

Homework Week 7: Consumption and Savings Model

Write your answers in the space provided or on your own paper. When you have finished, scan or take pictures of your work, combine all images to a single PDF file, assure that all pictures are oriented right-side up, and upload your work as a single PDF file to the Canvas Assignment area.

1. Suppose current income decreases for consumers, but there is no change in expected future income. Describe and illustrate the impact on current consumption, future consumption, and savings. If any of these effects are indeterminate, explain why.

2. Suppose the representative consumer is a borrower. Describe and illustrate the impact of a decrease in the interest rate on current consumption, future consumption, and savings. If any of these effects are indeterminate, explain why.

3. Suppose the representative consumer is a saver. Describe and illustrate the impact of an increase in the interest rate on current consumption, future consumption, and savings. If any of these effects are indeterminate, explain why.

4. Suppose consumer confidence improves and that consumers expect higher incomes in the future. Describe and illustrate the impact on current consumption, expected future consumption, and savings. If any of these effects are indeterminate, explain why.

5. Suppose the government announces a decrease in current taxes in combination with an equivalent decrease in future government expenditures. Use the intertemporal government budget constraint (equation 9-19 in text) and the intertemporal consumer's budget constraint (equations 9-11, 9-12) to describe the impact on consumers' lifetime income. Describe and illustrate the impact on current consumption, future consumption, and savings.

6. Suppose the government increases government expenditures in the future period and makes no changes to current taxes or current government expenditures. Use the intertemporal government budget constraint (equation 9-19 in text) and the intertemporal consumer's budget constraint (equations 9-11, 9-12) to describe the impact on consumers' lifetime income. Describe and illustrate the impact on current consumption, future consumption, and savings.