



Why are central banks reporting losses? Does it matter?

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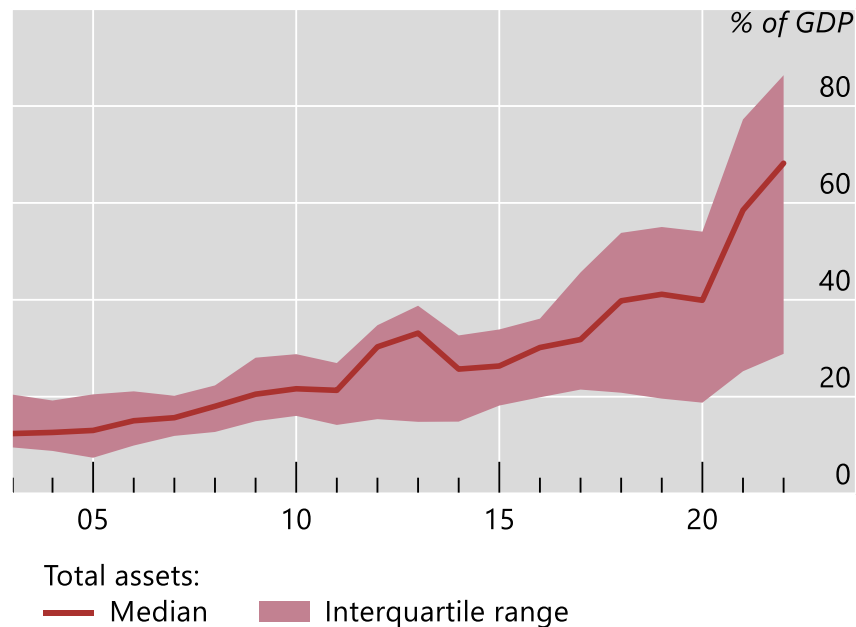
*The views expressed here are those of the presenter and are not necessarily those of the Bank for International Settlements.

Why are central banks reporting losses?

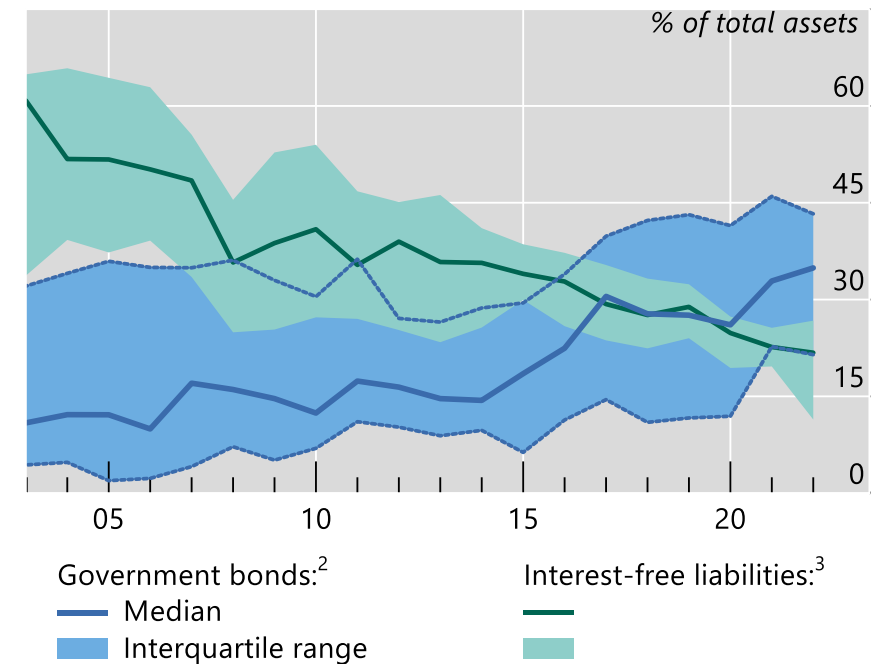
- Rising interest rates are reducing profits or leading to losses at advanced economy central banks that purchased domestic currency assets to stabilise economies in response to recent crises.
- Central banks with large FX reserves built to cushion external shocks (emerging market and small open economies) often experience profit volatility as a result of exchange rate fluctuations.

Advanced economy central bank balance sheet expansion since the GFC and Covid-19¹

Balance sheets expanded significantly



As central banks bought bonds, the share of interest-free liabilities declined

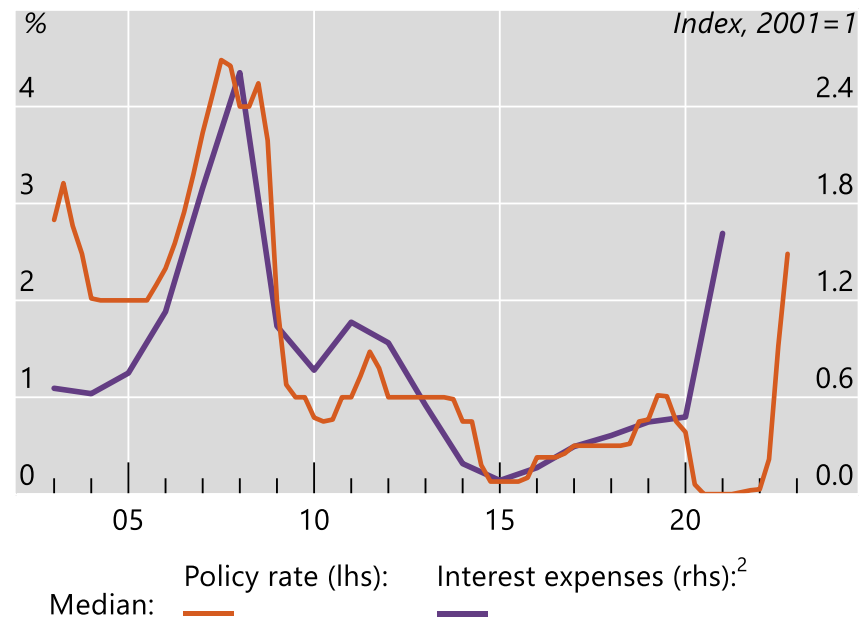


¹ Based on 27 AEs, including euro area national central banks. ² Subject to data availability, otherwise proxied by claims on government. ³ Includes cash in circulation and equity.

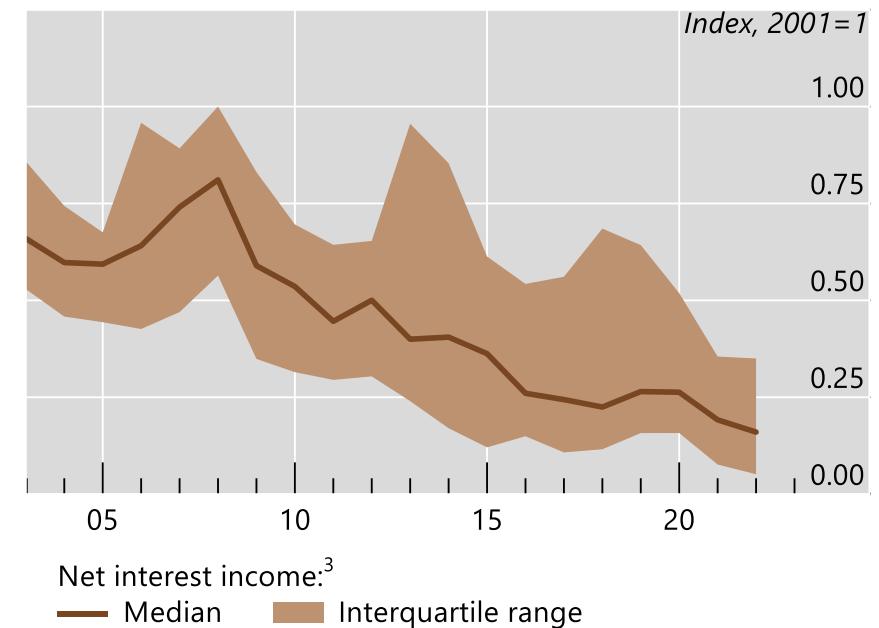
Sources: IMF, *International Financial Statistics*; national central banks; BIS Calculations.

Rising interest rates are reducing central bank profits¹

Rising interest rates mean central banks' funding costs rise ...



... making their net interest income decline



¹ Based on 27 AEs, including euro area national central banks. ² Funding for lending operations (in some cases at negative interest rates) caused a spike in interest expenses in 2020. ³ Net interest income as a share of assets.

Sources: IMF, *International Financial Statistics*; national central banks; BIS Calculations.

Do central banks losses matter?

- Neither losses nor negative equity compromise a central bank's ability to fulfil its mandate.
- The success of central banks should be judged on whether they fulfil their policy mandates, not on profitability.

Central banks are not commercial banks

- Their purpose is to act in the public interest.
- They are part of the consolidated public finance picture.
- Central banks can operate successfully without capital, and even withstand extended periods of losses and negative equity.

What happens when central banks face losses? It depends on the accounting approach

Mechanism	Approach	Description and comments
<i>A: Accounting</i>	Fair value changes go directly to P&L	Changes in market values have immediate impact on P&L, thus introducing volatility to income and distributions.
	Fair value changes go to equity account	Changes in market values are recognised but retained in equity by reserving, thus reducing volatility from asset valuations.
	Historic cost accounting	Changes in market values are not recognised unless and until the asset is sold. Reduces volatility from asset valuations.

What happens when central banks face losses?

It depends on income recognition and distribution rules

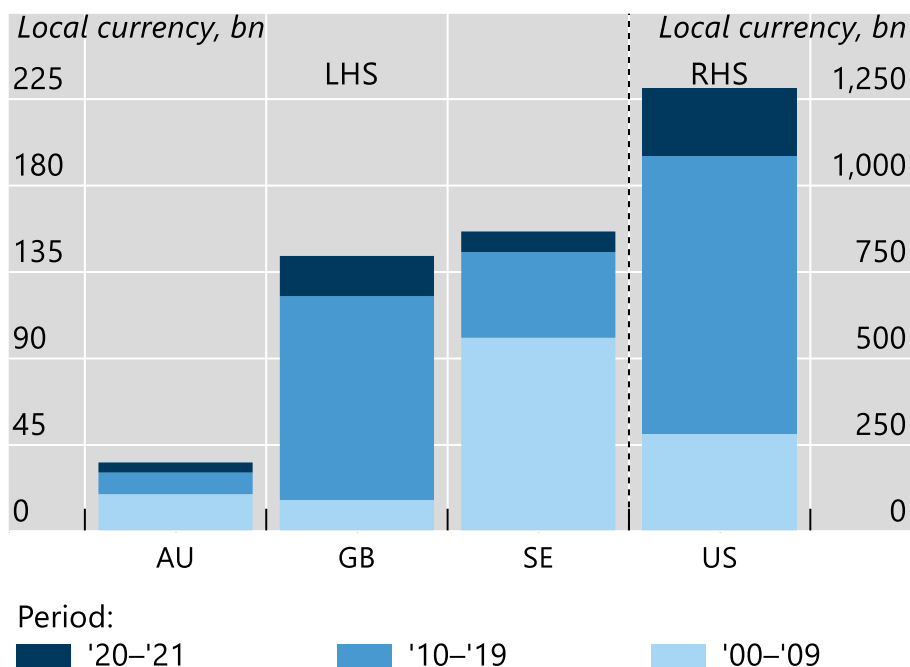
Mechanism	Approach	Description and comments
<i>B: Income recognition and distribution rules</i>	Full transfers	Any income in excess of expenses is automatically transferred (and building buffers may be explicitly prohibited).
	Fixed or contingent distributions	Distributions are of fixed magnitude; or are contingent on targeted equity level or requirements to hold similar buffers for loss coverage. Allows central banks time to rebuild reserves.
	Discretionary risk buffers	General or specific risk buffers (built in some cases before P&L is calculated). Can cover a range of risks but excess buffers could lead to socially inefficient overcapitalisation. Can be at central bank discretion or subject to joint decision with government (which may introduce risk of disputes).
	Distribution smoothing	Decouples volatility from distributions, making transfers to fiscal authority more predictable.
	Automatic loss coverage or recapitalisation by government	Makes it clear that fiscal backing is ultimately required and can avoid negotiation over terms of a recapitalisation.

What happens when central banks face losses? It depends on risk transfer arrangements

Mechanism	Approach	Description and comments
<i>C: Risk transfer</i>	Government indemnities	Government may provide indemnity, eg by creating a special purpose vehicle (SPV) for non-standard central bank activities or providing one for specific operations. Can be used to segregate specific operations where desired.

What happens to government revenues when central banks face losses?

Cumulative transfers since 2000¹



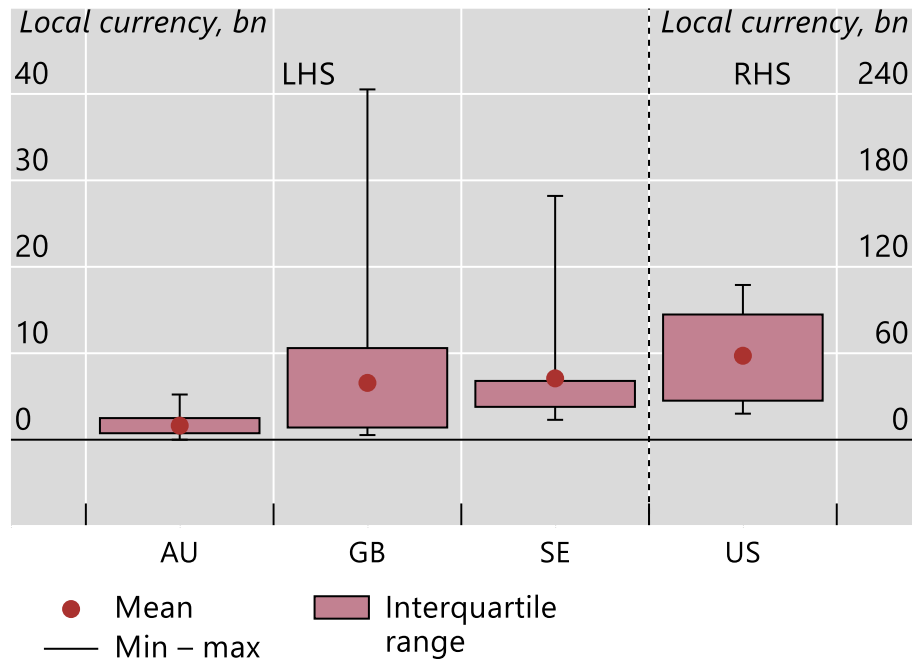
- In the last decade bond purchases boosted central bank income.
- Central banks made relatively large transfers to governments.
- Now, many central banks will not contribute to government finances for years to come.

¹ Accounting treatments and reporting periods are not directly comparable across countries and data should therefore be interpreted with caution.

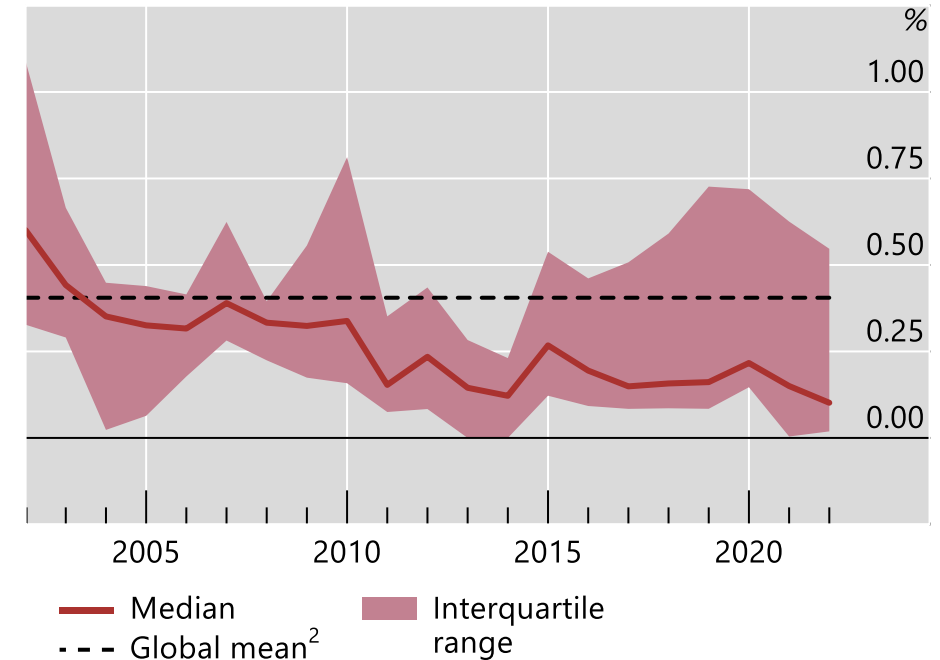
Sources: *International Financial Statistics*, IMF; national central banks; BIS Calculations.

Central bank profit transfers have been sizeable, but are still a modest share of government revenues

Annual transfers since 2000



Transfers as a share of government revenue¹



¹ Based on 27 AEs, including euro area national central banks. ² Resulting mean after pooling all country-year figures.

Sources: IMF, *International Financial Statistics*; national central banks; BIS Calculations.

When could central banks losses matter?

1. If the government uses central bank losses (or need for recapitalisation) to exert pressure on how the central bank discharges its mandates;
2. If there is public uncertainty or misunderstanding about the reason for losses and how they will be handled;
3. In the context of extreme macroeconomic mismanagement and lack of state credibility, losses may erode the central bank's standing.

Conclusion

- Central banks should put their policy objectives before profits.
- Societal benefits of price and financial stability outweigh the costs of losses, which are sometimes the price central banks pay for meeting their objectives.
- Central banks can underscore their continued ability to achieve their policy objectives by clearly explaining the reasons for losses and highlighting the benefits of policy measures.