The Euro

- January 1999
  - Most European Nations adopt a common currency, the Euro (€)
- January 2002
  - The domestic bills disappear and the conversion is complete.

Floating Exchange Rates

- After 1971, major currencies “floated”, with their values determined daily by the laws of supply and demand.
- See our US-Mexico example.

The Case for Fixed Exchange Rates

$1_{\text{Ohio}} = $1_{\text{New York}}$

- Enormous benefits to the economy.
- Eliminates uncertainty.
  - In trade
  - In investing

T-shirts and CDs Yet Again

- Mexicans grow tired of American CD’s and the demand curve shifts to the left.

\[ p_{CD} = 2p_{TS} \]

- T-shirts stay at 50 Pesos; CD’s at $15.
- The exchange rate must be $1 = 6 2/3$ Pesos.
T-shirts and CDs Yet Again

Before:
- T-shirts at 50 Pesos
- CD’s at 150 Pesos

After:
- T-shirts at 50 Pesos
- CD’s at 100 Pesos

T-shirts at $7.50
CD’s at $15

You make Mexican widgets, for 200 pesos.
Before: $20.
After: $30

Investing

A Mexican firm wants to borrow 1 Billion Pesos ($100,000,000) for 10 years.

Potential American Investors need to worry about
- The Mexican firm’s credit-worthiness.
- The US Inflation Rate
- The Exchange Rate

If the loan is denominated in dollars:
The Mexican firm then worries about the exchange rate, to see how much must be repaid 10 years hence.

The Role of The Central Bank

Ohio

California
The Role of The Central Bank

Questions

- Does this make sense? Yes
- Why is it working? ECB
- Will England Join? Probably
- Should we Join? No

Competition

- Most international transactions take place in US dollar, which is to our advantage.
  - Oil
  - Russian Holdings
  - Drug Dealers
Competition

- Most international transactions take place in US dollar, which is to our advantage.
- European Community would like to compete.
  - Initial Rate: 1€ = $1.18