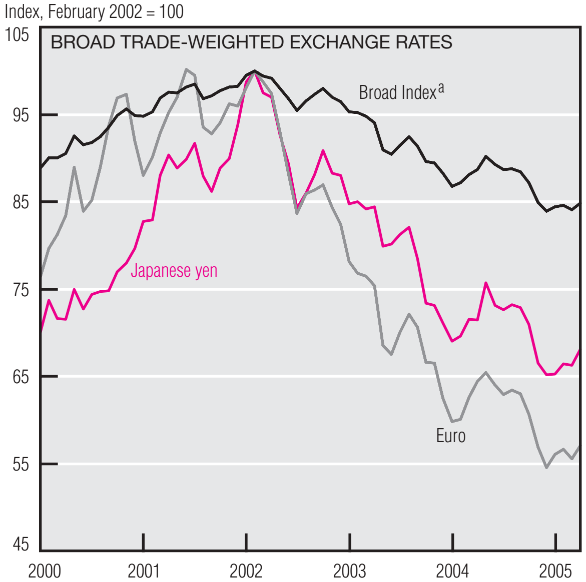
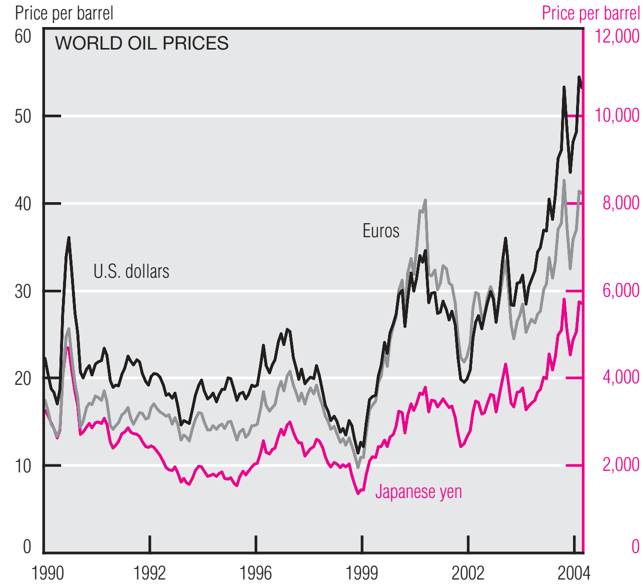
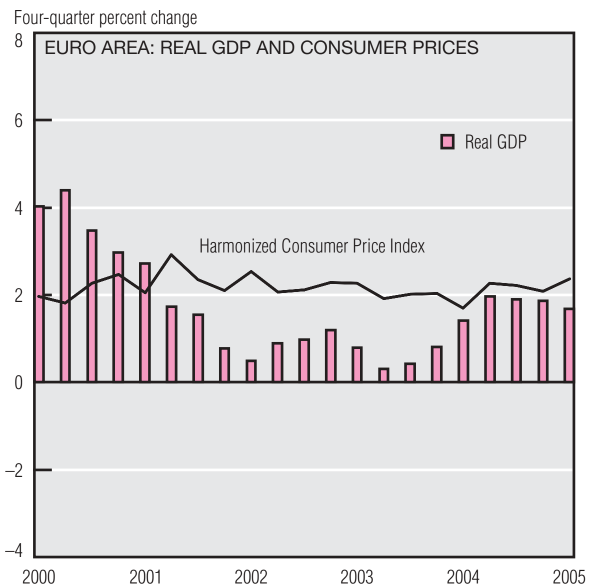
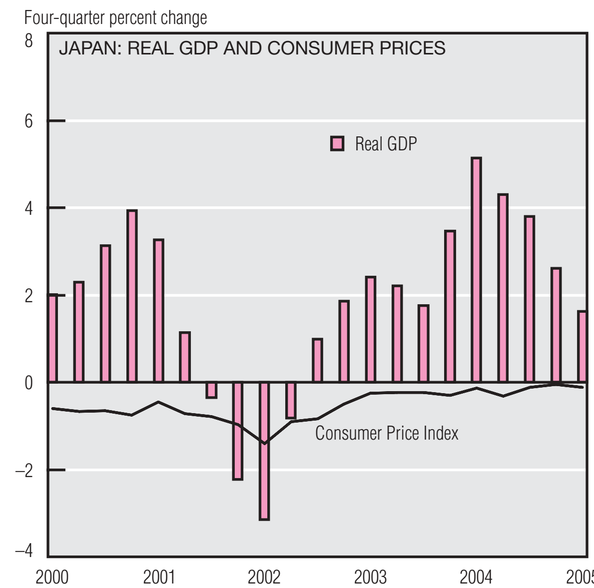
# Economic Growth in the Euro Area and Japan




a. The Broad Index measures the trade-weighted average change in dollar exchange rates against our most important trading partners.
SOURCES: Board of Governors of the Federal Reserve System, “Foreign Exchange Rates,” *Federal Reserve Statistical Releases*, H.10; Organisation for Economic Co-operation and Development, *Economic Outlook*; and the *Wall Street Journal*.

Economic growth in the euro area and Japan has been sluggish—less than 2% on balance—and is likely to remain so this year and next. The dollar’s depreciation and higher oil prices have weighed heavily on these economies. With economic activity in the U.S expected to advance at a fairly robust rate of $3\frac{1}{4}$% to $3\frac{1}{2}$%, global growth differentials will not help narrow the U.S. trade gap.

Since its peak in February 2002, the dollar has depreciated almost 49% on balance against the euro and nearly 25% against the Japanese yen. A dollar depreciation shifts worldwide demand toward U.S. goods and services by lowering their foreign-currency price and raising the dollar price of foreign products. In so doing, dollar depreciation tends to reduce foreign economic growth.

Because of this depreciation, the euro and yen prices of oil have not risen as fast as the dollar price. (Oil is priced in dollars around the globe.) Nevertheless, oil prices have risen briskly in both Europe and Japan and, as in the U.S., have had a negative impact on the pace of economic activity.

Inflation rates in Europe and Japan remain subdued. Although higher oil prices may tend to raise headline price measures, a dollar depreciation has the opposite effect. Ultimately, however, inflation depends on monetary trends. Most analysts expect Europe’s year-over-year inflation to remain around the European Central Bank’s target of 2%. They also expect that Japan’s persistent bout with deflation will soon end.