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Fall 2005, Intermediate Macroeconomics, section 3

ECON 219 Quiz III

General recommendations:

- Read questions thoroughly.
- Work individually.
- Please respond on this copy.
- There are two pages.
- You have 20 minutes.
- Good luck!

Your name:

1. Circle the appropriate answer on each of the following items. Circle multiple items if necessary:

   (a) We limit ourselves to two periods in the intertemporal model because: a) we just need to concentrate on the two phases of the business cycle; b) we can assume people can live two periods of say 30 years; c) this is all we need to emphasize the intertemporal trade-off; d) we need an even number of periods.

   (b) In the absence of a financial system, the two-period model predicts that: 1) consumption is as volatile as income; 2) consumption is less volatile than income; 3) consumption is more volatile than income; 4) we do not know.

   (c) Permanent income is: 1) proportional to life-long wealth; 2) proportional to current consumption; 3) proportional to the present value of life-long consumption; 4) zero on average.

   (d) What is exogenous in the two-period problem seen so far? 1) Future consumption; 2) household income; 3) the interest rate; 4) taxes.

2. Explain what happens to current consumption for a borrower when the interest rate goes up.

3. Explain what happens to current consumption for a lender when the interest rate goes up.

4. Why is there no budget constraint when one determines the equilibrium with the production possibilities frontier?

5. What happens to consumption in the static model when government expenses increase? Show it graphically.

Bonus question: Does a 10% increase in future income have the same impact on current consumption in the two-period model as a 10% increase in current income? Explain.