

May 2000

EURO TROUBLES

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The script certainly did not call for what is happening just now. Everybody remembers the proud founding of the European Monetary Union, champagne and great confidence that the new money in no time was a certain competitor to the dollar and, who knows might even dethrone the dollar as the leading world money—a great political project backed by a great economic region. All that seems to be up for grabs. The Euro sinks by the day and it is no longer inconceivable that in a few weeks or months the US Treasury has to step in and bail out Europe's fledging new money. What an irony that the money that was to dominate the dollar needs US assistance to stop the meltdown, yet that is where we might be heading. Worse, all this is happening just as Europe is heading toward the introduction of actual Euro notes, by January 2000.

No wonder that in Germany where a money with a great tradition is traded in something that suddenly looks like funny money there is deep disquiet. No wonder that the French who never had a good money are nervous once again and are calling for doing something, anything.

But in truth, all this is a vast exaggeration; it is painful for Europe to lose its pride in the new money being super special on day one, on having boasted and being caught with their pants down. But on the strict economics of it, Europe is alright, its money is alright, no great harm will come from the present weakness and the embarrassment is neither likely to get much worse nor last for very long.

Four questions are useful at this point: First, who is to blame? Second, what can be done? Third, is this the bottom or can things get worse? Lastly, there is nothing much to do, how long will this situation last and what will bring the change?

Looking for something to blame, or better yet someone, is the natural instinct of all those who are about to make a big mistake. We want to understand what is going on and then, perhaps, find fault and lay blame. But not in this case. The explanation surely is not the new ECB—it is unimpressive but so far it has handled things well—no loss of nerve, no departure from a price stability target, increasingly good communications. The chief reason for the Euro's pains is the super performance of the US economy. Even when things look more difficult in the US, when inflation numbers ran higher recently, when productivity growth came in lower, when the stock market sold off, the big bubble bursting never happened. Even bad news looked pretty good! In Europe there was no news, the 3 percent growth had already been celebrated for a year, and nothing else has come up to give extra excitement. Hence the Euro slide on the sheer reality of seemingly unending super performance in the US, absolute and relative to Europe.

What can be done—here is another common mistake, do something, anything but just do it! Anything Europe could do at this stage, more likely than not, would make matters worse. Raising

interest rates to the sky is not credible because it would cause a recession and the ECB surely could not do that for long. Intervention is even less plausible—the world has too many Euros, nobody has a shooter position and could be scared into frantically covering their risks. This is the time to let the market take its course, let the long positions come off and then ride hard the way up, once it happens. True, the US could turn the Euro around; what no European head of government or finance minister could accomplish, Alan Greenspan might by just muttering the Euro is too weak. But he rightly saves his words for more important issues.

Yes, this is not necessarily the bottom. In 1985, the synthetic Euro (the value of European currencies as a basket with present Euro weights) reached 67 US cents/Euro, another 25 percent down from current levels! It is very unlikely, but not impossible, that we get all the way there. More likely, the Euro will turn somewhere in the 80 cent range ND then make its gradual come back. But it is worth remembering that a weak Euro is not all pain; it makes Europe highly competitive and without that stimulus economic growth might be significantly less than the present 3 percent.

Lastly, what will change events, what will make the Euro look good and start to recover? The answer almost certainly has to come from the US. If and when the US economy runs into a bit more trouble, when the upside on US assets is far more of a question mark, then Euros become an alternative investment. At that point the present disenchanted holders of huge Euro positions take a fonder view of their holdings. Outsiders from the US and Japan will start believing that some diversification into Euros becomes tractable—after all the stiff is on sale. If and when that point is reached a bit of intervention can even start the long march up. That time could be months or a year off. In the meantime the fragile Euro is sure to stay on the front page and the debate about whom to blame and what to do will stay alive. Benign neglect is the right answer, but let no Euro-banker say it loud.