

# Economic Situation and Strategy

28 June 2024

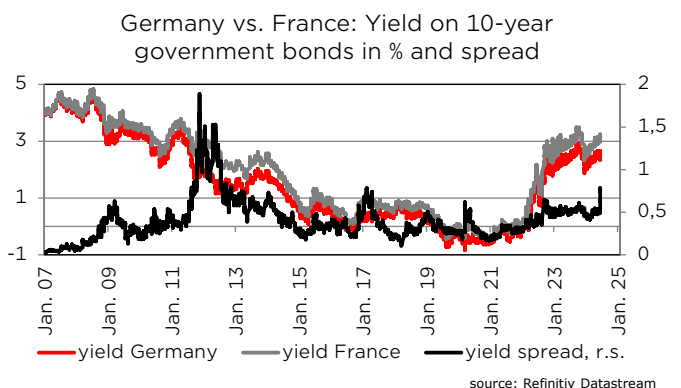
## Elections in France: Is a new European debt crisis looming?

French President Macron has announced early parliamentary elections following the victory of the far-right Rassemblement National (RN) in the European elections. The first round of voting will take place on June 30, the run-off on July 7. According to the latest election polls, the RN would emerge as the strongest force in the elections with around 36 percent of the vote, followed by the left-wing "Popular Front" with around 27 percent and President Macron's current ruling alliance with around 20 percent. Although Macron would remain French president, he would possibly have to work together with the right-wing RN under Marine Le Pen. Such a "cohabitation", i.e. a president and prime minister from different political camps, has already occurred several times in France in the past.

## French fiscal policy on a collision course with European rules

The capital markets reacted immediately to this outlook: European stock markets, led by the French CAC 40 index, fell significantly, with bank shares in particular among the losers. The euro depreciated and yields on French government bonds rose, with the yield gap to German government bonds reaching its highest level since 2017. The reason: in its election manifesto, the RN announced, among other things, that it would reduce VAT on energy and reverse the increase in the retirement age implemented by Macron. These measures could further increase the French government deficit of 5.5 percent of GDP in 2023. French national debt, which at over 110 percent of economic output is already one of the highest in the Eurozone (only Greece with over 160 percent and

Italy with 137 percent have even higher debt), is then likely to rise further. However, such a scenario is likely even without a political change in France. This is because it is currently assumed that the budget deficit will remain above five percent of GDP in 2024 and 2025. This would lead to an increase in the debt ratio towards 115 percent of economic output in the next two years.



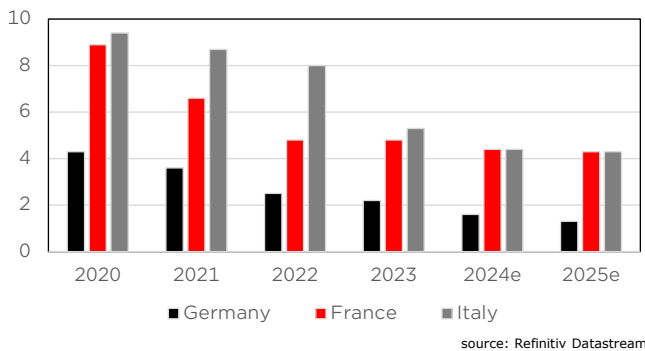
It is no wonder that the term "debt crisis" is frequently used again in connection with current developments. Since 2011, investors have been very sensitive to anything that could threaten the survival of the European Union or the common currency of its now 20 members. At that time, countries with unsound public finances, such as Greece and Portugal, were able to borrow at similarly low interest rates as Germany for a long time, which further encouraged the growth of unsustainable debt. The euro survived at the time mainly because its political popularity overshadowed its economic weaknesses: people feared that their savings would be converted into a devaluing national currency.

As a reminder, the Maastricht criteria stipulate a maximum annual budget deficit of three percent of GDP. Only

# Economic Situation and Strategy

then, under the simultaneous assumption of nominal economic growth of five (!) percent, a debt ratio of 60 percent would result. These assumptions reflect the economic realities of the early 1990s, but seem more than heroic from today's perspective. After all, no more than nominal growth of three to four percent can be expected in the Eurozone today (two to three percent inflation and one percent real growth). However, in order to achieve a debt ratio of 60 percent, as was the average for the Eurozone countries at the beginning of the 1990s, the annual budget deficit should only be 1.8 or 2.4 percent - which is illusory. However, the question arises as to whether a higher level of government debt than 60 percent of GDP would be sustainable. For example, in order to stabilize the debt ratio at 90 percent (the current level in the Eurozone), the annual budget deficit in the Eurozone would have to be 2.7 or 3.6 percent under the assumptions made above. This is difficult, but not completely unrealistic. With an annual deficit of four percent, the debt ratio would rise to 100 or 133 percent over the next few years. Whether this can still be considered sustainable in the long term remains to be seen.

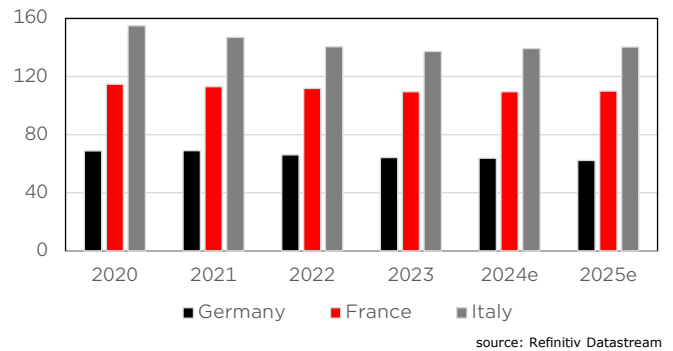
Eurozone: Budget deficit in % of GDP



## France only a mediocre debtor

So is there a threat of a new European debt crisis? We think this is very unlikely at present. The current development on the bond markets can be interpreted as putting France on a par with the other southern European countries that were once derided as members of the crisis-ridden "PIGS". The core of the problem is that neither the French government nor its voters recognize that the country needs to do something to return to sounder public finances and not lose the confidence of market participants. France thus shares the carelessness of the Americans, where nobody is interested in getting the deficit under control either. Unlike the USA, however, France does not have the security of the world's largest bond market, which is also supported by the world's reserve currency.

Eurozone: Government debt as % of GDP

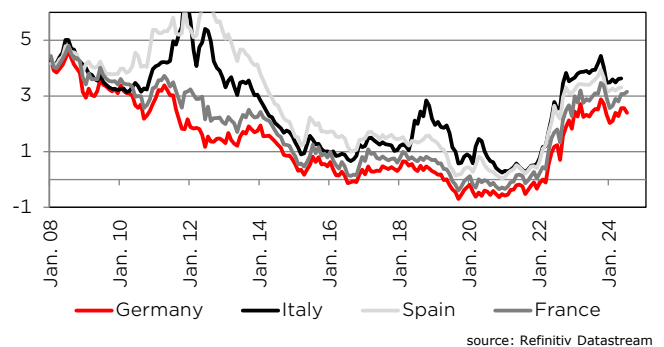


## ECB: Savior in times of need

However, even if the markets come to a negative assessment of France, it should not be forgotten that there is one (defensive) player in this "game" that no one can avoid: the European Central Bank. Ever since Mario Draghi's famous "whatever it takes" speech in 2012, investors have been able to rely on the ECB to act as a bulwark in the event of a debt crisis. In recent years, there have always been moments when it looked as if a new debt crisis could break out. For example, in mid-2018, when the populist Five Star Movement took over the government in Italy together with the Lega Nord or in the fall of 2023 after the election of Giorgia Meloni. However, this unrest on the government bond markets only proved to be a brief interlude in each case.

However, the ECB's intervention is in principle tied to compliance with EU budget rules. In the past, the central bank has often waited until the last moment to exert pressure on politicians to change course. We therefore believe it is likely that the ECB will not use its Transmission Protection Instrument (TPI), which was newly created in July 2022, to buy French government bonds, but will use it to buy Italian, Spanish or Portuguese bonds if necessary in the event of turbulence on the bond markets and a significant rise in bond yields.

Yield on 10-year government bonds in %



Investors who expect such a development should therefore focus on potential beneficiaries of a "flight to safe havens". These include all countries with relatively healthy public finances. In addition to German government bonds, this category also includes government bonds from the Netherlands and Ireland, both of which currently meet the Maastricht criteria without any problems. However, bonds from Spain and Portugal should also not come under sustained pressure in view of the good budgetary situation in these countries. In the case of French government bonds, on the other hand, it can be assumed that volatility will remain high due to the political uncertainties and that the country will have to pay

permanently higher interest rates for borrowing or refinancing government debt than has previously been the case. Further rating downgrades are therefore likely. Our conclusion: No new European debt crisis, but an expected permanent downgrading of France to the less solid "Club Med" of southern European countries. This is likely to severely disrupt France's current self-image as one of the top economies in the Eurozone (if not the world).

Carsten Klude

## Market data

	As of	Change versus				
	28.06.2024 11:11	21.06.2024 -1 week	27.05.2024 -1 month	27.03.2024 -3 months	27.06.2023 -1 year	29.12.2023 YTD
<b>Stock markets</b>						
Dow Jones	39164	0,0%	0,2%	-1,5%	15,4%	3,9%
S&P 500	5564	1,8%	4,9%	6,0%	27,1%	16,6%
Nasdaq	17859	1,0%	5,5%	8,9%	31,7%	19,0%
DAX	18311	0,8%	-2,5%	-0,9%	15,6%	9,3%
MDAX	25337	0,2%	-7,1%	-6,5%	-5,8%	-6,6%
TecDAX	3337	1,5%	-3,0%	-3,5%	7,8%	0,0%
EuroStoxx 50	4914	0,1%	-2,9%	-3,3%	14,1%	8,7%
Stoxx 50	4510	-0,1%	0,0%	2,1%	14,5%	10,2%
SMI (Swiss Market Index)	12036	0,2%	0,6%	2,8%	8,0%	8,1%
Nikkei 225	39583	2,6%	1,8%	-2,9%	21,7%	18,3%
Brasilien BOVESPA	124308	2,4%	-0,2%	-2,6%	5,8%	-7,4%
Russland RTS	1137	0,0%	-3,1%	0,7%	10,6%	5,0%
Indien BSE 30	79432	2,9%	5,4%	8,8%	25,3%	10,0%
China CSI 300	3462	-1,0%	-4,8%	-1,2%	-10,0%	0,9%
MSCI Welt	3522	0,4%	1,6%	2,5%	20,6%	11,1%
MSCI Emerging Markets	1082	-0,5%	-0,8%	4,4%	8,7%	5,7%
<b>Bond markets</b>						
Bund-Future	132,04	-49	168	-133	-212	-518
Bobl-Future	116,53	-27	14	-172	60	-275
Schatz-Future	105,72	-8	68	-1	80	-83
3 Monats Euribor	3,72	6	-19	-18	17	-16
3M Euribor Future, Dec 2024	3,28	0	-8	28	-8	98
3 Monats \$ Libor	5,60	-1	-1	3	7	0
Fed Funds Future, Dec 2024	4,99	1	-9	35	97	115
10 year US Treasuries	4,31	5	-16	12	55	44
10 year Bunds	2,47	8	-6	20	10	47
10 year JGB	1,05	8	4	34	68	43
10 year Swiss Government	0,56	-8	-27	-8	-37	-14
US Treas 10Y Performance	592,60	-0,2%	1,8%	0,2%	-0,5%	-1,4%
Bund 10Y Performance	553,37	-0,3%	1,0%	-0,6%	2,0%	-2,1%
REX Performance Index	443,15	-0,4%	1,0%	0,1%	1,8%	-1,1%
IBOXX AA, €	3,44	3	-4	19	-24	38
IBOXX BBB, €	4,01	2	-3	17	-59	25
ML US High Yield	8,02	1	-7	17	-71	23
<b>Commodities</b>						
MGBase Metal Index	427,55	-0,6%	-7,2%	9,9%	11,9%	9,4%
Crude oil Brent	86,98	1,2%	6,4%	1,2%	20,4%	12,0%
Gold	2328,05	-0,2%	-1,1%	6,3%	21,6%	12,7%
Silver	29,01	-2,5%	-4,3%	18,2%	27,0%	19,6%
Aluminium	2447,97	-0,7%	-6,4%	8,7%	13,5%	4,4%
Copper	9372,07	-1,8%	-8,2%	7,2%	11,8%	10,7%
Iron ore	106,51	-0,4%	-9,5%	-3,0%	-5,4%	-21,9%
Freight rates Baltic Dry Index	2031	1,7%	13,0%	10,1%	71,7%	-3,0%
<b>Currencies</b>						
EUR/ USD	1,0692	0,0%	-1,4%	-1,1%	-2,4%	-3,2%
EUR/ GBP	0,8460	0,0%	-0,5%	-1,3%	-1,5%	-2,4%
EUR/ JPY	171,87	1,2%	1,1%	5,1%	9,4%	9,9%
EUR/ CHF	0,9616	0,8%	-3,1%	-2,0%	-1,8%	3,8%
USD/ CNY	7,2635	0,0%	0,2%	0,5%	0,6%	2,2%
USD/ JPY	160,76	0,6%	2,5%	6,2%	11,6%	14,0%
USD/ GBP	0,79	-0,1%	1,1%	0,0%	0,9%	0,9%

Source: Refinitiv Datastream

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