<u>EUROZONE: ITS CURRENCY UNDER ASSAULT</u>

(c) Leo Haviland, 646-295-8385 July 9, 2012

"So much trouble in the world…
So you think you have found the solution
But it's just another illusion"
"So Much Trouble in the World", Bob Marley and the Wailers

CONCLUSION

The bloody retreat in the Euro currency that began in spring 2011 signaled a slowdown in the worldwide economic recovery that commenced around early 2009. The Euro FX's mournful slump does not merely reflect Europe's sovereign debt and banking crisis. In an interconnected international economy, Europe does not fight alone. Thus Euro FX weakness underscores the ongoing global economic disaster that emerged in 2007. The Euro currency's further breakdown since late winter 2012 warns audiences of growing worldwide economic feebleness. The Euro FX will continue to depreciate.

EURO CURRENCY: UNDER DEPRECIATED

First, examine the widely-watched Euro FX cross rate versus the US dollar. As the wonderful Goldilocks Era of unending prosperity rolled to its end, and not long after the final key high in America's stock marketplace (S+P 500; 5/19/08 at 1440), the Euro FX peaked at 1.6038. It decayed to 1.2330 on 10/28/08 (China's Shanghai Composite stock marketplace bottom 10/28/08 at 1665) as the economic crisis accelerated. It achieved an important low as the green shoots economic recovery began to spring. Note its rally from 3/4/09 at 1.2457, about the day of the major low in the S+P 500 (3/6/09 at 667).

The economic universe, either in Europe or elsewhere, did not collapse when the Euro FX reached a major low on 6/7/10 at 1.188. However, sustained accommodative central bank policies, including the advent of the Federal Reserve's glorious second quantitative easing foray in late summer/autumn 2010, helped to fortify many economies.

The Euro FX rocketed to a crucial top against the dollar on 5/4/11 at 1.4940. Compare the timing of major highs in the European stock marketplace. The Stoxx Europe (SXXP on Bloomberg) final high on 5/2/11 at 285.2 neighbored its slightly earlier pinnacle on 2/18/11 at 292.2. Compare the date of the initial peak for the S+P 500, 5/2/11 at 1371.

The Euro FX's 1/13/12 wintertime low at 1.2624 hovered above support reached at the advent of the Fed's second round of money printing (Euro FX 1.2588 on 8/24/10; notable S+P 500 bottom at 1040, which held on 10/4/11 at 1075). However, despite European Central Bank easing and assorted European (and other worldwide) political and economic summit meetings, the Euro FX backtracked steadily since its very important 2/24/12 interim top at 1.3487. Compare the time of the European equity high (3/16/12 at 272.9) and the S+P 500 peak (1422 on 4/2/12) with this late February Euro FX one. Note that in the commodity complex as well, the broad GSCI reached its 717 plateau on 3/1/12. The Euro FX faded to 1.2288 on 6/1/12. Although it managed an exciting rally for a brief period, it then violently fell. By the end of last week, the Euro FX stumbled down to its early June low.

What key support level relative to the US dollar will next be attacked? Again recall the 6/7/10 bottom at 1.188. A 20 percent swoon from 5/4/11's 1.4940 is 1.195. The NYTimes on 1/1/12 (p6) recalled that the Euro started as a trading currency in 1999 at 1.18. A 25pc fall from 1.6038 is about 1.2030. Thus watch around 1.18 to 1.20. The sustained breach of this range probably will encourage (confirm) stock marketplace weakness. Then monitor around 1.12 (a 25pc fall from 1.4940) to 1.16 (11/15/05 trough 1.1640).

****

European policy makers and some other viewers likewise pay attention to measures of the real European effective exchange rate (CPI deflated; first quarter 1999 equals 100; "EER"). This effective exchange rate probably is superior to cross rates (such as the one against the US dollar) as an indicator of Eurozone currency strength/weakness (and the Eurozone crisis). The European Central Bank provides data for the 17 Euro area countries against a group of 20 trading partners.

The EER established its major high in April 2008 at 111.8 (monthly average). The low during the October 2008 to April 2009 period, during which the Euro FX cross against the US dollar touched lows, was November 2008's 102.8. However, after marching up to 111.2 in October 2009 (thus bordering on the April 2008 pinnacle), the EER started traveling downhill. On an effective exchange rate basis, it made an important bottom in June 2010 at 98.1. Although it retrenched and climbed to an April 2011 height at 103.4, this April elevation only slightly exceeded the November 2008 depth.

Under almost relentless assault, the Euro EER measure has crumbled since April 2011. This sustained bear move thus emphasizes the weakness of the global economic recovery. For June 2012, this real effective exchange rate is about 94.8. This decisively breaks beneath the key floor of June 2010 at 98.1 (the December 2011 level also was 98.1; a 10pc fall form April 2008 is 100.6). The Euro effective exchange rate erosion in very recent months, and particularly the shattering of June 2010 support, reflect both the fearsome Eurozone crisis (and recession in many European nations) and confirm the deteriorating prospects on the international front. "In the IMF's updated assessment of the world economy, to be released ten days from now, the global growth outlook will be somewhat less than we anticipated just three months ago. And even that lower projection will depend on the right policy actions being taken." Speech on 7/6/12 by Christine Lagarde, Managing Director of the International Monetary Fund, "Partnership & Recovery- The Shared Path to Global Stability & Growth".

The ECB provides daily data for the nominal EER. The average for the first week of July 2012 was about 96.6, down about half of one percent versus the 97.1 calendar June 2012 average. Based on this .5pc decline in the nominal EER, the month-to-date July 2012 real EER average is about 94.3.

What are important support levels for this important currency benchmark? A ten pc slide from April 2011's 103.4 top reaches about 93.1. This is close to present levels and therefore readily within reach. The 90.0 to 86.5 range probably will face a fierce charge. A twenty percent dive from the April 2008 peak is 89.4, with the important February 2002 low 86.6. A 20pc break under April 2011's barrier gives 82.7; the major low of October 2000 was 82.6.

****

Further significant depreciation of the Euro FX may well turn out to be part of the solution for the Eurozone's ongoing sovereign debt (banking; economic; debt, leverage; political) crisis.

KEEPING IT REAL: THE UK, THE USA, AND JAPAN

The Bank of England's Sterling broad effective exchange rate index ("ERI", monthly average; January 2005=100) is a worthy indicator of the Pound's overall strength.

In June 2012, this broad effective exchange rate index was 82.5. The current ERI level therefore stands well under the January 1981 pinnacle about 108.0, as well as other peaks of the past decade. Note April 2000's 102.0, July 2004's 103.3, and the January 2007 105.1/July 2007 104.7 double top. The July 2007 height is noteworthy, for it was reached as the worldwide financial crisis emerged. The index collapsed from around 89.0 in September/October 2008 as the financial crisis accelerated.

A twenty percent fall from the July 2007 high is 83.8. In regard to that 20pc dive level, recall June 2009's minor top at 83.7, as well as May 2012's 83.2 high nearby it. The current index level rests ominously under this June 2009 minor top.

Is the British economy any stronger than that of the Eurozone (Europe) in general, or significantly independent of it? How wonderful is Britain's current fiscal situation? The UK recently embarked on yet another desperate round of money printing. To what extent is- or will be- the British Pound substantially independent of major Euro FX trends?

A critical support band for the British Pound effective exchange rate index exists from 79.4 down to 74.5. The recent noteworthy low is July 2011's 78.1; that lurks just beneath the important bottom of February 1985 at 79.4 (also see October 1986's 79.3 index low). The summer 2011 valley remained above key lows of 76.8 January 2009/76.9 March 2009 (compare the timing of the S+P 500 bottom and Euro FX lows), as well as March 2010's interim low at 77.0. The major floor in February 1993 around 74.5 and the final trough in December 1995 at 75.4 underpin these 2009/10 depths.

Deterioration in the Sterling effective exchange rate toward that 79.4/74.5 defensive corridor probably would be bearish for the Euro FX. This British Pound range probably will be challenged as the Euro FX heads lower alongside increasing global economic weakness.

****

The broad real trade-weighted United States dollar (monthly average; "TWD") reached its all-time low in July 2011 at 80.6. However, the TWD gradually has strengthened, with May 2012 at 85.0 and June 2012 at 86.2. This important exchange rate variable thus has climbed above prior major support around 84.0. The October 1978 low was 84.1, with July 1995's 84.0. The April 2008 TWD bottom was 84.1; compare the timing of the S+P 500's final high in May 2008 at 1440. Further rallies in the TWD probably will coincide with (confirm) bear moves in the Euro FX/dollar cross rate and the Euro FX effective exchange rate (as well as with declines in the S+P 500).

****

Japan probably does not want the Yen to appreciate much more, whether against the dollar (note the Y75 rampart), or on an effective exchange rate basis. Suppose nevertheless that the "Yen in general" continues to rally. What is a key near term level for the Japanese Yen's effective exchange rate (monthly average, Bank of England data)? Watch the January 2012 high at 185.6. Despite a decline to 171.5 in March 2012, the Yen advanced to 181.7 in June 2012. The Yen effective exchange rate rally since March 2012 is a bearish warning flag for the Euro FX (and for the world economy).

****