Euro could slide to parity against dollar by year end: expert

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March 21, 2015

WASHINGTON, March 20 (Xinhua) -- The euro will continue falling against the U.S. dollar this year and could slide to the parity with the greenback by the end of this year, a leading expert on monetary policy has predicted.

The euro has started its plummet against the dollar since the middle of 2014 from a peak of 1.4 dollars in May as the European economy kept weakening while the U.S. recovery got momentum.

The European Central Bank (ECB) initiated the quantitative easing on March 9, pumping 1.1 trillion euros into the market through buying public and private bonds in the secondary market. Such action tumbled the euro to 11-year lows against the dollar in the morning the next day.

"I think the launch of quantitative easing by the European Central Bank will probably further weaken the euro against the dollar," James Dorn, vice president for monetary studies in Cato Institute, told Xinhua in a recent interview.

If the ECB takes the quantitative easing for a year, it will possibly raise the inflation in the region as the policy will have stronger push for banks to make loans than the same action taken by the Federal Reserve, said Dorn.

"This is because unlike the Fed the new monetary base money is being kept at the Fed, not being lend out. In Europe, they have negative interest rates so you are penalized for keeping the money at the central bank," said Dorn.

The ECB slashed its deposit interest rate to minus 0.1 percent in June last year and made a further cut in September to minus 0.2 percent, which means banks have to pay the central bank interest if they deposit more money at the central bank than the amount required by the law.

Unlike the ECB, the U.S. central bank has kept the interest rate for excess reserve at 0.25 percent during the implementation of the quantitative easing, which has made banks build up huge excess reserves at the Fed to 2.6 trillion dollars but significant reduced the money put into real circulation.

According to a study of the Heritage Foundation, if banks lend all those excess reserves out, banks can create up to approximately 26 trillion dollars, more than twice the amount of money currently in the U.S. economy, which might have pushed the inflation in theUnited States to a much higher level.

That difference will cause the banks in Europe to have stronger incentive to lend the money created by the quantitative easing out, said Dorn. "That could be good for the economy in a short run, but over a large period of time there could be inflation," he said.

"If the European countries start to have inflation and it's higher relative to the inflation in the United States, that will weaken their currency," said Dorn.

Besides factors to drag down the euro, the Fed is expected to raise the interest rate in the middle of this year that will also give a support for the dollar.

"It's possible that dollar could further strengthen especially when Fed starts to increase the federal rate. That's why I think the euro could reach the parity of the dollar by the end of the year," Dorn said.