

Exercise 8

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International Economics

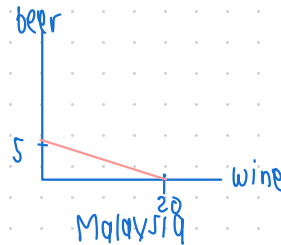
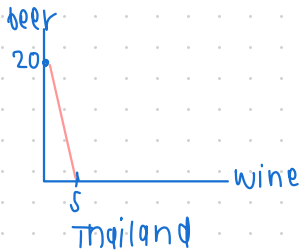
1. What is the difference between "absolute" and "comparative" advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

absolute advantage = when country use fewer resource to produce goods than others

comparative advantage = when the country produce goods at lower opportunity cost than others

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 x 5	1 x 5
Wine	1 x 5	4 x 5



Thailand has AA in beer production
Malaysia has AA in wine production

∴ After trade Thailand will get more wine from Malaysia.
Malaysia will get more beer from Thailand.

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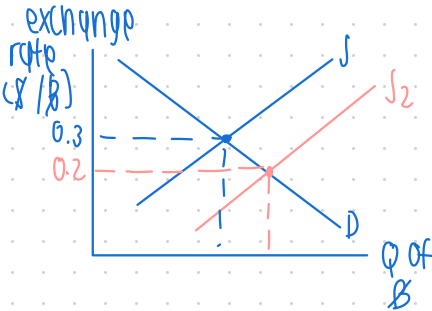
3. What do "current account surplus" and "capital account deficit" represent? What is the "Balance of Payment Identity"?

current account surplus - when inflows of balance of Trade, Primary Income, and Secondary Income more than outflows.

capital account deficit - when outflows of investment > inflows, it can suggest that nation is increasing its ownership of foreign assets.

Balance of payment identical - statement of all transaction made btw agents in one country and the rest of the world.

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.



"devalue = supply curve shift right"
 The gov. will sell ^{S2} baht, and buy USD.
 This can cause depreciation in 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).

◦ import from Thailand : Demand for THB increase
 → Appreciation in THB

◦ Thai investors invest abroad & Demand for THB decrease
 → Depreciation in THB

◦ Thailand will leave ASEAN & not effect

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

during inflation, π will increase and this attract investors to invest. ^{appreciate}
However, domestic goods become expensive and will cause a fall in ~~export and purchasing power~~. Therefore, less ppl want to hold this currency \rightarrow 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.

$$\begin{aligned} \text{PPP exchange rate} \Rightarrow 400 \text{ USD} &= 300 \text{ GBP} \\ \frac{400 \text{ USD}}{3} &= 1 \text{ PPP} \\ 1 &= 1 \text{ Actual rate} \end{aligned}$$

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.

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

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

if transportation cost is small, the price of goods should be roughly the same in different country.