TRENDS REPORT

In Europe And North America, Don't Expect Any CBDC Issuances Within The Next Two Years

Research And Tech Evaluation Activity Will Continue

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Summary

Central bank digital currencies (CBDCs) have been under discussion for several years, with activity intensifying in 2019. Since then, China's digital yuan project has progressed to an advanced pilot stage, India is piloting the digital rupee, and a handful of countries have launched a CBDC. But what about Western Europe and North America? This report sheds light on the dynamics that drive CBDC development and summarizes the latest status of the main initiatives in Europe, the US, and Canada.

Central Bank Digital Currencies: An Accelerating Evolution

Central bank digital currencies (CBDCs) have become a hot topic in the past few years, with nearly 100 countries and currency blocs embarking on projects. While most are still in the exploratory phase, some like China and India have progressed to the pilot or proof of concept (PoC) stages. The European Central Bank (ECB) is at the forefront of advocating for a digital euro, with countries like Germany, France, Spain, and Italy showing strong interest in CBDC development. Two key factors have driven the rapid evolution of CBDC investigations:

- **Cash falling into disuse in many countries.** While day-to-day habits differ across countries, cash use overall has been declining for some time. The pandemic further accelerated the use of non-cash payments, and it's clear that the trend is here to stay: In 2016, 72% of point-of-sale (PoS) payments in the euro area were in cash; in 2022, that number was down to 59%. 2016 also saw digital payments overtake cash use in Sweden, and the country started investigating the potential of an e-krona. By Q1 2022, only 34% of survey respondents had used cash to make a payment in the past 30 days. Hence, the Riksbank "sees an e-krona as a possible component in [its] long-term efforts to manage the challenges of digitalisation."
- **The risk of currency displacement.** Central banks became increasingly concerned about competition from privately issued money (stablecoins) and other countries' digital currencies. While several central banks had started investigating a CBDC long before June 18, 2019, that date marked a turning point: Facebook (now Meta) announced Libra, a stablecoin it intended to make available globally to Facebook users for payments and person-to-person transfers. Given the size of Facebook's user base (approaching 2.5 billion monthly active users in 2019), central banks and governments were concerned that Libra could displace national currencies and threaten financial stability. Around the same time, China accelerated the development of its digital yuan. While displacement of the established local currency by a Chinese CBDC is less of a domestic concern in Europe and North America, central banks everywhere started thinking about the implications of a digital yuan outside China's borders.

The Drivers For Retail CBDCs Are Country-Specific, But There Are Some Common Factors

There are two types of CBDC: retail (or general) CBDC for consumer and business use, and wholesale for financial institutions and interbank settlements. The drivers for wholesale CBDC are mostly the same globally: greater efficiency, lower cost, and lower risk. This report focuses on retail CBDC, where each country has its own set of drivers, but here are the common elements:

- **Addressing financial inclusion and accessibility issues.** Many countries grapple with financial inclusion challenges, and not just in emerging markets. For example, a substantial portion of the population lacks access to traditional banking services in many EU countries (especially Greece, Italy, and Spain) and the US. A CBDC could play a pivotal role in enhancing financial inclusion by providing an alternative means of accessing financial services; a retail CBDC wouldn't necessitate a bank account, enabling individuals and businesses to conduct transactions and payments without banking intermediaries. This potential for improved financial access resonates strongly in economies where traditional banking services are inadequate.
- **Ensuring all residents can access a universally accepted payment instrument.** In some regions, the high cost of cash distribution has resulted in banknotes and coins not always being available to those who need them. An example is the Bahamas, where the increasing difficulty of accessing cash on less populated islands was a key catalyst for the development of the Sand Dollar, the Bahamas' retail CBDC.
- **Facilitating cross-border payments and money transfers.** Within the EU, the euro is a widely used currency for cross-border transactions. However, the current cross-border payment infrastructure is often criticized for inefficiencies and delays. As the EU continues to prioritize cross-border trade and economic integration, CBDCs offer the potential to revolutionize the cross-border payment landscape and stimulate economic growth.
- **Preserving monetary sovereignty and counteracting currency substitution.** Widespread currency substitution isn't currently an issue for stable, mature economies. However, central banks and governments see a potential risk of this happening if a widely distributed and accepted stablecoin or a third country's CBDC becomes an attractive instrument for payments and money transfers. When it comes to countries where currency substitution has already happened, Cambodia is an example of one working to counteract it: In a heavily dollarized

economy, the central bank aims to encourage use of the local currency with a quasi-CBDC via an app called Bakong (quasi because the digital riel isn't an actual central bank liability).

- **Ensuring financial stability in the face of potential stablecoin risks.** While cryptocurrencies haven't gained traction as a payment instrument in economies with trusted currencies, stablecoins remain a concern. Businesses and consumers alike appreciate the speed and convenience of stablecoins for cross-border transactions. To date, adoption hasn't posed a challenge; should this change, systemic risks can arise from stablecoins with insufficient backing in highly liquid assets. Stablecoin regulation can address these to a degree, but not all jurisdictions welcome privately issued money. CBDCs can also offer an alternative to payment channels perceived as too slow and insufficiently transparent.
- **Not wanting to be left behind by China.** Countries and currency blocs have been observing the development of the digital yuan with interest and concern. The interest has been mainly in how China would address the technical challenges of universal access, including offline capabilities. The concern is around the potential of the digital yuan seeing adoption outside of China. It's seen initial success in China since the pilot project launched in April 2021: Transaction amounts have grown rapidly to reach 1.8 trillion RMB, with a 1,699% increase from August 2022 to June 2023. Its usage has expanded to include sectors like public sector payments, healthcare, and education. NFC technology enables the digital yuan's offline payments feature. But challenges remain; consumers need continued financial incentives for sustained usage, and there's no profitable business model for the digital yuan operating institutions like commercial banks. Overseas usage is limited due to China's cautious approach to capital account convertibility, slowing down the Chinese yuan internationalization.

The Digital Euro: Preparations Are Under Way, But No Launch Decision Yet

The ECB formally launched its investigations into the feasibility and design of a digital euro in July 2021. Many were expecting a firm decision on whether or not to launch a digital euro in October 2023, but that didn't happen. Instead, the ECB announced that the digital euro would now go into a two-year "preparation phase," starting on November 1, 2023.

Key Takeaways From The ECB's Four Progress Reports To Date

The ECB has issued several progress reports, outlining the project's direction:

- **The first report (September 2022) focused on user functionalities and limits.** It emphasized that the digital euro should allow both online and offline payments, resembling cash-like features. While privacy is important, the digital euro won't provide full anonymity due to money laundering concerns. The digital euro will serve exclusively as a payment method and not an investment, and individual holdings will likely be capped at €3,000 to €4,000 to avoid potential disruptions to the financial system.
- **The second report (December 2022) defined settlement and distribution roles.** The Eurosystem aims to control digital euro issuance, redemption, and settlement through technology (traditional or DLT). Banks and payment service providers will handle distribution and interface development, which will ensure anti-money-laundering checks.
- **The third report (April 2023) discussed payment methods.** This includes looking at options like contactless and QR codes through intermediaries' apps or a Eurosystem app. Access for non-euro-area residents might be possible later, but the initial focus is on this region. The digital euro won't be programmable money (e.g., the ability to restrict spending to certain types of payment or store), which will preserve user discretion. The report asserted that the Eurosystem would reveal its overall digital euro design plan in the second half of 2023. The responsibility for issuing and settling digital euros lies with the Eurosystem, while banks and payment providers handle distribution and onboarding. And the ECB will investigate the potential for cross-currency functionalities to allow for more efficient cross-border payments.
- **The fourth report (July 2023) discussed principles for a compensation model.** It also includes updates on ongoing work and the results of the prototyping exercise and market research completed in the second quarter of 2023. The report reflects the view that basic digital euro services should be free of charge to the consumer. To foster network effects, intermediaries deserve to be compensated for their services, but with controls in place to prevent them from overcharging merchants. The report reiterates the importance of designing a digital euro with digital financial inclusion in mind and states the requirement for offline usage.

What To Expect From The ECB In The "Preparation Phase" Through 2025

During the project's two-year "preparation phase," the ECB will have to:

- **Align policy drivers and agree design principles.** The digital euro's policy motivations "revolve around three issues: complementing cash in an environment of increasing digitalisation; promoting innovation and efficiency in the European payments system; and safeguarding our strategic autonomy and monetary sovereignty." These now need to be translated into detailed functional, technical, and operational designs, and all ecosystem participants need to agree to these.

- **Decide whether to issue a retail or wholesale CBDC, or both.** Discussion around the need for a retail digital euro continues, and the debate about its basic functions has intensified, especially around potential risks and downsides like invasion of privacy and cyberattacks. There are also increasingly loud voices questioning whether there's even a need for a retail digital euro today. Hence, it's likely that we'll see faster progress on the introduction of a wholesale digital euro than on a retail one.
- **Ensure operator collaboration.** Collaboration with intermediaries and stakeholders is pivotal to the digital euro's success. Financial institutions, payment service providers, and technology partners play essential roles in ensuring the digital euro's seamless integration into the payment ecosystem.
- **Encourage adoption.** In addition to ensuring that a digital euro is universally accessible and easy to use, effective communication and education are vital to fostering public understanding and support. Demonstrating tangible benefits, addressing privacy concerns, and emphasizing the digital euro's role as a complement to physical cash are key components of driving adoption.

Approaches Vary Widely In Non-Eurozone Europe And North America

Looking beyond the euro area, we find that several European countries — including Denmark and Switzerland — have ruled out the introduction of a retail CBDC for the time being, following intensive research and sometimes also PoCs. Canada has decided to forgo a CBDC, and the debate has become highly politicized in the US. Here's the state of play:

- **The UK has no firm plan yet to introduce a CBDC, but there's much debate.** In February 2023, the government and the Bank of England launched a consultation that ran until the end of June; in January 2024, they published their response. Given the general lack of enthusiasm, the next phase won't be smooth sailing: In February 2023, the House of Lords reiterated its position that "it has yet to hear a convincing case for why the UK needs a retail CBDC." A Forrester analyst noticed "Say No To CBDCs" spray-painted on a bridge over the M1 motorway, suggesting that there are others who aren't keen on a potential digital pound. December 2, 2023 saw the publication of a House of Commons report entitled “The digital pound: still a solution in search of a problem?” Meanwhile, several private sector initiatives, such as the Digital Pound Foundation (which includes Web3 players like Avalanche and Ripple), are pushing the case for a “Britcoin.”

- **Sweden has decided not to issue an e-krona for now.** All CBDC-watching eyes were on Sweden in late 2023, awaiting the central bank’s decision on how to proceed after a pilot project started in 2020 came to its conclusion in August 2023. The purpose of the pilot project was to test technical options for an e-krona, while continuing to deepen the understanding of policy issues. Between 2017 and 2023, the Riksbank published five reports on the e-krona project. The learnings from that project will feed into the Riksbank’s continuing work on assessing the implications of issuing a CBDC. It’s also closely monitoring developments elsewhere.
- **Denmark and Switzerland won’t issue retail CBDCs in the near future.** Denmark’s central bank governor made it clear in a speech in March 2023 that Danmarks Nationalbank saw no reason to consider introducing a retail CBDC at this point. At the same time, he also made it clear that wholesale CBDC was a different matter entirely, and more of a technology decision than anything else. Similarly, the Swiss National Bank doesn’t see the benefit of introducing a retail CBDC. It has, however, been an active participant in a number of wholesale CBDC PoCs and pilot projects.
- **Canada has found that a retail CBDC just solves the same problems as existing systems.** The Bank of Canada has done a considerable amount of research into both retail and wholesale CBDCs. But after carefully exploring whether a retail CBDC would address any gaps in payment instrument availability, it concluded that “we don’t see a need for a digital dollar right now.” The central bank continues to watch for developments that might lead it to change course.
- **In the US, a potential digital dollar faces political opposition.** In contrast to the central-bank-initiated studies elsewhere, it was the private sector Digital Dollar Project which started CBDC investigations in January 2020. The US Federal Reserve issued its first official paper in May 2022. There was also some hands-on work: The Boston Fed, in conjunction with MIT, carried out technical exploratory work which concluded in December 2022. Fed chairman Jerome Powell stated, “Our focus is on ensuring a safe and efficient payment system that provides broad benefits to American households and businesses while also embracing innovation.” He also made it plain that the fed wouldn’t do anything without congressional approval. As elsewhere, there are concerns in the US about privacy

violations and state surveillance. But the debate has become more political than in other countries, as evidenced in May 2023, when Florida adopted a bill which "prohibit[s] a central bank digital currency (CBDC) … from being treated as money under the Florida Uniform Commercial Code."

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