



ECONOMIC SITUATION AND STRATEGY

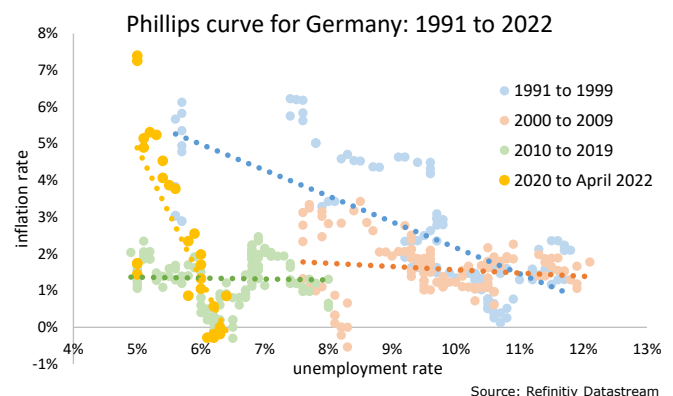
25 May 2022

Is a wage-price spiral looming in the USA and Germany?

With his statement "rather five percent inflation than five percent unemployment", Helmut Schmidt is still remembered by many today. With his view that there is a trade-off between price dynamics and unemployment, the former Chancellor took up the economic concept of the Phillips curve. The idea behind this is that an economic upswing that leads to a falling unemployment rate increases the demand for labour and thus exerts upward pressure on wages. In return, profit-maximising companies try to pass on part of the wage increases to consumers through price increases. In return, consumers demand higher wages again, so that the wage-price spiral feared by economists is set in motion.

At the latest after the global financial crisis, however, the concept of the Phillips curve lost its significance. Price pressure from international competition (globalisation) and a stable economic environment - not least due to the expansive impulses of monetary and fiscal policy - made possible a phase characterised by low inflation rates and low unemployment. After the outbreak of the Corona pandemic, however, there are increasing signs that this phase has ended. Currently, inflation rates are at record levels (USA: 8.3 percent, Germany: 7.4 percent), while unemployment rates are reaching new lows (USA: 3.6 percent, Germany 5.0 percent). The latest data thus raises the question of whether the Phillips curve may be making a comeback and central bankers and politicians will once again have to address the trade-off between unemployment and inflation.

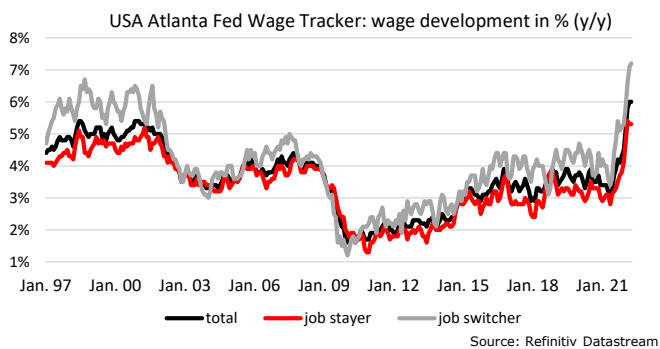
How sustainable the current development is and whether inflation rates will remain at this high level is directly related to the state of the labour market and the question of the extent to which employees can push through higher wage demands. A strong wage-price spiral is likely to prompt central banks to adopt a more restrictive interest rate policy, which will increase headwinds for the economy and the financial markets. However, if the second-round effects turn out to be weak, so that inflation rates return to their target values faster than expected, the capital markets should breathe a sigh of relief.



A first look at the key data of the US labour market should please politicians and economists: the unemployment rate recently reached historic lows of 3.6 percent, and the current employment level of 151.3 million persons is only slightly below the pre-Corona level of 152.5 million persons. Furthermore, data on the support of the unemployed show an encouraging trend: on the one hand, the number of weekly initial claims for unemployment benefits is at a historically low level, and on the other hand, the number of persons receiving unemployment

Economic Situation and Strategy

benefits has fallen to 1.344 million. This compares to 25 million at the height of Corona and an average of at least 1.6 million Americans receiving unemployment benefits before the outbreak of the Corona pandemic. Although these data underscore the cyclically impeccable condition of the US labour market, economists and market participants interpret them as warning signals: The feared wage-price spiral seems to be in full swing in the USA. In the first quarter of 2022, for example, the labour cost index rose by 4.5 percent compared to the same period last year - the highest increase in more than 20 years. The Atlanta Fed Wage Tracker, which measures the nominal wage development of American workers on the basis of population surveys, comes to a similar conclusion. Based on monthly data, a significant wage increase can be observed since the middle of last year. The wage increase of 7.2 percent is particularly high for job switchers. Workers who stay with their employer show a relatively smaller wage increase of 5.3 percent.



The particularly high wage increase among job switchers is also due to the disproportion between unemployed and vacancies. The current ratio is striking: on average, there are only 50 unemployed people registered for 100 advertised vacancies - the historical average since 2001 is around 228 unemployed people. On the one hand, this shows that companies are currently having difficulties finding and hiring qualified staff. On the other hand, the striking mismatch between labour demand and labour supply strengthens the negotiating position of those who want to change jobs or resume employment.



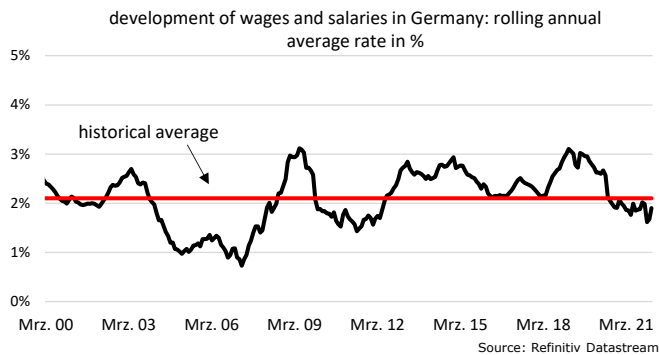
Under what circumstances could the wage-price spiral be slowed down? First, an increase in the labour force participation rate, i.e. the share of the labour force in the working age population, would increase labour supply and help to reduce the mismatch between unemployed and vacant jobs. With the outbreak of the Corona pandemic, older populations in particular have withdrawn from the labour market. However, if the savings of this population group are not sufficient for early retirement and high inflation significantly reduces real purchasing power, a rise in the labour force participation rate and, ceteris paribus, a slight easing of the US labour market can be expected. On the other hand, a decline in demand for labour on the part of companies would provide relief. In the best case, the decline in labour demand would be due to an increase in labour productivity - for example, through technological progress. In the worse case, an economic slump would cloud the outlook of companies and lead to lower labour demand or even layoffs. Although the latter would reduce price pressure, it would certainly not be in Helmut Schmidt's interest.

While wage and salary increases are already in full swing in the USA, the situation on the German labour market looks (still) relaxed. Monthly data from the German Bundesbank show that there have been no above-average wage increases so far. The rolling average over the last twelve months was 1.9 percent in February 2022, below its historical average since 2000 of 2.1 percent. A look at the quarterly data from the Federal Statistical Office shows a somewhat different picture. Here, nominal wage increases in the fourth quarter of 2021 - current data is not available at this time - were 3.6 percent, above the average since 2008 of 2.2 percent. The latest collective bargaining negotiations again show a restrained development. On average, collective bargaining earnings increased by 1.3 percent in 2021 compared to the annual average in 2020, which is the smallest increase since the beginning of the time series in 2010. The weak increase is partly due to the fact that Corona bonuses were paid in 2020, which ceased in 2021.

Similar to the US, the number of unemployed in Germany has declined significantly since the Corona peak in April 2020, while the number of vacancies has increased considerably. According to the Institute for Employment Research (IAB), never before have so many unfilled vacancies been recorded in the first quarter of 2022. With an increase of 54 percent compared to the previous year, the number of vacancies in the first quarter of 2022 increased to a total of 1.74 million people - the highest

Economic Situation and Strategy

value since the beginning of the measurement in 1989. According to the IAB, there were around 140 people registered as unemployed for every 100 vacancies advertised in the first quarter. Compared to the USA, however, the disproportion between unemployed and vacancies is not as dramatic.



Does this mean that the risk of a wage-price spiral in Germany is manageable? In fact, when answering this question, the increases in the minimum wage in Germany this year must be taken into account. On 1 July 2022, the minimum wage will increase from €9.82 per hour to €10.45 - an increase of 6.4 percent. A further increase to 12€ per hour is then planned from 1 October. According to the United Services Union (ver.di), 8.6 million people would benefit - that is about 19% of all employees. Fashionable wage adjustments, which are far below the current inflation rate of 7.4 percent, were made this year in the banking industry (2022: three percent), in the printing industry (2022: two percent) and in the insurance industry (2022: three percent) - but these moderate wage adjustments affected only 1.3 percent of all employees. Further collective bargaining is scheduled this year for the chemical industry, the iron and steel industry and the metal and electrical industry. These three sectors account for about 9.9 percent of all employees in Germany.



that the Federal Reserve will have to adopt a more aggressive monetary policy. The strong wage growth has occurred despite the low union density of 10.3 percent. Union density measures the ratio between the total number of union members and the number of employed workers. In the case of the US labour market, decentralised wage bargaining enabled workers to respond much more quickly and flexibly to the increased price level and to enforce their strengthened bargaining position. Due to the poorer data availability in Germany, the danger of a wage-price spiral is more difficult to assess, but the wage increase dynamic in Germany does not seem to have progressed as far as in the USA. However, future wage pressure is likely to increase due to the upcoming collective bargaining and minimum wage increases this year.

In summary, the wage-price spiral in the US is in full swing. This increases the risk that inflation will remain at a higher level for longer due to second-round effects and

Market data

	As of 25.05.2022 11:26	12.05.2022 -1 week	18.04.2022 -1 month	Change versus 18.02.2022 -3 months	18.05.2021 -1 year	31.12.2021 YTD
Stock markets						
Dow Jones	31929	0,6%	-7,2%	-6,3%	-6,3%	-12,1%
S&P 500	3941	0,3%	-10,3%	-9,4%	-4,5%	-17,3%
Nasdaq	11264	-0,9%	-15,5%	-16,9%	-15,3%	-28,0%
DAX	13921	1,3%	-1,7%	-7,5%	-9,5%	-12,4%
MDAX	28817	2,3%	-6,0%	-12,6%	-10,7%	-18,0%
TecDAX	3037	2,1%	-5,1%	-5,5%	-8,9%	-22,5%
EuroStoxx 50	3648	1,0%	-5,2%	-10,5%	-8,9%	-15,1%
Stoxx 50	3589	1,7%	-5,1%	-3,4%	4,6%	-6,0%
SMI (Swiss Market Index)	11508	0,0%	-7,8%	-4,2%	3,3%	-10,6%
Nikkei 225	26678	3,6%	-0,5%	-1,6%	-6,1%	-7,3%
Brasilien BOVESPA	110581	4,6%	-4,4%	-2,0%	-10,1%	5,5%
Russland RTS	1289	13,1%	39,2%	-7,3%	-18,1%	-19,2%
Indien BSE 30	53853	1,7%	-5,8%	-6,9%	7,3%	-7,6%
China CSI 300	3983	0,6%	-4,4%	-14,4%	-23,2%	-19,4%
MSCI Welt	2680	1,5%	-9,3%	-10,2%	-8,5%	-17,1%
MSCI Emerging Markets	1017	3,0%	-8,1%	-17,4%	-23,7%	-17,5%
Bond markets						
Bund-Future	153,94	-82	-101	-1240	-1488	-1743
Bobl-Future	127,48	-62	-26	-396	-688	-576
Schatz-Future	110,37	-23	-17	-151	-166	-166
3 Monats Euribor	-0,36	22	23	22	20	23
3M Euribor Future, Dec 2017	0,77	24	42	0	130	1
3 Monats \$ Libor	1,48	7	42	100	132	127
Fed Funds Future, Dec 2017	2,55	-1	18	0	247	2
10 year US Treasuries	2,74	-9	-12	80	110	124
10 year Bunds	0,95	8	13	78	106	113
10 year JGB	0,21	-3	-3	0	13	14
10 year Swiss Government	0,70	0	-16	44	81	83
US Treas 10Y Performance	613,32	-0,5%	-1,1%	-8,8%	-9,7%	-12,2%
Bund 10Y Performance	595,21	-1,3%	-1,4%	-7,1%	-9,4%	-10,1%
REX Performance Index	462,98	-0,6%	-0,6%	-3,8%	-5,6%	-5,7%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	1,97	12	40	99	162	149
IBOXX BBB, €	2,88	10	56	129	212	201
ML US High Yield	7,81	14	117	195	302	290
Convertible Bonds, Exane 25	6830	0,0%	-7,0%	-10,1%	-16,8%	-16,6%
Commodities						
MG Base Metal Index	460,14	2,5%	-13,4%	-7,1%	1,8%	-0,2%
Crude oil Brent	114,50	6,3%	2,4%	22,7%	66,3%	46,0%
Gold	1857,59	0,9%	-6,4%	-2,0%	-0,6%	1,9%
Silver	21,60	3,3%	-17,1%	-9,8%	-23,1%	-7,2%
Aluminium	2838,76	4,7%	-13,2%	-14,0%	16,0%	1,2%
Copper	9250,10	1,6%	-10,2%	-7,6%	-10,9%	-5,0%
Iron ore	133,31	1,0%	-14,3%	-5,5%	-37,5%	18,5%
Freight rates Baltic Dry Index	3253	4,4%	52,2%	65,6%	16,4%	46,7%
Currencies						
EUR/ USD	1,0671	2,5%	-1,9%	-6,0%	-12,7%	-5,8%
EUR/ GBP	0,8531	0,2%	2,9%	2,2%	-0,8%	1,6%
EUR/ JPY	135,49	1,2%	-0,6%	3,8%	1,8%	3,9%
EUR/ CHF	1,0269	-1,0%	0,8%	-1,8%	-6,3%	-0,6%
USD/ CNY	6,6745	-1,7%	4,8%	5,5%	3,9%	5,0%
USD/ JPY	128,23	-0,1%	1,0%	11,5%	17,8%	11,4%
USD/ GBP	0,80	-2,2%	4,1%	8,6%	13,6%	8,3%

Source: Refinitiv Datastream

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