M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

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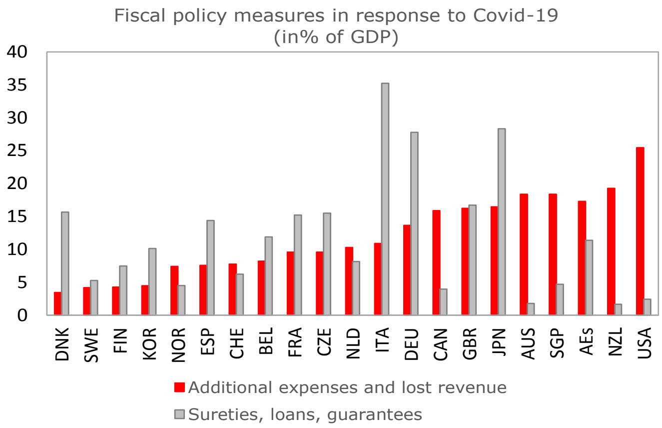
German Economy: Postponed, Not Cancelled

Any major economic stimulus program typically elicits economist comments along the lines of ‘nice try, no cigar.’ That is to say that governmental economic stimulus almost never achieves what it sets out to do. The reason for this is that the underlying structural problems that caused the economic weakness to begin with are not remedied with a financial band aid here and there. Such political interventions may even aggravate the economic problems since they delay or even prevent creative destruction processes.

In the wake of the Covid pandemic, many countries have launched enormous stimulus projects in the past 15 months that got tailwind from unprecedentedly expansive monetary policy by central banks across the globe with regulatory boosts from many national financial sector supervisory bodies as a cherry on top. Especially the governments of industrialized countries poured massive amounts of money into combatting the global business Grinch. According to International Monetary Fund calculations, for instance, German federal and state aid packages totaled about EUR 450 billion to help finance medical measures and help workers who had their hours cut as well as providing subsidies for companies and self-employed people. The spending volume came to almost 14 percent of Germany’s total economic performance. The US was even more generous at some 25 percent of its gross domestic product spent on economic stimulus, Australia spent 18 percent of its GDP, Japan 17 percent. And Great Britain 16 percent. Germany can additionally draw on up to EUR 900 billion (almost 30 percent of German GDP) in sureties and loans from the newly created Economic Stability Fund and the Development Branch of the Federal Reconstruction Bank.



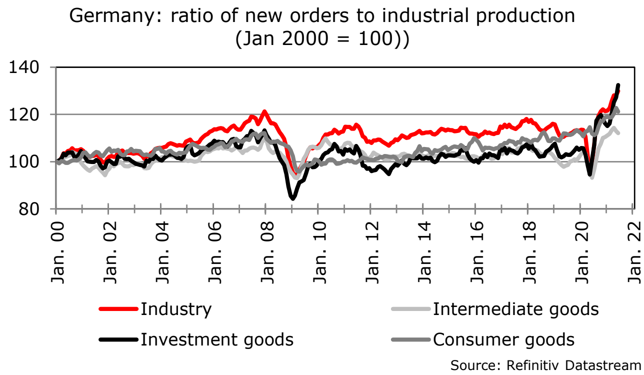
Source:https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19

To what extent the available sureties and loans will be drawn on is not clear yet, but past experience suggests that this is going to be more than a flash in the pan considering the staggering amounts of government aid, which will probably fuel several years of economic growth going forward. By comparison, after the Lehmann Brothers debacle and subsequent financial crisis in 2008/2009, countries like Germany and the US spent some 5 percent of their GDP on bailouts. Moreover, last year’s economic slump was not due to structural economic failures but more akin to the aftermaths of a natural disaster. As such, the economy will probably recover swiftly and sustainably as soon as the pandemic is under control and no new social and economic restrictions become necessary.

Now that more than 55 percent of the German population is fully vaccinated, it is getting less likely that there will be more major nationwide lockdowns notwithstanding the recent rise in new Covid infections. That means basically all prerequisites for a swift and vigorous economic recovery were already met this year. Yet, economic performance in the first half of the year was disappointing. The first quarter still suffered from Covid-related social and economic restrictions that particularly impacted consumption and private spending on services. The German economy still failed to pick up speed in the second quarter. While real gross domestic product contracted 2.1 percent in the first quarter, preliminary figures suggest that the second quarter saw only 1.5 percent growth, which is insufficient to balance Q1. This prompts us to lower our forecast for total German 2021 GDP growth from four to three percent.

However, this by no means signals that economic recovery is losing steam already. It is also no flash in the pan. The prerequisites for appreciably accelerating economic growth over the next few quarters - and not just briefly – are clearly there. That means the lingering weakness in the first few months of this year was predominantly the result of industry (the heart of Germany's economy) suffering from lacking availability of core input products. Skyrocketing global demand at still limited or at least inadequately growing supply is setting back delivery schedules for many goods. Bottlenecks in transport capacities are further aggravating supply chains. Moreover, the Delta variant is sweeping through some Asian countries with low vaccination rates where the governments have now imposed new economic restrictions. For instance, China closed the Ningbo Zhoushan container terminal this week – its second-largest container harbor after Shanghai. A few weeks before that, China closed down operations in the important Yantian harbor near Shenzen for several weeks. Although China has comparatively few Covid cases, its strict zero-tolerance policy for Covid is throwing a major monkey wrench into the global supply and trade chains. The good news is that most currently held-up goods will reach their recipients eventually. As such, value creation is only postponed not cancelled.

We see this most clearly when looking at the development of order intake and production in Germany since the beginning of the year. Order intake increased for five out of six months in the first half of 2021 while industrial production decreased in five out of six months! Consequently, order backlogs are more than thirty percent higher than the year before while industrial production only grew some five percent. The book-to-bill ratio is currently at its highest in the past thirty years and shows that German industry has enormous growth potential, although it is not yet clear when production can start realizing this potential.



The German economy currently has no reason for concern: Even if 2021 GDP growth is relatively disappointing at three percent, we expect almost five percent growth for 2022. Postponed is not cancelled, indeed!

Market data

Stock marktes	As of 13.08.2021 15:05	Change versus 05.08.2021 -1 week	09.07.2021 -1 month	11.05.2021 -3 months	12.08.2020 -1 year	31.12.2020 YTD
Dow Jones	35500	1,2%	1,8%	3,6%	26,9%	16,0%
S&P 500	4461	0,7%	2,1%	7,4%	32,0%	18,8%
Nasdaq	14816	-0,5%	0,8%	10,7%	34,5%	15,0%
DAX	15991	1,6%	1,9%	5,8%	22,5%	16,6%
MDAX	35890	0,5%	3,2%	12,9%	29,2%	16,5%
TecDAX	3825	0,2%	6,0%	16,0%	23,2%	19,0%
EuroStoxx 50	4232	1,7%	4,0%	7,2%	25,8%	19,1%
Stoxx 50	3662	1,3%	3,4%	8,2%	20,4%	17,8%
SMI (Swiss Market Index)	12462	2,1%	3,9%	13,4%	21,2%	16,4%
Nikkei 225	27977	0,9%	0,1%	-2,2%	22,5%	1,9%
Brasilien BOVESPA	120701	-0,8%	-3,8%	-1,8%	18,2%	1,4%
Russland RTS	1665	0,7%	1,8%	7,2%	27,4%	20,0%
Indien BSE 30	55437	1,7%	5,8%	12,8%	44,5%	16,1%
China CSI 300	4946	-0,1%	-2,4%	-1,5%	6,4%	-5,1%
MSCI Welt (in €)	3116	1,2%	2,8%	10,1%	30,3%	20,8%
MSCI Emerging Markets (in €)	1291	0,0%	-1,3%	0,5%	18,1%	4,3%
Bond markets						
Bund-Future	176,58	-71	268	713	34	-106
Bobl-Future	135,17	-35	69	60	40	-1
Schatz-Future	112,31	-8	14	26	26	3
3 Monats Euribor	-0,55	1	1	1	-7	3
3M Euribor Future, Dec 2017	-0,54	0	-1	-2	-8	0
3 Monats $ Libor	0,12	0	-1	-4	-14	-12
Fed Funds Future, Dec 2017	0,09	1	0	1	6	0
10 year US Treasuries	1,35	14	0	-27	68	44
10 year Bunds	-0,45	9	-11	-29	3	13
10 year JGB	0,02	1	1	-5	-2	0
10 year Swiss Government	-0,36	6	-7	-23	10	13
US Treas 10Y Performance	701,09	-1,1%	0,3%	3,1%	-3,8%	-2,1%
Bund 10Y Performance	681,51	-0,3%	1,6%	3,3%	0,6%	-0,5%
REX Performance Index	498,22	-0,3%	0,5%	1,3%	0,2%	-0,2%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,12	4	-10	-18	-7	10
IBOXX BBB, €	0,48	4	-12	-24	-51	-8
ML US High Yield	4,71	4	16	-8	-124	-27
Convertible Bonds, Exane 25	8327	0,0%	-0,6%	1,7%	7,1%	0,0%
Commodities						
MG Base Metal Index	435,06	-0,3%	1,2%	-4,2%	42,5%	22,7%
Crude oil Brent	71,13	-0,4%	-6,0%	3,6%	56,4%	37,1%
Gold	1764,66	-2,1%	-2,4%	-3,6%	-9,2%	-7,0%
Silver	23,55	-6,7%	-9,9%	-14,4%	-8,9%	-10,7%
Aluminium	2582,75	-0,1%	4,1%	3,3%	47,6%	30,9%
Copper	9482,50	0,1%	0,0%	-9,2%	47,4%	22,4%
Iron ore	167,94	-2,3%	-22,2%	-22,0%	39,7%	7,8%
Freight rates Baltic Dry Index	3503	3,8%	6,2%	7,7%	127,5%	156,4%
Currencies						
EUR/ USD	1,1766	-0,7%	-0,8%	-3,3%	0,0%	-4,1%
EUR/ GBP	0,8504	0,1%	-0,8%	-1,1%	-6,0%	-5,0%
EUR/ JPY	129,63	-0,1%	-0,6%	-1,9%	2,9%	2,5%
EUR/ CHF	1,0822	0,8%	-0,3%	-1,4%	0,6%	0,2%
USD/ CNY	6,4788	0,3%	0,0%	0,8%	-6,6%	-0,8%
USD/ JPY	110,42	0,6%	0,2%	1,7%	3,3%	6,9%
USD/ GBP	0,72	0,7%	0,0%	2,2%	-5,6%	-1,2%

Source: Refinitiv Datastream

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