

**Problem set 10 (November 19, 2016)**

(Recommended reading: *The Fundamental Principles of Financial Regulation*, sections 1-4, CEPR, 2009 (link available on the course reading list))

1. Discuss the externalities related to failures in the banking sector.
2. Define funding liquidity and market liquidity. How and through what channels might funding *illiquidity* and/or market *illiquidity* have contagious impact within the banking system? (Your answer should touch on the issues of loss spirals and margin/haircut spirals, see sec 2 of the recommended reading)
3. Discuss whether it will be sufficient for the safety of the banking system as a whole to make each individual bank safe by passing a *stress test*.
4. Could countercyclical capital requirement be an effective instrument against some of the problems that have been identified above?