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.

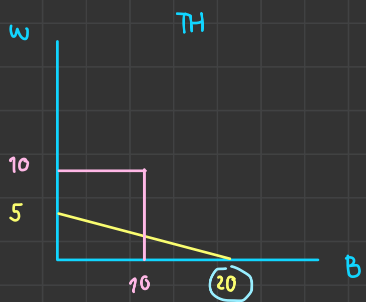
9. What assumptions are required for the Law of One Price to hold?

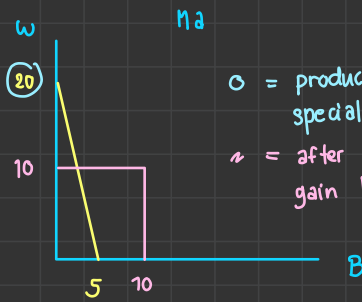
1. What is the difference between “absolute” and “comparative” advantages? What are the main implications of these two theories? (i.e. what do they suggest?)

- absolute → produce at what we specialize (lower cost)
- Comparative → produce at lower opportunity cost

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





o = produce what they specialize

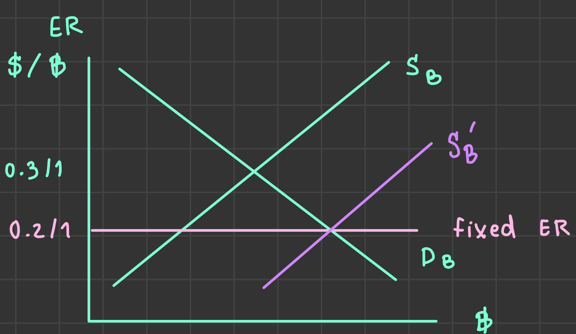
= after trade both will gain benefits.

20 B	:	5 W			5 B	:	20 W
1 B	:	1/4 W			1 B	:	4 W
4 B	:	1 W			1/4 B	:	1 W

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

- current account surplus is when we get inflows in any CA such as export > import.
- capital account deficit is when we have outflows in any KA such as Thai workers at Japan buy apartment in Japan
- BOP => CA + KA = 0

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.



BOT can sell reserve to buy $

↳ THB depreciate

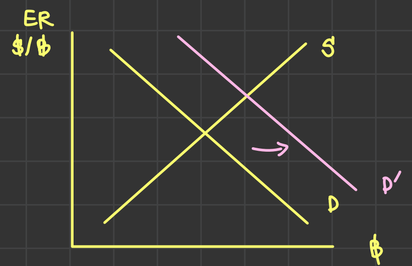
↳ Demand for ฿ increase

↳ Supply of ฿ decrease

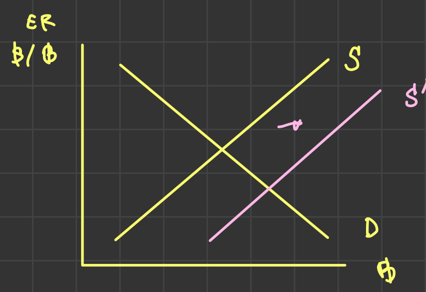
↳ $ appreciate. (can get ฿ in cheaper price)

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).

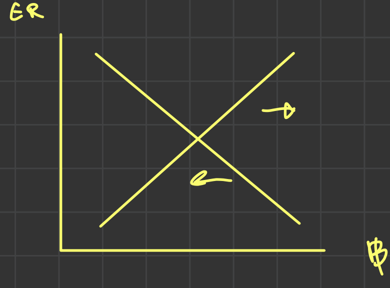
1. foreign buy ฿ = D ↑ → THB appreciate



2. Thai pp. buy foreign currency ($) → S ↑ → THB depretiate.



3. Thai leave ASEAN
   ↳ foreigner don't want to trade with TH → D ↓ → ฿ dep
   ↳ TH pp. don't invest in Asean : S ↓ → ฿ appreciate



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 $\uparrow$

$i \uparrow$ cause demand for bath is up (more returns in investors view)

→ they will save more THB ⇒ THB appreciate

when $\pi \uparrow$, the price of domestic goods ↑ that makes 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

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.

$$\frac{\cancel{20}\ \cancel{฿} \times 2\ \cancel{GBP}}{1\ \cancel{GBP} \times \cancel{20}\ \cancel{฿}} = 2 \text{ real exchange rate}$$

∴ 2 thai apple : 1 UK apple.

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

cost of transportation are small