FOREX FOCUS: Diary Date For Selling The Euro

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By Nicholas Hastings
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LONDON (Dow Jones)--As you check out your 2011 diaries, make a date to sell the euro.

With the single currency ending 2010 down only about 10 cents on the year, and with the threat of sovereign-debt contagion remaining extremely high, the euro looks ripe for another selloff.

Its performance earlier in 2010 may have been helped by massive doses of liquidity provided by the European Central Bank, as well as by the continued hope that European Union leaders would eventually ride to the rescue.

But, as the year ends, there are not only signs that the ECB is losing patience, as well as credibility, but that EU leaders are still miles away from a permanent solution.

This was certainly the case at last week's summit in Brussels at which ECB President Jean-Claude Trichet not only lambasted the politicians for their lack of fiscal discipline and sought a doubling in the ECB's capital base, but at which the leaders themselves sidestepped contentious proposals that would have forced Germany and France to further subsidize weaker euro-zone members.

The euro itself has remained remarkably resilient, as it has done all this month, keeping well above the $1.30 watermark that might suggest it was sinking.

Central bank support, end-of-year book-squaring and declining market liquidity have all been cited as factors supporting the euro.

China's message Tuesday that it endorses the EU's stabilization plans illustrated just how much a problem a weak euro will pose. Not only is the euro zone China's largest export partner but, with 30% of the world's foreign exchange reserves in its hands, China is heavily exposed to the single currency.

Nonetheless, there is little doubt that sovereign-debt woes will prevail once trading resumes in the new year and investors take a more studied view of "whither the euro next."

There are still hopes that EU leaders will eventually come up with the goods: a Franco-German solution for expanding the European Financial Stability Facility. If this convinces financial markets that the euro zone can now cope with a failing Portugal, then the risk of contagion might start to retreat.

In the meantime, though, there is little to convince investors that the euro is a safe bet.

On the contrary, the bond yield spreads of peripheral debtor countries over Germany have continued to widen, and even the cost of insuring French debt has risen to a new record high in these quiet year-end trading conditions.

A sharp fall in the euro after Moody's warning Tuesday about Portugal's credit rating was another reminder of just how fragile support for the euro remains. Moody's warning came even though Portugal reported a decline in its central government deficit.

As 2010 draws to a close, hopes for an economic upturn in the euro zone have also proved of little comfort for the euro.

Germany's strong recovery, which has knocked unemployment to a 20-year low, has failed to provide any help for euro-zone debtors, leaving the divergence between the strong and the weak even wider than it was at the start of the year.

So unless EU leaders surprise the financial markets with a solution well before the next finance ministers' meeting scheduled for March, selling pressure on the euro is likely to rise, with technical analysts now looking for a decisive break under $1.30 in the weeks ahead.

Bloomberg	TNI FRX POV
Reuters	USD/DJ
Thomson	P/1066 or P/1074

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