Faculty of Commerce- English Section

Money and Banking

Tutorial 5: Banking management

Lecturer: Dr Doaa Akl Ahmed

***Economics of Money, Banking, and Fin. Markets, 10e* (Mishkin)**

Question 1: Give the suitable definitions of the following concepts:

1. **asset transformation**
2. **liquidity management**
3. **capital adequacy management**
4. **bank failure**

Question 2: Choose the correct answer:

1) Banks earn profits by selling ________ with attractive combinations of liquidity, risk, and return, and using the proceeds to buy ________ with a different set of characteristics.
A) loans; deposits
B) securities; deposits
C) liabilities; assets
D) assets; liabilities

2) In general, banks make profits by selling ________ liabilities and buying ________ assets.
A) long-term; shorter-term
B) short-term; longer-term
C) illiquid; liquid
D) risky; risk-free

3) Asset transformation can be described as
A) borrowing long and lending short.
B) borrowing short and lending long.
C) borrowing and lending only for the short term.
D) borrowing and lending for the long term.

4) When you deposit a $50 bill in the National Bank,
A) its liabilities decrease by $50.
B) its assets increase by $50.
C) its reserves decrease by $50.

D) its cash items in the process of collection increase by $50.

5) Holding all else constant, when a bank receives the funds for a deposited check,
A) cash items in the process of collection fall by the amount of the check.
B) bank assets increase by the amount of the check.
C) bank liabilities decrease by the amount of the check.
D) bank reserves increase by the amount of required reserves.

6) When a $10 check written on the First National Bank of Chicago is deposited in an account at Citibank, then
A) the liabilities of the First National Bank increase by $10.
B) the reserves of the First National Bank increase by $ 10.
C) the liabilities of Citibank increase by $10.
D) the assets of Citibank fall by $10.

7) When $1 million is deposited at a bank, the required reserve ratio is 20 percent, and the bank chooses not to hold any excess reserves but makes loans instead, then, in the bank's final balance sheet,
A) the assets at the bank increase by $800,000.
B) the liabilities of the bank increase by $1,000,000.
C) the liabilities of the bank increase by $800,000.
D) reserves increase by $160,000.

8) When $1 million is deposited at a bank, the required reserve ratio is 20 percent, and the bank chooses **not** to make any loans but to hold excess reserves instead, then, in the bank's final balance sheet,
A) the assets at the bank increase by $1 million.
B) the liabilities of the bank decrease by $1 million.
C) reserves increase by $200,000.
D) liabilities increase by $200,000.

9) A deposit outflow results in equal reductions in
A) loans and reserves.
B) assets and liabilities.
C) reserves and capital.
D) assets and capital.

10) Which of the following are primary concerns of the bank manager?
A) Maintaining sufficient reserves to minimize the cost to the bank of deposit outflows
B) Extending loans to borrowers who will pay low interest rates, but who are poor credit risks
C) Acquiring funds at a relatively high cost, so that profitable lending opportunities can be realized
D) Maintaining high levels of capital and thus maximizing the returns to the

owners.

11) If a bank has $200,000 of checkable deposits, a required reserve ratio of 20 percent, and it holds $80,000 in reserves, then the maximum deposit outflow it can sustain without altering its balance sheet is

A) $50,000.
B) $40,000.
C) $30,000.
D) $25,000.

12) If a bank has excess reserves greater than the amount of a deposit outflow, the outflow will result in equal reductions in

A) deposits and reserves.
B) deposits and loans.
C) capital and reserves.
D) capital and loans.

13) A $5 million deposit outflow from a bank has the immediate effect of

A) reducing deposits and reserves by $5 million.
B) reducing deposits and loans by $5 million.
C) reducing deposits and securities by $5 million.
D) reducing deposits and capital by $5 million.

14) If, after a deposit outflow, a bank needs an additional $3 million to meet its reserve requirements, the bank can

A) reduce deposits by $3 million.
B) increase loans by $3 million.
C) sell $3 million of securities.
D) repay its discount loans from the Fed.

15) Of the following, which would be the first choice for a bank facing a reserve deficiency?

A) Call in loans
B) Borrow from the Fed
C) Sell securities
D) decrease deposits

16) In general, banks would prefer to acquire funds quickly by ________ rather than ________.

A) reducing loans; selling securities
B) reducing loans; borrowing from the Fed
C) borrowing from the Fed; reducing loans
D) "calling in" loans; selling securities

17) If a bank needs to acquire funds quickly to meet an unexpected deposit outflow, the bank could

A) borrow from another bank in the federal funds market.
B) buy U.S. Treasury bills.
C) increase loans.
D) buy corporate bonds.

18) Which of the following statements most accurately describes the task of bank asset management?

A) Banks seek the highest returns possible subject to minimizing risk and making adequate provisions for liquidity.
B) Banks seek to have the highest liquidity possible subject to earning a positive rate of return on their operations.
C) Banks seek to prevent bank failure at all cost; since a failed bank earns no profit, liquidity needs supersede the desire for profits.
D) Banks seek to acquire funds in the least costly way.

19) The goals of bank asset management include

A) maximizing risk.
B) minimizing liquidity.
C) lending at high interest rates regardless of risk.
D) purchasing securities with high returns and low risk.

20) As the costs associated with deposit outflows ________, the banks willingness to hold excess reserves will ________.

A) decrease; increase
B) increase; decrease
C) increase; increase
D) decrease; not be affected

21) A bank failure occurs whenever

A) a bank cannot satisfy its obligations to pay its depositors and have enough reserves to meet its reserve requirements.
B) a bank suffers a large deposit outflow.
C) a bank has to call in a large volume of loans.
D) a bank is not allowed to borrow from the Fed.

22) Bank capital has both benefits and costs for the bank owners. Higher bank capital ________ the likelihood of bankruptcy, but higher bank capital ________ the return on equity for a given return on assets.

A) reduces; reduces
B) increases; increases
C) reduces; increases

D) increases; reduces

23) Banks hold capital because
A) they are required to by regulatory authorities.
B) higher capital increases the returns to the owners.
C) it increases the likelihood of bankruptcy.
D) higher capital increases the return on equity.