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Eurozone vs the Euro

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By Afonso Vieira | Posted: 12-25-11 | 06:12 AM | E-mail Article

The Eurozone sovereign debt crisis started in 2009 and has resulted in lending to Greece, Ireland and Portugal. In 2011 the crisis has also become political because there is no clear road map on how to solve the problem quickly.

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On the short-term, the Eurozone countries decided to impose austerity measures (higher taxes, lower public benefits) on the three countries above and also on Italy, Spain and France (albeit discreetly), the next in line. What's more, the worldwide economic slowdown coupled with austerity at home is now pushing the Eurozone toward a new recession in 2012. The media announce almost daily that things are going to get a lot worse before… they get worse! But even with bad news the euro remains stable. Why? I believe there are two main reasons.

Market Share

First, the euro conquered its place as an alternative to the US dollar since physical notes and coins were introduced on January 1st 2002. According to the International Monetary Fund[1], at the end of 2001, 71.5% of the total of official holdings of foreign exchange was kept in US dollars and only 19.2% in euros. By the end of 2010 the euro share increased to 26.2% getting closer to half of the US dollar share that had dropped to 61.5%. The international dimension of the euro can also be seen on the international debt securities markets. To gauge the dimension of these markets, it's better to focus only on issuance in a currency other than the currency of the country in which the borrower resides. According to the European Central Bank[2] at the end of 2010 the

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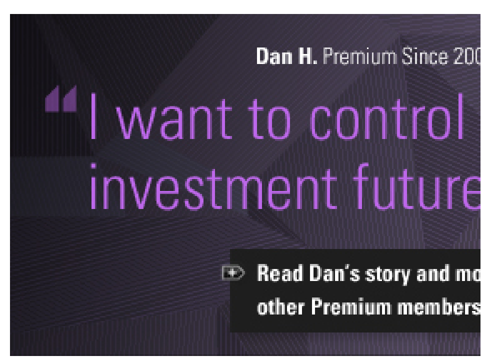

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Nominees for Fixed-Income Manager of the Year total stock of debt securities stood at USD 11,000 billion. Of this, euro-denominated securities amounted to USD 2,900 billion, corresponding to a share of 27.4% of the total outstanding amount, more than half of usd-denominated securities that were 48.7%.

Steady

Second, investors know that the two main alternatives, the US dollar and the British pound, have lost value versus the euro since January 1st 2002. Ten years ago 1 US dollar could buy 1.1287 euros but now it can only buy 0.7722 cents, a fall of over 31%. The pound also lost value versus the euro. Ten years ago a British travelling in Europe would have bought euros at 1.6375. Now it can only do it at 1.1933, a loss of 27%. Investors also look for stability. Despite the media hype in 2011, the euro as kept its stability (low volatility) status intact. The period high and low in the USD/EUR is roughly 14% apart, and 8.5% for the GBP/EUR pair.

In conclusion, the financial markets regard the euro and the Eurozone separately. Markets believe the currency will survive, either in its present form (17 countries) or as the currency of a core group of strong countries. Experienced investors know that if something isn't going down on terrible news, it is not going to go down.

Sources:

[1] http://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/a1.pdf

[2] http://www.ecb.int/pub/pdf/other/euro-international-role201107en.pdf

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