M.M. WARBURG & CO
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Crisis in the German economy: The role of China

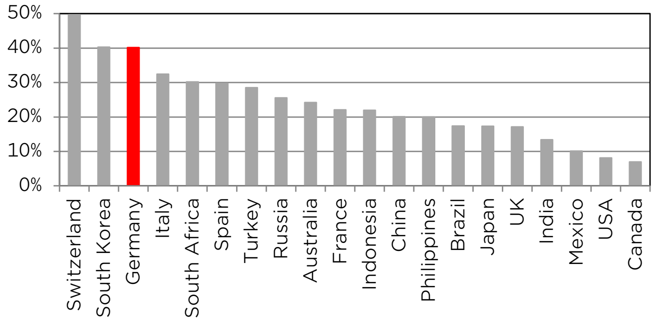
Lately we've been hearing a lot about Germany as the "new sick man" in Europe, including from us. In the analysis of our weaknesses, the economists are largely in agreement: we need 1. affordable energy (from our point of view, however, a subsidized industrial electricity price is the wrong way, because all companies, whether industrial or service providers, whether large or small, but private households are also in the same boat here), 2. significantly less bureaucracy and regulation, 3. a higher standard of education, 4. a digitization offensive, especially in public administration, 5. a targeted immigration policy and 6. not shorter, but longer working hours - unless we soon experience an unexpected boost in productivity, which artificial intelligence might be able to help us with.

The German economy depends on industry and industry on China.

However, the German economy is also weakening because we are still an industrialized country in which the share of the manufacturing industry in the total value added is, at 20 percent, significantly higher than in many other developed economies (Spain and the Netherlands around 12 percent, France and the USA about 10 percent). On the other hand, services, which generally react less strongly to economic fluctuations, play less of a role for the German economy in an international comparison.

For German industry, it is above all foreign trade that decides the weal and woe. Exports account for 40 percent of total value added. This means that the German export rate is one of the highest among the industrialized countries in the world. Only Switzerland, with a share of around 50 percent, is an even more "open" economy. In Italy (32 percent), France (22 percent), but also in China (20 percent) and Great Britain (17 percent), the proportion is significantly lower. And in the USA (eight percent) and Canada (seven percent) exports only play a subordinate role in overall economic activity. In this respect, it is not surprising that around one in four jobs in Germany depends on exports. Conversely, the German economy is also dependent on imports, since we only have a few raw materials of our own. Above all, to cover our energy needs, we depend on the import of fossil fuels.

Share of nominal exports in GGDP



Germany's most important trading partner, measured by the sum of exports and imports, has been China since 2016, which has overtaken the USA and before that France in this ranking. If, on the other hand, one only looks at exports, there have been downright tectonic shifts in the last three years. While in 2020 China was still roughly the same as the USA as the most important destination country for German exports, China has now been clearly overtaken by the USA and has also been overtaken in terms of importance by France and the Netherlands. Countries like Poland and Italy are also hot on China's heels. This loss of importance is due to the fact that exports to China have not grown or have hardly grown at all since mid-2021 and this year even showed a significant decline of almost ten percent compared to the previous year. With Chinese exports accounting for just under three percent of gross domestic product, a not inconsiderable part of the current German economic weakness can be traced back to China.

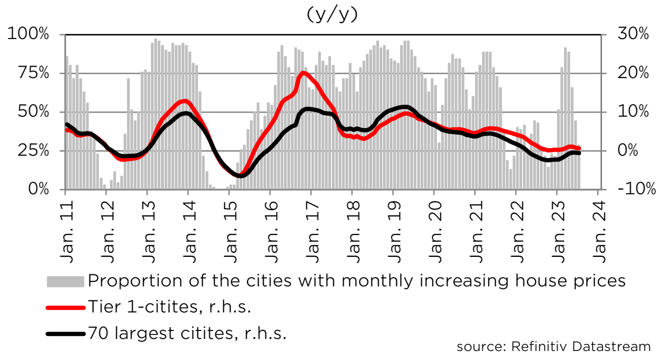
China: The giant stumbles.

For a long time, China was the engine of the world economy with unprecedented growth rates. Since the year 2000, the Chinese economy has grown by an average of more than eight percent per year, spurred on by accession to the World Trade Organization (WTO) in 2001. However, China's export-driven growth model has now run into serious difficulties. Similar to Germany, Chinese exports are hardly growing any more. Exports to the USA, China's most important export market, fell by 15 percent this year, and fewer exports were made to the EU than in the previous year. One of the few countries with which exports are growing is Russia, but the total volume of Chinese exports to Russia is so small (0.4 percent share of total exports) that this growth is hardly significant.

Overall, the latest economic data shows that the Chinese economy is developing much weaker than expected. The economic recovery after the lifting of strict Covid-19 rules earlier in the year has proved a flash in the pan and it is increasingly likely that China will miss the government's five percent growth target this year. The global growth weakness, to which China itself is a major contributor, is having a negative impact, as is the high level of debt, which is leading to a slowdown in infrastructure investments on the one hand and has plunged the real estate sector into a crisis on the other. The booming real estate market was at times responsible for around 25 percent of total economic output and has given the country a strong boost to growth. But the golden days are over. Real estate prices in China's 70 largest cities have been falling for almost a year and a half. This is having a negative impact on consumption, industrial production and the labor market, where youth unemployment has risen to record levels.

Similar to Germany, the Chinese economy not only has a cyclical problem, but above all a structural one. In view of the high level of debt, further extensive government fiscal programs to support the domestic economy can hardly be financed. One is reminded of the situation in Japan in the 1990s, when the bursting of the housing bubble led to years of deflation and economic stagnation. And China has another parallel to countries like Japan and Germany: a shrinking population. The United Nations assumes that China's population will shrink from the current 1.4 billion to 1.3 billion in 2050 and to less than 800 million in 2100. A decline in the population from today's 84 million to 79 million in 2050 and to 69 million in 2100 is forecast for Germany. Since the potential growth of an economy, i.e. the long-term economic growth that can be achieved with normal utilization of production capacities is determined by the development of the labor supply or the labor force potential and labor productivity, it can be assumed that China’s growth rates will decline significantly in the coming years. The growth rate of a good five percent currently targeted by the Chinese government will not be achievable on average over the next few years; growth of two to three percent is more likely.

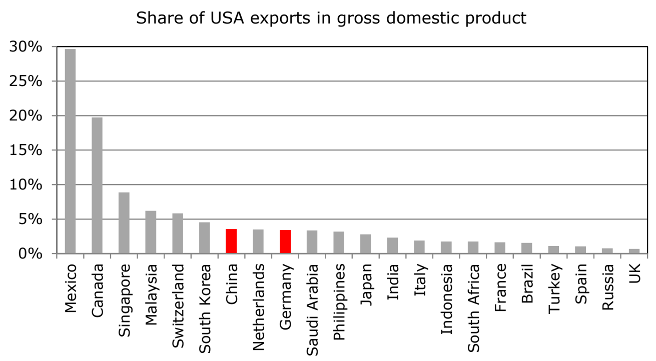
House price developments of China’s largest cities (y/y)



source: Refinitiv Datastream

Risk factor Trump.

Even if the next US presidential elections are still more than a year away, all economic nations for which international trade and in particular economic relations with the USA play an important role should already be concerned with the possible effects of Donald Trump's re-election. Should Trump become US President again, a new global trade war is imminent. Trump has announced that he will impose new tariffs of ten percent on all goods imported into the United States. Even if this would lead to enormous costs for US consumers and probably provoke countermeasures from the countries concerned, Trump has already shown in his first term in office that he largely doesn't care about economic laws as long as the issues are populist enough to get him heard and supported by the population. In particular, transatlantic relations could be subjected to another stress test, especially since Trump has already threatened the United States to leave NATO. At his first G7 summit, the then new US President Biden declared: “America is back”. The question is how long this statement is still valid.



Necessary adjustments to changed framework conditions.

The considerations made here show that Germany has to rethink its previous "business model" as an industrial and export nation in order to be successful in the long term and to ensure the prosperity of its citizens. However, it is also clear that economic structures that have grown over many years, if not decades, cannot be changed overnight. Nevertheless, it seems imperative to reduce dependence on foreign trade in general and on China in particular and to try to strengthen the service sector in the coming years. However, this will be a very time consuming process if actually attempted. As a first step, given the problems outlined, it could make sense to focus less on China in the future and instead look for other trading partners who buy the products of German industry. For example, these could be countries that will experience strong growth in the coming years due to positive demographic forecasts, such as India, Brazil, Indonesia, Mexico or the Philippines. And who knows, maybe the topic of AI will also help us with the necessary boost in productivity. Economic success cannot always be planned one hundred percent, just like in real life, there is always a little bit of luck involved.

Carsten Klude

Market data

	As of	Change versus				
	01.09.2023	25.08.2023	31.07.2023	31.05.2023	31.08.2022	30.12.2022
Stock marktes	09:54	-1 week	-1 month	-3 months	-1 year	YTD
Dow Jones	34722	1,1%	-2,4%	5,5%	10,2%	4,8%
S&P 500	4526	2,7%	-1,4%	8,3%	14,4%	17,9%
Nasdaq	14035	3,3%	-2,2%	8,5%	18,8%	34,1%
DAX	15964	2,1%	-2,9%	1,9%	24,4%	14,7%
MDAX	27746	2,8%	-3,8%	4,6%	10,0%	10,5%
TecDAX	3163	2,6%	-5,0%	-1,1%	8,2%	8,3%
EuroStoxx 50	4307	1,7%	-3,7%	2,1%	22,4%	13,5%
Stoxx 50	3976	1,4%	-1,9%	1,3%	13,6%	8,9%
SMI (Swiss Market Index)	11115	1,4%	-1,7%	-0,9%	2,4%	3,6%
Nikkei 225	32711	3,4%	-1,4%	5,9%	16,4%	25,4%
Brasilien BOVESPA	115742	-0,1%	-5,1%	6,8%	5,7%	5,5%
Russland RTS	1057	1,3%	0,0%	0,1%	-16,0%	8,9%
Indien BSE 30	65244	0,6%	-1,9%	4,2%	9,6%	7,2%
China CSI 300	3791	2,2%	-5,6%	-0,2%	-7,0%	-2,1%
MSCI Welt	2986	2,5%	-2,6%	6,6%	13,7%	14,7%
MSCI Emerging Markets	980	1,0%	-6,4%	2,3%	-1,4%	2,5%
Bond markets						
Bund-Future	133,19	109	19	-286	-1478	26
Bobl-Future	116,00	44	11	-214	-708	25
Schatz-Future	105,09	9	4	-53	-352	-33
3 Monats Euribor	3,80	15	41	66	315	191
3M Euribor Future, Dec 2023	3,86	-4	-3	15	141	25
3 Monats $ Libor	5,67	1	4	15	257	90
Fed Funds Future, Dec 2023	5,44	-5	5	47	185	80
10 year US Treasuries	4,11	-14	16	46	96	28
10 year Bunds	2,48	-5	2	21	100	-8
10 year JGB	0,63	-2	5	20	41	22
10 year Swiss Government	0,92	-8	-7	5	8	-69
US Treas 10Y Performance	582,88	1,2%	-0,9%	-2,9%	-4,2%	0,5%
Bund 10Y Performance	541,41	0,8%	0,4%	-0,8%	-5,3%	3,1%
REX Performance Index	433,91	0,2%	0,3%	-1,1%	-3,8%	0,3%
IBOXX AA, €	3,67	-8	3	13	94	7
IBOXX BBB, €	4,52	-7	5	3	62	-18
ML US High Yield	8,46	-21	5	-41	-2	-52
Convertible Bonds, Exane 25	6620	0,0%	0,0%	0,0%	0,0%	0,0%
Commodities						
MG Base Metal Index	384,04	0,0%	-3,4%	3,0%	-0,8%	-8,2%
Crude oil Brent	87,21	3,1%	1,9%	18,5%	-9,7%	2,7%
Gold	1942,30	2,0%	-1,3%	-1,5%	13,0%	7,0%
Silver	24,44	1,4%	-1,5%	3,7%	34,7%	2,9%
Aluminium	2165,75	2,5%	-3,5%	-5,3%	-8,6%	-7,8%
Copper	8404,50	1,0%	-4,5%	4,1%	7,1%	0,5%
Iron ore	115,85	7,1%	3,0%	10,3%	10,6%	4,1%
Freight rates Baltic Dry Index	1086	0,6%	-3,6%	11,2%	12,5%	-28,3%
Currencies						
EUR/ USD	1,0855	0,4%	-1,5%	1,6%	8,6%	1,8%
EUR/ GBP	0,8555	-0,3%	-0,2%	-0,5%	-1,0%	-3,6%
EUR/ JPY	157,89	0,1%	0,7%	5,9%	13,8%	12,2%
EUR/ CHF	0,9570	0,1%	-0,5%	-1,6%	-2,3%	-2,8%
USD/ CNY	7,2602	-0,5%	1,6%	2,0%	5,3%	5,2%
USD/ JPY	145,55	-0,6%	2,3%	4,4%	4,7%	11,0%
USD/ GBP	0,79	-1,0%	1,4%	-2,3%	-8,3%	-5,2%

Source: Refinitiv Datastream

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