Question 1: **Use the demand and supply model. Predict the directional change of the exchange rate (baht/USD) under the following situations.**

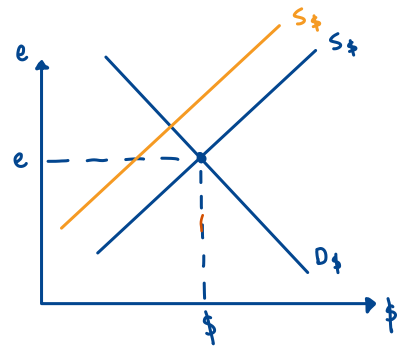
1.1 The bank of Thailand cuts its policy rate.

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

1.3 The US government has imposed a trade sanction on Thai's agricultural product exported to the US market.
support

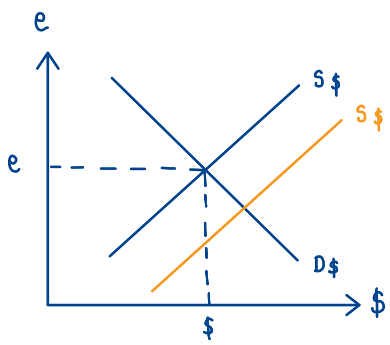
1.4 A positive improvement in production technology of Thailand causes a decrease in domestic price.

1.1



Supply for dollar in Thailand market is demand for Thai bant. When the bank of Thailand cut its policy rate means that interest rate (r) decrease. The foreigner will not participate in investing in Thailand. This cause demand for Thai baht decrease and then supply $ for Thai market will decreas which it shift to the left.

1.3)

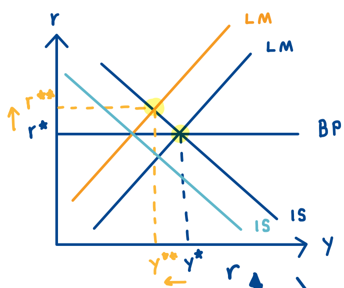


when US government has imposed trade sanction on Thai's export meaning that US government support Thai's product and this cause thier country would like to import more Thai's product to their country and spend more $ to Thai Economy so, supply for $ will increase (shift to the right)

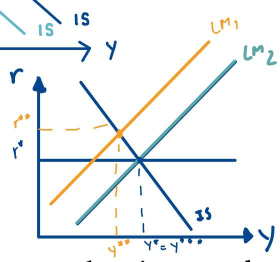
3.1) A reduction of money supply.

BP = perfect capital mobility

FLEXIBLE



FIXED



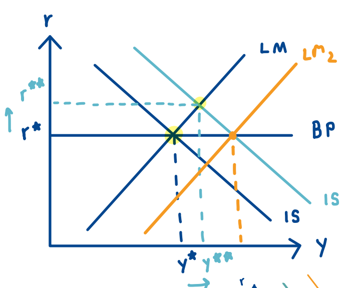
From the statement, a reduction of supply leads to the shift of LM, which interest rate will rise from r* to r**. So, interest rate (r**) > BOP contribute to US people want to invest in Thai Market. Therefore, supply for USD skyrockets leading to the drop of rer and then Thai Bath Appreciation

fixed : Central Bank buy USD, sell THB to increase Ms to shift back so interest rate decrease.

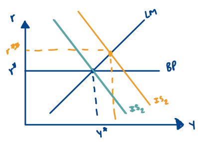
flexible : Export ↓ – Import ↑ = Net export ↓ , so IS shift left leading to increase In Current Account and BOP to the left.

3.3) Thai government has imposed a tariff on imported products.

Fixed



FLEXIBLE



Due to the thai government has imposed a tariff on imported products, people do not want to import so the IS curve shift to the right because (X – M). ↑

Therefore, r > BOP meaning that foreigner want to invest in TH market. Thus, supply for USD increase leading to decrease in rer and thai Baht appreciation.

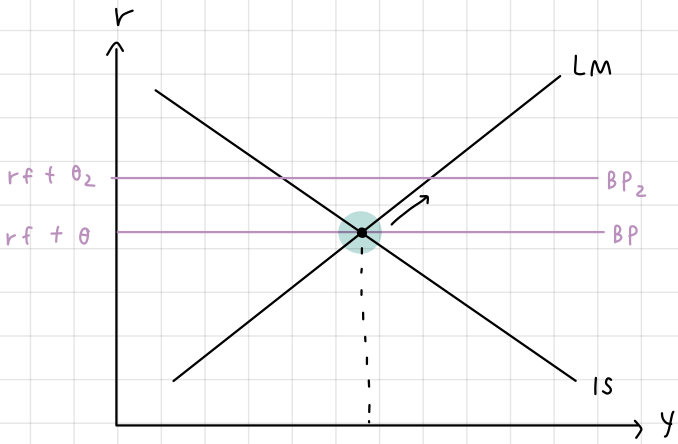
fixed : Central bank will increase Money supply by buying USD and selling THB so as to shift the LM curve to the right

flexible: As net export decrease so current account decrease and BP shift to the left as well as IS shift to the left.

uncertainty

Question 2 Suppose that S&P, an international credit-rating agency, has decided to *downgrade* the credit rating of Thai economy. Answer the following problems. θ↑ because risk premium ↑

a) Under the flexible exchange rate, how does the ~~upgrade~~ downgrade of credit rating affect the value of Thai currency?

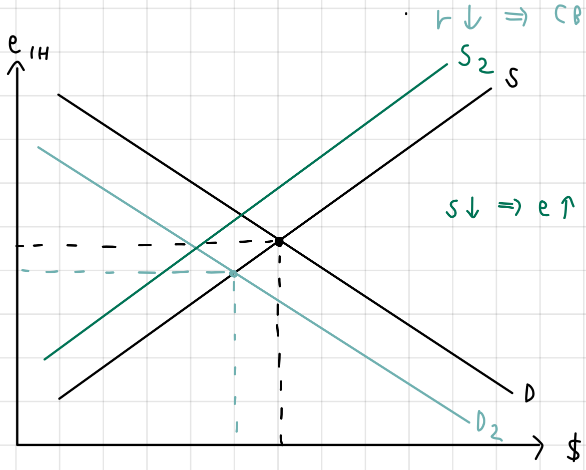


1) BP > eq^{m} ⇒ r ต่ำไป ⇒ KA↓ ⇒ e↑ (e_{TH}↓)

The downgrade of the credit rating of Thai economy means that the uncertainty will increase (θ↑) due to the higher risk premium meaning that the BC (rf+θ) will shift upward. Since the BP shift upward, the interest rate is too low and it attracts lower foreign investments meaning that KA will be lower, and then the Thai baht will be appreciate / USD depreciate. In this case, it is a flexible exchange rate, when THB gets appreciate, the net export will be decreased due to the higher import and lower export, and then the balance payment will shift left.

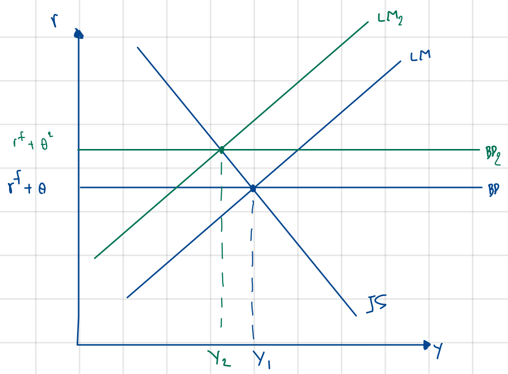
b) If the authority wishes to resist the movement of the exchange rate (baht/USD), what does the authority need to do? Explain about the implementation process under the forex market intervention. ✓ fixed exchange rate

r↓ ⇒ CB intervene โดยการ ⇒ ขาย



In the fixed exchange rate, the lower interest rate causes the demand curve to shift leftward because Thai baht generates lower return. In this case, central bank would like to intervene by buying THB from the money supply, so that the interest rate will be higher, resulting in a shift in supply curve and the market will adjust itself back to the new equilibrium with the same interest rate as the government announced.

c) Discuss about the unintended impact of the ✓ foreign exchange market forex market intervention on the domestic financial system. If the authority wishes to limit the sided effect of the forex market intervention, what does the authority need to do?



Accoding to Thai economy become risker, BP shift upward due to higher risk θ↑, so If the authority wishes to limit the sided effect of the forex market intervention ; CB have to sell market USD and buy THB inorder to decrease Ms. LM curve shift to the left causing new equilibrium at (Y_2, r_2).