No way to build EUtopia

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The EU's Social Charter and wider legislation has introduced rights empowering those working within it to a degree unparalleled over European history, and indeed practically anywhere else at any time. As such employees in it should of course only warm to restrictions on the maximum number of hours demanded at work, the guarantee of a 'living wage', immunity from summary dismissal, health & safety protection, and other cushions against the evils of 'corporate opportunism'. Those however looking beyond the benefit side of the ledger to the 'cost' column, must see EUtopia as being under serious structural threat.

The reality is, a great many EU workers operate in traded good sectors producing fungible wares being more cheaply made elsewhere; products that is, put together in economies outside the EU and vying it for the same export customers. For their part those parts of the EU whose trade is tourism, compete with just as substitutable sun and sea not that far away. Overlaying a less competitive € (at a record trade weighted high, chart 3) to worker protections inflating labour costs and surely then EU jobs in traded good and tourist sectors cannot fail to be lost? Discuss.

There is of course an internal EU market, whose ramparts can be raised ever more to ensure competing imports are restrained and so jobs contained. Indeed, some readers will consider my concerns as grossly overdone; seeing rising wages across EM's and their currencies strengthening (notably China's yuan), being overlaid with 'just' ESG demands, as driving reshoring and job creation, not destruction; with even more tax on travel to keep carbon footprints down, ensuring EU tourists stay close to home. Discuss? Well, to me quite frankly such views are complacent.

The reality is there will be little let-up in the challenge to EU export-leaning manufactured jobs coming from rivals elsewhere, and so too the challenge from competing beaches not far from the EU.

Chart 1: Swedish Krona's per €, high & higher still?

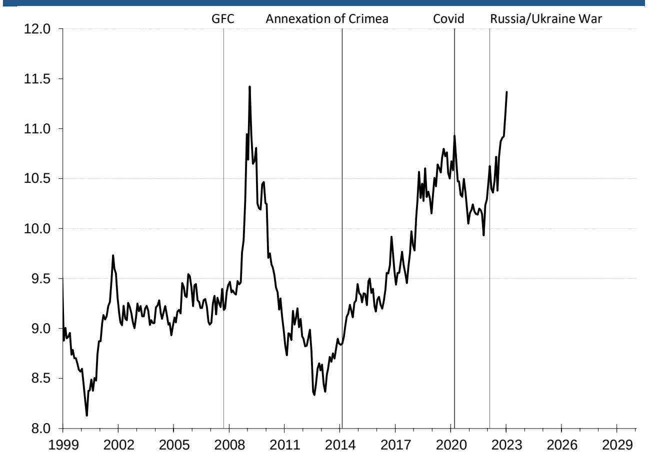
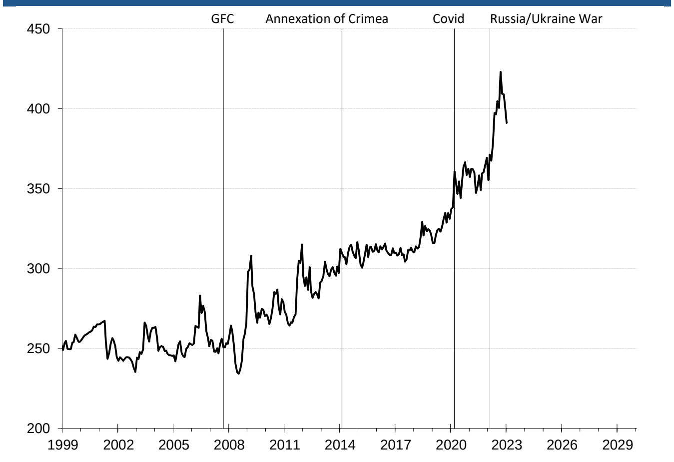


Chart 2: Hungarian Forints' per €, further up to come?



Source: Bloomberg, Toscafund

To raise its chill all the further the EU faces onslaughts from within its ramparts. I write here of a competitive threat to EZ producers coming from EU nations with currencies which in beggar-thy-neighbour devaluations, look poised to FALL relative to the €. Consider this 'threat' from Wieslaw Janczyk, a member of Poland's MPC, "*Having our own currency gives, among other things, the opportunity to influence the competitiveness of Polish goods and services in exports. At a time of significant weakening of orders in the German industry, the currently observed valuation of the zloty seems to be favourable*". Less we forget the zlotys "supportive" yield premium over the € fell 100bps; a 75bps cut in its rate vs a 25 rise in the €'s.

Chart 3: Trade-weighted €, ALL TIME HIGH

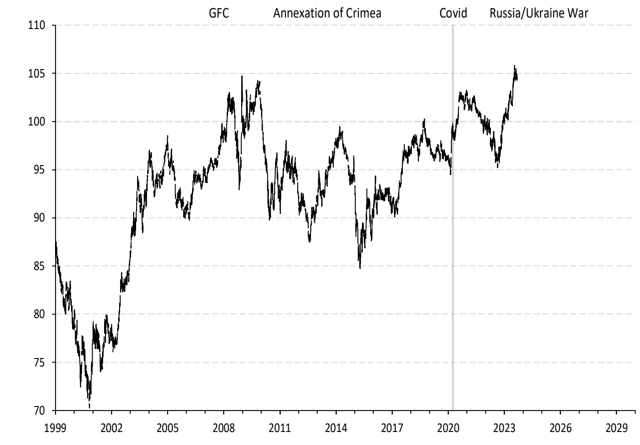


Chart 4: Yen's per €, not all time high but….

Source: Bloomberg, Toscafund

To me the 'devalue and be damned' unilateralism we are seeing with Poland will most likely also be played out in Hungary (chart 2), and then domino-like Romania (chart 5), Czechia and very possibly Sweden (whose krona has already shown noticeable weakness against the euro, chart 1). Indeed, beyond the EU's borders another depreciation looms in Turkey, a nation which less we forget, enjoys a Free Trade Agreement with it. Egypt and Tunisia too are set to devalue, and all the more dam(n) the EU?

Chart 5: Romanian Leu's per €, poised to rise?

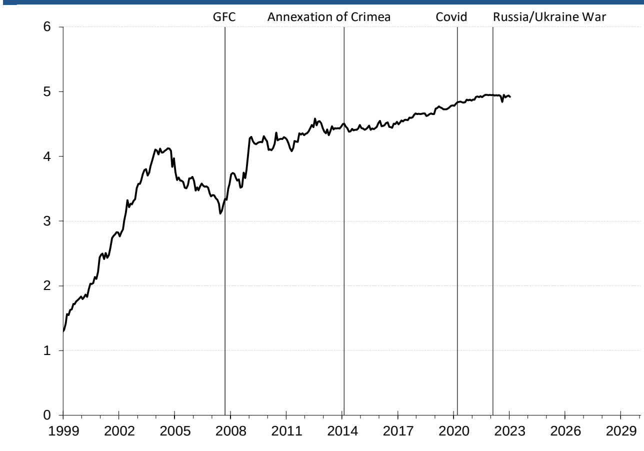
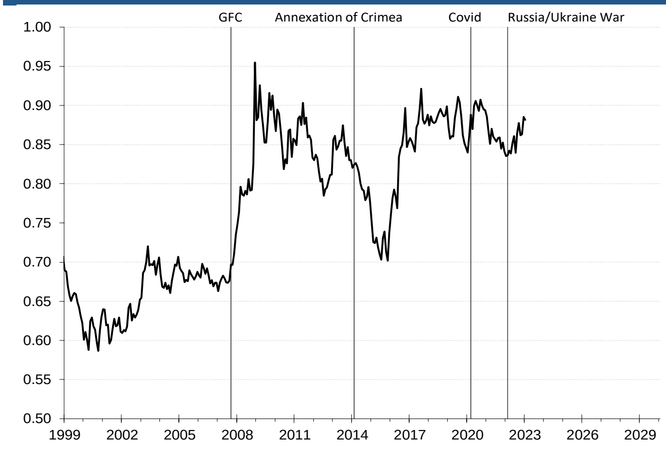


Chart 6: Pound's per €, set to fall?



Source: Bloomberg, Toscafund

If what is being predicted in all that has come before does indeed come to pass (and comparatively soon), then should one expect the ECB to shockingly ACT? Act that is, by being the first of the 'western central banks' to loosen monetary policy.

If the above is indeed how events shockingly unfold, could one NOT ONLY SEE sterling strengthening relative to the euro (chart 6), but the MPC having to alter its own monetary course? Altering its course that is by ALSO considering/initiating a rate cut far sooner than markets are pricing; or IF NOT watching as the pound reclaimed lost ground & so adding further monetary tightening? Indeed, could such moves well justify Budgetary fiscal loosening?

So, in short, could those reciting the mantra of European interest rates being "higher for longer", come quickly to sing to a very different tune?

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