

A licence to lose money

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Highly lucrative business

- Fed reported profits of over \$23 billion in 2003
- Fed pays no interest on its liabilities, more than 90% of which are notes in circulation
- It collects a tidy sum from its assets, principally save, American government securities
- ECB made a loss in 2004
- BOJ owns a lot of Japanese government bonds with almost zero interest

Asian central banks

- amassed \$2 trillion in foreign exchange reserves, perhaps 70% in dollars
- **Should the dollar fall**, these central banks will be exposed to heavy **capital loss**
- Higgins and Klitgaard (2004): a 10% appreciation of Yuan would mean a capital loss of 3% of GDP
- Roubini and Setser: A 33% appreciation of the yuan at the end of 2006 might inflict a capital loss of almost 15% of GDP

Nicaragua and Argentina

- In 1989, the central bank of Nicaragua suffered losses worth 13.8% of GDP
- In the second quarter of 1989, Argentina central bank made losses worth 23.5% of GDP

Why central bank losses?

- The central banks made losses because of the exchange rate ploy
- In pursuit of a cheap currency, central banks have diverted savings into low-yielding foreign assets
- **There is now no way** that Asia's central banks can sell their reserves, reinvesting the proceeds in higher-yielding assets, without triggering the very capital loss they would hope to avoid