M.M. WARBURG & CO
BANK

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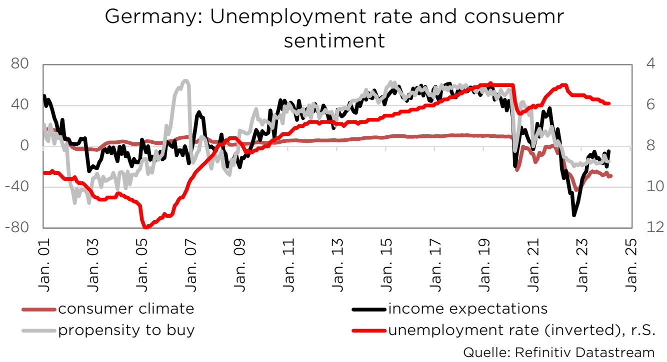
Germany in a crisis of mentality

Most people in this country agree that Germany is in a difficult situation. The causes of this crisis have been extensively and well analyzed and the most frequently heard thesis is that we are in an economic crisis. Excessively high energy prices, excessively high taxes and levies, a major digitalization deficit in public administration, excessive bureaucracy and regulation and a dramatic deterioration in the general level of education are just some of the components of Germany's misery. In addition, the German economy is heavily dependent on the well-being of industrial companies on the one hand and on exports in general and China in particular on the other. All of this is well and correctly analyzed. We don't have a problem recognizing these problems, but we do have a problem implementing how we can solve them.

Consumers see the black

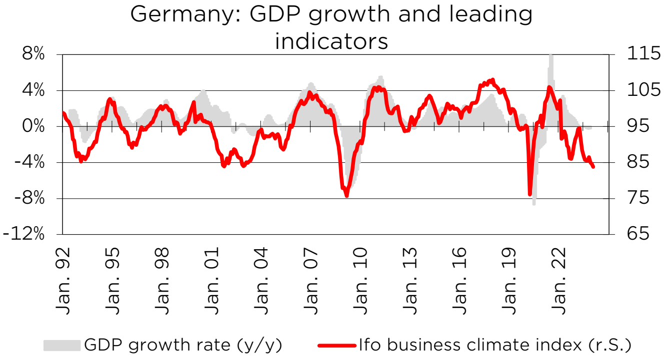
However, a neutral look at the macroeconomic indicators also shows that not everything is bad here. Unemployment in Germany is lower than in almost any other western industrialized country, and Germany is also among the top 20 in terms of per capita income, as it has been for the past 30 years. In addition, last year Germany overtook Japan for the first time in the ranking of the largest economies and pushed it out of third place, even if this is largely due to the weakness of the Japanese currency (a country's economic performance is measured in US dollars for better comparability). Nevertheless, the sentiment among both private households and companies is worse than it has been for a long time.



Even at the height of the coronavirus pandemic, the sentiment among German consumers was better than it is today. If you look at the individual components of the survey conducted by the GfK consumer research organization, you get the impression that the answers and opinions of those surveyed have little to do with the economic reality reflected in the published figures and data. For example, it is noticeable that private households are very negative about their income expectations, despite considerable income growth in the last three years (gross income +17 percent, net +19 percent, mass income, i.e. net income plus state transfers, +16 percent). In contrast to most forecasts by economists and economic researchers, negative or skeptical voices also predominate when it comes to expectations of future price trends or the assessment of the future situation on the labor market. It is therefore perhaps not surprising that social peace, which has long been a flagship of our country, is under threat in Germany. This is reflected in strikes, high sickness rates and many protest actions by a wide range of interest groups. Many feel disadvantaged and believe they should get a bigger slice of the cake because others are supposedly better off than they are. It was recently reported that the majority of Germans go to restaurants less often because of the higher prices. But have you ever tried to get a table spontaneously in the evening? Even at lunchtime, many restaurants - at least in the city centers - are well frequented and there is little sign of consumer restraint. Travel has also become more expensive and therefore less affordable. Nevertheless, the booking figures for this summer are well up for many tour operators despite supposedly tight budgets.

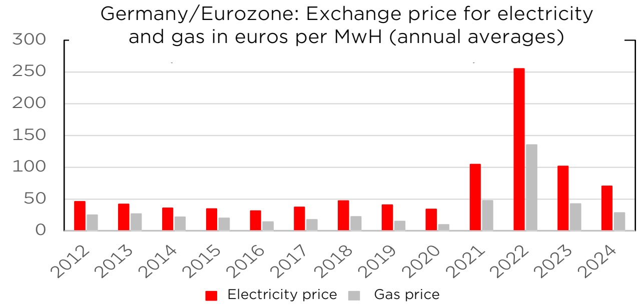
Sentiment worse than the situation

However, the sentiment is not only poor among consumers, but also among companies in Germany. The ifo business climate index, probably the most important leading indicator for the state of the German economy, has been bobbing along at recession level for some time now. In the past, economic growth in Germany could be explained comparatively well by this leading economic indicator, but this is no longer the case. Judging by the survey results, Germany should be in a severe recession and not in a phase of economic stagnation.



Source: Refinitiv Datastream

In industry in particular, many companies are complaining about the high energy prices, which are putting a strain on their competitiveness. Energy-intensive companies are taking this as an opportunity to turn their backs on Germany or at least consider doing so; there is a threat of deindustrialization. A Prognos study from fall 2023 comes to the conclusion that energy prices in Germany and Europe are higher than in Asia and America; in a European comparison, prices are around the middle of the pack. However, prices are expected to fall significantly by 2030. Exchange prices for electricity and gas have already fallen significantly in recent months. Compared to the previous year, energy prices are around 30 percent cheaper, and even more than 70 percent cheaper compared to 2022. This has significantly reduced the absolute cost burden. In addition, the German government passed an electricity price package last fall that includes a significant reduction in electricity tax and additional electricity price compensation for particularly energy-intensive companies. According to Prognos, these measures could reduce German electricity prices from around 20 cents per kilowatt hour in the fall of 2023 to between four and five cents per kilowatt hour in 2030, the lowest level in Europe. Even for companies that do not benefit from the additional electricity price compensation, the electricity price could fall to eight to ten cents by 2030 and thus reach a level that can currently be found in countries such as the USA and China, which have the lowest electricity prices internationally.



Source: Refinitiv Datastream

Out of the vale of tears!

Despite these positive developments, pessimism prevails in many places. And the external view of our country is also mostly negative at the moment. Formerly German virtues such as punctuality, reliability and perseverance in achieving self-imposed goals have recently been lost. Instead, Germany is "strike country" and "protest country". Whereas we used to look pityingly at other countries where farmers, workers and employees from a wide range of professions regularly paralyzed public life, it is now standard for us to call a strike somewhere in the country every week. Sometimes it's for more pay, sometimes for shorter working hours, sometimes - so the impression goes - simply for the ego of the leader of the respective collective bargaining party. More pay with shorter working hours is a proposal that, as an economist, can only make you shake your head. After all, our prosperity has to be earned, it does not fall from the sky, even if some trade unions try to give their members this impression. However, it is also clear that it must be worthwhile for employees to work (more).

A comprehensive tax reform could make an important contribution to improving Germany's attractiveness as a business location. Neither under chancellor Merkel nor chancellor Scholz has anything positive happened here in recent years. The problem, however, is that a tax reform leads to lower state revenues and thus inevitably to higher public debt, at least in the short term. However, this is not possible with the rules of the debt brake, which the German state has imposed on itself due to the sharp rise in the debt ratio in the wake of the financial and economic crisis of 2008/2009. The federal government has a minimum debt leeway of 0.35 percent of GDP, adjusted for economic factors, while the federal states are required to have structurally balanced budgets from 2020.

The usefulness of this debt rule is questionable. In view of the European debt crisis, which hit countries such as Greece, Ireland, Spain, Italy and Portugal hard at the time, German politicians wanted to send a signal to their citizens that they wanted to pursue a sensible and serious spending policy again in future. However, with the Maastricht criteria of an annual budget deficit of a maximum of three percent of GDP and a national debt ratio of a maximum of 60 percent of GDP, there are already rules in place to prevent excessive debt. The additional debt rule is, like so much else in Germany, another regulatory monster: complicated to calculate and hardly intuitively comprehensible even for experts. It starts with the question of how exactly a "nominal output gap" is to be determined for a particular financial year and ends with the concept of "budget semielasticity", which is recalculated by the EU Commission every few years. Anyone interested in the details is recommended to read the "Compendium on the federal debt rule (debt brake)". If you have been suffering from sleepless nights, this treatise can help.[1]

The basic idea behind the debt brake was that low national debt is the basis for keeping the interest burden in the national budget low and therefore having more leeway for other expenditure. In addition, countries with lower debt or a debt rule would also have higher economic growth. In contrast, it should be left to the capital market to determine the level of an appropriate interest rate. With a debt ratio of 65 percent of GDP, Germany has an interest burden (interest in relation to GDP) of around one percent. In Japan, on the other hand, with a debt ratio of 250 percent of GDP, the interest burden is only 0.5 percent. The theory that lower debt leads to more economic growth also stands on very shaky ground. Unfortunately, Germany, with its low national debt in an international comparison, also has very low growth in an international comparison, unlike the USA (debt ratio: 122 percent, economic growth in 2023: 2.5 percent), Spain (108 percent and 2.5 percent) or Portugal (103 percent and 2.3 percent). More growth is therefore also possible with higher debt; the abolition of the debt brake and a tax reform worthy of the name could put us back on the right track. But for this to happen, the many doubters in this country will have to jump over their shadows. As it was said in "7. Sinn", the popular traffic education program that was broadcast on ARD from 1965 to 2005: Danger recognized, danger averted. With this in mind: don't just talk, finally take action!

Carsten Klude

[1] https://www.bundesfinanzministerium.de/

Market data

Stock marktes	As of 08.03.2024 08:50	Change versus 01.03.2024 -1 week	07.02.2024 -1 month	07.12.2023 -3 months	07.03.2023 -1 year	29.12.2023 YTD
Dow Jones	38791	-0,8%	0,3%	7,4%	18,1%	2,9%
S&P 500	5165	0,5%	3,4%	12,6%	29,6%	8,3%
Nasdaq	16273	0,0%	3,3%	13,5%	41,1%	8,4%
DAX	17843	0,6%	5,4%	7,3%	14,7%	6,5%
MDAX	26168	0,2%	1,8%	-1,4%	-9,3%	-3,6%
TecDAX	3485	1,6%	3,2%	8,2%	6,8%	4,4%
EuroStoxx 50	4974	1,6%	6,3%	11,2%	16,2%	10,0%
Stoxx 50	4370	1,6%	3,2%	8,5%	12,1%	6,8%
SMI (Swiss Market Index)	11575	0,7%	3,3%	5,5%	4,6%	3,9%
Nikkei 225	39689	-0,6%	9,9%	20,8%	40,2%	18,6%
Brasilien BOVESPA	128340	-0,7%	-1,2%	1,8%	23,1%	-4,4%
Russland RTS	1152	2,7%	2,4%	9,6%	21,1%	6,3%
Indien BSE 30	74119	0,5%	2,7%	6,6%	23,1%	2,6%
China CSI 300	3545	0,2%	6,0%	4,5%	-12,4%	3,3%
MSCI Welt	3391	0,8%	3,9%	11,6%	24,5%	7,0%
MSCI Emerging Markets	1030	0,5%	2,8%	6,2%	4,2%	0,6%
Bond markets						
Bund-Future	133,34	58	-96	-178	127	-388
Bobl-Future	118,37	208	82	-46	400	-91
Schatz-Future	105,85	66	7	14	130	-70
3 Monats Euribor	3,94	4	3	4	102	6
3M Euribor Future, Dec 2024	2,96	-4	28	40	-45	66
3 Monats $ Libor	5,59	-1	1	-5	56	-1
Fed Funds Future, Dec 2024	4,51	-1	28	36	29	67
10 year US Treasuries	4,07	-11	-4	-8	10	21
10 year Bunds	2,28	-12	1	11	-42	28
10 year JGB	0,74	2	3	-2	24	11
10 year Swiss Government	0,72	-9	-20	-3	-79	2
US Treas 10Y Performance	594,49	0,8%	0,5%	1,4%	2,6%	-1,1%
Bund 10Y Performance	556,10	1,0%	0,1%	-0,2%	6,2%	-1,6%
REX Performance Index	442,59	0,4%	-0,1%	-0,5%	3,9%	-1,2%
IBOXX AA, €	3,32	-9	1	3	-55	25
IBOXX BBB, €	3,94	-9	-1	-12	-80	18
ML US High Yield	7,87	-11	-8	-49	-74	8
Commodities						
MG Base Metal Index	389,47	2,3%	3,3%	5,1%	-5,9%	-0,4%
Crude oil Brent	83,37	-1,0%	5,3%	12,4%	-0,1%	7,3%
Gold	2160,70	4,2%	5,9%	6,4%	18,8%	4,6%
Silver	24,40	5,6%	9,2%	2,7%	20,4%	0,6%
Aluminium	2208,55	0,1%	0,6%	5,4%	-4,0%	-5,8%
Copper	8546,49	1,6%	4,2%	3,5%	-2,2%	1,0%
Iron ore	117,96	3,6%	-7,1%	-12,2%	-7,4%	-13,5%
Freight rates Baltic Dry Index	2251	2,2%	51,4%	-9,8%	73,4%	7,5%
Currencies						
EUR/ USD	1,0932	1,1%	1,4%	1,5%	2,5%	-1,1%
EUR/ GBP	0,8536	-0,3%	0,2%	-0,5%	-4,3%	-1,5%
EUR/ JPY	161,63	-0,7%	1,2%	3,5%	11,3%	3,4%
EUR/ CHF	0,9588	0,1%	2,1%	1,5%	-3,7%	3,5%
USD/ CNY	7,1878	-0,2%	-0,1%	0,4%	3,3%	1,2%
USD/ JPY	148,05	-1,4%	-0,1%	2,7%	7,9%	4,9%
USD/ GBP	0,78	-1,2%	-1,3%	-1,8%	-7,3%	-0,4%

Source: Refinitiv Datastream

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