

Central banks move one step closer to issuing digital currencies

Six central banks and the Bank for International Settlements have formed a working group to discuss “potential cases” for central bank digital currencies. What's going on?



Central bank digital currency debate greatly accelerated in 2019...

Central banks have been toying with the idea of digital currencies for some time, but Facebook's announcement last year that it plans to create its own digital currency, Libra, has led to an increased sense of urgency. Previously a mere thought experiment, CBDC is now moving into the realm of reality. Some central banks want to ensure that their sovereign currencies are not sidelined by a privately-issued digital currency. Others worry about the declining use of physical cash, and fear a situation where citizens would, in practice, lose access to central bank money.

To address these concerns, six central banks- the Bank of Canada, Bank of England, Bank of Japan, European Central Bank, Sweden's Riksbank and the Swiss National Bank, along with the BIS, announced yesterday that they had formed a working group, with the aim of moving from conceptual issues to the operational issues of running a CBDC, and managing the consequences for the rest of the financial system.

International coordination on CBDC is important

The working group continues the joint work of the G7 and Financial Stability Board. It is important to coordinate because currencies and payment infrastructure will have effects across borders. Two

central banks stand out by their absence: the Federal Reserve and the Monetary Authority of Singapore (MAS). It's particularly surprising that the MAS is absent given that it has previously championed digital currency research.

What will be on the agenda of this working group?

There are quite a number of challenges and questions, but to pick out a few:

- **How can CBDC be implemented without massively disrupting the existing banking system?** CBDC disintermediates banks: They may structurally lose part of their deposit funding as people substitute into CBDC, and may become more vulnerable to runs. Central banks are well aware of this, and will want to discuss ways to best mitigate these effects.
- **What is the division of labour between central banks and the private sector?** Will central banks offer CBDC and all account services around it (like payments, FX transfers, overdrafts, budgeting etc)? That would be a lot of work. Just think about it: the central bank would suddenly become the biggest retail bank (in terms of customers) in the country! Does the central bank have the IT resources to service millions of people, or to do proper customer due diligence? And who is going to supervise them? An obvious alternative solution is to have the central bank issue CBDC, but incumbent banks and other businesses offer CBDC account services – a bit like the EU's PSD2 legislation allows third parties to provide payment and account information services on top of bank accounts. This is something that has to be thought through carefully.
- **What are the effects of CBDC on monetary policy and financial stability in a cross-border context?** In the eurozone crisis years, the Swiss franc came under upward pressure as foreign money poured in. But the existence of a Swiss CBDC could have made these FX pressures more pronounced by allowing global investors to deposit funds 100% risk-free directly at the Swiss National Bank. How can the central bank manage such events and mitigate these FX pressures?

We will be watching this space with great interest. The CBDC train has left the station. Central banks will prefer thoroughly tested solutions over quick fixes, so it will be a few more years before retail CBDC will see the light of day. But expect more research, experiments and teasers in the meantime.

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