RISK MANAGEMENT FOR CENTRAL BANKS

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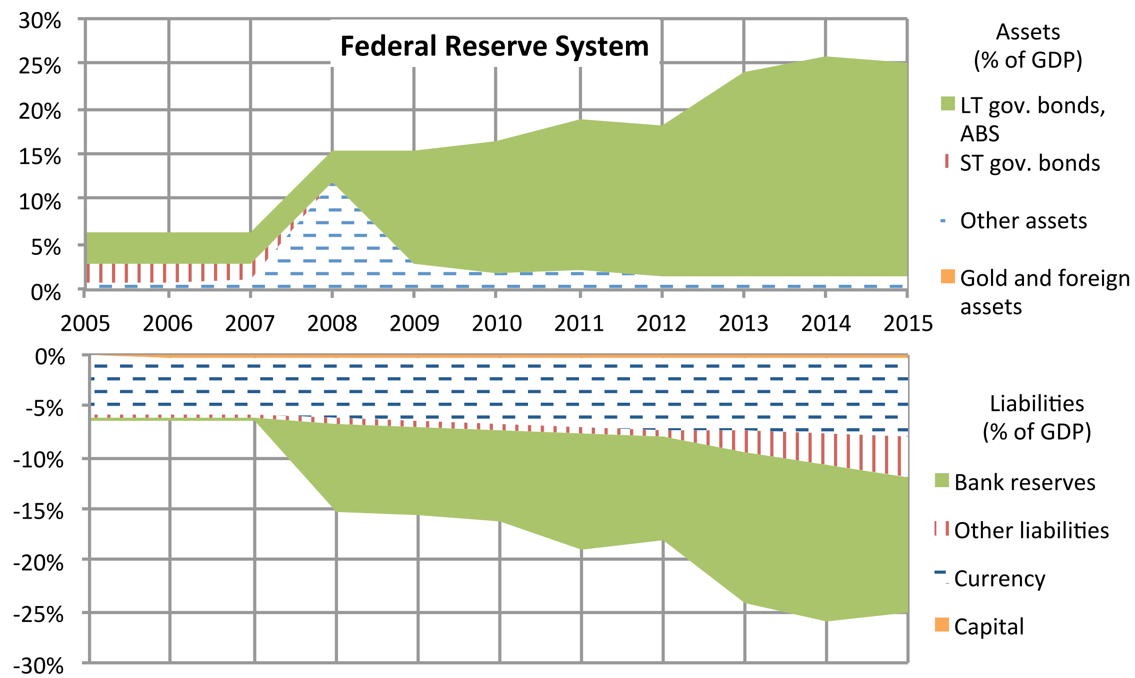
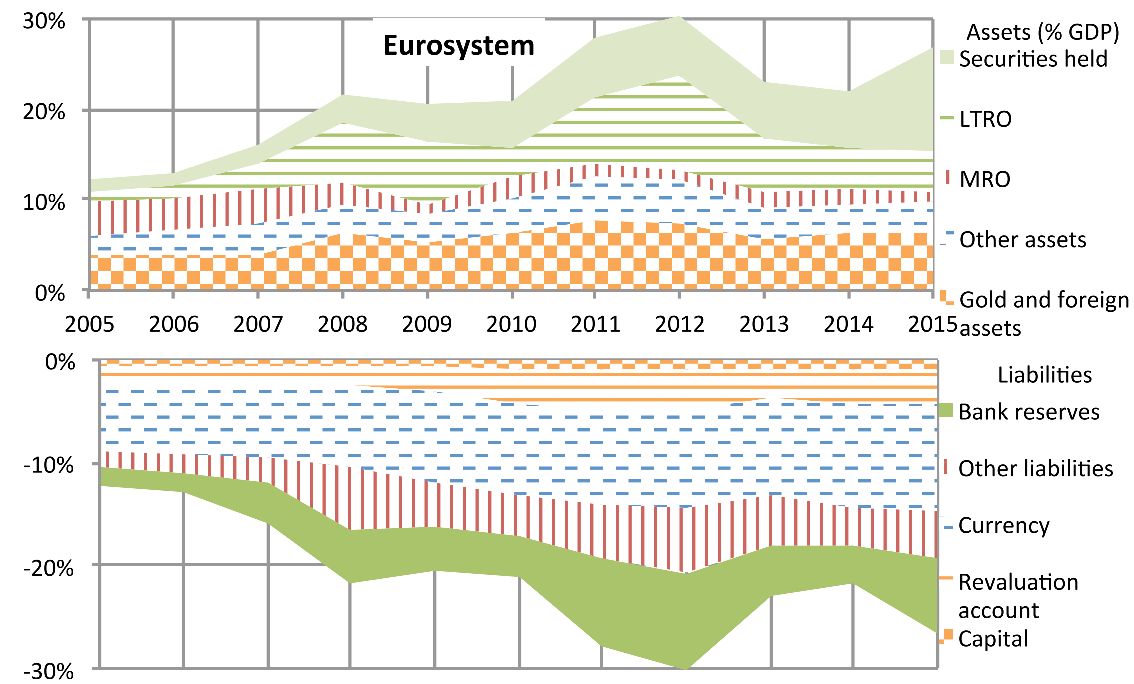
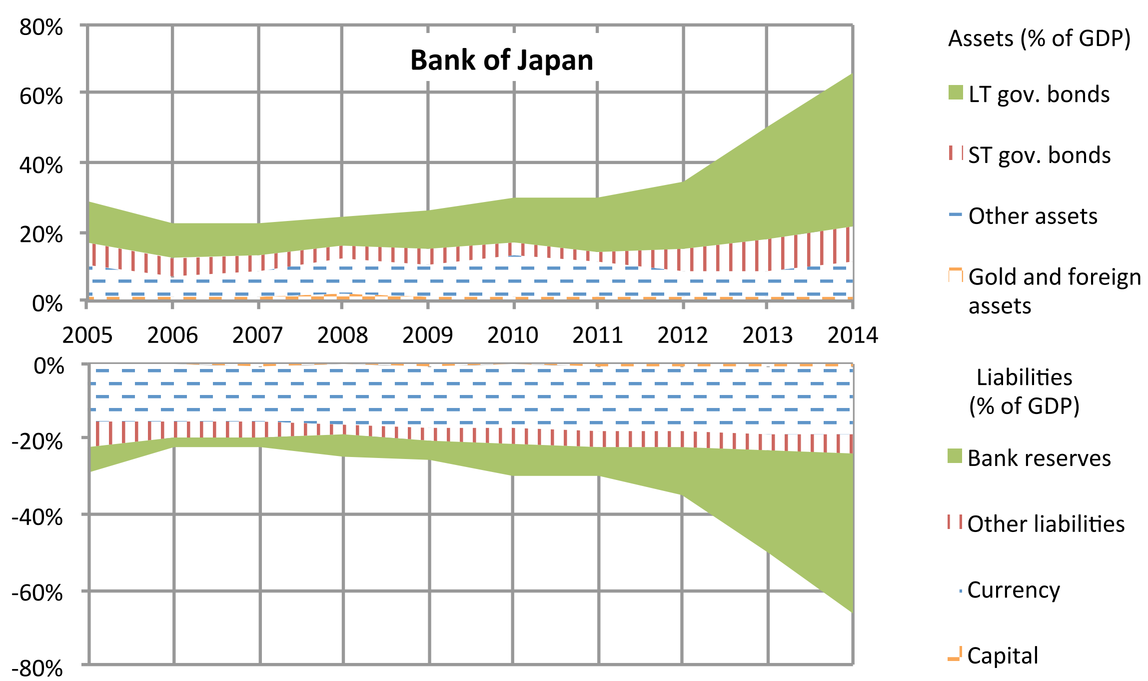
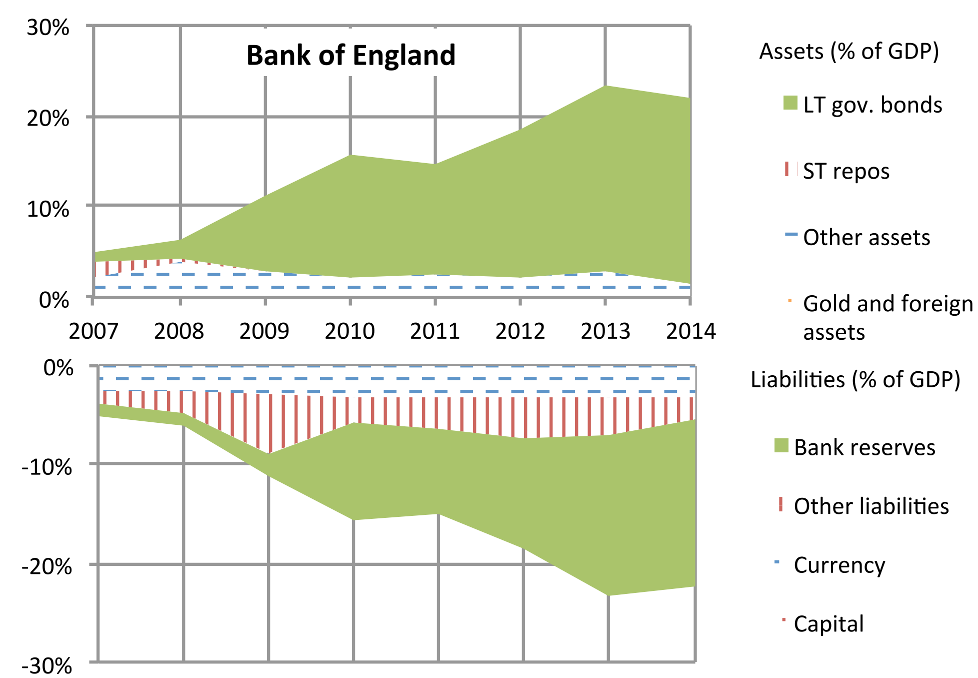
BEYOND SIZE OF THE BALANCE SHEET: THE COMPOSITION IS IMPORTANT

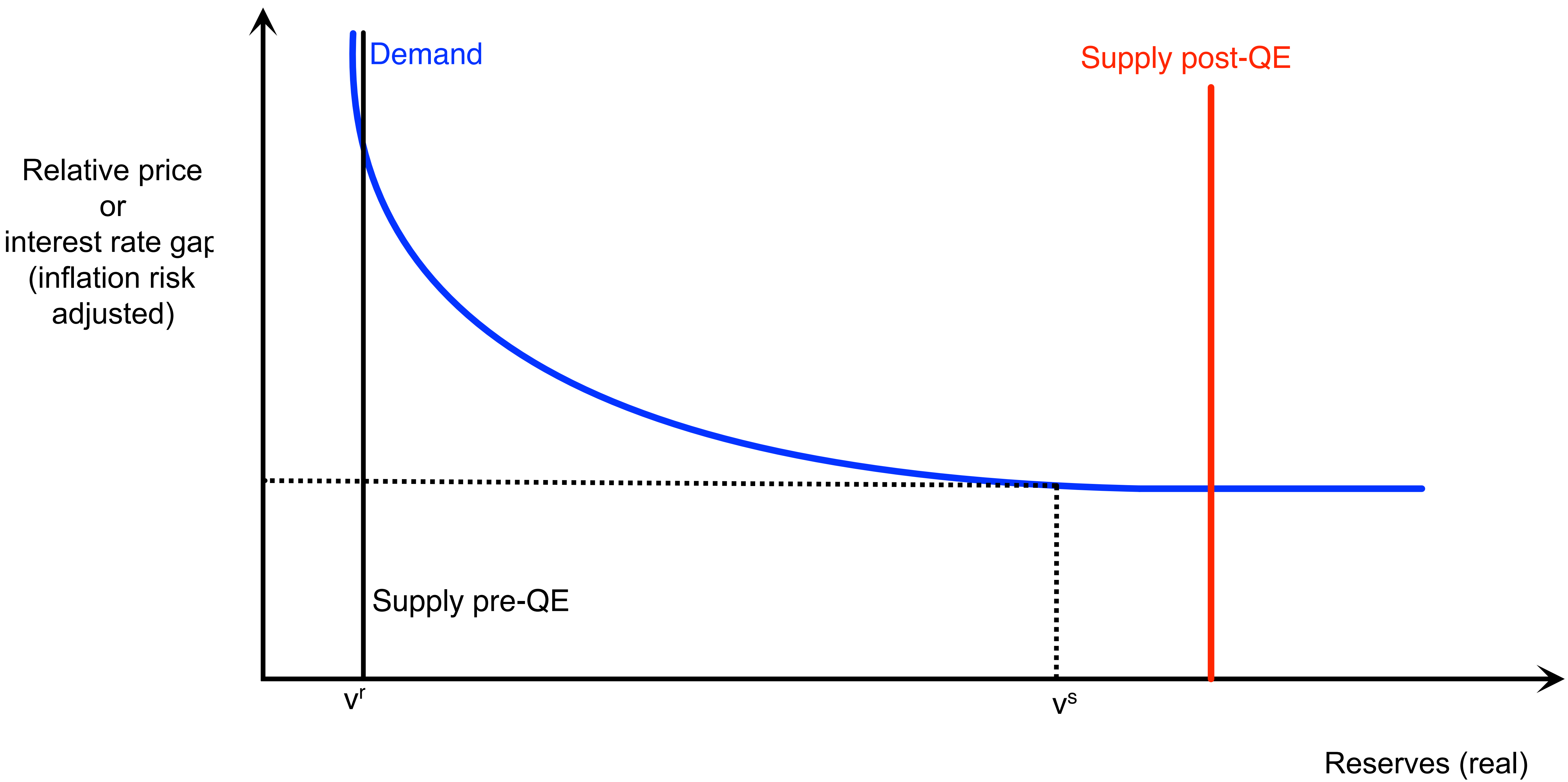








NEW IMPLEMENTATION OF STANDARD POLICY LOWERS RISK OF INFLATION



RISK MANAGEMENT OF BALANCE SHEET AND CENTRAL BANK INDEPENDENCE

- **Central bank insolvency**: hit limit of fiscal backing, outstanding reserves exceed seignorage revenues, reserves become Ponzi scheme, banks give no real resources in exchange, value of reserves goes to zero, hyperinflation, currency reform.

- **First principle of risk management:** what are limits, statutory or political, to the transfer of real resources between central bank and fiscal authorities?

- **Second principle of risk management:** what are sources of income risk? Usually they are: (i) unexpected currency appreciation, (ii) default on assets, (iii) inflation, (iv) steepening of yield curve.

MOVING FORWARD AND INNOVATIONS

- **Normalization / exit strategies**: Do not cross satiation point, keep interest on reserves as the main policy tool while keeping QE as an additional tool. Manage selloff of assets with mind on time path of potential losses and how they interact with the political fiscal backing constraint.

- **Innovations moving forward:** longer-term deposits at the central bank. Allow matching of maturities, and direct effect on yield curve and expectations.

- **More radical:** real payments on reserves, reserves for the people as electronic currency.