HSBC Emerging Markets Index

Q1 2012

HSBC

Stephen King

EMI underlines the relative immunity of emerging nations to the economic permafrost of the developed world

12 April 2012

Policymaker attention turns to promoting growth after period of quantitative tightening

The rise in the HSBC Emerging Markets Index to 53.4 in the first quarter of 2012 from 52.4 in the final quarter of 2011 underlines the relative immunity of emerging nations to more damaging developments elsewhere in the world.

Fears that emerging nations would suffer from their economic connections with the eurozone – through either trade or financial flows – have mostly proved unfounded. While the eurozone is now flirting with recession – with some member states already contracting – conditions in the emerging world have gently improved, even if emerging nations, in aggregate, have not been able to keep pace with the US.

Although the EMI has now risen for two successive quarters, the index remains at a relatively low level, suggesting that there has, as yet, been no return to "business as usual". Part of the reason has been a further deterioration in readings on the Chinese economy where, with the exception of the precipitous drop that took place at the end of 2008 and the beginning of 2009 – when the world economy crumpled in the light of the Lehman crisis – latest manufacturing results are the weakest since the China series began in 2004.

Part of China's weakness doubtless reflects deteriorating export prospects: at the beginning of 2012, new export orders fell at their sharpest pace in twelve quarters. Yet China's slowdown is not just an export story: new orders in total remained weak in the first quarter of 2012, continuing the softer pattern seen through much of last year. This domestic softening owes a lot to earlier persistent increases in Chinese banks' reserve ratios, an attempt to bring earlier inflationary pressures under control via "quantitative tightening".

Thanks to quantitative tightening and other unconventional measures – including, for, example, an increase in the use of controls to limit capital inflows – inflationary pressures both in China and across the emerging world more generally have eased. Although the beginning of 2012 saw a return of higher oil

prices, there is no indication as yet of any significant feed through into higher emerging market inflation. Policymakers are now a lot more focused on promoting growth than on limiting inflation.

The latest EMI readings are consistent with this change of tack. There are, however, one or two exceptions: inflationary pressures remain high in India, even if they have abated from their highs seen earlier last year while, in Turkey, input price inflation remains high even as output price inflation has drifted lower. And with interest rates in the western world remaining persistently low in coming years, policymakers in the emerging world will have to remain on the look-out for possible "hot money" threats to price stability in their own economies.

This, however, is a small problem to have. Compared with the developed world, the emerging world enjoys plenty of advantages, at least from the point of view of economic growth. With much lower per capita incomes, many emerging nations still have many years of economic "catch-up" ahead of them, suggesting that their growth rates – driven by continuous urbanisation alongside productivity gains linked to improved access to global capital – should remain significantly higher than in the west.

They also enjoy a lot more policy flexibility. Whereas interest rates are down at more or less zero in both the US and Europe, matching the earlier experience of Japan, emerging nations still have plenty of available ammunition including rate cuts, reserve ratio cuts and, if necessary, fiscal stimulus.

Overall, however, emerging nations still have to perform a juggling act, balancing the risks of too little growth against the threat – if not yet the reality – of too much inflation. Rising commodity prices have the capacity, eventually, to add both to inflation and, more worryingly, to income inequality, suggesting that the scale of any stimulus in the light of any growth shortfall will be a lot more modest than seen in, for example, 2009. One result is likely to be the weakest Chinese growth rate since 2001.

Despite this near-term cyclical weakness, the outlook for emerging nations remains encouraging. With the developed world suffering from economic permafrost, emerging nations are set to move further up the global economic rankings. By 2050, the top three economies in the world are likely to be China, the US and the India while the top ten will also include, from the emerging world, Brazil and Mexico.

Stephen King

Group Chief Economist

HSBC Emerging Markets Index

Emerging market output rises at fastest rate in three quarters in Q1

Key findings:
- Manufacturing production returns to growth in Q1, but lags rate of expansion in services output
- No change in manufacturing employment
- Input cost inflation little changed at below trend rate
- Service sector business optimism the highest in one-and-a-half years

Emerging market output growth gains traction in Q1

Growth of emerging market output (covering manufacturing and services) accelerated for a second successive quarter in Q1 2012, with the HSBC Emerging Markets Index, a quarterly indicator derived from the monthly *PMI*™ surveys, rising to 53.4 from 52.4 in the preceding quarter. Despite posting a three-quarter high, the Q1 index nonetheless signalled a below trend rate of expansion.

The EMI is based on 21 *PMI*™ *(Purchasing Managers' Index™)* surveys conducted across 16 emerging markets and provides the earliest and most reliable indication of economic trends.

Behind the rise in output at the headline level was a sustained expansion of activity at service providers, with growth reaching a three-quarter peak. Manufacturers meanwhile saw output increase for the first time in three quarters, albeit at a marginal rate.

Weakness in China weighs on growth of factory output

Under performance in China was the main drag on manufacturing output growth at the headline level in Q1. Manufacturers in the world's second-largest economy reported reduced production for the third quarter in a row, with the pace of decline the sharpest in that sequence. Apart from Q4 2008 and Q1 2009, when the financial crisis was at its worst, the index measuring trends in factory output was the lowest on record.

China was the only one of the big-four emerging markets to register lower manufacturing production in Q1. India saw output growth surge to a three-quarter high, while Brazil recorded a rise in production for the first time since Q2 2011. On a less positive note, Russia saw production growth ease to within touch of the nine-quarter low registered in Q3 2011.

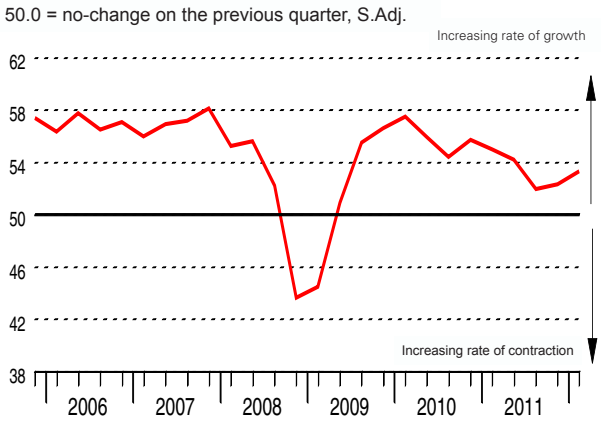
Demand for goods produced by emerging market manufacturers on global markets remained muted in Q1, with new export business falling marginally. Of the largest emerging markets, only India recorded growth of new export orders in the first quarter.

Service sector growth ticks higher; outlook improves

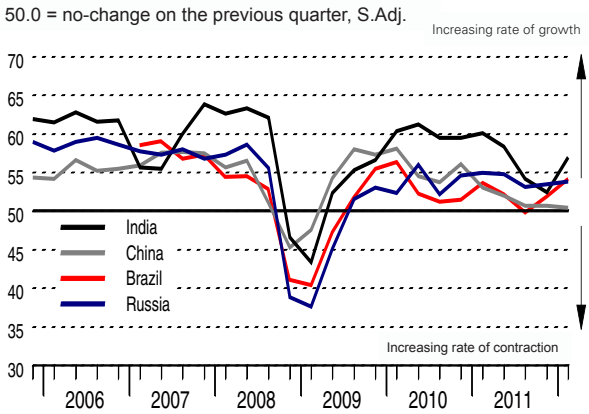
Emerging market service providers reported the strongest expansion of business activity in three quarters, although the pace of growth remained below trend. Of the big-four emerging markets, rates of expansion were broadly similar in Brazil (fastest in almost four years), India (three-quarter high), and Russia.

Looking ahead to the next 12 months, service sector business optimism was the highest in one-and-a-half years, with

EMI (all-sector output)



BRIC (all-sector output)



confidence improving across the board. However, with degrees of confidence below trend in three of the four monitored markets (Brazil the exception) the overall level of positive sentiment remained weaker than the series average. Service providers in Brazil were the most optimistic about the one-year business outlook since Q4 2007.

Muted supply chain pressures reflect subdued trend in purchasing

The average time taken by vendors to deliver inputs to emerging market manufacturers continued to lengthen marginally in the first quarter of 2012. Moreover, the incidence of delivery delays was unchanged on the preceding quarter (when the degree of lead time lengthening was the lowest in two-and-a-half years). This largely reflected muted demand amongst manufacturers for production inputs. Although only marginal, a fall in input buying contrasted with strong growth seen at the start of last year. The weak trend in purchasing was centred on Chinese manufacturers, which saw a first reduction in buying activity for three years. In contrast, strong rates of purchasing growth were recorded in India and Saudi Arabia. With companies acquiring fewer inputs, this contributed to a further depletion of pre-production inventory holdings in Q1, extending the current period of reduction to one year.

Manufacturers cut their charges in Q1, despite higher costs

The rate of input cost inflation at emerging world firms held broadly steady in Q1, breaking a trend of moderation observed throughout much of 2011. Although solid, the latest increase in average costs was among the weakest recorded by the series to date. For the second quarter in succession, service providers recorded a faster rate of input price inflation than manufacturing firms. Of the largest emerging markets, strong cost rises in India contrasted with only a marginal increase in overall costs faced by Chinese firms.

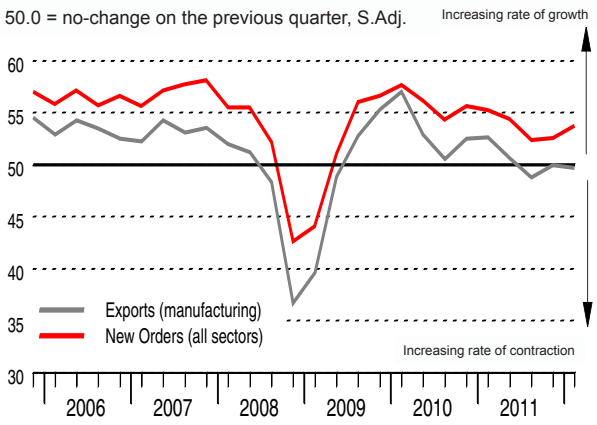
Emerging market firms passed on rising input costs to clients through increased output charges in Q1. However, the rate at which firms raised their charges was only modest. There were divergences at the sector level. Manufacturers noted a second successive quarter of output price discounting, while service providers reported a slight uptick in inflation. Looking at the breakdown by market, China was the only one of the big-four to record a reduction in overall selling prices in Q1.

Jobs growth remains muted in Q1

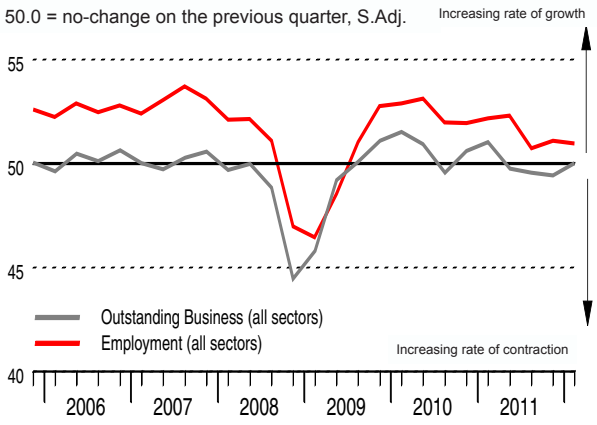
On the employment front, emerging market jobs growth remained subdued at the headline level. This not only reflected a stagnation of manufacturing employment, but also a relatively muted pace of job creation across the service sector. China and India were the principal drags on the overall pace of employment growth in Q1, with weakness seen across both manufacturing and services.

Part of the reason for the muted labour market picture was a lack of capacity pressure at firms' units. Both manufacturing firms and service providers reported a stabilisation of levels of work-in-hand (but not yet completed) in Q1, which resulted in no change at the composite level.

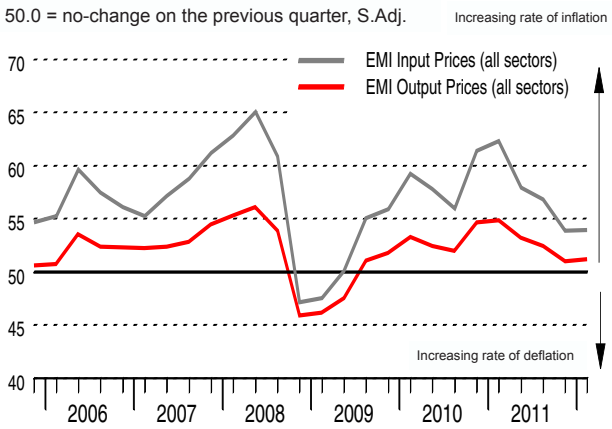
Orders and exports



Employment and backlogs of work



Input and output prices



Output

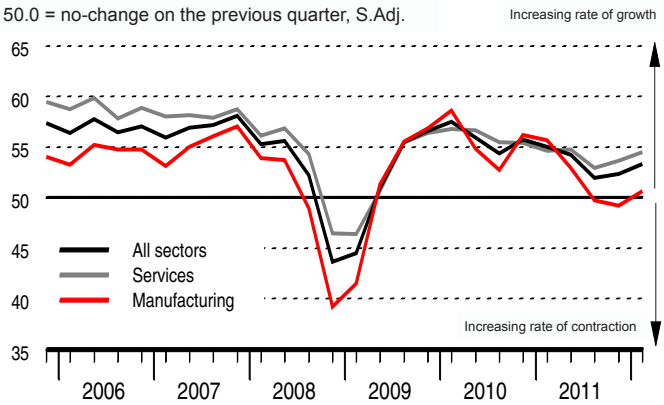
Emerging market output growth gains momentum at start of 2012

Emerging market output (covering manufacturing and services) continued to rise in Q1 2012, with growth reaching a three-quarter high. The latest expansion in output was the twelfth in as many quarters.

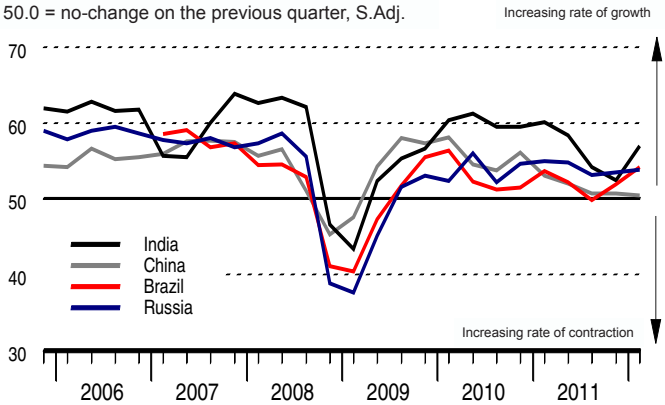
Looking at the breakdown by sector, manufacturers recorded a marginal rise in output for the first time in three quarters, while service providers saw a sustained expansion. Service sector business activity grew at the sharpest rate since Q2 2011, although the latest increase was below trend.

Of the big-four emerging markets, India saw the sharpest rise in overall activity (highest in three quarters), followed by Brazil (two-year high) and Russia (fastest since Q2 2011). On the other hand, China recorded only a marginal expansion of overall activity in Q1, with growth the slowest in three years.

Output by sector



Output in BRIC countries (all sectors)



New Business

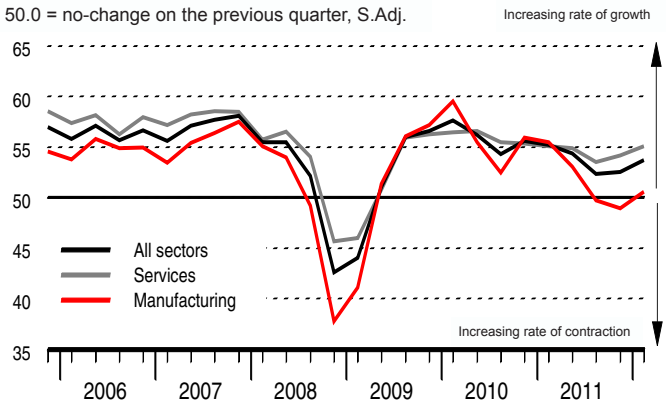
Growth of new business reaches three-quarter high in Q1

Behind the latest increase in output was a sustained rise in new orders placed at emerging market companies. Q1 saw the strongest growth of incoming new work in three quarters.

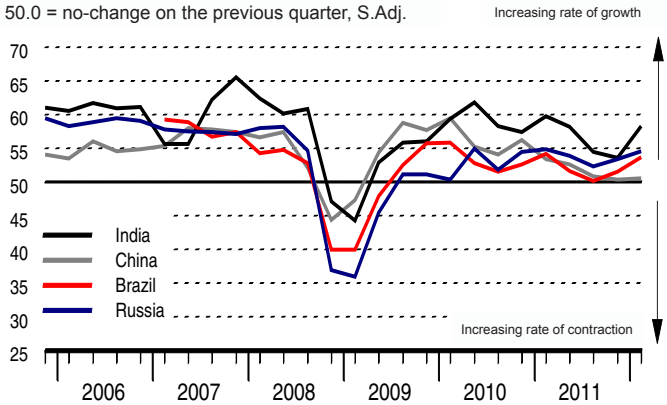
Overall growth of new business was centred on the service sector, which saw the highest rate of expansion for a year. Emerging market manufacturers meanwhile signalled an increase in new order intakes for the first time since Q2 2011, although growth was only marginal.

Assessing the combined growth of manufacturing and service sector new orders in the largest emerging markets, Brazil, India and Russia all recorded noticeably stronger rates of expansion than in the preceding quarter. China was the principal drag on growth at the headline level, with new orders continuing to increase at a marginal rate.

New business by sector



New business in BRIC countries (all sectors)



Outstanding Business

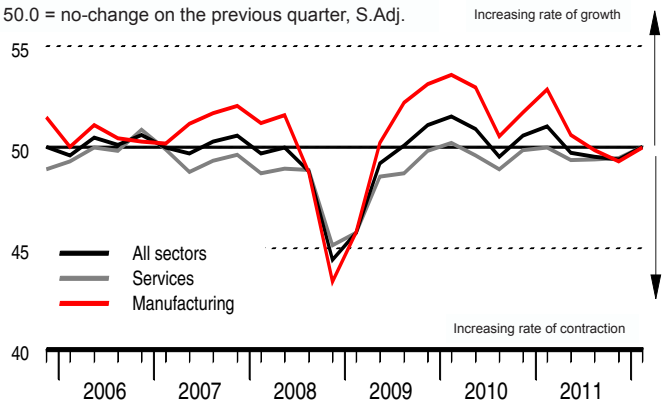
Backlogs of work were unchanged across manufacturing and services in Q1

Having fallen marginally in each of the past three quarters, backlogs of work at emerging market firms were unchanged in the first quarter of 2012.

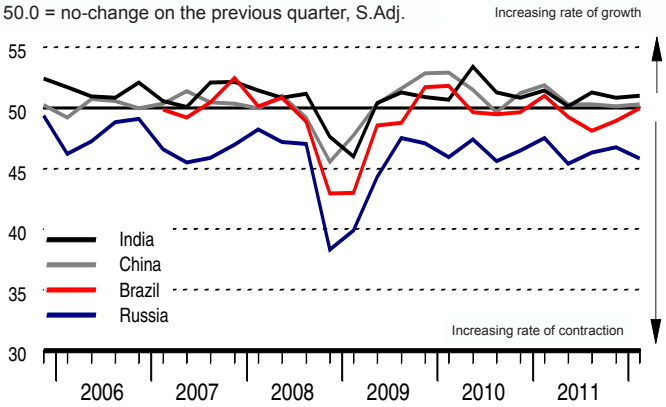
Emerging market manufacturers and service providers both reported no change in volumes of work-in-hand (but not yet completed) in Q1. The stabilisation of backlogs of work at manufacturers brought an end to a two-quarter period of decline, while Q1 was also the first quarter not to see a fall in service sector outstanding business for a year.

Russian companies recorded a marked decline in total work outstanding at their units, which contrasted with growth in China and India. Brazilian companies meanwhile recorded no change in backlogs of work, ending a three-quarter period of reduction.

Outstanding business by sector



Outstanding business in BRIC countries (all sectors)



Employment

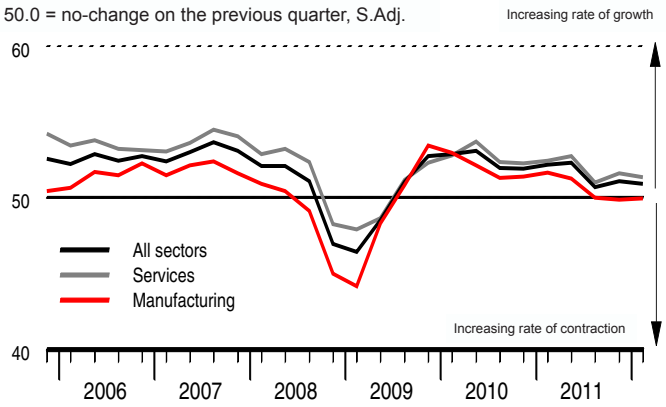
Jobs growth supported by hiring in services, as manufacturing employment stagnates

The latest EMI findings showed emerging market employment increasing for an eleventh successive quarter in Q1. However, the rate of jobs growth was marginal, and among the slowest in that sequence.

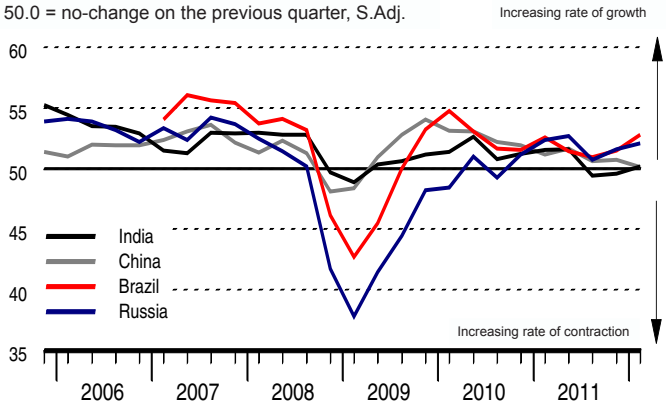
No change in the size of the manufacturing sector workforce was signalled by the latest data. In contrast, service providers noted a further increase in staff numbers in Q1. However, the rate of job creation was only modest, and the second-slowest in two-and-a-half years.

Looking at the largest emerging markets, total staff numbers increased to the greatest extent in Brazil (fastest in seven quarters), followed by Russia (highest since Q2 2011). In contrast, companies in China and India reported negligible rates of job creation in Q1.

Employment by sector



Employment in BRIC countries (all sectors)



Input Prices

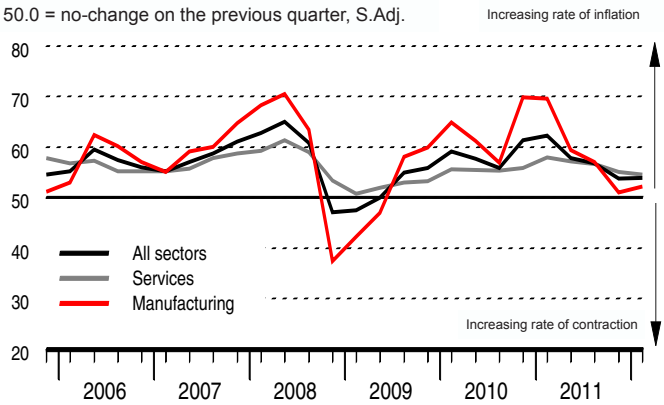
Input price inflation little changed at solid rate

Emerging market companies noted another quarter of input price inflation in Q1, extending the current period of rising costs to three years. Although solid, the overall increase in operating costs was markedly weaker than that recorded at the start of 2011.

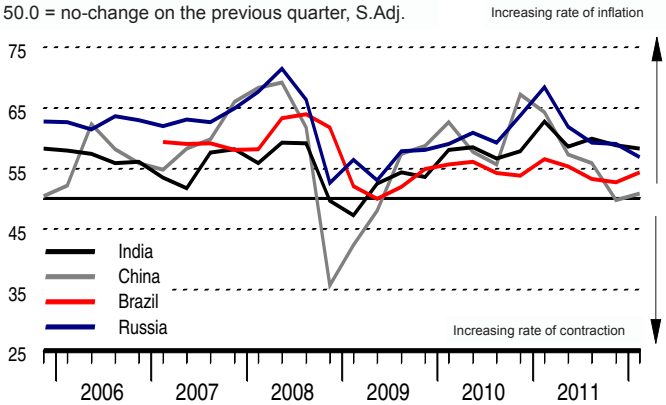
The rate of input price inflation in the manufacturing sector accelerated for the first time in five quarters. However, the latest rise was still among the weakest recorded by the series to date and slower than that seen in the services industry, where the pace of cost inflation eased to a nine-quarter low.

Of the big-four emerging markets, India saw the sharpest rate of input cost inflation across the combined manufacturing and service sector. Conversely, China noted only a marginal rise in average cost burdens faced by companies.

Input prices by sector



Input prices in BRIC countries (all sectors)



Output Prices

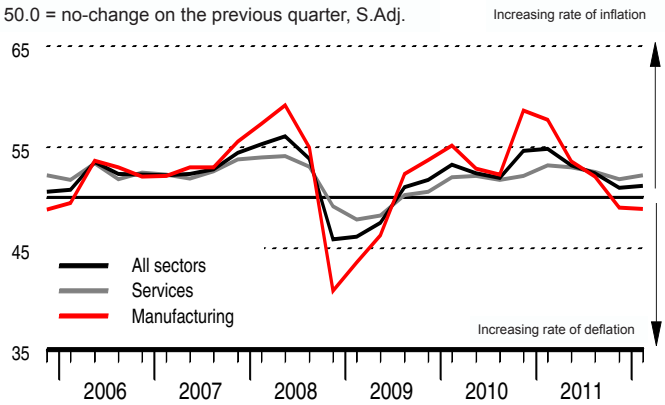
Output price inflation ticks higher in Q1, but nonetheless remains muted

In line with the trend observed since Q3 2009, output prices set by emerging market companies rose in Q1 2012. Despite inching higher since the preceding quarter, the rate of output charge inflation was only modest.

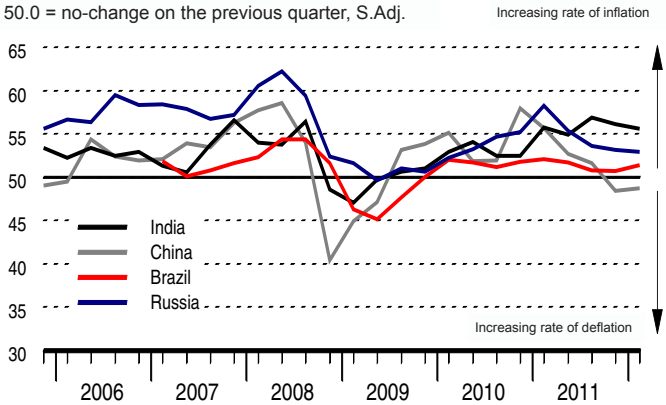
There were divergent trends at the sector level. Manufacturers reported a further reduction in factory gate charges, although the rate of decline remained marginal. Service providers, meanwhile, noted a continued rise in selling prices, with the pace of inflation slightly higher than in the preceding quarter.

Looking at the largest emerging markets, China was the only one to record a reduction in average tariffs at the composite level. Output charge inflation eased in both India and Russia, reaching three- and eight-quarter lows respectively. Meanwhile, Brazilian firms raised their tariffs at a modest rate in Q1.

Output prices by sector



Output prices in BRIC countries (all sectors)



New Export Orders

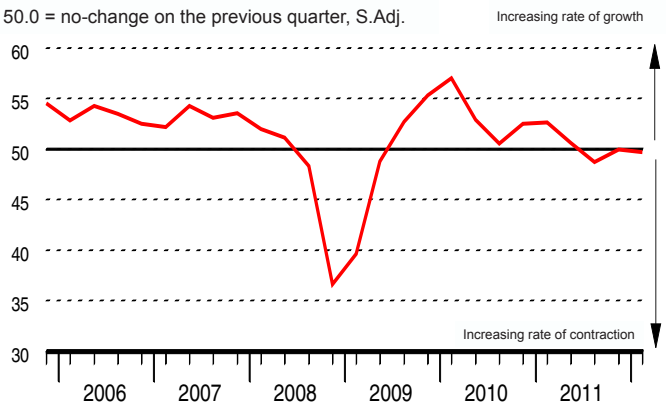
EMI findings show renewed decline in new export business

The level of new export business received by emerging market manufacturing firms fell in Q1, following no change in the final quarter of 2011. However, the pace of reduction in new export orders was marginal.

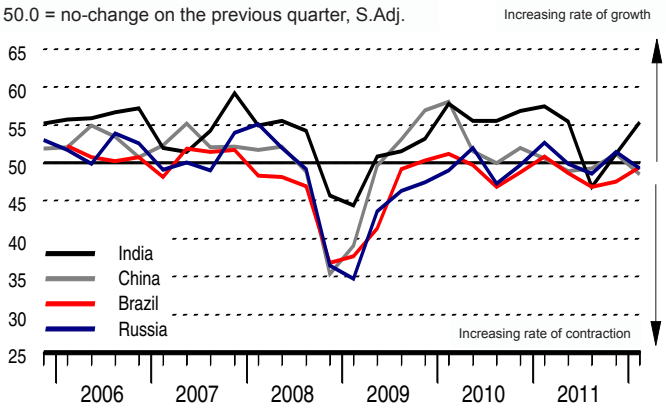
Of the largest emerging markets, India was the only one to record a rise in foreign order levels, with growth reaching a three-quarter peak. Russia recorded a renewed decline in new export business, albeit marginal, while Brazilian manufacturers reported the weakest pace of reduction in new work from international clients for a year.

Meanwhile, manufacturers in China saw new export orders fall at the sharpest rate in 12 quarters. Reduced export sales were also recorded in the Czech Republic, Israel, Singapore and South Korea.

New export orders (manufacturing)



New export orders in BRIC countries (manufacturing)



Quantity of Purchases

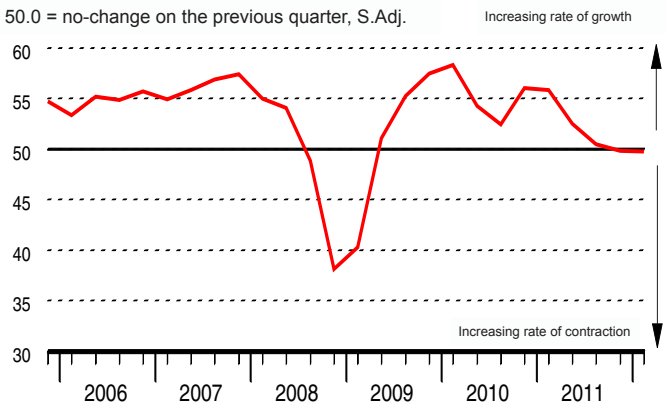
Purchasing activity declines marginally in Q1

A further decrease in the amount of inputs purchased by emerging market companies was signalled by the latest EMI data. The index measuring trends in buying activity was nonetheless at a level indicative of only a marginal rate of reduction.

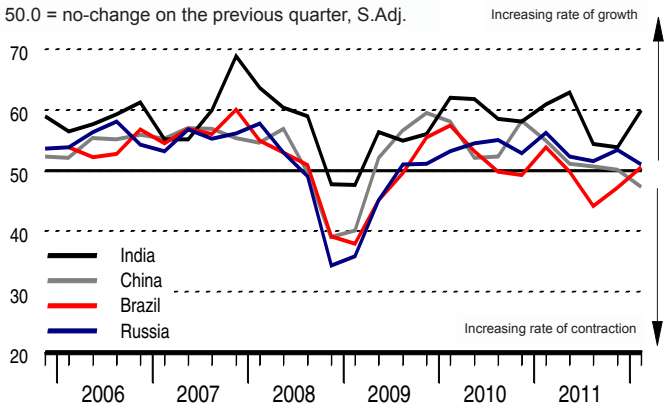
The decline in purchasing at the headline level mainly reflected reduced buying activity at Chinese manufacturers in Q1 – the decline was the first in three years. Brazil saw purchasing return to marginal growth, while input buying in Russia rose at the slowest rate in nine quarters.

In contrast, manufacturers in India and Saudi Arabia saw rates of purchasing growth surge in the first quarter of 2012, with the increase in the India the sharpest since Q2 2011.

Quantity of purchases (manufacturing)



Quantity of purchases in BRIC countries (manufacturing)



Stocks of Finished Goods

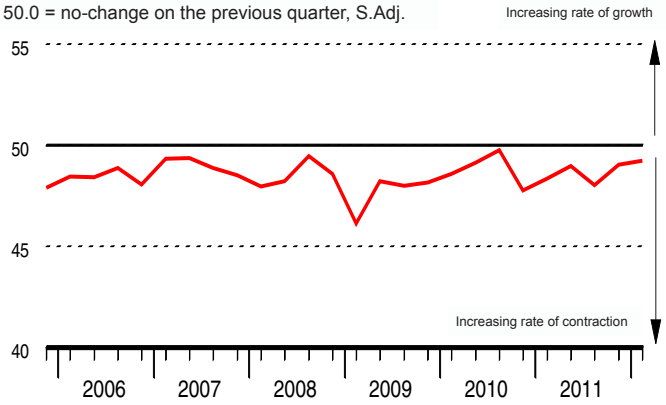
Manufacturers record slowest decline in stocks of finished goods since Q3 2010

Post-production holdings at emerging world manufacturers were reduced during Q1, as has been the case throughout the series history. The rate of inventory depletion was marginal, however, and the slowest in one-and-a-half years.

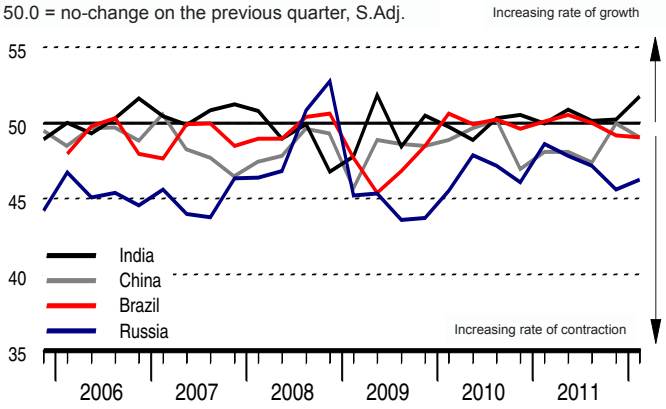
Stocks of finished goods fell across the majority of emerging markets monitored by the EMI, with India, Singapore, Turkey and Taiwan the exceptions.

Brazilian manufacturing firms reported a further decline in post-production inventories. Although marginal, the rate of depletion was the sharpest in nine quarters. China recorded a similarly marginal drop in stock levels during Q1. Meanwhile, manufacturers in the Czech Republic, Poland and Russia registered particularly marked rates of inventory depletion.

Stocks of finished goods (manufacturing)



Stocks of finished goods in BRIC countries (manufacturing)



Stocks of Purchases

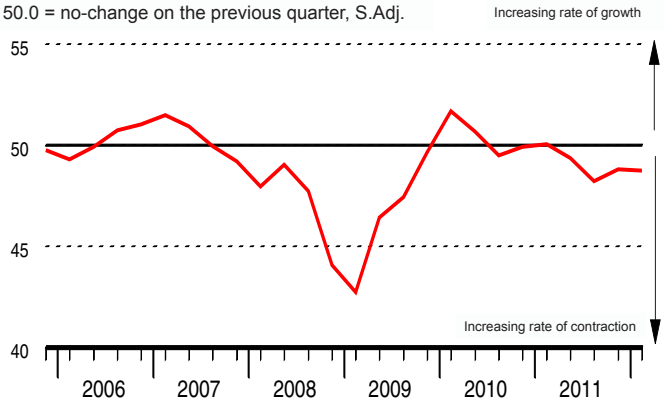
Pre-production inventories down for the fourth quarter in succession

Reflecting reduced buying activity, stocks of purchases at emerging market manufacturers fell during Q1, extending the current period of reduction to four quarters.

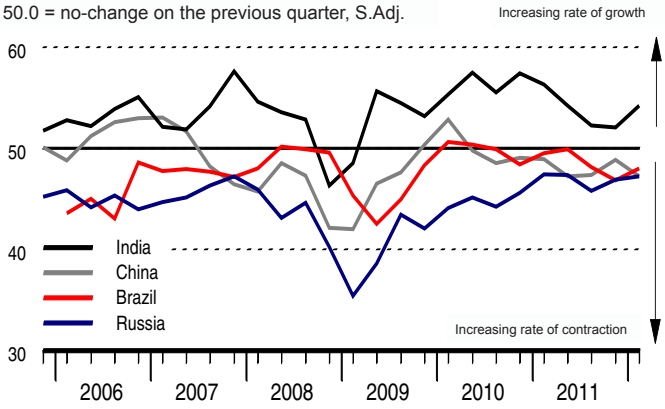
Of the 16 markets for which inventory data are available, nine recorded lower stock holdings in Q1, with Israel recording the sharpest rate of inventory depletion.

India was the only one of the big-four emerging markets to record a rise in stocks of purchases, with the pace of increase the highest in three quarters. In contrast, manufacturers in China registered the fastest drop in inventory levels since Q2 2011. Elsewhere in Asia, South Korean manufacturers reported reducing their inventory holdings in Q1, while companies in Taiwan noted growth for the first time in three quarters.

Stocks of purchases (manufacturing)



Stocks of purchases in BRIC countries (manufacturing)



Suppliers' Delivery Times

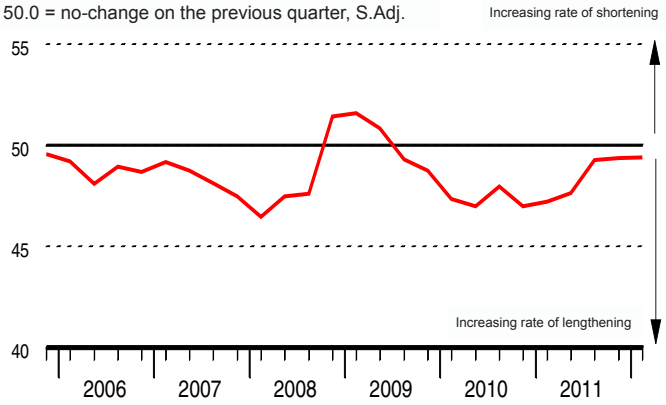
Supplier lead times lengthen at marginal rate in Q1

The average time taken by suppliers to deliver inputs to emerging market manufacturers lengthened in the first quarter of 2012. However, the rate of deterioration in vendor performance remained slight.

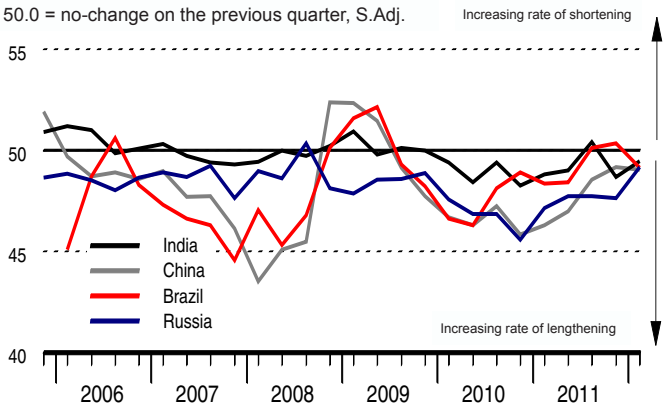
The latest EMI findings showed average supplier performance deteriorating marginally in each of the big-four emerging markets. Brazil recorded longer lead times for the first time in three quarters, but Russian manufacturers noted the lowest incidence of delivery delays in three-and-a-half years.

Manufacturing firms in the Czech Republic noted the sharpest rate of delivery time lengthening of all monitored markets, followed by Taiwan. Longer lead times in Taiwan largely reflected supply chain disruption emanating from the Thailand flood crisis.

Suppliers' delivery times (manufacturing)



Suppliers' delivery times in BRIC countries (manufacturing)



Business Expectations

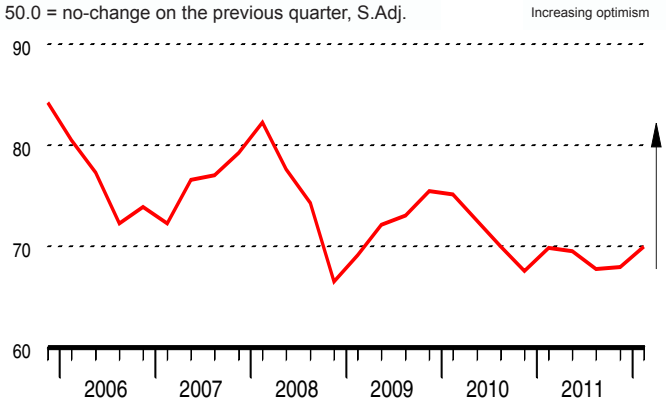
Service sector confidence the highest for a year-and-a-half, but still below trend

Emerging market service providers expect business activity to be higher in 12 months' time, with the degree of optimism improving to the highest for a year-and-a-half. The index measuring trends in business expectations was nonetheless below the long-run series average.

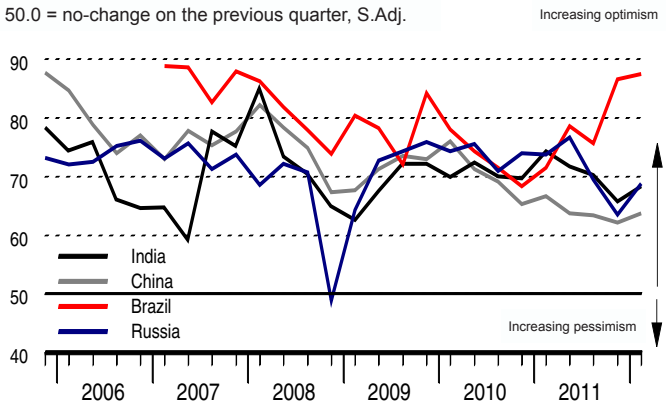
Brazilian service providers reported by far the most optimistic view regarding the 12-month outlook for business activity, with positive sentiment the highest in more than four years.

China saw service sector optimism improve to a three-quarter high, while Indian firms were also more confident than in the final quarter of last year. Meanwhile, Russia recorded a strong rebound in service sector optimism. In all three cases, however, Business Expectations Indexes remained lower than their respective long-run averages.

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, 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.

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	IMEF
UAE	Markit
Saudi Arabia	Markit

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About 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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