



HSBC Emerging Markets Index

Q4 2012



Stephen King

Turnaround in manufacturing drives pick-up in emerging world growth

10 January 2013

Emerging markets growth improves, but still well below pre-crisis levels

The HSBC Emerging Markets Index rose to 52.9 in the final quarter of 2012, up from 52.2 in the third quarter.

The improvement is more than welcome. Over the summer, as the Eurozone crisis went from bad to worse, it seemed for a moment that the world might be heading back into the abyss. Thankfully, that scenario has been avoided. Still, the latest readings are hardly consistent with buoyant economic growth. They're still well below the levels recorded in late-2009 and early-2010 as the world economy recovered from the 2008 Lehman crisis and even further below pre-crisis levels.

The main reason for the improvement is a turnaround in manufacturing conditions. Following a modest contraction in the third quarter, activity picked up in the fourth quarter. There are also encouraging signs for the early months of 2013. Stocks of finished goods fell in the fourth quarter following an earlier phase of what appears to have been involuntary restocking associated with the Eurozone crisis. New orders are picking up, growing at their second-fastest rate since the second quarter of 2011.

Much of this better news appears to be domestically-led: export orders are still contracting, although not at the worrying pace seen mid-year. Continuous weakness in the global economy has had a variable impact on emerging market prospects. Smaller markets with higher export dependencies have been hit harder than others, not so much because their export performance has been any worse but, rather, because they lack large domestic markets. Manufacturing activity levels are, thus, much lower in the Czech Republic, Israel, Poland, South Africa, Singapore, Taiwan and South Korea than in Brazil, China, India, Russia, Turkey and Mexico.

Admittedly, the larger economies have their own problems: in Brazil, the hoped-for boom in investment ahead of the 2014 FIFA World Cup has failed to materialise while, in India, infrastructure shortfalls, particularly related to roads, railways and power generation, have led to significant supply-side constraints. Some emerging market difficulties are, it turns out, home-grown.



China also suffered mid-year and, although there has been some modest improvement since then, it can hardly be said that the Middle Kingdom has regained its former poise. Still, the fourth quarter increase in manufacturing new orders marks the first gain since the second quarter of 2011, thanks to a renewed pick-up in domestic infrastructure investment. As a result, the outlook for Chinese growth is improving: HSBC projects GDP growth of 8.6 per cent in 2013, up from 7.8 per cent in 2012. For the emerging world as a whole, HSBC expects growth of 5.4 per cent in 2013, up from 4.8 per cent in 2012.

China is pivotal in this story. Although, on our projections, growth doesn't return to the pace witnessed pre-financial crisis, China is now a much bigger economy than it was back then. As a result, although its own growth rate may have slowed, its contribution to global growth is on the rise. On our calculations, China will make its biggest-ever contribution to global growth in 2014.

Thanks to China's enhanced gravitational pull, it's useful to think about the world economy in terms of two separate narratives: an "old world" story focused on the ongoing deleveraging in Europe and the US and a "new world" story focused on the structural dynamism of the emerging world and, in particular, China. At HSBC, we've termed this story "The Great Rotation". We are moving away from a US- or Europe-led world to a world led by China. So far the benefits have accrued mostly to those markets either geographically close to China or important in satisfying China's insatiable demand for commodities. Many of them are emerging economies.

One way to measure this is to look at the overall increase in exports to China as a share of a country's GDP since the beginning of the 21st Century. The results are striking. South Korea's exports to China now amount to 12% of South Korea's GDP whereas, in 2000, they accounted for a more modest 3.5%. Likewise, Malaysia and Singapore have experienced big increases in their export exposure to China. Commodity producers – including Australia, Chile, Kazakhstan and Saudi Arabia – have also shared in the spoils. And, demonstrating China's ever-increasing connections with Africa, Angola is now China's 14th most important source of imports, ahead of France, Canada, Italy and the UK. Interestingly, India is also behind Angola: the lack of trade between India and China must count as one of the great missed opportunities of recent years.

The "old world" has yet to catch the China express. The US

exports a mere 0.7% of its GDP to China. Canada, France and Italy are more or less the same. The UK's exposure to China is lamentable: exports to China account for only 0.4% of UK GDP, not much more than a rounding error. Japan and Germany do a lot better yet their higher exposures can't hide underlying weaknesses. In Japan's case, its uneasy political relationship with its mainland rival – exemplified in an unresolved island dispute – led to a collapse in exports from Japan to China in the second half of 2012. Meanwhile, Germany's heightened trade relationship with China has been absolutely swamped by an even bigger increase in its dependency on the rest of Europe, one reason why, despite its competitive advantages, Germany found itself succumbing in the second half of 2012 to a crisis which had already engulfed other parts of the Eurozone.

There can be no doubt that a stronger China connection pays dividends. Those economies which have increased their trade exposure to China – typically at the expense of their exposures to the "old world" – have mostly enjoyed rapid gains in economic activity over the last decade or so. In contrast, those economies which have shunned China's advances have mostly found themselves suffering from persistently disappointing GDP growth. The Emerging Markets Index may not be particularly strong at the moment but China is set to have a bigger influence than either the US or Europe on the economic destiny of many emerging markets.

Stephen King

Group Chief Economist

HSBC Emerging Markets Index

Emerging market growth accelerates slightly in Q4 as manufacturing sector expands

Key findings:

- Overall activity growth strengthens since Q3, but still below trend
- Manufacturing production rises moderately following Q3's contraction
- Russia overtakes India among major BRIC economies as Brazilian expansion resumes
- New export business at goods producers falls for fourth successive quarter

Emerging market growth picks up in Q4

The final EMI report for 2012 indicated a slight acceleration in economic growth across emerging markets worldwide. That said, total activity rose at a pace that remained weaker than the average shown over the four years since the 2008 financial crisis.

The HSBC Emerging Markets Index (EMI) rose from 52.2 in Q3 to 52.9 in Q4, the first upward movement since the first quarter of 2012. This signalled a mild acceleration in output growth, although the overall pace of expansion was still weaker than posted during the first half of the year, and the EMI remained weaker than its historic average of 54.4.

The EMI is based on 23 *PMI™* (*Purchasing Managers' Index™*) surveys conducted across 18 emerging markets, and provides the earliest and most reliable indication of economic trends.

Manufacturing output rose modestly in the final three months of the year, following a marginal decline in Q3. This mainly reflected returns to growth in China and Brazil, and sharper expansions in India, Mexico and Turkey. Meanwhile, activity in the global emerging markets service sector rose at a rate only fractionally stronger than Q3's four-quarter low.

Growth resumes in Brazil, and strengthens in Russia

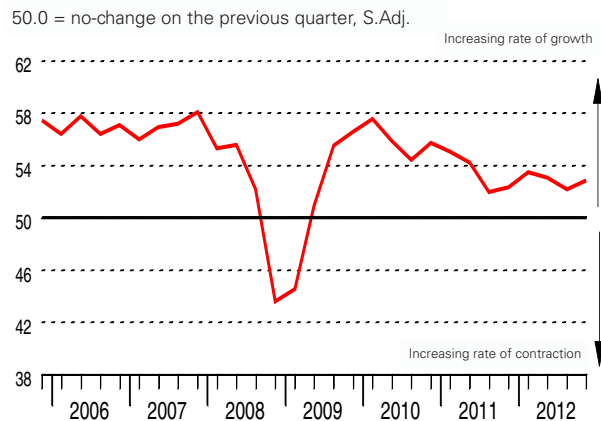
The combined manufacturing and service sectors of the major BRIC economies all registered expansion in Q4, as Brazil posted a return to growth following Q3's stagnation. Growth picked up in China, but remained relatively weak, while India posted a broadly stable solid rate of expansion. Meanwhile, Russia registered the best rate of output growth since Q2 2010.

China's goods producers registered higher output for the first time in a year-and-a-half in Q4, while Brazilian manufacturing production increased for the first time since Q1, expanding at the fastest rate since the first quarter of 2011. Manufacturing output growth accelerated in India, and was broadly stable at a solid pace in Russia.

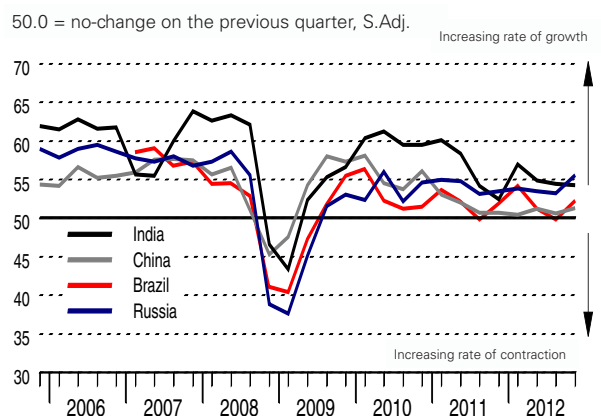
Brazilian services activity rose moderately in Q4, following stagnation in the previous quarter. Service sector growth in Russia strengthened to the highest since Q2 2010, while rates of expansion eased in both China and India.

Non-oil PMI data for the Middle East showed further private sector output growth in Q4. Saudi Arabia continued to post a sharper rate of growth than the United Arab Emirates, as has been the case since the two series started in the fourth quarter of 2009. That said, growth in Saudi Arabia was the second-weakest of any quarter to date.

EMI (all-sector output)



BRIC (all-sector output)



New order growth in manufacturing accelerates

Goods producers in emerging markets posted the fastest increase in new orders since Q2 2011 in the fourth quarter. This mainly reflected the resumption of growth in China and Brazil. The strongest rates of expansion were indicated in Mexico, India and Russia. New business continued to fall, however, across a range of markets, including Poland, the Czech Republic, Israel, South Africa, Singapore, Taiwan, South Korea and Vietnam.

In contrast to the overall rise in new orders, new export business declined marginally in Q4, marking a fourth consecutive quarter of contraction. This partly reflected weak demand from advanced economies, especially those in the Eurozone. Only four emerging markets registered higher new export orders in Q4, namely India, Mexico, Indonesia and Turkey.

Services outlook still below-par

The overall 12-month outlook among service providers across the four major BRIC economies remained positive in Q4, and improved slightly on the third quarter's record low. That said, the strength of sentiment was still the fourth-weakest of any quarter since the series began in Q4 2005.

By country, the strongest outlook for service sector activity in 2013 was held by Brazil, followed by India. Meanwhile, Russian and Chinese service providers remained relatively subdued in their expectations for growth over the forthcoming year.

Labour market strengthens

Employment at manufacturers and service providers in global emerging markets increased at the strongest rate in six quarters in Q4. This reflected growth in the service sector as manufacturing workforces contracted for the fifth quarter running, albeit marginally. Job losses at manufacturers were most widespread in Israel, Poland, the Czech Republic and Singapore. Chinese manufacturing employment fell for the sixth successive quarter, albeit at a weaker rate than in Q3.

Widespread destocking across manufacturing

Warehouse stocks of finished manufactured goods declined in Q4 for the first time since the opening quarter of 2012. All monitored economies except for Mexico and Indonesia registered lower final goods inventories. The steepest rates of decline were posted in Poland, Russia and the Czech Republic.

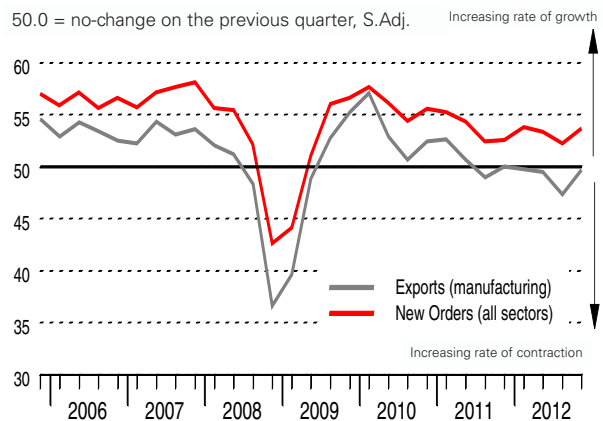
Inflationary pressures remain subdued

Cost pressures in emerging markets remained muted in the final quarter of 2012. The Composite Input Prices Index rose from Q3's 13-quarter low, but was still weaker than the six-year historic average.

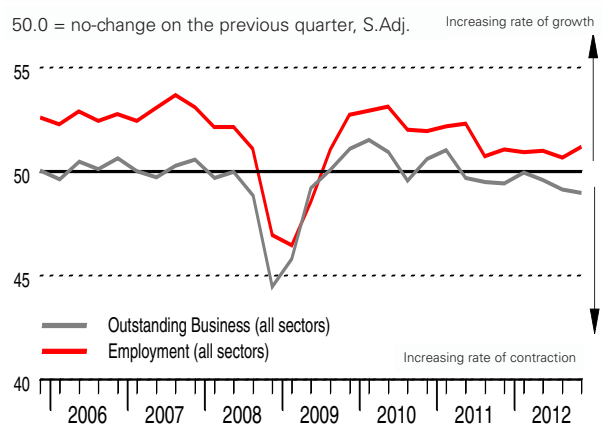
The overall strengthening in input price inflation was centred on the manufacturing sector, where input prices increased following Q3's decline. Overall, manufacturers faced the strongest cost pressures since Q3 2011, with the fastest rates of inflation registered in South Africa, Turkey and India.

Input cost inflation in the service sector was little-changed from Q3's 11-quarter low. Russian service providers continued to face the sharpest increase in input prices among the four BRIC economies.

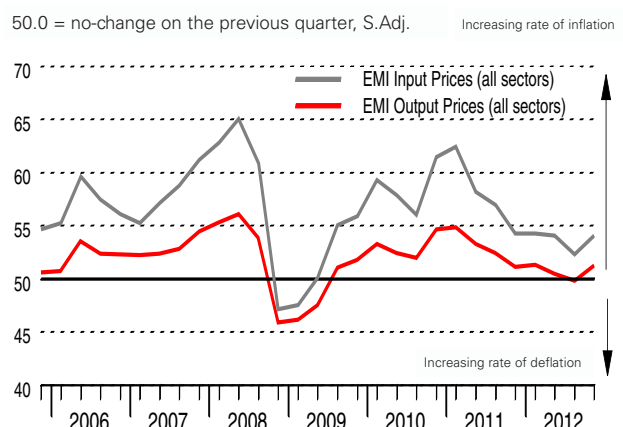
Orders and exports



Employment and backlogs of work



Input and output prices



Output

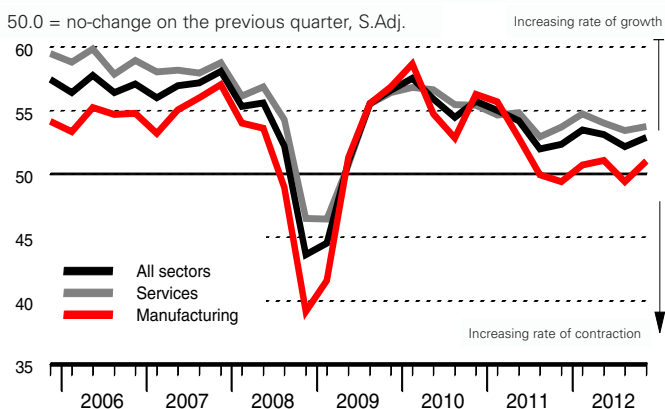
Emerging markets output growth picks-up in Q4

Emerging markets output (covering manufacturing and services) increased during Q4 2012. The rate of expansion quickened, albeit slightly, from Q3. Output has expanded continuously since Q2 2009.

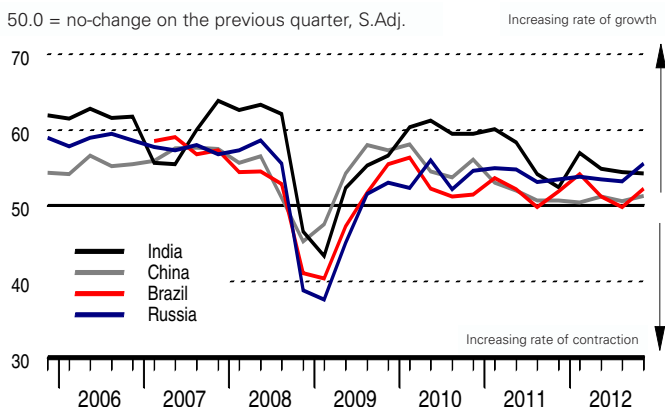
Services activity continued to rise in Q4, and at a fractionally faster pace than in Q3. Manufacturers also registered an increase in production following a marginal reduction in Q3. That said, the rate of expansion was only modest.

Chinese output (across manufacturing and services) rose at a quicker rate in Q4. India posted a broadly similar rate of growth to Q3. Meanwhile, Russian output increased at the quickest pace Q2 2010. Brazil also registered an expansion of output following stagnation in Q3.

Output by sector



Output in BRIC countries (all sectors)



New Business

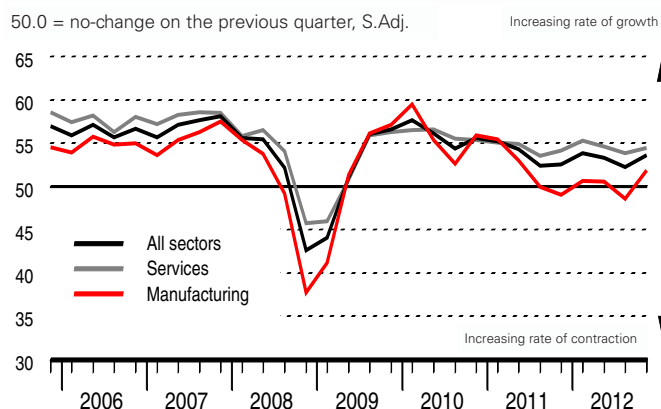
Growth of new business fastest since Q1 2012

Total new orders in emerging economies increased in the three months to December. The growth rate of new business was the fastest since Q1, and the second-fastest since Q2 2011.

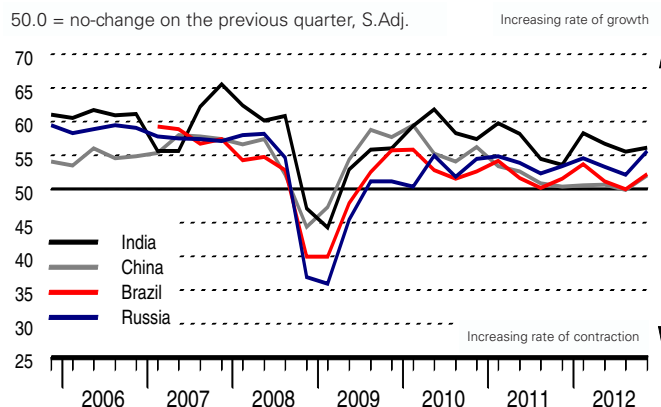
The rise largely reflected an increase in incoming business for service providers in the last quarter of 2012. That said, manufacturers also reported an increased amount of new business in Q4, following a decline in Q3. Moreover, it was the strongest rate of growth since Q2 2011.

New business in China's private sector rose during Q4, after a stagnation in Q3. India and Russia registered further growth of new orders, and at quicker rates than in Q3. New business at private sector firms in Brazil increased in Q4 following no change in Q3.

New business by sector



New business in BRIC countries (all sectors)



Outstanding Business

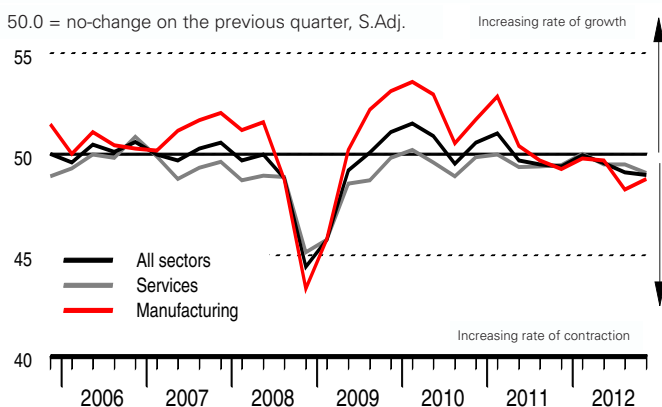
Backlogs depleted at fastest pace since Q1 2009

The level of outstanding business across emerging markets fell in the last quarter of 2012, extending the current trend to three consecutive quarters. Moreover, it was the quickest rate of backlog depletion Q1 2009.

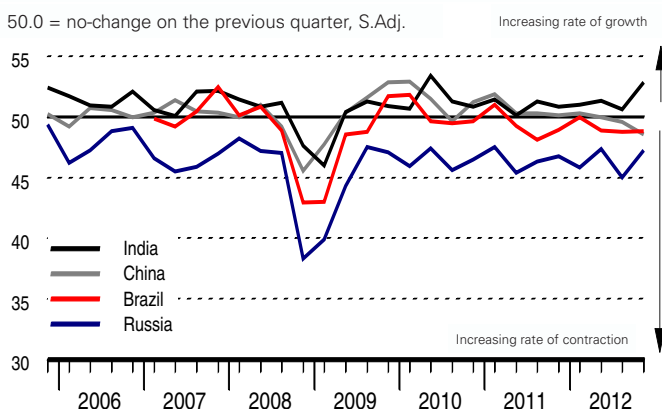
Backlogs of work at service sector firms were reduced at the fastest pace since Q3 2010. Meanwhile, the level of work-in-hand at manufacturers declined at a slower pace in Q4.

Outstanding business fell across three of the four largest emerging economies in Q4. India was the only BRIC country to record a higher level of work-in-hand, with the rate of accumulation quickening from Q3. Russia registered the strongest reduction in backlogged work. Backlogs were cleared at a slightly faster pace in China in Q4, and Brazil signalled a similar, marginal rate of depletion to Q3.

Outstanding business by sector



Outstanding business in BRIC countries (all sectors)



Employment

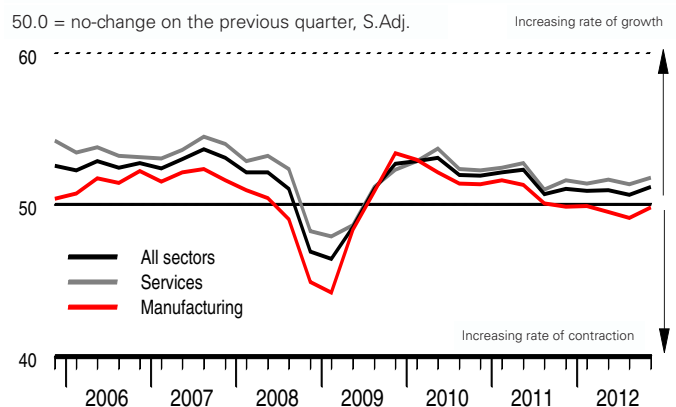
Quickest rate of job creation since Q2 2011

Employment levels at manufacturing and service sector firms in emerging markets increased for the fourteenth successive quarter in Q4. The rate of job creation accelerated from Q3 to the quickest since Q2 2011.

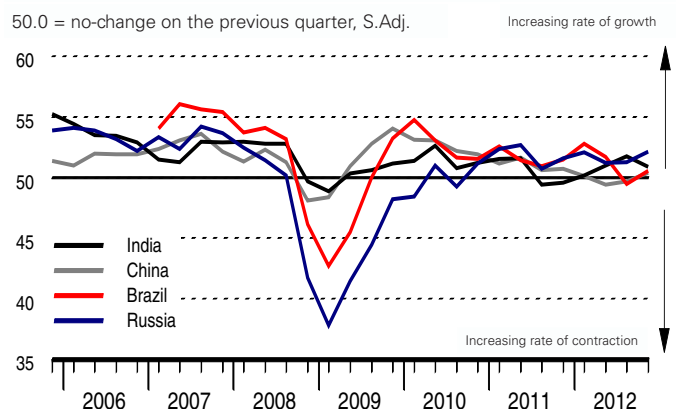
Service sector firms registered another expansion of workforce numbers in Q4, with employment now increasing at the fastest pace since Q2 2011. In contrast, manufacturers shed staff for the fifth successive quarter, albeit only marginally.

Employment rose across all four of the largest emerging economies in Q4. Brazil, China and India all signalled slight rates of expansion. Russia, however, recorded a stronger rate of job creation that quickened since Q3. Service sector staff increased in all four BRIC economies, but India was the only one to register job creation in its manufacturing sector.

Employment by sector



Employment in BRIC countries (all sectors)



Input Prices

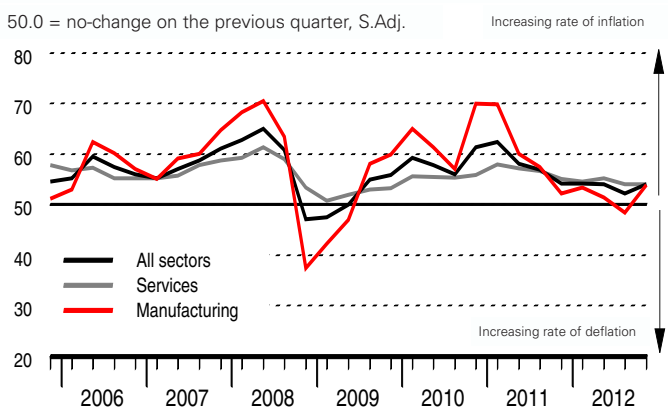
Cost inflation quickens but remains below-trend

Average input prices faced by firms in emerging markets increased in Q4. The pace of inflation quickened from Q3, which was particularly weak, but remained below the long-run average.

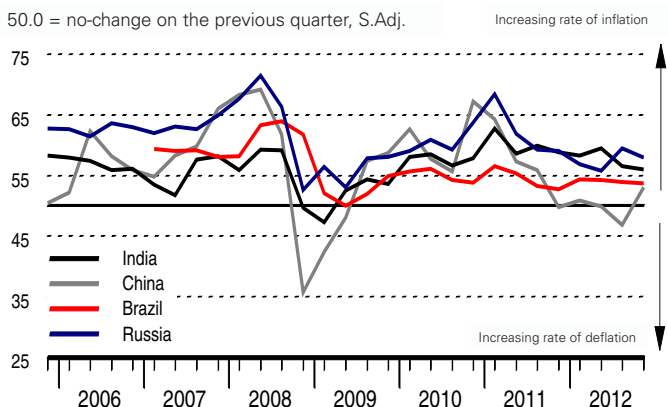
Manufacturers' input prices rose following a modest reduction in Q3. The rate of inflation was the quickest since Q3 2011. Meanwhile, service sector input price inflation remained similar to Q3, posting the second-weakest rate of any quarter in the past three years.

Input prices in China's combined manufacturing and services economy rose after falling for two consecutive quarters, while Brazil and India both registered slightly slower rates of inflation. Input price inflation in Russia remained the sharpest out of the four BRIC economies, despite having eased slightly in Q4.

Input prices by sector



Input prices in BRIC countries (all sectors)



Output Prices

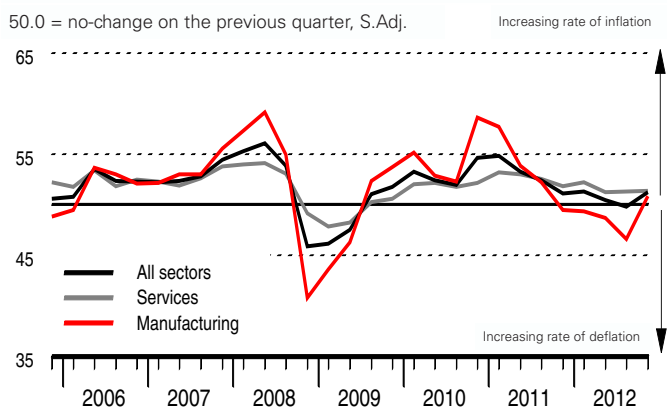
Average tariffs increase in Q4, after no change in Q3

Average tariffs charged by firms in emerging markets for goods and services increased marginally in Q4, following a flat trend in Q3.

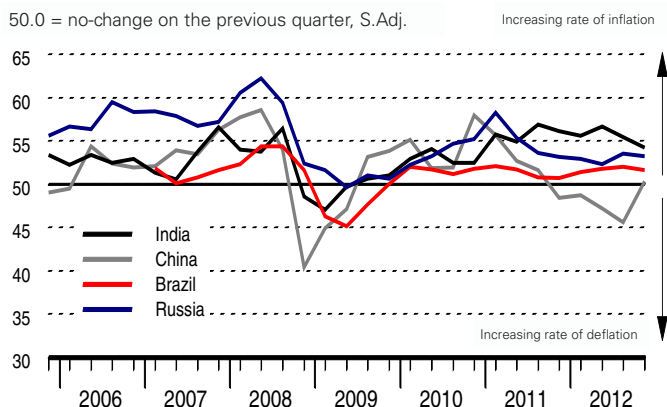
Manufacturers increased output charges in Q4 following four successive quarters of discounting. However, the overall rate of increase was only marginal. Meanwhile, service sector charges continued to rise at a modest pace.

The renewed rise in average tariffs reflected gains across all of the four largest emerging economies in Q4. China's private sector signalled a fractional increase in output charges after four consecutive quarters of reductions. Average tariffs in Brazil, India and Russia all rose at a slightly weaker rates compared with the previous quarter.

Output prices by sector



Output prices in BRIC countries (all sectors)



New Export Orders

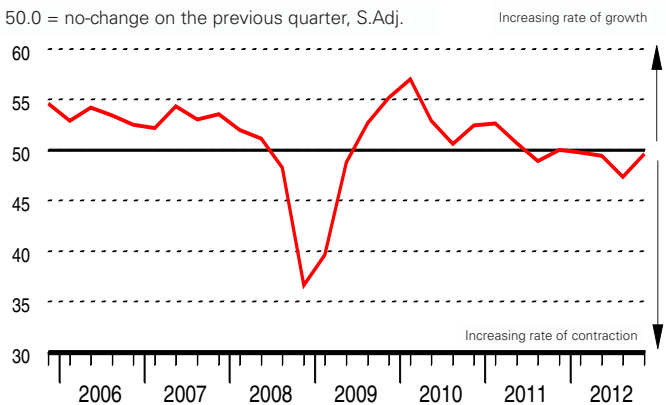
New export orders fall at weakest pace since Q1 2012

Manufacturers in emerging markets signalled a reduction of new export orders for the fourth successive quarter in Q4. However, it was the weakest reduction in new exports since Q1.

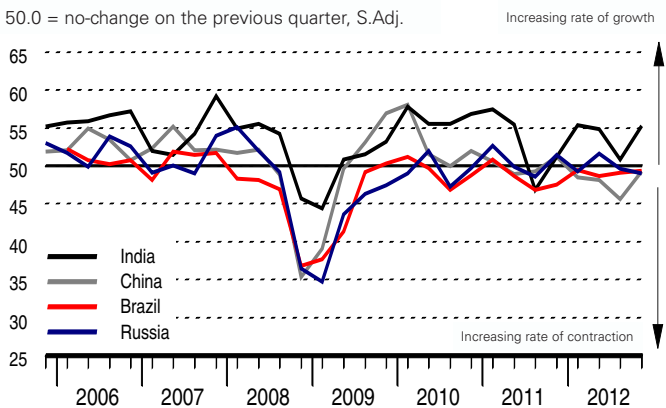
In Asia, new export business fell across all monitored regions except India, Indonesia and Turkey. Moreover, growth of new export business in India accelerated during Q4 to the quickest since Q1. Strong increases were also recorded in Saudi Arabia and the United Arab Emirates.

Chinese new export orders fell at a marginal pace, the weakest pace in the current four-quarter sequence of reduction. The strongest falls in new export orders were recorded in Israel, the Czech Republic, Poland and Taiwan. Brazil and Russia signalled only marginal declines in new export business.

New export orders (manufacturing)



New export orders in BRIC countries (manufacturing)



Quantity of Purchases

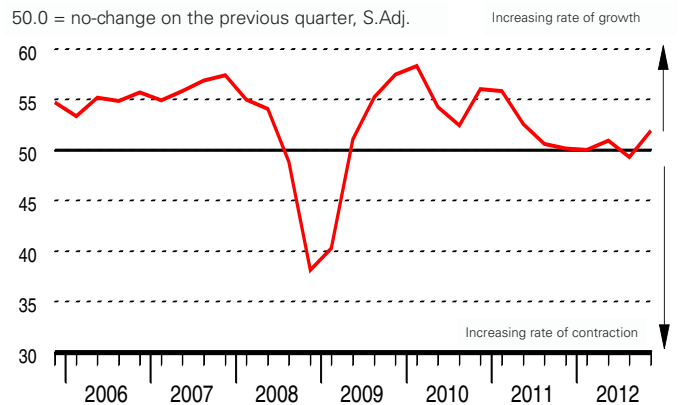
Purchasing activity increases at fastest rate since Q2 2011

Purchasing activity at manufacturing firms in emerging markets increased in Q4, following a slight reduction in Q3. Moreover, the rate at which input buying increased was the quickest since Q2 2011.

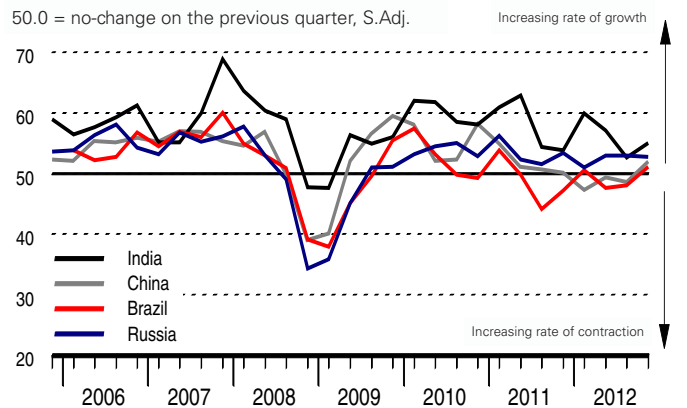
China registered purchasing growth after a three-quarter period of reduction. Rising input volumes were also registered in Brazil, India, Mexico, Indonesia, Russia, Turkey, Saudi Arabia and the United Arab Emirates.

Purchasing in India picked up in Q4 from the low in Q3, but remained below long-run average. Brazilian manufacturers reported growth after a modest contraction in Q3. Purchasing fell in the Czech Republic, Poland, Taiwan, South Korea, Vietnam and Hong Kong.

Quantity of purchases (manufacturing)



Quantity of purchases in BRIC countries (manufacturing)



Stocks of Finished Goods

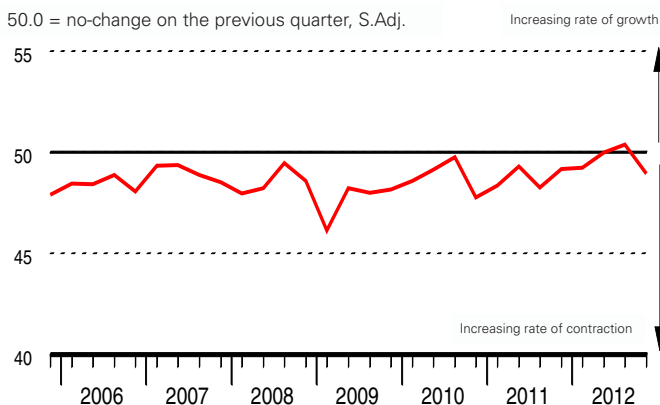
Stock levels fall in Q4

The level of final goods held in stock at manufacturing companies in emerging markets fell in the three months to December, after increasing slightly in Q3. That said, the rate of reduction was only modest.

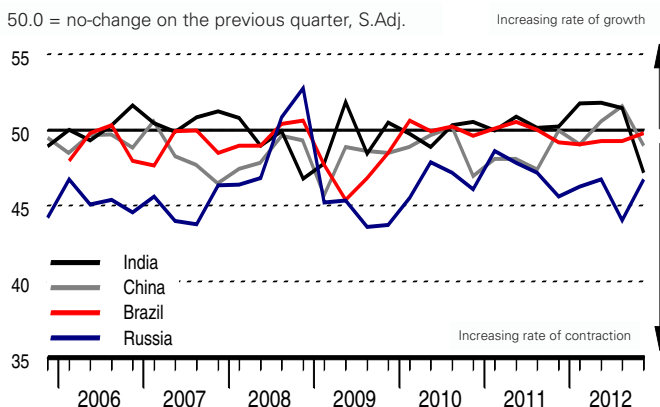
Goods producers in China reported a reduction in inventories after a modest accumulation in Q3, though the rate of depletion was only slight. India reported a fall in stocks in Q4 after an increase in Q3, and recorded a modest rate of depletion. Stocks also fell in Brazil, the Czech Republic, Poland, Russia, Singapore, Turkey, Taiwan, South Korea and Vietnam.

Only manufacturers in Indonesia and Mexico registered an accumulation of stocks in Q4, with the rates of expansion marginal and modest respectively.

Stocks of finished goods (manufacturing)



Stocks of finished goods in BRIC countries (manufacturing)



Stocks of Purchases

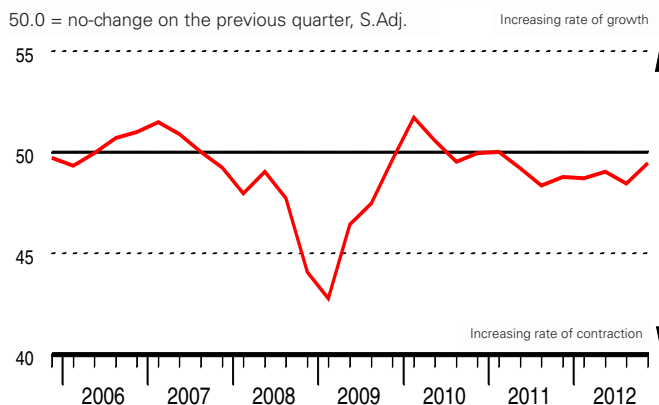
Stocks of purchases decline at weakest pace in current sequence

Stocks of purchases held at manufacturers in emerging markets continued to fall in Q4. Stocks have now fallen in each quarter since Q2 2011. However, it was the weakest rate of reduction in the current trend.

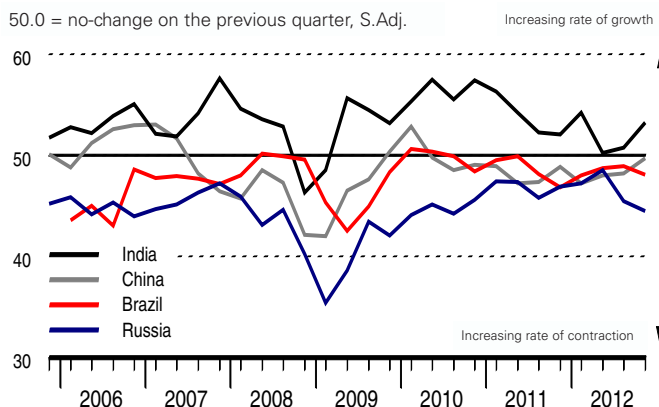
Stocks of inputs in Brazil, China and Russia continued to be depleted in Q4, with the most marked rate of reduction noted in Russia. Israel registered the sharpest rate of reduction out of all monitored regions, while falls were also noted in Poland, the Czech Republic, Turkey, Taiwan, South Korea and Vietnam. Input inventories in South Africa fell in Q4 for the first time in three years.

The only BRIC economy to register an accumulation of stocks was India, where stocks have risen since Q2 2009. Saudi Arabia, Mexico, Hong Kong, Singapore and the United Arab Emirates all signalled a higher level of pre-production goods.

Stocks of purchases (manufacturing)



Stocks of purchases in BRIC countries (manufacturing)



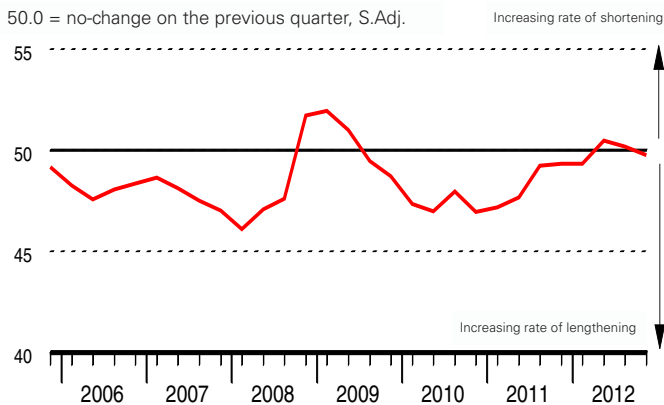
Suppliers' Delivery Times

Supplier performance deteriorates in Q4

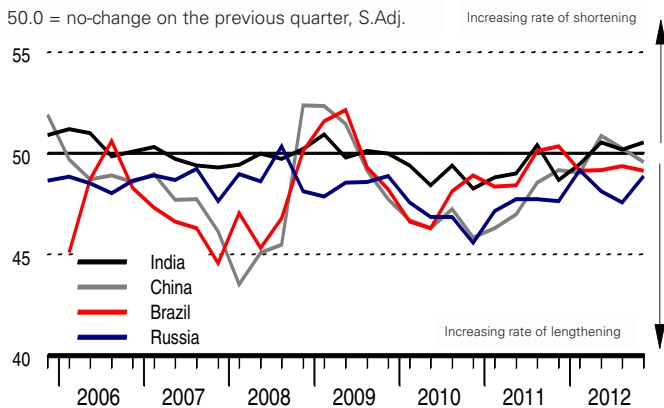
Average suppliers' delivery times at manufacturers in emerging economies lengthened in Q4, after quickening slightly in Q3. However, the rate at which times lengthened was only slight. Supplier performance worsened in China following an improvement in Q3, though the rate of deterioration was only marginal. Vendor performance also deteriorated in Brazil, the Czech Republic, Poland, Russia, Turkey, Taiwan, South Korea and Mexico. Times lengthened at a modest pace in both Brazil and Russia.

India was the only BRIC economy to report an improvement in vendor performance. Times also shortened in Israel, South Africa, Singapore, Hong Kong, Saudi Arabia, the United Arab Emirates, Vietnam and Indonesia.

Suppliers' delivery times (manufacturing)



Suppliers' delivery times in BRIC countries (manufacturing)



Business Expectations

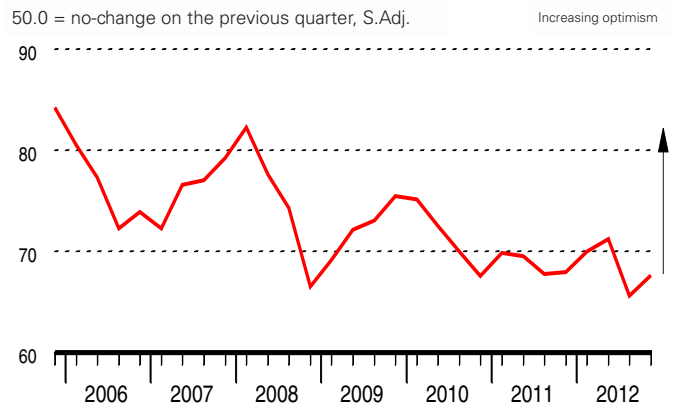
Service providers signal a subdued level of confidence

Positive sentiment among service providers regarding growth expectations in 12 months' time was registered in Q4, having increased from the record-low reported in Q3. That said, the degree of optimism was still below the long-run series average, and one of the lowest readings in the series.

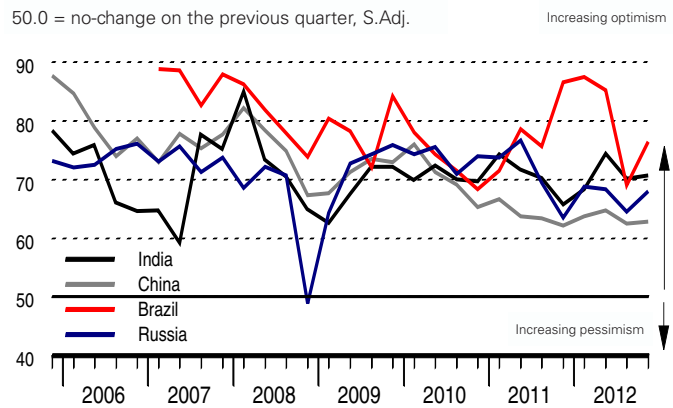
Optimism was weakest in China, where it remained at a broadly similar level to Q3. The second-lowest degree of sentiment was registered in Russia, despite having improved since Q3.

Brazilian service providers posted the strongest degree of confidence, having risen sharply from the previous quarter. Optimism in India was also strong, having increased slightly from Q3.

Business expectations (services)



Business expectations in BRIC countries (services)



Background Information

The Survey

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, Vietnam, Indonesia, the United Arab Emirates, Saudi Arabia and the increasingly important BRIC economies of Brazil, Russia, India and China. These surveys collectively track business conditions in over 8,000 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.

Data Sources

Country/ Region	Producer:
Brazil	Markit
Russia	Markit
India	Markit
China	Markit
South Korea	Markit
Taiwan	Markit
Hong Kong	Markit
South Africa	BER
Singapore	SIPMM
Israel	IPLMA
Turkey	Markit

Poland	Markit
Czech Republic	Markit
Mexico	Markit / IMEF
Indonesia	Markit
Vietnam	Markit
UAE	Markit
Saudi Arabia	Markit

HSBC

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We serve around 60 million customers through our four global businesses: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets, and Global Private Banking. Our network covers 84 countries and territories in six geographical regions: Europe, Hong Kong, Rest of Asia-Pacific, Middle East and North Africa, North America and Latin America. Our aim is to be acknowledged as the world's leading international bank.

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Issued by HSBC Holdings plc
HSBC Holdings plc
8 Canada Square
London E14 5HQ.

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