



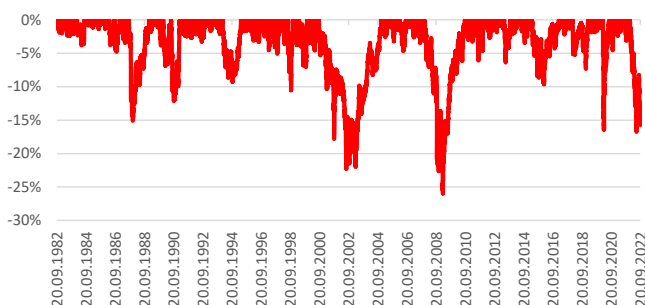
ECONOMIC SITUATION AND STRATEGY

22 September 2022

Economic and Financial Policy in Germany: Advice for Difficult Times

It would be a lie to claim that the world has been uncomplicated in the past. People tend to assess current challenges as particularly dramatic, while past problems quickly fade in memory and thus tend to be underestimated. Nevertheless, no one is likely to disagree with the opinion that the current mixed situation is indeed critical this time around. If capital markets are used as a yardstick, the current situation may even be particularly critical. In the 10435 trading days of the last 40 years, according to our calculations, the underwater chart of a global mixed portfolio of stocks and bonds was below current levels on only about three percent of the days. In other words, on almost 97% of the trading days, the respective setbacks from the previous peak were smaller than currently.

Draw-Down of a mixed portfolio (50% stocks, 50% bonds)



This is no surprise. How are markets supposed to react when there is a partial mobilization in Russia to intensify the war of aggression against Ukraine, gas and electricity prices reach dizzying heights, gas utilities have to be nationalized, producer prices rise as strongly as they have not since 1920s of the last (!) century, key interest rates

around the globe are raised significantly, leading indicators slip into recessionary territory, and Italy is facing an election this coming weekend that is likely to contain huge explosives for Europe.

For a country's economic and financial policy, these circumstances pose extreme challenges. It cannot and should not come as a surprise if political decisions lack a common thread when viewed from the outside. After all, there is no script for such a situation to follow. Nevertheless, from now on it is important to make as few mistakes as possible and to deal with the challenges in the best possible strategic way. The course is now being set for whether the current situation will remain a temporary crisis or whether it will be the starting point for the long-term decline of Germany and ultimately of the continent. We therefore take the liberty of throwing some (unsolicited) advice into the ring of political opinion-forming. Some readers may wonder whether we, as the economics department of a bank, should be giving smart advice here. However, we believe that some added value could be provided. After all, as an economist, you learn during your studies that the purpose of your training is to be able to provide policy advice later on, and to do so if necessary.

Ultimately, as an economist, you are always an ambassador of economic thought structures, which usually stand out pleasantly from ideological thought structures. Secondly, the ability to think strategically becomes second nature when you have to make decisions on capital markets day in, day out. Precisely because you have to make decisions under uncertainty every day, capital markets are an ideal school not only for learning humility, but also

for strategic thinking. So let's get started and pick out a few points by way of example:

The high electricity and gas prices are an expression of a physical shortage of gas. This problem will remain as long as the physical shortage is not reduced. Since the purchase of Russian gas is likely to be eliminated in the foreseeable future, the task now is to increase supplies from other countries as quickly as possible and to reduce our own consumption. In particular, our own consumption is an area where we can still do something. The task here is to bring as many nuclear power plants and as many coal-fired power plants as possible back into operation or to keep them running so that gas is never again burned in the base-load operation of power generation, but only as regulating energy in interplay with wind and solar power.

We are well aware that these statements have the potential to trigger a "shitstorm". But the task of a strategy consulting firm is not to follow the zeitgeist, but to gather facts and make decisions based on them. And the truth is that the continued operation of German nuclear power plants for a few years is justifiable from a safety point of view and that the additional nuclear waste produced will only increase the amount to be stored by a few percentage points (if at all). The operation of coal-fired power plants is also much less critical than many people think. Of course, coal-fired power plants emit more CO₂ per megawatt hour of electricity produced than gas-fired power plants, but emission rights have to be bought for this. In addition, since the amount of European emission rights is strictly limited, more emissions cannot be produced if more German coal-fired power plants are in operation. However, the emissions must then be saved elsewhere - exactly where this happens is decided by the market, and the market manages to do this quite efficiently. Nevertheless, more nuclear power and more coal-fired generation can only be short-term solutions to get us out of the current emergency situation. In the long term, there is no way around covering the (by the way, significantly increasing) demand for electricity as far as possible with renewable energies, also in order to be independent of other countries and suppliers. In Germany, wind energy plays a particularly important role here. However, if the dominant share of electricity and hydrogen in Germany is to be generated with wind power (let's say in 15 years), then we are facing a Herculean task, the dimensions of which - with all due respect - have not even begun to be understood by politicians. We need completely new legislation to enable the expansion of power lines, hydrogen

pipelines and hydrogen storage facilities in the shortest possible time. And we need authorities with the personnel and technical capabilities to carry out contract award procedures as quickly as possible. Efforts are possible here that are otherwise really only known from the war economy. These are harsh words, but the fact alone that per capita CO₂ emissions in Germany have hardly changed in the last 20 years speaks volumes and shows that we are completely barking up the wrong tree with current procedures and methods. Moreover, if strategic importance is attached to this area, then it would also make sense to selectively support the domestic wind power industry. Because if we continue as we are now, in five years not only will all solar modules come from China, but all wind turbines will as well. Does all this cost a lot of money? Of course! Does the state have to support this? Of course! Is it necessary to cushion the social hardships that will inevitably arise and become even greater in the coming years? Absolutely! Should the German debt brake be mothballed for this? We think so! In our view, one fact is being completely overlooked in this debate. In view of the expectation of a further increase in the ECB's key interest rates, rising spreads between German and southern European government bonds, and the success of extremely anti-European parties in many European countries, it is in any case only a matter of time before European debt is commonized and a transfer and fiscal union is introduced. This will then tap into an additional German debt potential of 1,500 to 2,000 billion euros - a sum that Germany could still spend on itself now. The window of opportunity for this is closing, however, and courageous decisions are called for. Patterns of action along historical lines of behavior are not a good guide. Everything must be put to the test. If policymakers do not understand this very quickly, this crisis will not let us go.

Market data

	As of 23.09.2022 09:40	15.09.2022 -1 week	19.08.2022 -1 month	Change versus 21.06.2022 -3 months	21.09.2021 -1 year	31.12.2021 YTD
Stock markets						
Dow Jones	30077	-2,9%	-10,8%	-1,5%	-11,3%	-17,2%
S&P 500	3758	-3,7%	-11,1%	-0,2%	-13,7%	-21,2%
Nasdaq	11067	-4,2%	-12,9%	0,0%	-25,0%	-29,3%
DAX	12453	-3,9%	-8,1%	-6,3%	-18,9%	-21,6%
MDAX	23015	-5,9%	-14,7%	-16,3%	-34,2%	-34,5%
TecDAX	2685	-7,3%	-13,6%	-5,8%	-31,3%	-31,5%
EuroStoxx 50	3415	-3,6%	-8,5%	-2,3%	-16,7%	-20,6%
Stoxx 50	3404	-2,9%	-7,3%	-0,3%	-3,1%	-10,8%
SMI (Swiss Market Index)	10301	-4,1%	-7,7%	-1,7%	-12,6%	-20,0%
Nikkei 225	27154	-2,6%	-6,1%	3,5%	-9,0%	-5,7%
Brasilien BOVESPA	114070	3,7%	2,3%	14,4%	3,5%	8,8%
Russland RTS	1145	-11,1%	-2,2%	-17,1%	-33,1%	-28,3%
Indien BSE 30	58326	-2,7%	-2,2%	11,0%	-1,2%	0,1%
China CSI 300	3856	-4,2%	-7,1%	-10,9%	-20,6%	-21,9%
MSCI Welt	2489	-4,0%	-10,7%	-2,1%	-18,4%	-23,0%
MSCI Emerging Markets	923	-3,8%	-7,9%	-9,3%	-26,9%	-25,1%
Bond markets						
Bund- Future	140,02	-320	-1215	-331	-3172	-3135
Bobl- Future	119,99	-154	-512	-113	-1549	-1325
Schatz- Future	106,97	-58	-233	-113	-530	-507
3 Monats Euribor	1,12	46	120	170	166	171
3M Euribor Future, Dec 2017	2,31	6	98	0	285	3
3 Monats \$ Libor	3,60	8	65	145	348	339
Fed Funds Future, Dec 2017	4,04	-1	59	0	396	3
10 year US Treasuries	3,68	23	69	38	236	219
10 year Bunds	1,93	18	75	17	225	211
10 year JGB	0,24	-2	4	0	20	17
10 year Swiss Government	1,32	24	68	-14	157	145
US Treas 10Y Performance	591,98	-0,4%	-3,8%	-0,8%	-16,1%	-15,3%
Bund 10Y Performance	554,00	-1,3%	-5,7%	-0,1%	-17,6%	-16,4%
REX Performance Index	444,54	-0,5%	-3,2%	-0,6%	-10,0%	-9,4%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	3,15	22	86	19	291	267
IBOXX BBB, €	4,32	25	92	31	374	345
ML US High Yield	8,77	17	98	27	418	387
Convertible Bonds, Exane 25	6427	0,0%	-6,3%	2,0%	-22,2%	-21,5%
Commodities						
MG Base Metal Index	381,52	-0,5%	-4,3%	-13,0%	-12,6%	-17,3%
Crude oil Brent	89,35	-1,9%	-7,7%	-22,1%	19,6%	14,0%
Gold	1667,68	0,0%	-4,7%	-9,3%	-6,3%	-8,5%
Silver	19,46	1,3%	1,6%	-10,7%	-14,1%	-16,4%
Aluminium	2177,50	-5,3%	-9,0%	-13,6%	-22,9%	-22,4%
Copper	7749,00	-1,3%	-4,3%	-13,9%	-13,7%	-20,4%
Iron ore	98,83	-1,6%	-6,4%	-26,0%	-17,0%	-12,2%
Freight rates Baltic Dry Index	1720	6,7%	34,5%	-30,8%	-61,0%	-22,4%
Currencies						
EUR/ USD	0,9773	-2,2%	-2,8%	-7,4%	-16,7%	-13,7%
EUR/ GBP	0,8738	0,5%	2,7%	1,6%	1,7%	4,1%
EUR/ JPY	138,98	-3,1%	1,0%	-3,3%	8,3%	6,6%
EUR/ CHF	0,9569	0,0%	-0,5%	-6,3%	-11,8%	-7,4%
USD/ CNY	7,1064	1,6%	4,2%	6,2%	9,8%	11,8%
USD/ JPY	144,05	0,4%	5,2%	5,4%	31,9%	25,2%
USD/ GBP	0,89	2,8%	5,6%	9,9%	22,0%	21,1%

Source: Refinitiv Datastream

Carsten Klude
+49403282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Mark Simon Landt
+49 40 3282-2401
mlandt@mmwarburg.com

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