



Digital Currencies and the Challenges for Central Banks

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World Bank Europe and Central Asia Office of the Chief Economist Talk Series March 17th, 2022 **Challenges for CBs from CBDC**

From domestic use of <u>own</u> CBDC

From domestic use of foreign CBDC

Appropriate CBDC design and well-crafted policies can help mitigate challenges

Challenges from domestic use of own CBDC

- Balance privacy and integrity
- Balance integrity and inclusion
- Limit disintermediation and deposit runs
- Minimize cyber risks and ensure resilience

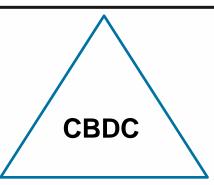
Balance privacy and integrity

Privacy

Financial integrity

CBDC can protect privacy without undermining integrity if...

- Limits on size of anonymous transactions exist
- Appropriate customer due diligence in place & transactions recorded but identity revealed only if illicit activity suspected



CBDC can undermine integrity if ...

 Full anonymity and large-value transactions allowed

Balance financial inclusion and integrity

- Financial inclusion is an important motivation for CBDC
 - In 2021 BIS survey, inclusion was a key objective for CBDC among EMDEs.
- Globally, 30% percent of adults are unbanked according to World Bank
- Lack of documentation is a significant barrier to inclusion
- CB needs to facilitate inclusion while protecting integrity
 - Developing digital IDs
 - Providing access to CBDC without full documentation setting limits on size of holdings and transactions
- Issuing a CBDC alone might not suffice to increase inclusion.
 - Factors such as access to financial infrastructure, internet and mobile phones as well as financial literacy will also have to be addressed.

Limit disintermediation and runs

To limit disintermediation

- Set limits on holdings of CBDCs to avoid deposit drain
- Remunerate CBDC at a lower rate
- Help banks maintain ties with customers (two-tier CBDC)

To reduce run-risk

- Deposit insurance
- LoLR
- Limits on holdings of CBDC

Minimize cyber risk and ensure resilience

- Trust in money and the central bank is key for the functioning of the payment system and the conduct of monetary policy
- Central banks have large reputational risks at stake when issuing a CBDC
- Choosing the appropriate technology and designing an infrastructure for CBDC that is secure and resilient will be critical

Challenges from domestic use of foreign CBDC

- Currency substitution & loss of monetary independence
- Capital flow volatility
- Faster transmission of global financial conditions
- Shifts in reserve configurations

Several conditions need to be met for these challenges to materialize

Addressing challenges from domestic use of foreign CBDC

- To curb currency substitution countries could explore:
 - Feasibility of limiting CBDC in circulation (issuer)
 - Desirability of imposing restrictions on the use of foreign CBDC
 - Implementing robust legal tender provisions to ensure that the national currency is favored
 - Strong local currency and robust monetary framework
 - Issuing own CBDC might not be the solution
- To ensure the stability of the international monetary system, cooperation among CBs to provide backstops will be critical in case currency substitution increases

Conclusions

- CBs are increasingly exploring CBDCs
- There could be challenges from the domestic use of own CBDC and of foreign CBDC
- Appropriate design and regulations could mitigate some of the challenges
- Cooperation across countries will be key to minimize negative cross border implications

IMF Digital Money Strategy

CAUSES

Digital money

- CBDCs
- Stablecoins & eMoney
- Cryptoassets
- Others...



Forces of change

- Technology & infrastructure
- Services & service providers
- Entrepreneurs
- Consumer behavior & expectations

IMPLICATIONS

IMS stability

- Currency substitution & policy independence
- · Capital flows
- Payment integration
- · Reserve currencies
- Backstops

Domestic stability

- Narrow
 Consumer protection, safety
 & soundness, integrity...
- Broad Innovation, credit and banking, competition, inclusion, climate, fiscal...

Others

- Technology choices
- Development
- · Standards...

POLICY RESPONSES

IMF

Collaboration & partnerships

Other institutions

- Central banks
- Ministries of finance
- Regulators
- Other agencies
- · BIS(IH), CPMI
- FSB
- World Bank
- Other IFIs and standard setters...

Key mandate

- International monetary cooperation
- IMS stability
- · Domestic stability

Core competencies

- Wide membership
- Macrofinancial focus
- Diverse expertise
- Link to members

Activities

- Surveillance
- · Capacity development
- Lending
- Policy development

Skills and resources

References

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