The meaty dollar

Our Big Mac index of global currencies reflects the dollar's strength

Emerging-market currencies and the euro look undervalued against the dollar

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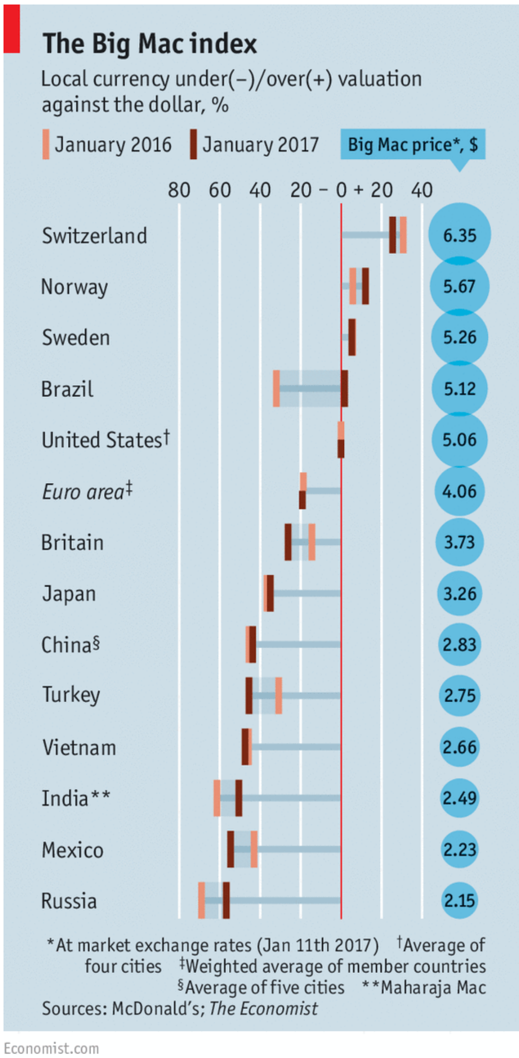

IT IS perhaps not surprising that the worst-performing major currency in the world this year is the Turkish lira. Many emerging-market currencies have taken a battering since the election in November of Donald Trump raised expectations of faster monetary tightening in America and sent the dollar soaring. But the lira has many other troubles to contend with, too: terrorist bombings, an economic slowdown, alarm over plans by the president, Recep Tayyip Erdogan, to strengthen his powers, and a central bank reluctant to raise interest rates to defend the currency. It has plunged to record lows. According to the Big Mac index, our patty-powered currency guide, it is now undervalued by 45.7% against the dollar.

The Big Mac index is built on the idea of purchasing-power parity, the theory that in the long run currencies will converge until the same amount of money buys the same amount of goods and services in every country. A Big Mac currently costs $5.06 in America but just 10.75 lira ($2.75) in Turkey, implying that the lira is undervalued.

However, other currencies are even cheaper. In Big Mac terms, the Mexican peso is undervalued by a whacking 55.9% against the greenback. This week it also plumbed a record low as Mr Trump reiterated some of his campaign threats against Mexico. The peso has lost a tenth of its value against the dollar since November. Of big countries, only Russia offers a cheaper Big Mac, in dollar terms, even though the rouble has strengthened over the past year.

The euro zone is also prey to political uncertainty. Elections are scheduled this year in the Netherlands, France and Germany, and possible in Italy. The euro recently fell to its lowest level since 2003. Britain's Brexit vote has had an even bigger effect on the pound, which has fallen to $1.21, a 31-year low. According to the Big Mac index, the euro and the pound are undervalued against the dollar by 19.7% and 26.3%, respectively.

One of the drawbacks of the Big Mac index is that it takes no account of labour costs. It should surprise no one that a Big Mac costs less in Shanghai than it does in San Francisco, since Chinese workers earn far less than their American counterparts. So in a slightly more sophisticated version of the Big Mac index, we take account of a country's average income.

Historically, this adjustment has tended to raise currencies' valuations against the dollar, so emerging-market currencies tend to look more reasonably priced. The Chinese yuan, for example, is 44% undervalued against the dollar according to our baseline Big Mac index, but only 7% according to the adjusted one. The deluxe Big Mac index has typically made rich-world currencies look more expensive. Because western Europeans have higher costs of living and lower incomes than Americans, the euro has traded at around a 25% premium against the dollar in income-adjusted burger terms since the euro's inception.

But what once seemed to be an immutable axiom of burgernomics is true no longer. So strong is the dollar that even the adjusted Big Mac index finds the euro undervalued. The dollar is now trading at a 14-year high in trade-weighted terms. Emerging-world economies may struggle to pay off dollar-denominated debts. American firms may find themselves at a disadvantage against foreign competition. And American tourists will get more burgers for their buck in Europe.

Access the interactive Big Mac index here (http://www.economist.com/content/big-mac-index)

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