Digital Currency – no need for cash?

The General Manager of the Bank for International Settlements (BIS) maintained that "global central banks may have to issue their own digital currencies sooner than expected". Digital currencies are becoming widespread in the midst of block-chain and distributed ledger technologies (DLT). Digital currencies have a good future as regulated, central bank issued currencies; although, some private ones are trying to get into the business and compete.

Some central banks maintain that central bank digital currencies (CBDCs) could well minimise or eliminate the involvement of 3rd party intermediary in the global payments system which is facilitating real-time settlement of cross-border financial transactions, ie, at a wholesale level. And that's why they want to see digital currencies to be used more. They also aim to make digital currencies as an alternative to cash. The potential for using digital currencies is enormous and that is why deep research is now happening into their use, eg, required level of administration, governance and regulations by governments.

The 2018 report by the Committee on Payments & Market Infrastructure (CPM) and the Market Committee defines CBDCs as "new variants of central bank money different from physical cash or central bank reserve/settlement accounts. This report therefore categorizes into two types of CBDC: (1) general purpose (2) wholesale. It is noteworthy that CBDCs used at a wholesale situation is expected to further revolutionise the global payments systems and provide robust competition in the global settlement and/or clearing system.

According to a recent survey by the Bank for International Settlements (BIS), "across the world, central banks are reportedly thinking about how new central bank digital currencies (CBDCs) could replace traditional money. It should be noted the survey differentiated between so-called "crypto-currencies" and other private digital tokens with crypto-currencies defined as decentralised tokens without an issuer or representing an underlying asset or liability since private digital tokens comprise the wide variety of digital tokens not issued by central banks.

Definition of money

Basically, there are four characteristics of money: (1) issuer, eg, central bank (2) form, digital Vs physical (3) accessibility, widely Vs restricted (4) technology. In relation to technology, consider whether it is “token-based” or account-based”. In other words, the receiver of a token will want to verify that the token itself is valid, whereas an intermediary needs to verify the ID of an account holder.

In late 2019, the Reserve Bank of Australia (RBA) delivered an issues paper, commencing the review of a regulatory framework for retail payments. (Note: only for retail payments?). Could it be start to issuance of “eAUD” for local consumers? Or a eAUD for block-chain requirements?

In early 2020, a group (comprising of The Bank of Canada, The Bank of England, The Bank of Japan, The Sveriges Riksbank (Sweden) and The Swiss National Bank, together with the European Central Bank and BIS) had been formed “to assess the economic, financial and technical design choices, including cross-border interoperability on emerging technologies. It is noteworthy that recently, China had partially launched its own digital sovereign (YUAN) currency and digital wallets for the management and distribution of its YUAN currency.

Value-based Vs Account-based

A number of central banks including Sweden’s Riksbank, are working on their own versions of digital currencies. As such, a good case study on the use of digital currencies is Sweden. In fact, cash use in Sweden has rapidly decreased over the past few years. The Sweden’s digital currency, ie, e-krona, is currently considered to be “value-based” ie, a restricted access digital token for wholesale settlements (eg, interbank payments or security settlement). A value-based situation is compatible with the Riksbank’s clear mandate under the nation’s Act whereas the account-based e-krona (ie, an account at the central bank for the general public and widely available for retail transactions), would require a clearer and adaptable mandate at this stage. According to a BIS survey, “the current version of distributed ledger technology (DLT) is considered to be too immature, although they are not ruled out for the future. The Riksbank envisages a “platform” where payment service providers of the e-krona would connect and distribute the currency”. There are various definitions of tokens (as mentioned previously) due to technology impact and it is also important to differentiate between value-based and account-based forms of CBDC.

Questioning fundamentals

Some key questions relating to digital currencies include:

1 What is the impact on economic growth, inflation and monetary policy and financial governance?

2 To what extent will it impact on cross-border transactions?

It is arguable that digital currencies could well enhance financial resilience, competitions and innovation via more flexible infrastructure.

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