

SHOULD THE FALL IN VALUE OF THE EURO BE CAUSE FOR CELEBRATION?

On Tuesday May 4th, as the euro fell against the dollar and broke the 1.30 mark, the European currency reached a record one-year low. The Greek crisis and rumours about the possibility of Spain asking for aid from the IMF have wreaked havoc with the euro. On Monday May 17, the exchange rate for the euro dropped against the dollar to 1.22, the lowest level in four years. Concerns raised over Greece's austerity plan, compounded by doubts about the solvency of several other European Union member states could spur the euro to decline further in the coming months. Should this be cause for celebration?

The euro dropping against the dollar makes greater competitiveness possible for European exporters who sell their products on American and even Asian markets, i.e. when currencies—like the Chinese yuan—are pegged to the dollar. In addition, the rise of the dollar against the euro may well lead European contractors to cut back on their sourcing in Asia and strengthen their reliance on sourcing closer to home.

Producers in Europe and the Mediterranean Basin may thus benefit, as the gap between their production cost structure and Asia's shrinks.

The fall in the European currency foreign exchange rate is therefore welcome, insofar as the euro continues to be overvalued, since in terms of purchasing power parity, the euro's exchange rate stands at approximately 1.2 dollars. But below 1.2 dollars, a sharp fall in the value of the euro would significantly contribute to higher prices for imported goods, thus curtailing households' spending power and weakening economic growth, which in Europe is largely driven by consumption. For companies, it would help trigger higher prices for raw materials.

Too great a drop in the euro could weaken the European currency, which is by no means to be desired. Thinking back to the competitive devaluation policies of some European countries before the advent of the euro should suffice to convince us. These practices succeeded only in fuelling

excessive intra-European competitiveness, something we must take pains to avoid today, at a time when one key to the future of the textile-apparel sector lies in strengthening the Euro-Mediterranean partnership.

For the risk of contagion from the Greek crisis can certainly not be ruled out. Although less dire than in Greece, the situation in Spain and Portugal is indeed worrisome. Both countries' budget deficits exploded in 2009. The Spanish government plans to reduce its public deficit to 6.5 % of GDP in 2011, while in Portugal, the government's target is 5.1 % of GDP. France has not been spared either, as the government announced a freeze on public spending for the next three years.

The depreciation of the euro is Europe's inevitable comeuppance for its fragile governance; Europe has without a doubt waited too long before reacting to the Greek crisis. To keep the euro from falling too low, measures such as creation of a monetary

fund and the possibility of the European Central Bank shouldering state debts are steps in the right direction. Only the future will tell if they are sufficient...

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