

Written Exam for the M.Sc. in Economics summer 2016

Economics of Banking

Master's Course

16. June 2016

(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 country with a large number of banks, there is general concern about the financial sector, since many of the banks have very risky credit engagements. It is supposed that something should be done, and that closing down some of the banks would reduce the overall riskiness also in the future. Give an assessment of this argumentation based on the relevant theory.

It is suggested that the number of banks will be reduced if the policy of assisting banks in acute need of liquidity is made more restrictive. At present, assistance can be offered either by the central bank or by the deposit insurance organization. Both are formally private institutions, and they must cover the cost of liquidating a bank, which is closed due to their decision. Give an advice as to how such a restrictive policy might be organized without interfering with the organizations' own assessments.

2. A bank has as one of its fields of business the offering of credits to private hospitals. The patients are either paying themselves, through out-of-pocket expenses or assisted by private insurance, or they are patients from the public healthcare system sent to private hospitals due to capacity problems in the public system. For some years, the number of patients of the latter type has varied considerable from one month to the next, so that the business situation of these hospitals has been rather unstable. Discuss how the loan contract between bank and borrower should be designed in this case.

In connection with a change in government, the hospitals are given long-term contracts for patients paid by the public healthcare system, and it is expected that this will result in a full capacity of the private hospitals for some time to come. Does this give rise to a change in the design of the loan contracts?

3. After a period of exceptionally low interest rates, it is expected that interest rates will move upwards over the next few years. A new financial enterprise applies for a loan in the bank. Its business plan consists in holding portfolios of bonds, and it asks for credits on the usual terms which are: current interbank market rate plus a risk premium of 2%. Interest rate is paid each year and the loan terminates after 2 years.

Give a short sketch of the considerations that the bank should go through before accepting this engagement.

The financial advisors of the bank argue that it is doubtful whether the enterprise could earn any profit following their business plan. The bank is however very eager to expand its credit portfolio. Give a suggestion to changes in the terms which may reduce the risk of loss.