Euro at 11-Month Low

**Selloff Comes After Period of Resilience for the Currency**

By TOM LAURICELLA

The euro tumbled to its lowest level against the dollar in nearly a year Tuesday amid mounting concerns about Europe's economy and doubts about the latest government efforts to contain the continent's debt crisis.

In the past two days the currency has dropped 2.6% to $1.3037, a level not seen since January. The euro is down 12% from its 2011 high in May.

Tuesday's drop came as investors became more wary about the commitment from European governments to agreements reached at Friday's summit. Senior European officials warned of the difficulties of implementing any accord that calls for tougher budget discipline. Some leaders also questioned whether last week's agreement to channel €200 billion to the International Monetary Fund was allowed under European Union rules.

Also Tuesday, markets were shaken briefly by new data showing Greece's economy is even worse off than thought.

This week's selloff comes after a period of surprising resilience by the euro. Despite gloomy headlines, the currency remained well above $1.30 most of the year. But the backdrop has grown increasingly negative for Europe's common currency.

"A lot of folks are just fed up with the euro-zone process," said Robert Sinche, currency strategist at RBS Global Banking & Markets.

Much of the pressure is coming from a belief that the European Central Bank could be forced into a more aggressive pace of cutting interest rates. Lower rates typically make a currency relatively less attractive to investors. Last week, the ECB cut its key lending rate to 1% and investors believe the pace of any easing could accelerate if ECB officials feel governments are moving more quickly to address the debt crisis.

Many investors believe that Europe's economies are headed for a recession that could prove deep if officials don't move more quickly to restore confidence. Of particular concern is a credit crunch as European banks hoard cash in order to shore up their balance sheets. Europe's economy is seen as especially vulnerable to a credit crunch thanks to its reliance on bank lending rather than capital markets for corporate borrowing.

The euro's decline "is a move ahead of potential more aggressive ECB easing," said Jose Wynne, head of North American foreign exchange strategy at Barclays Capital.
Barclays believes the recent decline sets the stage for a sharply lower euro in 2012. It expects the euro to hit $1.25 by June and $1.20 by the end of next year.

Alan Brown, chief investment officer at Schroders Investment Management, with almost $300 billion under management, said his firm has a modest bet against the euro. It's possible the euro would drop to $1.25 next year, he said, but could rally sharply if there is any resolution to the crisis.

In the meantime, investors said they have been continually disappointed by the efforts of European officials to address the continent's debt crisis. Tuesday brought fresh reminders that even the problems in Greece, where the crisis began in 2010, continue to fester.

The IMF warned Tuesday that the recession in Greece is turning out to be deeper than expected and released a wider-than-forecast budget shortfall for the struggling country.

With the recession weighing on tax revenues and boosting spending on social welfare, the budget deficit this year is projected at about 9% of gross domestic product, compared to a recently revised government forecast of 8.5%.

"The economy is trending notably lower than what was expected," the IMF said. When it comes to attracting new investment to Greece, "sentiments have not improved as hoped, given the unexpected turmoil in other countries in the euro area periphery, uncertainties among investors about the framework for a comprehensive policy response to the crisis, and also uncertainties about private sector involvement in reducing Greece's debt," it said.

Meanwhile, European Council president Herman Van Rompuy acknowledged that the path toward implementing last week's agreement among 26 governments will be complicated by the decision of U.K. Prime Minister David Cameron to veto an EU-wide plan. "It will not be easy," Mr. Van Rompuy said.

Investors have been largely dismissive of the results of Friday's EU summit, where leaders agreed to channel more money to the IMF and bring more fiscal unity to the region.

"People asked me about Friday's summit and whether it was what I expected or whether I was disappointed," says Mr. Brown of Schroders. "Yes, it was what I expected, and yes, I was disappointed."

Ironically, the euro's decline comes at the tail end of a year that had frustrated many investors who were bearish on the euro. Betting on a lower euro had been a particularly fruitless trade for many hedge funds. Even as European stocks and many country's bonds were clobbered, the euro held strong against the dollar.

The euro hit a 2011 high of $1.4849 in early May, having started the year just below $1.34. The currency took a nosedive in September, but rebounded to nearly $1.4150 in late October.

The euro's buoyancy against the dollar in part reflected issues in the U.S. The U.S. Federal Reserve continued to ease monetary policy, economic growth was slow and there was little progress in addressing the U.S. budget deficit.

But the euro received somewhat unexpected support from European banks scrambling to shore up their balance sheets by selling off assets—such as loans—from outside the euro zone. To bring the cash home, they had to buy euros, propping up the currency.

In addition, the euro was boosted by central banks in emerging markets, which were buying euros as part of their efforts to diversify their holdings beyond U.S. dollars. Analysts say some of that buying has diminished in recent months, removing one area of support for the euro.
Expectations among investors that the ECB will be more aggressive in cutting rates have grown despite last week's ECB meeting, where policy makers showed some reluctance to ease. The decision to lower its key benchmark rate to 1% from 1.25% wasn't unanimous.

Despite the ECB's stated reluctance to cut rates, some analysts said a deep recession, especially one where bond yields for fiscally stretched countries such as Italy stay elevated, could leave the central bank with little choice.

"The general consensus is that each time the fiscal authorities don't come up with concrete, well-funded plans, the probability increases that the ECB has to step in," said RBS' Mr. Sinche.

There is still debate about whether the ECB will choose to become more accommodating, possibly through making large bond purchases, or whether the central bank will be forced into action. For now, Mr. Sinche said, "the 'forced into' camp is probably gaining the upper hand."

—Stelios Bouras contributed to this article.

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