# What happens when a central bank runs out of money?

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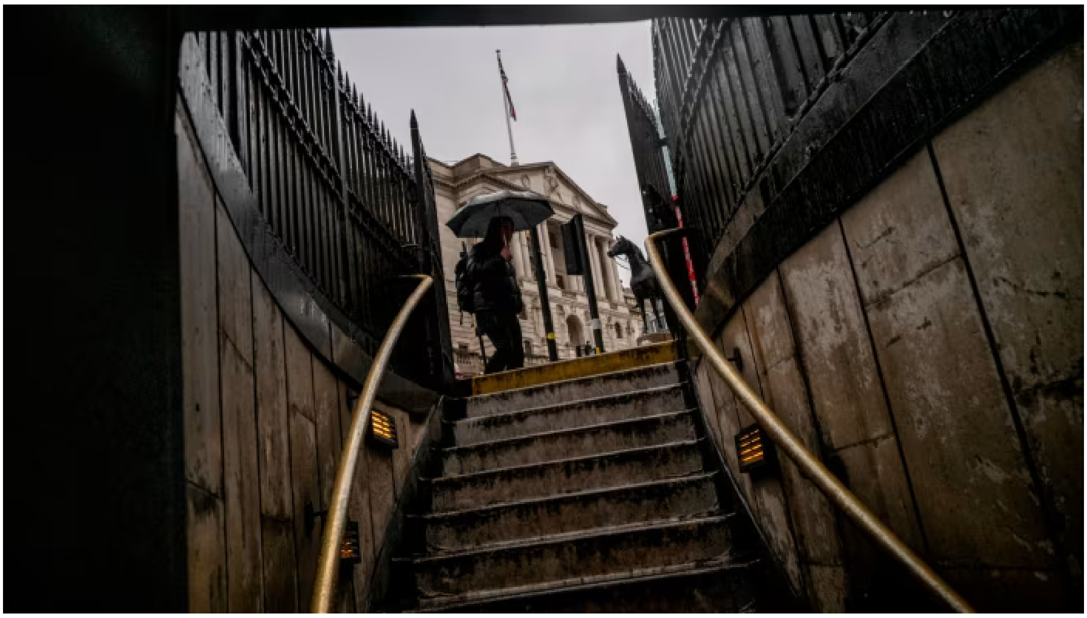


Macro types simply love to chat about the prospect of central banks running out of money. And with the bonds that central banks had printed money to buy for so many years collapsing in value, the question as to what happens next becomes increasingly less academic.

In the UK the answer is clear. The HM Treasury is obliged to come good on the guarantee negotiated back in the Global Financial Crisis by Mervyn King against any and all losses arising from its QE portfolio.

But the answer in the US is different. When the Federal Reserve makes a loss, a non-interest bearing deferred financial asset is created; earnings stop remitting to the Treasury until sufficient earnings have been retained to cover the loss and pay off this deferred asset.

And what happens in Azerbaijan? In Kenya? In the Philippines?

Such questions sound pretty basic. Answering them can take days off your life and years off your soul. So this new Bank of England Working Paper by Jamie Long and Paul Fisher is worth bookmarking. The paper, about central bank profit distribution and recapitalisation, walks handily through the ABCs as to how central banks make money, which is nice. But its real value sits in its annex.

The annex summarises the profit distribution mechanisms of 70 central banks around the world. It sketches documented arrangements for dealing with a financial loss, and any recapitalisation plans they've tucked away for when things go catawampus. The sheer diversity of arrangements is quite something.

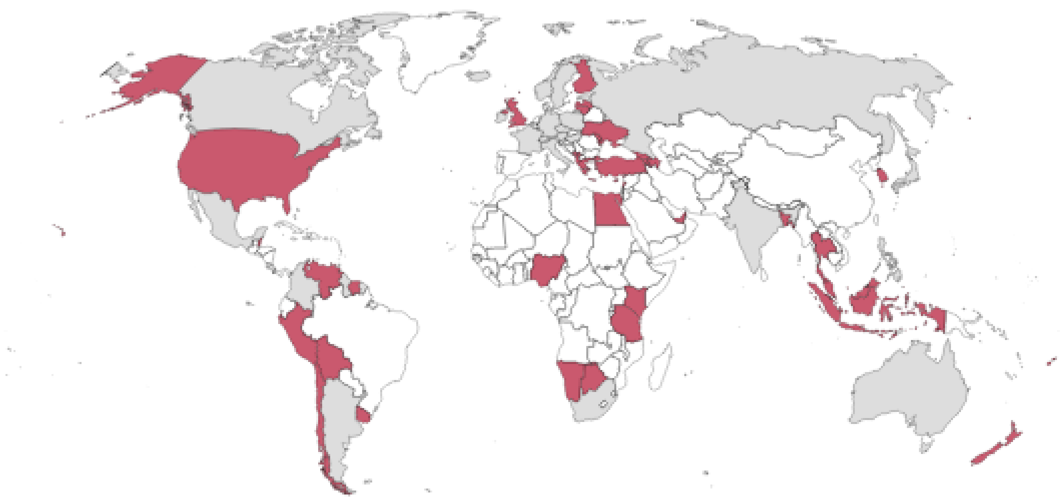
In the spirit of public service journalism, we've translated the 24 page annex into one stunning interactive dataviz. Click on (or search for) a country's central bank to see an outline of its institutional arrangements. A lot of countries seem to countenance recapitalisation even if they don’t all elaborate on the specific mechanics (coloured red on the map). But a large minority appear to be silent about the whole possibility (coloured blue).

## Central bank profit distribution, revaluation and recapitalisation arrangements

## 2024

Recapitalisation countenanced

Silent



Our quick reading of the data suggests that Albania, Azerbaijan, Georgia, Kosovo, North Macedonia, Montenegro, Tanzania and Uruguay share with the UK a commitment from their Treasuries to recapitalise central banks with cash or interest-bearing marketable debt. Fiji, Botswana and Armenia commit also to recapitalisation, albeit with nonmarketable non-interest-bearing promissory notes (aka, an accounting entry?).

Beyond this simply fabulous resource, the paper explores the age-old question as to whether central banks even need capital in the first place. As the authors note:

> Central banks do not exist to make profits and generally cannot be declared bankrupt by a court in their home jurisdiction.

Adding, in case the point is lost on the reader that:

> A central bank can continue to operate with negative net worth in accounting terms because it has the power of money creation and is exempt from normal corporate solvency rules. As the sole issuer of its domestic currency, central banks can always meet obligations arising from liabilities denominated in their domestic currency.

So peripheral to central banking is the existence of capital that a number of central banks have just kept on trucking in spite of negative equity. As the authors explain:
*The central banks of Chile, Czech Republic, Israel and Mexico in recent years have all effectively pursued their policy objectives despite being technically insolvent by private sector standards (BIS, 2013).*

For balance, they note that it helps the central bank to be financially independent from the government if it wants to … act independently. The ECB had a stab at making the case for central bank capital when the question as to what it was even really for was posed by the Finnish Ministry of Finance in 2003. They reckoned that positive capital gave national central banks options to act in a crisis among other things. (*cough* Liz Truss *cough*)
The Bank of England's solvency – from an accounting perspective – is dependent on HM Treasury passing them large dollops of cash for several years hence. This is quid pro quo for the Bank passing the Treasury large dollops of cash over the last several years, and the Bank pursuing what it judged to be the best monetary policy for the overall economy.
It is interesting to have catalogued the myriad of arrangements in situ across the globe. The institutional choices made in the UK are not unique, but it's hardly a case of TINA.