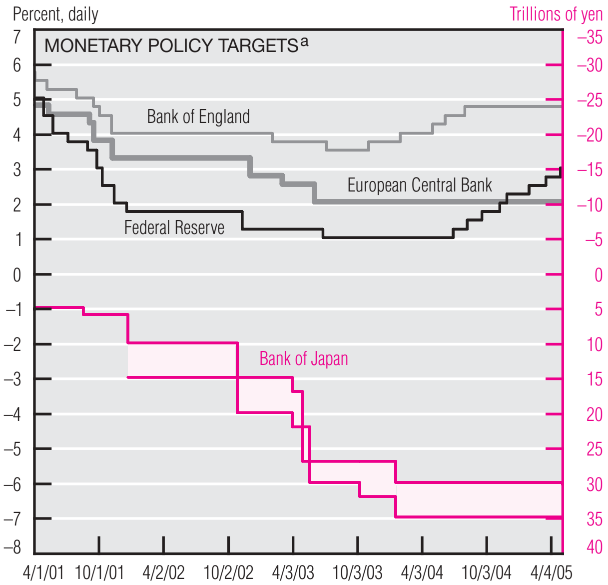
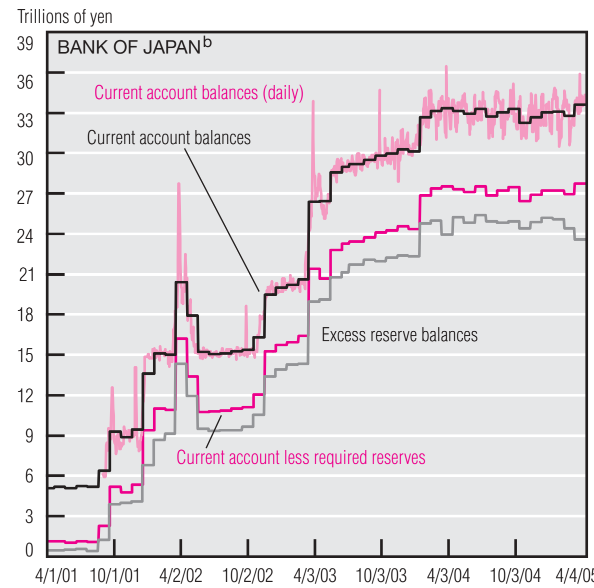
Foreign Central Banks





Examples of Central Bank Losses, 2004

Bank	Loss (billions of national currency)	Loss (U.S. dollars)	Loss (percent of 2003 year-end net worth)	Explanations
European Central Bank	1.6 (euro)	$2.2 billion	2.5%	Revaluation of foreign-currency-denominated assets
Bank of Korea	150 (won)	$146 million	1.9%	Interest payments on Monetary Stabilization Bonds

Past Examples of Central Bank Losses

Bank	Year	Loss (billions of national currency)	Loss (percent of prior year-end net worth)
Korea	1994	73.3 (won)	7%
Czech Republic	1996	8.7 (koruna)	32%
Hungary	1996	51.6 (forint)	108%
Brazil	1997	1.9 (real)	52%
Chile	1997	756.6 (peso)	570%
Thailand	1997	67.7 (baht)	147%

a. Federal Reserve: overnight interbank rate. Bank of Japan: a quantity of current account balances (since December 19, 2001, a range of quantity of current account balances). Bank of England and European Central Bank: repo rate.

b. Current account balances at the Bank of Japan are required and excess reserve balances at depository institutions subject to reserve requirements plus the balances of certain other financial institutions not subject to reserve requirements. Reserve requirements are satisfied on the basis of the average of a bank's daily balances at the Bank of Japan starting the sixteenth of one month and ending the fifteenth of the next.

SOURCES: Board of Governors of the Federal Reserve System; European Central Bank; Bank of England; Bank of Japan; Bank of Korea; CentralBankNet; and John Dalton and Claudia Dziobek, "Central Bank Losses and Experiences in Selected Countries," IMF Working Paper WP/05/72.

Among the four major central banks, only the Federal Reserve has changed a policy setting recently. It raised the target for the overnight federal funds rate another 25 basis points (bp) to 3.00%. This was expected: Each successive 25 bp increase since June 2004 has been preceded by a statement that "policy accommodation can be removed at a pace that is likely to be measured."

Central banking commonly is considered innately profitable. Typically, it involves the sale of non- or low-interest-bearing money to banks and the public in return for interest-bearing loans and securities. For example, since 1914 the Federal Reserve has maintained modest capital growth by transferring about $13 billion of earnings to surplus after paying statutory dividends of $6.5 billion to member banks. The remaining $549 billion of cumulative earnings were transferred to the U.S. Treasury.

Losses do occur, however. The European Central Bank (ECB) recently announced a €1.6 billion loss for 2004 after a €0.5 billion loss in 2003. The proximate cause of these losses was not profligate spending but prudent accounting. The ECB holds a substantial amount of assets denominated in foreign currencies, principally U.S. dollars, which it revalues on its balance sheet when exchange rates alter. Euro appreciation resulted in unrealized revaluation losses of almost €2.1 billion in 2004, deducted from income. The Bank of Korea reported a loss of 150 billion won for 2004; the proximate cause apparently was not revaluation but the interest expense of issuing securities intended to sop up liquidity that was created in trying to prevent appreciation of the won.