Student No..................................

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EE431 Economics of Financial Markets and Institutions
Problem Set 5: Banking and the Management of Financial Institutions

Please submit at the BE office, 5th floor department of Economics building.

Deadline of submission : November 18th, 2014, before 15.00 hrs.

Late submission will not be accepted.

1. Banks earn profit when ....

   (Hint: The interest rate on their assets exceeds the interest rate on their liabilities, The interest rate on their liabilities exceeds the interest rate on their assets)

2. By law, banks must 0.2% of their demand deposits as required reserves. Thus, we say the 0.2% is the ....

   (Hint: required reserve ratio, discount rate, capital reserve requirement)

3. The bank you own has the following balance sheet:

Assets		Liabilities and Equities	
Reserves	300	Deposits	1300
Security	100	Equities	100
Loans	1000		

   If the bank suffers a deposits outflow of $200 million with a required reserve ratio on deposits of 10%, does the bank have enough reserves to meet the reserve requirement?

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4. The bank you own has the following balance sheet:

Assets		Liabilities and Equities	
Fixed rate asset	400	Fixed rate liabilities	1400
Variable rate assets	1300	Variable rate liabilities	200
		Equities	100
Total assets	1700	Total liabilities and equities	1700

   Use the gap analysis to analyze the bank's interest rate risk.

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5. “The banks’ capital base was far too thin to protect them against the shocks in property markets that eventually eroded confidence in virtually all big banks in America and Europe. ...”

   The Economist, April 13, 2013.

   How could the banks’ capital base help protecting them against the shocks in property market? Why did too thin capital cushion erode confidence in the big banks? Explain.

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