Among the four major central banks, only the Federal Reserve has changed a policy setting recently. It raised the target for the overnight federal funds rate another 25 basis points (bp) to 3.00%. This was expected: Each successive 25 bp increase since June 2004 has been preceded by a statement that “policy accommodation can be removed at a pace that is likely to be measured.”

Central banking commonly is considered innately profitable. Typically, it involves the sale of non- or low-interest-bearing money to banks and the public in return for interest-bearing loans and securities. For example, since 1914 the Federal Reserve has maintained modest capital growth by transferring about $13 billion of earnings to surplus after paying statutory dividends of $6.5 billion to member banks. The remaining $549 billion of cumulative earnings were transferred to the U.S. Treasury.

Losses do occur, however. The European Central Bank (ECB) recently announced a €1.6 billion loss for 2004 after a €0.5 billion loss in 2003. The proximate cause of these losses was not profligate spending but prudent accounting. The ECB holds a substantial amount of assets denominated in foreign currencies, principally U.S. dollars, which it revalues on its balance sheet when exchange rates alter. Euro appreciation resulted in unrealized revaluation losses of almost €2.1 billion in 2004, deducted from income. The Bank of Korea reported a loss of 150 billion won for 2004; the proximate cause apparently was not revaluation but the interest expense of issuing securities intended to sop up liquidity that was created in trying to prevent appreciation of the won.