HSBC

News Release

7 July 2011

HSBC EMERGING MARKETS INDEX Q2 2011

Weakest emerging market growth for two years but victory over inflation promises soft landing

Key points

- **HSBC Emerging Markets Index eases to 54.2 in Q2 2011**
- **Slowdown led by manufacturers and reduced export orders in China, Brazil and Russia**
- **Cornucopia of quantitative tightening measures helps deliver sharpest easing of input cost inflation for 2.5 years**
- **Tamed price pressures offer prospect of soft landing as emerging markets co-invest in infrastructure**
- **Structural trade and investment shift underway between emerging markets along *"The Southern Silk Road"***

Summary

Emerging market growth slowed to its weakest level in two years in the second quarter of 2011, reflecting global economic fragility, the exceptional consequences of the Japanese tsunami and amid the lingering impact of recent inflation, the HSBC Emerging Markets Index (EMI) shows.

The HSBC EMI dipped to 54.2, down from 55.0 in the first quarter and edging below the long-run series average of 54.8.

Price pressures eased sharply against a backdrop of continued monetary tightening by central banks across the emerging world in response to menacing inflationary pressures identified by previous HSBC EMIs. The Q2 HSBC EMI signalled the most acute easing of input cost inflation for two-and-a-half years.

The moderation in overall activity growth reflected a weaker increase in manufacturing production, with the pace of expansion easing to the slowest in three quarters. Meanwhile, service providers recorded a slightly faster rise in business activity, albeit one that was the second-slowest since Q2 2009.

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Stephen King, HSBC's Chief Economist, said: *"HSBC's latest EMI confirms that, after a strong rebound in the immediate aftermath of the global financial crisis, the pace of activity in the emerging markets has faded. In many parts of the emerging world, there has been a noticeable reduction in the growth of export orders, consistent with the recent experience of countries in the developed world, suggesting world trade growth peaked in the first quarter of the year.*

"More encouragingly, the cornucopia of 'quantitative tightening' measures HSBC identified at the last EMI seem to have tamed the significant risk presented to longer-term economic growth by inflation. This seems particularly true of China, where both output growth and inflation fell markedly during the first half of 2011.

"Emerging nations remain magnets for global capital and are increasingly investing in each other with the prospect of more and more Asian-funded infrastructure projects in Latin America and parts of Africa. As this new infrastructure comes on stream, so a new network of economic connections across the emerging world will be established, along what HSBC has termed 'The Southern Silk Road'.

"If a soft landing can be achieved, the stage is set for a sustained period of growth across the emerging world driven by new 'South-South' connections. The result of all these changes could easily be a tenfold increase in intra-emerging market trade in the first half of the 21st Century."

Rates of production growth eased across the majority of manufacturing sectors monitored by the survey, with South Africa and Singapore the two exceptions. In emerging Asia, China saw growth slow to the least marked in nine quarters while output rose at the weakest rates for two quarters in Taiwan and South Korea. Even India recorded a slower rise in manufacturing output, although the rate of growth remained substantial, and by far the healthiest of all emerging markets monitored by the survey. In Europe, particularly marked slowdowns were registered in Turkey and the Czech Republic while Russia saw activity growth moderate to a five-quarter low.

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The weaker increase in manufacturing output in part reflected a lessening in new order growth, which in turn was linked to a slowdown in the rate of expansion in new export orders. Of the largest emerging markets, Brazil, China and Russia all recorded reductions in new export orders. Meanwhile, India reported the slowest pace of growth for one and-a-half years, and rates of expansion eased noticeably in Taiwan and South Korea. Only marginal increases in exports were seen in Turkey and Poland.

Despite easing to a six-quarter low, India again recorded the fastest rate of growth of all emerging market service sectors monitored by the EMI, followed closely by Russia. Rates of expansion held broadly steady in Brazil and Mexico, while output growth accelerated from Q1's record low in China. Business optimism among emerging market service providers dipped to the fourth-lowest in the series history, with confidence in China sliding to a record low and India dipping below Q1 levels. Conversely, optimism in the one-year business outlook reached a six-quarter peak in Brazil, and hit a six-and-a-half year high among Russian service sector firms.

As quantitative tightening begins to confound rampant price rises, the latest EMI signalled the sharpest easing of input cost inflation for two-and-a-half years to fall more than four points from Q1's eleven-quarter high. The moderation was centred on the manufacturing sector, where purchase price inflation eased to a three-quarter low. Service providers again recorded a slower rise in average costs than manufacturers. However, with only a modest easing of price pressures in services, latest data indicated a sharp narrowing of the inflation gap between the two sectors.

With input price inflation weaker, emerging market firms raised their output charges at the slowest rate for three quarters in Q2 2011. Similar to the trend for average costs, manufacturers recorded a sharper moderation in output price inflation than their service sector counterparts. All four of the largest emerging markets saw a slower rise in output charges as measured across both manufacturing and services.

Fred Neumann, HSBC's Co-head of Asian Economics, said: *"The stage is set for a stabilisation and ultimately, re-acceleration of growth in Asia as industrial activity normalises and inflation cools. While Asian manufacturers and service providers have experienced a slowdown in manufacturing and export growth in H1 2011 from a record*

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high post-financial crisis, new orders will continue to stream in, albeit at a slower pace, as inventories remain insufficient to meet demand. More importantly, easing inflation in many parts of Asia will boost consumer demand to reset the cycle of growth in the region.

"Asian businesses stand to benefit on many fronts from the opening of the 'Southern Silk Road'. As a key producer and importer of commodities, Asia will continue to drive global trade activity, centred on China. Asian capital will also fund investments in emerging market infrastructure required for the likes of China and India to access raw materials to support further growth. Asian companies should also position themselves to meet new consumer needs as emerging market demand will change future trade and retail landscapes."

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

The next HSBC EMI will be released on 10 October 2011.

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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.

HSBC Holdings plc:

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$180bn at 31 December 2010. We are headquartered in London. As 'The world's local bank', we combine the largest global emerging markets banking business and a uniquely cosmopolitan customer base with an extensive international network and substantial financial strength. HSBC operates through long-established businesses and has an international network of some 7,500 offices in 87 countries and territories in six geographical regions; Europe, Hong Kong, Rest of Asia-Pacific, the Middle East, North America and Latin America.

HSBC in Emerging Markets:

- HSBC's birthplace was in Hong Kong and Shanghai in 1865.
- HSBC is the largest international Emerging Markets bank.
- In 2010, HSBC generated PBT US$13.98bn in Asia, Latin America, and the Middle East.
- HSBC is the leading international bank in mainland China:
    - in 2010 HSBC generated PBT of US$2.57bn in mainland China;
    - the largest financial services network of any foreign bank in mainland China, comprising 108 outlets;
    - invested over US$5 billion in select mainland financial services entities and in the growth of its own operations
- HSBC is the leading international bank in the Middle East, where we have been doing business for over 50 years.
- HSBC is one of the largest international banks in Latin America, with over 17m customer accounts at year end 2010:
    - 1,147 branches, over 6,300 ATMs and approximately eight million customers in Mexico.
    - HSBC Bank Brazil has more than 5.4 million individual customers and 358,419 corporate clients
    - a network of 118 branches and over 400 ATMs in Argentina.
- HSBC's Global Banking and Markets strategy is emerging markets-led, financing-focused:
    - GBM won key industry awards in 2010 including 'Best Global Emerging Markets Bank' from Euromoney.

HSBC in Emerging Markets (continued):

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    - At year end 2010, Global Asset Management had US$145bn funds under management in emerging markets.
- HSBC has the largest international Commercial Banking franchise and in 2010, 67% of PBT was from emerging markets.

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About HSBC's data provider

Markit:
Markit is a leading, global financial information services company with over 2,200 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 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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