CHAPTER I GLOBAL ECONOMY AND WORLD MARKETS

I.1. GLOBAL ECONOMY

After a year of economic contraction, global economic activity returned to positive growth rates in 2010[1]. This growth relied mainly on a rapid economic expansion of emerging economies and economic growth of advanced economies. Numerous fiscal and monetary growth drivers managed to take economic growth rates into positive territory. World inflation was higher than a year earlier, mainly pushed by increased food and energy prices, as well as the statistical effects of low prices during 2009. Financial markets had rising tendencies and were highly volatile in certain segments, in particular in sovereign bonds markets in the euro-area economy. However, albeit the positive performance, the global economy continues to be characterised by structural and conjunctural weaknesses concerning an unequal distribution of economic growth, macroeconomic imbalances within advanced economies and among different countries, financial health and public finance soundness of individual countries, with high unemployment rates and rising already high commodity prices.

Table 1 Key macroeconomic indicators

	GDP change		Unemployment rate	Inflation rate	
	2009	2010	2010	2009	2010
US	-2.6	2.9	9.6	-0.8	1.7
Euro area	-4.1	1.7	10.0	0.3	1.6
Germany	-4.7	3.6	6.8	0.2	1.2
France	-2.6	1.5	9.7	0.1	1.7
United Kingdom	-4.9	1.3	8.0	2.2	3.3
Japan	-6.3	4.0	5.1	-1.2	-0.7

Source: Eurostat, statistics institutions of respective countries.

- *EURO AREA ECONOMY*

According to preliminary data from Eurostat, the euro-area economy increased by 1.7% in 2010. This increase was higher in Q2 and Q3, while the other quarters of 2010 were featured by decelerated GDP growth. The main factors contributing to this growth were the decisions made by advanced economies' governments, being reflected in increased government and consumer spending, and the export growth under the impact of the global demand. Confidence indicators improved constantly during 2010, reflecting the economic growth. Despite the improved economic activity, unemployment rate rose to 10% in 2010. The 2010 inflation rate settled at 1.6%, very close to the European Central Bank's target.

1 *According to preliminary data from IMF, world economy grew by 5% in 2010. For the same period, economic growth was 7.1% in emerging economies and 3% in advanced economies.*

- *UNITED STATES ECONOMY*

Following the 2009 recess, the US economy, under the influence of continuous fiscal and monetary stimuli, showed recovery trends in 2010. Thus, GDP expanded by 2.9% y-o-y. Increased consumer spending, aggregate investments and federal government spending provided the main contribution to this performance. While exports in value marked an upward trend, their positive influence on GDP calculation was totally dwarfed by faster growing imports. Due to fiscal stimulus, the federal government budget deficit remains high. Although the US budget deficit to GDP decreased by 1.1 percentage points in 2010, it still remains 8.9%. Average unemployment rate was 9.6% in 2010, about 3.5 percentage points higher than the historical average in the last ten years. Average annual inflation rate was 1.7%, mainly affected by high energy price.

- *BRIC[2] COUNTRIES*

During 2010, BRIC countries posted economic growth, although the growth rates were not similar across all four countries. Thus, China experienced the fastest growth, estimated at 10.5% in annual terms. Contrary to the previous years, when net exports played a key role in China's economic performance, over this year, consumer spending and aggregate investments were the main contributors to GDP growth. Following the 2009 contraction, the Russian economy showed recovery, albeit at a slower pace. This development is mainly supported by export growth and consumer spending. However, a considerable drop in agricultural output during 2010 H2 and lower oil industry profit vis-à-vis the initial forecast had negative impacts on the domestic economy. In India, the accelerated industrial output growth tendency influenced the economic expansion by 9.5% y-o-y. In Brazil, the industrial output and domestic demand maintained their upward trend during 2010, contributing to the country's positive performance.

BRIC central banks pursued tightening monetary policies by increasing the relevant key interest rates and the required reserve several times during 2010. The main goal remains to prevent national economies from overheating, which is already manifested in high inflationary pressures.

Table 2 Some macroeconomic indicators for BRIC countries

Countries	Annual real GDP change		Annual Inflation	
	2009	2010	2009	2010
Brazil	5.1	7.5[1]	4.3	5.9
Russia	-7.9	3.9[1]	11.7	6.9
India	7.2	9.5	10.8	12.0
China	8.7	10.5	-0.7	3.3

Source: IMF, OECD, statistics institutions of respective countries.
[1] IMF, World Economic Outlook, October 2010

- *ECONOMIES IN THE REGION*

With the exception of Greece, the economies of the region recorded positive GDP growth rates during 2010. The Italian economy recorded an annual

[2] *These countries are Brazil, Russia, India and China.*

growth of about 1.1% in 2010. The main contributors were a substantial rise of the external demand and the increase of domestic industrial output. Latest estimations show an annual contraction of the economy by about 4.6% in Greece. Fiscal consolidation undertaken by the Government by cutting public sector wages, expanding the taxable products scope and raising the actual level of taxes, has led to a drop of private consumption and aggregate investment. Although the budget deficit for 2010 is projected at 9.6% to GDP, it remains about 6 percentage points lower than the ratio recorded a year earlier[3].

After the contraction of 2009, the Turkish economy recorded a fast expansion of the economy by about 7.5% during this year. In addition to the low comparative base of 2009, consumer spending, net exports and aggregate investments are assessed to have provided a significant contribution to this performance. In the meantime, economic activity in the Former Yugoslav Republic of Macedonia expanded moderately, as a result of a low growth pace of consumer spending and a drop in aggregate investments. According to IMF preliminary data, economic activity in Kosovo improved compared with 2009. Under the effect of increased domestic demand, Kosovo's economy is estimated to have grown by 4.6% in 2010, from 2.9% in 2009. During 2010, economic activity in Croatia contracted compared with e a year earlier. Nevertheless, it is worth mentioning that the Croatian economy departed from recession in 2010 Q3, after a series of quarters with negative growth rates. Net exports and a slight rise in consumer spending contributed to this growth. According to preliminary data, net export and industrial output growth led to positive growth rates for the economy of Serbia in 2010.

During 2010, unemployment rate rose in Italy, Greece, Serbia and Croatia and fell in Turkey and Macedonia. Upward annual inflation rates were recorded in all the countries of the region, except for Croatia.

Table 3 Economic indicators for the countries in the region

Country	GDP change		Annual Inflation		Unemployment rate
	2009	2010	2009	2010	2010
Italy	-5.0	1.1	0.8	1.6	7.8
Greece	-2.0	-4.6	1.3	4.7	12.2[2]
FYROM	-0.6	1.3[1]	-0.8	1.6	32.4[3]
Serbia	-3.1	1.5[1]	6.6	6.5	19.2[4]
Croatia	-5.8	-1.8[1]	2.2	1.1	11.8
Turkey	-4.5	7.5[1]	6.3	8.6	12.0[2]
Kosovo	2.9	4.6[1]	-2.4	3.5	:
Albania	3.3	2.6[1]	2.3	3.6	13.7

Source: Respective statistics institutions, EuroStat, EcoFin, IMF
1 IMF outlook, WEO October 2010, and European Commission, EIF autumn 2010
2 Arithmetic average for January - November 2010
3 Arithmetic average for 2010 Q1-Q3
4 Arithmetic average for January – October 2010
: Data not available

3 According to the assessment of the Report on Economic Adjustment Programme for Greece, December 2010, the *European Commission Directorate-General for Economic and Financial Affairs*.

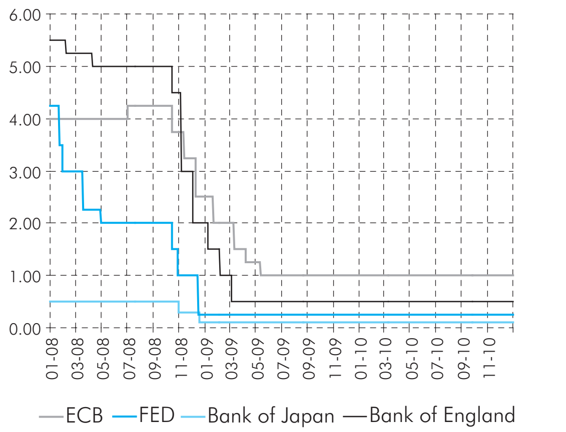
I.2. MONETARY POLICY OF MAIN CENTRAL BANKS AND FINANCIAL MARKETS DEVELOPMENTS

Central banks of advanced economies kept their interest rates unchanged, opting for non-traditional[4] measures to stimulate their economies. Except for the Bank of Japan, which has also included the lower level of 0% in the definition of its overnight interest rate, other banks did not make any changes in 2010 interest rates. The European Central Bank (ECB) kept its rate at 1%, the Federal Reserve at 0-0.25%, the Bank of England at 0.5%, and the Bank of Japan at 0-0.1%.

Among non-traditional measures used by central banks, the following stand out: the ECB's decision to inject ample fixed-price liquidity until early 2011; the possibility to acquire euro-area government bonds in the secondary market; quantitative easing by the Federal Reserve and the Bank of England, which aim to add the stock of money in circulation by acquiring bonds and other financial instruments.

Financial markets recorded a slightly upward performance in 2010. The winding down effect of several facilities activated by the ECB along the crisis,and the uncertainty induced by problems in some euro-area countries, were reflected in higher EURIBOR rates for all maturity terms in the euro-area money markets. The USD LIBOR rate has pursued a downward trend over most of the year, being more notable in the last months, mainly due to quantitative easing policy pursued by the Federal Reserve (FED). In terms of the bonds market, the demanded yields showed a downward trend in the first half of the year, and then an upward turnaround during 2010 H2. Optimistic signals for the economic performance in most advanced economies affected the market agents' expectations for central banks' potential key interest rate rise in the near future, contributing positively to demanded yield rise. In the meantime, the introduction of public debt problems in a group of euro-area countries (Greece, Portugal, and Spain) was another factor that influenced further bond yield rise of the respective debt. The stock markets pursued an upward trend during this year recovering gradually the pre-crisis levels. The positive performance of quarterly balance indicators of many businesses supported the growth recorded over this period, whilst the influence of problems with regard to public balance sustainability of the above-mentioned states is reflected in the stock markets' higher volatility.

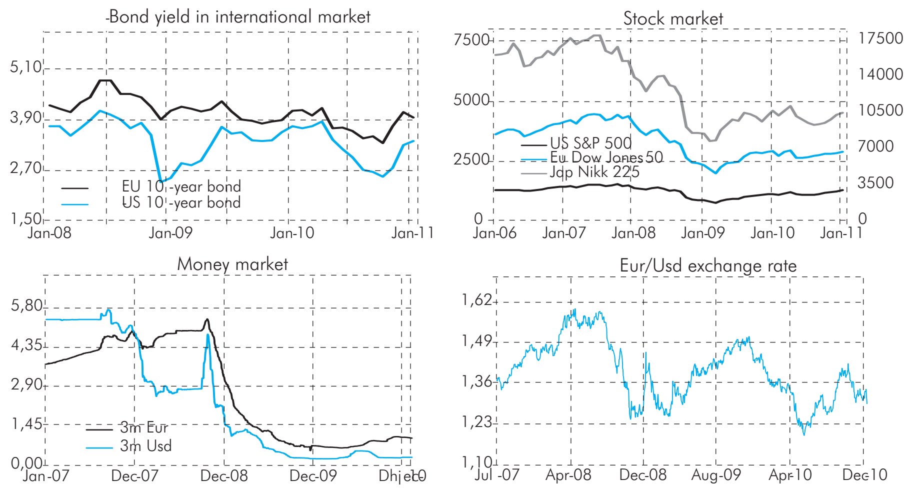
Chart 1 Key interest rates



Source: ECB, FED, Bank of England, Bank of Japan

[4] *These measures focused mainly on high and long-term liquidity injection and acquisition of government T-bonds.*

Chart 2 Some financial indicators in international markets



Source: ECB, Reuters

In December 2010, the Euribor rates[5] averaged 0.30 percentage points higher y-o-y. The three-month Libor interest rates dropped by 0.35 percentage points y-o-y, to 0.30% at end-December.

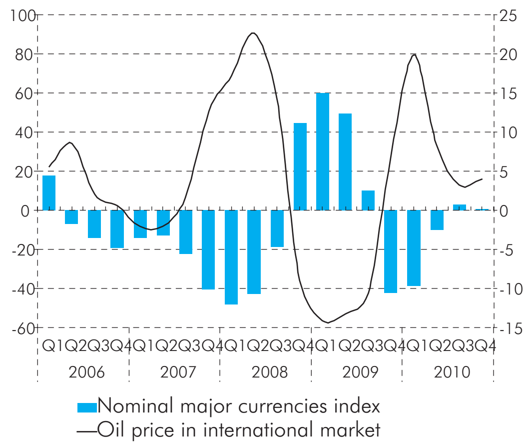
In the foreign exchange markets, the euro depreciated against the US dollar, Japanese yen, British pound and Swiss franc. On average, in December, 1 euro was exchanged for 1.32 US dollars or 9.5% less than a year earlier, while over the course of this year the euro depreciated on average by 4.95% compared to the previous year.

I.3. PRIMARY COMMODITY PRICES

- *INTERNATIONAL OIL MARKETS*

International oil markets were characterised by upward price trends in 2010. Average price ranged around USD 75-85 per barrel, up by 30.4% of the average annual price. Recovery of the major industrialised economies and ongoing accelerated GDP growth rates in some of the major emerging economies, contributed to upward oil prices. Moreover, a slight depreciation of the US dollar against major international currencies[6], by around 3%, put pressure on upward prices in international markets. In addition to the increased demand for oil, the global supply of this product increased by about 2.1% compared to a year earlier.

Chart 3 Annual fluctuations of oil prices and the Nominal Major Currencies Dollar Index

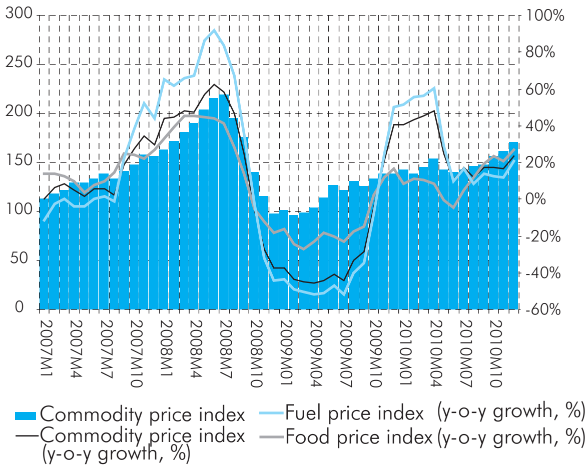


Source: Eurostat, EIA

[5] *During this period, the 1-, 3-, 6- and 12-month Euribor rates in the money market reached 0.81%, 1.02%, 1.25% and 1.53%, respectively.*

[6] *Measured by the Nominal Major Currencies Dollar Index, by the Federal Reserve, including 26 weighted currencies according to trade with the USA, in US Dollars. http://www.federalreserve.gov/releases/H10/Summary/indexn_m.txt.*

Chart 4 Price Indexes by primary commodities



Source: IMF, World Economic Outlook, October 2010

- *PRIMARY COMMODITY PRICES*

Primary commodity indices rose in 2010, due to increased demand as a result of the world economy recovery and low comparative base of 2009, when prices were hit by the international financial markets' turmoil. Adverse weather conditions in Russia, one of the biggest producers of grain, were added factors that contributed to higher food prices globally. Thus, in 2010, the Commodity Price Index was up 24.9% y-o-y; Food Price Index was up 11.5%; and Oil Price Index was up 25.9%.

"Albania going towards its own destiny"

100 Francs Gold Coin, issue of 1926