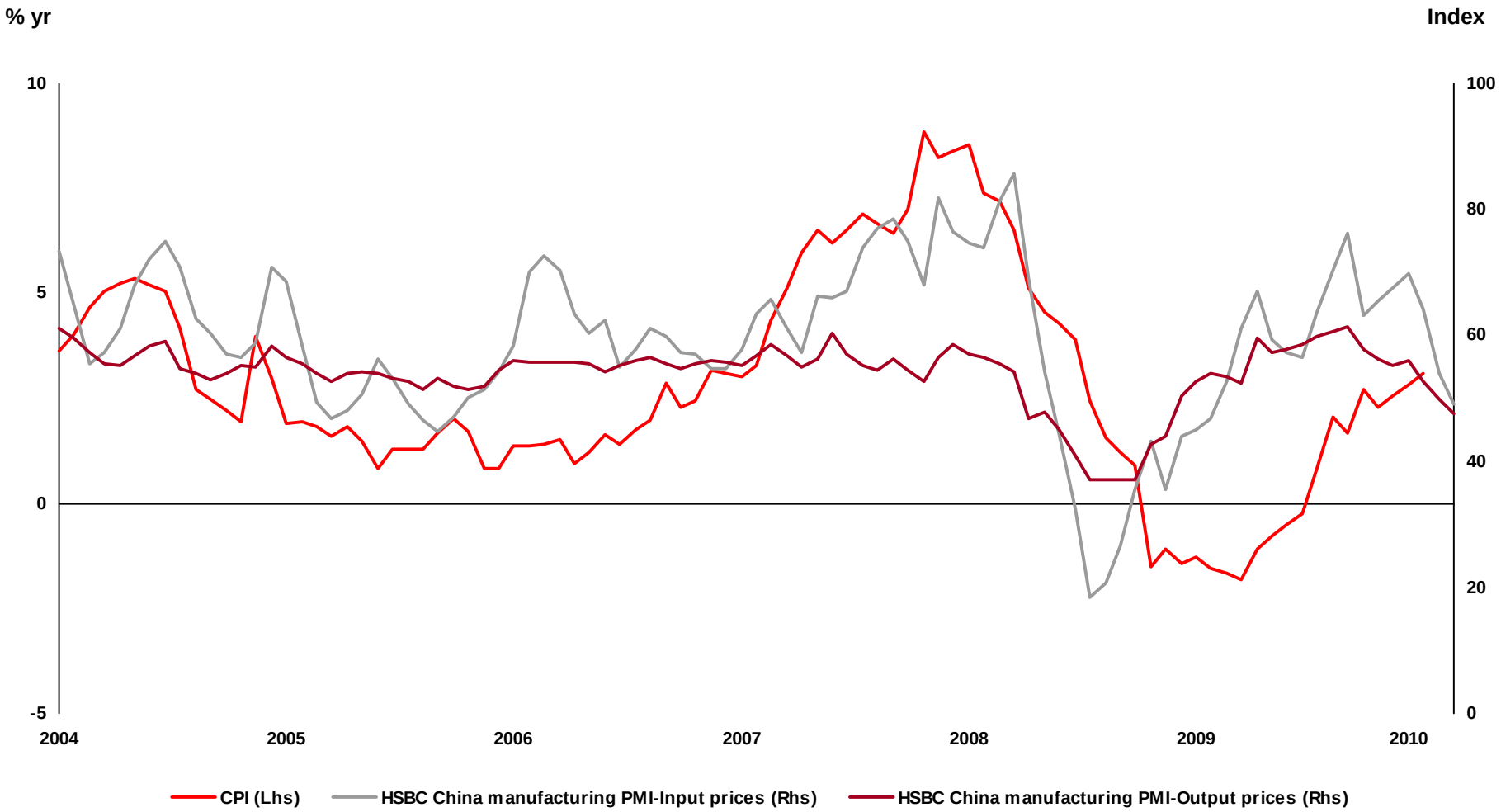
Source: CEIC, HSBC

Taking the heat out of the economy is crucial to contain inflation



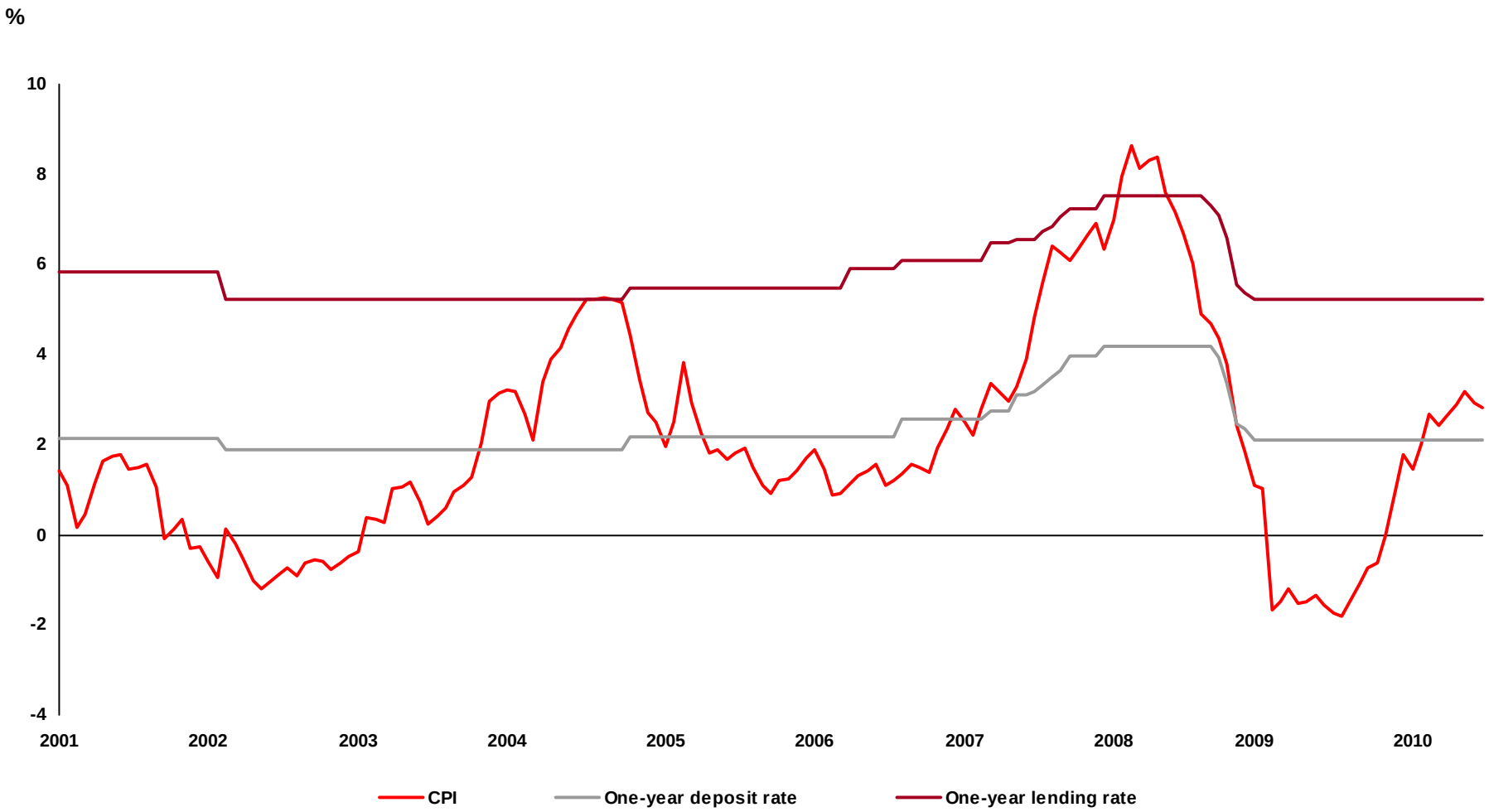
Source: CEIC, HSBC

CPI inflation should peter out in the coming months



Source: CEIC, Markit, HSBC

No need for further tightening

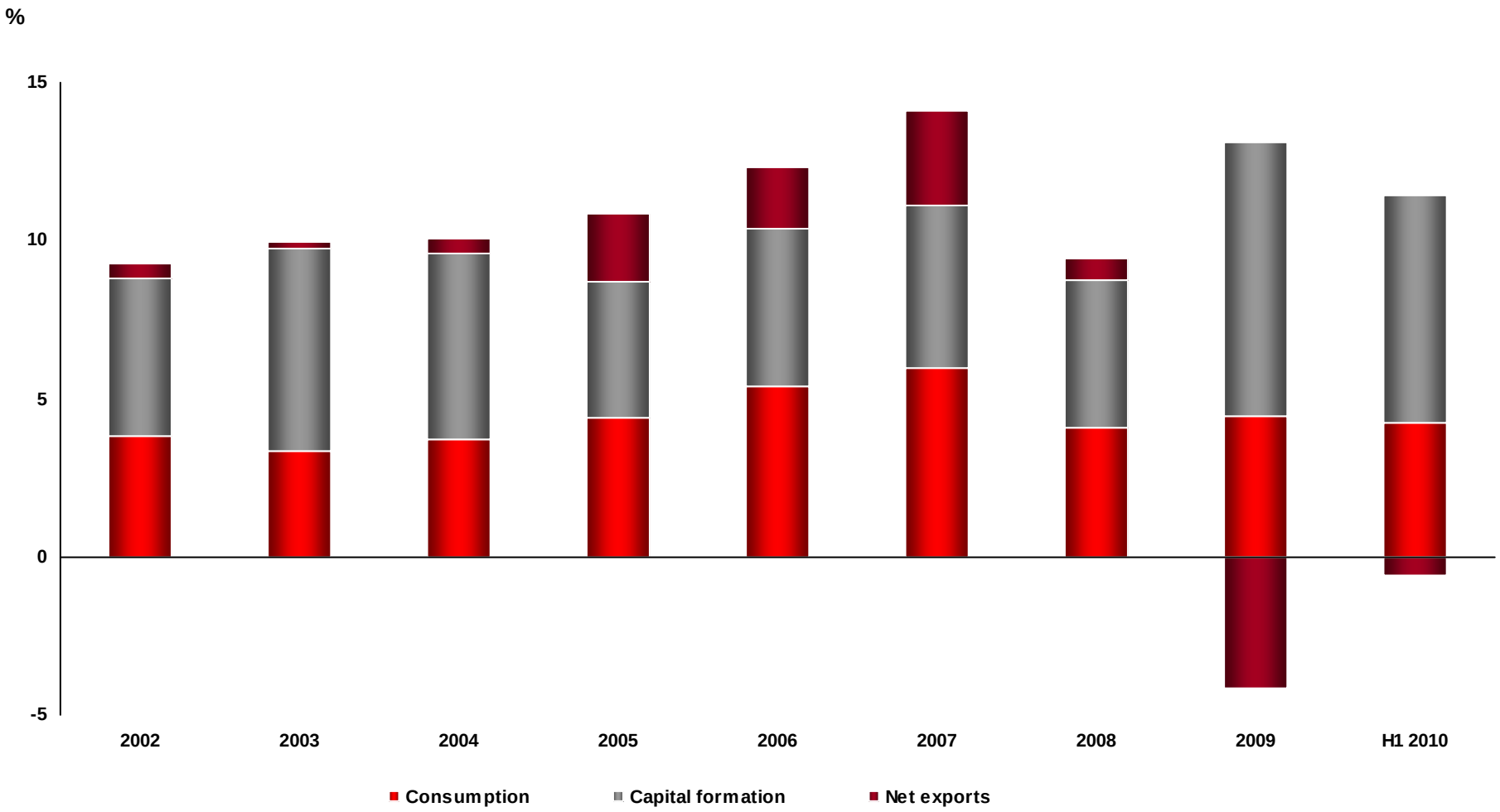


Source: CEIC, HSBC

No double-dip

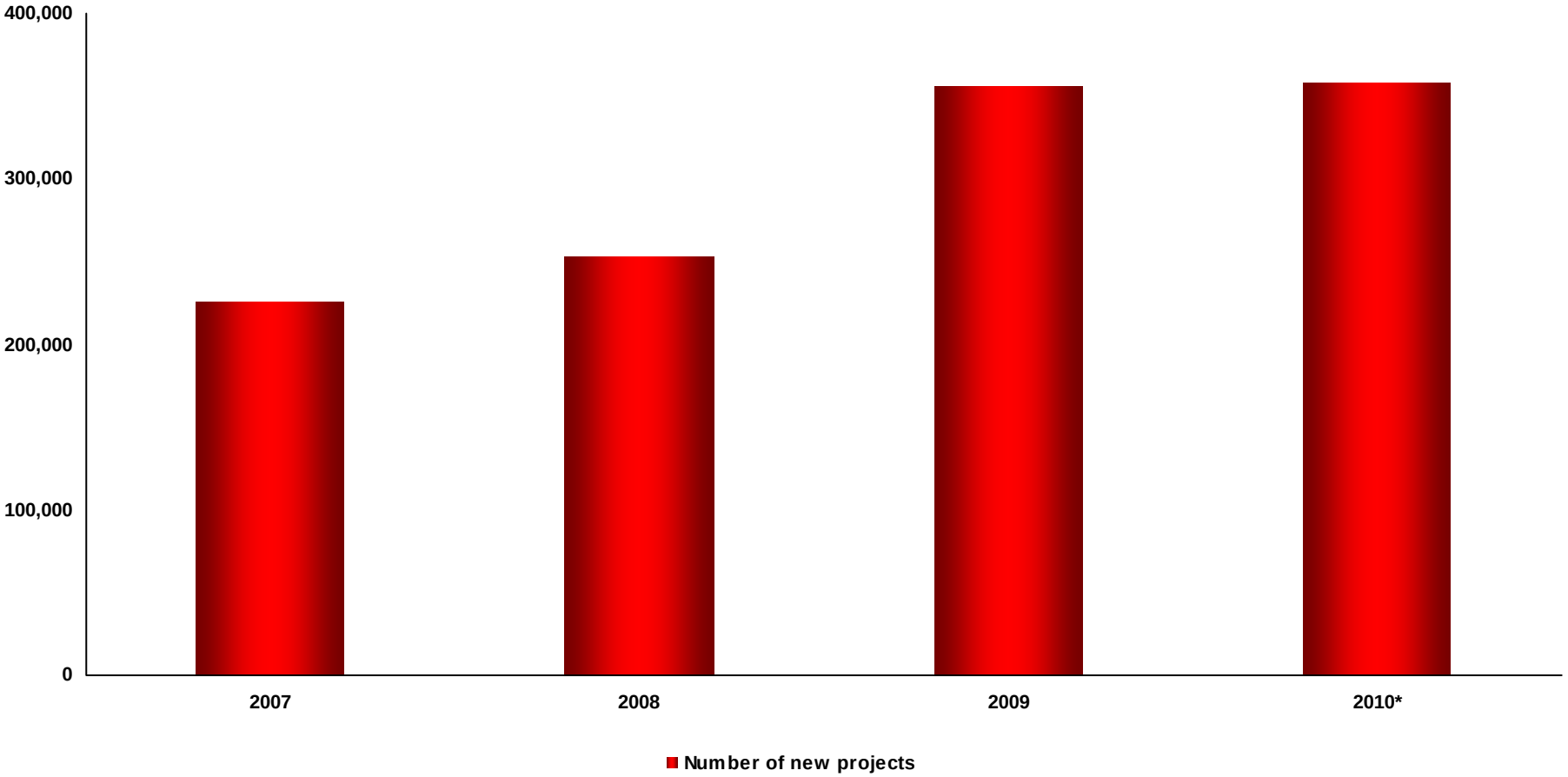
HSBC
The world's local bank

Domestic demand, not exports, has been driving growth recovery



Source: CEIC, HSBC

Continued investment in 100,000 ongoing infrastructure projects will cushion the investment slowdown

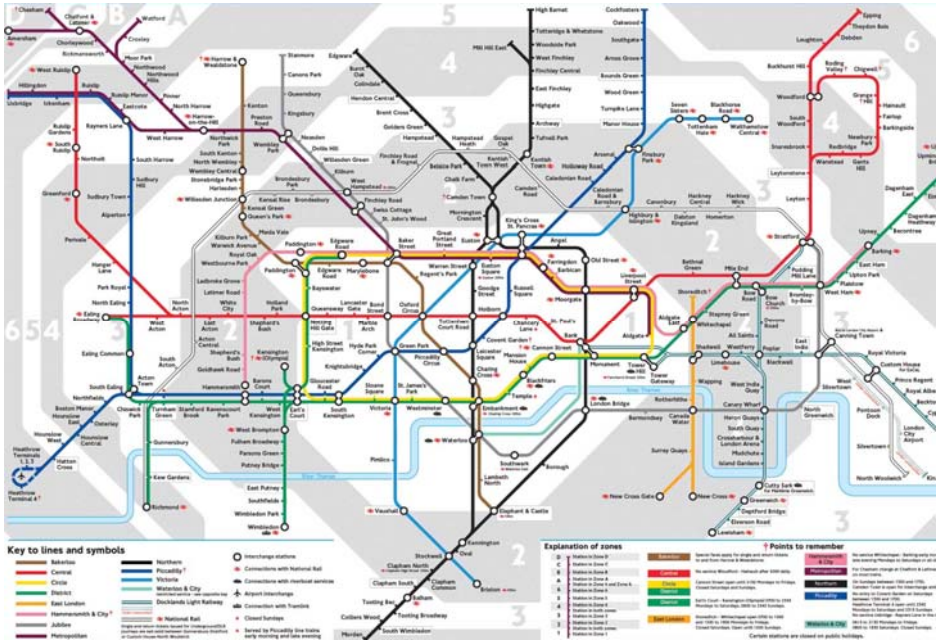


Source: CEIC, HSBC. * Annualised based on January-July data

What overcapacity?

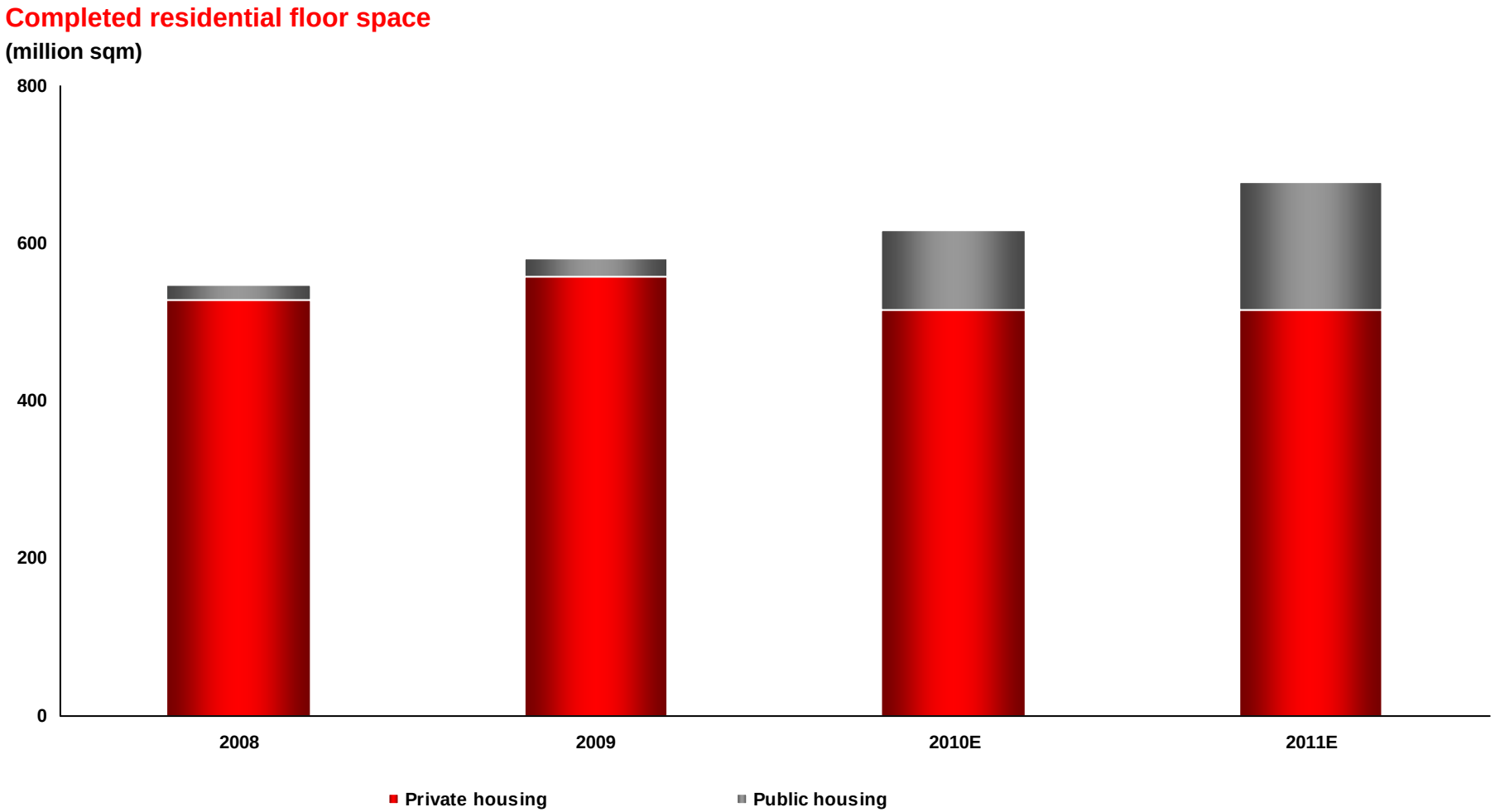
Beijing Subway

London Underground



Source: www.bjsubway.com, www.tfl.gov.uk

Construction of public housing to speed up



Source: CEIC, HSBC

Deregulation rules to lift private investment

- **Infrastructure construction**
- **Social and cultural areas including healthcare, education and vocational training and social welfare, culture, tourism and sporting industries**
- **Financial services**
- **Commercial wholesale and retail business and logistics**

Source: CEIC, HSBC

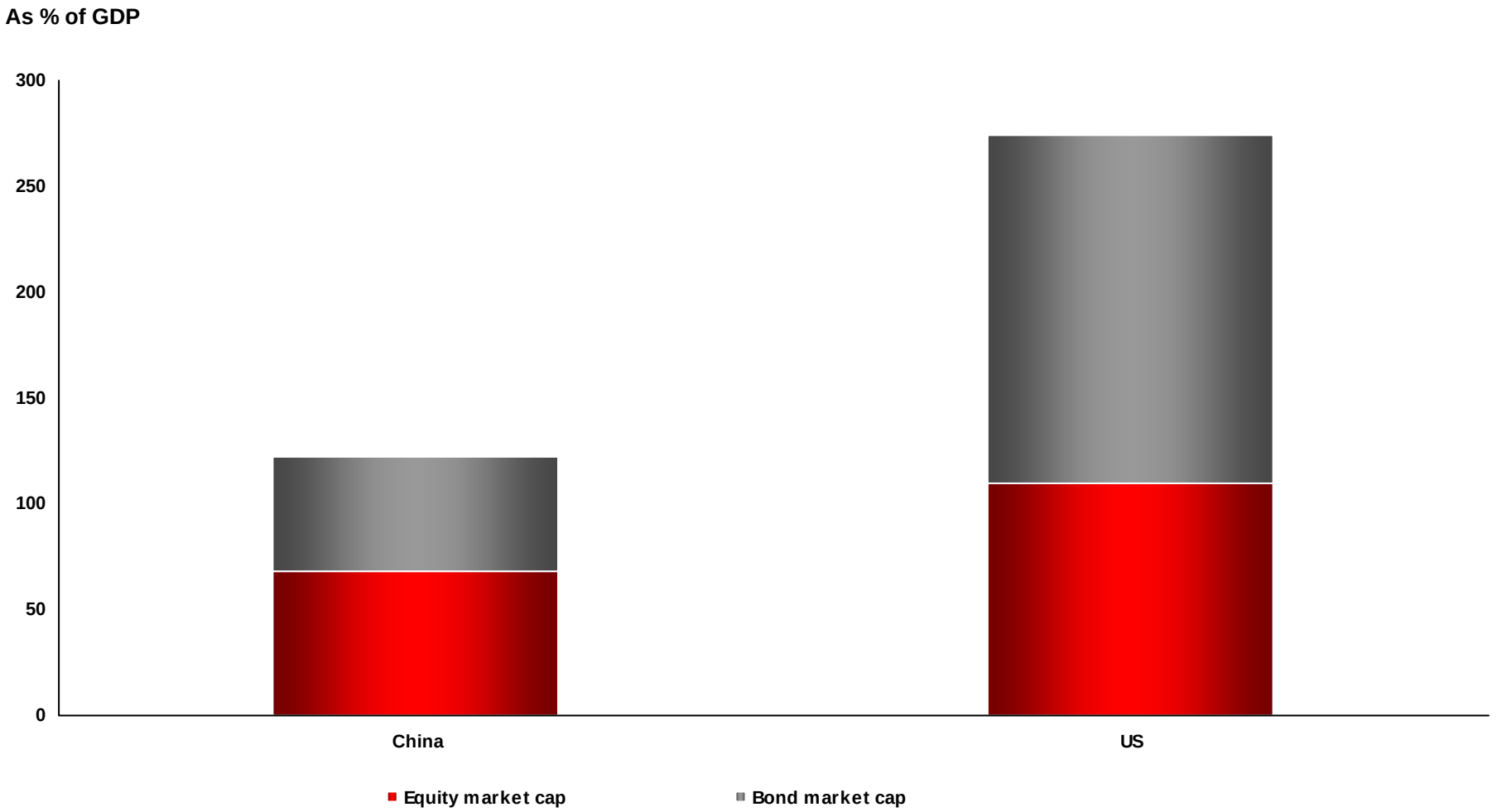
Government has room to releverage

Government's simplified balanced sheet (2009)

Assets	RMB trillion	Liabilities	RMB trillion
Equity stake of listed companies (red chips, H shares, A shares)	13	Government bonds outstanding	6
Net assets of unlisted state-owned enterprises	10	Hidden local government debt	7~10
Government's bank deposits	2.1	Government foreign debt	0.3
Rail, road and other infrastructure facilities	n/a	Total liabilities	13.3-16.3
Land and resource reserves under earth	n/a	Net worth	>8.7

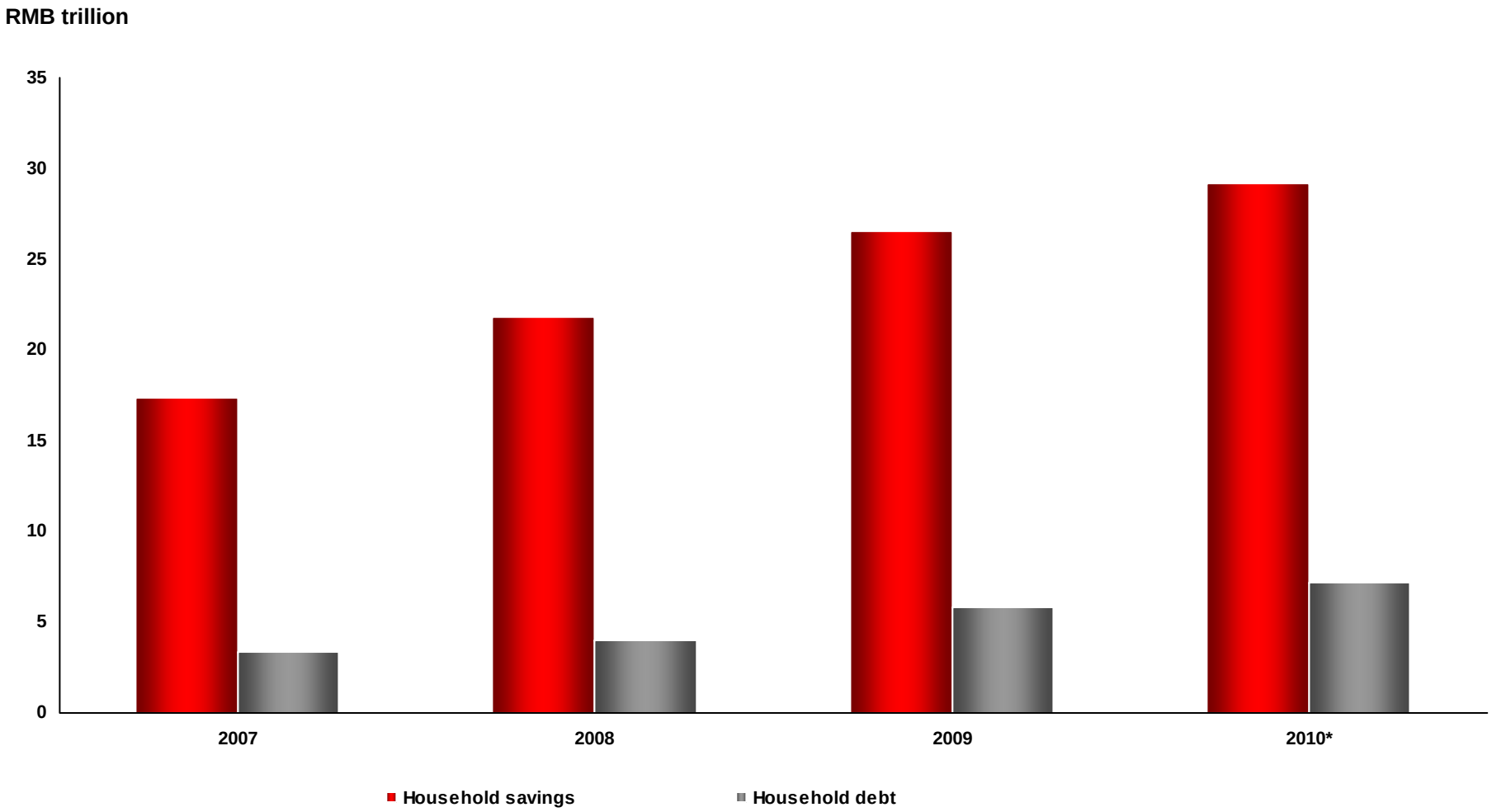
Source: HSBC estimates

Big potential in bond market



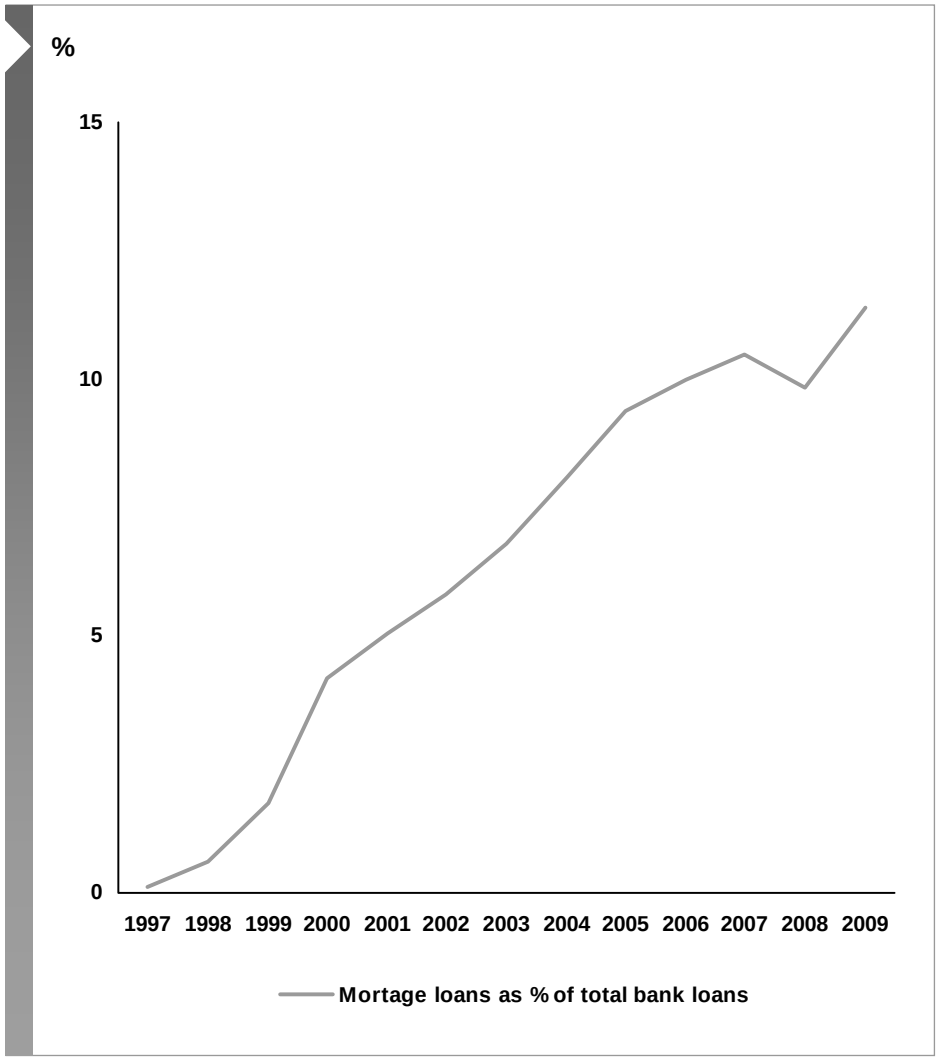
Source: CEIC, HSBC

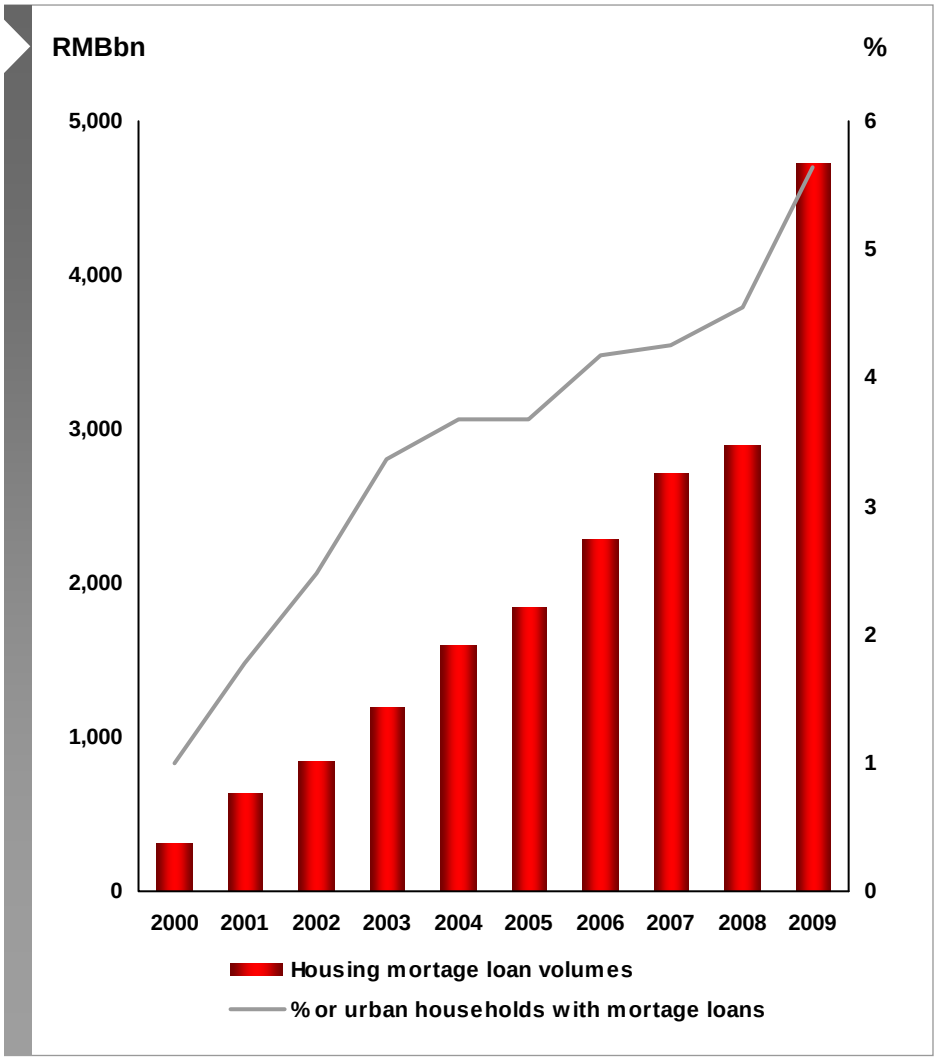
Household debt is tiny



Source: CEIC, HSBC * as of H1 2010

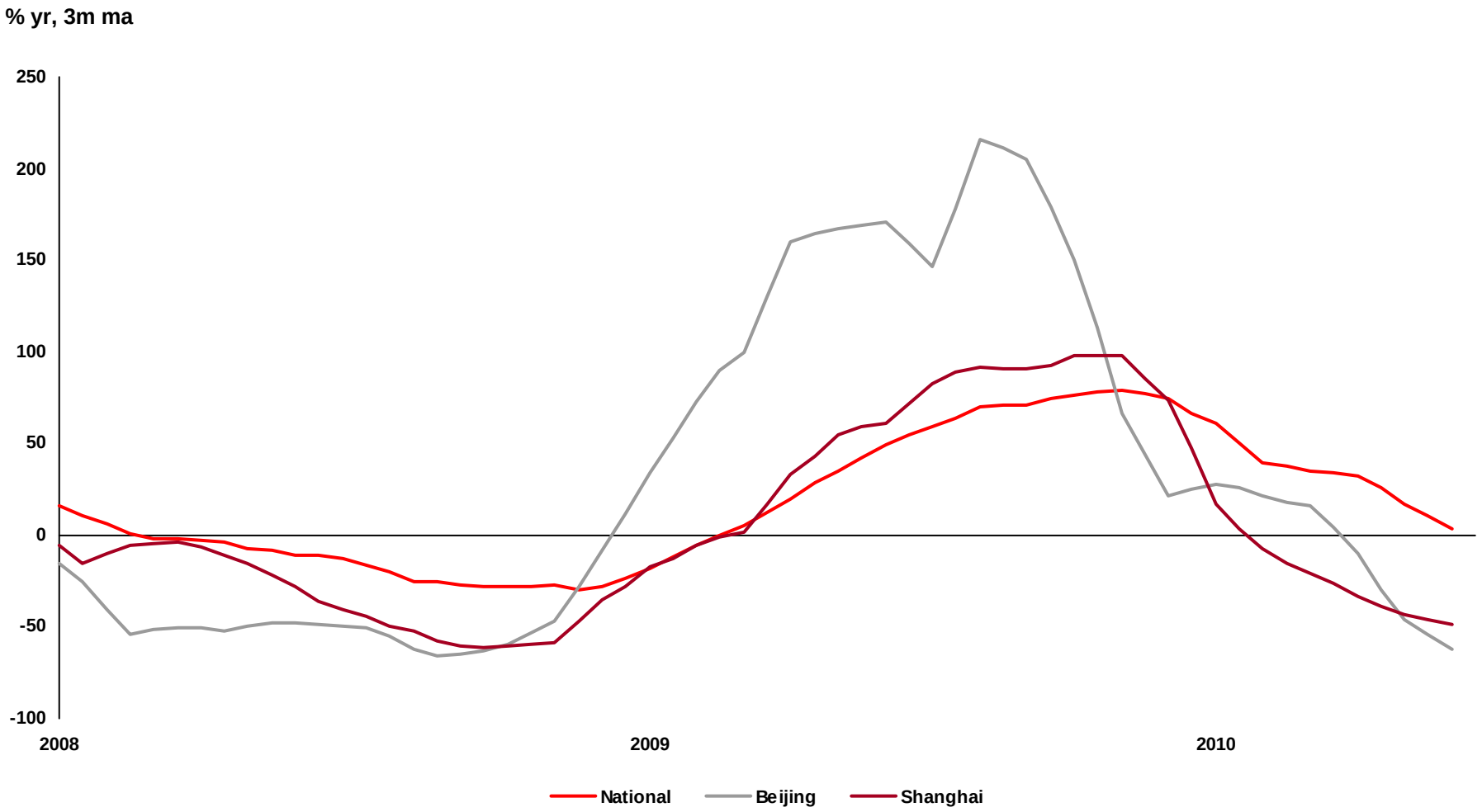
Property market is overheated but still underleveraged...





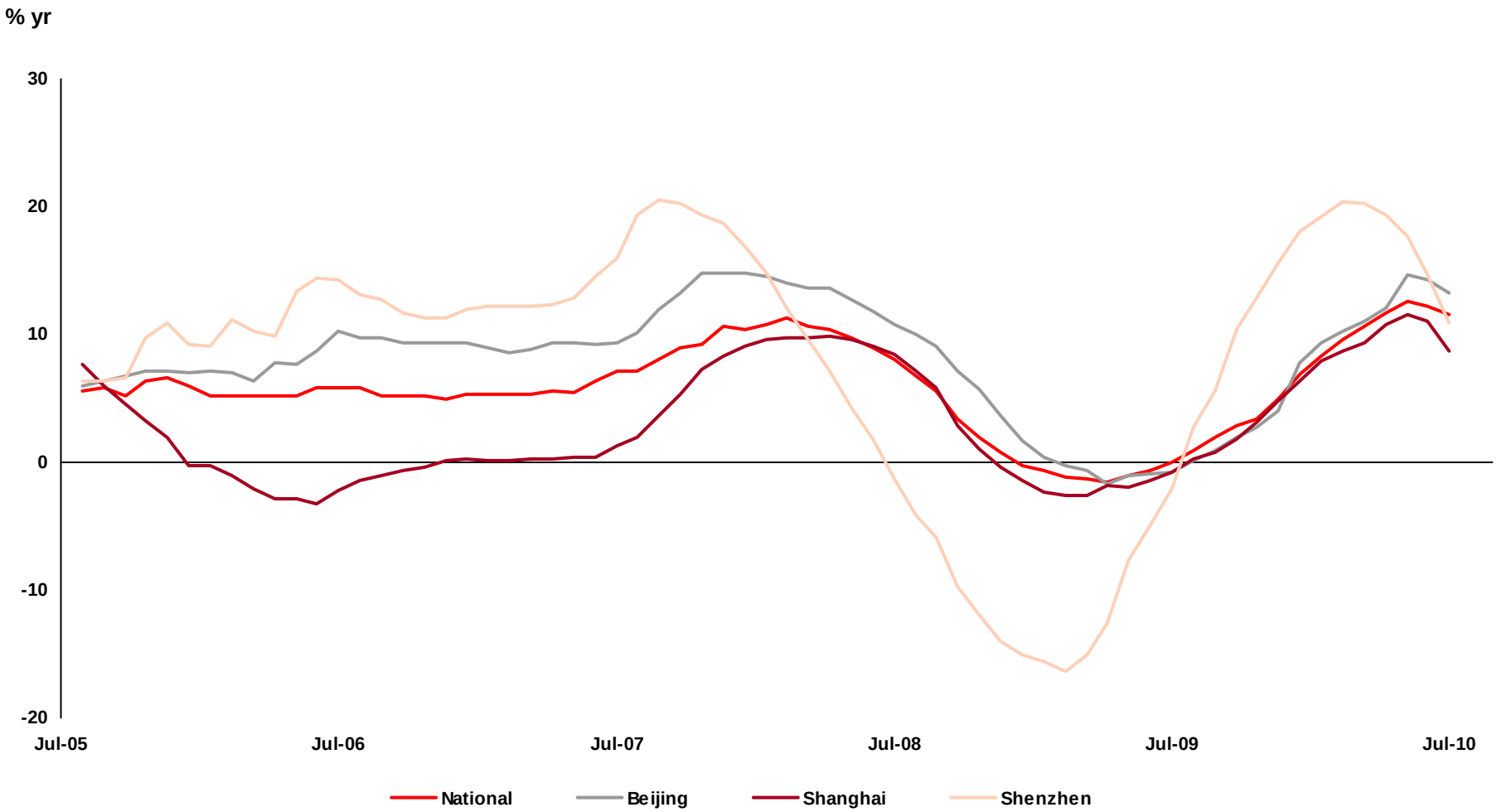
Source: CEIC, HSBC

Significant drop in property transaction volume in big cities



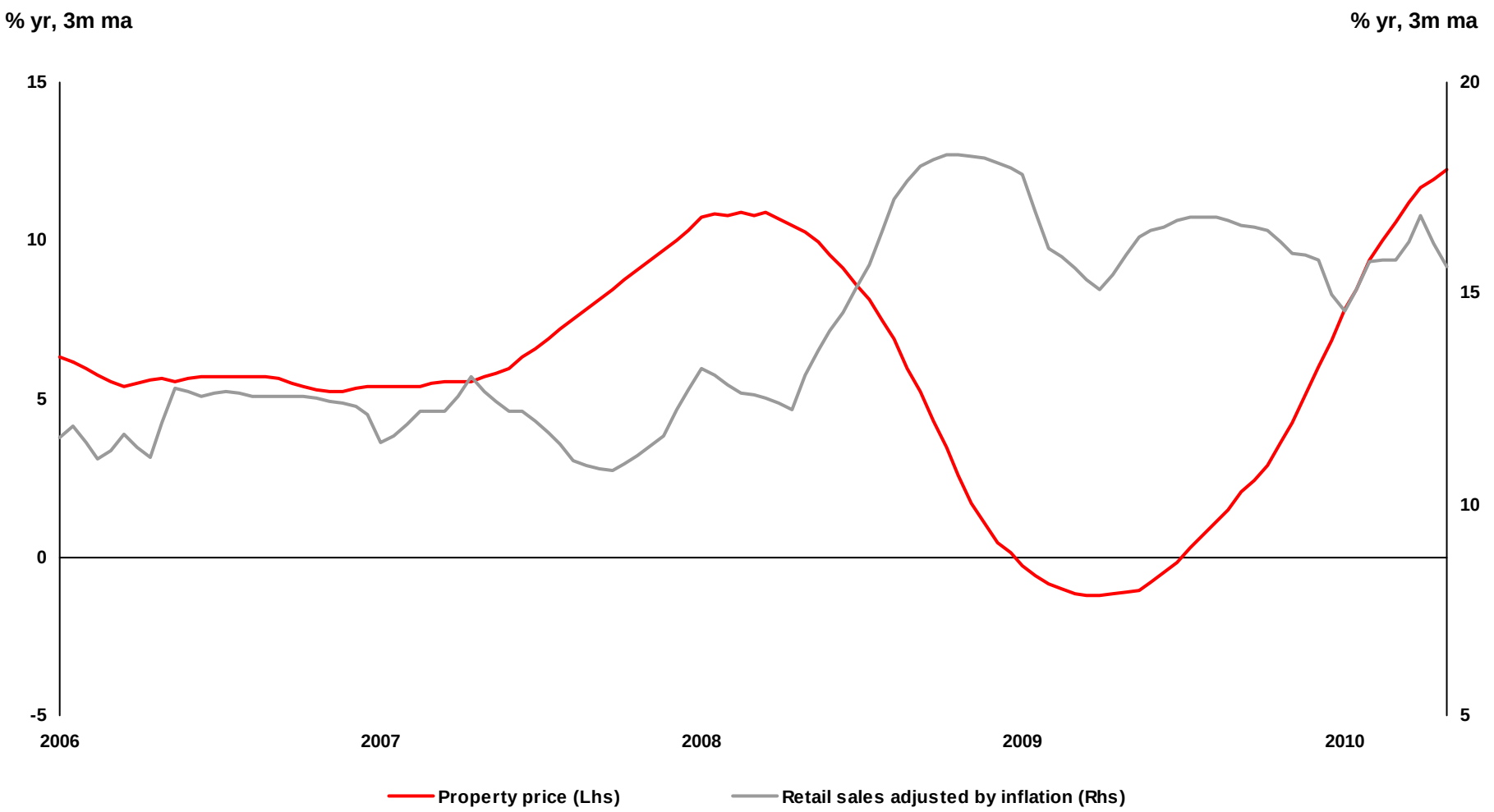
Source: CEIC, HSBC

…property price growth slows



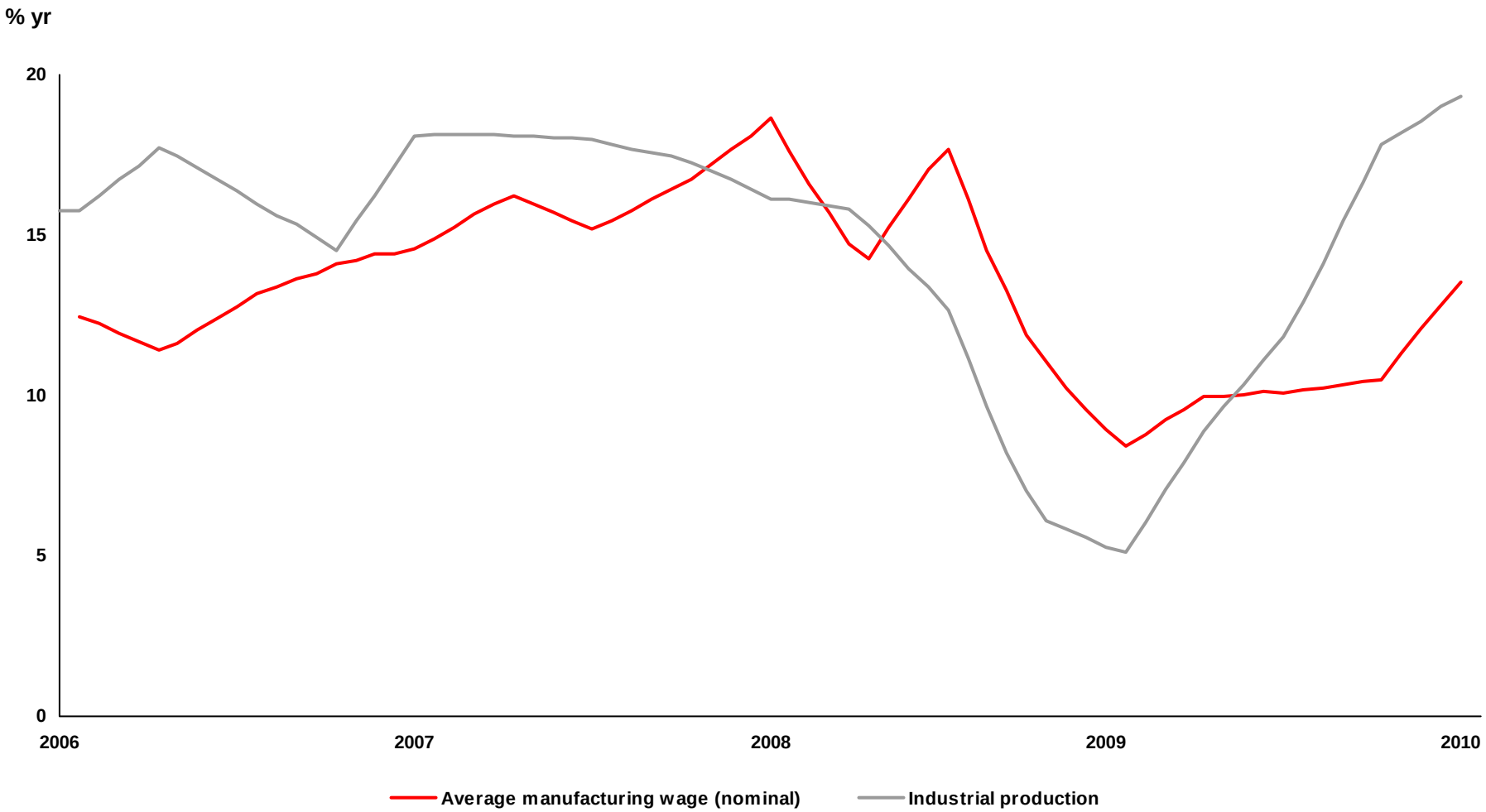
Source: CEIC, HSBC

A drop in property prices won't derail the consumption story



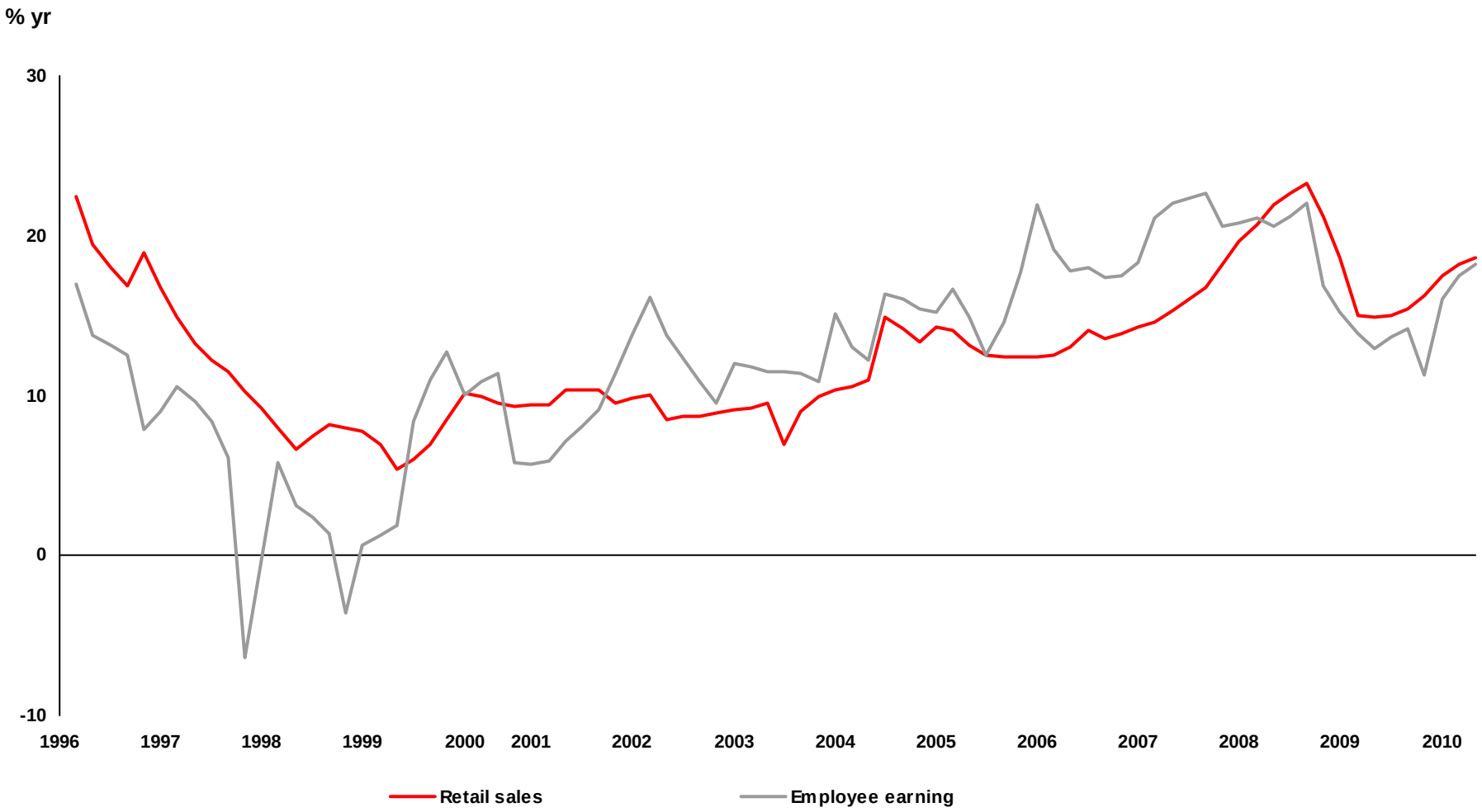
Source: CEIC, HSBC

Labour market has been improving...



Source: CEIC, HSBC

…which will support private consumption



Source: CEIC, HSBC

Improving social welfare supports private consumption

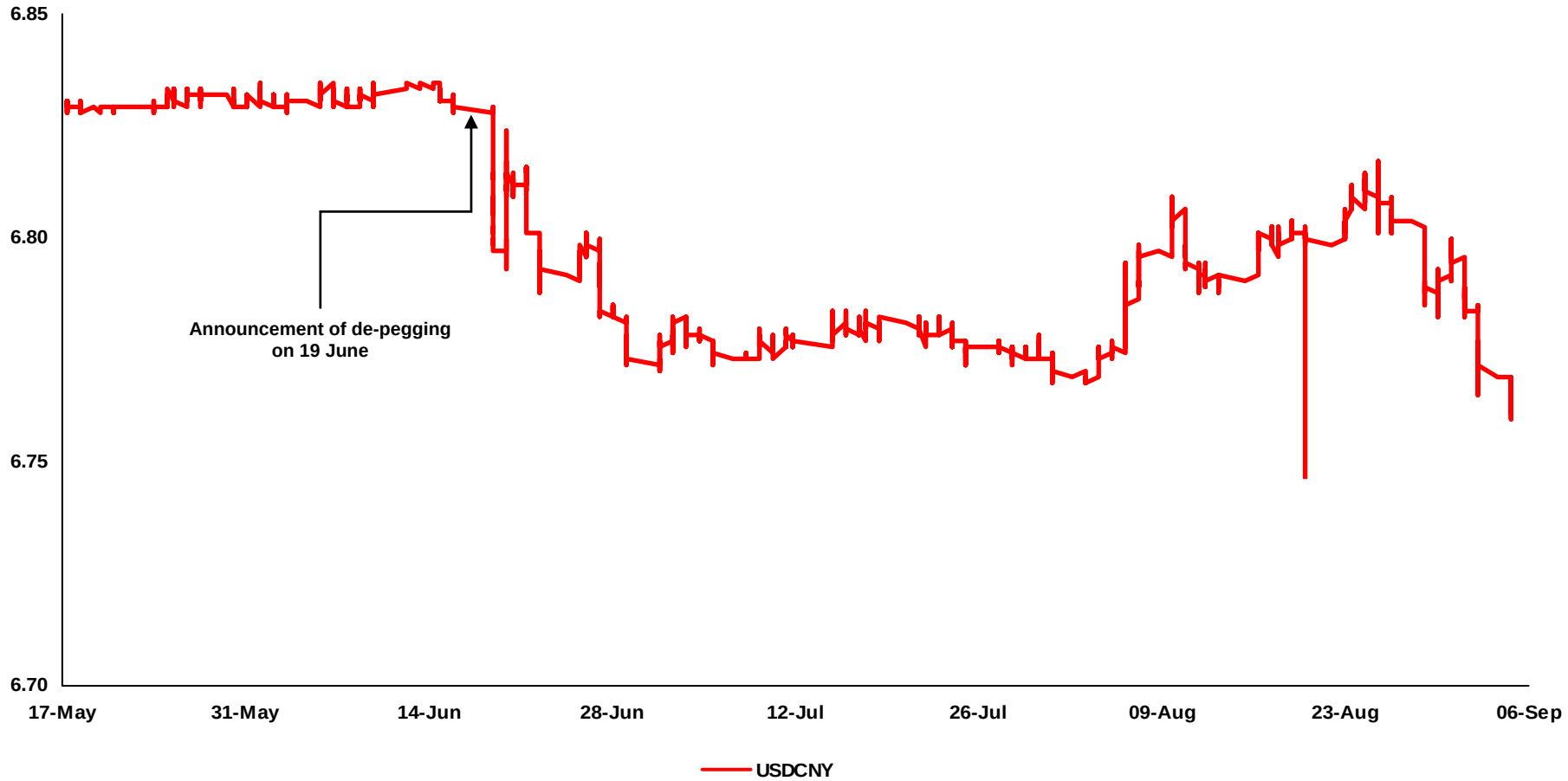
- **The pilot rural medical cooperative reform has been extended to cover over 72 per cent of the rural population, from 50 per cent four years ago. And this covers 50 per cent to 80 per cent of medical expense for the rural population**
- **The pilot rural pension scheme was rolled out last year. This is set to cover 50 per cent of the ageing rural population in three years, and expand to 80 per cent by 2017**
- **Free nine-year compulsory education to all rural families**
- **A total of RMB850 billion to be invested in reforming the medical care system in 2009-2011**

Source: CEIC, HSBC

Renminbi’s new regime: Two-way volatility

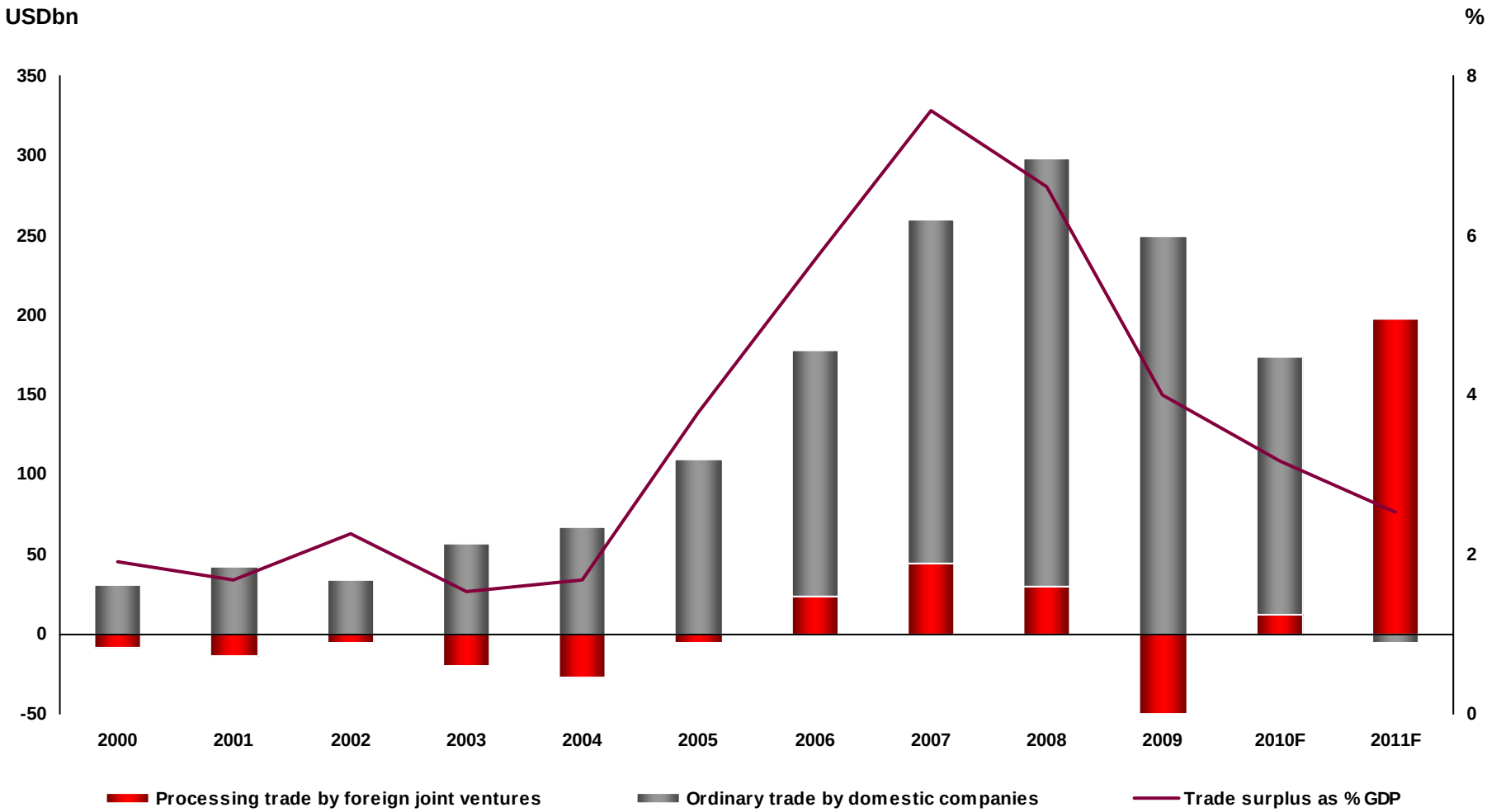
HSBC
The world’s local bank

Two-way volatility rather than appreciation will be the focus



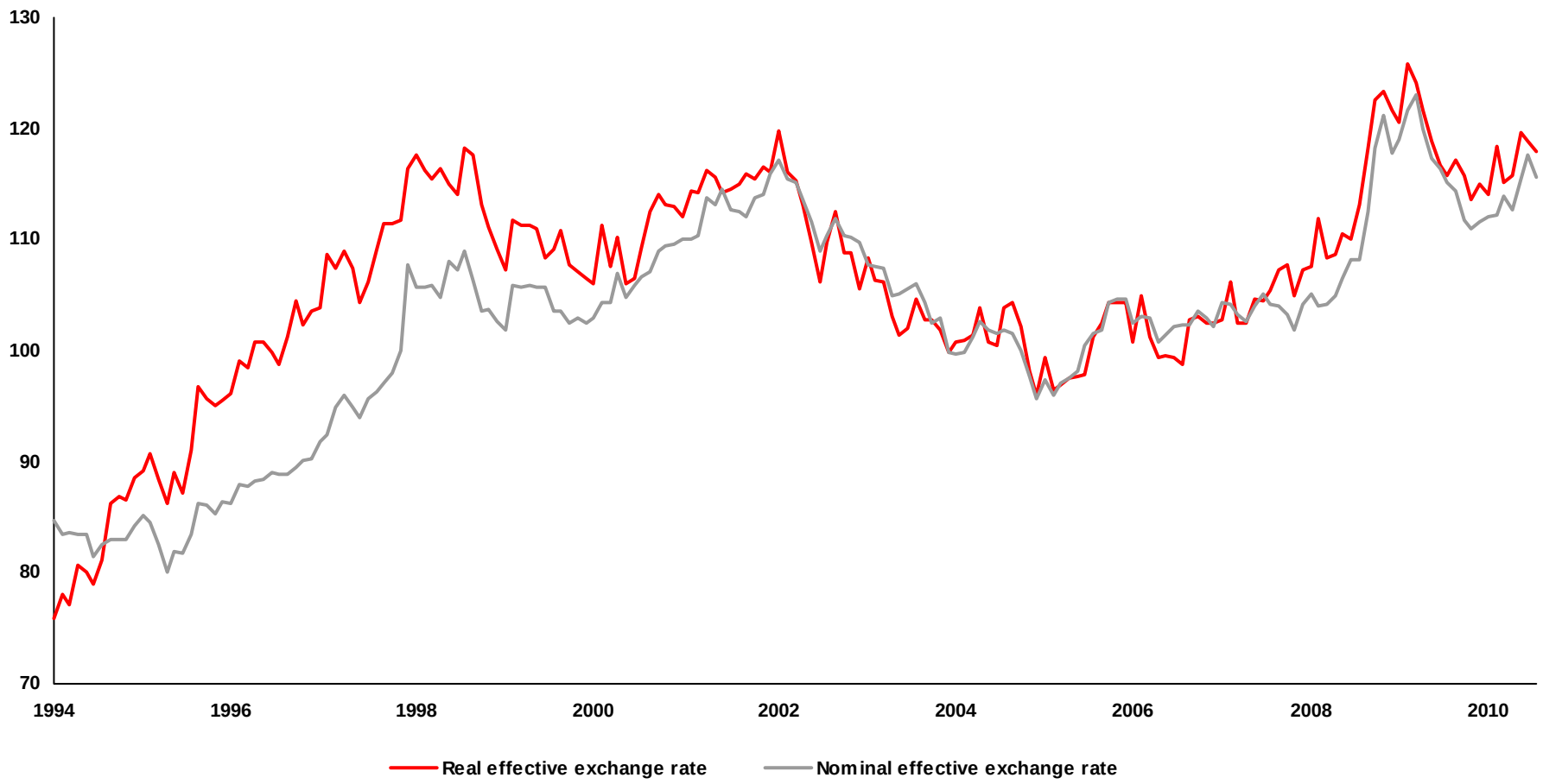
Source: CEIC, HSBC

Pace of appreciation likely to be much slower than in previous years



Source: CEIC, HSBC

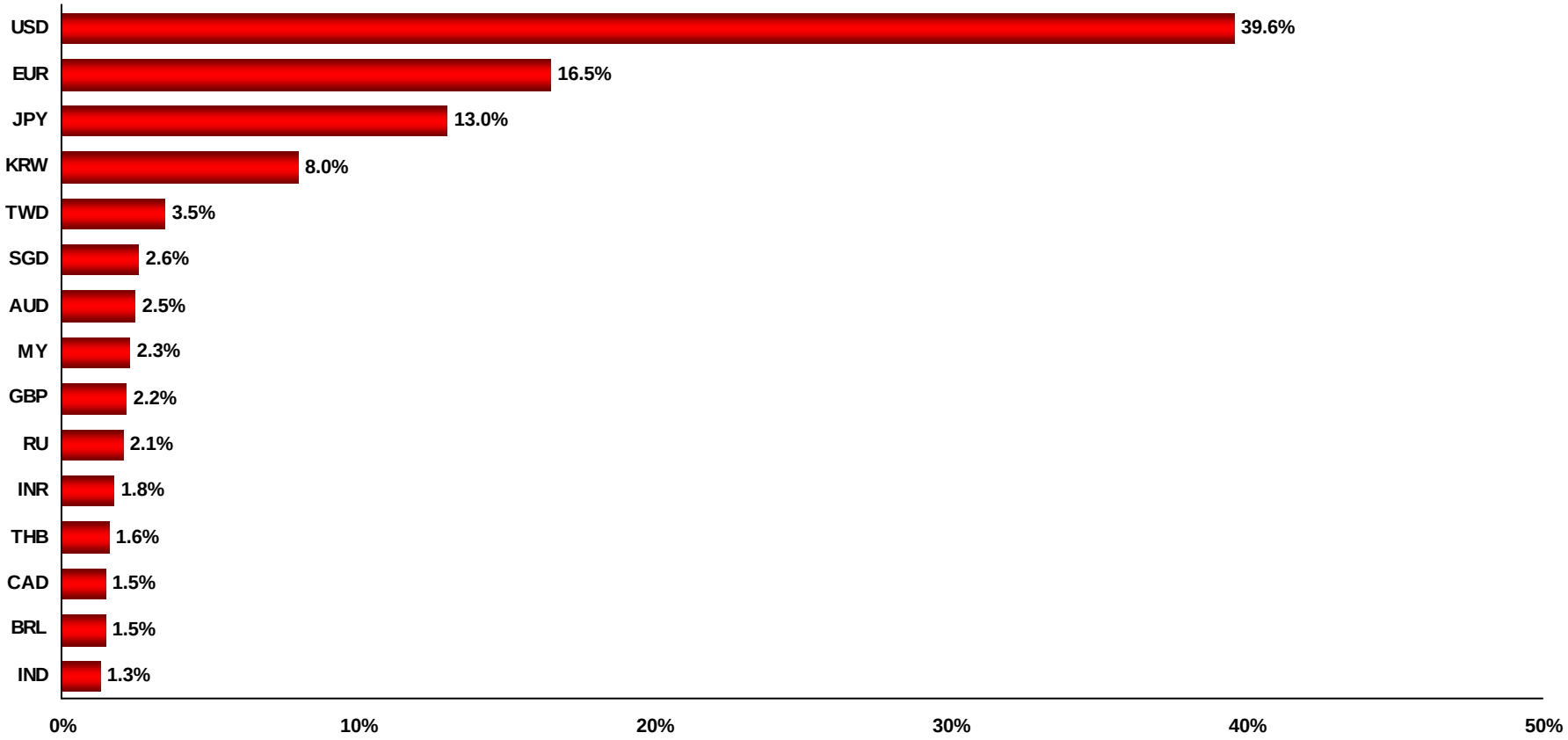
Renminbi's undervaluation is overvalued



Source: BIS, HSBC

Currency basket plays a bigger role?

Estimated renminbi currency basket based on trade, foreign debt and FDI profiles



Source: HSBC estimates

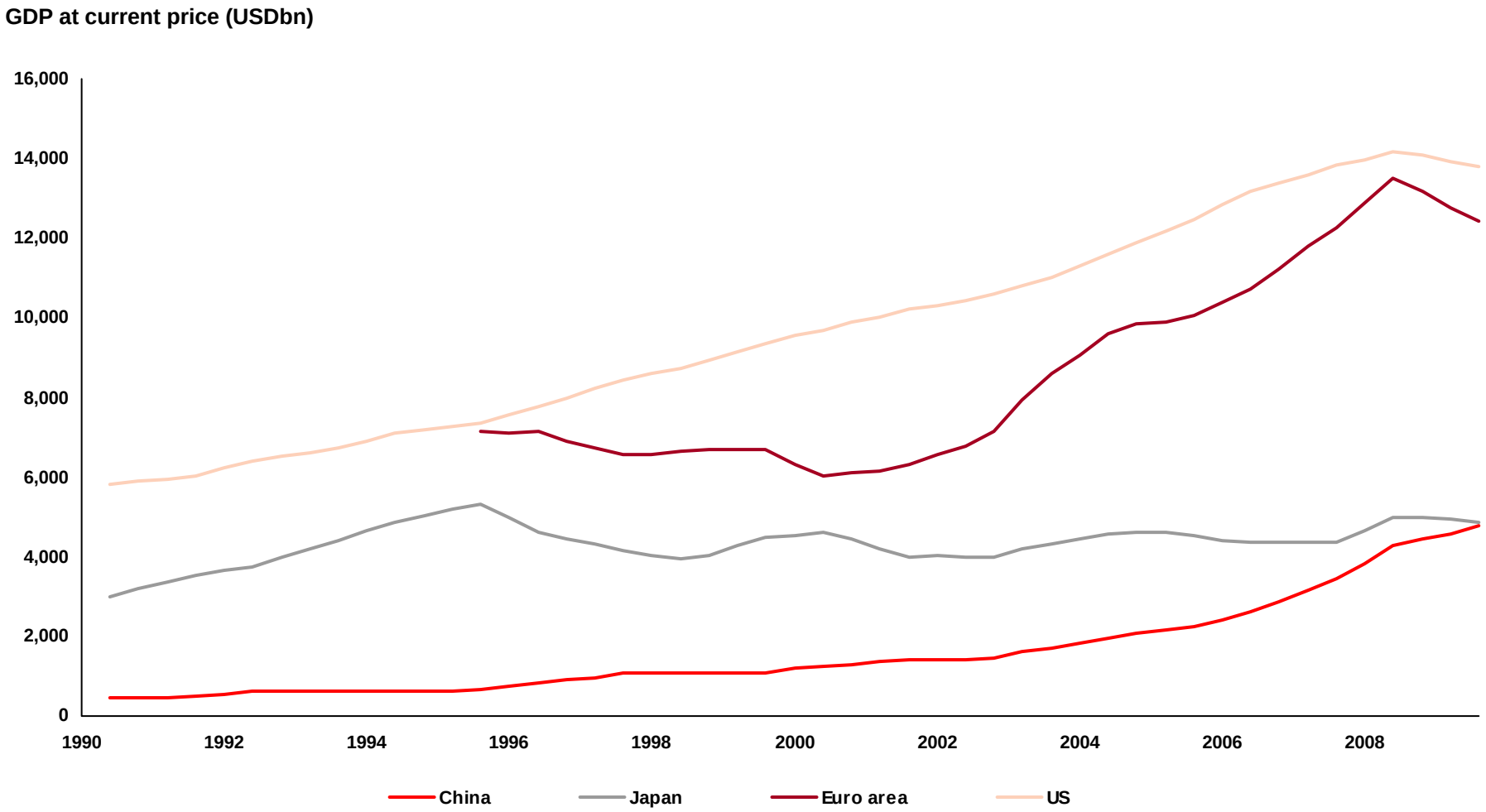
Renminbi internationalisation: Faster than expected

HSBC
The world's local bank

China’s strategic plan

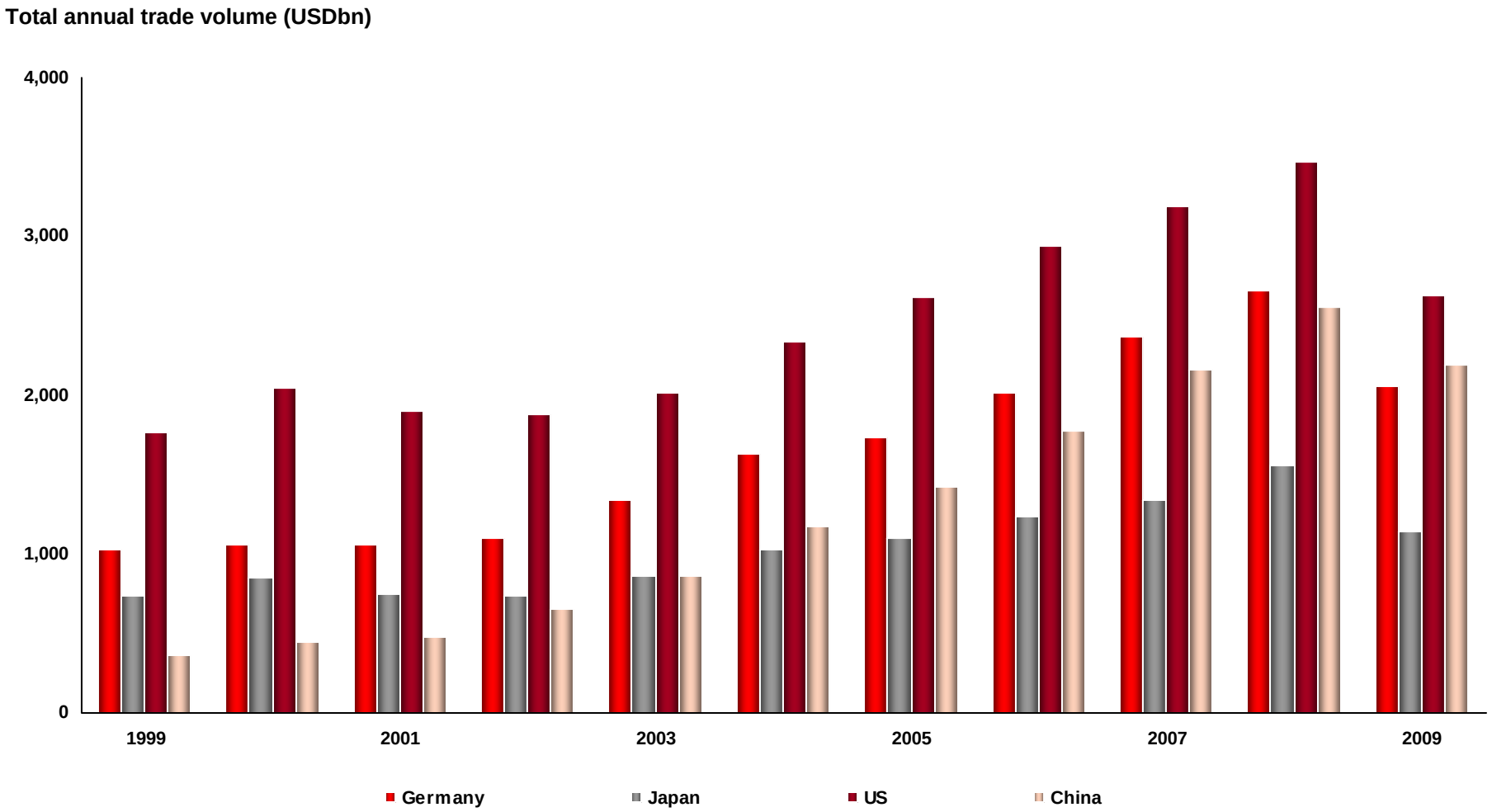
- **Internationalisation of renminbi seen by many as the ultimate solution to China’s dollar trap**
- **Three-step process: From trade settlement to investment/debt and then to reserve holdings**
- **Reserve currency still a long way away**
- **But expanding use of renminbi in trade settlement would be faster than many expect**

Matching China's rising economic power



Source: CEIC, HSBC

…and its dominant position in global trade

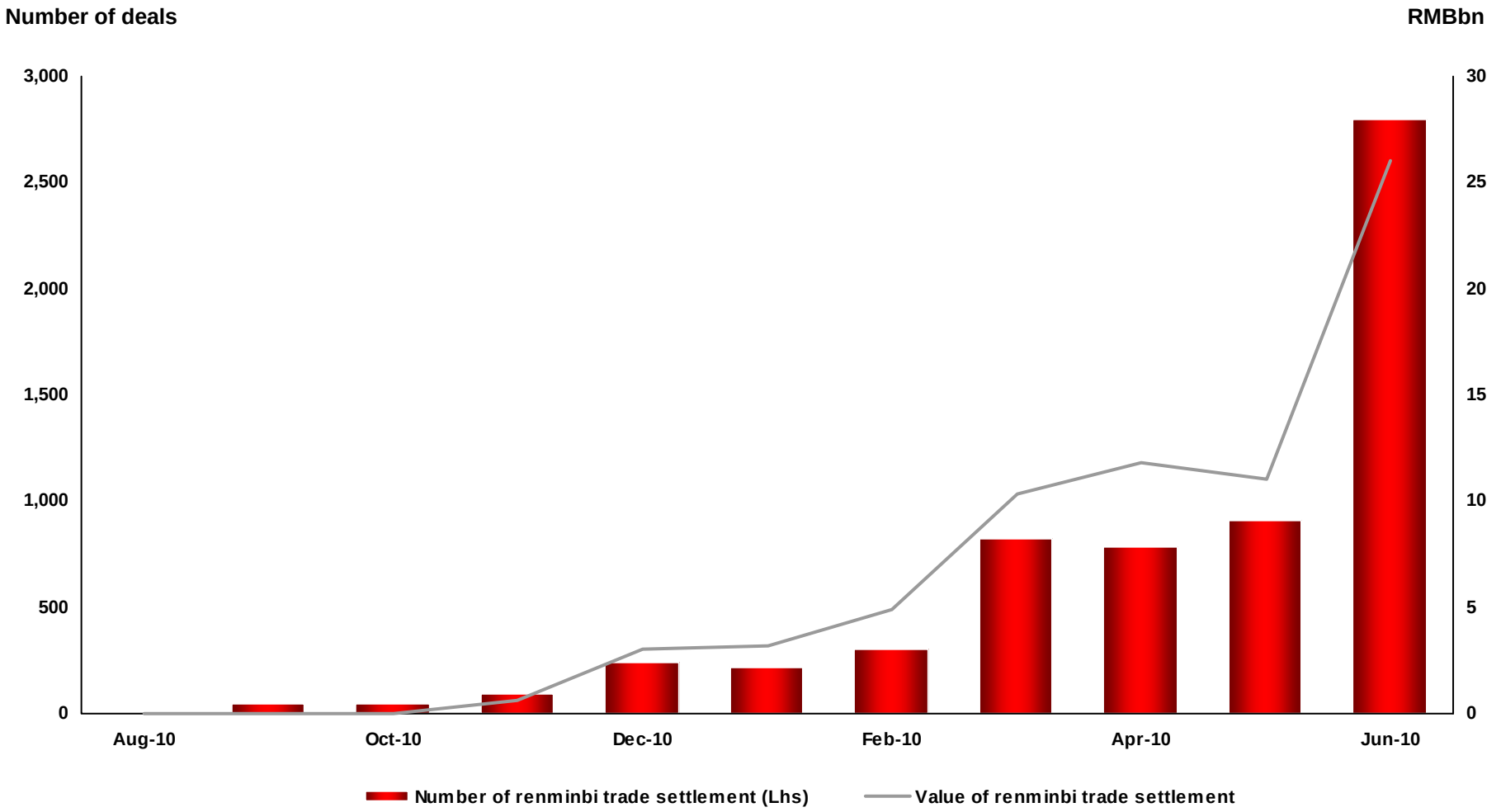


Source: EcoWin, HSBC

Key policy initiatives

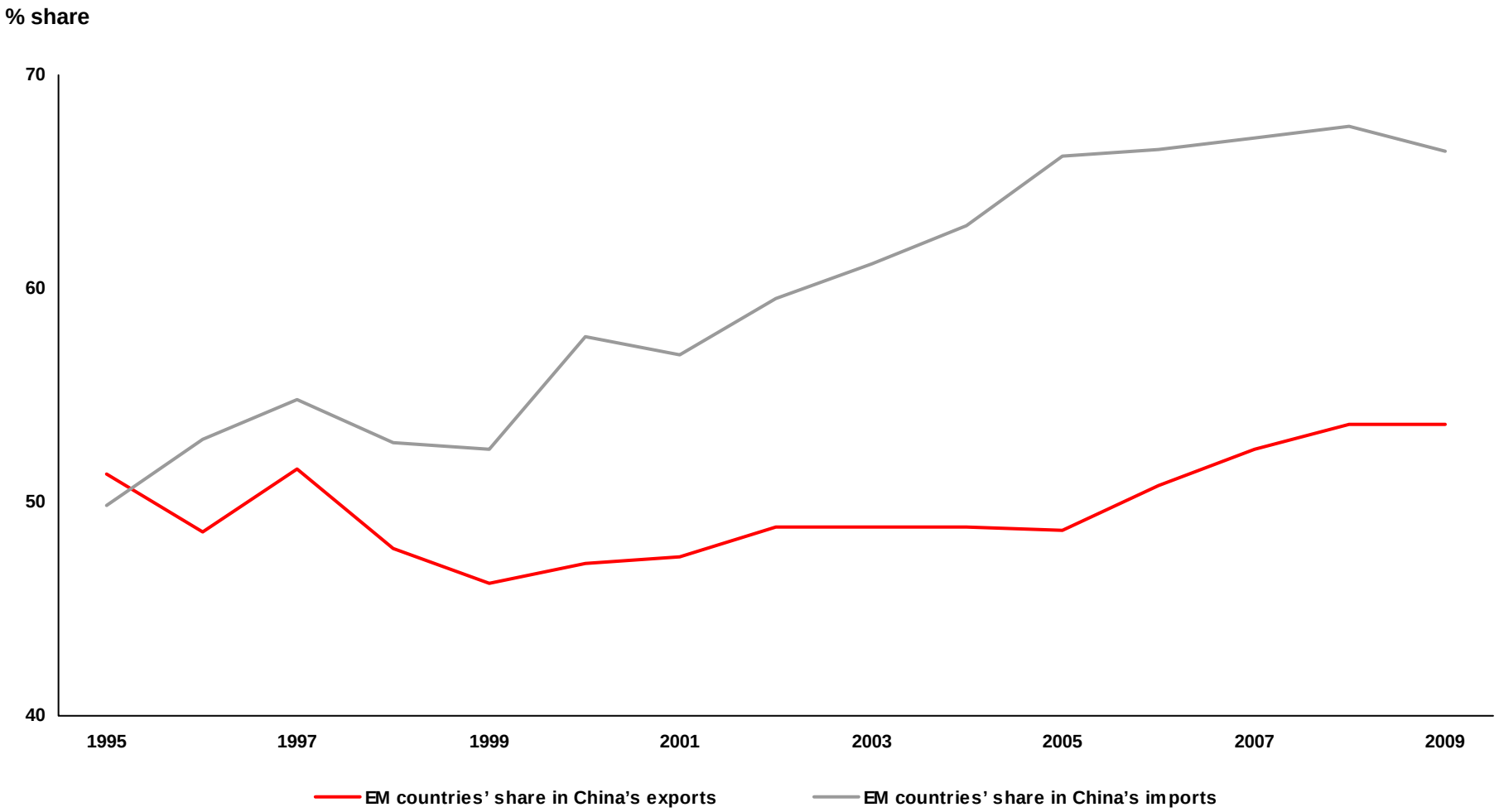
- **29 June 2009: PBoC and HKMA Memorandum on RMB trade settlement in Hong Kong**
- **3 July 2009: Pilot scheme for settlement of cross-border trade in RMB released by the PBoC**
- **19 June 2010: Reform of RMB exchange rate regime resumed**
- **22 June 2010: Expansion of the RMB trade settlement scheme**
- **16 August 2010: RMB Clearing Bank, foreign central banks and other eligible institutions outside the Mainland are allowed to invest their RMB funds into the Mainland's interbank bond market**
- **27 August 2010: Selected enterprises in Beijing, Guangdong, Shandong and Jiangsu are allowed to keep export proceeds offshore**

Renminbi cross-border trade settlement is taking off



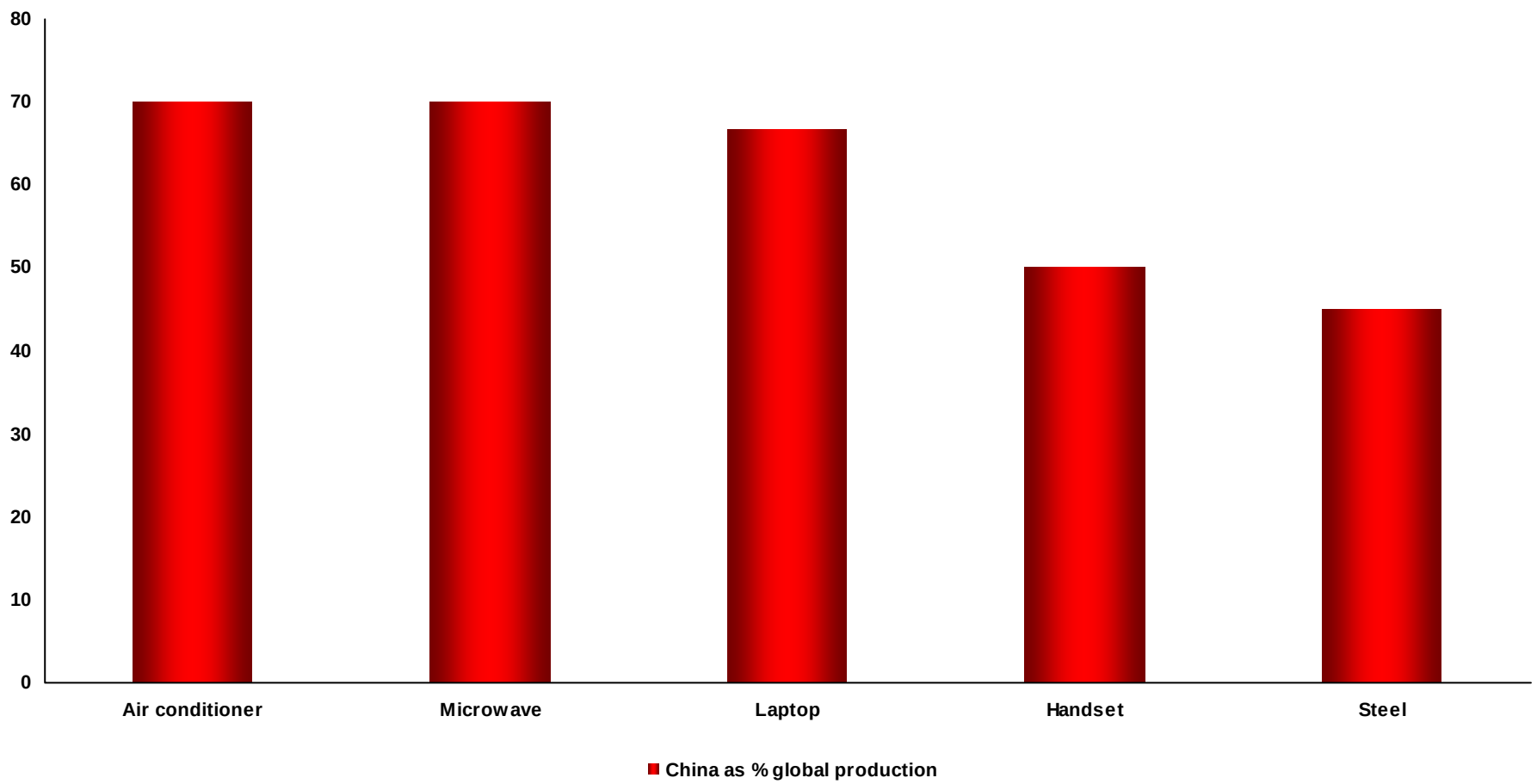
Source: PBoC, HSBC

Who wants to use renminbi?



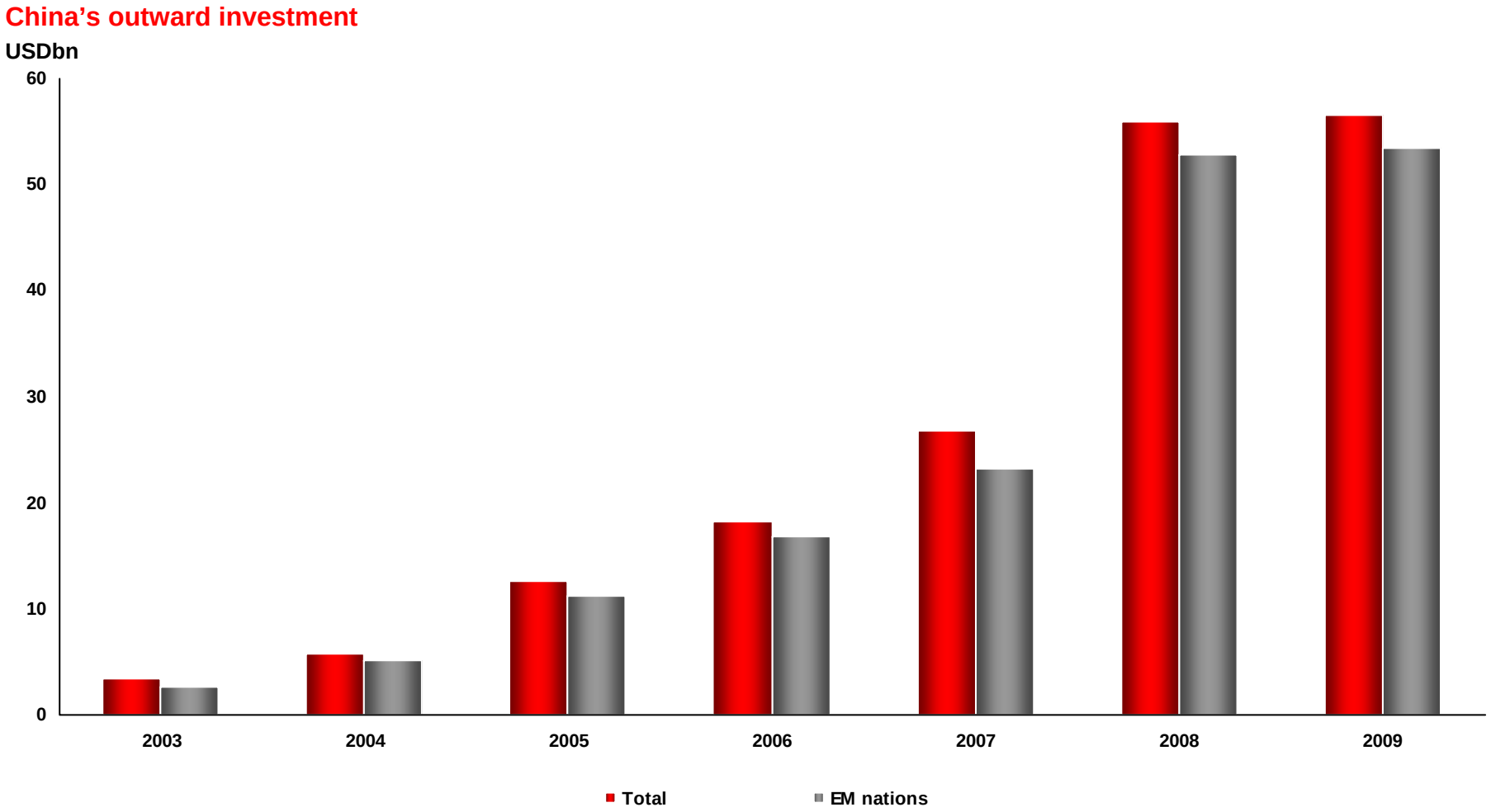
Source: CEIC, HSBC

Can Chinese exporters drive a hard bargain?



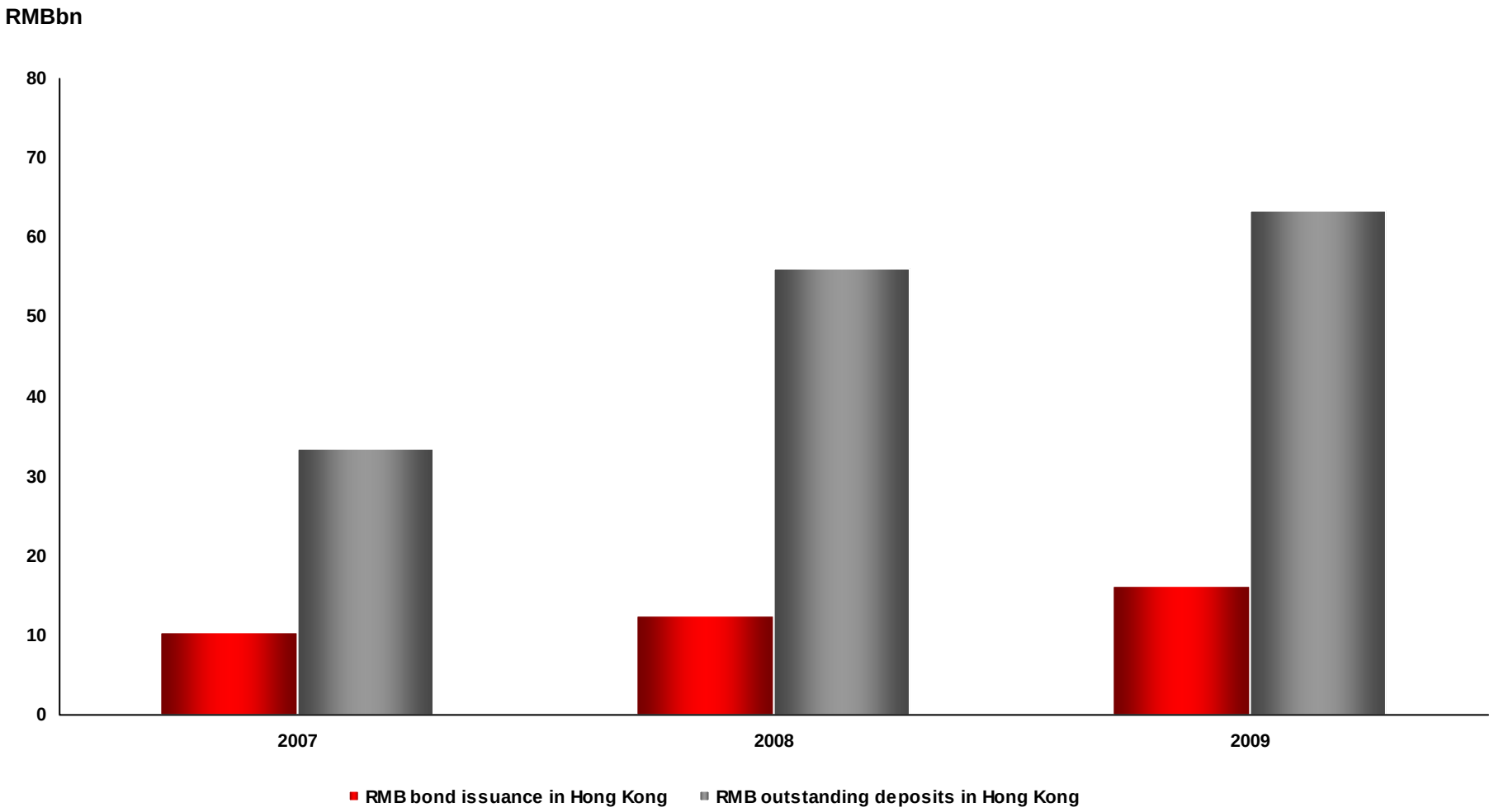
Source: CEIC, HSBC

Surging Chinese investment in EM countries also helps



Source: CEIC, HSBC

Offshore RMB market helps foreigners park and trade renminbi



Source: CEIC, HSBC

Renminbi in five years

- **Renminbi trade settlement is likely to result in nearly USD2 trillion in annual trade flows being settled in renminbi**
- **This, plus further financial reforms, should pave the way for full convertibility**
- **Rising growth differential between China and its main trade partners support gradual appreciation**
- **All these will reinforce the expansion of the renminbi's role in the global economy**

HSBC China economic forecast

% year (annual average)	2005	2006	2007	2008	2009	2010	2011F
Nominal GDP	18,322	21,192	24,953	31,405	34,051	38,541	42,994
Real GDP	11.3	12.7	14.2	9.6	9.1	10.0	8.9
Consumer spending	8.5	8.7	9.0	8.9	8.0	9.5	9.2
Government consumption	12.9	11.7	14.3	12.0	12.5	16.0	15.0
Nominal fixed-asset investment	27.2	24.5	25.8	26.1	29.5	26.0	20.0
Merchandise exports	28.4	27.2	25.7	17.2	-17.9	23.0	18.0
Merchandise imports	17.6	19.9	20.8	18.5	-16.3	27.0	17.0
Industrial production (VAI) ex-small enterprises	15.9	16.2	16.0	12.9	11.0	15.5	13.5
Nominal retail sales	12.9	13.7	16.8	21.6	15.5	17.5	16.8
Consumer prices, year avg	1.8	1.5	4.8	5.9	-0.7	2.9	2.5
Current account (% GDP)	7.2	9.4	11.3	9.4	5.8	4.4	3.9
Budget balance (% GDP)	-1.2	-1.0	0.6	-0.4	-2.9	-2.7	-2.5
Foreign reserve (USDbn)	819	1,066	1,528	1,946	2,399	2,550	2,650
Three-month time deposit (%), year-end	1.7	1.8	3.3	1.7	1.7	1.7	1.7
One-year lending (%), year-end	5.6	6.1	7.5	5.3	5.3	5.3	5.3

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Hongbin Qu

Important Disclosures

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other investment products mentioned in it and/or to participate in any trading strategy. Advice in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document and take into account their specific investment objectives, financial situation or particular needs before making a commitment to purchase investment products.

The value of and the income produced by the investment products mentioned in this document may fluctuate, so that an investor may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Value and income from investment products may be adversely affected by exchange rates, interest rates, or other factors. Past performance of a particular investment product is not indicative of future results.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

** HSBC Legal Entities are listed in the Disclaimer below.*

Additional disclosures

1 This report is dated as at 16 September 2010.

2 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

** Legal entities as at 31 January 2010*

'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiplo, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited.

Issuer of report

The Hongkong and Shanghai Banking Corporation Limited
Level 19, 1 Queen's Road Central
Hong Kong SAR
Telephone: +852 2843 9111
Telex: 75100 CAPEL HX
Fax: +852 2801 4138
Website: www.research.hsbc.com

The Hongkong and Shanghai Banking Corporation Limited ("HSBC") has issued this research material. The Hongkong and Shanghai Banking Corporation Limited is regulated by the Hong Kong Monetary Authority. This material is distributed in the United Kingdom by HSBC Bank plc. In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient.

This material is distributed in Japan by HSBC Securities (Japan) Limited. HSBC Securities (USA) Inc. accepts responsibility for the content of this research report prepared by its non-US foreign affiliate. All US persons receiving and/or accessing this report and intending to effect transactions in any security discussed herein should do so with HSBC Securities (USA) Inc. in the United States and not with its non-US foreign affiliate, the issuer of this report. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. In the UK this material may only be distributed to institutional and professional customers and is not intended for private customers. It is not to be distributed or passed on, directly or indirectly, to any other person. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF).

Any recommendations contained in it are intended for the professional investors to whom it is distributed. This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. The decision and responsibility on whether or not to invest must be taken by the reader. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)

© Copyright. The Hongkong and Shanghai Banking Corporation Limited 2010, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited. MICA (P) 142/06/2010 and MICA (P) 193/04/2010