

Written Exam at the Department of Economics summer 2022

## **Economics of Banking**

Final Exam

May 30, 2022

(3-hour closed book exam)

Answers only in English.

**This exam question consists of 2 pages in total**

### **Falling ill during the exam**

If you fall ill during an examination at South Campus, you must:

- submit a blank exam paper.
- leave the examination.
- contact your GP and submit a medical report to the Faculty of Social Sciences no later than five (5) days from the date of the exam.

### **Be careful not to cheat at exams!**

You cheat at an exam, if during the exam, you:

- Make use of exam aids that are not allowed
- Communicate with or otherwise receive help from other people
- Copy other people's texts without making use of quotation marks and source referencing, so that it may appear to be your own text
- Use the ideas or thoughts of others without making use of source referencing, so it may appear to be your own idea or your thoughts
- Or if you otherwise violate the rules that apply to the exam

**1.** After a campaign of outsourcing activities of the public sector, a large number of small firms engage in transportation services using high-quality electric vehicles in the healthcare sector and in social service. This newly created sector is very competitive, profits are small on the average and, since all tasks are agreed on a day-to-day basis, subject to considerable variation over time.

The firms complain that they have problems with access to credits and that loan rates are too high. Faced with such complaints, the banks point to a large number of cases where the borrowers default on their credits.

The vehicles used are all equipped with a device which keeps track of all its activities. The banks argue that if they were allowed access to these data, it would improve the credit situation of the firms. Give a theoretical explanation of why the banks might be right. Could there be other ways of improving the situation?

**2.** In a region the local business community is served by two competing banks of comparable size, one of them being an old bank owned by the rich families of the region, the other one being a recently established bank with a broad ownership. Since the region is crucially dependent on a few lines of industry, there are strict rules preventing the banks from specializing in any of the fields of business, and to prevent bank runs, a deposit insurance is being introduced. Give a suggestion based on relevant theory of what the banks should pay for the insurance.

One of the two banks decides to introduce a new program of customer services, whereby borrowers entering the program gather points in accordance with their previous performance with the bank, so that after some period they can be ranged as ordinary, silver or gold customers. It is argued that borrowers will have considerable advantage of joining the program since it will facilitate their access to credit over time. Comment on whether this argument holds.

**3.** The banking sector of a country contains several traditional banks taking deposits and arranging loans to the industry of the country. Over the years, the interest rates have been falling and by now the level of the interbank rate is just around zero. As a consequence, the deposit rates of the banks have become negative, causing widespread complaint in the population. It is argued that the negative deposit rates are needed since loan rates are low, since otherwise the banks will face increased risk of default.

To mitigate this situation, a minimal loan rate is introduced, with the rule that banks must pay the difference to the government if they charge a lower rate. Give an assessment based on relevant theory of the effects of this measure.

To avoid the interest rate controls, banks choose to arrange some of their new business as shadow banking, issuing securities based on the loan contracts and attracting funds through repo trades. How will this development effect interest rates and overall financial stability?