

Exercise 8

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International Economics

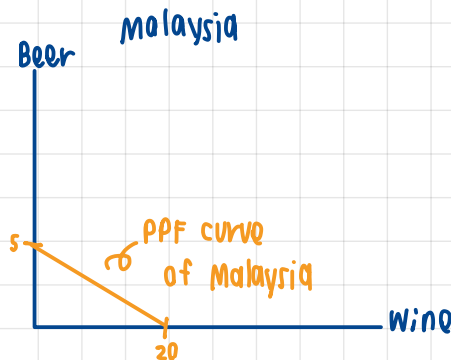
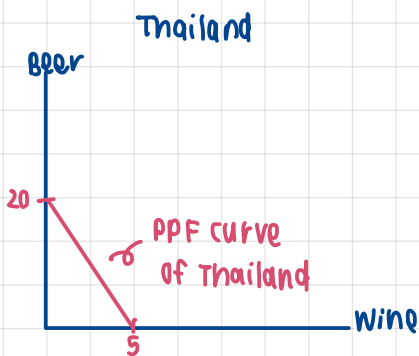
1. What is the difference between "absolute" and "comparative" advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

: **Absolute advantages** is when one country use a fewer resources of production than the other country.

: **comparative advantages** is when one country produce a good at lower opportunity cost than other country.

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



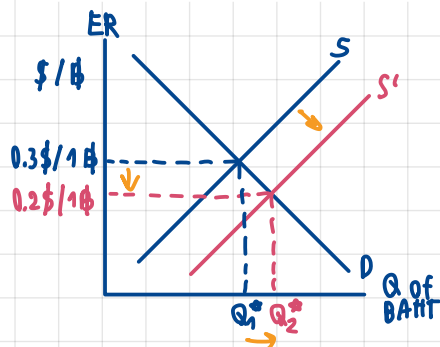
3. What do "current account surplus" and "capital account deficit" represent? What is the "Balance of Payment Identity"?

Current account surplus: when we have exports > imports

capital account deficit: when we have outflow > in-flow

Balance of payment identity is $CA + KA = 0$, when we have current account surplus while capital account deficit.

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.

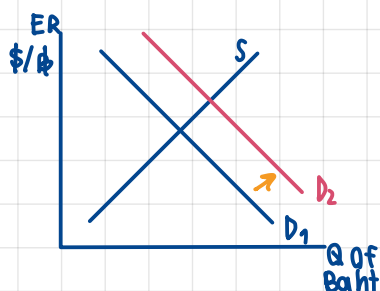


The central bank can devalue Thai baht by increasing supply of baht. The central bank will sell the baht and buy more the USD. This will lead to depreciation in THB.

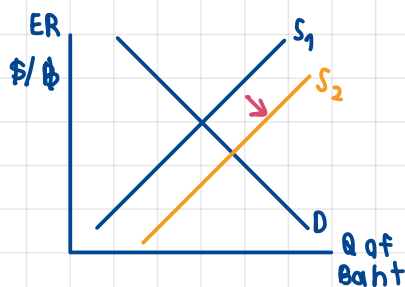
5. How does the floating exchange rate regime work? Under such regime, how does each of the following events affect Thai Baht (assumed to be a domestic currency)?

- 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).

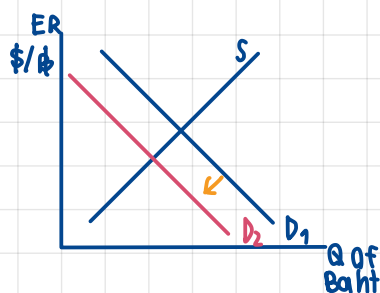
Floating exchange rate regime: demand & supply curve which can change because some factor can affect demand & supply of currency. And we have to know that who demand baht and who supply baht.



Demand in THB will increase so THB will appreciate. B/c the rest of the world want THB more.



Supply of THB will increase b/c you want to buy other currencies for investing abroad by selling Thai baht. THB will depreciate.



When Thailand left the ASEAN, it means that other country will not want our currency anymore, so the demand of THB will decrease and supply remains the same. THB will depreciate

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

- Inflation makes interest rate increase. When the interest rate increase, foreigners will want to buy both to invest in our country so, when the demand of THB increase, THB will appreciate
- Inflation makes domestic good are expensive, so Thai people will want to buy abroad capitals at lower price. As a result, export will be reduced and import will increase so that THB 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.

$$\frac{400}{300} = \frac{4}{3} = 1.33 \text{ USD} : 1 \text{ GBP}$$

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.

$$\begin{aligned} & \text{40 THB} : 1 \text{ GBP} \\ & \frac{40}{20} = 2 \end{aligned}$$

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

The price of the same good in a different country should be the same.