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Jul 28th 2011, 14:35 by The Economist online

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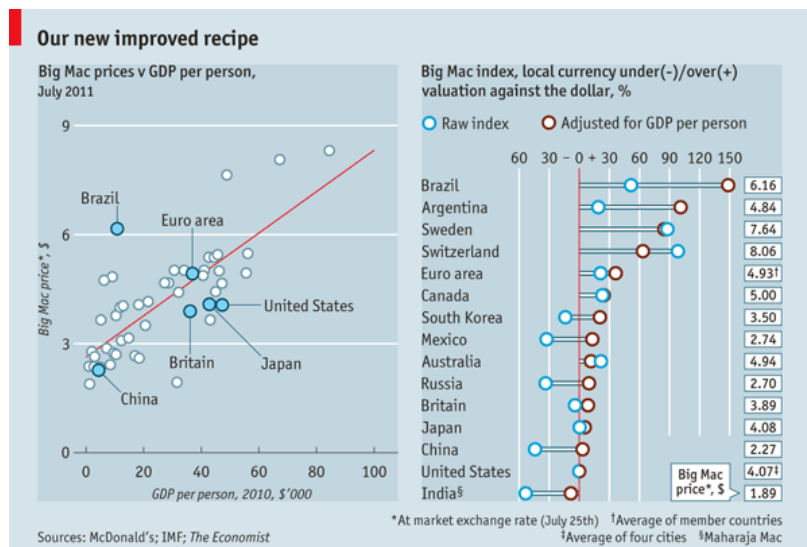
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A beefed-up version of the Big Mac index suggests that the Chinese yuan is now close to its fair value against the dollar

THE Economist's Big Mac index is a fun guide to whether currencies are at their "correct" level. It is based on the theory of purchasing-power parity (PPP), the notion that in the long run exchange rates should move towards the rate that would equalise the prices of a basket of goods and services around the world. At market exchange rates, a burger is 44% cheaper in China than in America. In other words, the raw Big Mac index suggests that the yuan is 44%

undervalued against the dollar. But we have long warned that cheap burgers in China do not prove that the yuan is massively undervalued. Average prices should be lower in poor countries than in rich ones because labour costs are lower. The chart above shows a strong positive relationship between the dollar price of a Big Mac and GDP per person.

PPP signals where exchange rates should move in the long run. To estimate the current fair value of a currency we use the "line of best fit" between Big Mac prices and GDP per person. The difference between the price predicted for each country, given its average income, and its actual price offers a better guide to currency under- and overvaluation than the "raw" index. The beefed-up index suggests that the Brazilian real is the most overvalued currency in the world; the euro is also significantly overvalued. But the yuan now appears to be close to its fair value against the dollar—something for American politicians to chew over. Read more in our [Economics focus \(http://www.economist.com/node/21524811\)](http://www.economist.com/node/21524811) and [leader](#)



(<http://www.economist.com/node/21524873>) .

Click on the tabs in the table below for a ranking of currencies on both the raw and the adjusted index:

- For more on the **Big Mac index**, see this week's *leader* (<http://www.economist.com/node/21524873>) and *economics focus* (<http://www.economist.com/node/21524811>)

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