

## 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

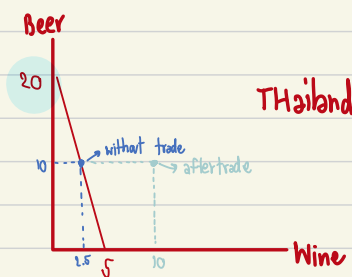
3. What do “current account surplus” and “capital account deficit” represent? What is the “Balance of Payment Identity”?
4. Suppose the current market exchange rate is  $\$0.3 / 1$  Baht. Use the foreign exchange market diagram to explain how the Central Bank of Thailand can “devalue” Thai baht to  $\$0.2 / 1$  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?)

- AA is the advantage of one country when it uses fewer resources to produce a good than other country
- CA is the advantage of one country when it produces a good at a lower opp. cost than the other country.

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.

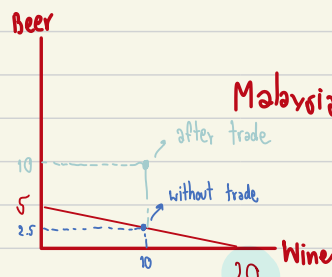
	Thailand	Malaysia
Beer	4 20	1 5
Wine	1 5	4 20



$$20 B : 5 W$$

$$4 B : 1 W$$

$$B : \frac{1}{4} W$$



$$5 B : 20 W$$

$$B : 4 W$$

$$\frac{1}{4} : W$$

produce what they specialize.

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

$$CA \text{ surplus} = \text{inflow} > \text{outflow}$$

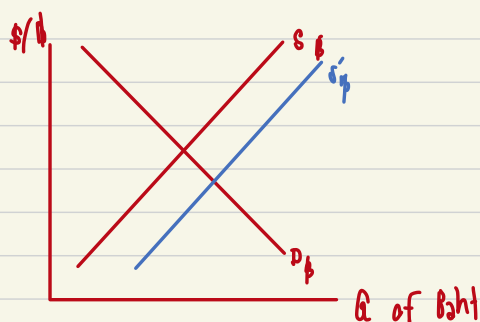
$$KA \text{ deficit} = \text{outflow} > \text{inflow}$$

$$\therefore BBI = CA + KA = 0$$

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.

mf xlv

indonesia vs  
dan TH



devalue : CB sell reserve \$ → buy \$  
THB depreciate (cheaper)  
USD appreciate (expensive)  
∴ Due to supply 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).

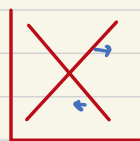
1.) foreigner buy more  $\text{฿}$  :  $D \uparrow \rightarrow \text{TH appreciate}$



2.) Thai buy more \$ :  $D \uparrow \rightarrow \text{US appreciate}$   
 $S \uparrow \rightarrow \text{TH depreciate}$



3.)



foreigner don't want trade with TH :  $D \downarrow$  TH depreciate

TH don't want to invest in ASEAN :  $S \downarrow$  TH appreciate  
 $\therefore$  total effect depend on size

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

when  $i \uparrow$ , foreigner demand for  $\text{฿}$  b/c they want to save in TH  
 $\rightarrow$  TH appreciate

when domestic goods more expensive, Thai ppl sell Thai Baht to get USD, so we will import more b/c foreign products are more cheaper.  
 $\rightarrow$  TH depreciation

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.

$$\begin{array}{l} \text{Price in US} : \text{Price in UK} \\ 400 \$ : 300 \text{ £} \\ \frac{4}{3} \$ : \text{£} \end{array}$$

1 GBP is equal to  $\frac{4}{3}$  \$

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.

$$\begin{aligned}\text{real exchange rate} &= \text{NER (THB/GBP)} \times \left( \frac{P_{\text{GBP}}}{P_{\text{THB}}} \right) \\ &= \frac{40 \text{ THB}}{1 \text{ GBP}} \times \frac{1 \text{ GBP}}{20 \text{ THB}} \\ &= 2\end{aligned}$$

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

The price of same good in different country should be the same if we don't have transportation cost.