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Currencies

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Euro sinks further after ‘break up’ talk

By Steve Johnson
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The under-fire euro fell further on Wednesday, slumping to an eight-month low against the US dollar amid rumblings over the long-term future of the eurozone.

The fresh selling was prompted by a report claiming that Hans Eichel, the German finance minister, and Axel Weber, the president of the Bundesbank, were present at a meeting at which the possible break-up of European Monetary Union was discussed.

The German Bundestag is also said to have commissioned a report on the legal repercussions of a country wishing to leave the EMU.

Germany’s finance ministry labelled the talk “absurd”, while Mr Eichel and Mr Weber issued a statement saying the euro was a “unique success story”. But the damage had been done.

Although most currency analysts regard the break-up of the eurozone as an extremely faint prospect, they said the potentially disastrous repercussions of such an event mean it could not be totally ignored.

Tony Norfield, global head of forex strategy at ABN Amro, put the probability of a splintering of the eurozone at “5 per cent or less”.

“Our view is that EMU will not break up. That will be way down the line as the last resort because of the political capital eveyone has got invested in it,” he said.

Nevertheless Mr Norfield added that if a break-up was to occur, it would be a “disaster” for the euro.

Alan Ruskin, research director at 4Cast, suggested Asian central bank diversification from the dollar into the euro, a key factor in the rise of the shared currency in the past three years, could now be questioned.

“The average speculative player may not worry about the breakdown in the euro in the next five years, but for those central banks thinking in decades and readily raising their ratio of euro reserve assets, these are extremely relevant questions,” he said.

Steven Pearson, chief currency strategist at HBOS, raised the prospect of a buyers’ strike by Asian central banks. “They are probably questioning whether they have taken the proportion of eurozone assets too far,” he said.

The euro was also undermined yesterday by renewed expectations that the next move from the European Central Bank may be to cut, rather than raise rates.

This talk, although by no means a majority view, was fanned yesterday by news that euorozne manufacturing output contracted for a second month in April. Furst quarter eurozone growth was also revised down.

Jim O’Neill, global head of economics at Goldman Sachs, forecast a rate cut in the third quarter of 2005, and floated the possibility of the ECB opening the door to such a move by talking down its inflation forecasts at the press conference due to be held in the wake of today’s monthly rate decision.

Exit polls suggesting a 63 per cent no vote from the Dutch weakened the euro even further in US trading, where it slid to $1.216 from $1.223 in London, taking its slide against the dollar since mid-March to more than 9 per cent. The euro also hit a nine-month low of Y132.52 against the yen, and a four-week low of £0.6749 against sterling.

The euro’s woe spread further afield with rumours of a devaluation of the Moroccan dirham, possibly by up to 15 per cent, to counter strength against the euro.

Elsewhere sterling fell 0.3 per cent to $1.8111 against the dollar, just off a fresh seven-month low of $1.8094, and 0.4 per cent to Y196.28 against the yen after the Chartered Institute of Purchasing and Supply’s UK manufacturing survey fell to its lowest level since March 2003.

“This is a particularly depressing report, even by recent standards,” said Howard Archer at Global Insight.

The Australian dollar fell 0.7 per cent to a seven-month low of $0.7501 after first quarter economic growth came in at a disappointing 0.7 per cent.

■The recent ructions in the currency markets have had their effect on trading volumes. The Chicago Mercantile Exchange reported a record 230,844 euro FX futures contracts traded on Tuesday, representing a notional value of $35.5bn

EBS, the interdealer platform, also reported a sharp surge in volumes on the same day. More than $200bn was traded on the system, up sharply from the daily $110bn average seen this year. A total 89,949 trades were conducted with euro-dollar the most active pair.

Last year, the Bank for International Settlements’ triennial study of the FX market reported record average daily volumes in the spot, forward and options markets of $1,900bn.

Additional reporting by Jennifer Hughes in New York