

HSBC Emerging Markets Index Q4 2011

Lacklustre economic expansion from emerging markets in Q4 as manufacturing weakness negates services activity

Key points

- **HSBC Emerging Markets Index reflects little change with only marginal increase to 52.2 in Q4 2011**
- **Decline in inflation across emerging markets but eurozone crisis casts shadow on growth prospects**
- **Manufacturing slowdown sharpest since Q1 2009 led by emerging Asia, including China, although India outperformed**
- **Service sector activity growth increases slightly during Q4 but optimism muted by historic standards**
- **Slowdown in world trade growth throughout 2011 since peaking at the beginning of the year**

Summary

Emerging market growth remained lacklustre in Q4 as an improved rate of expansion in service activity only marginally outweighed a further decline in output from manufacturers, the HSBC Emerging Markets Index (EMI) shows.

The EMI edged slightly higher to 52.2, from 52.0 in Q3, reflecting a subdued rate of economic expansion as world trade declined during 2011, following its peak earlier in the year. The risk of further economic contagion from the US, the UK and even the emerging nations themselves weighed heavily on sentiment.

Consistent with a trend identified in the previous EMI, service activity outperformed manufacturing, as the divergence between each sub-index reached its widest in 11 quarters. Emerging market manufacturing output fell for a second successive quarter and at the sharpest pace since Q1 2009, driven by a reduction in factory output across emerging Asia. In contrast, service providers saw business activity growth accelerate in Q4 from the nine-quarter low seen in Q3, and the services sector expressed continued optimism in its one-year business outlook, although the degree of positive sentiment was muted relative to previous indices.

Price pressures eased to a ten-quarter low as manufacturers and service providers felt the benefits of ongoing quantitative tightening by central banks across the emerging world in response to inflationary pressures identified by previous HSBC EMIs. The Q4 EMI signalled that the index monitoring manufacturing input price trends was more than 19 points lower than one year earlier.

Paul Bloxham, Chief Economist, HSBC New Zealand says: "Weaker conditions in the emerging economies is a concern for New Zealand, given the large trade

exposure to Asia. But despite weaker overall conditions, it is clear that demand for commodities has remained strong, which is a positive for New Zealand's farm sector. The emerging middle class in Asia, and particularly in China, is an ongoing medium-term driver of Asia's growth, despite the current global cyclical downturn. Policy moves by Asian authorities to support growth across the region, will also help to support demand for New Zealand's exports."

Stephen King, HSBC's Chief Economist, said: "Emerging markets finished 2011 with only a marginal improvement in economic expansion for the final quarter, emphasising a decline in world trade growth over the year after peaking at the beginning of 2011. Although not recording the previous lows at the height of the recession in late 2008 and early 2009, this quarter's EMI is far from those levels reached in the early months of recovery during late 2009 and early 2010.

"While some have blamed a reduction in emerging market activity on factors beyond their own control, namely the eurozone crisis, and weakness both in the US and UK, the emerging economies themselves have also contributed to a lack of momentum. Additionally, as events in the Middle East increased economic and political uncertainty in the region and also led to elevated oil prices, inevitably emerging nations had to adopt policies to inhibit growth and ease price pressures to avoid inflation.

"These 'quantitative tightening' policies have had some success, replacing the inflationary concerns of policymakers in the emerging markets with new growth fears which are expected to continue during 2012 as the full impact of the eurozone crisis is felt. Although the emerging markets will have much to contend with over the next twelve months, they have retained some firepower to deal with the fallout, with room to cut interest rates and provide fiscal stimulus to provide some 'bounceback-ability' across the region."

The decrease in manufacturing production was led by Taiwan and South Korea but the trend was mirrored across Asia, with China and Hong Kong easing and Singapore output stagnant. In contrast, Indian manufacturers registered a solid expansion in production levels, although the index was at the third-lowest level in the series history. Russia and Turkey recorded stronger rates of activity growth, with the rise in the latter the fastest in three quarters, while the Czech Republic and Poland registered expansion at markedly weaker rates than one year earlier.

Emerging market manufacturers reported fractionally

lower volumes of new export business during Q4, although the pace of decline slowed compared with the previous quarter. China, India and Russia all experienced renewed export growth but Brazil saw a third successive quarterly decline. Of the other emerging markets surveyed, Turkey, Saudi Arabia and the UAE also recorded growth in the fourth quarter while all other markets declined.

Service sector activity growth edged upwards from the nine-quarter low seen in Q3 2011, with Brazil and China both recording faster rates of expansion during Q4 even as India and Russia both saw growth ease. When questioned about the prospects for activity over the coming year, emerging market service providers demonstrated muted optimism, with Chinese confidence touching a series-low, closely followed by India and Russia who posted 11- and 12-quarter lows respectively. Brazil bucked this trend, with service providers the most optimistic in four years.

Frederic Neumann, HSBC's co-head of Asian Economics Research, said: *"The Q4 EMI findings painted a broadly similar picture to that seen in Q3. Asia's manufacturers may have been hit harder than others but domestic demand remains resilient. We are not seeing the return of 2008 with a collapse in the region but merely slowing economies. With the uncertainty in the Eurozone still lingering, policy stimulus may be needed to sustain Asia's growth. For the effect to unfold, however, it will take some time, with growth only beginning to perk up again by the second quarter, barring another combustion in Europe."*

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 12 April 2012.

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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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