"Why are central banks reporting losses? Does it matter?"

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Profit distribution of central banks / public banks a universal topic

**Imperial charter for the Exchange Bank of Nürnberg 1498**

VII. With this interest income, pay the above-mentioned officials and founders of the exchange bank for their work, and if the interest income goes beyond this, pay this excess for the general use and good of the City of Nurnberg.

(…und von denselben Zinssen die obberürten Amptleuthen und auffrichter solcher Wechselbannckh ihres solds und arbeit entrichten, unnd ob alssdann derselben Zinnssen dermass were, diesselben Ubermass zu gemeinen Nutz und gutem der Statt Nürnberg obgemelt wenden und kehren mügend, alss andere derselben Statt gemeine güttter.)
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Plan for Stockholm Banco by J Palmstruch, 1652

9. From the interest income received by the above-mentioned lending bank of Amsterdam, not only all the employees of both banks are paid, but a significant profit remains, to the great benefit of the city.

Von denen in besagte Amsterdamische Leen-Bancq einkommenden Interesse geldern, werden nicht allein alle die bedienten der beiden Bancqven gehalten undt bezahlet, sondern es schisset von denselben, zu. grossen nutzen der Stadt, Jährlich noch ein merchliches über.

ECB OPS 234: “Early French and German central bank charters and regulations
What makes central banks special?

First, central banks are structurally profitable: issuing unremunerated deposits while holding positively remunerated financial assets. They benefit here from the privilege and monopoly to issue legal tender. Structural profitability should also be able to restore positive capital in case of a negative shock.

Second, the balance sheet structure of modern CBs is no indicator of their default probability, as anyway they can’t default. Neither liquidity mismatches, nor low or negative equity are per se a problem => enormous policy leeway (to hold illiquid assets; to act as LOLR; to combat deflationary risks or undue currency appreciation through asset purchases)
What makes central banks special?

Third, one should also think of the CB BS as being a part of the consolidated state balance sheet. One should always test both approaches conceptually to see if some conclusions e.g. on income implications of policy measures only hold under one.

Fourth, central banks have a clear policy mandate – price stability, but no profit target
Still losses should be an exception for central banks

- Being loss making or even operating with negative capital should only happen exceptionally because of the natural profitability of central banks.
- The central bank should know in advance the financial risks implied by policy measures (e.g. holding large foreign reserves or large long term bond portfolios).
- It should be transparent ex ante on its financial risk taking (e.g. by being transparent on its asset positions)
- It should explain the link between risk taking (ex ante), losses (ex post) and the policy mandate.
- Analysis should be both in a disaggregate and aggregate state balance sheet approach; in accounting and economic terms, in the short term and long term perspective. This allows to avoid misleading conclusions
The two real risks…

Conclusion from Bindseil, Manzanares, Weller (2004), “The role of central bank capital revisited” ECB WP 392

“In this model, the only real dangers of not returning to profitability in the long run are the case of a deflationary trap (from which there is no escape in our simple Wicksellian setting), or if banknote growth slows down too much (namely below the growth rate of operating costs).”

Two implications:

- Getting out of a potential deflationary trap as is overall positive from the profitability perspective, even if it leads to temporary losses

- CBDC can be considered an important element in the long run profitability and expected seignorage income of the central bank. Providing an effective means of payment is not only the basis of the usefulness of the central bank for society, but also the basis of its profitability.