

Where is the Euro Heading?

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I- SAILING THROUGH RAGING WATERS

The shadows of the “Euro zone crisis” have continued to haunt the old continent up until our present day, staining the Euro area’s economic, social, and political canvases and fueling the need for prompt policy actions. More particularly, economic growth in the Euro zone remains hindered by the high unemployment rates, frail demand, financial market fragmentation, and weak banking sector balance sheets, only to name a few.

In light of such a grim environment, the Euro currency did not escape the claws of the economic slowdown, displaying signs of volatility against various currencies. Said volatility was, in fact, the fruit of the European sovereign debt crisis and macroeconomic woes on the one hand, and the long-simmering debate surrounding the proclamations and actions of policy makers and rating agencies on the other, and this according to many renowned economists.

In fact, and after having burgeoned for seven consecutive years, the Euro currency’s exchange rate against the US Dollar succumbed to the grip of the global financial crisis in the years 2009 and 2010, before embarking on a roller-coaster journey during the following years. In figures, the Euro’s exchange rate against the greenback plummeted from 1.4709 in 2008 to 1.3942 in 2009 and a much lower 1.3275 in the year 2010¹. The Euro’s swoon during said period was first triggered by the rising public fury in Greece against the previous government with regards to matters of spending and corruption, which led to “an emphatic snap general election victory” of the Socialists during the month of October 2009, followed by the release of official data uncovering that the country was suffering of a EUR 300 billion worth public debt, the highest level in modern history. Greece’s debt-to-GDP ratio accordingly peaked at 113% in 2009, exceeding by far the 60% threshold required for Euro zone nations. In this context, international rating agencies were impelled to downgrade Greece’s sovereign and banking sector ratings notwithstanding ex-Prime Minister Mr. Papandreou’s denial of any possible default by his country. Simultaneously, fears of an increasing public debt burden in various European Union nations emerged in November 2009 amid the Dubai sovereign debt crisis, pouring additional pressure on the Euro’s exchange rate. This bleak picture was further exacerbated in 2010, with Greece’s borrowing costs spiking to new record highs. Greece was also criticized for having revised its 2009 deficit-to-GDP ratio from 3.7% to 12.7%, exceeding the permitted revision ceiling for EU nations by more than four times. The country’s 2009 deficit-to-GDP metric was later fixed at a much higher rate of 13.6%. As Greece was on the verge of resorting to an austerity plan and to reduce its governmental spending, strikes and riots shook the Greek territories in protest against such measures. In this perspective, the Euro zone members and the IMF had jointly consented to grant the Greek government a safety net aggregating to EUR 22 billion, before agreeing on a EUR 110 billion bailout package. Other peripheral economies came into the spotlight in the year 2010, namely Ireland, Portugal, and Spain. The Euro zone members and the IMF have accordingly approved an EUR 85 billion bailout package for Ireland, coupled with stringent austerity measures from the country’s side.²

The Euro currency later slightly appreciated against the Dollar in the year 2011 to reach 1.3924, before regaining its downward twirl the next year to 1.2858³. In fact, the Euro zone’s finance ministers have engineered and launched a permanent bailout fund in February 2011 named the

¹ Oanda

² Thomson Reuters Datastream, Reuters EDREF - BBC, “*Timeline: The Unfolding Eurozone Crisis*”

³ Oanda

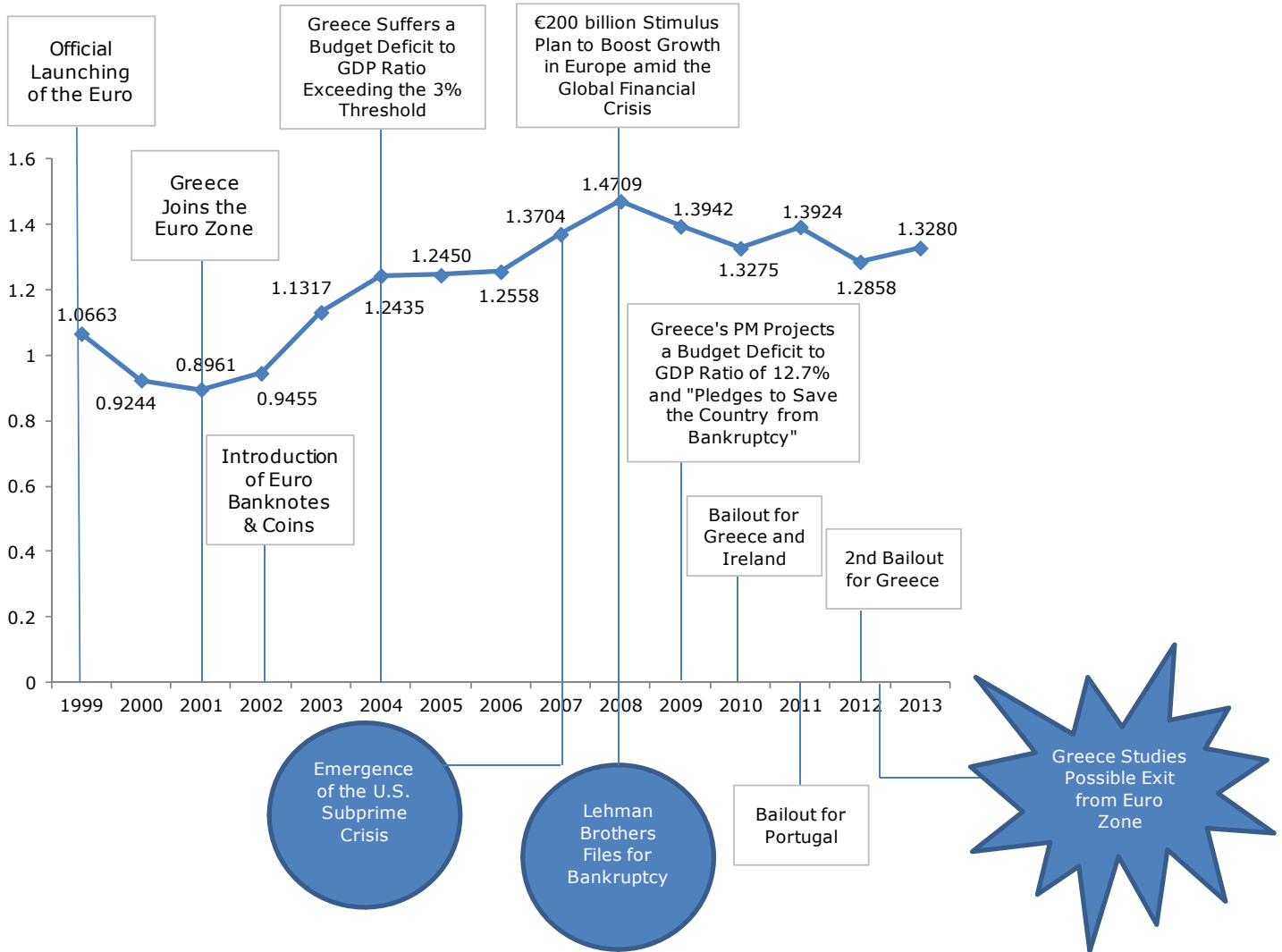
“European Stability Mechanism”, with a total size of around EUR 500 billion. The Euro zone members and the IMF also agreed on a EUR 78 billion bailout for Portugal in May 2011, and on a second bailout package for Greece of EUR 109 billion allocated over \$155 billion and GBP 96.3 billion in the summer of that same year. The latter was approved “to resolve the Greek crisis and prevent contagion among other European economies”, and was accompanied by the adoption of a new set of stringent austerity measures by Greek authorities. The ECB later announced its decision to purchase Italian and Spanish government bonds in an endeavor to tame the rally in the related countries’ borrowing costs and avoid a wider dispersion of the sovereign debt crisis. It is worth noting, in this context, that the yields on Italian and Spanish government bonds had skyrocketed throughout the year, while those on German government bonds sank to record lows. Both Italy and Spain have, however, passed various decisions to limit their budget deficits, while Spanish authorities considered requesting a bailout package. As optimism surrounding such a step faded, Spanish borrowing costs peaked to their highest level since the launching of the Euro currency in the year 1999. In this perspective, Standard & Poor’s (S&P), the international rating agency, downgraded Italy’s sovereign debt rating from “A+” to “A” during the last quarter of 2011, with the IMF downwardly revising its growth projections for the Euro zone, warning of an upcoming “dangerous new phase”. In parallel, the European Central Bank announced its decision to structure emergency loans that aim at supporting banks in need, while the Bank of England injected some GBP 75 billion in its economy under the umbrella of a quantitative easing (QE) policy. The combination of all of the aforementioned events, coupled with investors’ growing fears and the rising public debates, have dragged the Euro zone’s financial markets and stock prices into a downward spiral. Market sentiment, however, improved when French and German authorities reached a consensus on the set of measures needed to resolve the prevailing crisis, accompanied by a substantial bailout package granted to the Franco-Belgian bank Dexia, which investors deemed as a sign that authorities are willing to support ailing banks back into growth. By the end of October 2011, European policy makers had reached a “three-pronged agreement” geared towards resolving the crisis. After such a frail ray of hope towards a potential recovery from the sovereign debt crisis and the shy appreciation in the Euro currency’s exchange rate, the region plunged back into the pit in the year 2012, with S&P downgrading the sovereign rating of nine Euro zone countries and that of the EU bailout fund in January of that year. Greece also had to opt for additional spending cuts in order to receive its bailout funds, the thing which sparked public outrage in the country. The crisis’ epicenter also witnessed a majority vote against the bailout agreement, with the efforts to form a coalition government failing. Various statistics were released in the first quarter of 2012, depicting a contracting GDP and a record-high unemployment rates in the Euro zone. Said statistics were paradoxically met by encouraging retail sales figures, mirroring what was labeled as “tentative signs of recovery”. The second half of the year 2012 remained quite bitter, with concerns that France and Italy might need a bailout surfacing. As for Greece, new votes came in favor of the austerity plan in June 2012 as rumors of a possible exit from the Euro zone started circulating⁴.

The following chart illustrates the historical evolution of the Euro’s exchange rate against the U.S. Dollar since its inception in the year 1999, along with the main events which have marked its journey⁵:

⁴ BBC, “*Timeline: The Unfolding Eurozone Crisis*”

⁵ Oanda - Thomson Reuters Datastream, Reuters EDREF - BBC, “*Timeline: The Unfolding Eurozone Crisis*”

Historical Snapshot on the Evolution of the EUR/USD Exchange Rate



Source: Oanda, Reuters, BBC, Credit Libanais Economic Research Unit

II - A QUEST TO REACH THE SHORE

The Euro area has been struggling to surpass its latest debt crisis which has been looming since early 2009, with various EU nations failing to comply with the Maastricht norms and requirements and consequently striving to remain part of the Union. In light of the sluggish recovery, which has been accompanied by a relatively low interest rate environment during the last couple of years, the European Central Bank has been envisaging various sorts of measures and policies, including several rounds of quantitative easing (QE), to counter the economic setback and to assure the stability of the zone's inflation rates (i.e. "below, but close to, 2% over the medium term" according to the ECB). Nevertheless, the stimulus measures that have already been applied by the European Central Bank remain mild when compared to the Federal Reserve's QE actions. This owes primarily to the relatively lower liquidity needs of the Euro zone's financial markets comparing to that of the United States, the interest rates divergence across the zone's various countries, and especially between central and peripheral economies, in addition to the absence of any serious deflation risks in the concerned region. In fact, the ECB's purchases of government bonds have never surpassed the 9% mark of its total balance sheet⁶.

More recently, the murk that had dwarfed the Euro zone's economic performance for quite some time started to dissipate by the end of the year 2013, with the zone's GDP shyly blossoming by 0.3% during the last quarter of 2013, up from 0.1% in the second quarter of that same year. In fact, the performance of various Euro zone economies outpaced by far analysts' expectations in the last three months of 2013, most notably that of Germany, France, Italy, Holland, and Portugal⁷. In parallel, many of said countries witnessed a sharp improvement in exports, fixed investment, and business survey results in the last quarter of last year⁸.

Concurrently, the Euro currency bucked its losing streak after a long struggle in the eye of the storm, recording a substantial appreciation against the U.S. Dollar and other major currencies in the year 2013. More specifically, the Euro's exchange rate against the greenback rose from 1.2858 in 2012 to 1.3280 in 2013⁹. Said increase was mainly buoyed by the repatriation of funds by various Euro zone banks in an attempt to shore up their capital bases, and this prior to the end of the year and the ECB's Asset Quality Review, coupled with banks' reimbursement of relatively cheap crisis-related loans to the ECB. Capital flows and money market rates were also seen as stimulating elements to the Euro's exchange rate throughout the year. In addition, the European Central Bank's comments by the end of the year were supportive of the currency, refuting the need for any prompt interest rate cuts and denying any imminent signs of deflation¹⁰. It is worth noting that the U.S. Federal Reserve's quantitative easing measures throughout the year 2013 had their share in fostering a bullish environment for the Euro¹¹.

The chart on the following page depicts the monthly evolution of the Euro currency's exchange rate against the U.S. Dollar since early 2013, reflecting the recently adopted upward trend (as validated by the trendline):

⁶ Bloomberg, "QuickTake", February 25, 2014

⁷ Bloomberg

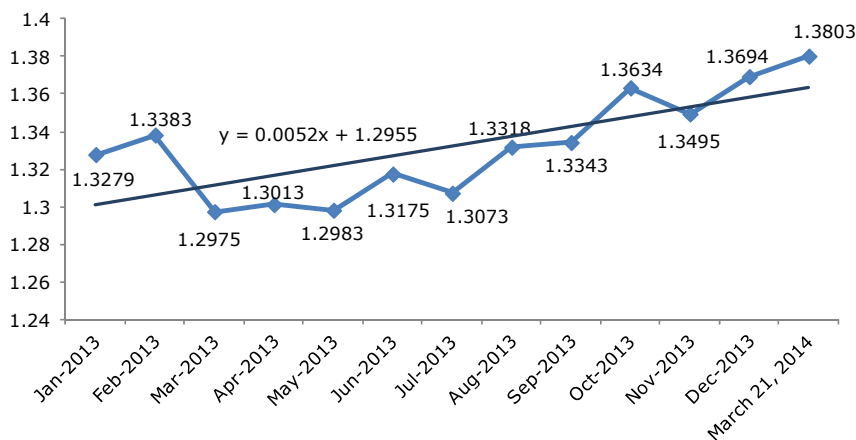
⁸ IIF, "Global Economic Monitor", February 2014

⁹ Oanda

¹⁰ Reuters

¹¹ Market Watch

Monthly Evolution of the EUR/USD Exchange Rate in the Year 2013



Source: Oanda, Credit Libanais Economic Research Unit

Despite the rosy picture, the Euro zone's inflation rates have not regained their target level yet. Consequently, it remains unsure whether the ECB will effectively resort to QE measures, with such a decision remaining highly dependent on the future course of inflation. It is worth noting that according to most analysts, the possibility of an actual deflation occurring during the upcoming period is rather unlikely¹², yet cannot be completely ruled out, prompting as such the ECB to remain in an observatory mode while adopting an "accommodative stance of monetary policy"¹³. More specifically, the ECB's President, Mr. Mario Draghi, has unveiled two scenarios which could trigger a new policy action, namely "a deterioration in the medium-term inflation outlook" and "an unwarranted tightening of short-term money markets"¹⁴. From another perspective, it is highly discouraged that the ECB applies any stimulus measures at present, as such a decision would imply injecting more money into the European economy, the thing which would wear down the Euro currency's purchasing power¹⁵.

In this context, the European Central Bank has set a list of possible policy actions to implement in the event either of the aforementioned scenarios effectively takes place. The implementation of any of said actions will have a depreciating effect on the Euro. These actions include:

1- Interest Rate Cuts:

As the ECB had already lowered its official lending rate by 25 basis points to a record low of 0.25% in November 2013, the leeway to further cut borrowing rates remains limited. In fact, and if deemed necessary, said rates would be merely amended, leading to a muffled impact on the economy. Such an observation can be validated by a survey conducted by Reuters, uncovering that most analysts ruled out any further interest rate cuts by the ECB up to June 2015. As far as interest rates on deposits are concerned, the ECB's overnight deposits rate is currently at 0%. In this context, shrinking said rate into negative territories would propel banks to boost their lending activities¹⁶.

¹² IMF, IIF, Bloomberg, and Reuters

¹³ ECB's President, quoted in Bloomberg

¹⁴ ECB's President, quoted in Reuters

¹⁵ Reuters

¹⁶ CNBC, Reuters

2- A Suspension of Sterilization:

The European Central Bank has been sterilizing the funds paid to purchase sovereign bonds during the Euro zone's debt crisis under its then-applied Securities Markets Program, and this in an endeavor to shun any inflationary pressure or sharp currency appreciation. In this perspective, suspending said sterilization would inject some EUR 175 billion (i.e. around \$236.43 billion) of liquidity into the Euro zone's financial system¹⁷ while extending the full allotment provisioning in the ECB's refinancing operations¹⁸.

On the other hand, many analysts fear that a potential sterilization suspension could be used to thwart the questioning of the ECB's bond-buying program, which has been in conflict with the German law.

3- A Long-Term Refinancing Operation (LTRO):

Two three-year long-term refinancing operations (LTROs) with low interest rates were adopted by the ECB in late 2011 and early 2012, channeling more than EUR 1 trillion to the Euro area's financial system. Said action granted banks sufficient liquidity and relieved the then-tensed money markets. LTROs were, in fact, first initiated by the ECB to spur lending activity to both retail and corporate clients. Nevertheless, banks have been reimbursing large chunks of their loans under the LTRO programs prematurely, resulting in an absence of any guarantee that "they would jump again at a repeat offer, especially as they are tidying up their books ahead of a health check of the banking sector by the ECB"¹⁹.

In light of the decreasing loans to the private sector in the Euro zone, added the gradual withdrawal of liquidity prior to the redemptions of the aforementioned LTROs in early 2015, the ECB might consider resorting to a new LTRO around spring to support the banks that are in need of financing.

4- Quantitative Easing:

The ECB could opt for a quantitative easing policy, injecting more money into the economy and fending off the risk of deflation amid the broadening money supply. Under a QE policy decision, the ECB would in fact purchase government bonds on the secondary market, dragging interest rates lower and alleviating money market tensions.

Nonetheless, the adoption of quantitative easing measures across the Euro area remains quite controversial among analysts amid concerns regarding a possible easy exit once implemented and the ambiguity surrounding the "merits of the QE"²⁰.

At present, economists agree that the European Central Bank will most probably remain in a wait-and-see mode at least throughout the month of March amid the release of encouraging macroeconomic data, and despite the relatively low inflation figures.

¹⁷ Reuters

¹⁸ Société Générale's European Economist, Anatoli Annenkov, to CNBC

¹⁹ Reuters

²⁰ Reuters

III- WHERE IS THE EURO HEADING?

A. The Explanatory Factors of the Euro's Volatility²¹:

1) The Main Assumptions:

As previously mentioned, various economists had labeled the volatility of the Euro currency as the fruit of the region's macroeconomic woes on the one hand, and the long-simmering debate surrounding the proclamations and actions of policy makers and rating agencies on the other. Nonetheless, a working paper issued by analysts at the European Central Bank (ECB) in April 2013 rules out such a correlation based on the adopted econometric model, attributing the volatility of the Euro's exchange rate solely to "comments about rescue packages to Euro area countries and their likelihood and conditions, about a possible default of a country, or about private sector involvement in case of a default". After a thorough analysis, the paper concludes that the pricing of assets in the Euro zone financial markets and the fluctuations in the Euro currency's volatility are highly dependent on authorities' statements and politicians' speeches, rather than on public debates. The paper, however, found it difficult to justify with exactitude the Euro's exchange rate fluctuations and volatility during the Euro zone crisis when compared to normal economic activity.

More specifically, the paper has built an extensive database covering more than 1,100 statements made by around 100 speakers deemed as "potentially relevant" whether locally or internationally, and allocated over different speaker groups and statement topics. Among the covered groups of speakers, statements made by politicians of AAA-rated countries seemed to have accentuated the currency's volatility, and most notably throughout the most critical periods. As far as the statements' topics are concerned, and as mentioned above, the most influential subjects in politicians' speeches revolved around the rescue packages to Euro area countries along with their likelihood and conditions, the possible default of a country, and the private sector's involvement in case of a default. It is worth noting that, according to the ECB paper's findings, pessimistic speeches had a much larger influence on the Euro currency's volatility than optimistic statements. On the other hand, the ECB's decisions have proved to attenuate the Euro's volatility during the crisis, alleviating economic uncertainties and soothing the markets. In this context, and according to the ECB paper, policy makers' communication strategies during periods of crises must take into consideration the latter's potential repercussions that might consequently arise on the financial markets and the currency's exchange rate.

2) The Econometric Model & Methodologies:

The econometric model on which the ECB paper has based its assumptions and conclusions is an exponential GARCH (EGARCH) model following Nelson, with the adopted conditional mean equation being:

$$r_t = c_1 + \alpha_1 r_{t-1} + \sum_i \beta_{s,i} s_{i,t} + \sum_j \beta_{a,j} a_{j,t} + \sum_k \beta_{m,k} m_{k,t} + \mu_t$$

²¹ The European Central Bank - Eurosystem, Working Paper No. 1532 / April 2013, "The Euro Exchange Rate during the European Debt Crisis – Dancing to its Own Tune?", Authors: Michael Ehrmann, Chiara Osbat, Jan Strasky, and Lenno Uusküla

In this equation, “ r_t ” represents the first principal component of the fluctuation in the Euro currency’s exchange rate against four major currencies, with “ r_{t-1} ” being its lagged value and “ s ”, “ a ”, and “ m ” designating public statements, policy actions, and “macro news surprises”. More specifically, “ s ” is the “statements” variable and represents the public debate surrounding the European sovereign debt crisis. The “ s ” component varies over the paper’s various models and takes into consideration different (i) speaker groups. It effectively sums all statements made by one specific group of speakers on a particular day, mirroring as such the intensity of the prevailing debate instead of solely indicating the occurrence of statements. In parallel, “ a ” represents European Union leaders, the European Central Bank, and rating agencies, and is included in all of the paper’s models. As for “ m ”, the latter represents macroeconomic news and is composed of the German and Italian industrial production figures. The paper has chosen German and Italian industrial production out of an extensive dataset of macroeconomic indicators that includes unemployment, industrial production, inflation, PMI, trade balance, and retail sales across various Euro zone nations in addition to other economic indicators related to the United States, Japan, and Switzerland, as the selected two gauges have proven to be statistically significant, factoring out as such other international macroeconomic indicators. “ m ” is also included in all of the paper’s models. The values of the “ s ” and “ a ” metrics can either be +1 in case of positive news or statements, 0 in case of neutral news/statements, or -1 in case of negative news/statements.

As for μ_t , the paper highlighted that its econometric analysis resorts to an information set dating from the previous period (i.e. I_{t-1}), and assumes that the distribution of the disturbance is: $\mu_t | I_{t-1} \sim (0, h_t)$, with h_t being the conditional variance.

In this paper, the conditional variance is calculated as follows:

$$\log(\hat{h}_t) = c_2 + \kappa_1 \left(\left| \frac{\mu_{t-1}}{\sqrt{\hat{h}_{t-1}}} \right| - \sqrt{2/\pi} \right) + \kappa_2 \left(\frac{\mu_{t-1}}{\sqrt{\hat{h}_{t-1}}} \right) + \kappa_3 \log(\hat{h}_{t-1}) + \sum_i \gamma_{s,i} s_{i,t}^* + \sum_j \gamma_{a,j} a_{j,t}^* + \sum_k \gamma_{m,k} m_{k,t}^*$$

The paper has, in fact, considered the “ s^* ”, “ a^* ”, and “ m^* ” metrics as dummy variables in the calculation of the conditional variance, equaling 1 in the event of a public statement, policy action announcement, or economic news release, or 0 in all other cases, differing as such from the “ s ”, “ a ”, and “ m ” components used in the calculation of the “ r_t ” metric. In this context, the model takes into account all business days, including those where no statements, policy actions, or macroeconomic news releases occurred, during which the related variables equal 0.

The paper’s hypotheses imply that all variables used in the mean equation “are defined in a way that positive values should lead to an appreciation of the Euro”. In other words, **the appreciation of the Euro can be triggered by optimistic public debates, encouraging policy announcements and constructive decisions**, and better-than-expected German and Italian industrial production readings. In this context, the paper assumed that the values of all β coefficients in its mean equation are greater than 0. The paper also projected that the values of the γ coefficient in its error term variance equation are positive in the event of a growing volatility and negative in the event of a decreasing volatility.

Consequently, the paper comments on the double usefulness of its model, with the latter being able to estimate the impact of the chosen factors on the Euro’s exchange rate fluctuations on the one hand, and the degree of the currency’s volatility on the other.

The paper further elaborates on the notion of volatility, resorting to a quantile regression to study the volatility of the Euro against four major currencies. The conditional quantile equation of the Euro's volatility is:

$$v_t = c_{1,\theta} + \alpha_{1,\theta} v_{t-1} + \sum_i \gamma_{s,i,\theta} s_{i,t}^* + \sum_j \gamma_{a,j,\theta} a_{j,t}^* + \sum_k \gamma_{m,k,\theta} m_{k,t}^* + \xi_{t,\theta}.$$

According to the ECB paper's assumptions, " v_t " constitutes the principal component of the Euro's volatility against the four major currencies, with " v_{t-1} " being its lagged value and " θ " being the conditional quantile of " v_t ".

Having set the concerned equations, the paper starts by tracking the evolution of the public debate during the Euro zone crisis, plotting the moving average of the number of statements made during a specific day against various financial markets-related indicators, namely the Euro currency's exchange rate, its fluctuations, its implied volatility, and the government bonds spreads of Greece, Ireland and Portugal versus Germany. The output of said observation mirrors an obvious correlation between the number of public statements and the aforementioned indicators. It is worth noting, however, that the number of statements made on one day solely reflects the frequency of statements. Accordingly, the paper uses the following dispersion measure equation to quantify the level of controversy related to said statements in an attempt of painting a more realistic picture:

$$\Omega_t = \frac{\sum_{i=1}^{N-1} \sum_{j=i+1}^N |s_{i,t} - s_{j,t}|}{\frac{1}{2} \cdot (N^2 - D)}$$

In this equation, " N " represents the number of statements made in one specific day, with " s " representing the content of said statements (i.e. if they are positive, neutral, or negative) and consequently having a value of +1, 0, or -1. Concurrently, the " D " metric is a dummy variable, equaling 0 in the event " N " is an even number or 1 in the event " N " is an odd number. This normalization was used as the paper was seeking to find a dispersion measure which varies between 0 and 1 to show whether the related statements were controversial or not and the level of said controversy. For instance, the value of Ω_t would be 0 in the absence of dispersion between statements, which means that all statements made during the concerned period had the same tone. On the other hand, the value of Ω_t would be 1 in the presence of a maximum degree of dispersion across said statements, which means that the statements made during the covered period were contradictory, with half of the statements having a score of +1 and the other half having a score of -1.

After having studied the level of intensity and controversy of statements made during the sovereign debt crisis, the paper gears its attention towards the impact of said two indicators on the Euro currency's exchange rate and volatility.

The paper tries to discern at first the country of origin of politicians whose statements have had the biggest influence on the Euro currency's trend and volatility. For this purpose, the paper resorts to its previously elaborated mean equation, using five different models in which most variables remain constant at the exception of those related to public statements. Model (1) splits

politicians into 3 group of countries, namely AAA-rated countries (i.e. France, Germany, Austria, Finland, Luxembourg, and the Netherlands), countries that had sensed the sovereign debt crisis' pinch (i.e. Greece, Spain, Italy, Ireland, and Portugal), and all other remaining European nations. Model (2), however, takes into account France and Germany separately from the group of AAA-rated countries. As for Model (3), the latter combines France and Germany into one category, while joining all other countries into another category. Model (4) reallocates France and Germany back into the group of AAA-rated countries (similarly to Model (1)), yet divides the group of nations that had sensed the sovereign debt crisis' pinch into countries under the EU/IMF adjustment program (i.e. Greece, Portugal, and Ireland) on the one hand, and the other struggling countries (i.e. Spain and Italy) on the other. Lastly, Model (5) readopts the assumptions of Model (1), yet replaces the statement variables by a dummy variable (as already explained). Such a distinction between the different grouping of countries aims at discerning the origin of public statements which had the largest influence on the Euro currency's fluctuations and volatility. **The use of these five models led, in fact, to the previously stated assumptions, which uncover that statements made by politicians of AAA-rated countries seemed to have accentuated the currency's volatility throughout the period of the crisis.**

As far as the statements' topics are concerned, the paper takes into account solely the statements made by politicians from the AAA-rated group of countries, and splits the statements by topic. In this context, Model (1) includes all types of statements made by politicians from the selected group of countries. Model (2), on the other hand, divides said statements according to their topics. Model (3) aggregates the statement variables into dummy variables (-1, 0, or +1 to indicate the balance of views in the mean equation, and 0 or 1 to indicate the occurrence of at least one statement by the chosen speaker group in the variance equation). As for Model (4), the latter spreads public statements between positive and negative statements. Concurrently, Model (5) takes into consideration all statements made by politicians from AAA-rated countries and the dispersion of said statements (Ω_t). Model (5) also separates the days when the integrality of speakers agreed on a negative speech content ("Unanimously negative"), from all other days in which statements were publically made ("Positive or disputed negative"). This helps detect any relationship between politicians' disagreements and the volatility of the Euro. **Said analysis led to the aforementioned conclusion that politicians' speeches which revolved around the rescue packages to Euro area countries along with their likelihood and conditions, the possible default of a country, and the private sector's involvement in case of a default had the most significant impact on the Euro's volatility, and that negative speeches detained a much larger influence on the Euro's volatility than positive statements.**

3) The Conclusion:

After having tested its model and integrated the various statistics, the paper concludes that the main factors behind the Euro currency's fluctuations and volatility revolve around the statements, decisions, and actions made by the European Central Bank and key Euro area authorities²². Said observation is reiterated by HSBC, which clearly states in one of its reports that the Euro's outlook remains highly dependent on the ECB and European authorities' policy decisions and actions, with other factors such as the improvement in the zone's current account

²² The European Central Bank - Eurosystem, Working Paper No. 1532 / April 2013, "*The Euro Exchange Rate during the European Debt Crisis – Dancing to its Own Tune?*", Authors: Michael Ehrmann, Chiara Osbat, Jan Strasky, and Lenno Uusküla

balance and capital flows for instance having a temporary and marginal effect²³. Nevertheless, the vast majority of economists and analysts agree that it is difficult, if not impossible, to predict the future level of the EUR/USD exchange rate, with the latter rather “dancing to its own tune”.

Consequently, the key element to anticipate the future trend of the Euro currency’s exchange rate resides in tracking the ECB’s plans and speeches to build a more realistic projection.

B. A Glance Into the Future:

The Euro currency’s exchange rate against the U.S. Dollar enjoyed a bullish trend during the first week of March 2014, as the ECB’s President Mr. Mario Draghi had announced the Bank’s decision to abstain from resorting to any unconventional measures, at least for the short term. Such comments were met by an over-enthusiasm by traders according to many analysts, the thing which boosted the Euro’s exchange rate against the greenback to a two-and-a-half year-high of 1.3915 on Friday, March 7, 2014. The Euro, however, corrected negatively during the second week of the month, shedding 0.1% against the Dollar on Tuesday, March 11, 2014 to 1.3856²⁴. The currency sustained its losing streak on Wednesday of that same week, with the corresponding resistance level reaching 1.3877 against the Dollar at first before increasing to 1.3898. In this perspective, Credit Suisse foresaw “a move on to the 50% retracement [of the Euro currency] of the 2008/12 fall at 1.3958”, and anticipated the currency to witness a wedge trendline resistance at 1.3972/76²⁵. The Euro, however, bucked its downturn later throughout the week, appreciating to a 2.25 year-high of 1.3967 on Thursday, March 13, 2014²⁶, with the near-term support level advancing to 1.3873 by Friday and the wedge trendline resistance remaining valid, yet at the 1.3967/80 level²⁷. In a different study, Credit Suisse considered the Euro trend against the greenback as moderately bearish, commenting that the ECB’s decision not to adopt any new monetary stimulus measures increases the probability of an additional strengthening of the Euro currency in the near term, and stating that the EUR/USD could even surpass the 1.40 mark in the absence of any unfavorable ECB statement. Nonetheless, Credit Suisse projected a contraction in the Euro’s exchange rate during the coming months as “the real interest rates’ move against it and flow-based support likely fades”, and this despite the upside risks²⁸. Credit Suisse consequently projected the EUR/USD rate to reach 1.36 in three months and 1.32 in a year²⁹.

The chart on the following page tracks the Euro currency’s exchange against the U.S. Dollar during the one-year period ending March 12, 2014, and displaying the 4-day (pink curve), 10-day (green curve), and 20-day (yellow curve) moving average curves. The chart also spots the light on the trend followed by the Euro’s exchange rate against the greenback throughout the aforementioned year³⁰:

²³ HSBC, “*Currency Outlook*”, January 2014

²⁴ Reuters

²⁵ Credit Suisse, Fixed Income Research, “*FX Daily - Global Strategy Technical Analysis*”, March 12, 2014

²⁶ Credit Libanais Foreign Exchange Department, “*FX Snapshot*”, March 21, 2014

²⁷ Credit Suisse, Fixed Income Research, “*FX Daily - Global Strategy Technical Analysis*”, March 17, 2014

²⁸ Credit Suisse, Fixed Income Research, “*FX Compass: Commonwealth Currencies, Uncommon Drivers*”, March 12, 2014

²⁹ Credit Suisse, Fixed Income Research, “*The Global Macro Pulse*”, March 13, 2014

³⁰ Bloomberg, Credit Libanais Economic Research Unit



The above chart captures the upward trend of the Euro currency throughout most of the year 2013 and the first quarter of 2014.

The tables below depict the March 27, 2014 morning levels of the Euro currency’s exchange rate against the greenback, together with its bid and ask levels, high and low values, support and resistance levels, pivot, and major crosses³¹:

EUR/USD - March 27, 2014 - Morning Levels		Major Crosses - March 27, 2014 - Morning Levels				
Bid	Ask	EUR/GBP	EUR/CHF	EUR/CAD	EUR/JPY	
1.3789	1.3790	Resistance 3	0.8341	1.2225	1.5360	142.06
		Resistance 2	0.8331	1.2215	1.5337	141.54
		Resistance 1	0.8324	1.2211	1.5318	141.26
High	Low	Pivot	0.8314	1.2201	1.5295	140.74
1.3796	1.3776	Support 1	0.8307	1.2197	1.5276	140.46
		Support 2	0.8297	1.2187	1.5253	139.94
		Support 3	0.8290	1.2183	1.5234	139.66
Technical Analysis						
Resistance 3	1.3818					
Resistance 2	1.3807					
Resistance 1	1.3798					
Pivot	1.3787					
Support 1	1.3778					
Support 2	1.3767					
Support 3	1.3758					

Source: Credit Libanais FX Department & Economic Research Unit

³¹ Credit Libanais Foreign Exchange Department, “FX Snapshot”, March 27, 2014

According to Credit Libanais' Foreign Exchange Department, the Euro currency resumed its upturn to a 2.25 year-high of 1.3967 on Thursday, March 13, 2014. In such a context, Credit Libanais' FX Department had assumed that as long as the Euro's exchange rate against the Dollar remains above the 1.3915 bar, the latter is most likely expected to further appreciate to the 1.3960/65 level. On the other hand, any "loss of momentum" would instead cap the currency's exchange rate at 1.3977/82. Nevertheless, the EUR/USD exchange rate fell back throughout the third week of March, leading to expectations of an irregular consolidation. Credit Libanais' FX Department further estimated that as long as the new resistance level of 1.3810 remains applicable, downside bias will prevail for another selloff at a later stage. More recently, the Foreign Exchange Department at Credit Libanais pointed to a cross-inspired retreat on Thursday, March 27, 2014 to 1.3776, from 1.3828 on Wednesday, and projected the Euro currency to remain consolidative within the 1.3749-1.3877 band. The Department further observed a meek upside tendency in the event the current support level remains stable.

IV- TO SUM IT ALL UP

Glancing into the future, the Euro currency seems to continue its solo act, dancing to its own tune and puzzling economists.

Nevertheless, and as witnessed during the latest sovereign debt crisis, the speeches, decisions, and actions of the European Central Bank and Euro zone influential authorities continue to be the main, if not the sole, explanatory factors behind the fluctuations and the volatility of the Euro currency, with other elements such as the improvement in the zone's macroeconomic indicators (current account balance, capital flows, etc.) and other world macroeconomic indicators having a temporary and marginal effect on the currency's direction.

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