

2. Suppose there are only 2 goods that Mr. A can choose to consume, says cup noodle and cola. He works and earns a monthly income of 100 Baht. The price of cup noodle and cola are 5 and 10 Baht, respectively. Answer the following questions.

a) Write down a budget line equation and construct a graph by plotting the quantity of cup noodle on the horizontal axis. Identify an optimal consumption bundle on the graph. (Note: You cannot find the optimal point without drawing ICs)

b) What is the condition that must be satisfied in order for Mr. A to maximize his utility? Why is it necessary for this condition to hold? Explain.

c) Suppose that price of cup noodle decrease from 10 Baht to 8 Baht. Plot the new optimal consumption bundle. Show how Mr. A reacts to the change in price by using substitution effect and income effect given that cup noodle is an inferior good.

d) Derive Demand curve for cup noodle based on your analysis on d.