

# Analyses

## Currency war?

**” The big war,  
the small burger  
and the large cake “**

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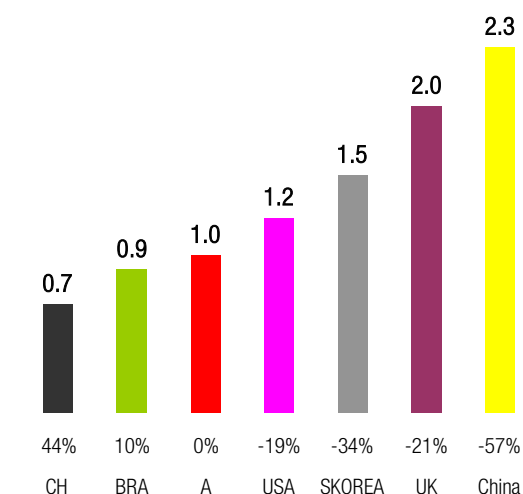
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## The big war, the small burger and the large cake

International debate in the last few weeks has focused on the “currency war“. This is based on the belief that some countries are attempting to make their exports cheaper by keeping their currency undervalued, which will give them a larger slice of the world trade cake.

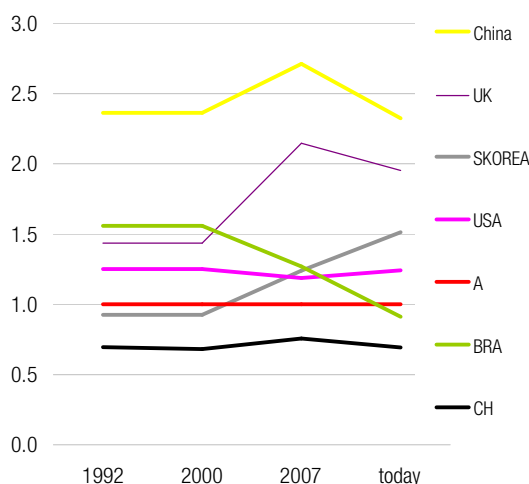
China’s currency, in particular, is criticised as being undervalued. A glance at the Big Mac Index shows that this criticism is not unfounded. According to the index, the yuan is currently undervalued by as much as 60 % against the euro. For the price of one Big Mac in Austria, one gets almost two and a half in China. But this has always been the case, or least since the beginning of the nineties, and it is less the effect of an actively pursued exchange rate policy than a phenomenon of countries with low productivity levels (measured in terms of per capita income).

How many Big Mac do you get?  
(for the price of one Big Mac in Austria; % indicates under-/overvaluation against the euro)



Source: Economist, Bank Austria Economics & Market Analysis Austria

How many Big Macs do you get?  
(for the price of one Big Mac in Austria)



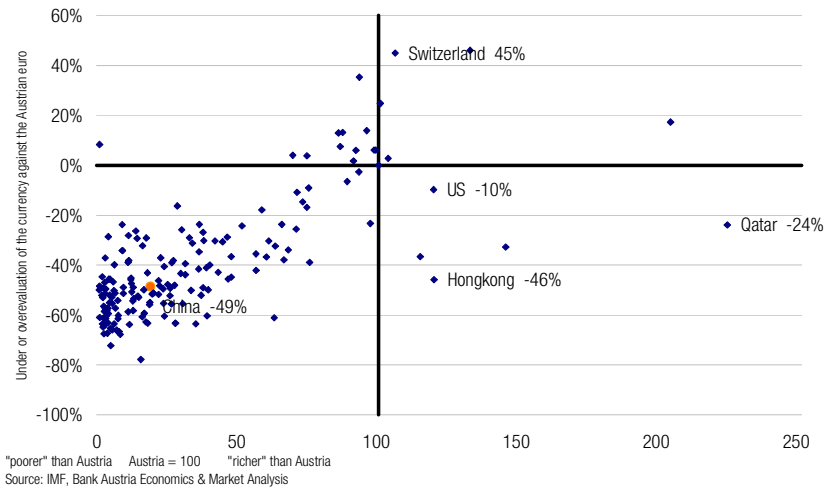
Source: Economist, Bank Austria Economics & Market Analysis Austria

There are only about ten countries worldwide which, based on purchasing power per inhabitant, have higher income levels than Austria. Five of these have (compared with Austria) a currency which is overvalued, and five countries have a currency which is undervalued. Four of the five countries whose currency is undervalued are either city-states or small states (Hong Kong, Singapore, Qatar and Bahrain). The US is the only large country in this sub-group.

Twelve countries worldwide have a currency which is overvalued compared with Austria, although they are poorer than Austria (but only marginally). These are primarily almost all euro area countries. Most of the world’s countries have lower income levels than Austria, and consequently a currency which is undervalued. This group comprises 155 countries.

The undervaluation of a currency, measured in terms of a country’s price levels, is largely linked to productivity. The more productive a country is, the higher are its wage levels. This however also applies to the area of the economy whose productivity hardly differs to that of other countries worldwide, especially the service sector. The price of high income levels and high productivity are higher wage levels, which is then largely responsible for the currency being overvalued. While high productivity justifies higher wages in industry, it pushes up prices in many areas of the service sector, which is why the Big Mac costs more in productive/rich countries. The export performance of a rich country such as Austria therefore depends less on whether its currency is over- or undervalued than on its productivity.

**Income levels and currency evaluation**  
(177 countries in relation to Austria, 2010)



**The slice of the cake is getting smaller, but the actual portion is getting bigger.**

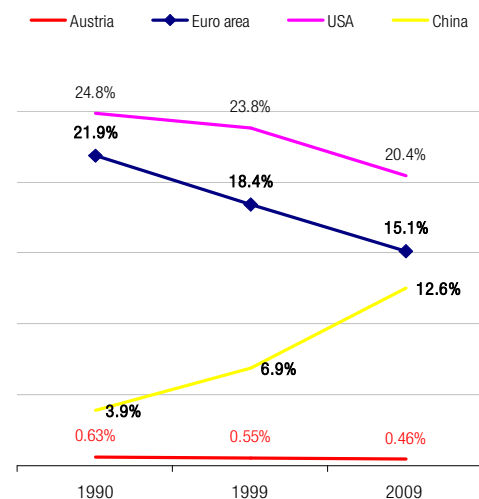
Since the significant achievements of many emerging markets, primarily China, in global exports, many industrial countries are afraid that China may displace all other countries in the area of global foreign trade.

China's global market share in exports has risen from 2.5 % in 1990 to 11.2 % today, with the US and Germany each losing about 2 percentage points. Similarly, China's share of global production has risen from 3.9 % to 12.6 %.

A fact one tends to overlook, however, is that although the share of the industrial countries is getting smaller, the "cake" as a whole, i.e. exports and output, is definitely getting bigger. For example: the euro area countries' share in global production declined from 21.9 % to 15.1 %, but 21.9 % of EUR 18,000 bn in 1990 is much less than 15.1 % of EUR 41,000 bn in 2009. The same applies to exports.

**Share of global output**

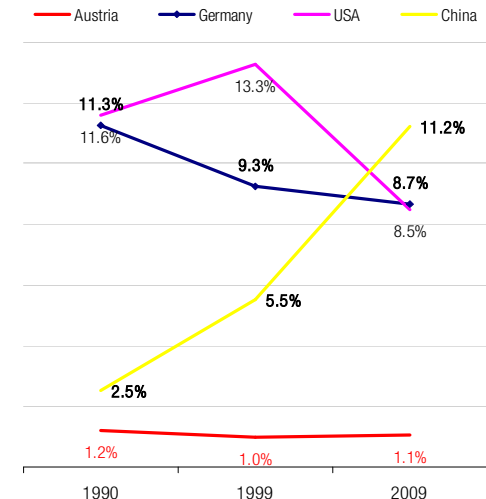
(share of global GDP at purchasing power parity)



Source: IMF, Bank Austria Economics & Market Analysis Austria

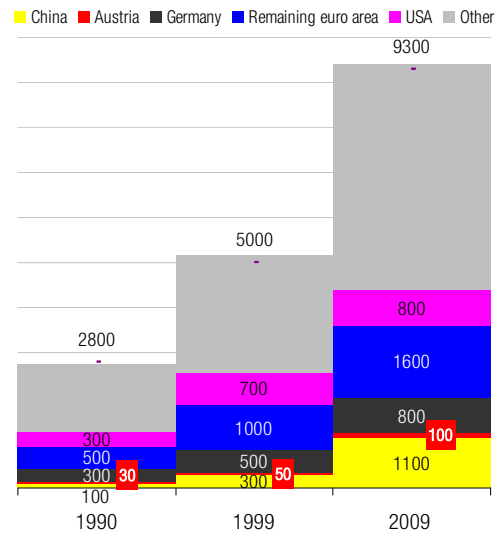
**Share of global exports**

(in %)



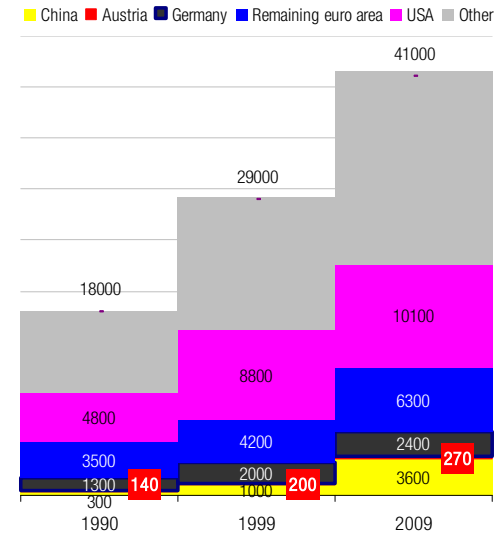
Source: IMF, Bank Austria Economics & Market Analysis Austria

**Global export market**  
(in Euro bn)



Quelle: IMF, Bank Austria Economics & Market Analysis Austria

**Global output**  
(GDP in EUR bn)

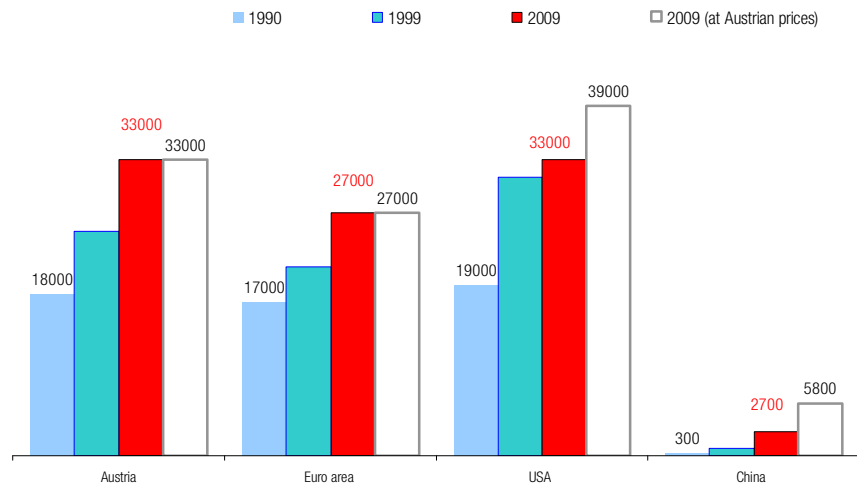


Source: IMF, Bank Austria Economics & Market Analysis Austria

Consequently, incomes in industrial countries, in percentage terms, rose much more slowly than in China, for example. Translated into purchasing power, incomes in the euro area have risen by about 60 % since 1990, and in China by an impressive 676 %. At the same time, incomes in absolute terms (adjusted for inflation and price differences) have risen from EUR 17,000 to EUR 27,000 in the euro area, and from EUR 740 to EUR 5,800 in China; i.e. the EUR 10,000 increase in the euro area compares with a rise of about EUR 5,000 in China.

This means that globalisation and the emerging markets' participation in the global division of labour are not a one-way street, and they are not processes with winners or losers – everyone can win. However, such a system requires an economy which succeeds in steadily improving productivity (and consequently income levels).

**GDP per capita**  
(in Euro)



Source: IMF, Bank Austria Economics & Market Analysis Austria

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