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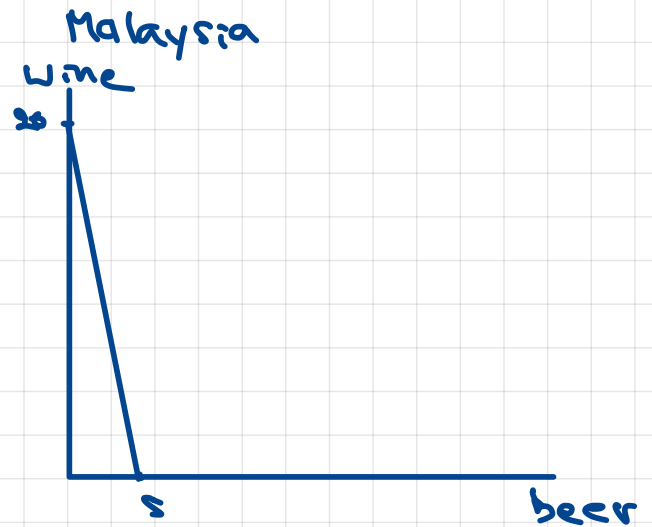
### Exercise 8

#### Answers:

①. "Absolute advantage" refers to an entity's superior capability of production compared to another.

"Comparative advantage" refers to an entity's lower opportunity cost in producing something compared to another.

②. Thailand

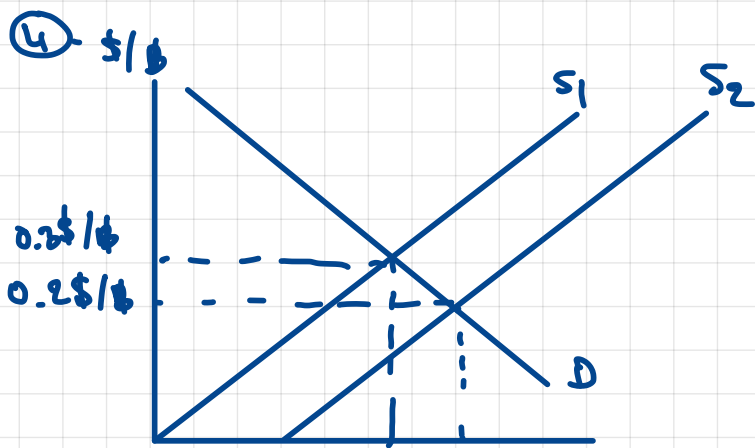


Thailand would sacrifice 4 beers for 1 wine and  $\frac{1}{4}$  wine for 1 beer.  $\rightarrow$  specialize in beer because lower comparative opportunity cost

Malaysia would sacrifice  $\frac{1}{4}$  beer for 1 wine and 4 wine for 1 beer.  $\rightarrow$  specialize in wine because lower comparative opportunity cost

$\rightarrow$  higher total output if specialize and can trade after.

- ③. - current account surplus represents  $X > M$   
 - capital account deficit represents  $k < 0$   
 - The identity of BOP is  $CA + KA = 0$ .



Central bank can devalue THB through selling baht to increase money supply and buying \$ as foreign currency reserve.

⑤. Floating exchange rate regime:

- The rest of the world imports more than Thailand
  - Demand for THB increases → THB gets expensive
- More Thai investors invest abroad
  - Demand for THB decreases → THB gets cheaper
- Thailand leaves ASEAN
  - No more free trade <sup>with ASEAN</sup> → Demand THB decreases
  - THB cheaper

⑥. Inflation cause currency to inflate or deflate because:

- Interest rate increases → attract foreign investor → THB demand increases → THB appreciates
- Domestic products price rise → import more → THB demand decrease → THB depreciate
- THB get cheaper → people don't trust → THB demand go down → THB depreciate

$$\textcircled{7}. \text{ PPP} = \frac{\$400}{\pounds300} = \$\frac{4}{3} = \pounds1$$

$$\textcircled{8}. \frac{\$40}{1} \times \frac{2}{\$20} = 2$$

$\textcircled{9}$ . Law of One Price requires that cost of transportation is dismissively small or zero so goods prices everywhere are the same.