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“Making the case for a Digital euro”

Panel Participation on Central Bank Digital Currencies - the future of the digital euro

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Many of us here share the view that technology is revolutionising the way we are carrying out our everyday lives and that we live the most transformational period of the modern history of finance.

Digital acceleration is occurring at an unprecedented speed. Changes to the way we do business, communicate and transact are occurring as we speak.

Even when finance becomes digital, it is still finance and risks exist.

Digital innovation requires investment in technology and skills as well as adequate regulatory framework. We must admit that technological developments have not been envisaged by the existing regulatory framework. In many instances there is also lack of clarify on how existing framework applies to innovative business models and processes.

As you know, the EU has embraced the digital transformation proactively, while aiming at mitigating any potential risks.

As it seems broadly recognised the future of finance, is indeed, digital, it seems justified to look at the digital euro efforts in the context of digital transformation in finance. We should add to the notion of resilience also digital, operational resilience.

In this emerging reality, we see a profound shift in payment preferences, where citizens are turning more and more towards digital payments solutions and away from cash and digitalisation. This started before the pandemic and today we see more of it.

A digital euro is primarily driven by this trend, to respond to the needs of the citizens and to make the euro fit for the digital age.

The ECB announced that it intended to begin considering the creation of its own digital currency, or “digital euro”, in October 2020. It came in reaction to this changing payment landscape.

But it also came as response to the initiatives of other central banks, which have been developing their own digital currencies for years. And I, also, want to believe that it comes in response to digital money innovations.

I would say that to a certain extent the EU has found itself under pressure to enter the space of digital currencies.

Indeed, there is unprecedented geopolitical context here and we can see many jurisdictions moving towards digital currency. Some more swiftly than others.

This is adding to concerns that Eurozone could lose control of it money supply. European institutions therefore have become concerned about external threats to their monetary sovereignty.

When I look around, I would risk saying that Europe is a relative latecomer to this trend. And it is legitimate to ask why we started later than some other jurisdictions.

Global competition between central banks racing toward a CBDC is increasing. China, which started in 2013, is the furthest ahead. Russia plans to launch a pilot beginning of 2022. Bank of Japan has started trials. Bahamas sand dollar was launched in October last year. Sweden has been working on it since 2017 and has also completed a pilot. UK has established a task force and working on it. For US the introduction of a CBDC is a high priority. They are under strong political pressure to adopt their own digital currency. FED looks at technologies.

I would say all major central banks and tens of smaller ones have been examining options with seriousness on how to provide a digital equivalent of official cash. I think, in this context, that it is important to look at this process also from the point of view of the entire international financial system. That implies that a lot of cooperation and involvement of global institutions. So, is there a risk that we might come too late with digital euro, our CBDC, in the context of the global race?

Public reflection of recent months focuses on both benefits and disadvantages, and includes big question on how to do it in a way ensuring long-term perspective of competitiveness.

I am of the view that the ECB initiative deserves strong support. It is clear that there are related issues which require utmost attention. It is not enough to say that it is about complementing and not replacing cash or payment solutions offered by the private sector.

Potential risks of banks have to be understood and addressed. Digital euro can more or less fundamentally affect the role of the ECB, private banks, non-bank service providers in the financial system and much more.

Digital euro is about a fully protected central bank account. It is not hard to imagine that in time of financial turmoil a large-scale withdrawal of cash from bank account with an aim to put into the central bank account can take place. A digital euro would allow this to happen much faster than today.

Some point of unintended discrimination against vulnerable groups of consumers may also be, while others on the contrary talk rather about benefits for those currently underserved by the banking sector. The financial inclusion is an important argument to look at.

The European Central Bank decision whether to proceed with a digital euro is still imminent, and according to an informal road map the formal launch of a digital euro may take another five years, That is after a two-year investigation phase and a two to three years implementation phase.

While the specific characteristics and design choices of a digital euro are not yet determined, the results of the ECB public consultation are useful. These were published in April. There were more than 8000 participants. Even though statistically it was not a representative group of population, participants included a representative group of population, with 460 participants from payment sector. ECB considered the consultation crucial because any form of the central bank money should respond to the needs of general public. My reading of the results is that they confirmed what ECB had focused their initial reflection on. For the participants in the public consultation, the most important features of a digital euro are privacy, security and board usability.

While the aim of the digital euro is to replicate the basic features of cash, the need to combine citizens' desire for privacy and supervisory requirements clearly transpires, in particular with regard to the prevention and illicit activities. People see the CBDC as a tool to fight AML, terrorism financing or sanctions evasion Total anonymity - as in the case of cash seems unlikely, but I can imagine that it could be possible for smaller transactions, possible up to 100/150 euro.

The challenge is to avoid situations when central banks become competitors of retail banks in offering payment services to the public.

The question is how to understand the level playing field on this context and ensure it. How to ensure that the CBDC will not crowd out private solutions or discourage new innovative initiatives in the payment market.

ECB says that cash will stay, nobody will be forced to choose CBDC account, still the retail banks must be prepared for their possibly modified role.

Certainly, an overarching condition for any CBDC solution is that it does not destabilise the financial system by draining commercial bank deposits in unpredictable ways. Reducing deposits could have a downside effect for society as it could render bank based financing more expensive, lowering down economic activity. Ideas for these scenarios could include putting a limit to the amount of digital euros that can be held or charging people for holding large amounts of them.

I can imagine that ECB should reflect on whether to allow users to hold digital euro only up to a threshold at any given time or to control the demand for digital euro through incentive schemes under which less attractive interest rates or service fees are applied when individual holdings exceed a given threshold.

On important issue that did not come up in the public consultation is the potential impact of the CBDC on the powers of central banks and monetary policy. The issue has been prominently present in the assessment of the Chinese digital currency process.

It is also worth considering the role that a digital euro can play in strengthening the global appeal of the euro. Certainly exploring at an early stage of the process the possibility of a cross border us of digital euro is key. My understanding is that the idea so far is focused rather on possible launch of the digital euro in the context of euro system, where it would be an ECB liability offered in digital form for use by citizens and businesses for their retail payment.

Of course, the single market is a multicurrency area, with important and growing cross border payments. Even in Banking Union, we have currently two non-euro member states.

Interoperability is even more challenging in the global context. The euro lags behind the dollar by a wide margin in terms of its use as an international reserve currency, invoicing currency and in its share of international exchange transactions and debt securities. It is a second global currency but far behind the first. And the gap can widen.

The global appeal of currencies depends on fundamental economic forces such as stable economic fundamentals, size and deep and liquid financial markets. I would risk saying that digitalisation is unlikely to alter these economic fundamentals.

However, characteristics that are specific to digital means of payment, including safety, low transaction costs and bundling effects, could promote the international usage of a currency.

For instance, a digital euro could also help support the use of the euro in cross border payments by reducing the frictions and costs of euro-denominated cross-border payments. However, building a digital euro to bolster the international role of the euro requires an infrastructure that is accessible by foreign institutions that can settle large value payment sand that allows easy exchange with foreign currencies.

For this, a multi-currency wholesale CBDC solution is required. Building a digital euro for small domestic retail payments, on the one hand, may require an infrastructure that is interoperable with existing point of sale terminal and with a variety of digital platforms, that have the ability to work offline too - which came as a high preference in the consultation, and which can, on the other hand, also guarantee user privacy, while preserving transaction monitoring to avoid money laundering and terrorist financing.

While it seems that ECB is currently focusing on a digital euro concept that would serve domestic needs, it is part of a group of central banks working on the possible introduction on a digital currency. The group includes Sweden, Switzerland, Japan, the UK and the US and aims to eventually ensure cross-border compatibility and interoperability. I assume the considerations developed in this group will form part of the ECB considerations during its project phase.

Striking a healthy balance between working together on a common public good and complete in racing toward a CBDC is difficult. I think competition is increasing. The issue of global environment, advancement of the process in other jurisdictions, potential for international cooperation among central banks is very relevant.

The case of China in particular, is a case that it is worth looking at due to, inter alia, their advancement in introducing the digital renminbi, which seems to go beyond its use by businesses and citizens toward an important geopolitical dimension. The big question is whether China can be successful in using its digital currency and to push forward its efforts to make renminbi a major reserve currency.

I would like to conclude by noting that I see it as very relevant to realise that beyond the digital euro, there is a market reality which we should not ignore. With the emergence of Decentralized Finance movement and its products, we have observed tremendous growth in the area of digital money. Currently, the DeFI industry can rely only on the USD stable coins to manage risk. There is not European alternative, no significant euro stable coins on public block chains. Those who know the market say that 99.5% of stable coins used across this ecosystem are anchored in American

currency with a guarantee of exchange into it. This might signal for us a huge dependency in the future.

Stablecoins that reference a fiat currency using either centralised or decentralized means are generating an enormous amount of activity and innovation. In this domain the US is taking the lead in response to strong and increasing demand for digital representations of fiat currencies.

To avoid another missed European opportunity in the digital transition, Europe needs a clear and unified vision for digital money innovation that takes in particular the form of privately-issued digital representations of euros (“euro stablecoins”). Today EU companies using the crypto assets must rely on US dollar which means that Europe’s innovation potential is underused.

I believe we need in Europe a shared, public private vision on digital money where both the CBDC, ECB digital euro that has started its path toward future and privately issued digital representations of euro that do not pose a risk to monetary sovereignty can work together to make euro more competitive and welcomed internationally.