

# The benefits of a falling euro

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## Summary

- The value of the euro has fallen strongly as a result of weak economic conditions and low inflation.
- A cheaper euro benefits companies exporting to countries outside the Eurozone and may provide a boost to overall Eurozone economic growth.
- Companies that import from outside the Eurozone stand to lose, as do households and companies that have borrowed in foreign currency.

## Euro tumbles

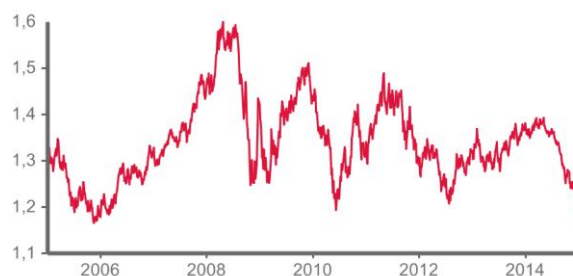
The value of the euro has fallen rapidly over the past month and may fall further this year. The euro lost 15% of its value against the US dollar (USD) between May 2014 and mid-January. On January 8th the value of the euro fell to USD 1.18, the lowest since 2006.

### Devaluation caused by weak economy and low inflation

The fall in the euro is caused by the continued economic weakness in the Eurozone, the low and falling rate of inflation and measures taken by the European Central Bank (ECB). The drive by the ECB to bring down long term interest rates makes it less attractive to invest in euro denominated bonds. Investors therefore search for higher yields outside the Eurozone. The value of the US dollar is at

## Euro falling

(1 USD per euro)



Source: IHS

the same time being driven upward by the strengthening US economy and the expected increase in interest rates by the US Federal Reserve Bank in mid-2015.

The ECB will step up its efforts by starting a quantitative easing program, buying government debt. Anticipation of this policy has already pushed down government bond yields. The depreciation of the euro is viewed by the ECB as a positive effect of its policy.

### **Exporters will benefit**

The lower value of the euro will improve the international competitive position of member states as export products get cheaper in foreign currency. This should boost export to countries outside the Eurozone and benefit overall Eurozone economic growth. It will also raise import prices of non-Eurozone products and services, which makes Eurozone companies relatively more competitive in Eurozone markets as well.

Another benefit is that the rise in import prices will push up inflation. In December of 2014, the Eurozone experienced deflation of 0.2% on an annualised basis. A higher rate of inflation would aid the economic recovery in the Eurozone by reducing the real burden of public and private debt.

Companies that import goods from outside of the Eurozone to sell in Eurozone markets stand to lose however, as their cost base will likely rise disproportionately with their selling prices. Eurozone companies, households and governments that have borrowed in foreign currency lose as well, because the value of their debt rises in euros.

Overall the falling euro should offer welcome support for economic growth across the Eurozone.

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