FOREIGN EXCHANGE NEWS, ANALYSIS AND EDUCATION FOR CURRENCY TRADERS

JANUARY - MARCH 2011

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"People only accept change when they are faced with necessity, and only recognize necessity when a crises is upon them"

Jean Monnet, father of the European Union

EURO: Between Life and Death

It was nine months ago, in these very columns, that I focused on the strains hitting the euro zone (*"Weak dollar, euro troubles"*). At the time, Greece was the culprit and the plot of the drama had only started to unravel under the eyes of investors a few weeks before. I was quite sure that a solution would have been found, albeit a temporary one. Only time, possibly a very long time, would have told us if Europe would have been able to reach safe ground from the quicksand of being "a monetary but not fiscal union".

Where are we now? The Greek crisis was in the end contained and the 'shock and awe' 750 billion Euro EFSF was quite beyond the makeshift solution I expected. Still here we are, even less than a year later, with the periphery under renewed attack, even in a broader way than before.

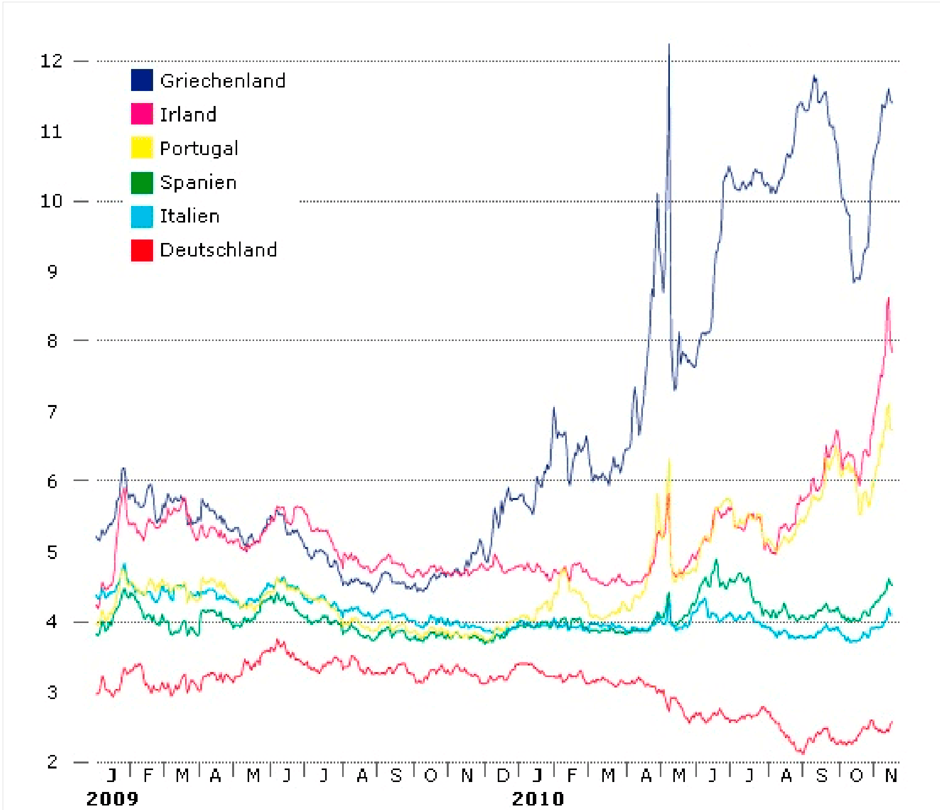
The story is actually developing pretty much as I expected, but more quickly. We may not have to wait few years to witness a life or death experience for the Euro since the market seems quite ready to find out sooner, maybe in 2011. It is very likely that the political will to keep the project alive will be forced to overcome structural and ideological issues, or to abandon it completely, sooner rather than later.

A new, broader crisis, generating a more complex response

The first act of the current crisis began in the chic French beach resort of Deauville in mid-October. To the consternation of their allies, Merkel and French President Nicolas Sarkozy announced the end of their ambitious goal to enforce a stricter stability pact with automatic sanctions for nations that break the deficit rules. In return, Sarkozy supported the German idea to assign some of the liability for future financial crises to private-sector creditors such as banks and to accept the possibility of bankruptcy for an insolvent country. The 27 heads of state and government approved the deal at the European summit in late October.

The German plan to automatically force bondholders to pay up when financial aid packages are approved "might seem attractive from a theoretical point of view," says ECB executive board member Lorenzo Bini Smaghi, but it would "in practice destabilize markets and have severe effects on economies in the euro area." It could ultimately achieve the opposite of what was intended, says the central banker, because "speculators would take advantage of the situation, while many small investors would suffer losses."

Such evolution and, later on, the horror stories about Irish banks, caused a stir in the financial markets, pushing up risk premiums for the government bonds of all the ailing countries.



10 year government bond yield (Source: Der Spiegel, Nov 22nd)