Is Euro the Worlds Currency

or not?

The fact is (whether we like it or not) that the Eurozone is currently experiencing the worst economic episode since its inception. We are currently at the worse point of the debt crisis that started 1.5 years ago. Contagion has already spread to Ireland, Portugal, Cyprus, Spain, Italy and even France is starting to feel the pain. The unwinding of fiscal imbalances, asset bubbles and over-leverage is a protracted, painful and disinflationary process. Without control of monetary policy, crisis hit countries are forced to adopt large and unprecedented medium term austerity measures.

There are examples in the past of debt crises that were successfully overcome, mainly with external help, but past episodes involved countries with the power to control their monetary policy and in all occasions a devaluation of their currencies and/or increase of the money supply was a basic step in their struggle to regain competitiveness.

However, countries in the Eurozone have delegated their monetary authority to the ECB which has the sole responsibility for the price stability of the whole Euro area. With Germany, the largest partner, growing at the fastest pace since the end of the global recession in 2009 and commodity prices shooting through the roof, the Eurozone average for inflation remains above the 2 % ECB target (in fact close to 3%) thus forcing the ECB to paradoxically start hiking rates during a severe debt crisis. This results in placing an extra burden on the highly indebted countries in the form of increased borrowing costs and a loss of competiveness due to the higher exchange rate of the Euro.

Surprisingly and despite the widespread debt crisis, the Euro has been able to appreciate since the start of the year against all but one (the Swiss Franc) of its other major counterparts. Euro has appreciated between 2% and 3% against the Japanese Yen, British Pound and even the Australian dollar while against the US Dollar the gains are around 9 % for the year! We are of the view that the reasons of the Euros persistent strength have more to do with the apparent weakness of the US dollar and also due to the divergence between ECB and FED policies.

The US authorities (both the FED and the Treasury) are “un-officially” but clearly targeting a weaker dollar and all their actions during the last years are in divergence with the policies adopted in the Eurozone. The ECB this year has started hiking interest rates while the FED has only recently finished its second round of Quantitative Easing (printing USD and buying back US Treasuries thus increasing the money supply) with US interest rates stuck at 0% and the markets already pricing a 30 % chance of another round of bond buying in the US. In this environment where investors are using cheap dollars to fund their investments the lack of a credible and liquid alternative to the USD makes the EUR their only choice especially for the high growth economies like China, Russia and India.

Consequently, as long as the US authorities continue their current policy of targeting a weaker dollar and risks of a Eurozone breakup or default do not materialize, the long term trend of the Euro is bound to remain upward.

By Christoforos Symeonides

Head of Treasury, TFI Markets