

FIN3005 V-2020

Comments to candidat: 10002

Problem 1 asked for definitions of risk aversion, the elasticity of intertemporal substitution, the equity premium, the equity premium puzzle, and dynamic programming. This candidate gave adequate definitions of the first four. The part about the equity premium puzzle became excessively detailed technically, but without making the main point about making decisions now under the assumption that future decision making will follow the same rule. 37 points out of 40 possible.

Problem 2 asked how the corona crisis can serve as an example for possible explanation of the equity premium puzzle. The expected answer was that this crisis is a possible example of rare disasters, which cause fat left tails for the probability distribution of economic growth and equity returns. The candidate saw this connection and gave an excellent account of Barro's model of rare disasters. The question included the main equation for the equity premium in this model, for which the candidate gave a very good explanation. 30 points out of 30 possible.

Problem 3 simply asked the students to present and explain a model with moral hazard as a key part of the mechanism that exacerbates business cycles. The question was meant to refer to Kiyotaki and Moore's model of credit cycles, where moral hazard makes creditors require collateral, and where movements in collateral prices exacerbate business cycles. The candidate gave an adequate presentation of the model and explained its main implications well. 30 points out of 30.

Total: 97 points out of 100 possible. Grade: A