Is the Appreciation of the Euro Threatening Economic Growth?

The euro has appreciated strongly since early spring. This movement is due to the widespread weakness of the U.S. dollar, as well as improved economic data in Europe. This improvement suggests that the European Central Bank (ECB) will soon announce a gradual reduction of its asset purchases, which supports the currency all the more.

Despite its recent appreciation, the value of the euro remains largely under the levels observed before the depreciation of 2014–2015. From the outset, this could calm fears about the potential negative effects on exports. In addition, the exchange rate is not the only variable to be considered. The trade balance was less affected after the latest phase of depreciation of the euro. The status of global and domestic demand may have a greater impact. A stronger global economy will foster exports, while rising domestic demand often drives imports. In line with this, it appears that improved economic growth in the euro area over the past few years was mainly due to the better performance of domestic demand, especially investment.

**IMPLICATIONS**

The euro does not yet seem to have appreciated enough to threaten economic growth, especially given that the recent improvement of the economy is based on domestic demand. That said, the ECB could raise the issue of inflation. In the past, it has suggested that a 10% movement of the currency would have an impact of around 1% on prices. Accordingly, the ECB could downgrade its inflation forecasts. Ultimately, this might reduce expectations about potential monetary tightening, and the euro could have greater difficulty in appreciating.