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A New Type of Money

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Description

Central Bank Digital Currencies (CBDCs) are a new type of money (in addition to cash, bank deposits and e-money) as a liability of the central bank aimed at effectively fulfilling the functions of money i.e, medium of exchange, store of value and unit of account. Talking about CBDCs at a global level, there are already two countries that have issued their CBDCs: The Bahamas and Nigeria. As for the great global players, we find China as the most advanced country in the study of its issuance (pilot phase) and Western economies are trying to keep up with the Asian Giant. For the Euro Zone, in July 2021 the European Central Bank (ECB) has decided to launch its Digital Euro Project. The CBDC dilemma continues to monopolize the debate when deciding the financial and technological characteristics of the CBDC.

Monetary authorities continue to seek a stable balance between adverse effects of CBDC (banking disintermediation) and its benefits, among which are:

(i) Mitigate the risk of currency substitution-stemming from private currencies such as Facebook's Diem or sovereigns such as China CBDC-and

(ii) Mitigate the risk of the disappearance of cash.

The latter implies that citizens do not have access to completely credit-risk-free money and causes digital money (today bank deposits) to be concentrated in very few payment networks with low competition and high financial exclusion.

Monetary authorities are diligently calibrating the financial characteristics of CBDCs in order to limit banking disintermediation. Because CBDC is a credit-risk-free money (bank deposits are not) it is likely that citizens will exchange bank deposits for CBDC, which reduces the balance of banks and their stable funding of deposits. In addition, the fact that non-bank operators (Fintechs & Bigtechs) participate in the Digital Euro Payment System and, therefore, could offer deposits at the central bank, implies that banks may lose customers and business activity in their main markets: payment services, lending markets, investment funds….

In order to limit banking disintermediation, central banks are considering the following financial design features:

(i) Quantitative limits on CBDC ownership (3,000 EUR per person?);

(ii) Negative interest rates on CBDCs that discourage the substitution of bank deposits for CBDCs;

(iii) Loans from the central bank to commercial banks-simulating the conditions of deposits-for offsetting the loss of bank deposits;

(iv) Limit CBDC distribution to commercial banks only.

Regarding the technological characteristics of CBDCs, central banks are considering a distribution model that follows a principle of public-private partnership, and in which

(i) Either the central digital ledger of retail CBDCs is registered within the central bank (Hybrid CBDC) or

(ii) There are wholesale CBDC ledgers in the central bank and retail ledgers in payment services providers (Intermediated CBDC), the latter being accounted off-balance sheet.

The debate on CBDCs, both in academic and institutional level, has intensified in the recent months at a global scale due to the significant rise in the Crypto assets market, specifically in relation to stable coins. Monetary and financial authorities consider urgent the design of a regulatory and supervisory framework for the stable coins. The main proposals, among which are those designed by the Financial Stability Board (FSB), are the following:

- Apply the same regulatory and supervisory legal framework of electronic money issuers to stable coins issuers.
- Apply the same regulatory and supervisory legal framework of commercial banks to stable coins issuers.
- Force stable coin issuers to maintain-on balance sheet-the 100% of the stable coin issues invested in central bank reserves. This proposal has been named, from academic fields, as Synthetic CBDC; and they are a sort of the full reserve banking proposals.

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