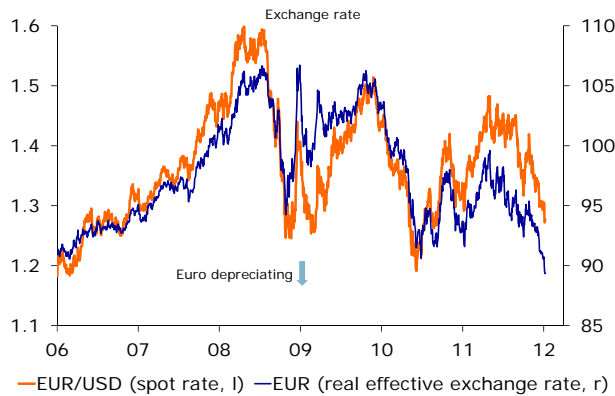




# Is a weaker euro desirable now?

*The depreciation of the euro may not result in the much-needed boost to the region's net exports. However, it is making life difficult for households. The rise in the price of oil expressed in euros to near record highs is adding to eurozone's economic woes.*

**Figure 1: Euro weakening**



Source: Reuters EcoWin

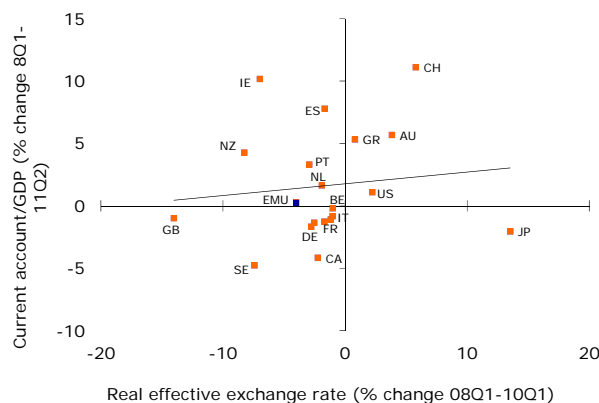
Governments usually like to boast in public that a strong and stable currency is highly desirable. Behind closed doors, however, they admit that a slight depreciation of the currency is actually needed to boost net exports. At least, that is what economic theory predicts.

So should we welcome euro's depreciation (see figure 2)? Not necessarily. Economic reality suggests that the relationship between net trade and the exchange rate is not as strong as perceived, especially during abnormal macro conditions. Figure 2 shows that a region such as the EMU, which experienced a currency depreciation in the period 08Q1-10Q1, has seen no improvement in its current account balance, while a country like Switzerland has seen its

current account surplus surge amid a strong appreciation of the franc. Of course, some members benefit more from euro depreciation owing to their outward orientation. For example, Germany profits more from a weaker euro given that around 60% of its exports are destined for outside the eurozone, while for Spain that figure is only 45%.

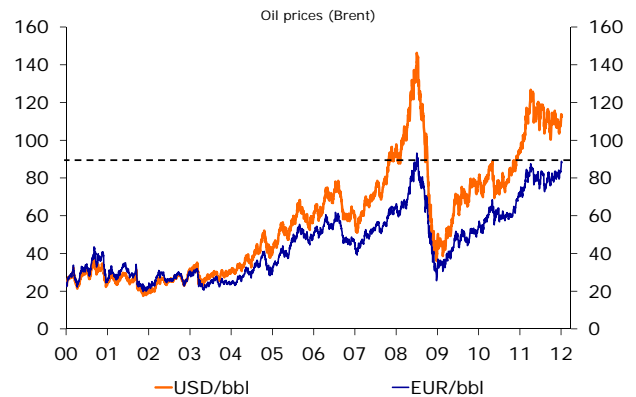
But a weaker euro does not come without costs. The most important cost of the euro depreciating is that the cost of imported goods and services will rise. In particular, the sharp rise in Brent crude oil price expressed in euros, being a touch below its all-time high reached in July 2008, is worrying. This will put downward pressure on households' purchasing power in the euro area while they are facing multiple headwinds already (e.g. austerity measures by the public sector and less favourable job/income prospects). This will undoubtedly add to eurozone's economic woes.

**Figure 2: Current account balance vs REER**



Source: Reuters EcoWin, Rabobank

**Figure 3: Price of oil is rising in euros**



Source: Reuters EcoWin

# Is a weaker euro desirable now?



Rabobank

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