2009 INVESTOR ROADSHOW – HONG KONG AND SHANGHAI

# China Economy

HONGBIN QU
CHIEF ECONOMIST
CHINA

DAY 4, 19 NOVEMBER 2009

HSBC
The world's local bank

# 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.**

All financial information used in this presentation is reported in accordance with IFRS and extracted from HSBC Holdings plc's 2009 Interim Report unless indicated otherwise. 'Hong Kong' includes Hang Seng Bank, 'Asia' includes Hong Kong and Rest of Asia and 'Asia-Pacific' includes Asia and the Middle East, unless stated otherwise.

# Agenda

**Infrastructure-led recovery will sustain momentum into 2010**

**Exit: when and how?**

**Internationalising the RMB**

**Rebalancing growth**

**HSBC forecasts**

# Infrastructure-led recovery will sustain momentum into 2010

HSBC

The world's local bank

# China's recovery earlier and stronger than expected

## GDP growth[1]

Note:
(1) CEIC, HSBC

# Infrastructure-centric rebound more sustainable

## Investment growth[1]

Note:
(1) CEIC, HSBC

# What overcapacity?

## Beijing Subway map[1]

## London Underground map[2]

Notes:
(1) www.bjsubway.com
(2) www.tfl.gov.uk

# Housing sales and investment recovering

## Housing sales and property investment[1]

Note:
(1) CEIC, HSBC

# Industrial profits have started to improve

## Industrial profit growth[1]

Note:
(1) CEIC, HSBC

# HSBC China PMI employment index surged to a 25-month high

## HSBC China Purchasing Managers' Index: Employment[1]

Note:
(1) Markit, HSBC

# Exit: When and how?

HSBC
The world's local bank

# Asset price bubble a real risk?

## Household income and property prices[1]

## PE ratio of Shanghai A shares

Note:
(1) CEIC, HSBC

# Consumer price index likely to turn positive in 4Q09

## Consumer price index (CPI) vs forecast[1]

## CPI and M1 money supply[1]

Note:
(1) CEIC, HSBC

# Until global demand fully recovers, spare capacity should curb inflation

## Output gap vs CPI and property price index

Note:
(1) CEIC, HSBC

# Export recovery: How strong?

## China exports and world GDP[1]

Note:
(1) CEIC, HSBC

# Addressing the root cause for excessive lending

## Monthly new loan breakdown[1]

Note:
(1) CEIC, HSBC

# Renminbi's de facto dollar peg not sustainable

## RMB/USD exchange rates[1]

Note:
(1) CEIC, HSBC

# How to exit?

- **Greater flexibility**
- **Depreciation the wrong medicine for a contraction in exports**
- **Plan to expand RMB role in trade settlement implies a policy preference for gradual appreciation**

# Pace of appreciation will likely be much slower than in previous years

## RMB against a basket of currencies[1]

Note:
(1) Bank of International Settlements, HSBC

# Internationalising the RMB

HSBC

The world's local bank

# Crisis also means opportunity

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

# Matching mainland China's rising economic power

## Nominal GDP[1]

Note:
(1) CEIC, HSBC

# Mainland China's dominant position in global trade

## Foreign trade (imports and exports)[1]

Note:
(1) CEIC, HSBC

# Setting up a framework

**People's Bank of China has signed a total of RMB650bn bilateral currency swap deals with six other central banks to provide seed money**

**More than 40 foreign banks participating in the pilot scheme for cross-border RMB trade settlement**

**Beijing has also launched a pilot scheme and tax breaks to kick-start the process**

# Where to park the RMB trade surplus?

## Offshore RMB markets in Hong Kong[1]

Note:
(1) CEIC, HSBC

# Big potential for RMB in China's trade with emerging markets

## China's trade with emerging markets (EM)[1]

Note:
(1) CEIC, HSBC; emerging markets defined as non-G3 (US, EU, Japan) markets

# Can Chinese exporters drive a hard bargain?

## China production as share of global production[1]

Note:
(1) CEIC, HSBC

# Surging Chinese investment in emerging markets also helps

## Mainland China's outward investment[1]

Note:
(1) CEIC, HSBC; emerging markets defined as non-G3 (US, EU, Japan) markets

# RMB in 5 years

- **RMB trade settlement is likely to result in nearly US$2trn in annual trade flows being settled in RMB**
- **This, plus further financial reforms, should pave the way for full convertibility**
- **Rising growth differential between mainland China and its main trade partners supports gradual appreciation**
- **All these will reinforce the expansion of the RMB's role in the global economy**

# Rebalancing growth

HSBC
The world's local bank

# Structural factors behind the high savings rate not be easily altered

## China's domestic savings, % of GDP[1]

## Capital formation in China, % of GDP[1]

Note:
(1) CEIC, National Bureau of Statistics, HSBC

# Government can reduce its own savings glut

## Government and household savings[1]

Note:
(1) CEIC, National Bureau of Statistics, HSBC

# Government can rebalance fiscal stimulus from construction to education and healthcare

## Fiscal spending on education[1]

## Share of health care expenditure[1]

Note:
(1) CEIC, World Bank, HSBC

# Shift in fiscal stimulus should ‘crowd in’ private consumption

## Key motivations for saving[1]

Note:
(1) People’s Bank of China (PBoC) , HSBC

# Expanding consumer credit also helps

## Consumer loans[1]

Note:
(1) PBoC, HSBC

# HSBC forecasts

HSBC

The world's local bank

# HSBC mainland China forecasts

| % Year (annual average) | 2005 | 2006 | 2007 | 2008 | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Nominal GDP (RMB bn) | 18,322 | 21,192 | 24,953 | 30,067 | 32,439 | 36,436 | 40,520 |
| Real GDP | 10.2 | 11.6 | 11.9 | 9.0 | 8.5 | 9.5 | 8.9 |
| Consumer spending | 8.5 | 8.7 | 9.0 | 8.9 | 8.0 | 8.5 | 8.6 |
| Government consumption | 12.9 | 11.7 | 14.3 | 12.0 | 18.0 | 16.0 | 14.0 |
| Nominal fixed-asset investment | 27.2 | 24.5 | 25.8 | 26.1 | 28.5 | 26.0 | 20.0 |
| Merchandise exports | 28.4 | 27.2 | 25.7 | 17.2 | -12.0 | 9.0 | 10.0 |
| Merchandise imports | 17.6 | 19.9 | 20.8 | 18.5 | -5.0 | 15.0 | 9.0 |
| Industrial production (VAI) excl. small enterprises | 15.9 | 16.2 | 16.0 | 12.9 | 9.5 | 14.0 | 13.0 |
| Nominal retail sales | 12.9 | 13.7 | 16.8 | 21.6 | 15.0 | 17.0 | 16.8 |
| Consumer prices, year avg. | 1.8 | 1.5 | 4.8 | 5.9 | -0.2 | 2.6 | 2.5 |
| Current account (% GDP) | 7.2 | 9.4 | 11.3 | 8.6 | 5.1 | 4.3 | 4.2 |
| Budget balance (% GDP) | -1.2 | -1.0 | 0.6 | -0.4 | -2.9 | -4.3 | -3.3 |
| Foreign reserve (US$bn) | 819 | 1,066 | 1,528 | 1,946 | 2,250 | 2,400 | 2,550 |
| RMB/USD, year end | 8.07 | 7.81 | 7.30 | 6.82 | 6.80 | 6.66 | 6.40 |
| 3-month time deposit (%), year end | 1.71 | 1.8 | 3.33 | 1.71 | 1.71 | 2.25 | 2.25 |
| 1-yr lending (%), year end | 5.58 | 6.12 | 7.47 | 5.31 | 5.31 | 5.85 | 5.85 |

# HSBC main forecasts

| | FX rate vs. USD | | | | | | Policy rate, % | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Year-end** | **2006** | **2007** | **2008** | **2009f** | **2010f** | **2011f** | **2006** | **2007** | **2008** | **2009f** | **2010f** | **2011f** |
| Australia | 1.27 | 1.14 | 1.43 | 1.16 | 1.05 | 1.05 | 6.25 | 6.74 | 4.25 | 3.00 | 4.00 | 5.00 |
| New Zealand | 0.71 | 0.77 | 0.58 | 0.69 | 0.73 | 0.73 | 7.25 | 8.25 | 5.00 | 2.50 | 3.25 | 4.25 |
| Mainland China | 7.81 | 7.30 | 6.82 | 6.80 | 6.66 | 6.40 | 6.12 | 7.47 | 5.31 | 5.31 | 5.85 | 5.85 |
| Hong Kong | 7.77 | 7.80 | 7.75 | 7.80 | 7.80 | 7.80 | 6.75 | 5.75 | 0.50 | 0.50 | 0.50 | 0.50 |
| India | 44.3 | 39.4 | 48.7 | 48.0 | 46.5 | 44.5 | 7.75 | 7.75 | 6.50 | 4.75 | 5.50 | 6.75 |
| Indonesia | 8994 | 9400 | 11325 | 9500 | 8800 | 8800 | 9.75 | 8.00 | 9.25 | 6.50 | 8.00 | 8.00 |
| Japan | 119 | 112 | 91 | 100 | 105 | 100 | 0.26 | 0.50 | 0.10 | 0.10 | 0.10 | 0.10 |
| Korea | 930 | 936 | 1260 | 1200 | 1075 | 1050 | 4.50 | 5.00 | 3.00 | 2.00 | 3.00 | 4.00 |
| Malaysia | 3.53 | 3.31 | 3.45 | 3.50 | 3.46 | 3.42 | 3.50 | 3.50 | 3.25 | 2.00 | 2.50 | 2.75 |
| Pakistan | 60.9 | 61.5 | 79.0 | 90.0 | 92.0 | 92.0 | 9.50 | 10.00 | 15.00 | 11.00 | 9.00 | 10.00 |
| Philippines | 49.01 | 41.20 | 47.4 | 46.0 | 43.5 | 42.5 | 7.50 | 5.25 | 5.50 | 4.00 | 4.75 | 5.50 |
| Singapore | 1.53 | 1.44 | 1.44 | 1.40 | 1.34 | 1.32 | 3.44 | 2.38 | 0.96 | 0.60 | 0.90 | 1.20 |
| Sri Lanka | 107.7 | 108.7 | 113.3 | 118.0 | 118.0 | 118.0 | 11.50 | 12.00 | 12.00 | 10.50 | 11.00 | 11.00 |
| Taiwan | 32.6 | 32.4 | 32.8 | 31.5 | 29.0 | 28.0 | 2.750 | 3.375 | 2.00 | 1.25 | 1.75 | 2.25 |
| Thailand | 35.5 | 33.7 | 34.7 | 33.0 | 31.5 | 31.0 | 5.00 | 3.25 | 2.75 | 1.25 | 2.00 | 2.00 |
| Vietnam | 16050 | 16017 | 17483 | 18200 | 18400 | 18400 | 7.75 | 8.25 | 8.50 | 7.00 | 11.00 | 11.00 |

# Disclosure appendix

## Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and 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

This report is designed for, and should only be utilised by, institutional investors. Furthermore, HSBC believes an investor's decision to make an investment should depend on individual circumstances such as the investor's existing holdings and other considerations.

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

For disclosures in respect of any company, 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 08 October 2009.
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. Chinese Wall 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 22 October 2008
'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; 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 2596 0200
Website: www.research.hsbc.com

This document has been issued by The Hongkong and Shanghai Banking Corporation Limited ("HSBC") in the conduct of its Hong Kong regulated business for the information of its institutional and professional customers; it is not intended for and should not be distributed to retail customers in Hong Kong. The Hongkong and Shanghai Banking Corporation Limited is regulated by the Securities and Futures Commission. All enquires by recipients in Hong Kong must be directed to your HSBC contact in Hong Kong. If it is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. This document 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 the Research Division of HSBC only and are subject to change without notice. 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 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 investment banking or underwriting services for or relating to those companies.
HSBC Securities (USA) Inc. accepts responsibility for the content of this research report prepared by its non-US foreign affiliate. All U.S. persons receiving and/or accessing this report and wishing 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 the UK this report may only be distributed to persons of a kind described in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. The protections afforded by the UK regulatory regime are available only to those dealing with a representative of HSBC Bank plc in the UK. 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. 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.
In Japan, this publication has been distributed by HSBC Securities (Japan) Limited. It may not be further distributed in whole or in part for any purpose.
© Copyright. The Hongkong and Shanghai Banking Corporation Limited 2009, 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) 177/08/2009