

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 advantage - refers to the advantage of one country when it uses fewer resources to produce a good than the other country does.

Comparative advantage - the advantage of one country when it produces a good at a lower opportunity cost than the other country does.

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"?

Current account surplus is a positive current account balance, indicating that a nation is a net lender to rest of the world. A country has more exports than imports of goods and services.

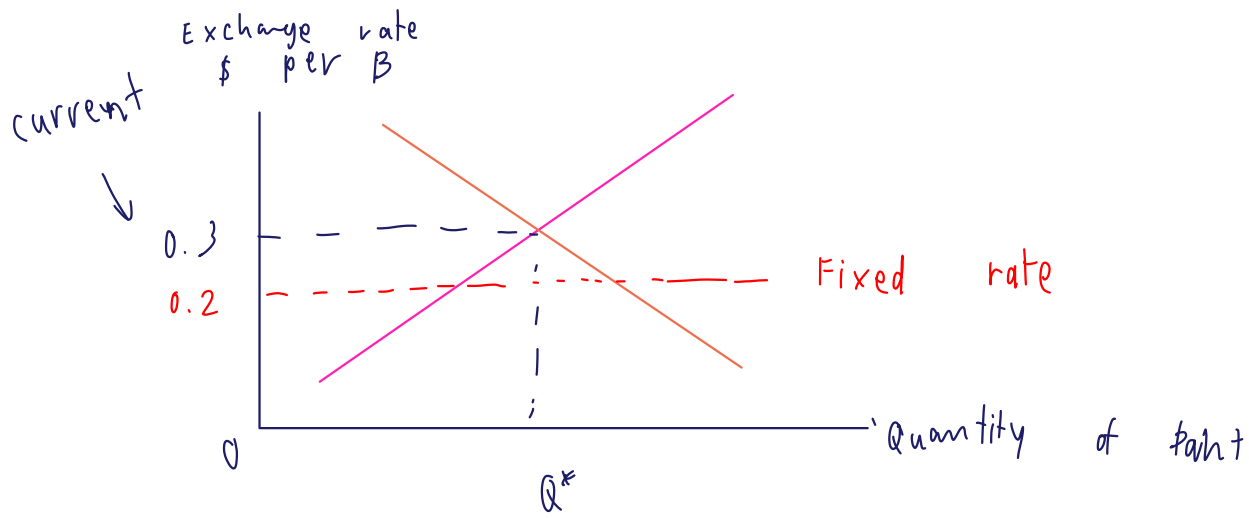
Capital account deficit means money is flowing out of the country and it suggests the nation is increasing its ownership of foreign

Balance of payment includes both current account and capital account. It summarizes all transactions that a country's individuals, companies, and government bodies complete with individuals, companies, and government bodies outside the country.

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.

\$ 0.3 / 1 B

\$ 0.2 / 1 B



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).

The rest of the world imports more from Thailand

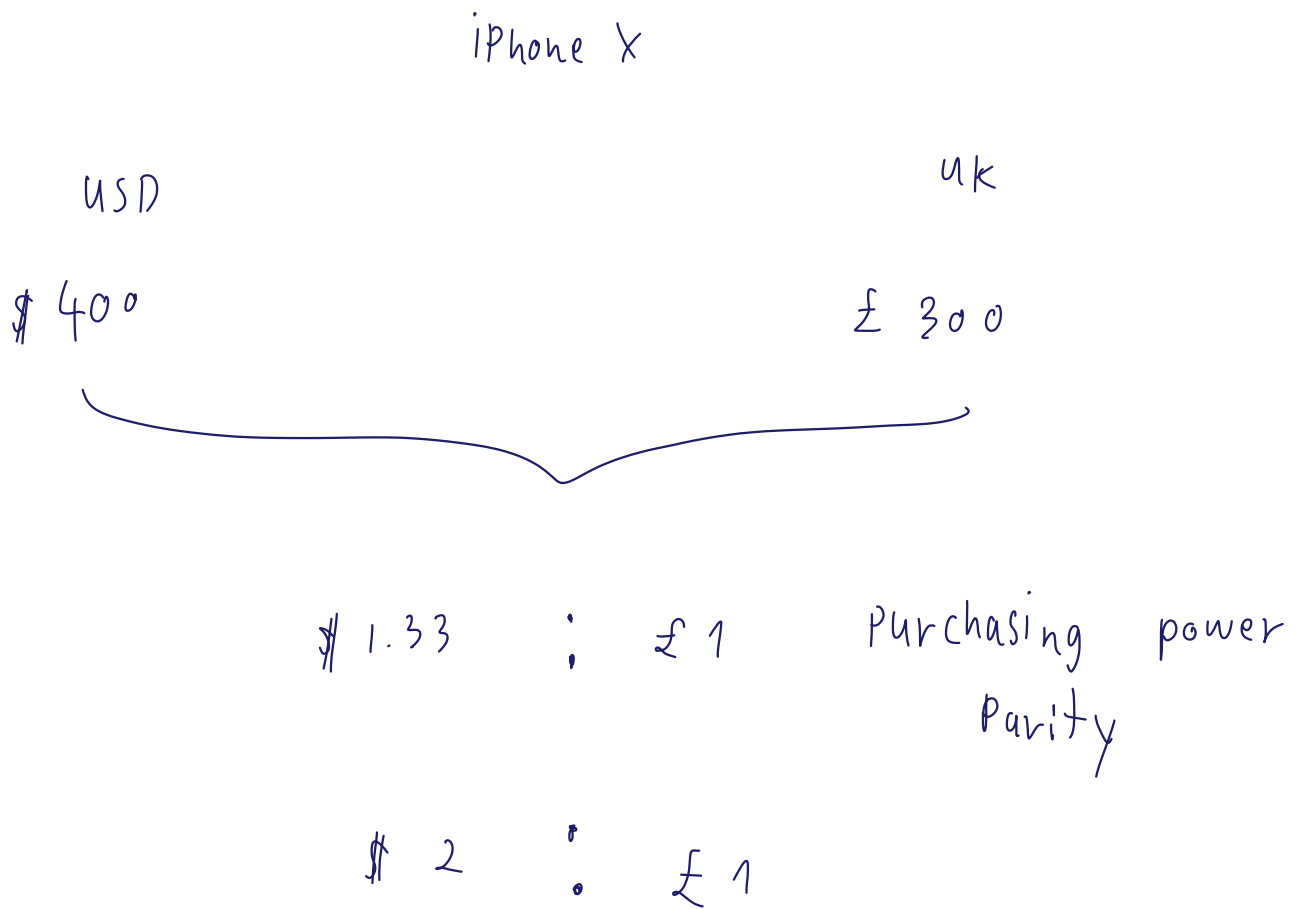
6. In the floating exchange rate regime, why might inflation cause a currency to appreciate and depreciate?

Floating Exchange Rate - The "equilibrium" exchange rate is determined by the demand and supply of the currency

Appreciation - A curvy the rise in value of one currency relative to another.

Depreciation - A curvy the fall in value of one currency relative to another.

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.

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

$$= \left(\frac{40}{1} \right) \times \left(\frac{2}{40} \right) = 2 \quad \text{A}$$

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

the cost of transportation are small, the price of the same good in different countries should be roughly the same.