

Burgernomics

When the chips are down

The latest Big Mac index suggests the euro is still overvalued

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ASK Western policymakers how they intend to squeeze growth from their sluggish economies and most pin their hopes on higher exports. That makes exchange rates an especially sensitive topic. A weaker currency improves the competitiveness of a country by making exports cheaper. It also encourages domestic consumers to switch from expensive imports to domestic goods. *The Economist's* exchange-rate scorecard, the Big Mac index, shows that currencies continue to be cheap in the developing world but overvalued in Europe.

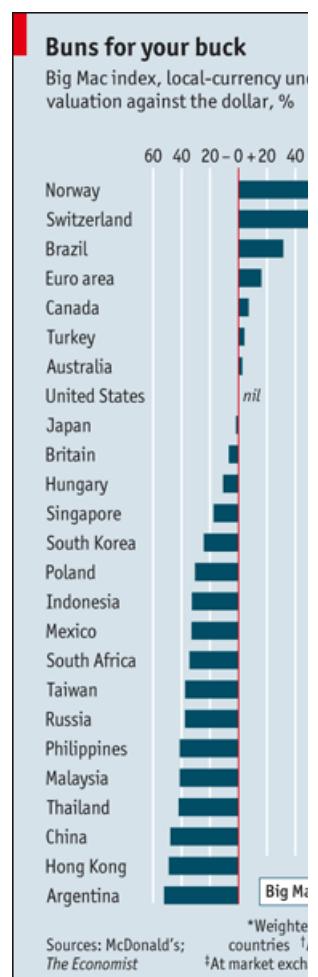
The index is a lighthearted attempt to gauge how far currencies are from their fair value. It is based on the theory of purchasing-power parity (PPP), which argues that in the long run exchange rates should move to equalise the price of an identical basket of goods between two countries. Our basket consists of a single item, a Big Mac hamburger, produced in nearly 120 countries. The fair-value benchmark is the exchange rate that leaves burgers costing the same in America as elsewhere.

Asia remains the cheapest place to enjoy a burger. China's recent decision to increase the "flexibility" of the yuan has not made much difference yet. A Big Mac costs \$1.95 in China at current exchange rates, against \$3.73 in America. Our index suggests that a fair-value rate would be 3.54 yuan to the dollar, compared with the current rate of 6.78. In other words the yuan is undervalued by 48%.

Other Asian currencies such as the Thai baht and the South Korean won are also undervalued. The Brazilian real is one of the few emerging-market currencies that is trading well above its fair value. With interest rates high—the policy rate now stands at 10.75%—Brazil has attracted lots of attention from yield-hungry investors. Burgernomics suggests that the real is overvalued by 31%.

The Big Mac numbers should be taken with a generous pinch of salt. They are not a precise predictor of currency movements. The bulk of a burger's cost depends on local inputs such as wages, which tend to be lower in poor countries. Consequently PPP comparisons are more reliable between countries with similar levels of income.

So it is particularly interesting to see that on a burger basis the euro is still overvalued by 20%.



compared with many other rich-world currencies. Sovereign-debt worries and soggy growth have helped shift the currency towards its fair value over the past 12 months. A year ago it was overvalued by 29% on the burger benchmark; that figure is now down to 16%. (British currency has gone from being mildly overvalued this time last year to slightly undervalued.) And the single currency has been moving back up again in recent weeks, on hopes that the results, which were due out on July 23rd, will shore up confidence in Europe's banking system.

Other currencies are dearer still. Investors looking for a safe place to put their money have refuge in the Swiss franc. Despite attempts by the Swiss central bank to stem the appreciation, the Swiss franc is overvalued by 68%. Those on the hunt for a value meal should also stop off in Scandinavia. In Norway a Big Mac would set you back by 45 kroner or \$7.20, nearly twice the cost in America.

The Big Mac index

	Big Mac prices*	Implied PPP† of the dollar	Actual dollar exchange rate July 21st	Under(-)/over(+) valuation against the dollar, %
	in local currency	in dollars		
United States‡	\$ 3.73	3.73		
Argentina	Peso 7.00	1.78	3.93	-52
Australia	A\$ 4.35	3.84	1.13	3
Brazil	Real 8.71	4.91	1.77	31
Britain	£ 2.29	3.48	1.52§	-7
Canada	C\$ 4.17	4.00	1.04	7
Chile	Peso 1,750	3.34	524	-10
China	Yuan 13.2	1.95	6.78	-48
Colombia	Peso 8,200	4.39	1,868	18
Costa Rica	Colones 2,000	3.83	522	3
Czech Republic	Koruna 67.6	3.43	19.7	-8
Denmark	DK 28.5	4.90	5.81	31
Egypt	Pound 13.0	2.28	5.70	-39
Estonia	Kroon 32.0	2.62	12.2	-30
Euro area**	€ 3.38	4.33	1.10††	16
Hong Kong	HK\$ 14.8	1.90	7.77	-49
Hungary	Forint 740	3.33	222	-11
Indonesia	Rupiah 22,780	2.51	9,063	-33
Israel	Shekel 14.9	3.86	3.86	3
Japan	¥ 320	3.67	87.2	-2
Latvia	Lats 1.55	2.80	0.55	-25
Lithuania	Litas 7.30	2.71	2.69	-27
Malaysia	Ringgit 7.05	2.19	3.21	-41
Mexico	Peso 32.0	2.50	12.8	-33
New Zealand	NZ\$ 5.00	3.59	1.39	-4
Norway	Kroner 45.0	7.20	6.25	93
Pakistan	Rupee 210	2.46	85.5	-34
Peru	Sol 10.0	3.54	2.83	-5
Philippines	Peso 102	2.19	46.5	-41
Poland	Zloty 8.30	2.60	3.20	-30
Russia	Rouble 71.0	2.33	30.4	-38
Saudi Arabia	Riyal 10.0	2.67	3.75	-29
Singapore	S\$ 4.23	3.08	1.37	-18
South Africa	Rand 18.5	2.45	7.54	-34
South Korea	Won 3,400	2.82	1,204	-24
Sri Lanka	Rupee 210	1.86	56.3	-50
Sweden	SKr 48.4	6.56	13.0	76
Switzerland	SFr 6.50	6.19	1.05	66
Taiwan	NT\$ 75.0	2.34	32.1	-37
Thailand	Baht 70.0	2.17	32.3	-42
Turkey	Lira 5.95	3.89	1.53	4
UAE	Dirhams 11.0	2.99	3.67	-20

Ukraine	Hryvnia 14.5	1.84	3.88	7.90	-51
Uruguay	Peso 79.0	3.74	21.2	21.1	nil

*At current exchange rates †Purchasing-power parity; local price divided by price in United States ‡Average of Atlanta, Chicago, New York and San Francisco \$Dollars per pound **Weighted average of prices in euro area ††Dollars per euro

Sources: McDonald's; *The Economist*

Finance and Economics

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