

# Coordination of Monetary and Fiscal policies

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Geneva, September 2018

# The Swiss central bank's record profit would make it the world's second most profitable company

By [Eshe Nelson](#) • January 9, 2018

**An equivalent of 8% of local GDP**

Listed company	Estimated net income 2017
Apple	\$57.5 billion
SNB	55
ICBC	43.5
Samsung	59.1

# Seignorage

- Under standard circumstances a central bank (CB) should operate with profit
- The traditional definition of seigniorage depends on both inflation (“tax inflation”) and the level of demand for reserve money.

$$\left(\frac{\pi}{1 - \pi}\right) * \frac{MB}{P * Y} = \left(\frac{5\%}{1 - 5\%}\right) * 15\% = 0.7\%$$

- Redistributing real resources to the currency issuer

# Profit/Loss of a central bank

## Revenues

- FX reserves
- Refinancing loans

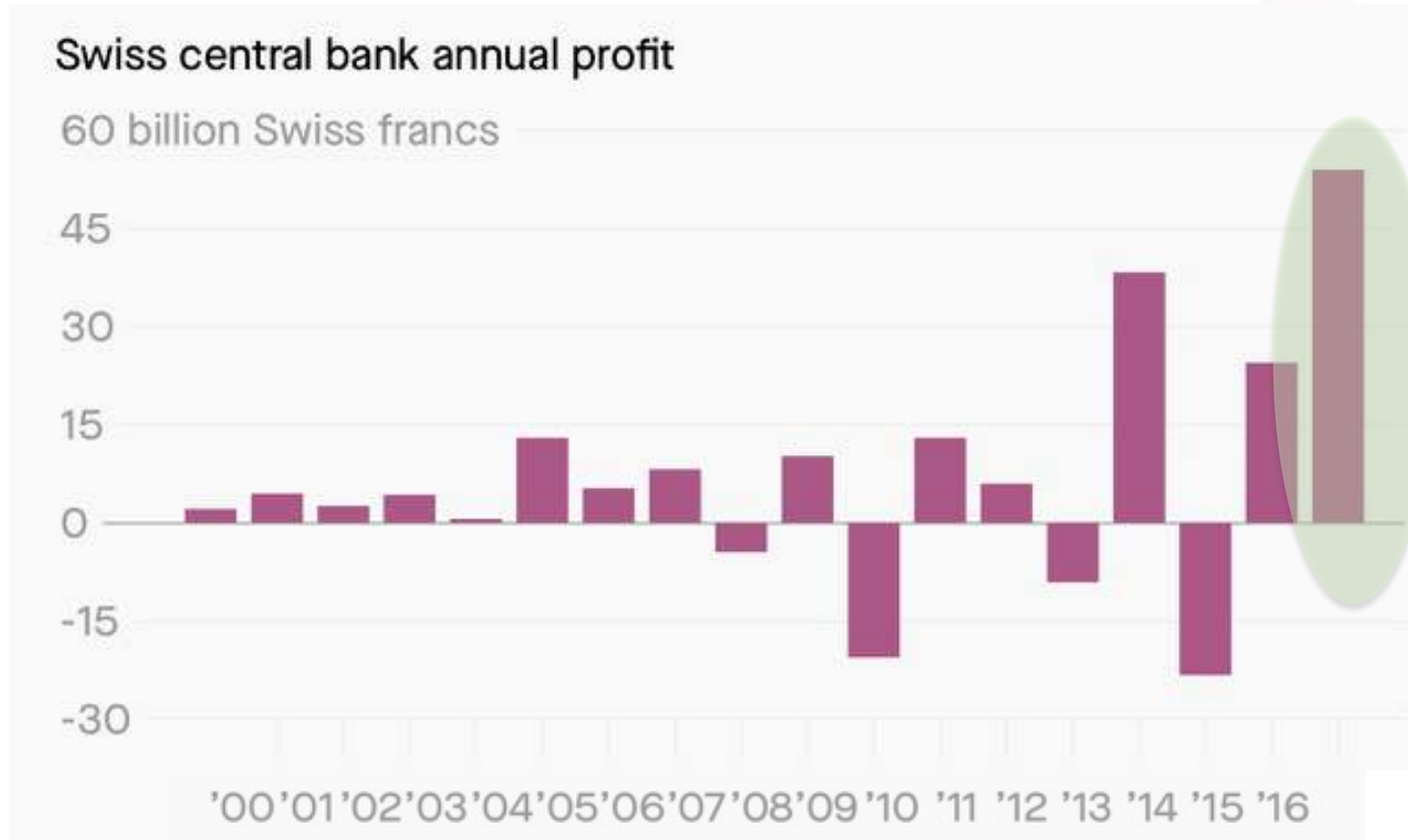
## Costs

- Operation costs
- Sterilization costs

Revaluation of FX reserves

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# SNB: Profit vs. FX fluctuations



2017: The profit on foreign currency positions amounted to CHF 49.7 billion. Overall, exchange rate-related gains amounted to CHF 21.0 billion.

# Challenges to emerging markets

- Numerous CB have faced substantial losses
- Economic convergence
  - real exchange rate appreciation (revaluation)
  - high risk premium (interest rate differential)
  - increasing monetization (M0 -> deposits with higher multiplier and sterilization costs)

# Coordination with fiscal

- Who should face the sterilization costs?
  - Government or CB
- What source creates liquidity to be sterilized
  - Sizeable government borrowings
    - Debt monetization
    - Borrowings from abroad
    - Preferential loans provided by central banks
    - Liquidity injections to stressed banking sector
  - FDI inflows
  - Monetization (M0 -> deposits)

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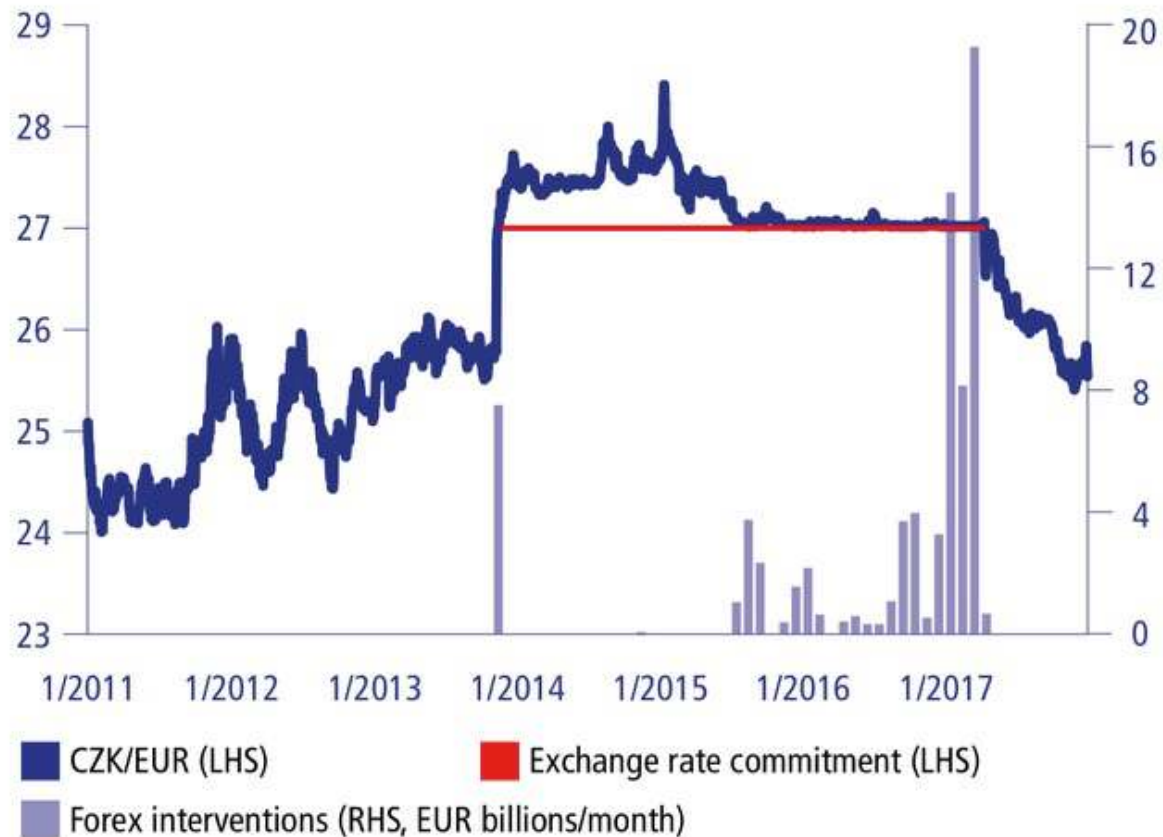
# No unique solution

- CB accumulates negative capital
  - CB credibility hampered
  - Hope for future profits once convergence slows
- High minimum required reserves
  - Hampers financial market development, high deposit-credit spread; hampered transmission
- Limited sterilization
  - High inflation, consistent with higher implicit inflation target
- Direct fiscal costs
  - Issuance of local bonds with proceeds kept at the central bank



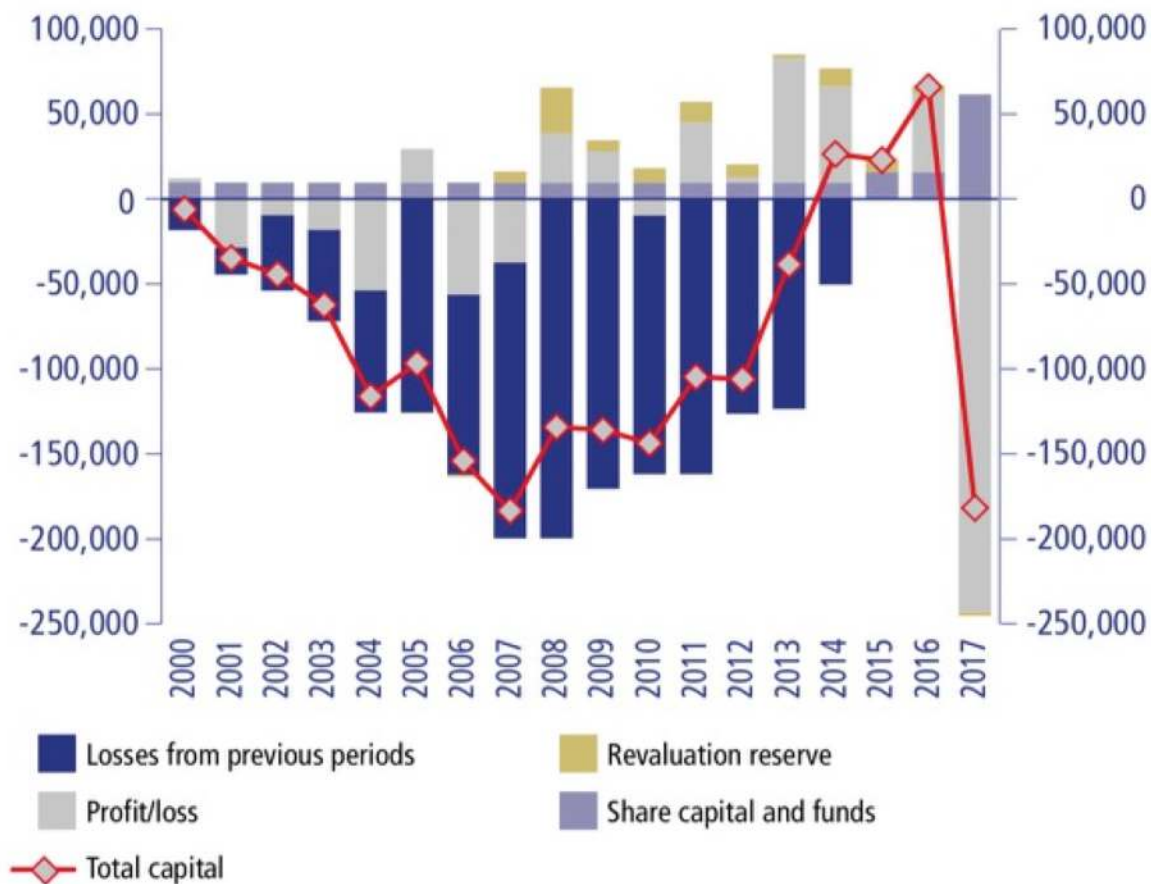
# CZK fluctuations

The koruna-euro exchange rate and the CNB's interventions



# Czech National Bank: Negative capital CZK 250bln ~ 5% of GDP

The CNB's capital 2000–2017 (in CZK millions)



# Lessons learned

- CB needs a buffer (~fund) to smooth profit transfers / recover temporary loss
  - CB law amendments
- Inflation target cannot be too ambitious
  - Allow for adequate seigniorage to keep CB balance-sheet in a good shape
  - Fast disinflation brings fiscal costs (sticky expenditures vs. decelerating revenues)
  - Fast disinflation requires policy tightening which involves larger sterilization costs
    - Typically, delayed response harms central bank credibility and larger increase is necessary later on

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