



ECONOMIC SITUATION AND STRATEGY

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Days of chaos in Great Britain

Is she still there? Or has she already left? How could it be otherwise these days? It's about British Prime Minister Liz Truss. What can be said with certainty, however, is that for some time now, politics in the United Kingdom has been making an impression that, even in a benevolent assessment, can only be described as "wild as a bird". One gets the impression that Mrs. Truss has set her sights on entering the Guinness Book of Records as the prime minister with the shortest term in office (although she will not succeed). While at least the fans of reality shows are currently getting their money's worth from what is going on in Westminster and at 10 Downing Street, the main players in British politics are a picture of horror for everyone else interested in political events. Or to summarise briefly and succinctly: Politics and especially the House of Commons in Britain are running amok.

Now, many continental Europeans (including us) have had a somewhat strained relationship with the British political establishment at least since the Brexit vote in June 2016, so that there is a danger of perhaps being a little too critical of politics on the island. After all, it has to be said that the majority of Britons themselves have not been as unhappy with their politicians in recent years as we have been. But of course it can't be any other way, after all, these politicians were elected by the people themselves and the saying "every people gets the government it deserves" still applies. But let's try not to get too polemical, even if it is difficult for us. In any case, the half-life of British governments has decreased significantly since the Brexit decision. After David Cameron took his hat in July 2016, Theresa May took office. Although she lost what she thought was a certain victory in the early elections in

summer 2017, she held on to power with a minority government. She resigned in the summer of 2019 after her withdrawal agreement from the EU failed in the British parliament. Boris Johnson, who achieved a very good result for the Tories in the general election in December 2019 and had to resign in July 2022 after a whole series of scandals, making way for Liz Truss, succeeded her. Nevertheless, Johnson, whom many observers on the European continent derided as a political buffoon, is still very popular in the UK, especially among the political base of the Conservative Party.

That it is not a question of whether Truss has to go, but when she will go, is due to the decisions she has made and the wild back and forth that has been associated with them in recent weeks. The political philosophy of "Trussonomics" that was developed as her trademark has failed with a bang. Yet the economic goals that Liz Truss had set for herself were quite comprehensible and by no means revolutionary. She made it clear at an early stage that she wanted to significantly reduce the burden on private households with an energy price cap and that she also wanted to improve the competitiveness of the British economy through strong tax cuts. These are not in themselves objectionable ideas. The problem, however, was that the question of how to finance this package, which would lead to less revenue and more spending, was left completely open. It probably hoped that its proposals would more or less finance themselves, freely according to the motto "more growth provides even more revenue". That this assumption, based on the principle of hope,

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does not work in reality, however, is something that students of economics are already learning in their first semester.

The effects of these economic policy proposals were disastrous. Fear of a sharply rising budget deficit in the future and a significant increase in government debt caused the British pound to depreciate significantly against the euro and, above all, the US dollar within a very short time, while at the same time yields on British government bonds (gilts) rose massively. After Liz Truss presented her "mini-budget" on 23 September, 10-year gilts recorded losses of almost ten percent within four days, 30-year bonds lost almost 25 percent. This market panic caused difficulties for large British pension funds, which in recent years had increasingly relied on so-called liability driven investing (LDI) strategies to generate the necessary returns for promised pension obligations due to the persistently low interest rate phase. LDI strategies promised higher returns than could be achieved with conventional government bonds because they were based on derivatives that could also be leveraged. What works well in normal times and brings correspondingly positive results, however, turns out to be a ticking time bomb in times of crisis. Due to the rapidly rising yields, to which LDI strategies react very sensitively, the hedging positions came under pressure and the pension funds had to inject additional collateral. But since they did not have these funds in their coffers, other securities, mainly government bonds, had to be sold. Emergency sales led to further emergency sales and a downward spiral was set in motion that threatened the stability of the entire British financial system. In order to prevent a meltdown of the financial system (which would certainly have had a negative impact on other markets as well), the Bank of England subsequently had to intervene in the markets by promising to act as a buyer of government bonds over a fixed period of time (which ended on 14 October) in order to avoid further significant losses for pension funds.

The culprit for this chaos was quickly found: Chancellor of the Exchequer Kwasi Kwarteng was dismissed last week and replaced by Jeremy Hunt. Hunt has since given the critics of Truss' policies what they wanted and has

reversed almost all the economic policy decisions announced by Kwarteng and Tuss. The turmoil in the capital markets has subsided, which on the face of it can be considered a success. Nevertheless, the pension funds (and perhaps not only they) are sitting on high losses that can no longer be made up. Moreover, it seems that a complete arbitrariness has entered British fiscal policy, and that it is primarily a matter of defending one's own government power, no matter what policy is pursued. In the long run, however, the result of this policy will be that Britain will be a country with lower growth, higher taxes and a higher inflation rate.

Unfortunately, the British central bank has not exactly covered itself with glory in recent weeks, even if it has managed to limit the swings on the capital markets again. For a long time, it was of the opinion that possible risks to financial stability could be limited by regulatory requirements alone; on the other hand, it underestimated the role that a very expansive monetary policy could play - like probably almost every other central bank. As of 1 November, it now wants to start reducing its very large bond portfolio; whether it will succeed remains to be seen. At the same time, it will raise interest rates at its next monetary policy meeting on 3 November. After surprisingly raising rates less than expected last time, by 50 basis points, this time it will probably decide on an increase of at least 75, if not 100 basis points. This is because the inflation rate in the UK is still above the ten percent mark, and since the relief for private households via the energy price cap is to be shortened in time, a sustained decline in price pressure is likely to be longer in coming.

"I'm a fighter, not a shirker!" was her last comment. But now Liz Truss has announced her resignation. Will this really end the chaos in Great Britain? Who knows, maybe there will be a reunion with Boris Johnson after all. Then the political show could go into the next round... In any case, investors should give British investments a wide berth for the time being.

Market data

	As of 21.10.2022 08:23	Change versus				
		14.10.2022 -1 week	20.09.2022 -1 month	20.07.2022 -3 months	20.10.2021 -1 year	31.12.2021 YTD
Stock markets						
Dow Jones	30334	2,4%	-1,2%	-4,8%	-14,8%	-16,5%
S&P 500	3666	2,3%	-4,9%	-7,4%	-19,2%	-23,1%
Nasdaq	10615	2,8%	-7,1%	-10,8%	-29,8%	-32,2%
DAX	12767	2,6%	0,8%	-3,9%	-17,8%	-19,6%
MDAX	23273	4,2%	-2,0%	-12,8%	-32,6%	-33,7%
TecDAX	2755	1,5%	-0,8%	-7,8%	-26,5%	-29,7%
EuroStoxx 50	3493	3,3%	0,7%	-2,6%	-16,3%	-18,7%
Stoxx 50	3424	1,7%	-0,2%	-3,5%	-5,5%	-10,3%
SMI (Swiss Market Index)	10473	1,4%	0,0%	-5,3%	-12,8%	-18,7%
Nikkei 225	26891	-0,7%	-2,9%	-8,1%	-2,9%	-6,6%
Brasilien BOVESPA	117171	4,5%	4,1%	19,2%	5,8%	11,8%
Russland RTS	1042	5,1%	-9,8%	-12,4%	-45,3%	-34,7%
Indien BSE 30	59581	2,9%	-0,2%	7,6%	-2,7%	2,3%
China CSI 300	3736	-2,8%	-5,0%	-12,8%	-23,9%	-24,4%
MSCI Welt	2429	2,2%	-4,9%	-8,1%	-22,8%	-24,8%
MSCI Emerging Markets	865	0,2%	-8,6%	-12,3%	-33,5%	-29,8%
Bond markets						
Bund- Future	135,70	-38	-500	-1558	-3301	-3567
Bobl- Future	117,92	-97	-239	-704	-1645	-1532
Schatz- Future	106,49	-33	-64	-285	-564	-554
3 Monats Euribor	1,46	81	80	204	201	205
3M Euribor Future, Dec 2017	2,32	3	3	0	286	3
3 Monats \$ Libor	4,28	8	68	152	415	407
Fed Funds Future, Dec 2017	4,23	1	20	0	416	3
10 year US Treasuries	4,26	26	69	123	263	276
10 year Bunds	2,47	11	53	127	259	265
10 year JGB	0,25	1	0	5	17	18
10 year Swiss Government	1,35	1	5	51	144	149
US Treas 10Y Performance	559,09	-1,8%	-5,1%	-8,6%	-18,5%	-20,0%
Bund 10Y Performance	530,66	-0,3%	-3,8%	-9,4%	-19,5%	-19,9%
REX Performance Index	431,92	-0,7%	-2,7%	-6,2%	-11,7%	-12,0%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	3,73	7	58	143	332	324
IBOXX BBB, €	5,11	9	80	160	431	423
ML US High Yield	9,47	-9	69	125	477	457
Convertible Bonds, Exane 25	6330	0,0%	-1,5%	-2,5%	-23,1%	-22,7%
Commodities						
MG Base Metal Index	369,22	-1,7%	-4,2%	-2,5%	-22,7%	-20,0%
Crude oil Brent	92,39	0,7%	1,9%	-13,8%	7,5%	17,8%
Gold	1620,23	-1,6%	-2,8%	-5,2%	-9,2%	-11,1%
Silver	18,91	3,6%	-1,7%	0,2%	-22,2%	-18,7%
Aluminium	2194,25	-4,8%	-1,4%	-9,9%	-28,2%	-21,8%
Copper	7645,50	-0,1%	-2,3%	3,9%	-27,1%	-21,5%
Iron ore	94,76	-1,2%	-4,1%	-9,3%	-23,3%	-15,8%
Freight rates Baltic Dry Index	1837	-0,1%	6,2%	-13,1%	-61,3%	-17,1%
Currencies						
EUR/ USD	0,9769	0,5%	-2,2%	-4,2%	-16,0%	-13,7%
EUR/ GBP	0,8736	0,8%	-0,2%	2,6%	3,6%	4,0%
EUR/ JPY	146,92	2,3%	2,5%	4,3%	10,6%	12,7%
EUR/ CHF	0,9826	0,7%	1,9%	-0,7%	-8,5%	-4,9%
USD/ CNY	7,2472	0,7%	3,2%	7,3%	13,4%	14,0%
USD/ JPY	150,15	0,9%	4,5%	8,6%	31,4%	30,5%
USD/ GBP	0,89	0,7%	2,1%	7,3%	23,6%	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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