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The value of the euro

The euro's exchange rate is an issue that engenders lively debate. For some the bilateral exchange rate between the euro and the dollar has been too high recently, ranging between 1.35 and 1.40 dollars. In such an extensive and diverse monetary area as the euro zone, it is normal for opinions to differ regarding the right value for the currency. Except for some transitory speculative episodes, the euro's exchange rate reflects the average of the euro zone compared with the US regarding competitiveness and the combination of ongoing monetary and fiscal policies.

Recently these two last factors have tended to strengthen the euro against the dollar as the euro zone's monetary policy has been much less expansionary than the US and its fiscal policy has also been contractive in tone. The measures adopted last month by the ECB have barely touched the exchange rate as they are aimed at boosting domestic demand and allaying the risk of deflation while their impact on the euro is secondary and uncertain. With regard to competitiveness, as this is not the same across the euro zone, weaker countries such as Spain tend to believe the euro is overvalued whereas it is the opposite in the stronger countries, such as Germany, which can export at a lower exchange rate than if they had their own currency.

The repercussions of such an averaging effect can be perceived as positive but they may be also negative if the national economic systems do not adapt to this exchange rate regime. On the positive side, for those areas that believe the exchange rate is too high, the euro's value encourages them to improve their productivity. This is necessary to avoid a serious deterioration in their current accounts and, in any case, to adjust prices and costs to ensure they are in line with the economy's actual level of productivity.

For more productive countries, a comparatively low exchange rate will encourage good export performance which ultimately results in a higher standard of living. This will tend to reduce the competitive advantage by pushing up prices and costs. Even the strongest countries run the risk of becoming less competitive.

But the consequences of differing levels of competitiveness within the euro zone can also be fairly negative. If the levels of competitiveness do not converge, either because increases in productivity do not happen fast enough in the weaker countries or because they register excessive rises in relative price levels and costs compared with their level of productivity, there will be an increasing gap in the monetary area with some countries experiencing a chronic external deficit and others a permanent surplus. Over the medium to long term this scenario is not sustainable in a single currency area such as the euro zone which, as it is not a political union, does not have any other means of adjustment that can at least partially accommodate such chronic imbalances, such as through fiscal and labour measures. This is what happened in the Spain of the peseta, where labour mobility and fiscal transfers led to, and some would even say encouraged, chronic current account deficits in different regions. It is crucial for the arduous reduction in imbalances that has been occurring throughout the now-ending recession to be a durable correction. Europe is unlikely to see political unification in the near future and monetary union will find it very difficult to withstand another episode of tensions such as we have witnessed over the last few years.