The need for a lower EUR

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European policymakers will look at all avenues to solve the impossible task of combining growth with austerity measures in the basket case economies of the Euro periphery.

Thus, the role of currencies will soon be brought into play. Specifically, the way fixed exchange rate regimes hold weak exporters hostage is unsustainable; the easiest way to open up export markets is to therefore depreciate the single currency.

We have all been waiting for this to arrive for months. The prolonged EUR/USD relative strength has been the bane of active currency managers and hedge Funds. They have been armed with a compelling Macro story, committed to the trade and the EUR has held firm. The Eurozone pressures have materialized cross border, where there is a "run" on a regional country, but the capital flows to Germany, for example, not to the US. Unwinding banks loans and Asian support have also been identified as other reasons for EUR stability.

So back to the next move in the EUR, we anticipate a meaningful move of around 10%. This is essential to aid those countries that prior to joining the EMU would have been able to cushion their economies with traditional depreciation, and let the international bondholders wear the FX risk, as opposed to credit risk.

To engineer this impending shift, there should be, over the next few weeks, official rhetoric that validates the currency markets' collective desire to see a lower EUR. The ECB should also verbalize lower interest rates and set the scene for a rate cut in June. The German finance minister recently signaled a tolerance for slightly higher inflation- perhaps absolving the ECB should inflation in Germany begin to drift higher as the upper bound of its inflation band is tested.

In addition, the weekend move by Chinese authorities to reduce the RRR is also a sign that lawmakers recognize that already weak local data might be exacerbated by a lower EUR/RMB, which will lead to Chinese exports being more expensive in Europe.

So, all of this put's inflation on the table. Recall that one of our fears is that of the potential downside effects from the credit crisis will be Central Banks policies that choose inflation to defeat deflation. The depreciation of future liabilities in order to maintain the present value of debt assets will become a political and social imperative, thus Central Banks will run loose monetary policy far longer "this time."

As a final comment, it would be hard to argue core Sovereign Bonds offer any sort of value if our greatest fears play out. Currently, US Treasury and Bund investors are slavishly long because there is nowhere else to go. The year 1994 was the last bond market rout (an unexpected Fed tightening) and I wouldn't be surprised if the next one arrives 20 years on; perhaps in 2014.

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