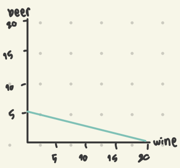
1. What is the difference between “absolute” and “comparative” advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

- absolute advantage = when a country uses fewer resource to produce goods. (it implies that the country is more specialized)
- comparative advantage = when a country produces goods at lower opportunity cost (it implies that the country is more suitable)

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	Malaysia
Beer	4 (20)	1 (5)
Wine	1 (5)	4 (20)

thailand



malaysia

	w/o trade		w/specialization		w/specialization & trade	
	TH	ML	TH	ML	TH	ML
beer	4	4	20	0	10	10
wine	4	4	0	20	10	10

∴ If they use both specialization & trade, they will end up with higher output on both beer & wine.

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

- current acc. surplus = a country has more X than M
- capital acc. deficit = a country has more M than X
- balance of payment identity = the diff. btw money flowing into the country in a particular period of time & outflow of money to 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.

The CB can sell thai baht and buy us dollar to devalue the THB.
B/c it will lower the reserve on foreign market.

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).

It works by the currency price of a nation is set by the demand & supply of the currency.

1. increase value of THB
2. decrease value of THB
3. decrease value of THB

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

appreciate = increasing i → attract foreign investor
depreciate = domestic good more expensive → M↑
= lower purchasing power → discourage C & I

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

4 : 3 = PPP ✻

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.

$\frac{40}{1} \times \frac{1}{20} = \boxed{2}$ // ans

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

The price of the same goods in different countries should be the same.

And PPP uses the LOP to create the PPP exchange rate.