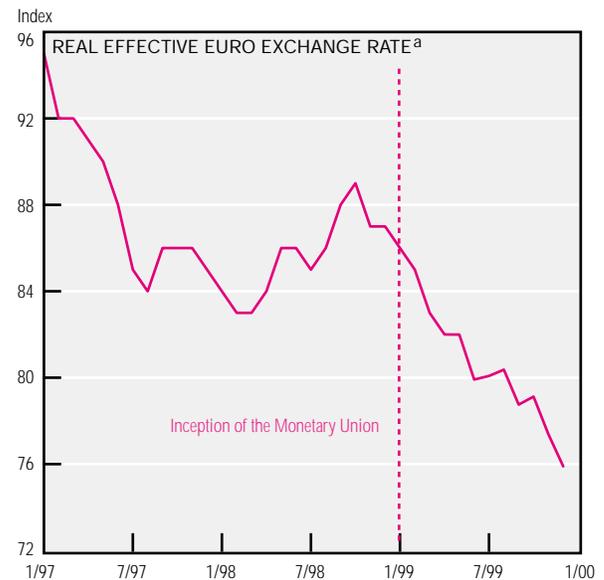
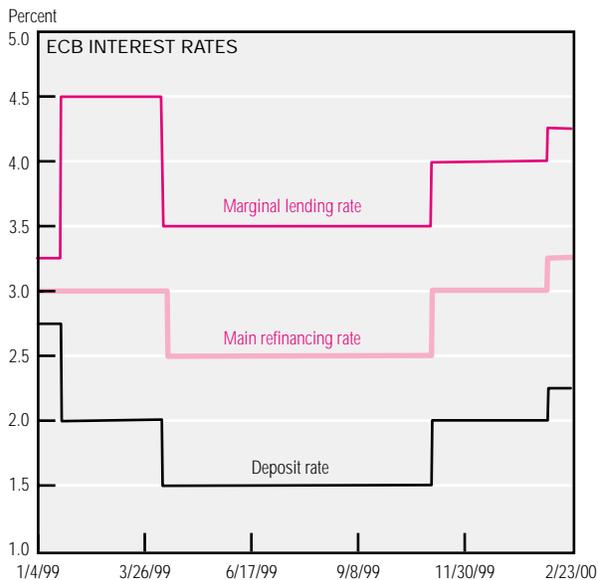
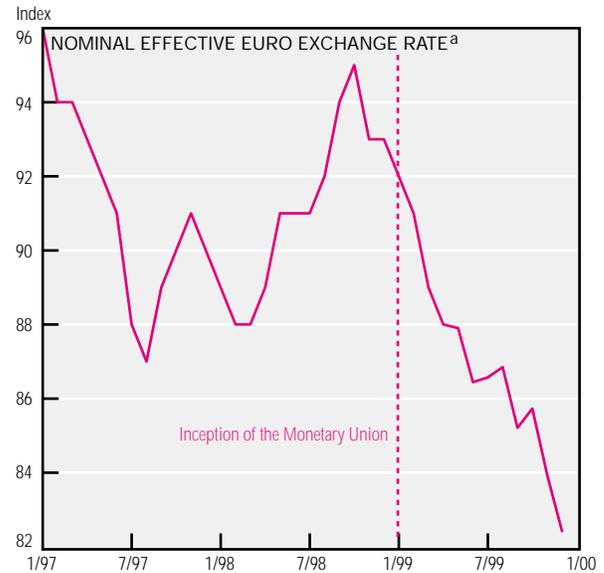


The Euro



a. The International Monetary Fund constructs a synthetic dollar/euro exchange rate for the period prior to January 1999 by applying official conversion factors to the dollar exchange rates of individual participant countries. The nominal and real effective trade weights for the euro are based on the total foreign trade of the euro area. The real effective euro uses unit labor costs as inflation proxies.

SOURCES: Board of the Governors of the Federal Reserve System; European Central Bank, <http://www.ecb.int/>; and International Monetary Fund, *International Financial Statistics*.

The euro fell below one-to-one parity with the dollar on January 27, 2000, initiating calls for foreign-exchange-market intervention. On a nominal effective basis, the euro has depreciated about 11% since its inauguration on January 1, 1999.

The European Central Bank (ECB) has two choices for influencing the dollar/euro exchange rate. One option is to tighten monetary policy relative to the U.S. On February 3, 2000, the ECB raised interest rates 25 basis points, following a similar hike

in the U.S. federal funds and discount rates on February 2.

A second option is to sell official dollar reserves without changing targeted interest rates. When central banks maintain interest-rate objectives—as do the ECB, the Federal Reserve, and the Bank of Japan—they automatically neutralize (or sterilize) any impact intervention might otherwise have on the target. Sterilized intervention does not alter relative money-growth rates, a key determinant of exchange rates. It

only influences exchange rates in the unlikely event that it affects market expectations or perceptions, so most economists regard sterilized intervention as largely ineffectual.

Neither intervention nor monetary policy has any lasting effect on nations' real exchange rates, which incorporate inflation differentials between countries. Since January 1, 1999, the euro has depreciated 12% on a real effective basis, an indication that its competitive position has improved.