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Global Strategy and Investment Trends by David Fuller **http://www.fullermoney.com**

The euro's strength is rapidly becoming a serious problem for Europe's economies.

Who is buying the euro and how high could it go? Trend-running currency traders - from banks, corporations and the public - have always had the collective firepower to fuel a move to today's high of $1.1624, within striking distance of the euro's January 1999 high at $1.1899. However considerable demand is also coming from the world's central banks, which naïvely had over 75 percent of their reserve assets in US dollars at yearend 2001, according to most estimates, and the figure is probably above 70 percent today. This is hard to justify since the US accounts for approximately 30 percent of global GDP. It also invites abuse. If everyone wanted US dollars, as they did 2 to 3 years ago, and if an overvalued greenback was hurting the US economy, as it was, the temptation to create more dollars becomes irresistible. Everyone now recognises that the US and Japan are producing new dollars and yen at a very rapid rate, mainly through credit creation. Consequently most other viable currencies are soaring against the dollar and yen - especially the euro, which due to liquidity is the only realistic alternative as a reserve currency for central banks. Consequently we have the ingredients for a very serious upside overshoot by the euro, a prospect last discussed in FMP203 (12 Mar 2003). Needless to say, the euro's current strength is very bad news for the region's export companies and tourist industry, already hit by slow growth and boycotts over German and French opposition to the war for regime change in a small consolation because they were already low, oil excepted.

How will the ECB respond to the euro's strength, which is based on trend momentum and fear of the alternatives, rather than economic strength? Initially, with masterly inactivity, as we have seen recently and also during the euro's post-launch descent, until the single currency's weakness became a huge embarrassment. Unfortunately for Europe, the ECB is an inexperienced central bank, with a deflationary mandate, answerable to a sprawling and inefficient committee of bureaucrats and politicians, rather than a single government. The ECB has loosened its inflation straitjacket recently but this will have little effect on euro momentum. As the single currency continues to rise, triggering a chorus of complaints from Euroland's exporters, we can expect the ECB to issue a string of comments. Unlike slow GDP growth, the ECB certainly can't blame the euro's strength on structural rigidities, so it will probably say that it is concerned, watching the situation and that further gains are not justified. It may blame the US, which would only exacerbate the problem. Since these efforts to talk the euro down will only interrupt rather than reverse the uptrend, the ECB will eventually threaten intervention. This too would be unlikely to produce more than a temporary reaction. Presumably the ECB would actually intervene at some point, but Euroland already owns lots of dollars via its member state central banks. Currency traders would back away for a while but if the euro's overall uptrend remained intact, as would be likely, they would soon challenge the ECB's resolve once again. Only multilateral intervention, which we last saw in September 2000 in support of the euro, would really change sentiment. However multilateral currency intervention is extremely rare, and only occurs when the major central banks conclude that the continuation of a forex trend is not in their respective national interests. I see no evidence that the Fed, BoJ, BoE or SNB are displeased with the euro's trend. In fact, they are probably delighted. Therefore if the euro's current up-leg is similar to the first two rallies from the base, we could see at least $1.20 before the next multi-week trading range occurs, provided there is little prior comment from the ECB. Where multilateral intervention would occur is anyone's guess - mine is that the euro would have to be closer to $1.50 than $1.20.

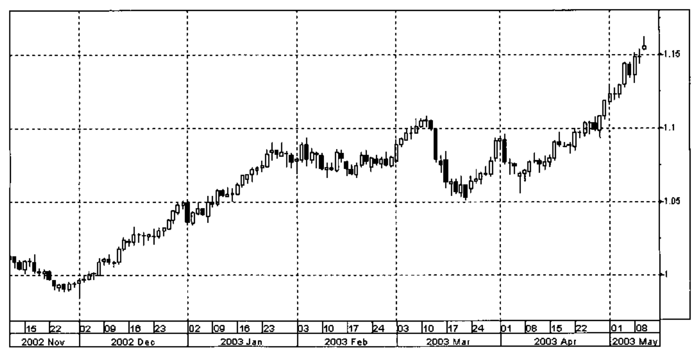
How to play it? As the euro's trend accelerates, I would consider a trailing stop of 2 to 3 cents for at least part of any trading position. There are usually setbacks, even within the strongest trends.

Best regards - David Fuller

Charts by Bloomberg

Euro/Dollar: $1.1556 (Weekly)

Euro/Dollar: $1.1556 (Daily)



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