CONTENTS

Preface		ix
Executive Summary		xi
Chapter 1.	Resolving the Crisis Legacy and Meeting New Challenges to Financial Stability	1
	A. How Has Global Financial Stability Changed?	1
	B. Could Sovereign Risks Extend the Global Credit Crisis?	3
	C. The Banking System: Legacy Problems and New Challenges	11
	D. Risks to the Recovery in Credit	24
	E. Assessing Capital Flows and Bubble Risks in the Post-Crisis Environment	28
	F. Policy Implications	39
	Annex 1.1. Global Financial Stability Map: Construction and Methodology Annex 1.2. Assessing Proposals to Ban "Naked Shorts" in Sovereign Credit	44
	Default Swaps	49
	Annex 1.3. Assessment of the Spanish Banking System	53
	Annex 1.4. Assessment of the German Banking System	59
	Annex 1.5. United States: How Different Are "Too-Important-to-Fail"	
	U.S. Bank Holding Companies?	64
	References	66
	supplemental annexes to Chapter 1 are available online at nf.org/external/pubs/ft/gfsr/2010/01/index.htm#chap1anx]	
	Annex 1.6. Analyzing Nonperforming Loans in Central and Eastern Europe Based on Historical Experience in Emerging Markets Annex 1.7. Credit Demand and Capacity Estimates in the United States, Euro Area, and United Kingdom Annex 1.8. The Effects of Large-Scale Asset Purchase Programs Annex 1.9. Methodologies Underlying Assessment of Bubble Risks Annex 1.10. Euro Zone Sovereign Spreads: Global Risk Aversion, Spillovers, or Fundamentals?	
Chapter 2.	Systemic Risk and the Redesign of Financial Regulation [Available online at http://www.imf.org/external/pubs/ft/gfsr/2010/01/pdf/chap2	.pdf]
	Summary Implementing Systemic-Risk-Based Capital Surcharges Reforming Financial Regulatory Architecture Taking into Account Systemic Connectedness Policy Reflections Annex 2.1. Highlights of Model Specification References	

Chapte	er 3.	Making Over-the-Counter Derivatives Safer: The role of Central Counterparties [Available online at http://www.imf.org/external/pubs/ft/gfsr/2010/01/pdf/chap3.pdf.	pdf]
		Summary The Basics of Counterparty Risk and Central Counterparties The Case for Over-the Counter Derivative Central Clearing Incentivizing Central Counterparty Participation and the Role of End-Users Criteria for Structuring and Regulating a Sound Central Counterparty How Should Central Counterparties Be Regulated and Overseen? One versus Multiple Central Counterparties? Conclusions and Policy Recommendations References	
Chapte	er 4.	Global Liquidity Expansion: Effects on "Receiving" Economies and Policy Response Options [Available online at http://www.imf.org/external/pubs/ft/gfsr/2010/01/pdf/chap4.p	odf]
		Summary Overview of the 2007–09 Global Liquidity Expansion Effects of the Global Liquidity Expansion on the Liquidity-Receiving Economies Policy Response Options for Liquidity-Receiving Economies Effectiveness of Capital Controls Conclusions Annex 4.1. Econometric Study on Liquidity Expansion: Data, Methodology, and Detailed Results Annex 4.2a. Global Liquidity Expansion—Capital-Account-Related Measures Applied in Selected Liquidity-Receiving Economies Annex 4.2b. Global Liquidity Expansion—Policy Responses Affecting the Capital Account in Selected Liquidity-Receiving Economies References	
Statisti		ppendix ilable online at http://www.imf.org/External/Pubs/FT/GFSR/2010/01/pdf/statappx.pd	df]
Boxes			
	1.1.	Explaining Swap Spreads and Measuring Risk Transmission among Euro Zone Sovereigns	7
	1.2.	Nonperforming Loans in Central and Eastern Europe: Is this Time Different?	18
	1.3.	Asian Residential Real Estate Markets: Bubble Trouble?	35
	1.4.	Could Conditions in Emerging Markets Be Building a Bubble?	38
	1.5.	Proposals to Address the Problem of "Too-Important-to-Fail" Financial	
		Institutions	43
	1.6.	Estimating Potential Losses from Nonperforming Loans for Spain	54
	1.7.		62
	2.1.	·	
	2.2.	Assessing the Systemic Importance of Financial Institutions, Markets, and	

2.3. Computing an Aggregate Loss Distribution

2.5. Contingent Capital—Part of the Solution to Systemic Risk?

2.4. Regulatory Architecture Proposals

3.1.	The Mechanics of Over-the-Counter Derivative Clearing	
3.2.	The Basics of Novation and Multilateral Netting	
3.3.	The Failure of Lehman Brothers and the Near-Failure of AIG	
3.4.	Central Counterparty Customer Position Portability and Collateral Segregation	
3.5.	History of Central Counterparty Failures and Near-Failures	
3.6.	The European and U.S. Regulatory Landscapes	
3.7.	Legal Aspects of Central Counterparty Interlinking and Cross-Margining	
4.1.	Global Liquidity Expansion and Liquidity Transmission	
4.2.	Capital Controls versus Prudential Measures	
4.3.	Capital Controls on Outflows versus Inflows	
4.4.	Reserve Requirements and Unremunerated Reserve Requirements	
4.5.	Capital Account Measures—Event Study Results	
4.6.	Market Participant Views Regarding Effectiveness of Capital Controls	
Tables		
1.1.	Sovereign Market and Vulnerability Indicators	5
	Estimates of Global Bank Writedowns by Domicile, 2007–10	13
	Aggregate Bank Capital Positions	14
	United States: Bank Writedowns and Capital	15
	Spain: Bank Writedowns and Capital	10
	Germany: Bank Writedowns and Capital	17
1.7.	Projections of Credit Capacity for and Demand from the Nonfinancial Sector	28
	Asset Class Valuations	33
1.9.	Global Financial Stability Map Indicators	48
1.10.	Ten Largest Sovereign Credit Default Swap Referenced Countries	49
1.11.	Spain: Baseline and Adverse-Case Scenarios	57
1.12.	Spain: Calculations of Cutoff Rates for Banks with Drain on Capital	58
1.13.	Estimates of German Bank Writedowns by Sector, 2007–10	60
	Germany: Bank Capital, Earnings, and Writedowns	63
	Comparison of Some Methodologies to Compute Systemic-Risk-Based Charges	
2.2.		
	Points in the Credit Cycle and Associated Systemic Risk Ratings	
	Capital Surcharges Based on the Standardized Approach	
	Systemic-Risk-Based Capital Surcharges through the Cycle	
	Systemic-Risk-Based Cyclically Smoothed Capital Surcharges Across Countries	
	Sample Systemic Risk Report	
	Currently Operational Over-the-Counter Derivative Central Counterparties	
3.2.	Incremental Initial Margin and Guarantee Fund Contributions Associated with	
	Moving Bilateral Over-the-Counter Derivative Contracts to	
4.1	Central Counterparties	
4.1.	1 ,	
4.2	Accumulation, and Liquidity and Alternative Exchange Rate Regimes	
4.2.	Fixed-Effects Panel least-Square Estimation of the Determinants of Asset	
4.2	Returns—41 Economies, January 2003–November 2009	
4.3.	Fixed-Effects Panel Least-Square Estimation of the Determinants of Asset	
4.4	Returns—34 Economies, January 2003–December 2009	
4.4.	Fixed-Effects Panel Least-Square Estimation of the Determinants of Equity	
	Returns— Regional Disaggregation, 34 Economies,	
<i>1</i> =	January 2003–December 2009 Eived Effects Panel Least Square Estimation of the Determinants of Capital	
4.3.	Fixed-Effects Panel Least-Square Estimation of the Determinants of Capital Flows—34 Economies, January 2003–December 2009	

GLOBAL FINANCIAL STABILITY REPORT

- 4.6. Granger Causality Relations between Global and Domestic Liquidity4.7. Determinants of Equity Returns, EGARCH (1,1) Specifications, January 2003–November 2009

Figures

1.1.	Global Financial Stability Map	1
1.2.	Macroeconomic Risks in the Global Financial Stability Map	2
1.3.		2
1.4.	Sovereign Debt to GDP in the G-7	4
1.5.	Sovereign Risks and Spillover Channels	4
1.6.	Contributions to Five-Year Sovereign Credit Default Swap Spreads	6
1.7.		6
1.8.	e e e e e e e e e e e e e e e e e e e	9
1.9.		
	October 2009 to February 2010	10
1.10.	Regional Spillovers from Western Europe to Emerging Market Sovereign	
	Credit Default Swaps	11
1.11.	Realized and Expected Writedowns or Loss Provisions for Banks by Region	12
1.12.		12
1.13.	Global Securities Prices	14
1.14.	U.S. Mortgage Market	16
1.15.	Banks' Pricing Power—Actual and Forecast	20
1.16.	Bank Debt Rollover by Maturity Date	21
1.17.	Government-Guaranteed Bank Debt and Retained Securitization	21
1.18.	Euro Area Banking Profitability	22
1.19.		22
1.20.		23
1.21.	Bank Return on Equity and Percentage of Unprofitable Banks, 2008	23
	Banking System Profitability Indicators	24
1.23.	Real Nonfinancial Private Sector Credit Growth in the United States	24
1.24.	Average Lending Conditions and Growth in the Euro Area, United Kingdom,	
	and United States	25
1.25.	Contributions to Growth in Credit to Nonfinancial Private Sector Credit Growth	25
1.26.	Nonfinancial Private Sector Credit Growth	26
1.27.	Total Net Borrowing Needs of the Sovereign Sector	26
1.28.	Credit to GDP	26
1.29.	Low Short-Term Interest Rates Are Driving Investors Out of Cash	29
1.30.	Emerging Market Returns Better on a Volatility-Adjusted Basis	3 0
1.31.	Cumulative Retail Net Flows to Equity and Debt Funds	31
1.32.	Refinancing Needs for Emerging Markets and Other Advanced Economies	
	Remain Significant	31
1.33.	Emerging Market Real Equity Prices: Historical Corrections	32
1.34.	The Incentives for Foreign Exchange Carry Trades Are Recovering	34
1.35.	Real Domestic Credit Growth and Equity Valuation	37
1.36.	All Risks to Global Financial Stability and its Underlying Conditions	
	Have Improved	45
1.37.	· · · · · · · · · · · · · · · · · · ·	47
1.38.	Net Notional Credit Default Swaps Outstanding as a Share of Total	
	Government Debt	50
1.39.	Correlation of Daily Changes in Five-Year Greek Credit Default Swap and	
	Bond Yield Spreads	50

1.40.	Sovereign Credit Default Swap Volumes, January 2009 to January 2010	52
1.41.	Spain: Nonperforming Loans	55
1.42.	Spain: Real Asset Repossessions	55
1.43.	Germany: Loan Loss Rates	60
1.44.	Germany: Loan Losses	61
2.1.	Network Structure of Cross-Border Interbank Exposures	
2.2.	Simulation Step 1: Illustration of the Evolution of Banks' Balance Sheets at	
	Different Points in the Cycle	
2.3.	Simulation Step 2: Illustration of Contagion Effects at Different Points in the	
	Credit Cycle	
2.4.	An Illustration of the Computation of Incremental Value-at-Risk for Bank 1	
2.5.	Simulation of Systemic Risk Capital Surcharges	
2.6.	Regulatory Forbearance under a Multiple Regulator Configuration	
\circ		

- Regulatory Forbearance under a Multiple Regulator Configuration with Systemic Oversight Mandate
- 2.8. Regulatory Forbearance under Multiple and Unified Regulator Configurations with Oversight Mandate over Systemic Institutions
- 3.1. Global Over-the-Counter Derivatives Markets
- 3.2. Outstanding Credit Defaults Swaps in the Depository Trust & Clearing Corporation Data Warehouse
- 3.3. Derivative Payables plus Posted Cash Collateral
- 3.4. Typical Central Counterparty Lines of Defense against Clearing Member Default
- 4.1. Global Liquidity
- 4.2. Change of Central Bank Policy Rates
- 4.3. Liquidity-Receiving Economies: Composition of Capital Inflows
- 4.4. Emerging Markets Equity Indices
- 4.5. Brazil
- 4.6. Colombia
- 4.7. Thailand
- 4.8. Croatia
- 4.9. Korea

The following symbols have been used throughout this volume:

- ... to indicate that data are not available;
- to indicate that the figure is zero or less than half the final digit shown, or that the item does not exist:
- between years or months (for example, 1997-99 or January-June) to indicate the years or months covered, including the beginning and ending years or months;
- between years (for example, 1998/99) to indicate a fiscal or financial year.

"Billion" means a thousand million; "trillion" means a thousand billion.

"Basis points" refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to !/4 of 1 percentage point).

"n.a." means not applicable.

Minor discrepancies between constituent figures and totals are due to rounding. As used in this volume the term "country" does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.