Economics 252 – Financial Markets

Spring 2011

Lecture 12: Banks

February 28, 2011

Multiple Choice Questions

Question 13.1

Consider the banking model by Peter Diamond and Philip Dybvig, published in the *Journal of Political Economy* in 1988. What is the main implication of the property that this model has multiple equilibria?

(a) Depending on expectations, there is a good and a bad equilibrium. The banking system in the good equilibrium is stable, whereas bank runs occur in the bad equilibrium.
(b) The two possible equilibria represent the moral hazard problem that banks solve.
(c) The two possible equilibria represent the adverse selection problem that banks solve.
(d) This model does not have multiple equilibria, but it has a unique equilibrium.

Question 13.2

Before 2007, the United Kingdom has not seen a bank run since 1866. What was the name of the bank that experienced a bank run?

(a) Deutsche Industriebank.
(b) Goldman Sachs.
(c) Washington Mutual.
(d) Northern Rock.

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Question 13.3

Professor Shiller mentions three theoretical purposes of banks. What are these? (More than one answer may apply.)

(a) By having knowledge of the local communities, the banks can make use of their reputation to address an adverse selection problem.
(b) Through constant monitoring, banks solve a moral hazard problem that firms take excessive risk with borrowed capital.
(c) Banks provide liquidity, which is a positive economic good.
(d) Banks honor the notes of goldsmiths, ensuring the public's access to gold.

Question 13.4

If a bank's risk-weighted assets equal $100,000,000, what is this bank's common equity requirement plus the capital conservation buffer, according to Basel III?

(a) $4,500,000.
(b) $6,000,000.
(c) $7,000,000.
(d) $8,500,000.

Question 13.5

Which of the following are examples of banking crises that occurred between 1990 and 2005?
(More than one answer may apply.)

(a) The German crisis from 1990.
(b) The Mexican crisis from 1994-1995.
(c) The Asian crisis from 1997.
(d) The Argentine crisis from 2002.

Correct Answers

13.1: (a)
13.2: (d)
13.3: (a), (b), and (c)
13.4: (c)
13.5: (b), (c), and (d)