Q&A

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Together on the journey towards central bank digital currencies (CBDCs)

How are Central Banks addressing Central Bank Digital Currencies (CBDC)? What are the key issues being tackled?

Central banks have embarked on the CBDC journey. As the Bank for International Settlements (BIS) has emphasised in its Annual Economic Report, this journey is designed to ensure that the unique advantages of central bank money -safety, finality, liquidity, and integrity- are preserved in a changing world, that the new world of digital payments is open and competitive, and that privacy can be kept to the highest standard.

Last year, a report from the BIS and the central banks of Canada, Euro Area, Japan, Sweden, Switzerland, United Kingdom and United States offered a guide for this journey. As such, official digital currencies should do no harm to monetary and financial stability, coexist in a flexible and innovative payment system, and promote innovation and efficiency.

The exact design will vary by jurisdiction and the issues they raise will have to be addressed along the way: system design, privacy, resilience, scalability, and interoperability in the areas of retail and wholesale CBDC. In the case of multiple CBDC arrangements for cross-border transactions, additional questions related to governance, integration and cross-border interoperability will arise.

What are the main objectives and use cases of CBDCs at the international level?

When we look around the world, we see that digital payments rise and CBDC projects are moving ahead ever faster as cash use falls. The pandemic has only reinforced this trend. Earlier this year, 86% of the world's central banks had already started to conceptualize and research the potential for digitalising their currency, 60% were building proofs of concept (PoCs) and 14% were deploying pilot projects, according to BIS research. As of August 2021, there are two live retails CBDCs: the Sand Dollar in the Bahamas and DCash in the Eastern Caribbean Currency Union. The People's Bank of China is performing large-scale pilots of its e-CNY project across China, and the European Central Bank just approved the investigation phase of a digital euro.

For the majority of central banks the introduction of a CBDC is likely some years away. Most of the jurisdictions are looking into both the wholesale and retail sides. The strategic objectives differ, however, somewhat across countries. In emerging markets, financial inclusion is a key driver. In advanced economies, efficiency and safety of payments are the main areas of interest. Despite the many different motivations, deep down it is all about payments, the historical raison d'être of central banks: a common focus on providing the public with a digitally advanced representation of central bank money and make payment system more diverse and resilient.

While the focus of most research and development projects is a matter of national taste, several projects explicitly consider or target cross-border use. A recent survey of central banks' initial thinking on cross-border use of CBDCs revealed that more than a quarter of 50 central banks are studying how to create multi-CBDC arrangements, and considering whether to allow its use by non-residents.

How is the BIS Innovation Hub contributing to the development of CBDCs?

The BIS Innovation Hub comes in on the experimentation that is a key part of any CBDC journey. Our role is to scout the trail. We are collaborating with a number of central banks to establish prototypes and PoCs to explore different uses of CBDC, primarily in a cross-border context. On the retail side, project Aurum explores a two-tiered distribution model. Project Arena builds the core platform and modules for wholesale CBDC settlement and a liquidity saving mechanism. Project mCBDC Bridge develops a prototype to support instant cross-border payments in multiple currencies among multiple jurisdictions. Project Dunbar explores shared settlement platforms for transactions with multiple CBDCs, and connectivity mechanisms to link up multiple shared platforms.

Project Jura, building on Phase I of project Helvetia, explores the use of a wholesale CBDC for cross-border settlement.

What are the expected interoperability challenges anticipated and how may they be addressed? Which other issues need to be explored further?

Making various national CBDCs interoperable has the potential to improve cross-border payments, as long as countries work together. Facilitating international payments with CBDCs can be achieved through different degrees of integration and cooperation, ranging from basic compatibility with common standards to the establishment of international payment infrastructures. This is the main message of a joint report to the G20 published last July by the Committee on Payments and Market Infrastructures, the BIS Innovation Hub, the International Monetary Fund and the World Bank.

To achieve the potential benefits for public welfare while preserving financial stability, further exploration of design choices and their macro-financial implications is essential.

Money is an essential attribute of sovereignty, and financial systems, payment preferences and attitudes towards privacy all differ across jurisdictions. Decisions on CBDC will be national, but they will have consequences across borders even when the initial motivation is purely domestic.

Central banks need to be on this journey together, and the BIS will help them map out the path.