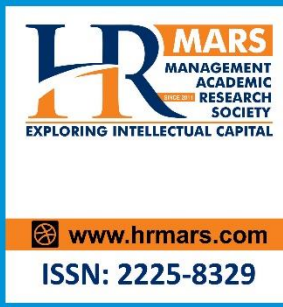




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Crisis in the Euro Area and the Euro: The Game of Giants - EURO vs. DOLLAR

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Abstract

Sovereign debt crisis in the Euro area, which began officially in Greece, was predicted by over the years for many specialists in the field. It has spread throughout the European continent, spreading it as an epidemic and affecting, as expected, more countries with a weaker economy, even if they were not part of the Euro area. However, its effects were seen in Europe and abroad, in the light of the fact that the single currency is an international currency and any flaw in her immune system makes the confidence the world actors in it to fall ... or not?

Keywords: Sovereign Debt Crisis, Euro, Dollar, International Currency, Supremacy

Introduction

The crisis that began in Greece culminated in a crisis throughout the Euro Zone. To answer the question how he ended up in this situation it is necessary to differentiate the three actors who had played a very important role in the development of this crisis, namely: Greece, the financial market and the authorities in the Euro Area (de Grawe, 2010).

The role of Greece could be summarized in a few sentences. Bad management and the feeling of deception that emanates from the authorities have made this crisis is possible. At present the Greek Government is struggling with a huge problem of lack of credibility, making the exit of the crisis to be increasingly more difficult, because they no longer had confidence in them (the Government). Any announcement made by the Government in connection with the Hellenes in their intentions to improve the budgetary situation will be received with a heavy dose of skepticism for years to come.

The Greek Crisis

Destabilizing role of financial markets was once again illustrated dramatically. Periods of euphoria alternating with periods of depression have amplified movements in the prices of assets. This is not a new one, of course, but the speed with which it happened this time was amazing. Just a year ago, sovereign bond markets were covered by a balloon which has led to record low levels of

interest rates in the long term, but this is at a time when the Government has placed on the market in large amounts. In just a few weeks, the situation was dramatically overturned and bond markets collapsed in several countries.

Credit rating agencies have taken a central role in destabilizing position of financial markets. One thing you can say about these agencies would be that they have failed to see the approaching crisis. And even after its emergence, they react consistently too much so that contribute to the enhancement of this crisis. This happened even two years ago, when the rating agencies have been caught completely unprepared for crisis loans. Repeat that scenario even now in recent months. Sovereign debt crisis began in Dubai. Only after Dubai had delayed reimbursement of its bonds and everyone has learned this from the Financial Times, have achieved ratings agencies and that it been a crisis and Dubai has sub classified bonds. Failing in a way so shameful to forecast a sovereign debt crisis, agencies began searching frantically in and also other possible crises. Have been focused on Greece, which was of course a natural target. But not only have limited searches to Greece. They visited other countries, the vast majority of these being countries south and began the process of sub classification. This has led to a significant decrease of the rates of government bonds in the countries concerned.

Thus, it can be said that the rating agencies make systematic errors "type I" during periods of euphoria, i.e. fail to other danger when it is imminent, and during periods of depression, thus making systematic errors of "type II", that is to say that there is a threat all the time even when it does not exist. As a result, it amplifies the movements of destabilization of the financial markets.

All these things would not be so bad if it would prevent rational thinking about how to reduce budget deficits and government debt levels. Government debt levels in the source of the explosion are the unsustainable levels of private debt in the face of the financial crisis. During the boom years, the private sector has accumulated many debts. Then came the recession and Governments have had to gather the shards. They did this in two ways. First, while the economy was drawn into recession, government revenue decreased and increased social expenditure. Secondly, since part of the private debt was guaranteed by the Government, he was forced to make his own debt to save private institutions.

Fear excessive government debt due to the present are likely to trigger the so-called "Fisher's paradox". As Governments are forced by the credit rating agencies to reduce debt levels, the future redemption of debt to the private sector becomes impossible. The private sector is able to reduce the debt only if the Government is willing to increase its own debt. Forcing the Government today to reduce debt while the private sector also tries to reduce its debt, leading to a dynamic of self defeat, in which neither the private sector nor the Government fail to reduce debts. This dynamic economy and pull it down by deflation. This dynamic that has been analyzed by Irving Fischer in the 1930s does not seem to be part of the intellectual with the utensils of the kit of credit rating agencies.

The manifestation of the crisis has been permitted by the hesitation that came from both the Governments of the countries in the Euro area and the European Central Bank (ECB).

The Greek debt crisis has turned into a step backwards with regard to the prospects for enlargement of the Euro area, with records management difficulties of an area with a single currency. Germany and the European Central Bank are determined not to let the Euro area into another Greece. Polish politicians have understood this and changed their attitude in this respect, saying that Poland will adopt the euro in 2015 at the earliest.

Analysts expect that both the European Commission and the European Central Bank should be stricter than ever in applying the criteria of accession candidate countries and insist that to attain the first real and sustainable convergence with the Euro area. This means to take into account the indicators of neglect more in the past, such as the current account balance and broader measures of competitiveness. When the eight countries of central and Eastern European countries joined in May 2004, along with Cyprus and Malta, a poll conducted by Reuters on 33 economists in the financial sector, revealed that they expected that all these States to join the Euro area in the course of that year.

Their accession treaties committing them to adopt the euro once they meet the criteria relating to the budget deficit, public debt, inflation, interest rate and exchange rate stability. However, only Cyprus, Malta, Slovenia, Slovakia and Estonia have entered into what is now the Euro area with 17 members. Lithuania has seen its document rejected in 2007 after having missed so close the inflation target.

Iceland comes and knocks at the door of the Euro area in search of the lifejackets after its banks fell in October 2008, but i was told that first you need to make the application for accession to the European Union. The negotiations should start but it might hit the less favorable replies of the United Kingdom and the Netherlands.

The Governments of the Czech Republic and Poland have illustrated a distant horizon of the euro when they approved the convergence plans that seem to delay adoption of the coin up in the second half of the Decade. Poland, which suffered the shame of last year when he had to jump over an over-optimistic projection that it would adopt the euro in 2012, and has set a new date, while the Czech Republic aim now to 2016 or 2017. Both have floating currencies that have depreciated during the financial crisis, helping them to avoid the deep recession that struck countries with Exchange rates euro compared with Latvia. Poland was the only EU economy enjoyed growth in 2009. Public opinion in the former socialist countries has become more hesitant in terms of early adoption of the euro, after an initial enthusiasm for this purpose after the financial crisis hit. Over two-thirds of voters polled in eight countries of central and Eastern European countries were of the opinion that their country should not hurry to adopt the single currency. The number of people who wanted to join the euro zone decreased from 25% to 28% as in May 2009. The percentage of those who were in favor of entry into the Euro area as late as possible has increased from 29% to 33%.

The specter of deflation Greece including sacrifices in the field of wages and pensions and a high rate of unemployment makes the Euro area no longer seem so attractive in this region.

This crisis of Greece have boosted EU rumors that Romania and Bulgaria, two countries that have big problems in terms of corruption and organized crime, were admitted into this integrationist organization too early. European officials are of the opinion that both the European Commission and the European Central Bank should convince Bulgaria not to apply for the second phase of the European Mechanism of exchange rate (the lobby of the Euro area), even if this country would have qualified from the technical point of view.

Poorest EU countries (Romania and Bulgaria) have been told to wait and to consider the first true convergence.

The game of giants: Euro vs. Dollar

About the struggle that gives worldwide between the Euro and the dollar, analysts have different views which show that they are divided into two camps: those who are in favor of the supremacy of the Euro and I think with her this and those who are part of the old buck.

"Yet there is the question how big will be the international Euro demand. Mundell has put forward the assumption based on the increasing demand for monetary reserve as a whole. World GDP values are always subject to error due to two factors resulting from imperfect measurement and the instability of the exchange rates. However, in round figures, Mundell presupposes that the nominal GDP will grow over the next 10 years by 6% per year. In this case, the GDP will double in 12 years, proportionally between European Union, US and the rest of the world. Europe's external current account will become defective, and of the United States in surplus. The effect "Exorbitant privilege" represents a considerable increase of power in short term, but in the long term, represents the temptation, unless it is not accompanied by a fiscal discipline. Being used as a way of obtaining a long-term substantial growth of debt.

The increasing role of the euro in international scale results from the simultaneous development of its use for private need and its official role. Euro has key features that are assigned to any international currencies, is already an investment currency and financing one of the foreground (30% of the volume of international debts security) as well as an important international trade (involved in 37% of transactions). Even if the role is now limited, the role of invoice currency will have to grow in the future.

The use of the euro in the currency of third countries is manifested in particular in regions which have close links with the euro area or who put into practice the special institutional arrangements with the EU (countries which have acceded and applicant countries, the Balkans, North Africa, and the franc Zone)" (Popescu-Mihăești, Trana, Nisipeanu, 2010).

The main use of the American dollar is and will remain in the United States. Symmetrically, the main use of the Euro is and will remain within the Euro area and the European continent. United States of America are ranked as two of the world economy¹, with a gross domestic Product (GDP) which represents 19.7 per cent of the global gross domestic product. The Euro area is the third power of the world with a gross domestic Product of about 14.6 per cent of the world market, which would increase considerably if all members of the European Union² should adopt the single currency. The third currency as important, as we have seen in the writing email, is represented by the Japanese Yen, Japan having a GDP which represents approximately 6.3% of world level.

Taking as reference currency and Euros, below we present the Euro conversion rates-dollar and Euro-Yen, to see their progress and then comment. Since conversion rates are changing very often from one day to the next, we particularly like the reference period and the last day of the last five months of the year 2011.

¹ The first place is taken by European Union.

² The gross domestic product of the European Union with 27 members represents around 21% of the world.

Table 4. Euro conversion rates of the major currencies of the world³ years (Units per Euro)

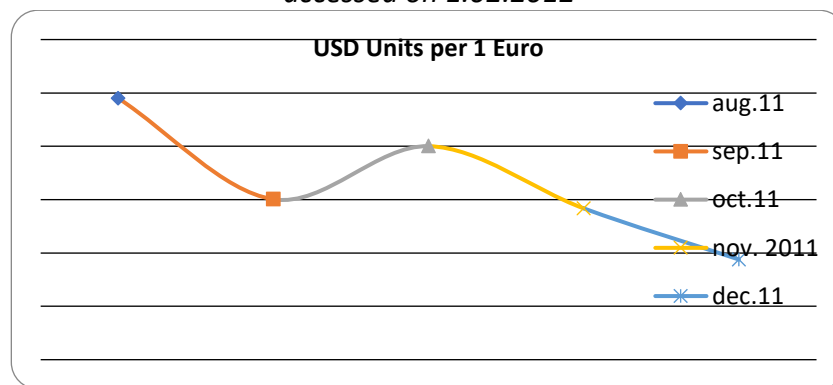
	2009	2010	2011
USD	1,2803	1,3863	1,3418
JPY	115,1158	125,1274	112,3912

Source: Table made by authors based on data taken from the site <http://www.xe.com/ict/?basecur> accessed on 1.02.2012

Table 5. Euro conversion rates of the major currencies of the world (Units per Euro)

	Aug. 2011	Sep. 2011	Oct. 2011	Nov. 2011	Dec. 2011
USD	1,445	1,3503	1,4001	1,3418	1,2939
JPY	110,55	103,79	109,22	104	100,2

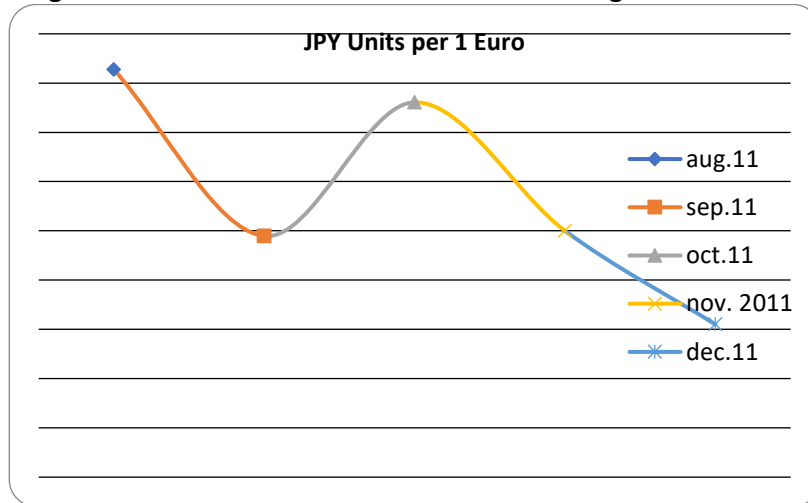
Source: Table made by authors based on data taken from the site <http://www.x-rates.com> accessed on 1.02.2012



Source: Graph made by author based on data taken from the site <http://www.x-rates.com> accessed on 1.02.2012

³ Data are for January 31, to three years taking into account.

Figure 1. The conversion rates of the Dollar against the Euro



Source: Graphic made by authors based on data taken from the site <http://www.x-rates.com> accessed on 1.02.2012

Figure 2. The conversion rates of the Yen against Euro

Note that both the US dollar and the Japanese yen had in the last year a trend down against the Euro, although the single currency through sovereign debt crisis further.

The analysis of the past three years, the 2009, 2010 and 2011, it is noted that the dollar has experienced a slight growth in 2010, at a rate of \$ 1,2803 per 1 euro, at a rate of \$ 1,3863 per euro, in 2011 to fall back to \$ 1,3418 per 1 euro, and in the first month of the year 2012 to arrive at a rate of \$ 1,3176 per 1 euro. Media on the facts taken into consideration is a rate of \$ 1,35228 per 1 euro, the lowest rate is \$ 1,2669 per 1 euro, recorded on January 19, 2012, and the highest rate was 1,4487 dollars per 1 euro, registered on 29 August 2011.

With regard to the Japanese currency, it appeared to the analysis on the three years that it has experienced a trend in increasing the conversion rate in the first two years, i.e. at a rate of 115,1158 yen per 1 euro in 2009 at 125,1274 yen per 1 euro in 2010 and in 2011 to fall at a rate of 112,3912 yen per 1 euro. Media conversion rates on the facts taken into consideration is 104,239 yen per 1 euro, the smallest value is passed on 16 January 2012 (97,2501 yen per 1 euro), while the highest was recorded on August 25, 2011 (111,31 yen per 1 euro). On the last day of the month in January 2012, the conversion rate was 100,63 yen per 1 euro. You must keep in mind the fact that this country is going through a period of restoration and it is not excluded that in future to be witnessing another "Japanese miracle" as happened after World War II.

Indeed, as we showed earlier, the single currency, the Euro, has already had a huge international success, just as he had on the European continent, bearing in mind that, in any year after the occurrence that currency was most often used for the international titles movements.

In the last fifty years, until the advent of the Euro, the US dollar has held the supremacy of the simple reason that no competitor. No other economy in the world is not even close to the size of the economy of the United States of America. If you were to go back in history, you might notice a similarity in terms of the influence of pound sterling on the financial market.

But, at some point, the international finance market saw a chance for the Euro when the dollar began to be cheaper. For example, in 2005, South Korea announced that it would move investments in currencies other than US dollars, which proved to be inspired by the events of the next three years.

After more than ten years after the creation of the single currency, there is still controversy about the European economic scene and beyond (Sima, Marin, Nisipeanu, 2011). They have been fed and sovereign debt crisis in the Euro Area and pessimists say that if it is not going to break, these crises will occur in the future. However, among the specialists in economy and people are more optimistic, as for example, the Chinn and Frankel.

They have provided in 2005, following a study, that the euro could surpass the dollar in the year 2022 as currency lending, but in their latest econometric calculations, in 2008, have approached this time horizon until the year 2015. These predictions are based on the influence of specialists has four main factors, described by me above, which economists consider them crucial in winning international currency status, namely:

- Economic size measured in output and trade;
- Deep financial markets, liquid and well developed;
- Confidence in the value of the currency;
- Externalities of the market.

While the first two determinants of both the euro and the dollar are at par, the dollar tends to fall below the level of the euro with respect to the third factor, despite disruptions by passing the Euro area.

Thus, in the view of these specialists, the question arises, whether inherent dollar could lose its dominant role of leader of the currencies of the world, and the answer might be yes.

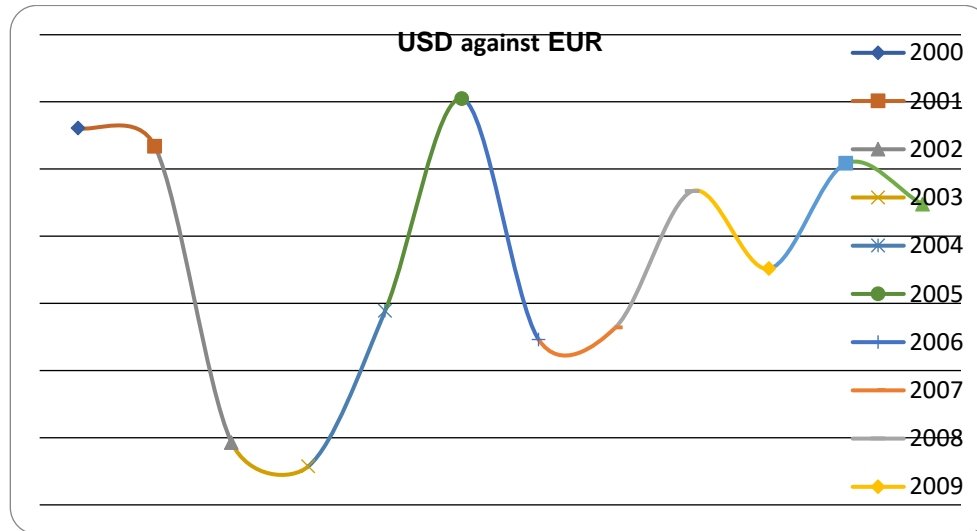
The first reason that comes to support this answer is that at the moment the euro exists on the market more a more genuine than rival were the German mark and Japanese yen. The second reason is that the United States of America has now more than twenty-five years of chronic current account deficit and that the dollar has over thirty-five years of depression (Chinn and Frankel, 2008).

To this conclusion came and other euro-optimists, Papaioannou and Portes (Papaioannou and Portes, 2008) and relying on the trend of dollar exchange rates-euro (2000-2010) shown in the following figure and table.

Table 6. Trend Euro - Dollar exchange rates (2000-2010)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
USD against EUR	0,0805	0,067	0,1536	0,1713	0,0555	0,1024	0,077	0,0679	0,0336	0,0242	0,0542	0,0237

Source: Table made by authors based on data taken from the site <http://www.rateslist.com/exchange-rate-trends-2011.html> accessed on 1.02.2012



Source: Graphic made by authors based on data taken from the site <http://www.rateslist.com/exchange-rate-trends-2011.html> accessed on 1.02.2012

Figure 3. Trend of the dollar-euro exchange rate (2000-2010)

So far, financial markets, the dollar has seen some revival over the euro, just because of the crisis through which that currency. For example, the inflation rate of seventeen countries of the Euro area fell from 2.8% in December 2011, from 3% in November, which makes it very likely that, at some point, the European Central Bank to lower interest rates below 1%.

This will cause devaluation of the euro should not be abruptly one product, so as to leave room for reaction to this phenomenon.

On the flip side, however, the US dollar is not better because it is stuck in the middle between the other main currencies.

Conclusions

Globally, the combination of a weak dollar and a weak euro can prove to be a pretty serious problem, affecting in particular trade. Of course that these declines are reflected in the prices of goods on the market, but they turn into losses for the countries producing and exporting.

Analyzing all the above facts we can conclude that in spite of the crisis through which the global economy, top international currencies at the moment unchanged, remain Euros on the runners-up. Note however, that this coin continued to win percentages in front of US currency, in terms of the share in international trade.

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