

Digital Currencies and the Challenges for Central Banks

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Challenges for CBs from CBDC

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From
domestic use
of own CBDC

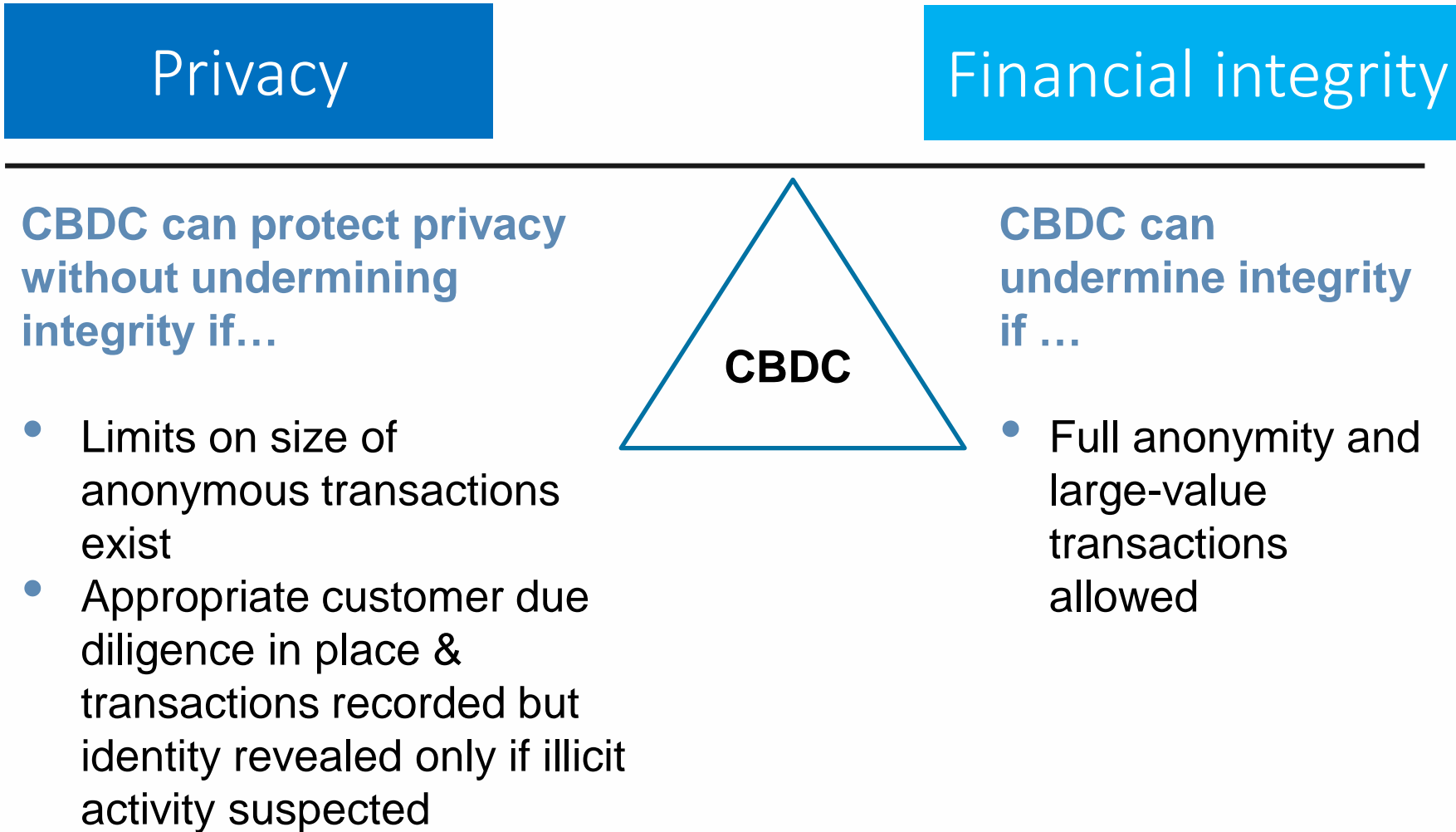
From
domestic use
of foreign CBDC

**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



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

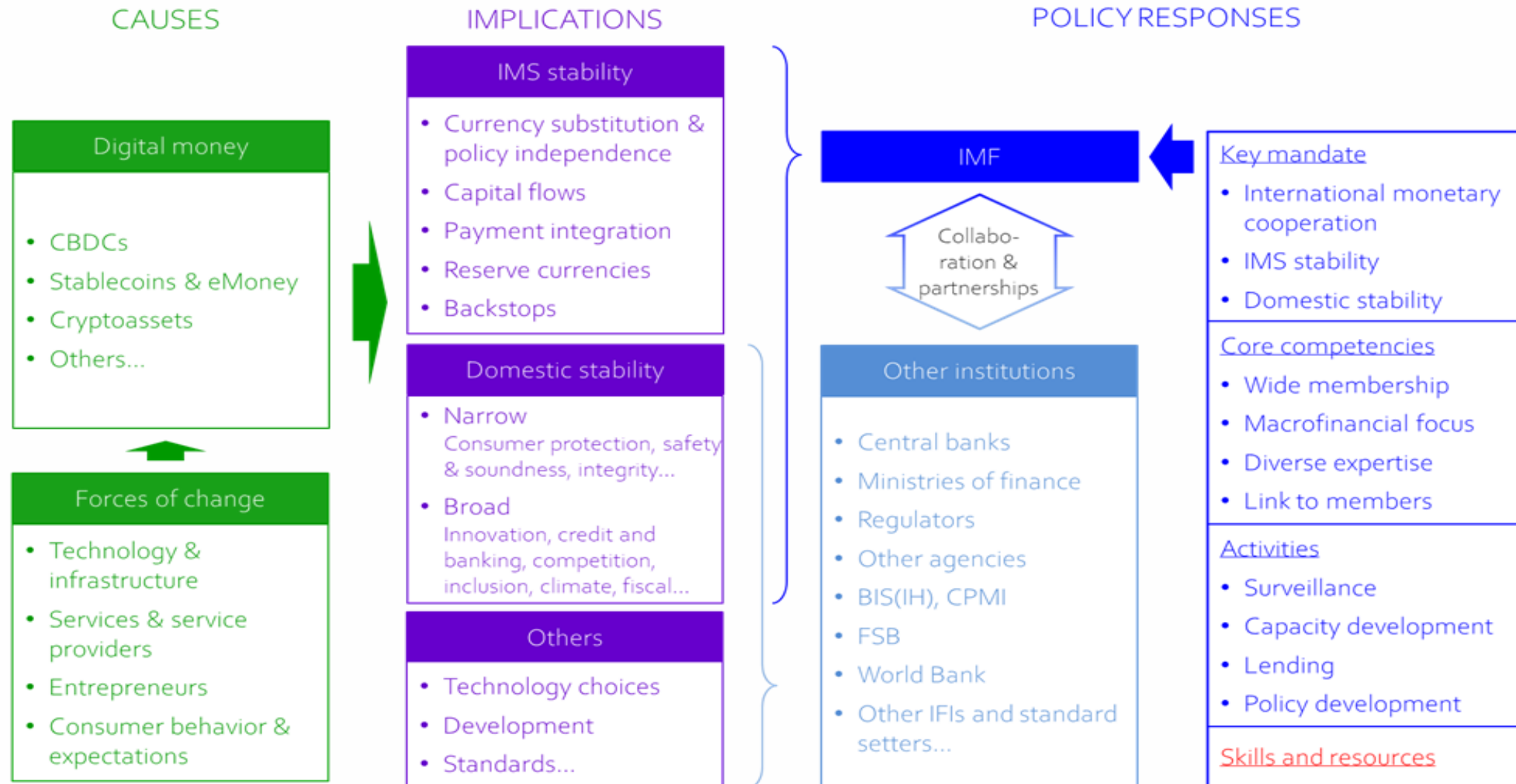
Addressing challenges from domestic use of foreign CBDC

- 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



References

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