

Overall Economic Development.

Global Economy.

The global economy was characterized by a powerful recovery in 2010 after the crisis year of 2009. In view of the aid packages from monetary and fiscal policy still effective in 2010, although the situation had been expected to improve, it could scarcely have been foreseen that the economy would maintain its upturn for virtually the entire year. The gross domestic product of the global economy is likely to have grown by 5.0% when the final balance sheet for 2010 is drawn up. There had still been a decline of 0.6% in 2009. The upturn was most impressive in China, where economic output rose by 10.3% in 2010. The Middle Kingdom thereby overtook Japan as the world's second largest economy.

Meanwhile, the largest economy worldwide remains the USA. Admittedly, the long-term consequences of the real estate crisis there are still being deeply felt. Despite this, gross domestic product grew by 2.9% year-on-year in 2010. However, the growth was not sufficient to make any effective improvement to the situation on the employment market. The unemployment rate in the USA was 9.4% in December 2010. It was only slightly higher at the end of 2009, at 9.9%. There has so far been no recovery on the housing market itself either. At 133.22 (seasonally adjusted), the national Case-Shiller Home Prices Index was at the end of the third quarter of 2010 only a little above the low of the first quarter of 2009 (131.39).

Economic development in the euro area was divided. Whereas the core of the states, which are geographically grouped around Germany, can largely look back on a good 2010 overall, most of those on the European periphery – the Mediterranean nations and Ireland – remained on the edge of or in recession. The reasons for this were high real interest rates, tax increases and public savings programs, which also had negative effects on overall demand. Although Greece reduced its budget deficit by 37% in 2010, as agreed at the passage of the EUR 110 billion rescue package initiated by the EU and IMF, the risk premiums for Greek sovereign securities and thus real interest rates continued to rise during 2010. At the end of 2010, Greece and the other peripheral states of the euro area have a problem. On the one hand, the public budgets must be consolidated; on the other hand, the high real interest rates are hindering economic recovery, which would be a prerequisite for resurgent tax income there. This in turn feeds doubt in the creditworthiness of sovereign debtors and the risk premiums, and real interest rates consequently remain on a level which cannot be sustained by these countries. Even after the EU summit in December 2010, there still appeared to be no way out of this dilemma.

Germany.

Germany found itself back on the bright side of the economy in 2010. Above all, a sharp increase in foreign trade led to a distinct upturn. According to an initial estimate by the German Federal Statistical Office, gross domestic product rose by 3.6% in 2010. This means that the massive slump which began with the start of the recession in the second quarter of 2008 and continued until the first quarter of 2009 has now been reversed by approximately three quarters. Further elements of growth other than exports (+14.2%) included investment in particular, which increased by 10.7% in 2010, and public spending, which rose by 2.2%. The development of the German employment market was also particularly noticeable. At 40.79 million, the number of people in work was approximately 430 000 up on the previous year in December 2010. Inflation caused little concern in 2010. At 1.1%, price increases at the consumer level were low in annual average terms. However, the inflation rate reached 1.7% by the end of the year, thus attaining the highest value since October 2008.

Central Bank Policy.

The major central banks continued their policy of low interest rates in 2010. The US Federal Reserve left its key rate at 0% to 0.25% throughout the entire year, while the ECB also held its main refinancing interest rate constant at 1%. The same applied to the Bank of England (0.5%) and the Bank of Japan (0% to 0.1%).

Monetary policy also served to stabilize the financial markets. In order to make enough liquidity available to the commercial banking sector, the ECB extended the full allotment of the euro system's tender transactions with the commercial banks, initially until April 12, 2011 (at least). As the situation on the inter-bank market in the euro area has already normalized for the most part, which can clearly be seen in the fact that the three-month Euribor rate of 1.01% at the end of the year was again just above the ECB's main refinancing rate, the ECB's decision is likely to have been a measure for the benefit of the banks from the euro area states with lower credit ratings, for which direct access to the euro area's inter bank market is difficult to obtain.

Meanwhile, the central banks in the USA and the euro area made the decision to acquire (further) sovereign bonds on the secondary market. The purchase of USD 600 billion of debt instruments from the US Treasury Department by the Federal Reserve, spread across several months until June 2011, serves the declared intention to cultivate the economic recovery and continue the policy of quantitative easing. The ECB decision to acquire bonds from member states of the euro currency union was part of efforts to secure the functionality of disrupted market segments so as to restore the adequate transmission of the ECB's monetary policy. At approximately EUR 74 billion, the overall volume of the ECB's bond purchases carried out by the end of the year was significantly below that of sovereign bond purchases in the USA. As at December 29, 2010, the Federal Reserve held sovereign bonds and treasury bills from the Treasury Department amounting to USD 1 016 billion.

Bond Market.

The bond market was marked by severe turbulence throughout 2010. Shortly after the beginning of the year, doubt in the solvency of Greece led to a massive increase in risk premiums on the country's sovereign bonds. From the end of April, Greek sovereign bonds were reaching double-digit yields. In this environment, the credit default premiums of other member states also rose considerably. The bonds of Portugal, Ireland and Spain came under particularly strong selling pressure. In order to prevent the European currency union from collapsing, the EU's heads of state and government, with assistance from the International Monetary Fund (IMF), decided at the end of April on an aid package for Greece amounting to EUR 110 billion, which was followed at the beginning of May by a multi-part rescue package for the remaining euro area states of EUR 750 billion (EUR 440 billion in the European Financial Stability Facility, EUR 60 billion in the European Financial Stability Mechanism and up to EUR 250 billion from the IMF). Ireland was the only member state in the euro area to have applied for and received aid by the end of 2010 (EUR 85 billion).

Despite this, the turbulence on the bond market did not abate at the end of the year. The interest rate premiums on sovereign bonds from the peripheral states with weak credit ratings against Bunds with the same duration were approximately 1 160 basis points in the case of Greece, around 260 for Spain, roughly 380 for Portugal and about 530 for Ireland. The spread development of unsecured bank bonds was virtually in lockstep with this, as the banks continued to be affected to a great extent by the risk premiums for the peripheral states. The spread widening was accelerated at the end of October by Franco-German plans for private creditors to be able to invest in restoring the finances of the peripheral states by means of debt restructuring. In the first phase of this crisis, up to August 2010, Bunds benefited enormously from the fears that Greece would fail to pay, and were sought as a safe haven. This resulted in the yields of 10-year Bunds falling to the historic low of 2.09%. For the rest of the year, however, there was a sharp increase in yields, which enabled the 10-year Bunds to rocket up to over 3%. Concern grew among investors that the costs for supporting the peripheral states would ultimately have a significant effect on German state finances as well. However, the decision of the EU states on December 16 and 17, 2010 at the summit in Brussels to remove the limit (initially mid-2013) on the rescue facility, but without defining a maximum volume, did little to calm the markets. The overall situation on the bond market has not changed since then.

Foreign Currency Market.

The foreign currency market was in the grip of the sovereign bond crisis in the euro area in 2010. In general, the euro lost value. The exchange rate for the euro against the US dollar sank from USD 1.45 per euro at the beginning of the year to less than USD 1.20 by June. The euro recovered in the second half of the year, reaching a rate of USD 1.34 per euro at the end of the year. Beneficiaries of the weak euro among the main currencies included the Japanese yen, which increased in value from JPY 134 to JPY 108 per euro, and the Swiss franc. At the beginning of the year, CHF 1.49 was still needed to buy EUR 1, but the exchange rate at the end of the year was 1.25 – a record for the Swiss franc.

Stock Market.

Satisfaction is likely to have been the dominant feeling among German investors on the stock markets at the end of the year. The main index for German blue chips, the DAX, increased from 5 957 to 6 914 points regardless of occasional setbacks in relation to the euro debt crisis. Mid-caps also impressed. The MDAX for medium-sized companies rose from 7 500 to over 10 000 index points. The Eurostoxx 50, comprising major companies in the euro area, performed much more poorly. It finished 2010 with 2 793 index points, below its previous year's total of 2 964 points. This discrepancy reflects the special economy in Germany and the difficult position in the peripheral countries of the euro area. The major share indices in the USA increased on a broad front, with the upturn only occasionally interrupted. The Dow Jones Industrial rose from 10 428 to 11 577, the S&P 500 from 1 115 to 1 257 and the Nasdaq Composite from 2 269 to 2 652. As well as the low-interest environment that caused investors to seek yields in shares, the Federal Reserve's quantitative easing is likely to have had a noticeable effect here with its massive supply of liquidity.