

The Euro



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 $\$1 = 6 \frac{2}{3}$ Pesos.

T-shirts and CDs Yet Again

- Mexicans grow tired of American CD's and the demand curve shifts to the left.
- T-shirts at 50 Pesos; CD's at 150 Pesos
- T-shirts at \$5; CD's at \$15
- The exchange rate must be $\$1 = 6 \frac{2}{3}$ 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
- The exchange rate
 - T-shirts at \$5
 - CD's at \$15
- The exchange rate
 - T-shirts at \$7.50
 - CD's at \$15

T-shirts and CDs Yet Again

- Before:
 - T-shirts at 50 Pesos
 - CD's at 150 Pesos
 - After:
 - T-shirts at 50 Pesos
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 - The exchange rate
 - T-shirts at \$5
 - CD's at \$15
 - The exchange rate
 - 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

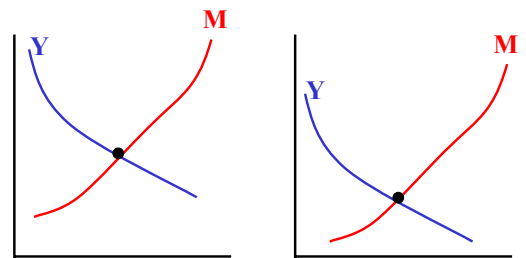
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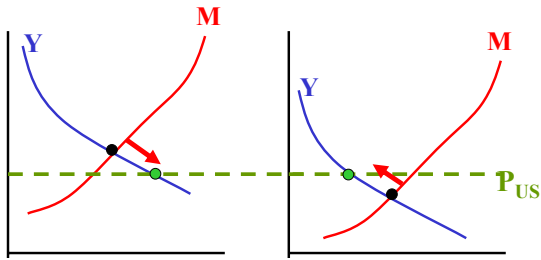
Investing

- 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 Exchange Rate~~

The Role of The Central Bank



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Questions

- Does this make sense? **Yes**

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- 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

The 500 €



The 500 \$



End

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