Stockholm University

Department of Economics

Course name:	**Financial Development and Crises**
Course code:	**EC7213**
Examiner:	**Jonas Vlachos**
Number of credits:	**7,5 credits**
Date of exam:	**Sunday 26 November 2017**
Examination time:	**3 hours [09:00-12:00]**

Write your identification number on each paper and cover sheet (the number stated in the upper right hand corner on your exam cover).

Use one cover sheet per question. Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked. **No aids are allowed.**

The exam consists of 4 questions, with a total of 70 points. The exact points are stated for each question and an additional maximum of 30 points are awarded for the term paper. For the grade E 45 points are required, for D 50 points, C 60 points, B 75 points and A 90 points.

Your results will be made available on your "My Studies" account **(**www.mitt.su.se), 15 working days after the exam occasion, at the latest.

Good luck!

Question 1. Brief answers, 3 credits per question (15 in total).

a) What is “shadow banking”?

b) How is financial development usually measured in empirical research? What are the main shortcomings of such measures?

c) Why are secondary markets important, even if no new capital is being raised?

d) What are the main similarities and differences between shadow banking and conventional banks?

e) The average annual fee of a Swedish mutual fund is about one (1) percent on the money invested. Why do people pay these fees?

Question 2 (20 points).

The following is a statement from an influential policy maker in banking: “It is socially wasteful to order banks to hold lots of unproductive capital on their balance sheets as a precaution against some very rare events.”

a) Using a stylized bank balance sheet, please evaluate the statement.

b) Discuss the difference between a leverage ratio and capital requirements. What are the advantages and disadvantages with the different measures?

c) Say that capital requirements on banks are increased, what (if anything) do you expect will happen to the required rate of return on bank capital? What (if anything) do you expect would happen to the interest rates that lenders to banks require?

d) Briefly explain the difference between a liquidity problems and solvency problems facing a bank.

e) Deposit insurance is perhaps the most central policy against liquidity problems. What do you think about implementing such a policy in a developing country?

Question 3 (20 points).

a) What determines the price of an asset according to basic asset pricing theory?

b) Are current asset prices useful when predicting future asset prices according to this theoretical view?

c) Briefly discuss the empirical evidence in supporting and questioning the basic theory of asset pricing

d) Are there potential theoretical links between current and future asset prices?

e) Define what you mean by “asset price bubble”.

f) Please outline a theoretical explanation for rational asset price bubbles, in other words, bubbles that can arise even though actors are rational.

Question 4 (15 points).

Securitization was first seen as a major financial innovation but was later blamed for being a major cause of the recent financial crisis.

a) Explain what securitization is and what useful purposes it fulfils.
b) Discuss the different problem that securitization creates.