



**FINAL EXAMINATION (PART 2)**  
**SEMESTER I, ACADEMIC SESSION 2010-2011**

APRIL 2011

DUE: 3.00 pm, 29 APRIL 2011

**COURSE CODE : EPPE6024**

**COURSE TITLE : MACROECONOMICS**

- INSTRUCTION :**
1. Answer ALL questions.
  2. Please answer in A4 papers only. All answers must be handwritten. Please put this cover page on top of your answer sheets.
  3. Total marks are 50.

PhD

Master

Postgraduate Diploma

Registration no. :

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Registration no.

EPPE6024

**INSTRUCTION:** Answer ALL questions.

1.
  - a. What is consumption puzzle?
  - b. Explain how life-cycle hypothesis and permanent income hypothesis resolve the puzzle.

[10 marks]

2. Suppose that investment depends on both income and the interest rate, that is the investment function is

$$I = I_0 + aY - br, \text{ where } 0 < a < 1 \text{ and } b > 0.$$

- i. Derive IS equation in Neoclassical-Keynesian model to incorporate this new investment function.
- ii. Analyze the short-run impact of increase in government purchases on national income  $Y$ , the interest rate  $r$ , consumption  $C$ , and investment  $I$ .
- iii. How might this investment function alter the conclusions implied by the basic IS-LM model?

[20 marks]

3. Use the dynamic *AD-AS* model to solve for inflation as a function of only lagged inflation and the supply and demand shocks. (Assume target inflation is a constant.)

- a. According to the equation you have derived, does inflation return to its target after a shock? Explain.
- b. Suppose the central bank does not respond to changes in output but only to changes in inflation, so that  $\theta_Y = 0$ . How, if at all, would this fact change your answer to part (a)?
- c. Suppose the central bank does not respond to changes in inflation but only to changes in output, so that  $\theta_\pi = 0$ . How, if at all, would this fact change your answer to part (a)?
- d. Suppose the central bank does not follow the Taylor principle but instead raises the nominal interest rate only 0.8 percentage point for each percentage-point increase in inflation. In this case, what is  $\theta_\pi$ ? How does a shock to demand or supply influence the path of inflation?

[20 marks]

**GOOD LUCK  
SELAMAT MAJU JAYA**