



CBDC – A POTENTIAL RESPONSE TO THE CHALLENGE OF DIGITAL CURRENCIES

The views expressed are those of the author and do not necessarily reflect the official view of the Magyar Nemzeti Bank.

THE 5 KEY CHALLENGES OF THE (NEAR) FUTURE



CLIMATE CHANGE



DEMOGRAPHY



**GEOPOLITICAL
CHALLENGES**



TECHNOLOGY



**MONEY IN THE
DIGITAL AGE**

WHAT IS MONEY? THE CENTRAL ROLE OF TRUST

 A collective fiction
(Harari)

 Debt
(Borio)

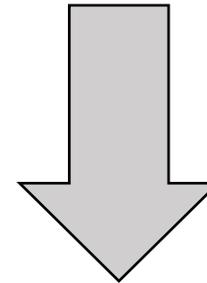
 Technology
(Levine)

 NPV of assets
(Bossone-Costa)

 Social construct
(Carstens)



*Money has to be **TRUSTED**
by members of the
community...*



*...maintaining trust is the
primary task of financial
institutions*

Conventional theories



The central bank/state controls the money supply

Credit institutions are only financial intermediaries

Bank only pass on savings to investors

Central bank decisions have perfect transmission



Modern economic thought



Money is created in the commercial banking sector

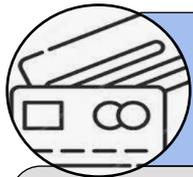
Loans are created „out of thin air”

Commercial banks are active players in economic relations

Central banks control money supply only indirectly

Ongoing digital revolution of money

Digital trends



Comfort functions

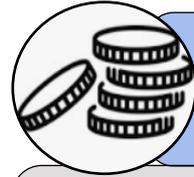
Features related to bank accounts, affecting deposit money



Appearance of new instruments

Seeking to fulfill certain money functions, pushing the limits of the current financial system

Emerging challenges



Crowding out of cash

No state-issued money in the financial system



Money substitutes

Digital money substitutes which are not backed by the state

MONEY COULD CHANGE NOT ONLY IN FORM BUT IN SUBSTANCE



- The use of cash is on a declining path
- Sweden is close to achieving a cashless society



- WeChat Pay and Alipay are the dominant payment methods
- Crowding out not only cash, but bank cards as well

These payments are backed by traditional bank instruments....



- Privately issued money, cryptocurrencies
- Cannot fulfill all money functions, serving as speculative tech-assets
- Some new projects (such as Libra) can work better as money substitutes

...but some new forms of money are not state-backed.

THE EFFECT OF COVID-19 ON CENTRAL BANKS' APPROACH TO DIGITALIZATION



Covid speeded up existing trends



Digitalization of payments

Consumers are shifting from physical instruments due to social distancing

New motivation for central banks to adopt digital solutions

The acceleration in the decline of cash usage prompts a new approach from central banks

Pressure on policymakers to „keep the economy alive”

The cost of non-intervention is high, new solutions become more widely accepted



A survey of BIS indicates that *“central banks try to strike a balance between urgency and caution – leaning somewhat more to the side of caution”*



“We do think it's more important to get it right than to be first”



“We need to make sure that we're not going to break any system, but to enhance the system”



Supporting the digitalization of payments and the economy



As a response to the decline of cash



To strengthen the transmission of monetary policy



Reducing the cost and the ecological footprint of payment systems



To preserve monetary sovereignty and to support independence

DIGITAL DOLLARIZATION – AN INCREASINGLY REAL CHALLENGE

Dollarization



- Stronger, more widely accepted international currencies can **drive out** national currencies
- The role of the local currency declines, the central banks room for manoeuvre shrinks
- Usually occurs in less-developed countries

Digital dollarization



- A private, electronic money crowds out the national currency
- Can pose a threat to developed economies as well...?

Constraints of digital currencies

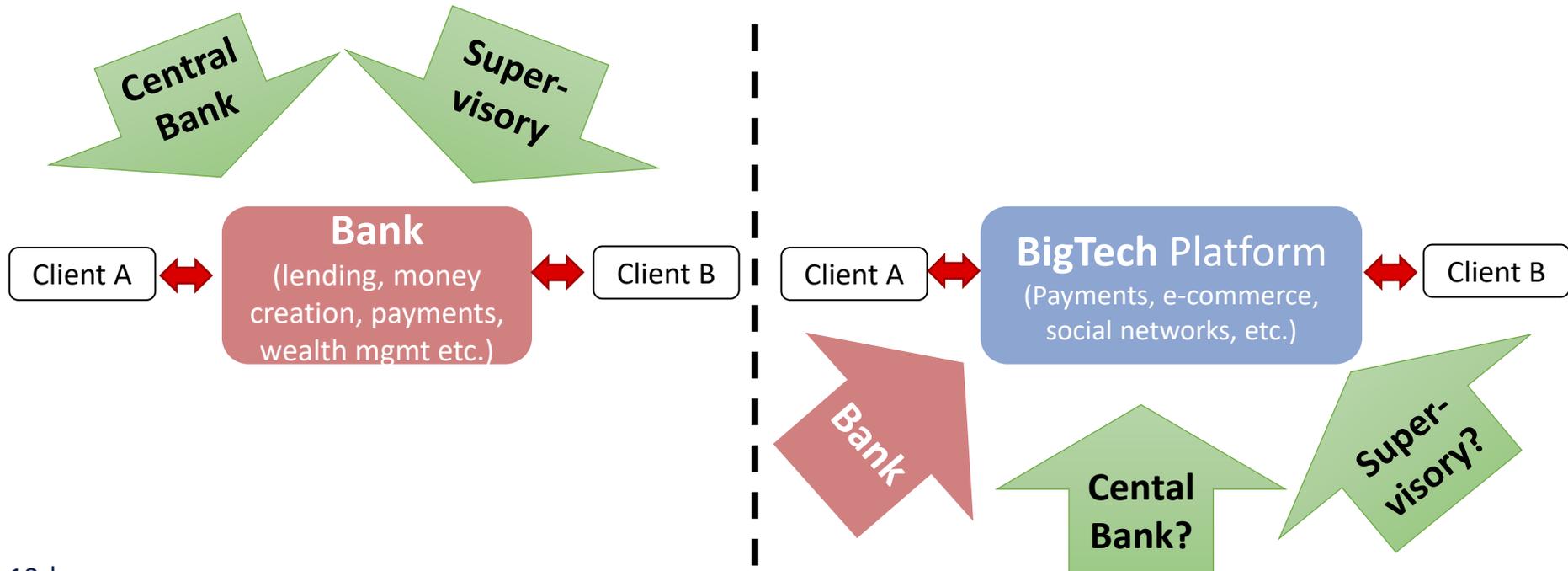
- Volatility, inability to fulfill core money functions
- Relatively low amount of transactions
- Lack of trust, danger of fraud

Enablers of more widespread use

- Appearance of stablecoins
- Support from BigTech companies
- Wide, young userbase of digital platforms open to new solutions

THE WIDESPREAD ADOPTION OF A TECH CURRENCY CONSTRAINS MONETARY POLICY

- Loss of basic monetary capabilities: inability to *generate money, pursue an independent exchange rate and interest rate policy*
- In modern monetary systems, the only live monetary link between the state and economic actors is through the banking system, but digital payment platforms **can marginalize traditional banks:**





Introduction of CBDC

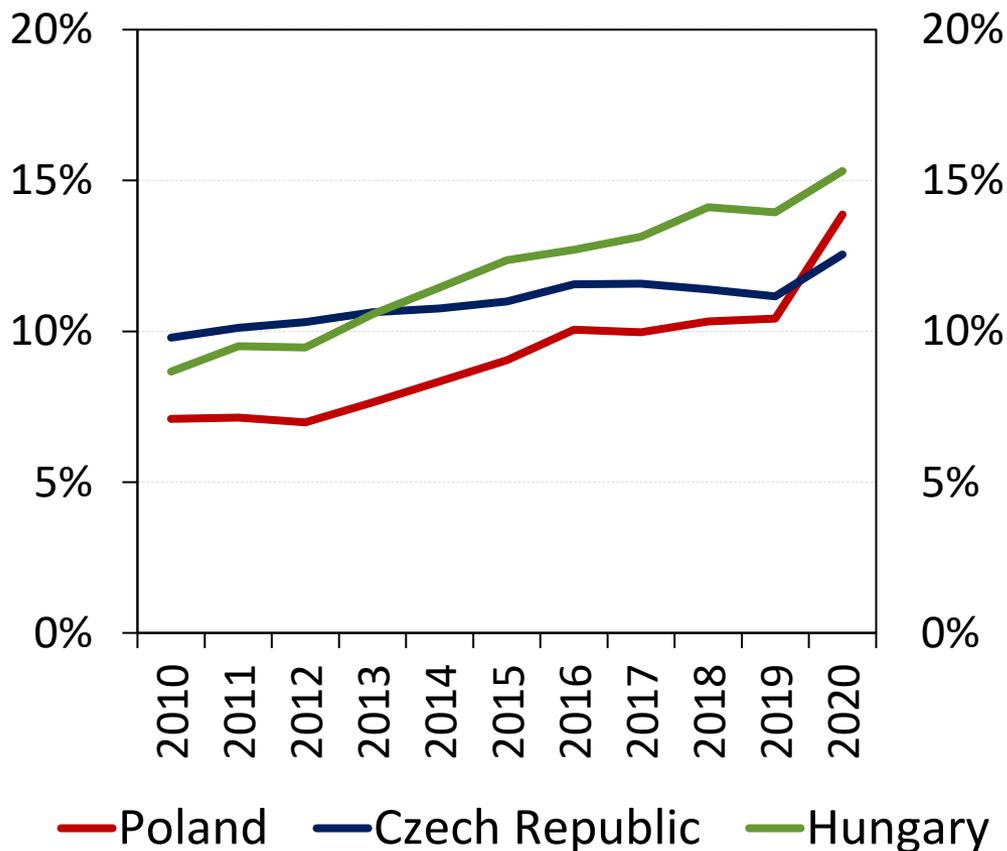


Securing sovereign monetary policy

- CBDC is owned by the state the same way as cash
- The legal tender can remain the unit of account in a cashless society
- Demand for CBDC is dependant on design features

- Makes a more direct monetary policy possible
- Less reliance on traditional financial intermediaries
- Better control on the pro-cyclical banking system
- Possibility of negative interest rates

THE AMOUNT OF CASH IN CIRCULATION IS ON THE RISE IN THE CEE-REGION



CURRENCY IN CIRCULATION, % OF GDP

State of CBDC projects in the region

- Ukraine launched a pilot project to develop the e-hryvnia in 2018
- The concluding report acknowledged legislative changes and payment system modernization will be required, no further dates are set/published yet
- Estonia and Lithuania published papers about the topic, however the Estcoin project was cancelled
- There has been **no other official announcement** of a CBDC project or ongoing research
- Central banks in the region - as the MNB - are monitoring developments regarding CBDC

The rising amount of cash could drive CBDC development

- Currency in circulation is steadily growing in the region
- „ is fairly high and is growing long-term, countering the idea of a **liquidity crisis** that might prompt such a launch (of CBDC)” – Holub, CNB Board Member



THANK YOU FOR YOUR KIND
ATTENTION!