

ex. 8

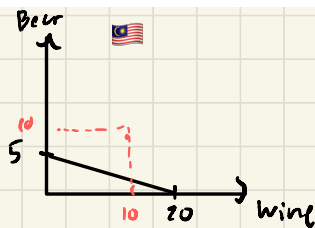
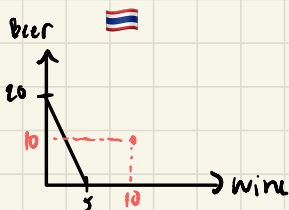
1. What is the difference between "absolute" and "comparative" advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

absolute advantage - the advantage of one country when it use less resources to produce a good than another

Comparative advantage - the advantage of one country when it produce a goods at a lower opportunity cost than another

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



→ Thailand have an absolute advantage in beer production (1 worker → 4 beer)

→ Malaysia has an absolute advantage in wine production (1 worker → 4 wine)

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

current account surplus - trade surplus, export > import

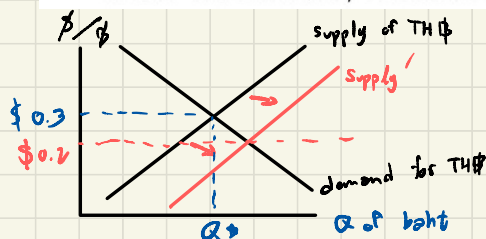
Capital account deficit - an increasing in ownership of owner assets, which make money flow out of the country

Balance of Payment Identity -  $BOP = \text{current account (CA)} + \text{Capital account (KA)} = 0$

↳ when we have CA surplus, we must have KA deficit.

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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.



To devalue TH฿, central bank has to increase supply of TH฿ by sell TH฿ and buy USD. Then, the exchange rate of TH฿ will fall.

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: the equilibrium of exchange rate is determined by demand and supply of the currency.

- Appreciation of TH฿, BC demand for TH฿ increase.
- Depreciation of TH฿, BC supply of TH฿ increase.
- Depreciation of TH฿, BC demand of TH฿ decrease.

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

When inflation goes up, so does the interest rate.

This attracts foreign investors, because when foreign investors

invest, the demand for Thai baht increases. So

this leads to an appreciation in Thai baht.

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.

$$\$ 400 = 300 \text{ GBP}$$

$$\$ \frac{400}{300} = 1 \text{ GBP}$$

$$\$ 1.33 = 1 \text{ GBP}$$

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.

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

RER implies that, in terms of purchasing power, ppl are willing to exchange 2 Thai apple with 1 GBP = apple

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

The assumption that required for law of one price to hold are there is no tax, no trade barrier, no transportation cost and the price should be the same, so you can freely move the goods to other country.