

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point on the assignment.

1) (20 points) What assumptions do our models of consumption make about credit? Why might those assumptions be true and what would that do to our theory? Explain your logic.

2) (20 points) Explain how durable goods can cause our consumption to fit our models of consumption, but make the statistics appear as if consumption does not fit the theory.

3) (20 points) Explain the equation $\frac{\Delta Y_{mp}}{\Delta I_0} = \frac{1}{1 - (a + b)}$. Explain why a change in a or b will cause the term on the left to change. Note that equation 8-16 in the book should have parentheses around the a + b.

4) (20 points) Explain why investment may be more unstable than GDP. Make sure you define “more unstable.”

5) (20 points) Draw the diagram that shows the cost of funds as a function of investment expenditure. Explain why the three sections are labeled as labeled and sloped as drawn.