

Box 1 I

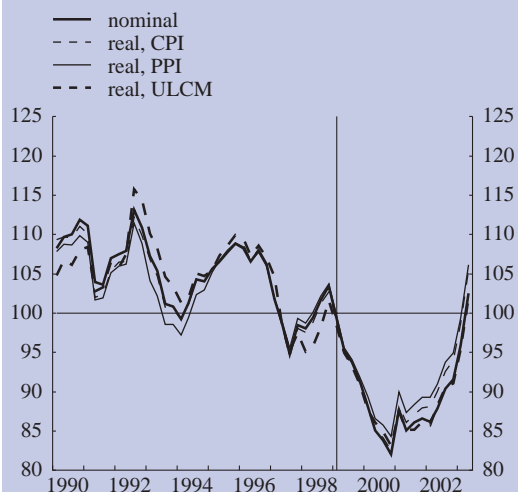
Euro effective exchange rate developments from a historical perspective

The exchange rate of the euro has appreciated fairly steadily since reaching historic lows in October 2000 – most notably in the course of 2002 and in the first half of 2003. This appreciation has been particularly pronounced vis-à-vis the currencies of the euro area’s three most important trading partners, namely the United States, the United Kingdom and Japan. More specifically, compared with the average levels of 2002, the euro has appreciated by more than 23.5% against the US dollar, by almost 17.5% against the Japanese yen and by around 14% against the pound sterling, and on 4 June 2003 traded around its launch levels against these currencies. The euro has also strengthened significantly against the Asian currencies included in the euro effective exchange rate index for the “narrow group” of 12 major trading partners of the euro area. Overall, these developments translated into a nominal effective appreciation of around 15% compared with the 2002 average.

In order to properly understand the significant magnitude of these recent exchange rate movements, they are best assessed from a broader historical perspective. In this context, the appreciation of the euro thus far appears to be a correction from rather low levels, and as such was widely expected. This notion is confirmed by looking at long-term euro effective exchange rate developments, both in nominal and real terms. Chart A displays the nominal effective exchange rate of the euro since 1990 as well as three real effective exchange rates, deflated respectively by the CPI, PPI and Unit Labour Costs in Manufacturing (ULCM) indices. These indicators – calculated vis-à-vis the currencies of the narrow group – show that the international price and cost competitiveness position of euro area firms has recently reached a level corresponding to its average since 1990. This holds irrespective of the price (CPI or PPI) or cost (ULCM) index used.

Chart A: Historical nominal and real effective euro exchange rates¹⁾

(quarterly data; index: average (1990 Q1 - 2003 Q1) = 100)

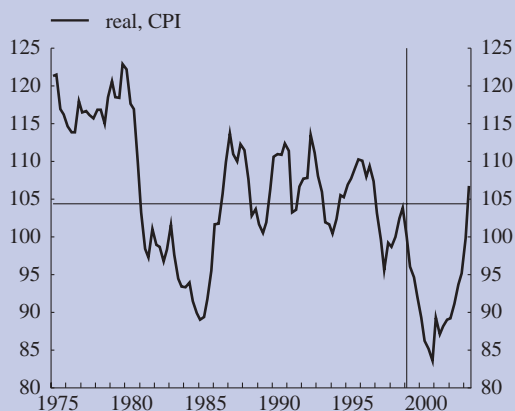


Source: ECB.

1) An upward movement of the index represents an appreciation of the euro. The latest observation is for Q2 2003. For the real EER indices the latest observation is an estimate, an exception being the ULCM-based real EER for which the last two observations are estimates.

Chart B: Historical real effective euro exchange rate¹⁾

(quarterly data; index: 1999 Q1 = 100)



Source: ECB.

1) An upward movement of the index represents an appreciation of the euro. The latest observation is for Q2 2003 and is an estimate. The horizontal line indicates the average since 1975.

Chart B further corroborates this finding by taking a longer-term perspective that covers the period since 1975. The current level of the (CPI-deflated) real effective exchange rate of the euro is also close to its average over this longer period, while the level observed in October 2000 corresponds to the long-term historical low.

Overall, when considered against past experiences, which have sometimes included rather dramatic exchange rate adjustments, it would appear that the appreciation has brought the euro into a range of levels that is broadly consistent with long-term averages.