

Assignment 2 (Due on Feb,21th before 3 pm. Please turn in at the BE office.)

EE312 Intermediate macroeconomics theory

Instruction: There are **FOUR** questions. Attempt all. Question will be not be graded, but you are still required to submit. Your trade will grade the next two; meanwhile, I will grade the last one. As usual, your answer in note-taking style will not be graded; answer the question in complete sentences.

Question 1: The law of one price revisited. (will not be graded)

a) In class, we discussed an important proposition/theorem in international trade, known as the *law of one price*. The theorem suggests that, under the international trading system without trading frictions/restrictions, the price of an identical product must be the same across countries. *Explain the mechanism why the theorem holds true.*

b) Suppose instead that international trading system is full of frictions. For example, government might impose tax on imports/exports of goods. Do you think the law of price can still hold if the imposition is to be lasting forever?

c) Find a line of your own argument and convince that even under the trading frictions as mentioned in (b), *law of one price can still be established if factor inputs and firms can freely relocate across border*. Analyze the possibility that the statement can be correct with some economics intuitions provided.

Question 2: (Graded by your TA) Use the exchange rate theorem and analyze the impact of the following developments on the market exchange rate, i.e. the value of Thai baht against the USD. (When you answer each question, use the diagram that we discussed in class, and provide some economics intuitions that support your narrative answer.)

a) Market expects that the Bank of Thailand will raise its policy rate soon.

b) Productivity growth in Thailand is expected to decline rapidly.

c) Market expects that US dollar will be appreciating in the future.

d) Rumor about the trouble in Thai banking sectors has become materialized.

Question 3: (Graded by your TA)

3.1) Explain why BP is an upward sloping curve. Should the slope of BP be steeper or flatter under low sensitivity in imports demand?

3.2) How does the increase in world GDP affect the three curves developed under the IS-LM-BP model?

Question 4: (I will graded)

4.1) Analyze the impact of a cut in pay-roll income tax under the imperfect capital mobility, i.e. upward sloping BP curve.

4.2) Within the Mundell-Fleming model assuming perfect capital mobility, analyze the effects of a positive innovation in financial technology on open-economy. Compare and contrast your results under two different choices of exchange rate regimes, i.e. both fixed and flexible exchange rate.