Research Task

Use the globalEDGE™ site to complete the following exercises:

1. One component of learning about another country or region is to understand the relationship of its currency with others on the world currency market. As such, you are assigned the duty of ensuring the availability of 100,000 yen for a payment scheduled for next month. Considering that your company possesses only U.S. dollars, identify the spot and forward exchange rates. What are the factors that influence your decision to use the spot or forward exchange rate? Which one would you choose? How many dollars must you spend to acquire the amount of yen required?

2. Sometimes, analysts use the price of specific products across locations to compare currency valuation and purchasing power. In fact, the Big Mac Index compares the purchasing-power parity of many countries based on the price of a Big Mac. Locate the latest edition of this index that is accessible. Identify the five countries (and the currencies) with the lowest purchasing-power parity according to this classification. Which currencies, if any, are overvalued?

The Curse of the Strong Dollar at STMicro

Europe's STMicro is the world's sixth-largest manufacturer of semiconductor chips, with sales of nearly $9 billion. The company makes chips for mobile phones, printers, and cars, among other things. It counts Nokia, the world's largest maker of wireless handsets, among its customers. Formed in 1987 from a merger between an Italian firm and a French firm, the majority of STMicro's operations have long been in Western Europe. During the early 2000s, when the dollar was strong against the euro, the currency adopted by 12 member states of the European Union, this location worked in STMicro's favor. Some 70 percent of the company's costs were denominated in Europe while semiconductors, like oil, were priced in U.S. dollars. The combination of a weak euro and a strong dollar translated into robust profits for STMicro.

However, in 2003 the euro began to rise against the dollar, rapidly shifting the profit calculus against STMicro. The euro, which traded as low as €1 = $0.83 in October 2000, had reached parity of €1 = $1.00 in late 2002. Few analysts predicted a rapid rise in the value of the euro against the dollar during 2003. As so often happens in the foreign exchange markets, the experts were wrong; by late 2003 the exchange rate stood at €1 = $1.20. The rise continued through 2004, with the exchange rate peaking at €1 = $1.32 in early 2005. It fell back to €1 = $1.20 in early 2006 before rising back to €1 = $1.30 by late 2006.

One cause of the rise in the value of the euro against the dollar was record U.S. foreign trade deficits in 2002–2006. The U.S. economy grew rapidly during 2003–2006, sucking in imports from foreign nations while generating anemic export growth. The result was a flow of dollars out of the United States into the hands of foreigners. Historically, foreigners had reinvested those dollars in the United States, and the return flow had kept the dollar strong despite persistent trade deficits. This didn't happen to the same extent in 2003–2006. Instead, many foreigners sold the dollars they received for other currencies, such as the euro, Japanese yen, or British pound. They did this because they had become increasingly pessimistic about the future value of the dollar and were reducing their dollar holdings accordingly. Their pessimism was itself a function of two factors. First, U.S. government officials stated that they would prefer a weaker dollar in order to increase the competitiveness of U.S. companies in the global marketplace (the theory being that a falling dollar would make U.S. exports more competitive). With the government talking the dollar down, many foreigners decided to reduce their dollar holdings. Second, the U.S. government ran record budget deficits in 2003–2006, and these were projected to remain high for some time. Looking at the situation, some foreigners concluded that the U.S. government might be forced to finance its spending by expanding the supply of dollars (i.e., by printing money), which would lead to inflation and reduce the value of the dollar even further. Thus, they sold dollars and purchased currencies thought to be less inflation prone.
For STMicro, the results of these macroeconomic events were serious. The company does very little currency hedging, so as the dollar fell, the euro value of STMicro's sales compressed, while costs, being largely dominated in euros, stayed high. Although strong global chip sales helped to offset the fall in the value of the dollar, STMicro's profits still slumped in 2004 and 2005. In response, STMicro's CEO, Carlo Bozotti, pledged to take some $500 million out of the company's cost structure, primarily by shutting down some high-cost European operations, cutting 3,000 jobs, and moving production to Asia where it planned to add 1,500 jobs. Mr. Bozotti described the strategy as one of "real hedging" that would allow STMicro to move production from Europe to Asia, and back if necessary, in order to deal with the consequences of shifts in exchange rates against the dollar.\textsuperscript{14}

### Notes


5. Ibid.

6. Ibid.


