## Contents

Letter of transmittal .............................................................. ix

Overview of the economic chapters ........................................... xi

### I. Building a stable future .................................................. 1

The year in retrospect ......................................................... 2
  - Recovery in advanced economies ....................................... 2
  - Inflation pressures prompt revisions to monetary policy expectations .. 4
  - Lingering fiscal policy concerns in the euro area .................. 7
  - Fiscal policy elsewhere .................................................. 8
  - Banks’ balance sheets improve but remain vulnerable ............. 8
The year in prospect ............................................................ 10
  - Fiscal challenges ......................................................... 10
  - Private sector balance sheet challenges ............................. 11
  - International imbalances ............................................... 12
  - Monetary policy .......................................................... 13
  - Regulatory reform ....................................................... 13
Box: Central bank governance and financial stability ................... 14
  - Measuring and monitoring the threats ............................... 16
Summing up ................................................................. 17

### II. Building new foundations for sustainable growth ................. 18

Imbalances, financial crises and growth .................................... 19
  - Sectoral imbalances ..................................................... 23
  - Private sector debt reduction ......................................... 24
  - Box: The effect of sectoral imbalances on growth: the case of manufacturing .. 25
  - Public debt and fiscal consolidation .................................. 27
Conclusions ................................................................. 30

### III. The risks of international imbalances: beyond current accounts .......................................................... 33

Current account balances: risks and responses ............................ 35
  - Risks ........................................................................... 36
  - The policy impasse ....................................................... 37
Box III.A: Some evidence of adjustment .................................... 38
  - Role for policy coordination ........................................... 39
Gross financial flows and financial imbalances .............................. 41
  - Risks ........................................................................... 43
  - Addressing financial risks ............................................... 45
Box III.B: Global liquidity ..................................................... 46
Summing up ................................................................. 48
IV. Monetary policy challenges ahead ........................................ 50

Challenges from the expansion of central bank balance sheets .... 50
  Implications of expanded central bank balance sheets .... 52
  Box IV.A: Interactions of sovereign debt management with monetary
  conditions and financial stability ............................. 53
Normalising policy rates ................................................ 54
  Inflation risk from higher commodity prices .............. 55
  Box IV.B: Commodity prices and financialisation ............. 57
  State of the recovery and risks of overheating ............ 58
  Assessing the current monetary policy stance ........... 61
Summing up .......................................................... 63

V. Financial regulatory reform: accomplishments, pitfalls,
prospects ................................................................ 64

How the financial crisis is shaping regulatory reform ............... 65
  Bank capital ....................................................... 65
  Box V.A: Capital instruments ....................................... 66
    Risk coverage ................................................... 66
    Liquidity ......................................................... 67
  Box V.B: The role of financial market infrastructures .... 67
    Macroprudential aspects ........................................ 68
    Box V.C: National and international progress on implementing macroprudential
    policy frameworks ........................................ 69
Impact of the new requirements ......................................... 70
Outstanding issues and future work ................................... 75
  Implementation ..................................................... 75
  More intensive and more intrusive supervision ............ 75
  Systemically important financial institutions ............. 76
  More effective cross-border bank resolution .............. 76
  Other financial sectors and firms ............................ 77
  Shadow banking .................................................. 78
  Other regulatory and supervisory initiatives .............. 79
The evolving financial system ........................................ 80
Summing up .......................................................... 82

VI. Closing data gaps to enhance systemic risk measurement .... 83

Systemic risk: where should we look? ................................. 84
  Common exposures ............................................... 85
  Leverage .......................................................... 88
  Maturity transformation and funding risk .................. 89
Data needs in a globalised world ..................................... 90
  Box: The BIS international banking statistics: uses and enhancements .... 91
Filling the data gaps .................................................. 94
Summing up .......................................................... 96
The chapters of this Report went to press between 6 and 10 June 2011.
Graphs

I.1 Asset prices in selected advanced economies .............................. 3
I.2 The divergence of advanced and emerging market economies ............ 3
I.3 Inflationary pressures .................................................... 4
I.4 Interest rates .................................................................... 5
I.5 Selected emerging market economies: inflation, policy rates and exchange rates ........................................... 6
I.6 Fiscal challenges in euro area countries ........................................ 7
I.7 Bank capital ratios and credit spreads ........................................ 9

II.1 Output in selected economies .............................................. 18
II.2 Real prices of residential and commercial properties ................. 20
II.3 Debt ............................................................................. 21
II.4 Booms in the construction and financial sectors ......................... 22
II.5 Productivity growth and sectoral imbalances ............................ 23
II.6 Household debt ratios ...................................................... 26
II.7 Fiscal deficits in 2010 ...................................................... 29
II.8 Fiscal balance in construction and financial booms ....................... 30

III.1 Global current account balances ......................................... 35
III.2 Regional current account balances ........................................ 36
III.3 Resisting real exchange rate adjustment .................................. 37
III.4 Gross flows for selected countries ........................................ 42
III.5 Linkages in the international banking system at end-2010 ............. 43
III.6 Demand and supply factors in cross-border bank lending to selected emerging markets ...................................................... 44
III.7 Gross flows from East Asian economies .................................. 48

IV.1 Central bank total assets in selected economies ......................... 50
IV.2 Central bank assets and liabilities ......................................... 51
IV.3 Central bank assets, monetary aggregates and consumer prices ...... 54
IV.4 Policy rates and inflation .................................................... 55
IV.5 Forward curves .................................................................. 56
IV.6 Inflation volatility and wage pressure ....................................... 58
IV.7 Comparisons between the current juncture and the 1970s at the global level ......................................................... 59
IV.8 Monetary policy stance ...................................................... 61
IV.9 Credit gaps and residential property prices in emerging market economies ..................................................... 62

V.1 Phase-in schedule for higher minimum requirements for bank capital and liquidity ......................................................... 65
V.2 Capital-raising and writedowns .............................................. 72
V.3 Aggregate impact of a 1.3 percentage point increase in the target capital ratio ..................................................... 73
V.4 Estimated long-run annual net economic benefits of increases in capital and liquidity .................................................. 74
V.5 Insurance companies: equity holdings and performance ............... 77
V.6 Hedge funds: size, performance and leverage ............................. 78
V.7 Growth of selected financial instruments .................................. 80
V.8 Return on equity .................................................................. 81
V.9 Maturity profile of bank bonds .............................................. 82

VI.1 Credit and asset price behaviour around banking crises ............. 85
VI.2 Market prices as contemporaneous measures of financial distress: the US example ......................................................... 86
VI.3 On-balance sheet USD positions at long-USD European banks ...... 90
VI.4 The structure of the global operations of the hypothetical firm TRUST Ltd .............................................................. 93
# Tables

| II.1 | Public debt | 28 |
| II.2 | Boom in the emerging market economies: falling into the same trap? | 31 |
| III.1 | Annual changes in official foreign exchange reserves | 40 |
| V.1 | Average capital ratios reported to the quantitative impact study | 70 |
| V.2 | Profitability of major banks | 71 |
| VI.1 | Large banks’ disclosure of exposures to structured instruments | 87 |
Conventions used in this Report

lhs, rhs  left-hand scale, right-hand scale
billion  thousand million
...  not available
.  not applicable
–  nil or negligible
$  US dollar unless specified otherwise

Differences in totals are due to rounding.

The term “country” as used in this publication also covers territorial entities that are not states as understood by international law and practice but for which data are separately and independently maintained.
submitted to the Annual General Meeting
of the Bank for International Settlements
held in Basel on 26 June 2011

Ladies and Gentlemen,

It is my pleasure to submit to you the 81st Annual Report of the Bank for International Settlements for the financial year which ended on 31 March 2011.

The net profit for the year amounted to SDR 816.0 million, compared with SDR 1,859.8 million for the preceding year. Details of the results for the financial year 2010/11 may be found on pages 139–42 of this Report under “Net profit and its distribution”.

The Board of Directors proposes, in application of Article 51 of the Bank’s Statutes, that the present General Meeting apply the sum of SDR 161.1 million in payment of a dividend of SDR 295 per share, payable in any constituent currency of the SDR, or in Swiss francs.

The Board further recommends that SDR 65.5 million be transferred to the general reserve fund, SDR 6.0 million to the special dividend reserve fund and the remainder – amounting to SDR 583.4 million – to the free reserve fund.

If these proposals are approved, the Bank’s dividend for the financial year 2010/11 will be payable to shareholders on 1 July 2011.

Basel, 10 June 2011

JAIME CARUANA
General Manager