

Opinion | 5 December 2018

Nouriel Roubini: Central bank digital currencies will destroy cryptocurrencies

Leading economic policymakers are now considering whether central banks should issue their own digital currencies rather than just to licensed commercial banks. The idea deserves serious consideration, as it would replace an inherently crisis-prone banking system and close the door on crypto-scammers, writes Nouriel Roubini



Nouriel Roubini

Central Bank Digital Currencies

The world's central bankers have begun to discuss the idea of central bank digital currencies (CBDCs), and now even the International Monetary Fund and its managing director, Christine Lagarde, are talking openly about the pros and cons of the idea.

This conversation is past due. Cash is being used less and less, and has nearly disappeared in countries such as Sweden and China. At the same time, digital payment systems – PayPal, Venmo, and others in the West; Alipay and WeChat in China; M-Pesa in Kenya; Paytm in India – offer attractive alternatives to services once provided by traditional commercial banks. Most of these fintech innovations are still connected to traditional banks, and none of them relies on

cryptocurrencies or blockchain.

Likewise, if CBDCs are ever issued, they will have nothing to do with these over-hyped blockchain technologies. Nonetheless, starry-eyed crypto-fanatics have seized on policymakers' consideration of CBDCs as proof that even central banks need blockchain or crypto to enter the digital-currency game. This is nonsense. If anything, CBDCs would likely replace all private digital payment systems, regardless of whether they are connected to traditional bank accounts or cryptocurrencies.

A big change to the status quo

As matters currently stand, only commercial banks have access to central banks' balance sheets; and central banks' reserves are already held as digital currencies. That is why central banks are so efficient and cost-effective at mediating interbank payments and lending transactions. Because individuals, corporations, and non-bank financial institutions do not enjoy the same access, they must rely on licensed commercial banks to process their transactions.

Bank deposits, then, are a form of private money that is used for transactions among non-bank private agents. As a result, not even fully digital systems such as Alipay or Venmo can operate apart from the banking system. By allowing any individual to make transactions through the central bank, CBDCs would upend this arrangement, alleviating the need for cash, traditional bank accounts, and even digital payment services.

Better yet, CBDCs would not have to rely on public "permission-less," "trustless" distributed ledgers like those underpinning cryptocurrencies. After all, central banks already have a centralized permissioned private non-distributed ledger that allows for payments and transactions to be facilitated safely and seamlessly. No central banker in his or her right mind would ever swap out that sound system for one based on blockchain.

CBDC's 'a boon' for financial inclusion

If a CBDC were to be issued, it would immediately displace cryptocurrencies, which are not scalable, cheap, secure, or actually decentralized. Enthusiasts will argue that cryptocurrencies would remain attractive to those who wish to remain anonymous. But, like private bank deposits today, CBDC transactions could also be made anonymous, with access to account-holder information available, when necessary, only to law-enforcement authorities or regulators, as already happens with private banks.

If a CBDC were to be issued, it would immediately displace cryptocurrencies

Besides, cryptocurrencies like Bitcoin are not actually anonymous, given that individuals and organizations using crypto-wallets still leave a digital footprint. And authorities that legitimately want to track criminals and terrorists will soon crack down on attempts to create crypto-currencies with complete privacy. Insofar as CBDCs would crowd out worthless cryptocurrencies, they should be welcomed. Moreover, by transferring payments from private to central banks, a CBDC-based system would be a boon for financial inclusion. Millions of unbanked people would have access to a near-free, efficient payment system through their cell phones.

The problem with CBDCs

The main problem with CBDCs is that they would disrupt the current fractional-reserve system through which commercial banks create money by lending out more than they hold in liquid deposits. Banks need deposits in order to make loans and investment decisions.

If all private bank deposits were to be moved into CBDCs, then traditional banks would need to become "loanable funds intermediaries," borrowing long-term funds to finance long-term loans such as mortgages. In other words, the fractional-reserve banking system would be replaced by a narrow-banking system administered mostly by the central bank. That would amount to a financial revolution – and one that would yield many benefits.

Central banks would be in a much better position to control credit bubbles, stop bank runs, prevent maturity mismatches, and regulate risky credit/lending decisions by private banks. So far, no country has decided to go this route, perhaps because it would entail a radical disintermediation of the private banking sector.

One alternative would be for central banks to lend back to private banks the deposits that moved into CBDCs. But if the government was effectively banks' only depositor and provider of funds, the risk of state interference in their lending decisions would be obvious.

A problem solver?

Lagarde, for her part, has advocated a third solution: private-public partnerships between central banks and private banks. "Individuals could hold regular deposits with financial firms, but transactions would ultimately get settled in digital currency between firms," she explained recently at the Singapore Fintech Festival. "Similar to what happens today, but in a split second." The advantage of this arrangement is that payments "would be immediate, safe, cheap, and potentially semi-anonymous." Moreover, "central banks would retain a sure footing in payments."

This is a clever compromise, but some purists will argue that it would not solve the problems of the current fractional-reserve banking system. There would still be a risk of bank runs, maturity mismatches, and credit bubbles fueled by private-bank-created money. And there would still be a need for deposit insurance and lender-of-last-resort support, which itself creates a moral hazard.

Such issues would need to be managed through regulation and bank supervision, and that wouldn't necessarily be enough to prevent future banking crises. In due time, CBDC-based narrow banking and loanable-funds intermediaries could ensure a better and more stable financial system. If the alternatives are a crisis-prone fractional-reserve system and a crypto-dystopia, then we should remain open to the idea.

This article first appeared in Project Syndicate

Author

Zoltán Homolya Economic research trainee zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Junior Economist, Global Macro amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland mateusz.sutowicz@ing.pl

Alissa Lefebre

Economist <u>alissa.lefebre@ing.com</u>

Deepali Bharqava

Regional Head of Research, Asia-Pacific <u>Deepali.Bhargava@ing.com</u>

Ruben Dewitte

Economist +32495364780 ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic 420 770 321 486 david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate <u>jesse.norcross@ing.com</u>

Teise Stellema

Research Assistant, Energy Transition teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare diederik.stadig@ing.com

Diogo Gouveia

Sector Economist diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist James.wilson@ing.com

Sophie Smith

Digital Editor sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan min.joo.kang@asia.ing.com

Coco Zhang

ESG Research coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure <u>Katinka.Jongkind@ing.com</u>

Marina Le Blanc

Sector Strategist, Financials Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist samuel.abettan@inq.com

Franziska Biehl

Senior Economist, Germany <u>Franziska.Marie.Biehl@ing.de</u>

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands) mirjam.bani@ing.com

Timothy Rahill

Credit Strategist timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst
eqor.fedorov@ing.com

Sebastian Franke

Consumer Economist sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist +31(0)611172684 laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK <u>james.smith@ing.com</u>

Suvi Platerink Kosonen

Senior Sector Strategist, Financials suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors <u>maurice.van.sante@ing.com</u>

Marcel Klok

Senior Economist, Netherlands marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research marieke.blom@ing.com

Raoul Leering

Senior Macro Economist raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

<u>Maureen.Schuller@ing.com</u>

Warren Patterson

Head of Commodities Strategy Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania +40 31 406 8990 ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research +44 20 7767 6209 Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas padhraic.garvey@ing.com

James Knightley

Chief International Economist, US <u>james.knightley@ing.com</u>

Tim Condon

Asia Chief Economist +65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist +31 20 563 8801 martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist +44 20 7767 6405 viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content +44 (0) 207 767 5331 owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist benjamin.schroder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM +1 646 424 6464 gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance +44 20 7767 5306 carlo.cocuzzo@ing.com