

- ① Briefly explain whether you agree with the following statements. In your answer, explain the effects on banks' profits or net worth.
 - ① "A bank that expects interest rates to decrease in the future will want to hold more variable-rate assets and fewer variable-rate liabilities."
 - ② "A bank that expects interest rates to increase will want the duration of its assets to be greater than the duration of its liabilities."
- ② Do banks typically have a positive or negative variable-rate gap (usually defined simply as *gap*)? Explain your answer by listing common bank assets and liabilities, and whether each are typically variable-rate or fixed-rate.
- ③ Do banks typically have a positive or negative duration gap? Explain your answer by listing common bank assets and liabilities, and whether each typically has long or short durations.

- ④ Describe the difference between an insolvent bank and an illiquid bank. Describe how an illiquid bank can become insolvent. Would a government lending to an illiquid bank likely see the funds repaid and with interest? Would a government lending to an insolvent bank likely see the funds repaid and with interest? Explain.
- ⑤ Describe what is systemic risk. Describe one reason a government may want to rescue an insolvent financial institution. Describe one reason why it may want to let the financial institution fail.
- ⑥ Describe the short-run and long-run macroeconomic impact of financial crises on lending, investment, and long-run production possibilities.