E-1

Read the article entitled "EU Economy May Have Slowed Slightly," taken from the Wall Street Journal, September 6th, 2000. Use the information contained in the text to address the following questions:

E1.1 From August 1999 to August 2000, US producer prices rose 3.3%. During the same period, US intermediate-goods producer prices rose by 11.4% and US consumer prices rose by 2.2%. Applying the Purchasing Power Parity principle, and based on the increase in the different European price indexes reported in the article, calculate the expected appreciation or depreciation of the US$ with respect to the Euro.

E1.2 From August 1999 to August 2000 the ER US$/Euro slid from 1.06 to 0.86. Calculate the % appreciation of the US$ with respect to the Euro and compare it with the expected appreciations indicated by the PPP principle in section E1.1. Which one is closest to the actual change in the ER?

E1.3 Why do we say that the PPP principle is not a good short-run predictor of ER variations? Explain in detail and use the conclusions from section E1.2 to support your arguments.

EU Economy May Have Slowed Slightly

Inflation Rate Ebbled a Bit, While Fall in Joblessness Stalled, July Data Show

A WALL STREET JOURNAL News Roundup

FRANKFURT—Euro-zone producer prices rose in July at a 5.5% annualized rate, while a steady decline in unemployment halted for the first time this year.

The data suggest the economy in the 11-nation region remained strong in the third quarter but slowed slightly from the second quarter, economists said. And inflationary pressures are receding only gradually.

The figures were roughly in line with consensus forecasts, but the euro fell to within a quarter cent of its historical low against the dollar and hit a new low against the yen. Traders wondered again about the unity of European policymakers following Monday’s assertion by German Chancellor Gerhard Schroeder that the euro’s weakness should be looked on positively because it will help exporters. That view contrasts starkly with worries about the weak euro expressed by finance ministers and the European Central Bank.

The euro slid to 88.50 U.S. cents, shedding gains of the previous few days and nearly touching last week’s record of 88.37 cents. Late yesterday, the euro traded at about 89 cents in Europe, down a penny from Monday.

Producer prices rose slightly less than the 5.7% that economists expected. But the data are likely to be of limited comfort to the ECB, which last week raised its benchmark interest rate by a quarter point to 4.5%—the sixth increase in the past year.

High crude-oil prices are forcing EU officials to raise projections for inflation this year.

Oil prices, the main factor driving euro-zone import prices and inflation upward, fell in July but have since risen to hit 10-year highs.

The European Commission said yesterday that it will have to raise its inflation forecasts because of the high price of crude oil. Last spring, the commission forecast consumer prices in the euro zone would rise 1.8% this year. The ECB says euro-zone consumer-price inflation, currently 2.4%, is unlikely to be below 2% for the full year.

Eurostat, the EU’s statistics agency, said the intermediate-goods component of the producer-price index—the one most exposed to energy and commodity prices—was up a year-on-year 11.4% in July, down from 11.9% in June.

Separately, Eurostat reported that euro-zone unemployment in July was unchanged from June’s 9.1%, in line with expectations. That’s down from 9.9% in July of last year, but well above the U.S. rate of 4.1%. Deutsche Bank AG, in a notice to clients, said the pause in the unemployment rate’s decline should be temporary, and that it should fall to 9.0% in August.