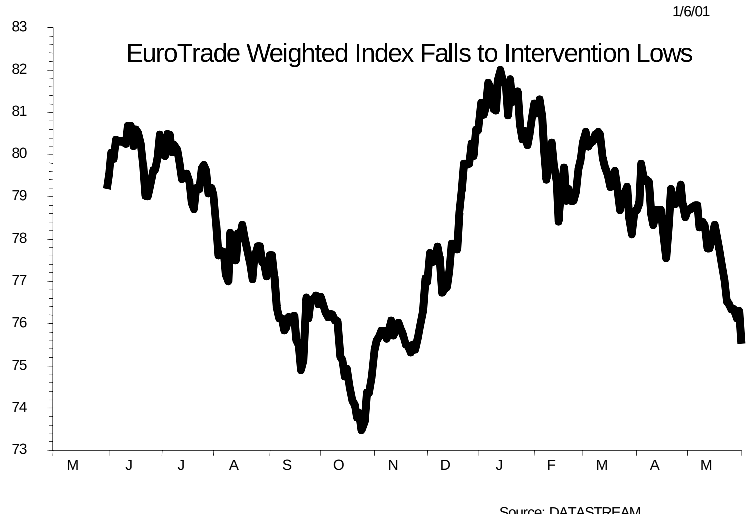
ECB Must Abandon Policy of Neglect

The euro has fallen to its level that first triggered intervention by the European Central Bank last September. At that stage, the euro was trading close to $0.87 but on a trade weighted basis, the euro index stood at 75.11 (base 1990=100) on 21 September (the day prior to intervention). The index now stands at 75.5.
As the chart below shows, a strong downtrend is evident. **Only intervention by the ECB will put some sort of a floor under the euro.**



On Thursday, the ECB President, Wim Duisenberg, appeared to rule out intervention when he remarked that "it (the exchange rate) only becomes important if it no longer supports our inflation target in a serious way- and that's not the case". His comments sent the euro lower. His comments are surprising in view of the fact that the eurozone's inflation rate is close to 3%. This is 1% above the ECB's inflation target. The weakness of the euro must increase the risks that inflation will increase in the months ahead.

Faced with growing evidence that the rate of economic growth is slowing in the euro area to 2% and the apparent lack of official concern about the performance of the currency, the risk has increased that the euro will hit new all-time lows against the dollar and sterling. This could see the euro fall to $0.80 or lower and to below £0.57. Against the Irish pound, this could mean levels of $1.015 and £0.72 respectively.

The ECB's management of the currency and its communication with the market are worrying. From an Irish perspective, the weakness of the euro increases inflationary pressures in the economy and creates further exchange rate uncertainty for the corporate sector. Intervention by the ECB will not change the direction of the euro but would act as a market support until the euro area can advance a more coherent economic strategy.

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