For this question, good $x_1$ is the good whose price decreases and is a normal good. Good $x_2$ is inferior.

Consider the following graph:

**Event** $P_i < P_i^*$ such that $P_i > P_i^*$.

When the price of good one drops, the consumer's budget curve pivots at point $A$. 
This is because good $x_1$, is now relatively cheaper than good $x_2$. This causes the consumer to shift resources from consuming good $x_2$ to consuming good $x_1$. This is represented by the shift in the bundle choice to point $B$ where quantity consumed of $x_2$ decreases and quantity of $x_1$ increases where $x_1 > x_1$ and $x_2 < x_2$. However, this change in price of $x_1$ allows the consumer to choose a larger basket thus causing an income. This income effect causes a parallel shift of the budget line out. Given that good $x_1$ is a normal good, an increase in income creates an increase in quantity consumed. However, good $x_2$ is an inferior good meaning an increase in income has the consumer to less of that good. Thus, the final bundle chosen is at point $C$ where $x_1 > x_1$ and $x_2 > x_2$. Note that as the consumer moves from $A$ to $B$ to $C$ he/she reaches
a higher level of total utility (a higher level of welfare).

Consider the following graph...
Event:
2) \( P_1 \), Good 1 is Normal, Good 2 is inferior

\[ CO \neq B \]
\[ BO \neq A \]
\[ AO \neq C \]
No violations of WARP

First to get the substitution effect, there needs to be a point through the original bundle to show that it is still affordable. The price increase shows the relative price change. The consumer substitutes from bundle A to bundle B because \( BO \neq AO \), this is because B was not available when A was chosen. Also, you move to bundle B.
because good 2 is normal and the
price of this normal good has decreased,
and by the law of demand your consumption,
as quantity demanded will therefore increase. And
since Good 2 is inferior you consume less
of Good 2 when you consume more of the
Normal Good 2; showing the substitution effect.
Next is the income effect. We needed to
shift the budget constraint out to show
the increased purchasing power the consumer
now has. This will also cause the consumer
to consume more of Good 1, because
good 2 is normal an increase in income
will cause you to consume more of this
Normal Good. This is why you move to
point C. C ⊗ B, and then also at
point C you are still consuming less
of Good 2 than you were, further supporting
the fact that good 2 is inferior.
B) False. A decrease in the interest rate will cause a rational saver to become a borrower. Because we can see by UARP that \( A \geq 0 \) any point on segment \( AC \) of the new budget constraint. \( C \) was available when \( A \) was chosen but at this new constraint \( A \) is not available. So the saver would be worse off if they continued to save. They will switch to being a borrower because the cost of borrowing is so low. They will pick point B for example.
Budget Constraint:
\[ M_1 - C_2 = M_2 + (1+r)(M_1 - C_1) \]
Event: \( r \uparrow, \pi \downarrow \)

Not necessarily, the rational borrower would be worse off if he continued to borrow lets say ending up at point B where we can see A@B so being at B would make him worse off. Yet, this would induce the borrower to become a saver, at lets say point C. Here we can see that the consumer could actually become better off if he became a saver. So it isn't exactly true that the consumer can be made better off, it depends on where his indifference curves lie. In this example he is made better off.
A. True, because if you switch to a net buyer, at least say bundle B, we can see that bundle B is not only $\leq A$, but it is also $\supset C$. We can see that the seller would continue to some end, say more to point C, become better off. This makes sense because if the price of the good you're selling goes up, you will continue to sell my sell less of the good, more for it, at the same amount.
B.) False, if you continued to be a net seller of the good you would become worse off. If you continued to sell let's say you would be at point C, we can see that BOC, thus you would become a net buyer of the good.
C) True if the price increases did not induce the buyer to become a will seller, the buyer would have worse off because
not chosen at the last budget constraint but was.
D) Not necessarily, the increased endowment of the normal good will not cause you to consume more of that good. You could continue to be a net seller just as long your consumption went up, or you could become a net buyer, let's say at point C, if your consumption went up drastically.