



ECONOMIC SITUATION AND STRATEGY

May 31, 2019

Rezo and Greta catapult the Greens to stratospheric heights – but will the climate ultimately benefit?

First, the good news. The European election could have been worse. Many euro-skeptical and populist parties have achieved decent results in all countries, but a clear sweep would look different. The majority of voters are still on the side of parties constructively and seriously engaged in policy issues at the European level and (mostly) refuse to accept simple answers and prescriptions. So, not that much has changed on the surface. As before the elections, the European People's Party (EPP) is again ahead of the Socialists and Democrats (S&P). Nevertheless, this election marks the emergence of a new political era. The traditional demographically broad parties have lost much of their appeal. There are different reasons for that in each country. Two factors have likely dominated in Germany.

First, the broad parties are obviously reaching fewer young people, whose ways of communicating and informing themselves are very different from those of older voters. Second, the Greens have almost exclusively laid political claim to and exploited the topic of environmental protection. In a way, their success there is a tour de force, because close inspection reveals no great differences between the major parties regarding the relevant assessments, objectives, and measures.

The climate and energy policies of the current government already contain some Green DNA, since they rest on the Renewable Energy Sources Act (EEG) of 2000. Green politician Jürgen Trittin was the Federal Minister for the Environment at that time, and the law is still recognized today as the origin of Germany's clean energy revolution and climate policy. The Greens are also

largely responsible for the country's exit from nuclear power and gradual phasing-out of coal-fired power plants. So, they can hardly complain, and if their party were in power, climate policy viewed from an outside perspective would presumably not differ much from current policy except for a few politically symbolic actions.

The question also arises whether the focus of climate policy heretofore pursued and perhaps intensified by the Greens if given governing responsibility will even prove effective. For, considering the huge expense incurred here, the results have been meager. Current CO₂ emissions in Germany are at about the same level as in 2009. It is almost an irony of history that CO₂ emissions have stagnated roughly since the year in which the EEG Surcharge (covering the difference between the wholesale power price on the exchange and higher fixed remuneration for renewable energies) increased enormously, while having steadily decreased in the years before. That contrasts starkly with countries like France and Italy, which are not exactly known for leading the way in climate policy.

In contrast to Germany, domestic issues and anti-Europe rhetoric, but not so much climate policy considerations, have again been the dominant EU election factors in France and Italy. Nevertheless, CO₂ emissions are steadily decreasing in those countries, with France performing much better than Germany in CO₂ emissions per capita. That figure in France was 5.99 metric tons per year in 2000 and fell to 4.38 metric tons by 2016, a decline of almost 27%. The number in Germany was 9.97

metric tons in 2000 and dropped to 8.88 metric tons in the same period. That is only a 10% decline, and the absolute level in Germany is now still 103% higher than in France. What a poor showing for a country that spends billions on green climate policy concepts, makes no impact in the process, but still styles itself a world leader in climate policy.

Even the United States under President Donald Trump, who denies the greenhouse effect, is doing better. The less energy-efficient Americans still emitted 20.3 metric tons per capita in 2000, but that fell to 14.95 by 2016 although the United States is structurally disadvantaged in such a statistic because of climate (need of air conditioning) and geography (long transport and commuting distances). The declines in the United States are nevertheless so dramatic that the country could overtake Germany in 15 years in terms of CO₂ emissions if this trend should continue. How can that be?

Much as it pains one to say so, the problem partly has to do with the hefty ideological bias of German energy and climate policy. In particular, the Greens have great faith in government intervention and subsidies for technology that superficially appear clean, but do not sufficiently take into account physical and economic expertise in their deliberations. Instead of getting behind the most efficient tools, they seem content to find instruments that somehow "feel good" because it certainly cannot be wrong to promote wind and solar power. And that is exactly the basis for the EEG, which the Greens devised and would gladly expand further. However, the effect of this law now is that EEG plant operators are increasingly feeding power into the grid that is not currently needed. That destabilizes power frequency and hence the need for secondary control power from natural gas power plants, especially since the electricity can hardly be stored for later use. The general public pays huge amounts for this, and few benefit. The redistributive effects of this law appear almost surreal when one considers that its authors are politically left-leaning. The evolution of the EEG Surcharge speaks volumes. In 2018, the paid EEG Surcharge amounted to almost EUR 0.08 per kilowatt/hour. Consequently, electricity costs in Germany are among the world's highest.

In the European Union, only Denmark has higher electricity costs than Germany. The price in France is about half, with half the CO₂ emissions per capita. The efficiency of German climate policy is shamefully poor to this day. Germany will spend about EUR 500 billion for

the clean energy revolution by 2025 and thereby achieve almost nothing. From a sober perspective, that verges on real-life satire. Oddly, there has been no outcry at all, since evidently nobody is willing to deal with hard, inconvenient facts and draw their conclusions from them.

One could say, "Let the Germans throw their money away however they like." But if the aim is not just somehow to feel good, but to achieve truly appreciable effects leading to global reduction of CO₂, then Germany is now doing just about everything wrong. As a comparatively small country, it is responsible for only about 2% of worldwide CO₂ emissions. If it wants to have a global impact, it must aim at providing a good example and serving as a prototype of efficient climate policy. But it is doing exactly the opposite. Germany has abatement costs for a ton of unemitted carbon dioxide higher than in almost any other country. Regrettably, it provides a daunting example of how not to do that, and some basic green ideas are largely responsible.

Even if Germany managed to cut its CO₂ emissions by 20% with interventionist measures, it would not matter at all for the global climate and would be unfeasible and hence irrelevant for the rest of the world. Germany would expend enormous amounts of economic resources with a goal achievement rate of nearly zero. Green, sustainable policy should not look like that. The aspiration should rather consist in seeking concepts that actually entail the chance of global CO₂ reduction. For that to work, such concepts must be capable of achieving consensus and being implemented worldwide. The prescriptions already considered and implemented in Germany unfortunately work in their current form only there. The German economy is (still) efficient enough to handle the enormous costs, and the society seems willing to bear the associated burdens. But in France, the yellow jackets would go amok given similar proposals, and in developing countries, people would just shake their heads at the burdens attending concepts like the EEG.

But does an approach even exist that would promise global success with a high degree of goal achievement and maximally efficient use of resources? In our opinion, such an approach would consist in utterly consistent application of trade in emission certificates. Many feel "uncomfortable" with this approach, since it rests on comparatively market-conforming principles. This reaction usually consists in questioning the fitness of market

processes when it comes to controlling CO₂ emissions. But we believe utilizing market processes is exactly the right solution.

And this is how global emissions trading could work ideally. The countries unite (optimally at the UN level) on a path toward reducing CO₂ emissions in the coming years and decades. Emission certificates are issued in the framework of the emission amount set for the first year. Every generator of CO₂ emissions may only do so if they have certificates for that. That applies to power plants, airlines, and industrial enterprises as well as to households. Since technical implementation would be difficult in the case of households, practicable solutions must be found. They could consist, for example, in having suppliers and dealers of gasoline, natural gas, and oil perform these services and acquire sufficient certificates for that purpose. Each year, some of the certificates are collected in line with the planned CO₂ reduction path. The amount of CO₂ emitted would thus decline automatically – and if applied consistently, by exactly the extent prescribed by policy. The huge advantage of this solution is that then every "polluter" has to consider whether they are willing to pay a (fluctuating) market price for certificates or whether it makes sense to reduce CO₂ emissions, for example, by using different technologies.

If this idea is consistently applied, the danger will no longer exist that the government will "dictate" a specific way of reducing CO₂. Instead, an efficient path toward that goal will arise almost automatically through economic incentives. Policymakers prescribe the path, and the market functions as pathfinder in a search and dis-

covery process to determine the economically most cost-efficient way of pursuing it. Is this a realistic scenario for the next five years? Presumably not, since many questions of detail would have to be cleared up. Would it be worthwhile nevertheless to take this path and fight for it? In our view, the answer is clearly affirmative.

Sadly, the Greens (as well as the SPD and the Left Party) are split over this approach and are not seeking consistent, global implementation. It would actually be a green project for which one could go down in history. Instead, outside observers must have the impression that the Greens have quietly long since given up hope of finding a constructive solution at the global level. However, all the propagated climate policy in Germany would then be a huge case of false labeling in which climate effects are not what really matter. The "climate cudgel" then would only serve as a pretext and efficient vehicle for reshaping society. The focus would then no longer be on seriously trying to save the climate, but rather on simply implementing a Green ideology. That is a pity. The Greens could make these ideas their action motto and not just produce feel-good effects but rather a real climate impact. They will very likely have a seat in Germany's next government. For the climate's sake, we sincerely hope they will actually use this opportunity non-ideologically – without political symbolism, but rather to achieve globally affordable and measurable effects. If the Greens have the courage to do that, they will actually go down in the history books.

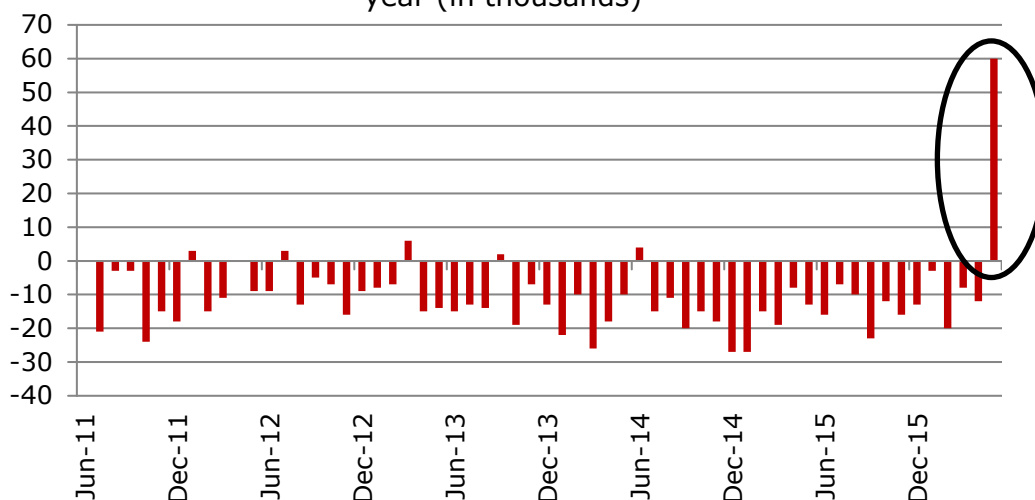
Weekly Outlook for June 3-7, 2019

	Dec.	Jan.	Feb.	Mar.	Apr.	May	Release
DE: PMI, manufacturing – final	51.5	49.7	47.6	44.1	44.4	44.3	June 3
DE: PMI, services – final	51.8	53.0	55.3	55.4	55.7	55.0	June 5
DE: New orders, m/m	1.0%	-2.1%	-4.0%	0.6%	0.2%		June 6
DE: New orders, y/y	-4.5%	-3.5%	-8.0%	-6.1%	-5.3%		June 6
DE: Industrial production, m/m	0.8%	-0.1%	0.4%	0.5%	0.1%		June 7
DE: Industrial production, y/y	-2.5%	-2.1%	0.1%	-0.8%	0.1%		June 7
EUR19: PMI, manufacturing – final	51.4	50.5	49.3	47.5	47.9	47.7	June 3
EUR19: Inflation rate, y/y – final	1.5%	1.4%	1.5%	1.4%	1.7%	1.5%	June 4
EUR19: Unemployment rate, s.a.	7.9%	7.8%	7.8%	7.7%	7.7%		June 4
EUR19: PMI, services – final	51.2	51.2	52.8	53.3	52.8	52.5	June 5
EUR19: Producer prices, m/m	-0.8%	0.3%	0.1%	-0.1%	0.5%		June 5

MMWB estimates in red

Chart of the Week: Unemployment rises

Germany: Change in jobless compared to previous year (in thousands)



The last time unemployment rose was almost two years ago. The number of unemployed persons in Germany increased by 60,000 on a seasonally adjusted basis. One has to go back to the financial crisis to find another such spike. For a long time, it seemed as if the labor market were immune to the slowing business cycle. But anyone who believed this would go on forever has now learned better. The unemployment rate has also climbed with the increase in the number of jobless, from its record low of 4.9% to 5.0% now (seasonally adjusted). However, a large part of that is due to a special factor (checking job placement status of persons entitled to Supplementary Unemployment Benefit II). The Federal Employment Agency (Bundesagentur für Arbeit) states

in its labor market report that this factor raised the jobless number by 40,000. That makes the increase not so serious, but still gives the impression that the labor market has peaked. Other labor market data continue to be good, but the tendency is worsening. That applies to the size of the labor force, which continues to increase but at slower rates, and to demand for new employees, which is still high but declining slightly. The labor market has been the backbone of the German economic upswing in recent years. Rising employment should continue to support the domestic economy, but the trend is losing momentum and will contribute less and less to growth.

Market Data Overview

Stock marktes	As of	Change versus				
	31.05.2019 11:16	24.05.2019 -1 week	30.04.2019 -1 month	28.02.2019 -3 months	30.05.2018 -1 year	31.12.2018 YTD
Dow Jones	25170	-1,6%	-5,4%	-2,9%	2,0%	7,9%
S&P 500	2789	-1,3%	-5,3%	0,2%	2,4%	11,2%
Nasdaq	7568	-0,9%	-6,5%	0,5%	1,4%	14,1%
DAX	11715	-2,5%	-5,1%	1,7%	-8,4%	10,9%
MDAX	24569	-2,4%	-5,7%	0,8%	-6,8%	13,8%
TecDAX	2721	-4,3%	-6,5%	4,6%	-2,8%	11,1%
EuroStoxx 50	3271	-2,4%	-6,9%	-0,8%	-4,9%	9,0%
Stoxx 50	3039	-2,1%	-5,0%	0,3%	-1,2%	10,1%
SMI (Swiss Market Index)	9516	-1,6%	-2,6%	1,4%	10,9%	12,9%
Nikkei 225	20601	-2,4%	-7,4%	-3,7%	-6,4%	2,9%
Brasilien BOVESPA	97457	4,1%	1,1%	2,0%	27,0%	10,9%
Russland RTS	1275	-0,3%	2,2%	7,3%	9,7%	19,6%
Indien BSE 30	39656	0,6%	1,6%	10,6%	13,6%	9,9%
China Shanghai Composite	2899	1,6%	-5,8%	-1,4%	-4,7%	16,2%
MSCI Welt (in €)	2066	-1,0%	-4,6%	1,4%	2,6%	12,6%
MSCI Emerging Markets (in €)	995	1,2%	-7,3%	-3,1%	-6,7%	5,8%
Bond markets						
Bund-Future	168,00	76	269	269	598	446
Bobl-Future	133,97	40	104	125	140	145
Schatz-Future	112,11	8	19	29	-9	17
3 Monats Euribor	-0,32	-1	-1	-1	0	-1
3M Euribor Future, Dec 2017	-0,36	-1	-5	-11	-29	0
3 Monats \$ Libor	2,52	0	-5	-9	22	-29
Fed Funds Future, Dec 2017	1,99	-13	-21	-40	-49	0
10 year US Treasuries	2,16	-17	-35	-56	-68	-53
10 year Bunds	-0,20	-9	-21	-39	-55	-45
10 year JGB	-0,09	-2	-5	-7	-12	-10
10 year Swiss Government	-0,49	4	-11	-18	-41	-25
US Treas 10Y Performance	610,71	0,9%	2,7%	4,7%	8,1%	5,2%
Bund 10Y Performance	656,44	0,5%	1,8%	3,5%	6,5%	4,7%
REX Performance Index	494,90	0,2%	0,8%	1,3%	1,9%	1,5%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,44	-3	-1	-24	-34	-44
IBOXX BBB, €	1,37	-2	10	-34	-23	-69
ML US High Yield	6,80	6	27	-2	23	-122
JPM EMBI+, Index	843	0,4%	1,1%	1,4%	5,8%	6,5%
Convertible Bonds, Exane 25	7238	0,0%	-1,2%	2,3%	-1,8%	5,0%
Commodities						
CRB Spot Index	417,41	0,7%	-1,1%	1,1%	-6,4%	2,0%
MG Base Metal Index	290,26	-1,1%	-6,8%	-9,4%	-17,6%	-1,5%
Crude oil Brent	65,16	-3,9%	-10,6%	-1,3%	-15,5%	22,6%
Gold	1295,24	0,9%	0,9%	-1,6%	-0,5%	1,1%
Silver	14,53	-0,3%	-2,8%	-7,2%	-12,1%	-6,3%
Aluminium	1757,50	-0,8%	-1,4%	-7,0%	-22,3%	-5,7%
Copper	5822,00	-1,9%	-9,4%	-11,2%	-14,8%	-2,1%
Iron ore	98,72	0,6%	5,9%	13,0%	49,5%	42,7%
Freight rates Baltic Dry Index	1097	2,9%	8,5%	66,7%	5,3%	-13,7%
Currencies						
EUR/ USD	1,1151	-0,3%	-0,6%	-2,3%	-4,1%	-2,6%
EUR/ GBP	0,8854	0,3%	3,0%	3,4%	1,2%	-1,4%
EUR/ JPY	121,35	-1,0%	-2,9%	-4,0%	-4,3%	-3,6%
EUR/ CHF	1,1202	-0,1%	-2,1%	-1,2%	-2,7%	-0,6%
USD/ CNY	6,9005	0,0%	2,4%	3,1%	7,5%	0,4%
USD/ JPY	109,62	0,3%	-1,6%	-1,6%	0,7%	0,0%
USD/ GBP	0,79	0,8%	3,5%	5,6%	5,4%	1,2%

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