

Written Exam at the Department of Economics summer 2024

Economics of Banking

Final Exam

20.8.2024

(3-hour written aids allowed/no aids allowed)

Answers only in English.

This exam question consists of 2 pages in total

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- 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.

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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. A country has traditionally had two ways of dealing with banks with too many troubled assets and liquidity shortages, namely (1) a transfer of decisions to the central bank, which may provide a loan or arrange a liquidation, or (2) a government institution which may liquidate the bank and reimburse the depositors. There has been some dissatisfaction with this, since debtors often have been paid only after several years, and mismanaged banks have been able to carry on with non-performing assets and strained liquidity. Give a theory-based explanation of this phenomenon.

Since the government wants to reduce its bureaucracy it looks for a way to avoid that banks should need assistance or be liquidated, and which does not change the existing rules for capital ratios. Give a proposal for how this could be achieved.

2. A bank wants to extend its engagement by offering credits to developers of innovative commercial applications of microchip devices. The success of a developer depends both on the technical competences and on the ability to find a suitable outlet for the new devices. Moreover, the typical developer is recently educated and has no property or alternative sources of income, which is why banks hitherto have been reluctant to offer credit facilities. Give a suggestion for the type of loan contract that the bank could use in this case.

After some years, the enterprises of the most skilled developers have been merged into larger companies, and for the remaining firms, the success depends largely on the shifting conditions of the market. Which consequences will this have for the loan contracts used by the bank when providing credits to these firms?

3. A country has a large sector of small firms engaged in maintenance and modernization of private houses and apartments. Their earnings are subject to considerable variation over time, depending on the general economic outlook as well as other factors such as the availability of a qualified labor force. The firms complain that they have difficulties in obtaining bank credits, and that rates are too high. On the other hand, the banks argue that defaults on these credits are common, so that the rates must be high. Give an assessment of this argumentation: Which side, if any, is right?

A number of firms have decided to form an association which should take care of the connection with banks on behalf of its members. Give a suggestion of how this connection should be organized if the member firms are to obtain easier access to credits.