



## Jens Weidmann resigned: Why German Fiscal Restraint Does Not Make Sense Any-more

Yes, you read the headline correctly. We are indeed proposing to abolish Germany's strict austerity policy and replace the current debt limits rooted in Germany's Basic Law. We are suggesting this despite decades (literal not metaphorical) of maintaining rather conservative political theories that most certainly would not easily accept unfettered government debt. Yet here we are and cannot help but take a new look at the subject not least because Bundesbank chief Jens Weidmann resigned.

Jens Weidmann was and still is one of the most qualified, experienced, and globally respected heads of a major central bank. For ten years he tirelessly fought to keep the ECB from becoming a dedicated low-cost refiner for Euroland member states. German ECB Council members have somewhat of a reputation for resigning over monetary policy disagreements. Axel Weber, Jürgen Stark, and probably also Sabine Lautenschläger left the ECB over heated monetary policy debates that made constructive cooperation problematic to be diplomatic in our word choice. As such, one should be sympathetic with Jens Weidmann considering the fact that he was the ECB's last outspoken, powerful, and courageous champion for a politically independent central bank. However, sometime down the line comes the time where one must admit defeat. Jens Weidmann's only real 'fault' was that he fought his debate battles as proper academic disputes rather than arguing with fewer syllables and more firepower. He could have, for instance, have stopped the Bundesbank from participating in any further bond purchases. This is history and we are now looking ahead to a future where ECB monetary policy no longer follows the tradition of an independent Bundesbank but rather that of the EU's

southern central banks that their governments tend to treat like part of their administrative structure – which indeed they were for many years.

It thus comes as no surprise that Jens Weidmann's resignation triggered an avalanche of official ECB statements that left no doubt over the path ahead: We can be relatively sure that the key lending rate will remain near zero percent and that bond purchase programs will be reduced but certainly not halted for a long time.

How convenient that the EU Commission is just now also debating an adjustment in the Maastricht criteria to allow government debt of 100 percent rather than only 60 percent of GDP. Actually, the original and still current criteria (three percent of GDP net new borrowing and 60 percent of GDP total debt) are not bad at all. Making plausible GDP growth and interest rate assumptions, these debt criteria are compatible with long-term stability in government debt that is unlikely to suddenly escalate. However, scaling up permissible government debt to 100 percent of GDP will mathematically only yield reasonable GDP stability given plausible assumptions if interest rates remain near zero in perpetuity. Indeed, this is what the ECB seems to want to implicitly guarantee now.

All this is happening at a time when the classic no-bail-out-clause is becoming irrelevant. The EU is evolving into a transfer and liability union where budget policy risks are increasingly born by all member states. Another step in this direction is the EUR 750 billion Covid Relief Fund. While the Covid crisis will probably be long over before this fund can commence distribution; the spirit of joint funding and liability will persist.

Is it still economically rational in this world to maintain a national debt ceiling as stipulated in Germany's Basic Law and observed rather diligently thus far? Not really. The debt ceiling would basically institutionalize and probably widen the debt gap between Germany and the rest of Euroland as new Maastricht criteria take effect. By keeping its debt ceiling, Germany would gradually drop back to a debt level around 60 percent of GDP while the rest of Euroland would find even 100 percent of GDP an ambitious debt goal as they currently average close to 110 percent of GDP (excluding Germany).

Novices to the Sacred Order of Econometry may not find these numbers particularly impressive but, believe me, they describe quite different worlds. If Germany were to, for instance, try and match its debt level to the other EU countries this would raise almost 1.6 trillion euros for debt funded expenses. If you have problems visualizing this number think of Germany's annual budget of 400 billion euros. Handing this kind of money over to politicians would be the genie they dreamt of. Extravagant education expenses? The magic purse just pays them all. Who needs taxes? Genie will build a brand-new infrastructure and we can invest into groundbreaking new technologies to combat climate change.

However, there is a catch: Germany's staggering spending potential resulting from its currently low debt level somewhat works like a fail-safe for the EU and Euroland. This fail-safe or fallback savings to pay the bills in times of need would diminish as Germany raises its debt level to the EU average. Saving your credit line to pay for others through a transfer and liability union is a type of economic lunacy. No country on Earth would be that altruis-

tic to save to its own starvation just to maintain a credit-worthiness that fundamentally only serves others. Even Germany could not be crazy enough to make sense of that one especially since the other countries are raising the pressure on Germany to abolish its debt ceiling and join them in deficit spending. To put it succinctly: The only sense in Germany walking the austerity path alone and keeping its debt far below EU levels - despite an EU transfer and liability union, modified Maastricht criteria, and virtually guaranteed zero-percent interest rates - would be planning the BRDexit. In that case Germany would be solely responsible for its own debt again and have to refinance in its own currency on the open market - and that probably at realistic market interest rates rather than artificially low ECB rates. However, Germany is NOT planning a BRDexit and that is good. If Germany deliberately decided to clearly remain in the EU and part of Euroland, it must also accept that the statutes of this club have changed. Since Germany obviously no longer has much clout in writing the rules of Euroland (as evidenced by the resignation of Bundesbank chief Jens Weidmann), Germany must adapt to its new rules. Skeptics may now ask: Can this end well? Assuming this somewhat flawed regulatory framework will go full speed ahead for twenty to thirty years before the iceberg sinks the ship, it is certainly better to face the future with a great infrastructure and a highly skilled labor force than with a country that has saved itself into poverty and must face a restart with nothing. Following this logic there really is no alternative to deficit spending. The German government only has the choice between efficient and inefficient spending. The old debt ceiling has done its duty and is no longer a solution.

## Market Data

Stock markets	As of	Change versus				
	29.10.2021 10:48	30.09.2021 -1 week	06.09.2021 -1 month	06.07.2021 -3 months	06.10.2020 -1 year	31.12.2020 YTD
Dow Jones	35730	5,6%	1,0%	3,3%	28,7%	16,7%
S&P 500	4596	6,7%	1,3%	5,8%	36,8%	22,4%
Nasdaq	15448	6,9%	0,6%	5,3%	38,5%	19,9%
DAX	15571	2,0%	-2,3%	0,4%	20,6%	13,5%
MDAX	34819	1,3%	-3,9%	0,8%	25,8%	13,1%
TecDAX	3808	1,8%	-4,0%	5,7%	22,4%	18,5%
EuroStoxx 50	4208	4,0%	-0,9%	3,8%	30,1%	18,4%
Stoxx 50	3652	4,4%	0,2%	3,7%	25,0%	17,5%
SMI (Swiss Market Index)	12066	3,6%	-2,9%	0,8%	17,9%	12,7%
Nikkei 225	28893	-1,9%	-2,6%	0,9%	23,3%	5,3%
Brasilien BOVESPA	105705	-4,8%	-10,3%	-15,5%	10,6%	-11,2%
Russland RTS	1854	4,3%	6,7%	12,7%	58,6%	33,6%
Indien BSE 30	59415	0,5%	1,9%	12,4%	50,1%	24,4%
China CSI 300	4909	0,9%	-0,5%	-3,4%	7,0%	-5,8%
MSCI Welt (in C)	3179	5,1%	2,1%	6,2%	35,1%	24,5%
MSCI Emerging Markets (in C)	1276	1,2%	-1,9%	-3,7%	17,2%	4,1%
<b>Bond markets</b>						
Bund-Future	169,06	-76	-619	-454	-521	-858
Bobl-Future	133,93	-100	-100	-45	-121	-125
Schatz-Future	112,01	-20	-25	-18	-27	-27
3 Monats Euribor	-0,56	2	1	1	-5	3
3M Euribor Future, Dec 2017	-0,54	0	0	-1	0	0
3 Monats \$ Libor	0,12	-1	1	-1	-11	-11
Fed Funds Future, Dec 2017	0,08	0	0	-2	3	0
10 year US Treasuries	1,61	8	29	24	87	70
10 year Bunds	-0,09	10	28	22	41	48
10 year JGB	0,10	3	6	7	7	8
10 year Swiss Government	-0,03	14	28	24	46	46
US Treas 10Y Performance	692,88	0,1%	-1,6%	-0,8%	-4,5%	-3,2%
Bund 10Y Performance	662,94	-0,1%	-1,8%	-1,0%	-2,6%	-3,2%
REX Performance Index	490,34	-0,3%	-1,1%	-0,8%	-1,6%	-1,8%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, C	0,34	1	14	11	19	32
IBOXX BBB, C	0,72	4	15	10	-17	16
ML US High Yield	4,76	8	17	20	-116	-22
Convertible Bonds, Exane 25	8153	0,0%	-2,4%	-2,8%	3,8%	-2,1%
<b>Commodities</b>						
MG Base Metal Index	435,13	0,7%	-1,3%	0,4%	41,9%	22,7%
Crude oil Brent	84,39	7,4%	17,0%	13,0%	97,4%	62,6%
Gold	1792,27	1,8%	-1,6%	-0,6%	-6,3%	-5,6%
Silver	22,54	2,1%	-8,9%	-13,8%	-5,4%	-14,6%
Aluminium	2883,75	1,5%	4,6%	15,0%	65,8%	46,1%
Copper	9052,60	1,2%	-4,1%	-2,5%	39,0%	16,8%
Iron ore	121,94	1,9%	-15,8%	-44,0%	0,1%	-21,8%
Freight rates Baltic Dry Index	3630	-29,7%	-5,0%	14,2%	73,1%	165,7%
<b>Currencies</b>						
EUR/ USD	1,1653	0,6%	-1,8%	-1,6%	-1,2%	-5,0%
EUR/ GBP	0,8458	-1,6%	-1,4%	-1,3%	-7,0%	-5,5%
EUR/ JPY	132,47	2,2%	1,6%	1,1%	6,3%	4,7%
EUR/ CHF	1,0622	-1,9%	-2,3%	-2,8%	-1,5%	-1,7%
USD/ CNY	6,3981	-0,8%	-0,9%	-1,3%	-5,8%	-2,0%
USD/ JPY	111,43	0,1%	1,4%	0,7%	5,5%	7,9%
USD/ GBP	0,73	-2,1%	0,4%	0,2%	-5,8%	-0,8%

Source: Refinitiv Datastream

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