

Exercise 8

International Economics

1. What is the difference between “absolute” and “comparative” advantages? What are the main implications of these two theories? (i.e. what do they suggest?)
2. The table below shows the amount of production that one worker in each country can produce. Assume that each country has 5 workers. **Draw a PPF and show** that both countries will benefit from trade.

	Thailand	Malaysia
Beer	4	1
Wine	1	4

3. What do “current account surplus” and “capital account deficit” represent? What is the “Balance of Payment Identity”?
4. Suppose the current market exchange rate is \$0.3 / 1 Baht. Use the foreign exchange market diagram to explain how the Central Bank of Thailand can “devalue” Thai baht to \$0.2 / 1 Baht under the fixed exchange rate regime.
5. How does the floating exchange rate regime work? Under such regime, how does each of the following events affect Thai Baht (assumed to be a domestic currency)?
 - The rest of the world imports more from Thailand.
 - More Thai investors invest abroad.
 - Thailand will leave ASEAN (similar to the UK leaving the EU).
6. In the floating exchange rate regime, why might inflation cause a currency to appreciate and depreciate?
7. Suppose an iPhoneX is priced at 400 USD in the US and 300 GBP in the UK. Calculate the PPP exchange rate between USD and GBP.
8. Suppose the nominal exchange rate is 40 THB / 1 GBP. One apple costs 20 THB in Thailand, but costs 1 GBP in the UK. Calculate the real exchange rate.
9. What assumptions are required for the Law of One Price to hold?

1. What is the difference between "absolute" and "comparative" advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

Absolute Advantages - when one country uses fewer resources / lower cost to produce a good than the other country does
 - Specialization (do what you good at)

Comparative Advantages - when one country produces a good at a lower opportunity cost than the other country does
 - look at opportunity cost

2. The table below shows the amount of production that one worker in each country can produce. Assume that each country has 5 workers. **Draw a PPF and show that both countries will benefit from trade.**

	Thailand	Malaysia
Beer	4	1
Wine	1	4

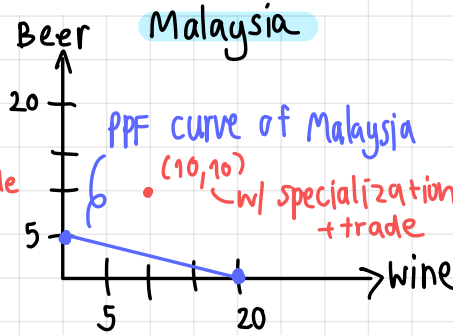
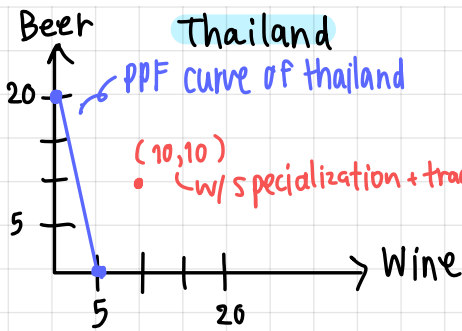
has AA in Beer production
has AA in wine production

w/ specialization

	TH	MS
Beer	20	0
wine	0	20

w/ specialization + trade

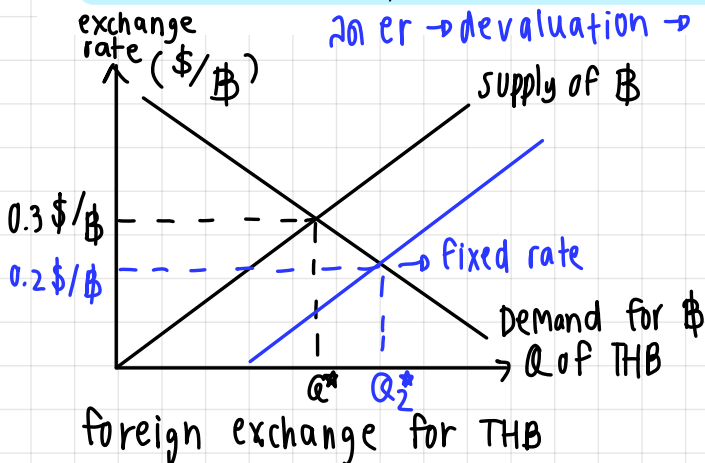
	TH	MS
Beer	10	10
Wine	10	10



3. What do "current account surplus" and "capital account deficit" represent? What is the "Balance of Payment Identity"?

- Current Account surplus : when export > import
- Current Account deficit : when outflow > inflow
- Balance of payment identity is $CA + KA = 0$, when we have current account surplus while capital account deficit

4. Suppose the current market exchange rate is \$0.3 / 1 Baht. Use the foreign exchange market diagram to explain how the Central Bank of Thailand can "devalue" Thai baht to \$0.2 / 1 Baht under the fixed exchange rate regime.



2018 → devaluation → sell ฿

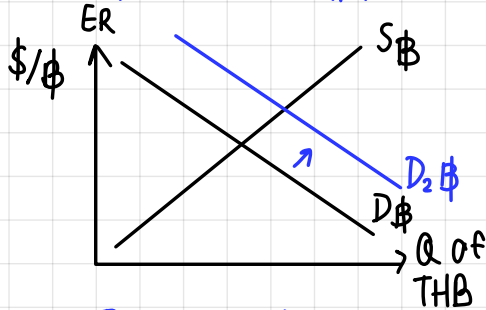
The CB can devalue THB by increase supply of Baht. CB sells THB and buy USD.
 This will lead to depreciation of THB

5. How does the floating exchange rate regime work? Under such regime, how does each of the following events affect Thai Baht (assumed to be a domestic currency)?

- The rest of the world imports more from Thailand.
- More Thai investors invest abroad.
- Thailand will leave ASEAN (similar to the UK leaving the EU).

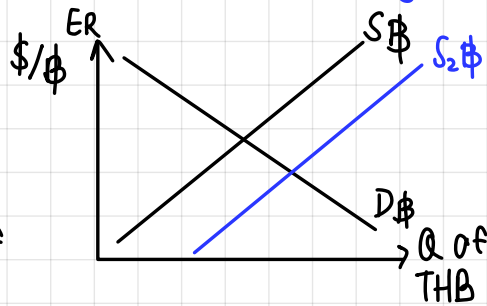
Floating exchange rate regime - the equilibrium exchange rate depends on demand & supply
 - must know who demand baht and who supply baht.

1) import from Thailand
 → Demand for THB ↑



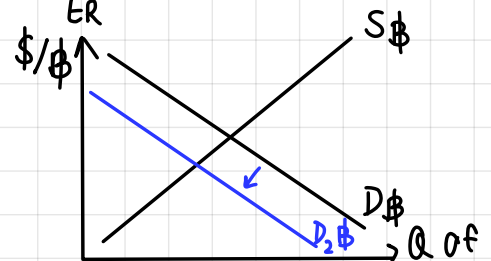
THB appreciate

2) Thai investor invests abroad
 → sell more THB and buy others



THB depreciate

3) Thailand leaves ASEAN
 → others countries don't want THB
 → Demand for THB ↓



THB depreciate

6. In the floating exchange rate regime, why might inflation cause a currency to appreciate and depreciate?

THB appreciate

- Inflation can increase interest rate which attracts foreign investors to buy THB and invest in Thailand.
 Demand for THB ↑

THB depreciate

- Inflation causes domestic goods to become more expensive. This makes Thai people want to buy products from abroad $M↑, X↓ \rightarrow D฿↓$
- Inflation makes the value of money ↓ so it discourages anyone to hold THB

7. Suppose an iPhoneX is priced at 400 USD in the US and 300 GBP in the UK. Calculate the PPP exchange rate between USD and GBP.

$$\frac{400}{300} = \frac{4}{3} = 1.33 \text{ USD} : 1 \text{ GBP}$$

PPP is
 (NOTE) exchange rate get when comparing value of the same good in 2 countries

8. Suppose the nominal exchange rate is 40 THB / 1 GBP. One apple costs 20 THB in Thailand, but costs 1 GBP in the UK. Calculate the real exchange rate.

$$\begin{aligned} \text{RER (THB/GBP)} &= \text{NER (THB/GBP)} \times (P_{\text{GBP}} \div P_{\text{THB}}) \\ &= \frac{40}{1} \times \frac{1}{20} = 2 \end{aligned}$$

9. What assumptions are required for the Law of One Price to hold?

when there is no cost of transportation/transaction, The price of the same good in different countries should be the same.