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THE EFFECTS OF A WEAK CURRENCY Introduction Many analysts believe that the European economy is likely to face more turmoil before it finally gets better. The impact of countries leaving the euro on other euro zone economies such as Germany, Ireland, Italy, Portugal and Spain could severely affect the financial stability of the global economy. The immediate impact will be requirement of alternate or new currencies which will be followed by departing countries to devalue their liabilities and assets. Not to mention the huge quantum of sovereign debt that member countries owe, the magnitude of austerity measures will be enormous (Atrissi and Mezher, 2010, pp. 1-5). The main reason for the Germany's bad economic fundamentals and euro losing strength was lack of unity among members of Eurozone and failure of financial authorities to understand the gravity of problem arising from sovereign debt at an early stage. Effects of weak currency on consumers and businesses The economic and financial problems in the Euro zone can be attributed to the weakening of euro against dollar. The weakening of euro can be considered as double edged sword for both businesses and the consumers. (Source: Moody's Analytics, 2012) For instance, for businesses exporting using euro dominated currency will experience a surge in income from the weak currency. Similarly, businesses that rely on imports will experience rise in their cost of production. These high cost will be passed on to the European consumers which can depress demand. This means that European economy would face slowdown in consumption and growth. While European exporters are expected to benefit from weak euro, the USA exporters will face see slow growth due to weak demand and report lower earnings (Frieden, 1998, pp. 25-31). Consequences of Germany Abandoning Euro and Alternative Strategies A political fear

regarding EU sovereign debt crisis and leaving of member countries such as Germany from Eurozone will send a global economic shock wave of disrupting the financial markets throughout the world (Eichengreen, 2007, pp. 4-7). Germany was the largest creditor among the Eurozone members but it was unwilling to take extra liabilities as a result of which the solution to sovereign crisis was delayed. The crisis that spread from Greece to other deficit countries in Eurozone ultimately threatened the very existence Euro. The consequences of bad economic outlook in Germany could permanently divide the European Union into debtor and creditor countries due to lack of unity and less propensity to share risk among them (Chinn and Frieden, 2012, pp. 8-11). (Source: European Banking Authority, 2012) In case Euro ultimately breaks up, and then consequently a legacy of mutual hostility and distrust would create leading to the breakup and failure of common markets. Many economists prefer Germany to lead instead of choosing the alternative of leaving euro. The reason for this is that euro debt crisis is denominated in Euro and so if Germany leaves euro, the immediate impact would be depreciation of Euro and mismatch of assets and liabilities in bank's balance sheets. The entire financial market will have to be reconfigured with new sets of currencies which will make the domestic banks to devalue their balance sheet. The government will have to provide austerity measures to manage the debt of defaulting countries. Banks will have to renegotiate their payments and cash management cycle. The risk exposures of the new financial currencies will require to be evaluated which will be developed from the separation. All existing loans, borrowings and transactions will have to be renegotiated in terms of new currency or even the exiting countries may push the government for austerity measures. The bank's balance sheet will

suffer huge losses due to unsettled accumulated claims within euro clearing structure (Scott, 1998, pp. 207-228). (Source: Moody's Analytics, 2012) From the above discussion it can be said that Germany now has two options open to resolve the crisis. One is to establish a balance between the creditor and debtor countries by refinancing government debt. Another way out of the sovereign debt crisis would be to aim at a growth rate of at least 5% so that it could tackle its debt burden with productivity and long term growth. Both these strategies are obtainable through act of solid reforms in structural policies and help from government. Whereas another school of thoughts suggest that Germany can take the easy way out from euro if the members could not co-exist and remain united. But as discussed, such an alternative could pose threat to stability global financial system and create depression in economy. Summary and Conclusion The impact of Germany leaving the euro could severely affect the financial stability of the global economy. The immediate impact would be requirement of an alternate or new currency which will be followed by the departing country (Germany). Leaving euro would lead to devaluing of liabilities and assets making it competitive in international market. But all existing loans, borrowings and transactions will have to be renegotiated in terms of new currency or even the crediting countries may push the government for austerity measures. In such case the entire financial system in the economy will tumble down with panic and uncertainty. One way out of such problem is to establish a balance between the creditor and debtor countries by refinancing government debt. Another way out of the sovereign debt crisis would be to aim at higher growth rate so that Germany could tackle its debt burden with productivity. References

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