Exercise 8

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?)

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	1
Wine	1	4

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

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.

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).

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

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.

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

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?)

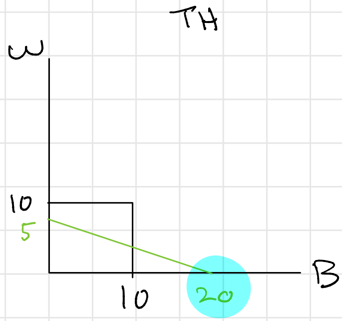
Absolute → Produce at what we specialize which is lower cost

Comparative → Produce at lower oppotunity cost.

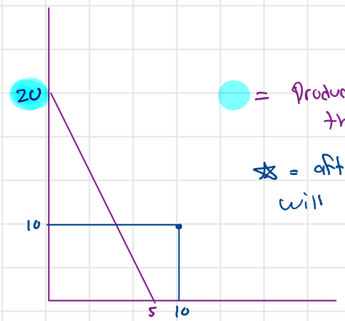
2. The table below shows the amount of production that <u>one worker</u> in each country can produce. Assume that each country has 5 workers. **<u>Draw a PPF and show</u>** that both countries will benefit from trade.

	Thailand	Malaysia
Beer	4	1
Wine	1	4

TH



MA



● = Produce what they specialize.

☆ = after trade both will gain benefits.

$20B : 5w$

$1B : \frac{1}{4} w$

$4B : 1w$

$5B : 20\ w$

$1B : 4w$

$\frac{1}{4} B : 1w$

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

CA + KA = 0

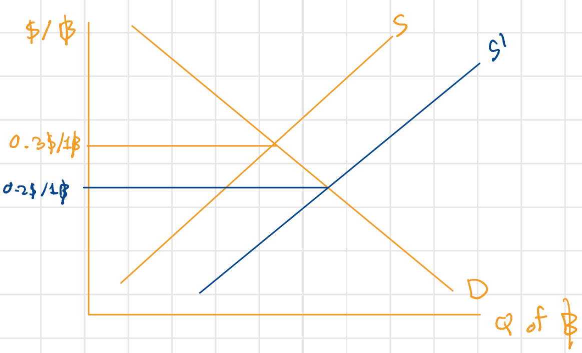
CA Surplus → X > m

KA deficit → capital flowout of country.

↳ (increase in domestic ownership of foreign asset)

When we export > import → we use foreign currency to buy foreign asset.

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.

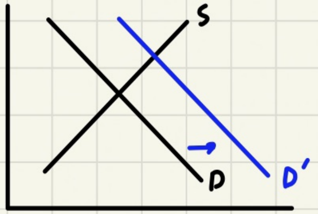


Devalue → CB sell reserve of ฿ → buy \$ THB depreciate (cheaper) USD appreciate (more expensive) due to supply of THB ↑

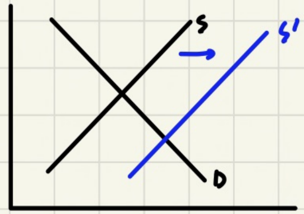
→ D&S

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).

foreigner buy ฿ : D↑ → THB appreciate



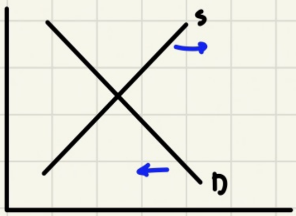
TH investors need more \$: S↑ → THB depreciate



TH leave ASEAN

foreigner don't want to trade with TH : D↓ → THB depreciate

TH don't want to invest in ASEAN : S↓ → THB appreciate



total effect depend on size

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

By fisher equation $i = r + \pi$ when $\pi \uparrow$, i also $\uparrow$

when $i \uparrow$, foreigner demand for ฿ b/c they want to save in TH

→ THB appreciate

when $\pi \uparrow$, the price of domestic goods ↑ that make export ↓ and import ↑

→ 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.

400 USD : 300 GBP

$\frac{4}{3}$ \$: 1 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.

Nominal exchange rate

40 THB = 1 GBP

TH apple → 20 THB = 0.5 GBP

UK apple → 1 GBP = 40 THB

Real exchange rate

2 TH apple = 1 UK apple *

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