

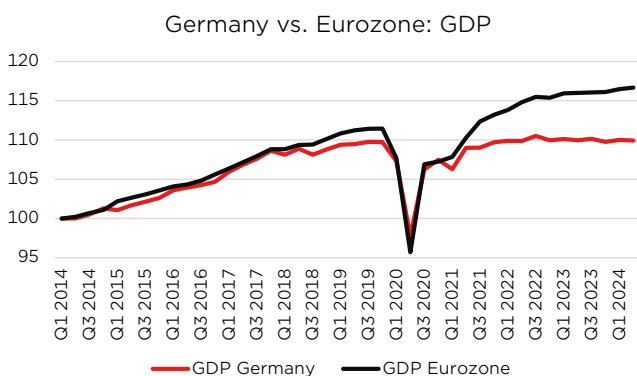
Economic Situation and Strategy

25 October 2024

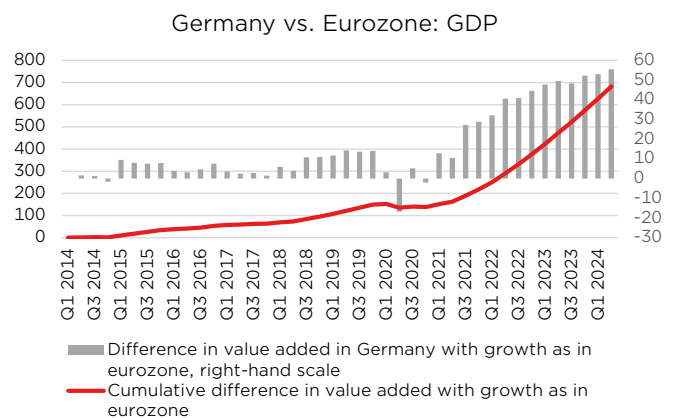
The German patient: heart failure since 2017, stroke in 2027?

In Germany, you often hear the theory that the mood in the country is worse than the situation. After all, people can live quite well in Germany and things are not always going well in other countries either. There is too much complaining in Germany and politicians simply do not explain well enough which projects are actually being tackled that make sense. Unfortunately, the reality is quite objectively different. One could even argue that the mood in the country is still far too good given the situation and that most people have not recognized the dramatic nature of the situation, as we are still living comparatively comfortably on the substance of the last few decades.

However, Germany has completely decoupled itself from the rest of the major Western economies in terms of the development of its value added since around 2017 - in a negative sense. Even the eurozone, which is not itself an example of exorbitant growth, has clearly set itself apart from Germany in terms of growth, even though the eurozone's growth path is significantly dampened by Germany.



In this context, we have calculated the extent to which Germany has foregone value added because the economy has not grown as strongly as the eurozone since around 2017, whose growth has itself been dragged down by Germany. The result is more than astonishing. In total, Germany has foregone almost 700 billion euros in value added since 2017 simply because, unlike its neighboring countries (and the rest of the world), we are no longer growing.



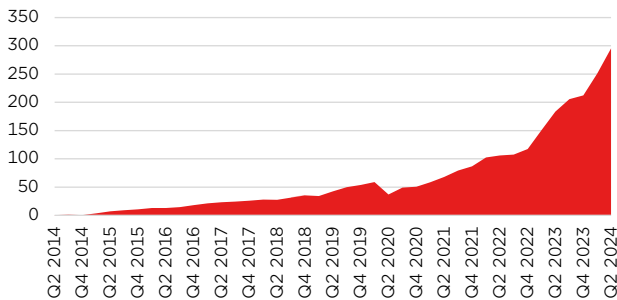
That is an incredibly large sum. With a government share of 50%, this means that the state has foregone around 350 billion euros that would otherwise have been available to invest in infrastructure, education, research and security. If you have the feeling that the mildew is slowly settling over Germany, then this is also because this sum was not available to move the country forward. We can also cite another example to illustrate the scale of the lack of growth.

Let's assume that Germany had continued to grow as fast as its neighbors in the eurozone since 2017 and had invested a third of this additional value creation in a fund that buys a DAX ETF (to keep it simple in the example). This fund would then have a volume of just under EUR

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300 billion by now and would very quickly reach a volume of EUR 500 billion in the next few years. The income from such a fund alone would be enough to cushion the demographic burden that the country will face in the coming decades. Seen in this light, foregoing growth is not an academic problem, but has tangible consequences for the welfare of a country.

Capital stock in bn EUR if Germany had grown like the Eurozone and a third of the difference in value added had been invested in the DAX



And with every year in which the trend is not reversed, the problem becomes bigger and harder to correct! Unfortunately, there is no sign of any improvement in the current situation - quite the opposite. The International Monetary Fund has just had to downgrade its GDP growth forecast for Germany for 2024 and 2025. Compared to all other major industrialized countries, Germany is still completely at the lower end of the forecast GDP growth rates. In view of the increasing refusal of companies to invest in Germany at all, there is no substantial improvement in sight for the coming years either. On the contrary, there is every indication that the coming years will initially be even more critical than they already are. Even if reforms are started now, success will only be achieved after a few years.

From a sober point of view, however, reforms such as those recently dared and implemented in Germany under Chancellor Schröder will no longer be enough to turn the tide. The situation is far too muddled for that. In a way, the country would have to completely reinvent itself; that would be a project for the next 20 years and not just for the next legislative period. In medical terms, Germany has suffered the odd mild heart attack since 2017 - but if there is no far-reaching treatment soon, a significant stroke can hardly be averted.

So what needs to change? What has gone wrong? From a sober point of view, several books could be filled with the answer to this question, and one should not even give the impression that one could create a program that addresses the most important aspects in just a few pages.

Nevertheless, we would like to take a few topics as examples and address them here - if only to show in which areas significant changes would have to take place if we want to work on a model for a Federal Republic of Germany 2.0.

Deregulation

For at least 20 years, there has been a consensus that bureaucracy and regulation need to be reduced in Germany. So far, nothing has happened. In the last few years in particular, the number of employees in ministries and authorities has increased by leaps and bounds. The increase in employees has also been accompanied by an increase in new regulations and laws. In the meantime, the intensity of state intervention in economic life and daily micromanagement by the state has reached a dimension with real satirical features.

In a democracy, the state is supposed to serve the people; in Germany, companies and people now tend to serve the state - it's a topsy-turvy world. This Gordian knot can no longer be untied by any deregulation commissions. The state has become so bloated in recent years that more radical methods seem appropriate. Presumably there is no way around more or less sweeping deletion of laws and regulations from the last 20 years in some areas and a massive reset. In a second step, laws and regulations that seem really important and have proven to be significant and beneficial could then be re-enacted. Without a radical solution, however, it will no longer be possible to give the economy and society room to breathe again.

Moreover, it is not as if the bloated authorities have become more efficient in recent years. The opposite seems to be the case. With the growth in the number of civil servants, there seems to have been a proportional increase in paralysis when it comes to decision-making. Too often, one gets the impression that responsibility is concealed and delegated instead of being taken on. Due to the federal structures, there is also a great confusion of competencies and responsibilities in Germany. However, as the digitalization of many authorities has not received a significant boost since the 1980s, the authorities seem to work without a common database in most cases. As a result, decisions and coordination take forever and are of poor quality in terms of content.

Abroad, some people are just tearing their hair out over these shortcomings if they are dependent on cooperation with German authorities. Here too, improvements in small steps are no longer a solution. Rather, we need a big bang in which competencies are completely reorganized and, if necessary, centralized. The world around

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us has changed dramatically. We can't pretend that organizational structures from 1951 are still the solution to all problems. Wherever any data protection issues stand in the way of sensible digitalization, these issues also need to be rethought. People gain nothing from the strictest data protection rules in the world if, at the same time, the state slips into dysfunctionality. A balance of interests must be struck here!

Electricity prices

Despite all its problems, Germany is still one of the largest industrialized nations on the planet. If it is to stay that way, the location needs a lot of electricity, and at affordable prices. It can also be assumed that the demand for electricity will increase massively in the coming years (hydrogen production, e-mobility, heat pumps, conversion of industrial processes from gas/coal to electricity, data centers, AI) and that this electricity must also be reliably available. Many politicians have no idea of the scale of this challenge, not least because they are often overwhelmed by the physics involved and only have a layman's understanding of what it means when Germany repeatedly reaches an electricity consumption of 80 gigawatts and, in the long term (including during dark doldrums), has to cover significantly higher levels. Many people don't even realize that there are cities in Germany like Ludwigshafen that consume roughly the same amount of electricity as entire countries (Kenya). This will not change - to make this very clear once again - as long as Germany remains an industrial location. However, for Germany to be a successful industrial location, electricity costs must not be too high. Unfortunately, this is the case. There is no other major industrialized nation in the world that has electricity costs as high as Germany. This is detrimental to growth, and it is detrimental to a green transformation of the economy.

How did this happen? First of all, it seems astonishing that the cost of electricity in Germany is so strikingly high, because in the last 25 years, around 600 billion euros have been invested in renewable energies in Germany. One of the reasons given for this was to replace expensive nuclear power; moreover, the sun and wind don't charge - at least that's how it was advertised at the time. As is so often the case, the reality is unfortunately a little more difficult.

On the surface, we live in a green electricity paradise: In 2023 alone, there was an addition of almost 15 gigawatts of installed capacity in photovoltaics; a similar figure could be reached this year. The only problem is that the supply of solar power is now so abundant that supply

massively exceeds demand on sunny days. The price of electricity on the electricity exchange then falls into negative territory. We then have to export electricity abroad and pay customers a premium for taking the electricity in the first place. This then leads to the completely absurd situation that hydroelectric power plants in Austria pump the water into reservoirs and are paid for by Germany. When the water is at the top, it is then fed down the mountain past the turbines into the valley, only to be pumped back up again at Germany's expense. This is so crazy that even Kafka would hardly have thought of such a thing, but this is the new reality, which becomes more critical with every solar cell that is added. But even if solar and wind power plants have to be taken off the grid because the electricity grid is at risk of collapse, the operators of the plants must continue to be compensated as if they were feeding the electricity into the grid. This is once again absurd, as it significantly increases the economic costs. It would be much better if, in future, at least the operators of new plants did not receive compensation payments for electricity that was not produced, but instead were only paid according to market prices. This would give operators an economic incentive to invest in storage technologies and to supply electricity when it is actually in demand and when there is a willingness to pay for it. More storage would also have the advantage of not having to maintain huge parallel capacities with gas and coal-fired power plants, which are utilized less and less and are therefore no longer profitable to operate, which in turn entails immense economic costs that will increase exponentially in the coming years with a further expansion of wind and solar power. Incidentally, constantly exporting cheap electricity or even electricity with negative prices and importing expensive electricity (as is constantly the case now) is not a sensible business model for Germany as an industrial location.

It was also not a particularly smart idea to say goodbye to base load-capable nuclear power, even though there is still a base load. Funnily enough, critics of nuclear power always smile pitifully at anyone who points this out, as if there would no longer be a need for base load if nuclear power plants were shut down. But the facts speak a completely different language. And in view of a structural increase in electricity demand, the need for base-load electricity production will also continue to rise. I fear that there is almost no way around the idea of returning to nuclear power if Germany wants to produce electricity cheaply and with low CO₂ emissions. In this context, we should probably also return to nuclear research at universities and focus in particular on the development of reactors based on TRISO particles. In the 1980s, Germany

was a leader in this field; in the meantime, the USA has made considerable scientific progress on which we could build in order to develop and build new and extremely safe and at the same time very economical reactors. Many people see such proposals as pure provocation, but we must not overlook the fact that the younger generation is much more relaxed about this issue than the over 50s.

Migration, the debt brake and co.

Germany has been the second largest immigration country in the world for several years. The social challenges associated with this have been systematically underestimated by politicians. As a result, new parties have emerged that have the potential to permanently change and, in the worst case, destroy the German political system, which has been very successful and admired by many to date. It is comparatively obvious: If politicians fail to find an adequate response to this pressing issue, many federal states and even the federal government are threatened with structurally dysfunctional governing coalitions. In addition, all other highly relevant political issues are currently being overshadowed by the migration issue. Many necessary discussions are not taking place because society is too focused on the issue of migration. Only a sufficiently effective solution that leads to an end to the loss of control over the issue of migration will pave the way for other pressing issues in society and politics to be discussed broadly and in detail again. If no solution is found, there is a risk of increasing state dysfunctionality with corresponding consequences for the economy and society.

The national debt brake is another topic that is causing a stir. The motivation for introducing the debt brake was

economically understandable and expedient at the time of its introduction. However, the idea of a national debt brake was always based on the implicit working hypothesis that Germany would have fiscal sovereignty virtually forever. Because only then - if at all - will it one day be possible to reap the rewards of a restrained fiscal policy. However, this working hypothesis is no longer tenable. We assume that there will be a gradual communitization of debt in Europe in the foreseeable future. In this context, a separate national debt brake is no longer appropriate. We therefore propose that Germany should aim for a deficit ratio similar to that of France. This would also give the country the leeway to invest significantly more in its ailing infrastructure and to reduce taxes and levies. After all, it makes no sense to torture oneself with austerity only to end up being liable for the party of others.

And finally, a few words about the government's mindset: over the last 20 years, a creeping change in the way it works has been observed: From year to year, ethics of responsibility were increasingly replaced by ethics of conviction; strategic action and action had to give way to symbolic politics and show effects. Vocal representation of particular interests became increasingly more important than the interests of the (silent) majority. If this type of politics does not change soon, companies will turn their backs on Germany and citizens will renounce their loyalty to the country. There are huge tasks to be solved! Let's get on with it! Otherwise the country will not only suffer another heart attack, but a stroke.

Dr. Christian Jasperneite

Market data

Stock markets	As of	Change versus				
	25.10.2024 13:07	18.10.2024 -1 week	24.09.2024 -1 month	24.07.2024 -3 months	24.10.2023 -1 year	29.12.2023 YTD
Dow Jones	42374	-2.1%	0.4%	6.3%	27.9%	12.4%
S&P 500	5862	0.0%	2.3%	8.0%	38.0%	22.9%
Nasdaq	18415	-0.4%	1.9%	6.2%	40.1%	22.7%
DAX	19430	-1.2%	2.3%	5.7%	30.6%	16.0%
MDAX	27135	-0.7%	4.0%	8.3%	11.1%	0.0%
TecDAX	3411	-0.7%	3.5%	2.8%	18.7%	2.2%
EuroStoxx 50	4935	-1.0%	-0.1%	1.5%	21.4%	9.1%
Stoxx 50	4435	-1.1%	-0.2%	-0.2%	15.4%	8.3%
SMI (Swiss Market Index)	12163	-1.3%	0.9%	-0.3%	17.2%	9.2%
Nikkei 225	37914	-2.7%	-0.1%	-3.2%	22.1%	13.3%
Brasilien BOVESPA	130067	-0.3%	-1.6%	2.9%	14.3%	-3.1%
Indien BSE 30	79402	-2.2%	-6.5%	-0.9%	23.0%	9.9%
China CSI 300	3956	0.8%	18.0%	15.7%	13.5%	15.3%
MSCI Welt	3707	-1.2%	0.1%	5.4%	32.3%	17.0%
MSCI Emerging Markets	1135	-1.8%	0.2%	4.8%	23.2%	10.8%
Bond markets						
Bund-Future	133,51	-68	-144	117	495	-371
Bobl-Future	119,06	-52	-104	224	321	-22
Schatz-Future	106,90	-11	-29	105	187	35
3 Monats Euribor	3,07	-34	-34	-59	-87	-81
3M Euribor Future, Dec 2024	2,74	-6	-16	-47	-57	44
3 Monats \$ Libor	4,85	0	-7	-69	-79	-74
Fed Funds Future, Dec 2024	4,51	0	25	-30	-20	68
10 year US Treasuries	4,20	12	47	-9	-62	33
10 year Bunds	2,28	10	22	-11	-52	28
10 year JGB	0,95	2	13	-9	13	33
10 year Swiss Government	0,47	4	-2	-8	-63	-22
US Treas 10Y Performance	604,17	-1.0%	-3.4%	1.6%	9.1%	0.5%
Bund 10Y Performance	567,33	-0.6%	-0.9%	2.1%	7.5%	0.3%
REX Performance Index	452,75	-0.2%	-0.4%	1.7%	4.7%	1.1%
IBOXX AA, €	2,95	4	-3	-35	-107	-12
IBOXX BBB, €	3,43	2	-5	-39	-146	-32
ML US High Yield	7,41	13	13	-39	-201	-38
Commodities						
MG Base Metal Index	434,60	0.6%	0.5%	7.8%	18.0%	11.2%
Crude oil Brent	74,82	3.0%	-0.3%	-8.7%	-15.2%	-3.7%
Gold	2721,92	0.1%	2.9%	12.2%	38.7%	31.8%
Silver	33,52	2.6%	5.6%	14.3%	46.1%	38.2%
Aluminium	2615,01	1.4%	3.2%	16.2%	20.6%	11.5%
Copper	9367,42	-1.4%	-3.1%	4.4%	17.3%	10.7%
Iron ore	104,40	-0.9%	13.6%	-2.9%	-11.7%	-23.4%
Freight rates Baltic Dry Index	1417	-10.1%	-29.6%	-24.0%	-27.3%	-32.3%
Currencies						
EUR/ USD	1,0823	-0.2%	-2.8%	-0.2%	1.8%	-2.1%
EUR/ GBP	0,8335	0.1%	0.1%	-0.8%	-4.2%	-3.8%
EUR/ JPY	164,41	1.0%	2.7%	-1.7%	3.2%	5.2%
EUR/ CHF	0,9384	-0.2%	-0.6%	-2.3%	-1.2%	1.3%
USD/ CNY	7,1243	0.3%	1.3%	-1.9%	-2.6%	0.3%
USD/ JPY	151,83	1.5%	6.0%	-1.3%	1.3%	7.6%
USD/ GBP	0,77	0.4%	3.1%	-0.5%	-6.2%	-1.8%

Source: Refinitiv Datastream

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