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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?)

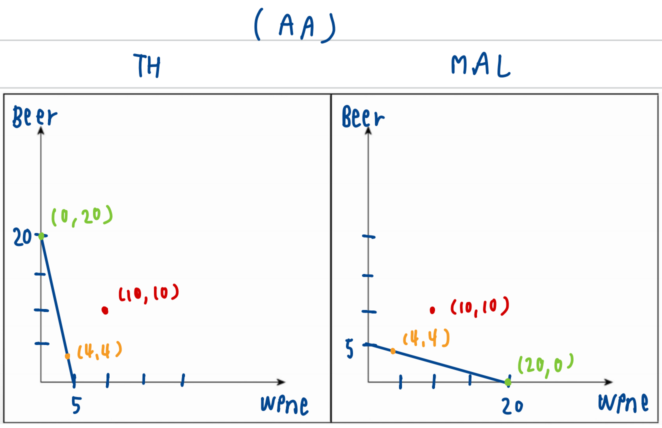
Absolute advantage is when one country can produce a good by using fewer resources than another country. It is about specialize in producing the good that it has absolute advantage.

Comparative advantage is when one country can produce a good at a lower opportunity. It is about the opportunity cost of production.

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

	Thailand (TH)	Malaysia (MAL)
Beer	4 (20)	1 (5)
Wine	1 (5)	4 (20)

TH has AA in beer production.
MAL has AA in wine production



• W/o trade

	TH	MAL
wine	4	4
beer	4	4

• W/ specialization

	TH		MAL
wine	0	← 10	20
beer	20	10 →	0

• W/ specialization + free trade

	TH	MAL
wine	10	10
beer	10	10

Without trade,
TH can allocate 1 worker for beer & 4 worker for wine to enjoy 4 units of beer & wine.

MAL can allocate 4 worker for beer & 1 worker for wine to enjoy 4 units of beer & wine.

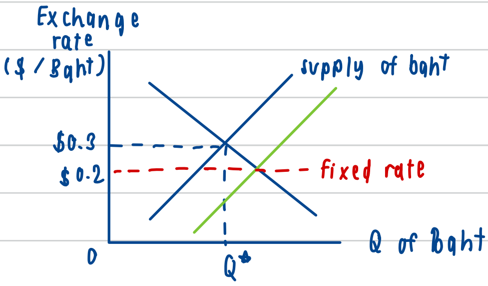
3. What do “current account surplus” and “capital account deficit” represent? What is the “Balance of Payment Identity”?

Current account surplus is when inflows more than outflows.
Capital account deficit is when outflows more than inflows.

Balance of Payment Identity is the sum of all accounts which must equal to zero.

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.

As you know, government can't control foreign exchange market but it can intervene by buying and selling in the market.



→ shift supply & exchange rate fall

The Central Bank sell Baht and buy $ in order to keep the currency cheap (to promote export).

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 D of USD / more S of THB => THB deppreciates, USD appreciates
   - More Thai investors invest abroad. more Supply of THB => THB deppreciates, USD appreciates
   - Thailand will leave ASEAN (similar to the UK leaving the EU). no effect

The floating exchange rate regime work same as in the demand & supply diagram.

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

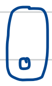
① In the fisher equation, inflation can increase interest rate. When inflation occurs, interest rate goes up. This can attract foreign investor. ⇒ THB appreciates

② Domestic goods become expensive because they can't be sold abroad. ⇒ THB depreciates

③ The value of money goes down ⇒ THB depreciates

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 USD



300 GBP

9.33 USD : 1 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.

$$RER = NER \times (P_{UK} / P_{TH})$$

$$= \frac{40\ THB}{1\ GBP} \times \frac{1\ GBP}{20\ THB}$$

$$= 2$$

People are willing to exchange 2 Thai apples with 1 UK apple.

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

If there is no transportation cost, there will be the opportunity for Arbitage, making the price of 2 countries the same. This means that it leads to the Law of One Price.