

Written Exam at the Department of Economics summer 2025

Economics of Banking

Final Exam

27.5.2025

(3-hour written aids allowed)

Answers only in English.

This exam question consists of 2 pages in total

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Ordinary exam 2025

1. In a country several banks have had problems with unexpected needs for liquid reserves in their investment portfolio and with large withdrawals of deposits. In the past, the problems have been solved by short-term loans from the central bank, but it has now been decided to reject future requests for credits for assistance, based on the argument that the past policy of the central bank gave rise to moral hazard on the part of the banks. Give a theory-based assessment of this argument.

The country has a well-functioning system of deposit insurance, but the banks argue that it will come into play only if the bank in trouble is liquidated, while in many cases the problems could have been solved by short-term credits. They propose to set up a joint liquidity pool: Troubled banks can apply for credit from this pool, and its directors will decide either to extend credit or to liquidate the bank, transferring the assets and liabilities to the other banks. Can the proposed arrangement fulfil its purpose, and can moral hazard be avoided?

2. A country has a large number of small firms which deliver maintenance and repair services to private households. The firms complain that their access to bank credits is limited and that loans when obtained are too expensive. However, banks point to the large number of defaults among such firms which result in considerable losses.

To improve their bargaining position, the firms have created an association dealing with public relation. This organization collects information about the business activity of each member, and it is now proposed that banks are allowed access to the information pertaining to member firms having a credit with the bank. Will this arrangement improve the access to credit of the firms, and if so, why?

After some considerations, it is decided to reject this proposal. Give an alternative suggestion on how the organization could arrange a cheaper access to credits for its members.

3. The financial sector of a country is characterized by the presence of a large number of rather small banks. This has traditionally been considered as beneficial for the general public, but recently it has been argued that the competition between the banks means that the overall level of risk in the financial sector has become too large, so that a reduction of the number of banks would be desirable. Give an assessment of this argument.

In order to achieve a reduction in the number of banks, it is proposed that banks should be allowed to merge as long as the average spread between loan and deposit interest rates remains unchanged. What will be the consequences on interest rates and overall riskiness?