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The Show that demystifies Economics

Economic Indicators - part 4

Purchasing Power

by Max Farrington and Michael Hirsch ©



Today's indicators are all about purchasing power; and with this we can determine the relative value of different currencies. Firstly, PPP, stands for Purchasing Power Parity, which means that the value of the money you have depends on the cost of living and the general price of things where you live, in relation to that of other countries and their currencies. The PPP helps us measure how much of a certain currency you will need to buy a certain amount of goods in a certain country. For instance, with €5 you can buy many more things in India than you can in France.

An example of one specific item that you can find in many countries is the McDonald's Big Mac. It was The Economist weekly newspaper that introduced the "Big Mac index" back in 1986. At the time, it was for a semi-humorous illustration of Purchasing Power Parity, but it was actually a half serious metaphor, showing that the more expensive the Big Mac is in a specific country, then the overall cost of living is higher in relation to per capita income. As of 2012, the most expensive Big Mac in US dollars can be found in Norway at \$9, followed by Sweden, Switzerland and then Brazil. The least expensive is in Hong Kong where a Big Mac costs only \$2.

With the Big Mac index we can also calculate how long it takes a worker to actually afford one. For example, in Tokyo it takes only 9 minutes of work to afford a Big Mac, while in Nairobi, Kenya you have to work a total of 84 minutes to pay for your lunch at McDonalds. Of course, there is a limit to this, as the price of a Big Mac also reflects its production and delivery cost. Another example, quite similar to the Big Mac index, is the iPad Index. This is somewhat different, obviously, because an iPad is much more expensive to manufacture or purchase than a Big Mac. An iPad in Norway is less expensive than in Slovakia or France, and also much cheaper than in Argentina, where it costs around \$1,000. The cheapest place to buy one is actually in Malaysia where it costs on average less than \$500!

Finally, another interesting indicator of purchasing power is the minimum wage. Minimum wages, as we all know, refer to the minimum amount of money, before deduction of taxes and social contributions that a worker can be paid. Not every country has a minimum wage and some countries have many depending on the type of work and location. India, for instance, has 1200 different minimum wages. Quite obviously, the higher the minimum wage is the stronger the general purchasing power. In the Eurozone, Luxembourg's minimum wage is €1,922 per month and in France it is €1,457. So, for someone who lives near the border, their purchasing power may be increased because of the ease in making cross-border shopping excursions. Inflation also must be considered, as, for example, if it is 2%, then the minimum wage will have to increase at least 2.1% for purchasing power to increase, and again, as we are all too familiar, this is not always the case.