Market conditions and trends

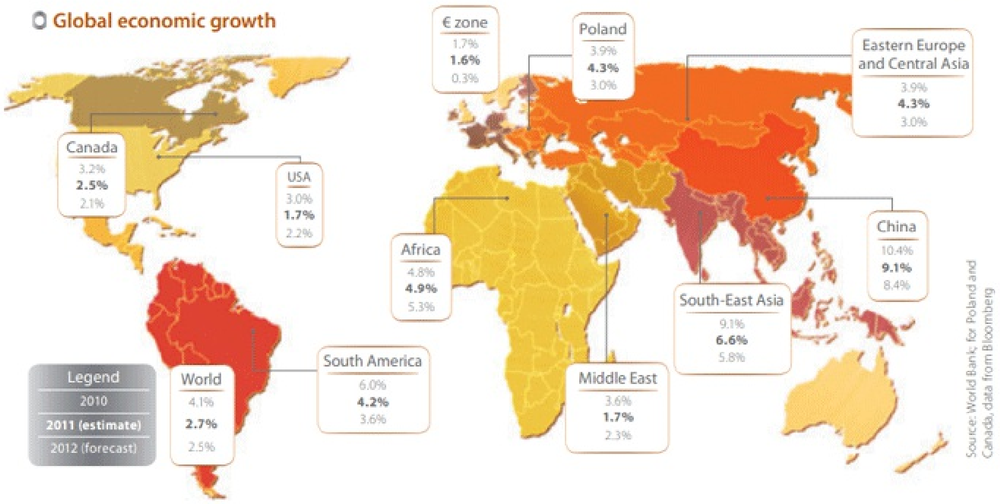
Global economy

Global economic growth in 2011 was lower than most forecasts at the start of the year. The debt problems of Eurozone countries harmed the entire global economy. There was an economic slowdown in emerging markets, which until then had shown substantial resistance to volatility on the financial markets. Nearly all of the large economies were impacted by the increased premium on market risk, which led to a higher cost for debt, lower prices for stocks and lower capital inflows to emerging markets. Three key regions for the global economy – the USA, Japan and the Eurozone – remained in stagnation, of which by the end of 2011 only the United States showed signs of hope for an improvement in the macroeconomic situation. In the emerging markets, in particular Brazil and India, there were clear signs of a substantial slowdown in growth, while for the first time in a decade China's potential for growth over the next few years was lowered.

According to World bank estimates, global economic growth in 2011 amounted to 2.7%, and was substantially lower than the 4.1% achieved in 2010. Nonetheless, the measured growth in global GDP led to a further increase in demand for raw materials. In USD terms, prices for raw materials – food, base and precious metals, plastics – increased on average by 20.7% in 2011. There was a dramatic increase in the price of crude oil, which in 2010 cost 79 USD/barrel, whereas in 2011 it rose 31.6% to 104 USD/barrel. Such a rapid rise in the price of a raw material which is crucial to economic growth led to inflationary pressure, and in consequence to the need for tighter monetary policy in many emerging market countries, and therefore to a slowdown in economic growth. In the second half of the year, the Purchasing Managers' Index (PMI) fell to its lowest level in three years, and in the case of most European economies it fell below 50 percentage points, meaning the increased likelihood of at least a short-term recession.

Due to tight financing in the equity markets, central banks and international institutions took numerous actions. To increase liquidity, a program to increase the capitalisation of banks (Long-term refinancing operations, or LTROs) was instituted, and the decision was made to reduce the negative impact of bad debt by restructuring Greek bonds. In the opinion of the International Monetary Fund, financial stability should be a governmental priority, though during the next several years it will be necessary to balance the flow of trade between emerging and developed economies. The former should concentrate on stimulating internal demand, while developed economies should reduce external demand.

In 2011, business conditions in the Euro zone and in the United States remained extremely limited due to the instability of the financial system, high government deficits and the enormous level of public and private debt. In particular, the second half of the year brought a large amount of negative information on the condition of Euro zone economies, raising fears of a repeat of the „Japanese disease" i.e. a repeat of the long-term stagnation which afflicted Japan in the 1990s. In terms of positive factors, there was improvement in the employment market in the USA, as well as a better balance of trade and personal spending, with indebtedness by Americans falling by up to 10 percent of GDP.



China seemingly continued to display the greatest stability and economic growth. This does not mean, however, that 2011 was a successful year for China. An increasing number of signals from this largest of Asian nations are worrisome for investors, in particular a return to the use of open lines of credit, the heavily undervalued yuan and steady pressure on asset appreciation, threatening the emergence of a new global financial bubble. Similarly as in the Euro zone, there was a weakening of Chinese economic indices, which by the end of the year had fallen for the first time in three years to a level foreseeing a deterioration in industrial output. The deterioration in the macroeconomic situation in China can also be seen in the strong outflow of direct foreign investment in the fourth quarter of 2011. A major discouragement for investors was the economic forecast for the next 5 years. For the first time in the current decade, the Chinese authorities reduced target GDP to 7.5% from 8.0%, simultaneously announcing the desire to increase internal consumption and to limit state participation in some sectors of the economy, such as banking. By instituting a new economic policy, China has an impact not only on the country's internal situation, but also on the condition of its largest trade partners.