

Written Exam for the M.Sc. in Economics summer 2014

Economics of Banking

Master's Course

8. August 2014

(3-hour closed book exam)

Please note that the language used in your exam paper must correspond to the language of the title for which you registered during exam registration. I.e. if you registered for the English title of the course, you must write your exam paper in English. Likewise, if you registered for the Danish title of the course or if you registered for the English title, which was followed by "eksamen på dansk" in brackets, you must write your exam paper in Danish.

This exam question consists of 2 pages in total

1. In a particular field of industry, several new firms have been set up to exploit recent technological developments. It turns out, however, that there are not only innovators experienced in the field but also complete newcomers among the entrepreneurs.

The government wants to support the new field and has set up an independent financial institution which offers credits to the entrepreneurs. The institution must be self-financing but is not intended to earn profits.

Give a suggestion, based on relevant theory, for the credit policy of the new financial institution.

After some time, the existing private banks realize that they may compete with the government institution in offering credits to the firms in this industry. Does this change the situation in the market, and if it does, how?

2. A country has recently experienced a number of bank failures, and it is discussed whether this is a consequence of the market structure, in particular it is argued that there are too many banks to conduct the business, and that this leads to excessive risk taking in banks. It is pointed out that banks on average have rather large profits, and that this is obtained only because they accept high risks.

Sketch a model for the assessment of these viewpoints. Depending on this assessment, give suggestions for ways of reducing the riskiness of the banks.

3. A country has a large number of savings banks which are used by households for deposit and payment purposes. The banks invest in loans to small and medium business, but there have been problems with the liquidity of the banks, since the depositors' demand for is difficult to forecast, and it may change much for the particular bank even if it is rather stable for the sector as a whole.

Give suggestions as to how the banks can improve this situation without changing the asset side of their business.

The savings banks decide to initiate a cooperation in order to support each other in cases of strained liquidity. Explain how this can work, and discuss advantages and disadvantages of the arrangement.