

## EURO-DOLLAR RATIO OF FORCES IN THE CURRENT STAGE OF ECONOMIC-FINANCIAL CRISIS

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### 1. Introduction

Euro-dollar ratio of forces is not a simple confrontation on a monetary plan. This dispute has implications on many plans such as social, economic, global development plan, natural resources. Globalization amplifies this report and gives importance in setting the global economic leader. The pride and american economic supremacy gives the dollar power on the international market, power that is assured by the rich history of the dollar against the euro. The european currency is gaining ground, relying on the dislikes of two great powers for the US, Russia and China.

The economic recession started in the U.S. both surprised and stalled the competition between the two currencies, while giving start to reveal the true power of both currencies. Will be interesting to study the report of forces after leaving the economic crisis because in the current period on this report also act conjunctural factors.

### 2. The evolution of the euro-dollar currency rate from the introduction of euro until present time

In his first day of trade on the stock exchange in Frankfurt in January 4, 1999, the euro was at a level of 1.1789 US dollars. From that day the euro rose in value, falling below the euro-dollar parity only a year later and continued to fall until October 2000 when the new currency reached its lowest level of 0.8225 \$.

Over the year, the average exchange rate was 0.95 \$. The euro has not recovered until the introduction of euro cash in 2002, when it increased from \$ 0.90 to \$ 1.02 in late 2002. A year later reached \$ 1.24.

The appreciation of the european single currency against the U.S. dollar in May 2003 has surprised those who had bet on the american currency. International analysts felt that the United States have benefited from appreciation of the euro against the dollar, which stimulated the export of American products. The Federal Reserve gains benefits because by making the expensive imports is an important ally in the fight against deflation. Also the U.S. firms with subsidiaries in euro area and the world have benefited, whose income in dollars increased.

The main cause of the appreciation of the euro on international currency markets is the inability of the U.S. economy to resume sustainable growth process, translated by adverse developments and reserved inability of most macroeconomic indicators: increasing trade deficit, rising unemployment, reduced capacity utilization production.

In November 2006, the European currency reached its highest level against the U.S. dollar since its introduction on the market. Such, an euro was worth \$ 1.4842, the dollar depreciation came after the FED officials have estimated a growth slowdown of the world's most powerful state.

Another threshold of historical evolution of the euro-dollar ratio in 2008 was reached in April when the value of the euro reached \$ 1.5958. After a sustained trend of dollar depreciation against the euro, the end of 2009 brought the first significant correction. Between March 2009 - October 2009, Euro gained ground, the values were of 1.24 to 1.25 dollars for one euro, until at around 1.5 to 1.51.

In November, the currency pair gained the resistance level of 1.5, considered a psychological step and December marked the beginning of a new patch, as the dollar held up near the level of \$ 1.42 for one euro.

A concrete example given by Richard W. Rahn in "Times" shows us exactly the euro influence on world economy.

"In 2001, a Spanish family from Barcelona and an American family from Orlando had house which values were similar. In that year, they each bought a BMW five series and paid the same amount. Over six years, each family was 30% assessed value of the house, and the cars only worth one third of the amount paid to purchase, however the Spanish family house and car worth 40% more than the American family.

The Spanish family has become richer than the American, just because of the increased euro against the dollar. " In just a few months, the market perception on the U.S. dollar has changed 180 degrees. If last year there were some speculation on the imminent dollar crisis, by which it could lose the status of international reserve currency, in recent weeks, fiscal instability problems in Europe have eclipsed the dollar.

While the U.S. budget deficit is still enormous the economic recovery is more likely than in Europe or Japan. Fiscal deficit estimated at 1560 billion U.S. dollars or 10% of GDP in 2010, remains a negative influence on the development of the dollar. But

economists say that the absolute magnitude of debt that matters, but its relative size. With the euro zone, Britain and Japan facing growing government debt, the dollar has shown the best choice from a long list of coins with problems.

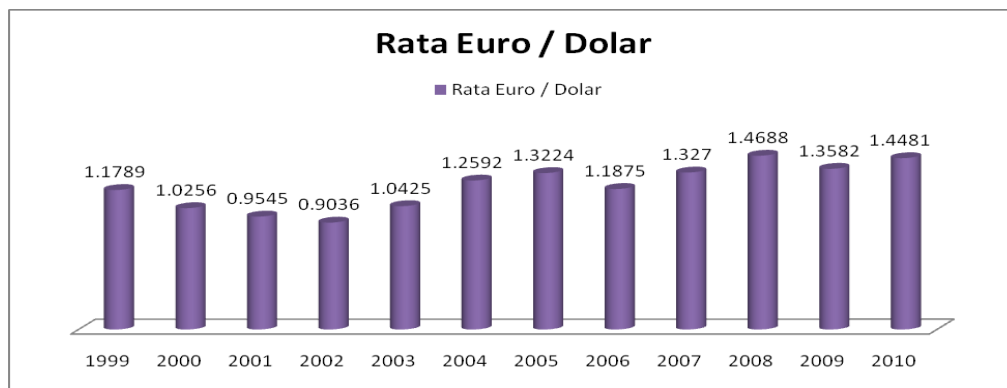
This, together with the uncertainty for the euro area could increase its attractiveness as an investment dollar. Also there are prospects that the U.S. fiscal situation will improve, particularly if economic recovery will be stronger than anticipated, thereby reducing costs and increasing economic incentives in tax revenue. It is a development deficit affected by that country's currency? Nick Bannenbroek and Vassili Serebriakov, currency strategists on currency problems, believe that the available data for the past 30 years show that there is a strong statistical relationship between budget deficits of the richest ten countries in the world and exchange rates of their currencies. For example during the first term of President Ronald Reagan in the early 80s, increasing the budget deficit did not affect the dollar because it was supported by a tougher monetary policy and a reference interest rate too high. But certainly the conditions today are different: monetary policy is more relaxed. Interest is low and deficits are much larger.

Lately more and more countries were concerned about the weak dollar, which in February and so far, lost about 17% before the euro. Europeans are the most unhappy with this situation, because a stronger European currency before the U.S. translates into cheap American products being exported to Europe, and a price increase of U.S. products exported to Europe, developments affecting major European exporters led by Germany.

Why the dollar falls against the euro? A handy explanation is that FED flooded the market with dollars, which made the dollar to devalue. In general,

when a bank prints money, the result is that the amount of money in the economy increases. If the money supply growth is not accompanied by an increasing amount of goods and services, the imbalance is reflected in rising inflation, and currency devaluation. Another plausible explanation for the devaluation of U.S. currency is that the euro has increased demand, while the

dollar demand has decreased, so the amount of euro became scarce, although the ECB has always made money. Meanwhile, the declining demand for dollars has led to oversupply the market and the dollar to depreciate. If Americans want a strong dollar, they have to restore the investor's confidence in the U.S. economy. But apparently they don't desire a strong currency at this time.



### 3. Euro-dollar balance of forces. Collision between giants

A long time, almost everyone thought that the dollar is the main currency, fixing the other currencies. A new research puts this into question. Currency markets are very volatile and do not necessarily reflect the basic principles. Lack of strength of the euro immediately after its launch in 1999, did not reflect differences in the growth or interest rates, but rather market uncertainty, towards both the commitment of Member States and to the new European central bank credibility. The strength that euro gained later shows that the currency was accepted as a global currency, rather than to prove a more performant growth.

For a currency to be considered and used as the dominant currency must meet four criteria closely linked, that implies another:

- Play a major role in international transactions and foreign trade;

- Currency is an important investment;
- To be attractive as a reserve currency for central banks;
- Play a central role as a monetary anchor in the existing system of exchange rates

For now, though it lost five percentage points from their positions, the dollar is used in making the 65% of global transactions. While the euro, although it was the winner of five percent is not only tender for about 22% of worldwide operations. Dollar strength is not only based on very strong American economy but also on the privileges that have been accorded to it six decades ago. When the dollar was invested with the function to be as good as gold standard then, gold has lost its role, the dollar remained the only means of payment in full international acceptance, strength being given by the fact that it didn't have a replacement.

A combination of factors gave more and more power with age. Thanks to international currency privileges, the

U.S. economy was and remains the only in the world that can finance its external deficits even with its own currency. Meanwhile, only the date agreed to let outsiders in the currency more than that on its own market, which involved not only responsibility but also enormous risks. Therefore, even if it was desired, the dollar couldn't be replaced as the international reserve means, that being a process that could last decades.

Forming the world's largest reserves, the dollar now enters in the composition of some countries' reserves that come strong from behind in the international competition, being or successful countries, or in possession of some huge natural resources and because they recorded large surpluses in trade their outdoor focused a substantial part of the mass of dollars circulating outside the U.S.. China, India, Russia, or Islamic oil exporting countries of Latin America are only a few. These countries continue to accumulate currency, to the extent that, due to massive earnings from exports, systematically buying currency to maintain an ongoing national currencies to ensure their own competitive goods. China, for instance, with its foreign exchange reserves amounting to the equivalent of 1.100 billion dollars, 70% of them are told to be in U.S. dollars. The fate of the dollar has become dependent on staff movements and political and economic interests of others, not all of the U.S., in fact even some U.S. enemies or competitors. Thus, in response to U.S. pressure on Iran, it has decided to change the euro component of its reserves in U.S. dollars. And also decided to do oil transactions only in euros. Venezuela who is antiyankee and tried even a socialist experience in Latin America, took this measure only in terms of reserves, because it sells oil directly to U.S. and cannot convert the operations in another currency. Gulf oil countries seek a formula for monetary union to enable

them to reduce current addiction for the American coin.

China and Russia use the threats of partially switching their reserves from dollar to euro in U.S. strategic games. It thus appears that decisions taken in Washington on a strong dollar or, alternatively, low may be simply annihilated by the political and economic movements from other parts of the world, that control larger quantities of dollars than the U.S. authorities.

According to current statistics, the dollar still holds absolute hegemony. Moreover, the euro became the currency of international reserve of great importance, not only because earlier all currencies in the euro area, regardless of where they were held, were converted into euros on January 1, 1999. Not all currencies have the potential to become a reserve currency, but euro is accepted as a payment method in an area large enough to represent the long term rival to the U.S. dollar. The euro area is the second economy in the world, in size. She is responsible for a greater share of world trade than the U.S. is.

Contrary to general belief, the ability of euro to replace the U.S. dollar as the currency for storing world coins depends on some statistical comparisons at all simple:

- First, the emergence of a reserve currency depends not only on levels of international trade, but their growth rates. As a percentage of the U.S. economy, international trade grew at a rate higher than the figures of the EU economies. Evolution is likely ahead! This trend will continue or not?

- Secondly, the size and depth of global capital markets is crucial in terms of keeping the status of currency reserves, compared with trade in goods and services.

The combined size of securities markets in the U.S. and bonds is more than twice the euro zone markets. U.S. domiciled twice as many listed companies. Demand for U.S. financial

assets drives an enormous demand for U.S. dollars, which are required to purchase those assets. Will businesses and investors in Europe develop, following the introduction of the euro, an appetite for shares and securities in the private sector appetite leading European capital markets at unprecedented size? Remains to be seen.

Long-term changes in fiscal and overall economic welfare of Europe in comparison with the U.S. will have a direct impact on international portfolio diversification into euros. The most worrying feature for investors in U.S. dollars is the history of 16 years current account deficits. If this trend continues, which means low savings and high costs, then investors worldwide will watch the euro as a more attractive source of long-term value. Moreover, the most worrying features of the EU for euro investors are represented by its structural rigidities and numerous unemployment problems.

The euro has already acquired from the U.S. dollar market a share in terms of currency reserves, but we can not aspect a major international status of the dollar in the near future.

One way of looking at the importance of coins is to see how they are used as reference currency for other countries. Works on exchange rate regime, focused on the de facto classification of these regimes. They confirmed the perception according to which the dollar is the most interesting and widely used as a reference currency than the euro. Carmen Reinhart and Kenneth Rogoff have listed 45 countries (outside U.S.) that use and set their currency and coordinate their currency to U.S. dollars based on the period 1999-2001. By comparison, they identified only 29 countries (outside the euro area) that have the euro as a reference. Eduardo Levy-Yeyati and Federico Sturzenegger identified 99 countries that had the dollar as a reference currency in 2000, including 31 countries that were fixed on the dollar and 21 with

intermediate regimes. They also list 17 countries outside the euro area anchored to the German mark, French franc 19 countries using it as the currency of reference, and only two that had the euro reference. Overall, the study identified 52 countries anchored the U.S. dollars and 33 to the mark, franc and euro.

The Annual Report over the Regulation and Restrictions of the Exchange Rate of IMF for 2004 shows a stronger balance: 28 countries anchored to the dollar and 24 anchored to the euro.

Research done by David Cobham, Heriot-Watt University, brings a new approach. It examines trends in exchange rates and monetary items not declared. The research uses three measures for rate exchange rates during certain periods. November 1998-June 2001 period is characterized by a strong appreciation of the dollar and a depreciation of the euro. June 2001 - shows just the opposite december 2004 and January 2005-December 2006 is a period of stability - euro / dollar rate has fluctuated but reached a puct close to home.

It was found that things do not change for the strong and powerful anchors for the periods taken into account, whether or not the euro has appreciated. If we exclude the period 1999-2001, more coins appear to be weak anchors for the dollar, but strong and very strong for the euro. The difference between previous studies and this one is that several countries have the euro as reference currency, but that is anchored in U.S. dollars less than previously thought.

Stable anchors can be considered those currencies that have remained anchored either on euro or the dollar, both in periods of appreciation and depreciation. Thus, in the stable anchor for the dollar category enter : small countries in the Western Hemisphere and Middle East countries, with exceptions such as China, Malaysia and India, Mexico and Vietnam (the category of low

anchors). Stable anchor for the euro are EU members, other European countries near the EU and countries of CFA (African franc zone). The exceptions are New Zealand and countries of the Common Monetary Area in Southern Africa who are poor anchors. A secondary finding of the research is that countries anchored to U.S. dollars are more willing to change policy than those anchored to the euro. First of all, two countries anchored strongly to the dollar in 1999-2004 were only weak anchors in 2005-2006.

The projection of the dollar as a global currency could be threatened. The euro was accepted by everywhere and its relative strength and stability could support a possible dominance. According to the economist Bergsen, director of the Institute of International Economics, Euroland is already comparing with the U.S. in terms of production, trade and stocks and will become increasingly stronger with new members integrated. While Europe will become a worldwide creditor, the USA has net debt of \$ 2000 billion. If the ECB will enhance the credibility of the euro, there will be transfers of private investors and central banks from dollars into euros between \$ 500-1000 billion. As a conclusion, the euro will become on a medium term, the U.S. dollar rival or partner.

#### **4. Conclusion: Prospects for the euro-dollar ratio trends**

Euro history is brief, very brief reported to the standards of international monetary history, but nobody can doubt the potential of the new currency. The degree of price stability in the euro is unprecedented, Europe's financial markets are stable and liquid. An international currency is the tend to naturally become a monopoly.

Undoubtedly, the euro will have a long way in order to attain the status of major world currencies. This is because

the Euro - U.S. dollar conflict is not just a beauty contest, but is related to more concrete economic factors.

The balance of the first decade of existence shows that the euro did not fulfill any extreme prophecies of those who warned that this is a serious error, which will increase irreconcilable differences between economies that will adopt the single currency, but it did not open nor was the growth and convergence of unprecedented economic euro area as the most enthusiastic promoters had hoped. Reporting to the major objectives of economic and monetary union in Europe, ensuring macroeconomic stability, promoting growth and creating jobs and enhancing the cohesion and convergence between Member States shows that, overall, the euro had a positive development and the single European currency contribution was undoubtedly beneficial.

A hard currency satisfies the pride of the nation, but is not appropriate economically because it brakes the exports. Americans have lived very well for decades with a weak dollar. For many exporting countries in Europe a weak euro is a better choice than a strong one. This situation is caused by the fact that exports to Western European countries is the main factor determining the growth and the conditions in which many countries (Asia, Latin America, Russia), decreases its imports.

Significant gain for the euro exchange rate against the dollar and euro as reserve currency growth among central banks is a challenge to the dominance of the dollar. The decline of the dollar exchange rate against the euro raises the question whether the dollar will follow the historic British pound which lost its status of international reserve currency.

Since September 2007, Reuters reported that former U.S. Federal Reserve Chairman Alan Greenspan said that it is quite conceivable that the euro replace the dollar as the dominant

reserve currency, or be as important as a reserve currency. Econometric analysis performed by Jeffrey Frankel and Menz Chinnor indicates that the euro could replace U.S. dollar as the major reserve

currency by 2020 if: dollar depreciation trend continues in the future or if the EU members as Britain should adopt the euro by then.

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