

Written Exam for the B.Sc. or M.Sc. in Economics winter 2011-2012

Economics of Banking

Final Exam

22 February 2012

(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.

If you are in doubt about which title you registered for, please see the print of your exam registration from the students’ self-service system.

Problem 1

In a country with many banks, some of them having rather risky credit portfolios, the institutions taking care of banks in trouble are the central bank and the deposit insurance organization. These institutions are guided by their assessment of the quality of the credit portfolio of the bank in question as well as by the current liquidity needs of the bank.

Sketch a model of this situation, where the decisions about closing a bank in trouble may be different for the central bank and the deposit insurer. It is assumed that if one of them demands that a bank be closed, it will have to bear some of the cost of liquidation.

Assume now that the central bank can appoint two members of the board of directors of a bank, which is considered as having a risk of default, and that these board members have the power to demand a voluntary liquidation of the bank. Give an assessment of the consequences.

Problem 2

A new and hitherto unpopulated beach is under development as a holiday resort. The entrepreneurs are local people with limited economic resources, so they need to attract credit for their individual projects. It has been proposed that they try to attract credit by going together.

Give an economic argumentation why this may be a way of getting cheaper credits, and give an assessment of whether the assumptions on which the argument is based will be satisfied in the case considered.

Problem 3

In a particular field of business, the firms are complaining that their access to bank credit is limited, while the banks point to the rather bad quality of the available investment projects, since most investors are tempted to take too high risks, with the consequence that failures and defaults are very frequent.

Give a sketch of a model, which explains why credit may be rationed in this situation. Could the situation be improved if banks are allowed to engage in profit-sharing contracts with their borrowers?