

20090629 BIS Annual Report: Rescue, recovery, reform – the narrow path ahead

Source: Bank for International Settlements

In its 79th Annual Report, released today, the Bank for International Settlements (BIS) looks at the narrow path ahead leading out of the financial crisis. The Report underlines the need to focus clearly on the medium term and on sustainability when designing both macroeconomic and financial policy responses.

The crisis had both macroeconomic and microeconomic causes: large global imbalances; a protracted period of low real interest rates; distorted incentives; and an underappreciation of risk. There were market failures, and regulation failed to prevent the build-up of excessive leverage.

In September and October 2008, the financial crisis intensified, forcing monetary, fiscal and regulatory authorities both to expand their fight to restore the health of the financial system and to counter the threats to the real economy. The scale and scope of the monetary and fiscal policy measures are unprecedented.

Nevertheless, the balance sheets of many financial institutions have still not been repaired. Further steps are needed to address this. A healthy financial system is a precondition for the effectiveness of expansionary policies and for stable long-run real growth. It is "essential that authorities ... repair the financial system", notes the Annual Report, and "persevere until the job is done". And they should resist financial protectionism, sometimes an unintended consequence of national support for the financial sector, as this would moderate growth and development.

Implementing the rescue is a complex task that is fraught with risks. Policies should aid, not hinder, orderly adjustment. They need to strike a balance between short-term stimulus and well articulated exit strategies that ensure long-term sustainability. They need to allow the financial sector to shrink as borrowers reduce their leverage. And they need to promote a shift in production patterns away from export- and leverage-led growth models towards more balanced ones.

Governments and the private sector have to work together to build a more resilient financial system. Addressing the broad failures revealed by the crisis means that systemic risk in all its guises must be identified and mitigated, adopting a macroprudential perspective – a core theme of the BIS's work for many years. Guillermo Ortiz, Chairman of the BIS Board of Directors, noted that "the work will have to be coordinated internationally across a wide range of countries. In particular, institutions with expertise in the field – including the Financial Stability Board and standard-setting committees – will need to play a leading role".

The BIS Annual Report argues that financial instruments, markets and institutions all require reform if a truly robust system is to emerge. For instruments, it means a mechanism that rates their safety, limits their availability and provides warnings about their suitability and risks. For markets, it means encouraging trading and clearing through central counterparties and exchanges. For institutions, it means the comprehensive application of enhanced prudential standards that integrate a system-wide perspective. Above all, regulators and supervisors must adopt a macroprudential orientation. By focusing on the stability of the system as a whole, as much as on the viability of individual institutions, it would reduce the probability of joint failures that arise from common exposures and at the same time moderate the procyclicality inherent in the financial system. Speaking today, BIS General Manager Jaime Caruana stressed that "there are several projects under way to make the macroprudential approach operational, building on the new-found international consensus supporting it. The BIS is actively involved in all of these initiatives".

But better regulation is not enough. Macroeconomic policies can and must play a role in promoting financial stability. For monetary policy, this means taking better account of asset prices and credit booms; for fiscal policy, it means putting a premium on medium-term fiscal discipline and long-term sustainability.

The 79th Annual Report was presented at the Bank's Annual General Meeting, held today in Basel, Switzerland, and chaired by Guillermo Ortiz. The Bank reported a balance sheet total of SDR 255 billion (USD 381 billion) at end-March 2009, a decrease of SDR 56 billion over the past year. Net profit was 18% lower than for the previous financial year, amounting to SDR 446 million (USD 666 million). Currency deposits by customers represent some 4% of the world's total foreign exchange

reserves.

To read the report [click here.](#)

NovaRes Team