EE312 Macroeconomics, 2/2017 (Sec. 046402)
Problem Sets - for chapter 9

*** No need to submit. Solution is provided on the BE moodle, see the section "homework solution"**
*** You can also practice doing the end chapter questions in the textbook.**
*** Exam will consist of essay-type questions only.**

Chapter 9. Two-period Model. Consumption and Saving Decision.

PART 1. True or False. Short Answer. If the statement is False, comment.

1. .... (T/F) Consumption smoothing implies that consumers consume the same amount each period.
   (Explain) ....

2. ....(T/F) Consumption smoothing has empirical support because real GDP is less variable than aggregate consumption

   ....

3. ....(T/F) Eliminating consumer durables from the measure of real aggregate consumption would lead to greater variability of consumption with respect to aggregate income.

   ....

4. ....(T/F) An increase in the real interest rate might cause a lender to increase current consump

5. tion if the substitution effect outweighs the income effect.

   ....

6. A decrease in the real interest rate might cause a borrower to decrease current consumption if the substitution effect outweighs the income effect.

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7. ....(T/F) A temporary increase in income leads to an increase in saving while a permanent increase in income need not result in more saving

   ....

8. ....(T/F) Under Ricardian Equivalence, a change in current taxes (say a decrease of $10 billion), exactly offset by an equal and opposite change in future taxes (an increase of $10 billion), has no effect on the real interest rate or on the consumption of individual consumers in equilibrium.

   ....

9. ....(T/F) Milton Friedman argued that the marginal propensity to consume out of temporary income is greater than the marginal propensity to consume out of permanent income.

   ....

Part 2. Short Answer.

1. Assuming $r = 0.25$, $t = 10$, $t' = 20$, $y = 100$ and $y' = 100$, write the consumer's lifetime budget constraint and derive the consumer's lifetime wealth.

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2. Show graphically the effect of a decrease in the real interest rate on current-period consumption for a lender whose income effect outweighs the substitution effect.

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