

## Box 6

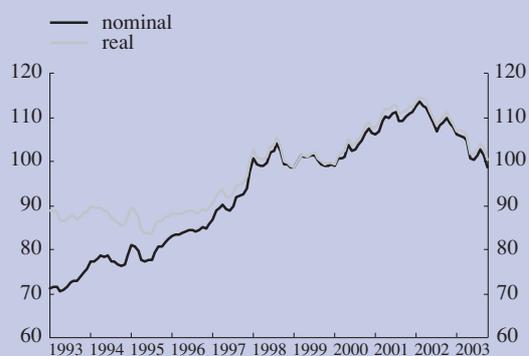
### Developments in the nominal effective exchange rate of the US dollar: a regional perspective

Based on the ECB's measure of the nominal effective exchange rate (NEER) of the US dollar against the currencies of 38 trading partners, the US currency had experienced a depreciation of around 10% by October 2003 compared to its average level in 2002, thereby partly reversing its strong nominal (and real) appreciation over the previous ten years (see Chart A).<sup>1</sup> The magnitude of this decline is somewhat greater than the 8.3% decline in the US Federal Reserve's broad index of the US currency over the same period, which employs a somewhat different methodology and a different set of partner countries.

The decline of the US dollar NEER over this period was not uniformly distributed, however. The depreciation of the US dollar by October 2003 with respect to its 2002 average was particularly pronounced against the euro, the Canadian dollar, and the group of "other countries" (see "absolute change" in Chart B). The latter includes several European currencies, which traditionally exhibit strong co-movement with the euro, the Australian dollar, the New Zealand dollar and the South African rand. Over the reference period, the US dollar also declined – albeit more moderately – against the Japanese yen and the pound sterling. By contrast, the currencies of the countries in Non-Japan Asia (NJA), which taken together have the highest weight in the

**Chart A: EER of the US dollar against the broad group of trading partners**

(Index: 1999 Q1=100)



Source: ECB.

<sup>1</sup> The NEER of the US dollar is based on a consistent trade matrix, which has been employed for the calculation of the NEER of the euro. A detailed account of the methodology is given in L. Buldorini, S. Makrydakis and C. Thimann (February 2002), "The effective exchange rates of the euro", ECB Occasional Paper No. 2. This paper also provides the regional breakdown of the broad group of 38 trading partners.

ECB's broad NEER index of the US currency, remained quite stable vis-à-vis the US dollar, mainly reflecting the formal/informal peg of several currencies in NJA to the US dollar. The overall depreciation of the US dollar was partly offset by its strengthening against the Mexican peso, which had a significant impact on the US dollar NEER reflecting the importance of Mexico as a trading partner.

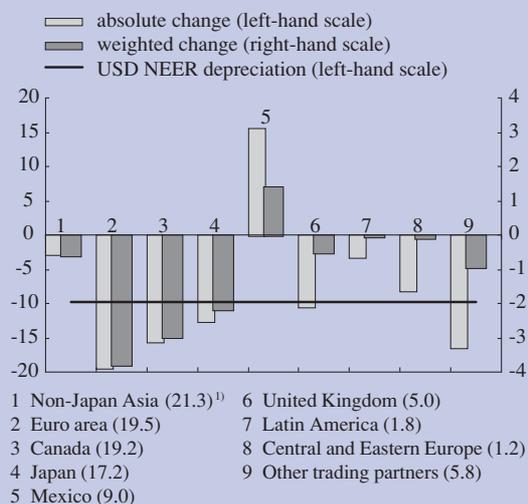
Given the weights in the US dollar NEER and, thus, the importance of the countries/regions as competitors for the US economy, the euro and the Canadian dollar accounted for most of the US dollar depreciation in nominal effective terms (see "weighted change" in Chart B). The appreciation of the euro alone explains almost four percentage points of the roughly 10% decline in the US dollar NEER, while the NJA currencies, which have more weight than the euro in the US dollar NEER index, account for roughly half a percentage point of the decline in the US dollar NEER.

Although the euro accounts for most of the US dollar NEER decline, its strong appreciation in 2002/03 needs to be gauged in the context of its strong depreciation in 1999/2000. As explained in a recent assessment of developments in the euro area's international cost and price competitiveness, the appreciation of the euro in 2002/03 could be largely interpreted as a fairly smooth and orderly return to levels broadly in line with historical averages.<sup>2</sup>

<sup>2</sup> See the article entitled "Developments in the euro area's international cost and price competitiveness" in the August 2003 issue of the Monthly Bulletin.

**Chart B: Change in the external value of the US dollar against selected countries/regions**

(in percentages, October 2003 with respect to 2002 average)



Source: ECB.

<sup>1</sup> Figures in brackets refer to trade weights (in percentages) of the countries/regions in the NEER index.