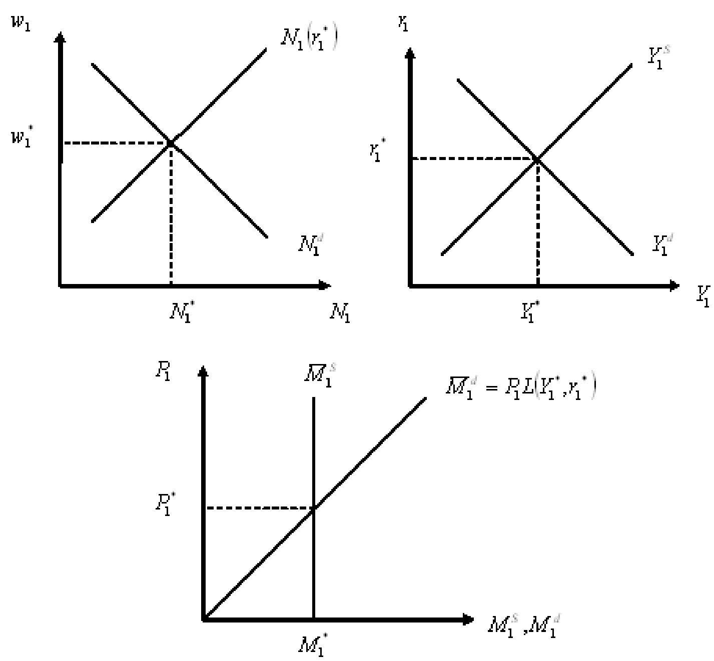
EC2102 Macroeconomic Analysis I
Tutorial 8, Week 11, March 29-April 2, 2010

Question 1

(modified version of Question 2 in EC2102 Final Exam Sem I AY2006/2007)

Let us consider the monetary intertemporal model studied in class, where all prices are fully flexible. Suppose that the economy is initially in an equilibrium. Equilibria in the labour, goods, and money markets in time period 1 are illustrated below.



(i) Now suppose that the economy is hit by a positive TFP (Total Factor Productivity) shock at the beginning of time period 1. This TFP shock is persistent, though it dies down over time. With the aid of graphs, illustrate the impact of this on equilibria in the labour, goods, and money markets in time period 1, as well as on decisions made by the representative consumer and the representative firm in time period 1.

(ii) From your analysis above, compare the predictions of this model to the data:

Variable	**Data**
Consumption	Procyclical
Investment	Procyclical
Price Level	Countercyclical
Money Supply	Procyclical
Employment	Procyclical
Real Wage	Procyclical
Average Labour Productivity	Procyclical.

Question 2

(Sem I AY2005/2006 EC2102 Final Exam Question 2)

Consider the monetary intertemporal model that we studied in class where there is a cash-in-advance (CIA) constraint.

(i) List the three properties that money must have?

(ii) Write down the cash-in-advance constraint for time period t, making sure you have carefully defined all the variables used. Which of the three properties of money listed in part (i) is the defining characteristic of money in this model?

(iii) What is the representative consumer's budget constraint in time period t?

(iv) Why is the representative consumer's budget constraint in time period t different from his cash-in-advance constraint in time period t?