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Euro Falls as Merkel's Election Defeat Boosts Haven Currencies
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By Lucy Meakin and Monami Yui

Sept. 5 (Bloomberg) -- The euro weakened versus the dollar, yen and Swiss franc after an election loss for Germany's ruling party stoked concern support is fading for bailouts of Europe's indebted states, boosting demand for refuge currencies.

The franc strengthened for a fourth day versus the euro after German Chancellor Angela Merkel failed to sway voters in her home state yesterday with a campaign based on her handling of the region's debt crisis. The euro fell to a three-week low against the yen as European shares tumbled before a U.S. report tomorrow that economists said will show service-industry growth slowed, adding to signs the global expansion is slowing.

"The U.S. economy is sluggish, the European debt concern is not going away in a hurry, so market sentiment is not going to improve for a very long time," said Alex Sinton, a senior dealer at ANZ National Bank Ltd. in Auckland, New Zealand.

"This week is certainly a risk-off scenario."

The euro slid 0.6 percent to \$1.4116 as of 8:10 a.m. in London after falling to \$1.4113, the weakest since Aug. 11. The single currency weakened 0.6 percent to 108.43 yen. The franc advanced 0.9 percent to 1.11013 per euro. The yen was little changed at 76.82 per dollar.

The Dollar Index, which tracks the greenback against the currencies of six major U.S. trading partners, rose 0.4 percent to 74.974. The Stoxx Europe 600 Index fell 2 percent and the MSCI Asia Pacific Index slid 2.7 percent.

Merkel's Loss

The Social Democrats, Germany's main opposition party, won yesterday's election Mecklenburg-Western Pomerania with 36.1 percent of the vote, while Merkel's Christian Democratic Union had 23.3 percent, ZDF television projections showed.

The result in the eastern state where Merkel's election district is located means her national coalition has been defeated or lost votes in all six German state elections so far this year as voters resist her bid to prevent a euro-region breakup by putting more taxpayer money on the line for bailouts.

"Positioning has turned against the euro again and news flow isn't helping," Sebastien Galy, a senior foreign-exchange strategist at Societe Generale SA in London, wrote in an e-mailed note. Merkel's defeat "simply adds to the sense that saving the euro is going to be made more difficult by opposition from within Germany."

Rate Outlook

European Central Bank President Jean-Claude Trichet is scheduled to speak in Paris today before the ECB's policy meeting on Sept. 8.

While all the 57 economists surveyed by Bloomberg forecast the central bank to leave its benchmark interest rate at 1.5 percent, traders bet it will cut borrowing costs by 26 basis points over the next 12 months, according to a Credit Suisse Group AG index based on swaps.

"If the ECB takes away the tightening bias, it's going to take away some support out of the euro," ANZ's Sinton said. "You would see the euro moving down to the \$1.4010 area."

The Institute for Supply Management's non-manufacturing index for the U.S. fell to 51 last month, the lowest since January 2010, according to the median forecast of economists in a Bloomberg News survey. U.S. financial markets are shut today for a holiday.

U.S. payrolls were unchanged in August, the weakest reading since September 2010, the Labor Department reported on Sept. 2. President Barack Obama is scheduled to outline his plans to spur the economy in a Sept. 8 address to Congress.

"The market went into payrolls hopelessly optimistic and that optimism wasn't rewarded," said Robert Rennie, chief currency strategist in Sydney at Westpac Banking Corp., Australia's second-largest lender. "Developments in Europe justify further risk aversion."

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