FAQs

Central bank digital currency (CBDC)

Q What is the context?

A Recently, Nigeria joined the Bahamas and five islands in the East Caribbean as the only economies to have introduced central bank digital currency (CBDC). This is a shortlist, but one that is likely to be supplemented.

Q What are Benefits of CBDC?

A

- Desire to make domestic payments systems and cross-border remittances cheaper, faster and more efficient, and deepen financial inclusion, represent key areas of priority for most other emerging market and development economies (EMDEs).
- Between 2019 and 2021, the last three surveys conducted by the Bank for International Settlements showed that the primary drivers for central banks of EMDEs to study CBDCs were domestic payments efficiency, financial inclusion and payments safety.

Q What are design features of CBDCs?

A

- In theory, the potential of CBDCs are only limited by their design and the capabilities of the central bank issuing it, but their appropriateness and form also depend on the state of the domestic banking and payments industry.
- Ultimately, CBDCs must be seen as a means to an end.
- A particular CBDC could, for example, be account-based or tokenised, may be distributed directly by the central bank or through intermediaries, may be interest-bearing (even the possibility of a negative interest has been considered), may be programmable, may offer limited pseudonymity to its holders (similar to, but not to the extent of, cash) and so on.
- Whether it may be one or the other depends on what its country requires it to be.

FAQs

Q What are challenges in CBDCs?

A

- An economy that adopts an interest-bearing CBDC could make the interest rate on CBDCs the main tool of monetary policy transmission domestically (assuming a high degree of substitution of fiat and fiat-like currency).
- On the other hand, as former RBI Governor D Subbarao recently warned, rendering an Indian CBDC as an interest-bearing instrument could pose an existential threat to the banking system by eroding its critical role as intermediaries in the economy.
- If CBDCs compete with bank deposits and facilitate a reduction of bank-held deposits, banks stand to lose out on an important and stable source of funding.
- Banks may respond by increasing deposit rates, but this would necessitate a higher lending rate to preserve margins, and dampen lending activities.
- The resultant shrinking of balance sheets will lead to a more pronounced disintermediation role for financial institutions, which could have long-term effects on financial stability, and facilitate easier bank runs.
- The introduction of CBDCs would require central banks to maintain much larger balance sheets, even in non-crisis times.
- They would need to replace the lost funding (because of migration of deposits) by lending potentially huge sums to financial institutions, while purchasing correspondingly huge amounts of government and possibly private securities.
- CBDCs could also have implications for the state from seigniorage as the cost of printing, storing, transporting and distributing currency can be reduced.

Q What can be way forward for India ?

A Recent comments by RBI officials have focussed on the desirability of introducing CBDCs. But the path to a "Digital Rupee" is not clear.