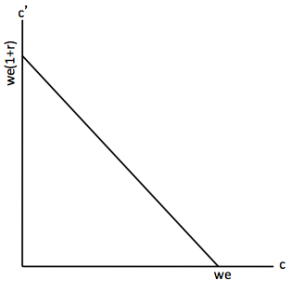
**EE312 Macroeconomics, 1/2020 (Sec. 046401-Sicha)**
**Chapter 8. Two Period Model Consumption-Savings Decision and The Credit Market**

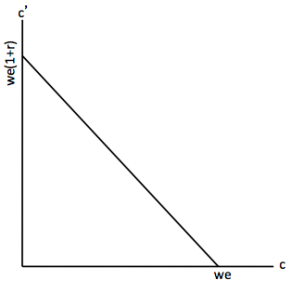
## 1. Intertemporal Consumption : borrower VS lender

## 2. An increase in current income



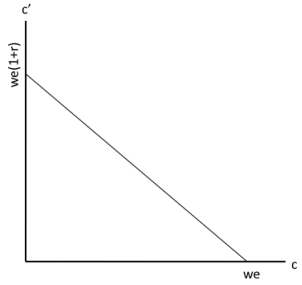

- current income ↑ from $y_1$ to $y_2$
- current consumption .....
- $\Delta c$.....$\Delta y$
- future consumption .....
- saving .....

## 3. An increase in future income




- future income↑ from $y_1'$ to $y_2'$
- future consumption .....
- $\Delta c'$.....$\Delta y'$
- current consumption .....
- saving .....

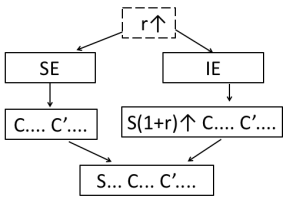
## 4. Temporary and permanent ↑ in y

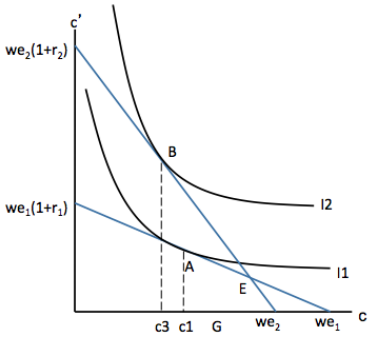



- **HJ** = effect of temporary rise in y.
- **HK** = effect of permanent rise in y.
- **A temporary increase in y** : HL, the budget line shifts from AB to ED.
- **A permanent increase in y** : $y_2 - y_1$= HL = $y_2' - y_1'$= LM. : the budget line shifts from AB to GF.

## 5. An increase in the real interest rate

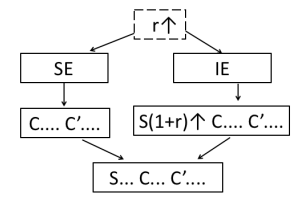
**The consumer is a lender**

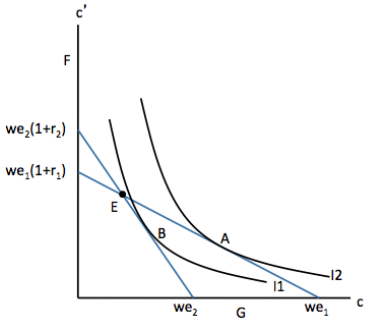



**Lender: stronger SE**

**The consumer is a borrower**




**Borrowers:**

## 6. Government's budget constraint: .....

## 7. Equilibrium (1) The credit market clears. (2) The income-expenditure identity.

## 8. The Ricardian Equivalence

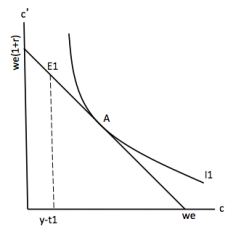
(1)

(2)

- $\Delta t$ is matched by $-\Delta t(1+r)$, (1) holds
- (2) remains unchanged

- $t \downarrow$, $S^p \uparrow$ and $S^g \downarrow$ by the same amount.
- The consumption bundle .....
- $\Delta S^p = \Delta B = \Delta T$ so the credit market equilibrium remains.

A current tax cut equals a future tax increase




Unchanged credit market