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## Euro's Gain Hurts Exports as Spain Sweats Biggest Rally in Year

By Matthew Brown and Paul Dobson - Jul 19, 2010

The euro's biggest rally in a year is threatening exporters in Europe's weakest economies as they grow more reliant on international sales for growth.

The 9.5 percent gain to \$1.3008 from a four-year low on June 7 reduced speculation that the region's debt crisis would break up the single currency. At the same time, the head of Spain's Exporters Club says the stronger euro will make it harder to counter a "paralyzed" domestic market. [European Aeronautic, Defence & Space Co.](#), the maker of Airbus planes, says at \$1.20, the currency still wouldn't be weak. Salvatore Ferragamo SpA says it's counting on exports to boost sales as austerity measures crimp demand from France to Italy.

Even after declining 14 percent during the past eight months as mounting deficits threatened the region's economic recovery, the euro remains stronger than the \$1.184 average since its introduction in 1999. The currency is overvalued by 14 percent, according to purchasing power data compiled by Bloomberg. Foreign-exchange strategists say the result will be a weaker euro.

"If the euro continues to appreciate it would be a disaster for the euro zone," said [Ken Wattret](#), chief euro-area economist at BNP Paribas SA in London. "The worst-case scenario for the euro area is you have a sustained exchange-rate appreciation because it would snuff out the recovery."

The euro advanced 2.29 percent last week, the biggest gain since May 2009, to \$1.2930. It traded little changed today at \$1.2946 as of 8:36 a.m. in London.

### Fair Value

The 16-nation currency traded below its fair value from its inception until the first quarter of 2003, and has remained above that level ever since, according to Bloomberg purchasing-power data. The methodology compares current levels of inflation with the 18-year period between 1982 and 2000 to determine a currency's fair value.

The advance may curb profit growth, which analysts say will be the fastest in six years, according to [Gareth Evans](#), an equity analyst at Deutsche Bank AG. Earnings for companies in

the [Stoxx Europe 600 Index](#) are forecast to rise 76 percent this year, the most since a more than 80 percent jump in 2004, according to more than 11,000 estimates compiled by Bloomberg.

The Stoxx 600 has dropped 3.9 percent since reaching a six-week high on June 21, as the euro rallied 4.7 percent during the same period.

“If the euro carries on moving higher, then people will start to worry about the impact on earnings,” London-based Evans said. “At the moment people are viewing the weak euro as a support.”

#### No Justification

The euro will decline to \$1.20 by the end of 2010, according to the median of 47 analyst estimates compiled by Bloomberg. It will finish next year at \$1.22, the median forecast of 30 analysts shows. None of the strategists project the euro will climb above \$1.42, while the most bearish prediction is for 98 cents, the data show.

The currency is “10 to 15 percent overvalued,” said [Mark Farrington](#), who oversees \$5.8 billion as head of currencies at Macro Currency Group, a unit of Principal Global Investors Europe Ltd. in London. “There’s no justification for it to be overvalued in this part of the business cycle, and in light of the structural problems facing the euro zone as an economic growth area.”

Bets on a drop climbed to an all-time high earlier this year as so-called peripheral nations from Greece to Spain struggled to sell debt to trim their deficits.

#### Greek Bailout

Greece abandoned attempts to auction bonds in April and turned to the European Union and Washington-based International Monetary Fund as the [yield](#) on its two-year notes soared to almost 19 percent. Spanish borrowing costs reached a two-year high at a sale of five-year notes on May 6 after Standard & Poor’s cut the nation’s credit rating amid concern that plans to address the budget may not be fulfilled.

[Bond yields](#) in the peripheral nations began to retreat after the EU and the IMF announced an aid package worth almost \$1 trillion on May 10, easing concern governments in the region would default.

Rising demand at bond auctions by Greece, Spain and Portugal in recent weeks and decreasing bets by hedge funds on a drop in the euro suggest that the region’s sovereign debt crisis won’t lead to a breakup of the shared currency.

Greece sold 1.625 billion euros of 26-week Treasury bills July 13 at an interest rate of 4.65 percent in the first auction since getting rescued in May. The government will pay less than the 5 percent charged by the EU for its bailout funds.

### Bond Sales

Spain sold 3 billion euros of 15-year bonds on July 15, attracting bids for 2.57 times the amount offered, up from 1.79 times in April. A day earlier, Portugal sold more 2012 and 2019 securities than it had indicated on July 8.

The difference in the number of bets by hedge funds and other large speculators on a decline in the euro compared with wagers on a gain, known as net shorts, fell to 27,050 on July 13 from a record 113,890 on May 11, data from the Washington-based [Commodity Futures Trading Commission](#) showed.

The euro may keep strengthening as investors focus on a slowdown in the U.S. recovery, according to HSBC Holdings Plc. [Sales](#) at American retailers fell in June for a second month, the Commerce Department said July 14. The U.S. [trade deficit](#) widened in May to the highest level in 18 months as a stronger dollar spurred a bigger increase in imports than exports.

The U.S. currency reached a level weaker than \$1.30 versus the euro for the first time since May last week as a gauge of American consumer confidence slid to the lowest level in a year and revenue at Charlotte, North Carolina-based [Bank of America Corp.](#), Citigroup Inc. in New York and [General Electric Co.](#) of Fairfield, Connecticut, trailed analysts' estimates.

### Industrial Production

While unemployment in the U.S. stands at 9.5 percent, Germany's [jobless rate](#) was 7.7 percent in June. German industrial production increased 2.6 percent in May, more than twice the pace economists had estimated, according to figures the Economy Ministry in Berlin released on July 8.

Bayerische Motoren Werke AG of Munich, [Daimler AG](#) of Stuttgart and Volkswagen AG's Audi unit in Ingolstadt are boosting deliveries amid demand from the U.S. and China.

"The market has been looking at the euro-negative story from one side of the coin," said [Paul Mackel](#), director of currency strategy at HSBC in London. "They should be looking at it more fairly, and the situation in the U.S. isn't that fantastic and now some dollar-negative sentiment is washing through."

### Germany Ahead

The rest of the region isn't keeping up with the euro- area's biggest economy. [German exports](#) surged 39 percent in May from a year earlier, outpacing Spain by eight percentage points and Portugal by 21 percentage points, according to the EU's statistics office in Luxembourg on July 16.

Exports in the euro area may increase 9 percent this year and 7.6 percent in 2011, after a drop of 13.2 percent in 2009, according to a July 9 report from Deutsche Bank. The Frankfurt- based lender forecasts that private consumption will be unchanged this year and increase 0.1 percent in 2011, following a drop of 1.2 percent last year.

Balbino Prieto, chairman of Nova Internacional, an advisory firm for Spanish exporters, said a stronger euro would make it harder for companies from his country to boost sales abroad.

#### 'Domestic Market Paralyzed'

"Germany has an advantage, which is that its products have much greater added value than ours, so people pay more for the brand," said Prieto, who is also chairman of Spain's Exporters Club. "With the domestic market paralyzed as it is, our companies have to go abroad to sell their products. To break into new markets, a strong euro doesn't help." Prieto said he hadn't yet noticed the effects of the stronger currency because the appreciation was recent.

The gap between German export growth and the rest of the region underscores the challenge of using the euro, the successor to the deutsche mark, as the legal currency for 16 nations with divergent economies.

While the German economy will expand 1.9 percent this year, according to the median estimate of 20 analysts surveyed by Bloomberg, Spain is projected to contract 0.5 percent and Greece by 4 percent. France, the region's second-biggest economy, will grow 1.3 percent, forecasts show.

The [DAX Index](#) of 30 German stocks gained 1.4 percent this year, while Spain's IBEX 35 Index tumbled 16 percent and Greece's ASE Index sank 27 percent. France's CAC 40 Index dropped 11 percent.

#### Stronger Euro

Germany accounted for 27 percent of the euro-region economy in the first quarter of 2010, compared with 31 percent of the original 11 members of the single currency at the start of 1999. Estonia will join the euro area as its 17th member next year.

"The euro is not the new deutsche mark," said [Simon Derrick](#), chief currency strategist in London for Bank of New York Mellon Corp., the world's biggest custodian of financial assets. "The euro is the sum of all its parts, and if that's true then from a valuation basis it should be below the average price of the last decade."

Of the 25 euro-region companies that complained about a stronger euro during earnings conference calls monitored by Bloomberg over the past 18 months, 15 were French, five were based in Italy, three were Greek and two were from Spain.

Currency fluctuations had a “very positive exchange rate impact, which might increase in the course of the year,” [Jean-Paul Agon](#), chief executive officer of Paris-based L’Oreal SA, the world’s biggest cosmetics maker, said on July 12, when the euro was at \$1.2596. Shoemaker Ferragamo of Florence, Italy, expects “a very good” 2010 as a weaker euro boosts sales and margins, CEO [Michele Norsa](#) said on July 1.

“It was good for us when the euro went to more reasonable rates, because we don’t think the euro is weak when it goes to \$1.20,” [Louis Gallois](#), CEO of Paris- and Munich-based EADS, said in a July 17 interview in London. “We see that the euro is strengthening now, we have to adjust. That’s life for us.”

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