

UNIVERSITY OF PORTSMOUTH BUSINESS SCHOOL

DEPARTMENT OF ECONOMICS

Economics of Banking and Money

U08433B

U17237

EXAMINATION PAPER

DATE: 21 January 2011

TIME: 16:15 – 18:15 (2 hours)

2 hours including reading time

Answer any **TWO** questions.

Calculators that are capable of holding text are **NOT** permitted in examinations
(For the purposes of identification, calculators capable of holding text will have an
alpha-numeric keypad, ie. a-z letters)

Specialist dictionaries such as Legal, Business, Technical or Accounting Dictionaries
etc. are not allowed in the exam. International students for whom English is a second
language are allowed to take into the exam one bilingual paper based dictionary
containing no annotations. Otherwise the normal University of Portsmouth
Examination Regulations will apply.

Answer any **TWO** questions.

Question 1

Critically explain and review the causes of bank failure, using case studies of your choice.

Question 2

UK and USA banking regulations have evolved to meet the needs of the modern banking industry. Discuss and explain the developments in the banking regulatory environment of both countries by highlighting their similarities and differences.

Question 3

- a. Explain the concept of a contestable banking market and, with reference to academic studies, discuss the degree of contestability in the banking industry. [30% of question marks]
- b. Banks have argued the case for free banking but still charged implicitly for some of their apparently free services. Review procedures for empirical tests to determine interest rate equivalence for non-price features in the banking industry. [30% of question marks]
- c. Critically explain the concept of the structure conduct performance (SCP) and the relative efficiency models in banking industry. Support your answer with reference to empirical studies. [40% of question marks]

Question 4

- a. Critically evaluate approaches to the management of market risk in the modern banking industry. [50% of question marks]
- b. In explaining banking risk measurement and management, Peter S. Rose (2002) presents the following cases. Read each case carefully and answer the questions that follow.

Case 1

Leland National Bank reports average asset duration of 4.5 years, and average liability duration of 3.25 years. The bank has total assets of \$1.8 billion and liabilities totalling \$1.5 billion.

- i. If interest rates rise from 7 percent to 9 percent, how will Leland's net worth change?
 - ii. What if interest rates fall from 7 to 5 percent?
- [25% of question marks]

Case 2

First National Bank of Barnett currently has the following interest-sensitive assets and liabilities on its balance sheet:

Interest-Sensitive Assets	Interest-Sensitive Liabilities
Federal fund loans = \$65	
Security holdings = \$42	Interest-bearing deposits = \$185
Loans and leases = \$230	Money-market borrowings = \$78

- i. What is the bank's current interest-sensitive gap?
- ii. Suppose its Federal funds loans carry an interest-rate sensitivity weight of 1.0 while its investments have a rate-sensitivity weight of 1.15 and its loans and leases display a rate-sensitivity weight of 1.35. On the liability side First National's rate-sensitivity weight is 0.79 for interest-bearing deposits and 0.98 for its money-market borrowings. Adjusted for these various interest-rate sensitivity weights, what is the bank's weighted interest-sensitive gap?
- iii. Suppose the Federal funds interest rate increases or decreases one percentage point. How will the bank's net interest income be affected given its current balance sheet make up and reflecting its weighted balance sheet adjusted for the foregoing rate-sensitivity weights?

[25% of question marks]