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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 about the "Specialization" (doing what they're good at). In other words, it is the advantage of one country when it uses fewer resources to produce good than the other country does (lower cost).

"Comparative advantages" is about the "Opportunity cost" (best forgone alternative). In other words, it is the advantage of one country when it produces a good at a lower opportunity cost than the other country does.

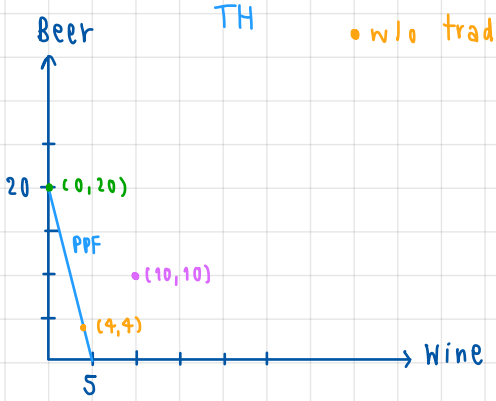
2. The table below shows the amount of production that one worker in each country can produce. Assume that each country has 5 workers. **Draw a PPF and show** that both countries will benefit from trade.

	Thailand (good at making Beer → AA in beer)	Malaysia (good at making Wine → AA in wine)
Beer	(20) 4	1 (5)
Wine	(5) 1	4 (20)

TH can allocate 1 worker for beer and 4 workers for wine to enjoy 4 units of beer & 4 units of wine.

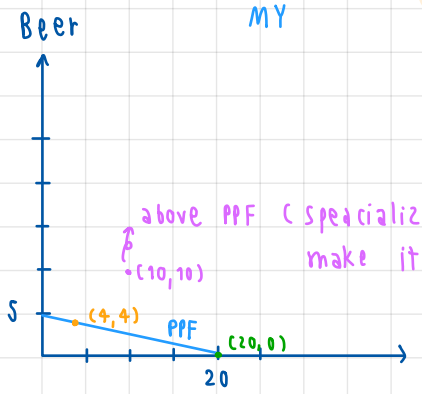
MY can allocate 4 workers for beer and 1 worker for wine to enjoy 4 units of beer & 4 units of wine.

TH



• w/o trade

MY



	TH	MY
w/o trade		
Beer	4	4
Wine	4	4
with specialization		
Beer	20	0
Wine	0	20
with specialization + free trade		
Beer	10	10
Wine	10	10

(TH gives to MY: Beer; MY gives to TH: Wine)

So, each country should produce the good that it has AA, then two countries with different specialization should trade in order to benefit for both countries.

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

"Current account (CA) surplus" represents money is flowing into the country, which has to be these 3 catagories of transactions → 1. the balance of trade 2. primary income (factor income) such as wage, rent, interest, and profit. 3. secondary income (unilateral transfer/free money) such as scholarship.

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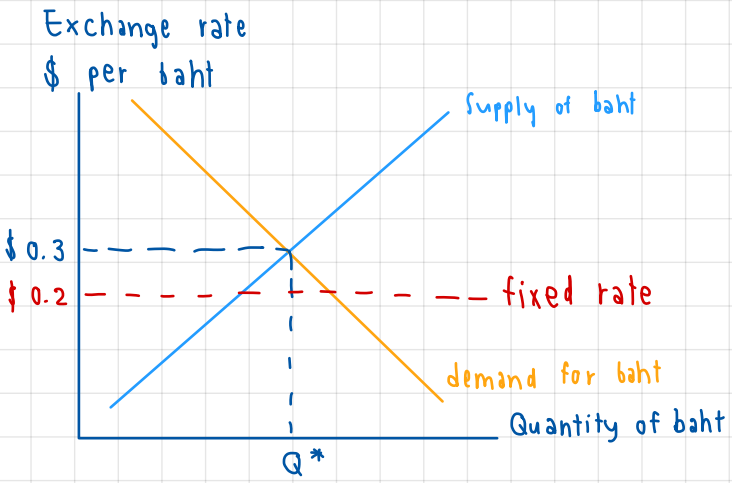
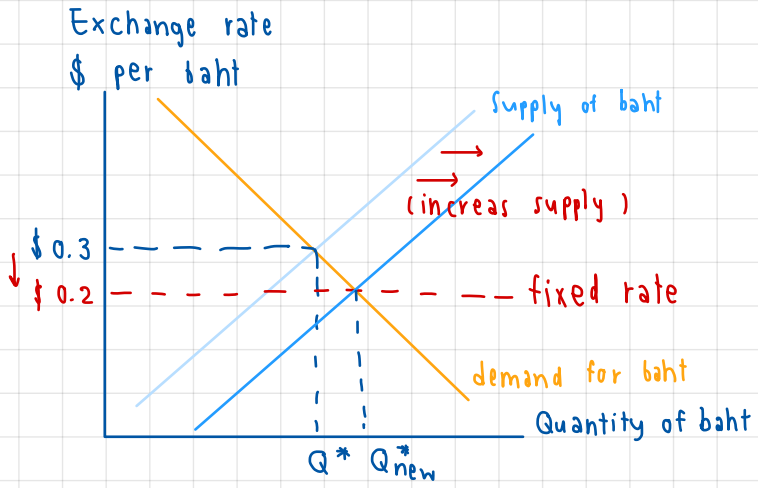
"capital account (KA) deficit (KA < 0)" represents money is flowing out of the country, and it suggests the nation is increasing its ownership of foreign assets.

"BOP identity" is CA + KA = 0. In other words, if we have CA deficit, we must have KA surplus.

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.



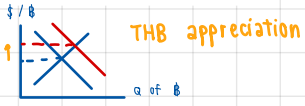


↳ The CB will increase supply of Baht by selling baht (and buy USD.) from the foreign exchange market. This will lead to depreciation in THB.

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).

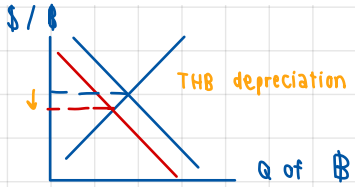
↳ In floating exchange rate regime, everything works as in the demand / supply diagram.

- The rest of the world imports more from Thailand.
  ↳ more D for THB



- More Thai investors invest abroad.
  ↳ more S of THB

- Thailand will leave ASEAN (similar to the UK leaving the EU).
  ↳ less D for THB (because it discourage foreign investors to invest in Thailand)



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

↳ Inflation cause a currency to appreciate because when we have inflation, the interest rate will increase and this attracts foreign investors. So, demand of THB increases (domestic currency) and leads to appreciation in THB. (domestic currency ↓)

↳ Inflation cause a currency to depreciate because when we have inflation, we can imply that domestic goods become more expensive (domestic currency), thus reducing export while raising import. So, $D_{฿}$ (domestic currency) ↓ and $S_{฿}$ ↑. This leads to THB depreciation (domestic currency). Moreover, when we have inflation, value of money will ↓ and people don't want to hold money. so, domestic currency's demand ↓ and leads to depreciation of that currency.

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
÷ 300 ↓
1.33 USD : 1 GBP → PPP exchange rate

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 is 40 THB / 1 GBP
1 apple costs 20 THB in Thailand
" ——— " 1 GBP in the UK

real exchange rate = NER (THB/GBP) × (P UK / P TH)
$= \frac{40\ \cancel{฿}}{1\ \cancel{GBP}} \times \frac{1\ \cancel{GBP}}{20\ \cancel{฿}} = 2$

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

↳ we must assume that the costs of transportation are small.