



## ECONOMIC SITUATION AND STRATEGY

4. March 2022

### Turning point

Vladimir Putin's unjustifiable war of aggression against Ukraine, which violates international law, marks a turning point in European history. After the end of the Second World War and the end of the Cold War, we are now entering a new era of which it is not yet clear how it will develop. In retrospect, no one can be surprised that it has come to this. For years, Putin has used every opportunity to strengthen himself militarily and to gain military influence - but no one wanted to see it. In Syria, Putin's military interventions saved the regime of Bashar al-Assad, then he got involved in Libya, Africa and Belarus. The successes and the largely indifferent attitude of the West have presumably encouraged him to now invade Ukraine. Anyone interested in history cannot help but see some astonishing parallels between Putin's behavior and that of Hitler. The keywords are the Spanish Civil War, the annexation of Austria, the Sudeten crisis and finally the fake attack on the Gleiwitz radio station.

However, the historical parallel does not stop there. Anyone who has carefully analyzed the speeches and actions of Western politicians since the last ten days or so may well come up with the idea of classifying the often-observed 180-degree turnaround as a kind of European Pearl Harbor moment. Japan's attack on the U.S. naval base at Pearl Harbor marked a turning point in that it was only at this moment that the U.S. was forced to show its colors in the Second World War. Only then was it also possible for politicians to demand great sacrifices from the population and actually enter the war. Now, of course, it is not a question of Europe or NATO becoming a party to the war - but it is certainly a question of the extent to

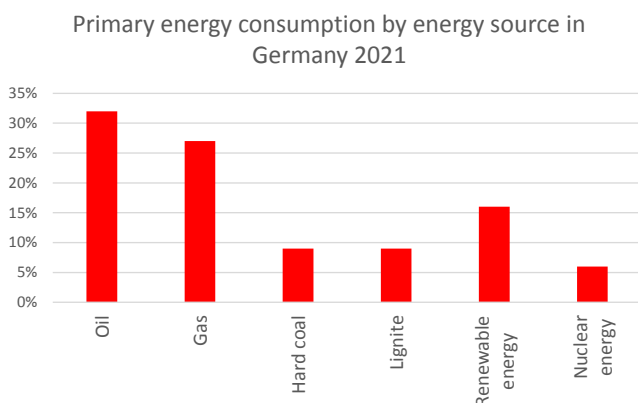
which the West is prepared to defend its values seriously, even militarily, in extreme cases.

This question arises not only with regard to the current developments in Ukraine, but also with regard to China, which has recently become much more aggressive and has just taken Hong Kong from the Western sphere of influence by comparatively violent means. It may therefore have come as a surprise to Putin that an SPD chancellor with a Green foreign minister in the Bundestag, of all people, is announcing a dramatic increase in the defense budget and promising very precisely to close precisely named gaps in military capabilities. This includes (and this has been somewhat overlooked by the public) an explicitly named modernization of fighter-bombers, the acquisition of stealth bombers capable of carrying nuclear weapons, fighter aircraft for electronic warfare and armed drones, to name just a few examples. Under normal circumstances, this announcement by an SPD chancellor would have led to a constructive vote of no confidence; last Sunday, the chancellor received a standing ovation instead. The repositioning of the federal government is not an isolated case. Similar considerations have been made everywhere in Europe. In the EU, moreover, a degree of determination and drive has been developed within a few days that one would not have thought possible. This includes a level of sanctions adopted that has not been seen before. And that is not the end of the story. The speeches of the politicians in the EU Parliament yesterday, for example, showed a degree of unity and - one could almost say will to fight - that has probably never been seen in such a concentrated form in the history of the EU. It is possible that Putin has achieved something

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with his terrible war that he never wanted to achieve: a very much accelerated political and military unification of Europe.

But that does not change the fact that the coming months will not be easy. In Ukraine, more and more people are being encircled in cities. The supply situation for the people in Ukraine will deteriorate dramatically in the coming days. The flow of refugees will probably reach unprecedented levels. We will have to see terrible images that make a further tightening of sanctions seem possible. And with this scenario, a white elephant enters the room that nobody really wanted to see so far: The possibility of Russia reducing or stopping the supply of oil, gas and coal in retaliation, which would lead to dramatic consequences. The following figure shows the current primary energy consumption in Germany.



Russia supplies more than 42 percent of oil, more than 50 percent of gas and more than 45 percent of hard coal. If there is a shortfall here, more than 30 percent of primary energy will be missing. In Germany, it has taken us about 40 years to bring renewable energies to a share of 16 percent. This share would have to be tripled to compensate for a shortfall in Russian supplies. This seems completely out of the question, even with a view to the next ten years. Even a redirection of all possible energy flows in Europe would not come close to compensating for a loss of Russian supplies, especially since many other countries in Europe are also highly dependent on Russian oil, gas and coal. Accordingly, it cannot be ruled out that the next few months, perhaps even the next few years, will be characterized by an extremely tight supply situation for oil, gas and coal - with all the negative effects this would have on the real economy.

In his remarkable government statement to the German Bundestag on February 27 (we would even call it a historic speech), Chancellor Olaf Scholz spoke no fewer than five times of a "turning point in time." The war of

aggression on Ukraine ordered by Russian President Vladimir Putin has shaken the world as we knew it to its foundations. War in Europe, only 800 kilometers away from Germany, was an unimaginable scenario for all of us. Now people are dying every day not far from us, many are driven from their homes.

Germany is reacting to this by supplying Ukraine with weapons for its defense, which was also unthinkable in view of German history. In addition, the Bundeswehr is to become a modern and efficient army. To this end, a "special Bundeswehr fund" with a volume of 100 billion euros (equivalent to around three percent of Germany's economic output) is to be launched, and in addition more than two percent of the gross domestic product is to be made available for defense spending in the federal budget every year from now on. In addition, our country must become independent of Russian oil and gas. The expansion of renewable energies is to be accelerated, and two LNG terminals are to be built in Wilhelmshaven and Brunsbüttel. But let's not fool ourselves: All these measures will take time to show tangible effects, especially since implementing them in a time of scarce and expensive resources is a Herculean task. It is likely that inflation rates will be further fueled and debt will rise in the coming years.

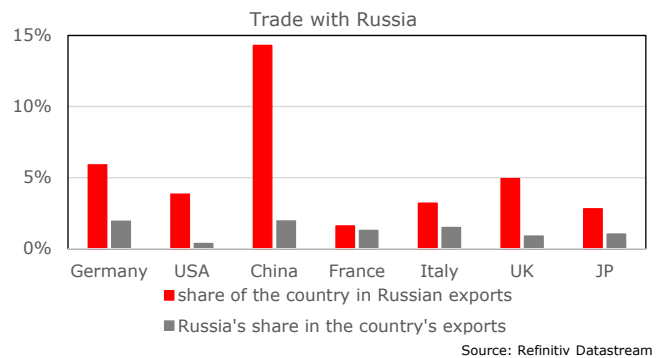
What economic effects will the war between Russia and Ukraine have on the global economy and on us? Unfortunately, the possible effects can only be estimated very roughly so far. According to the International Monetary Fund, Russia's total economic output in 2021 was about \$1,650 billion, which would give it a share of about 1.7 percent of the world economy. Previously, the IMF forecast Russia's economic growth at 2.8 percent in 2022. In view of the comprehensive sanctions, however, the Russian economy could slump by ten, perhaps even twenty percent. This would reduce global economic growth by 0.2 to 0.4 percentage points. From today's perspective, the risk of the global economy experiencing a severe downturn or even a new recession therefore appears to be low.

However, it is not only the Russian economy that is suffering; growth will also slow in other countries. For the world's largest economy, the United States, the direct economic risks are low because it has hardly any exposure to trade with Russia. For example, only 0.4 percent of total U.S. exports go to Russia, a share of just 0.03 percent in terms of gross domestic product. For China, the direct trade effects are somewhat greater. Just under

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two percent of Chinese exports go to Russia, which corresponds to a share of just under 0.4 percent of economic output. However, since China is not participating in the sanctions against Russia, the country could even benefit economically from a redirection of trade flows. But it is questionable whether and how Russia will be able to pay for additional imports from China; after all, the ruble has recently lost a good 30 percent of its value against the U.S. dollar. Around 80 percent of the Russian central bank's currency reserves of a good 500 billion U.S. dollars are held by Western financial institutions, the rest by Chinese banks; there are also physical gold reserves of around 100 billion U.S. dollars. The "liquidity reserve" derived from this amounts to around 200 to 250 billion U.S. dollars, which is roughly equivalent to the total Russian import volume for one year. This would then be used up.

Negative effects of the economic sanctions are also to be expected in Europe and here in Germany. This is because our exports to Russia last year amounted to around 0.8 percent of nominal economic output. Assuming a slump in exports of 80 percent, this would result in a GDP decline of 0.6 percentage points in isolation. However, Germany will also import significantly fewer goods from Russia (assuming a 40 percent decline), which would mitigate the net effect to about 0.4 percentage points. If Germany were to stop trading with Russia altogether, there would even be a positive growth effect, as Germany had a trade deficit with Russia in 2021. If the same considerations were made for the euro zone, there would be a negative net effect of around 0.2 percentage points. In addition to the direct trade effects, however, there are other negative effects due to the sharp rise in raw material prices and new supply chain problems. For example, automotive production suffers from the fact that Ukraine is the most important producer of wire harnesses and wiring systems. Since production there is at a standstill due to the war, this is also leading to production downtimes or even cutbacks at many German automakers. While until recently there was hope that the Corona-related supply chain problems would gradually be resolved this year and that more semiconductors would once again be available, this is now the next low blow for the auto industry. So far, we have expected economic growth of just under four percent for Germany this year. In view of current developments, we are now reducing this forecast to three percent. We still consider the risk of stagflation (economic stagnation coupled with high inflation) or recession to be low at the moment.



This current situation could lead to globalization being pushed back in the next few years and losing importance for world trade. Globally diversified supply chains, which have led to favorable cost structures in the past, and favorable just-in-time production without extensive warehousing are dependent on functioning structures and favorable transport routes. If these are not ensured, growth could suffer as a result and a lasting phase of higher price increase rates could be initiated. The Cold War is casting its negative shadow, and here too we are facing a turning point. In the long term, however, we do not want to lose sight of the positive: In the end, the war in Ukraine may become a spark for the United States of Europe, which will then move through the world in a less dreamlike manner and instead be able to define strategic goals in the interests of its citizens and then achieve them.

## Market data

Stock marketes	As of	Change versus				
	04.03.2022 10:35	24.02.2022 -1 week	02.02.2022 -1 month	02.12.2021 -3 months	02.03.2021 -1 year	31.12.2021 YTD
Dow Jones	33795	1,7%	-5,1%	-2,4%	7,7%	-7,0%
S&P 500	4363	1,7%	-4,9%	-4,7%	12,7%	-8,4%
Nasdaq	13538	0,5%	-6,1%	-12,0%	1,3%	-13,5%
DAX	13287	-5,4%	-14,9%	-13,0%	-5,4%	-16,4%
MDAX	29439	-4,0%	-13,5%	-12,8%	-7,3%	-16,2%
TecDAX	3086	-0,2%	-12,4%	-18,2%	-8,3%	-21,3%
EuroStoxx 50	3633	-5,1%	-14,0%	-11,6%	-2,0%	-15,5%
Stoxx 50	3470	-2,0%	-8,8%	-4,3%	8,8%	-9,1%
SMI (Swiss Market Index)	11445	-1,6%	-7,4%	-6,0%	5,8%	-11,1%
Nikkei 225	25985	0,1%	-5,6%	-6,4%	-11,6%	-9,7%
Brasilien BOVESPA	115166	3,2%	2,9%	10,2%	3,3%	9,9%
Russland RTS	937	26,1%	-36,0%	-44,6%	-35,5%	-41,3%
Indien BSE 30	54493	-0,1%	-8,5%	-6,8%	8,3%	-6,5%
China CSI 300	4496	-0,7%	-1,5%	-7,4%	-15,9%	-9,0%
MSCI Welt (in €)	2942	2,6%	-2,9%	-2,6%	16,1%	-6,4%
MSCI Emerging Markets (in €)	1173	2,9%	-0,7%	-2,4%	-5,8%	-2,1%
<b>Bond markets</b>						
Bund-Future	169,20	227	54	-355	-547	-217
Bobl-Future	133,08	161	111	-244	-160	-16
Schatz-Future	112,34	52	52	-5	11	31
3 Monats Euribor	-0,53	4	5	4	1	6
3M Euribor Future, Dec 2017	-0,10	-8	7	47	43	0
3 Monats \$ Libor	0,52	1	21	34	34	31
Fed Funds Future, Dec 2017	1,43	-13	22	135	133	1
10 year US Treasuries	1,79	-18	3	36	38	30
10 year Bunds	-0,01	-15	-1	36	37	17
10 year JGB	0,16	-3	-1	10	4	9
10 year Swiss Government	0,17	-9	9	42	42	31
US Treas 10Y Performance	675,78	1,0%	-1,0%	-3,3%	-1,8%	-3,3%
Bund 10Y Performance	652,46	1,5%	0,2%	-3,3%	-2,8%	-1,5%
REX Performance Index	486,55	0,7%	0,1%	-1,7%	-1,6%	-0,9%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,94	-17	25	58	77	46
IBOXX BBB, €	1,66	-14	45	87	101	79
ML US High Yield	5,82	-16	42	69	96	92
Convertible Bonds, Exane 25	7454	0,0%	-5,3%	-8,3%	-9,2%	-9,0%
<b>Commodities</b>						
MG Base Metal Index	522,22	3,4%	8,9%	18,0%	29,8%	13,2%
Crude oil Brent	111,23	12,3%	24,2%	59,1%	76,9%	41,9%
Gold	1940,70	0,8%	7,3%	9,9%	12,4%	6,5%
Silver	25,07	1,5%	10,1%	12,0%	-5,9%	7,7%
Aluminium	3585,50	4,4%	19,3%	37,1%	62,4%	27,8%
Copper	10194,25	2,8%	3,2%	6,3%	10,6%	4,7%
Iron ore	151,11	5,9%	8,0%	48,4%	-12,7%	34,3%
Freight rates Baltic Dry Index	2104	-3,8%	48,3%	-32,5%	25,8%	-5,1%
<b>Currencies</b>						
EUR/ USD	1,1016	-1,3%	-2,7%	-2,8%	-8,4%	-2,7%
EUR/ GBP	0,8272	-1,2%	-0,7%	-2,7%	-4,3%	-1,5%
EUR/ JPY	127,09	-0,9%	-1,8%	-0,7%	-1,2%	-2,5%
EUR/ CHF	1,0117	-2,0%	-2,7%	-2,9%	-8,4%	-2,1%
USD/ CNY	6,3169	-0,2%	-0,7%	-0,9%	-2,4%	-0,6%
USD/ JPY	115,52	0,0%	0,9%	2,1%	8,3%	0,4%
USD/ GBP	0,75	-0,3%	1,9%	0,0%	4,8%	1,7%

Source: Refinitiv Datastream

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