Reminder: DAE & BoP

From DAE:

Leakage = Injection

$$S + M + T = I + X + G$$

If govt is running the budget balance, $T = G$

$$S + M = I + X$$

$$S - I = X - M$$

Saving-Investment gap → KA

Export Import gap → CA (Trade Balance)

← Example: If $S < I$ → Capital inflows to finance I.

$X - M > 0 \Rightarrow S - I > 0$

(Surplus in trade balance)

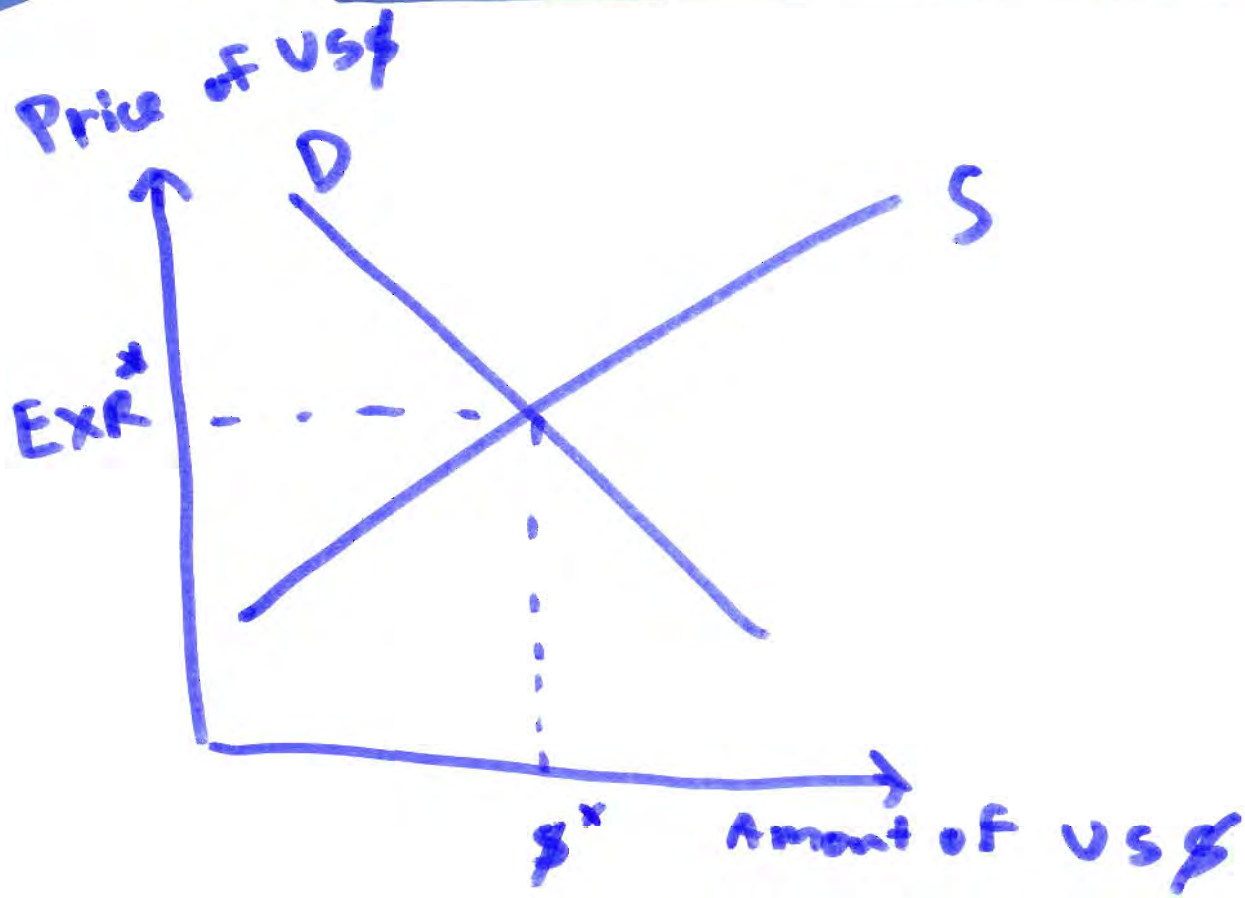
Reminder: CASE 1 Investment : to be recorded in KA (Capital Inflow)
[In the first year Thailand earns foreign Exchange]

Profit : to be recorded in CA (Income Outflow)
[Sending profits back to its home countries in later years]

CASE 2 Foreign Loan : to be an item in KA

Interest payment : to be an item in CA

Exchange Rate & Exchange Mkt

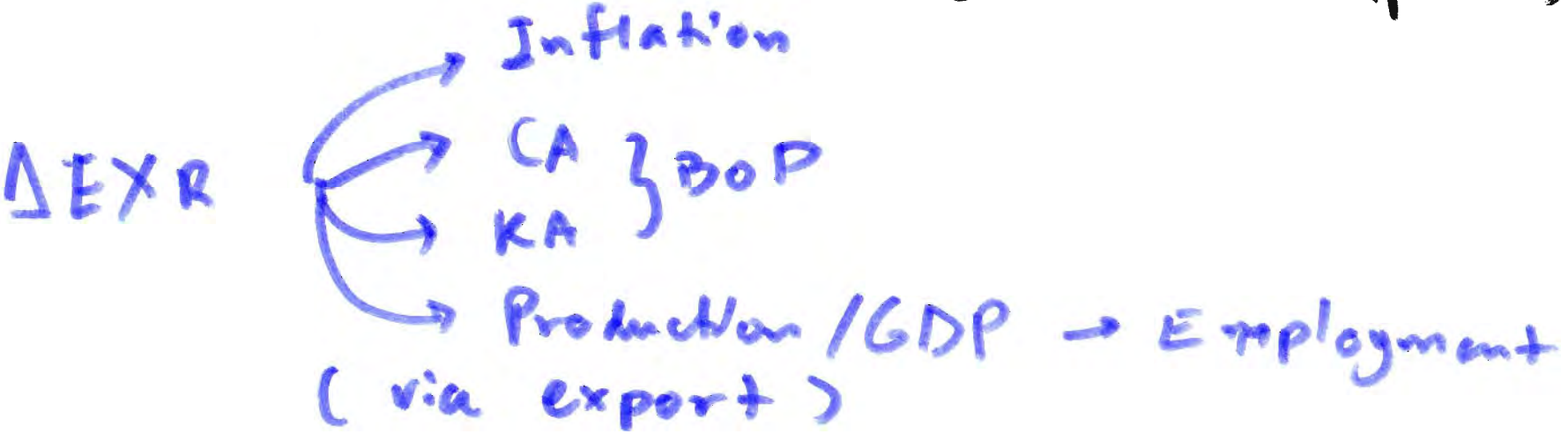


Foreign Exchange Rate : is the price of foreign currency compared to domestic price.
(Baht / US$)

Why EXR is important?

① EXR is the rate of exchange medium of exchange in the international trade
(i.e. global effect)

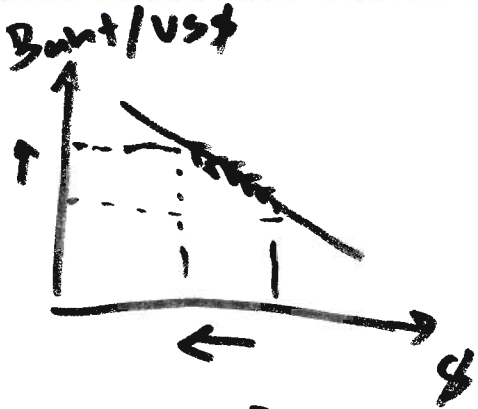
② Change in EXR affects the economy:
(i.e. local impact)



Example ΔEXR → ΔExport → Δproduction → Δ Employment

Move along the Curve

Demand



If $\frac{\text{Baht}}{\text{US\$}}$ ↑ (Baht Depreciates / US$ Appreciates)

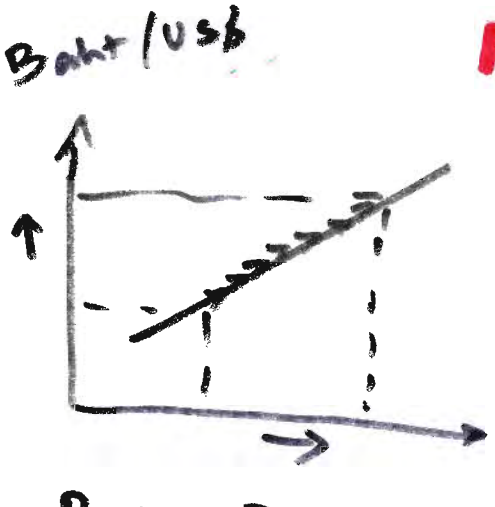
⇓

Demand ∧ (of Thai people) for foreign imports ↑

⇓

Demand for US$ ↓

Supply



If $\frac{\text{Baht}}{\text{US\$}}$ ↑ (Baht Depreciates / US$ Appreciates)

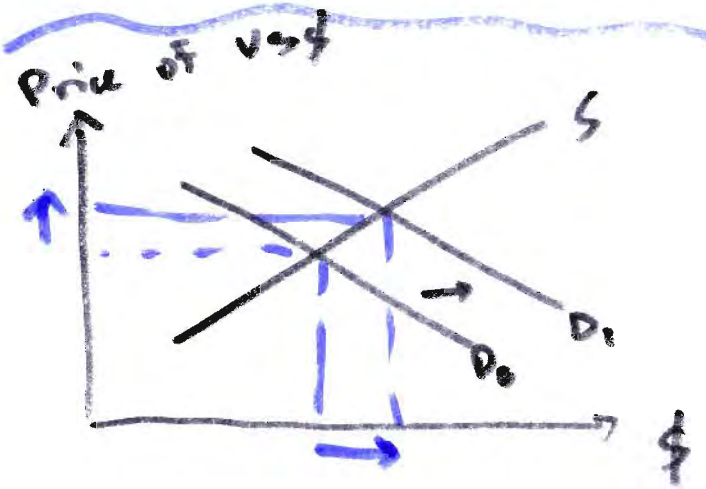
⇓

Demand for Thai exports ↑ (Thai exports are cheaper in the world market)

⇓

Supply of US$ ↑

Shift the Demand Curve



KA: ① Demand for foreign financial assets. (e.g. stock, bonds)
② Out-going FDI of Thai companies

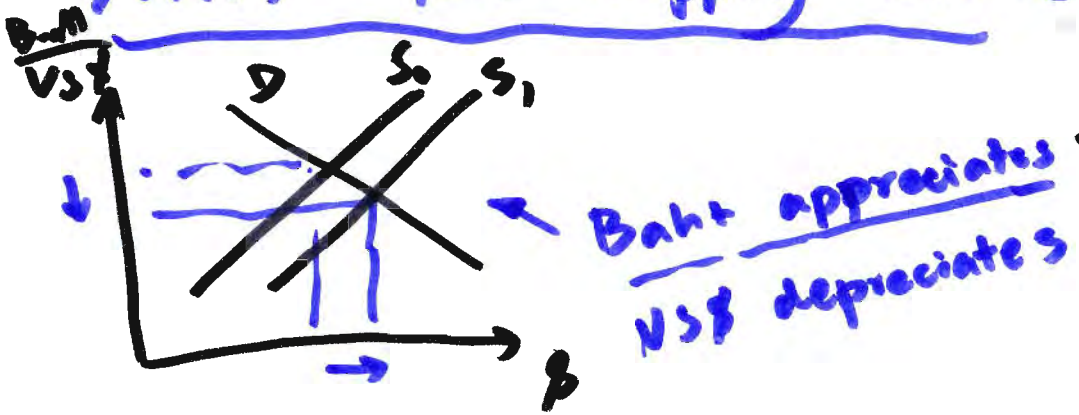
CA:
① Import of goods
② Import of Services (e.g. Thai tourists)
③ Income of (foreign workers) sending back to home country
④ Profit of (foreign companies) running abroad; sending back profits to home country.
⑤ Interest payment to foreign banks

Example:

① Thailand imports more oil → demand for US$ ↑ → Thai Baht depreciates

② Thai investors buy bonds in NY Mkt → demand for US$ ↑ → Thai Baht depreciates

Shift the Supply Curve



CA: ① Exports of Thai products
② Exports of Thai services
③ Income from Thai workers working abroad
④ Profit of Thai companies sending back to Thailand (Thai companies operating abroad)
⑤ Interest earned from lending to abroad borrowers

KA: ① Demand for Thai financial assets (e.g. Thai stocks, bonds)
② Incoming FDI

Example :

① Thailand exports rice to the world mkt → Supply of US$↑ → Thai Baht appreciates

② Japanese companies build factory in Thailand → supply of US$↑ → Thai Baht appreciates

Other factors that affect EXR adjustment

① Inflation gap (between 2 countries)

Inflation in Thailand ↑ → Thai Baht depreciates
(higher than the inflation rate in US)
(because people will lower the value of Thai currency)

← People prefer to hold US$ instead of Thai Baht
→ Demand for US$ ↑

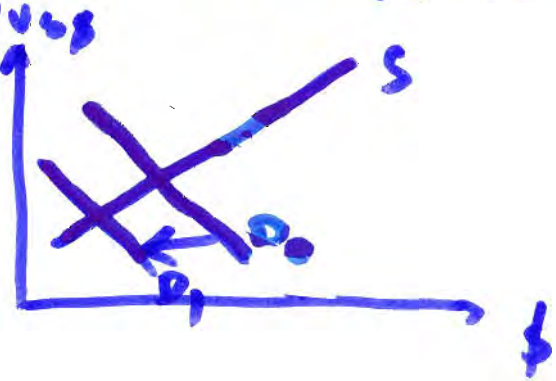
② Interest Rate gap (between 2 countries)

Interest rate in Thailand ↑ → more capital inflow.

↓

Thai Baht will appreciate

Demand for US$ ↓
and Demand for Thai Baht ↑



⑤ Elasticity of Export and Import

Thai Rice Price (in Baht) ↑ → Price of Thai Rice (in US$) ↑ (Export of rice ↓)

- Foreign Demand is elastic → Supply of US$ ↓ → EXR ↑ (Baht/$)
  ΔX.Q > ΔX.P
- Foreign Demand is inelastic → Export Income From rice ↑ (Supply of US$ ↑) → EXR ↓ (Baht/$)
  ΔX.Q < ΔX.P

US$ ipad ↑ (price in US$) → Price of imported iPad ↑ (price in Baht↑)

- Demand is elastic → Import ↓ (Demand for US$ ↓) → EXR ↓ (Baht/$)
  ΔX.Q > ΔX.P
- Demand is inelastic → Import ↑ (Demand for US$ ↑) → EXR ↑ (Baht/$)