Foreign Central Banks

The Federal Reserve’s Federal Open Market Committee continued its series of policy rate increases at its December 14 meeting, bringing the target for the overnight federal funds rate up 25 basis points to 2.25%. The Bank of England and European Central Bank have not changed their target repurchase agreement rates recently, and the Bank of Japan is poised to begin a second year of maintaining the ¥30 trillion to ¥35 trillion target for the supply of its current account balance liabilities.

Capitalization varies widely among central banks, at least as recorded on their balance sheets. A cushion of capital to cover losses might seem irrelevant for modern central banks, which are created by governments with virtually unlimited ability to create base money if needed to meet obligations. Current thinking, however, suggests that a central bank’s capitalization can be an important defense of its policy independence. Interest rate risk might lead to the realization of substantial losses on even the safest central bank assets. Any consequent impairment of capital and appearance of insolvency might damage the central bank’s credibility in preventing inflation. Depending on national legislation, the bank might have to seek recapitalization and/or budgetary assistance and approval from the legislative or executive branch of government, creating opportunities for bringing effective political pressures to bear on policy decisions.