

ECB inches closer to 'digital euro'

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Central bankers around the world are tracking the rise of private cryptocurrencies like bitcoin.

The European Central Bank inched closer to a "digital euro" on Wednesday with the formal launch of a pilot project, but questions remain about potential pitfalls and benefits for eurozone citizens.

The move comes as the coronavirus pandemic has hastened a shift away from cash, and as central bankers around the world nervously track the rise of private cryptocurrencies like bitcoin.

Here's a look at what a digital euro would mean for the 19-nation club.

What is a digital euro?

A digital euro, sometimes dubbed "e-euro", would be an electronic version of euro notes and coins.

It would for the first time allow individuals and companies to have deposits directly with the ECB. This could be safer than with commercial banks, which can go bust.

The ECB has promised that any future digital euro would be "a fast, easy and secure way" to make payments. The service would be free and payments could be made by card or smartphone app.

This would allow the Frankfurt-based institution to challenge the dominance of foreign payment card companies like Mastercard and Visa in the euro area.

A digital euro would "complement cash, not replace it", the ECB said.

The ECB is still studying which technology is best suited to develop the digital currency.

Why now?

The Covid-19 pandemic has accelerated a decline in the use of cash as customers try to avoid contact.

And the ECB is wary of falling behind virtual money issued by private actors like bitcoin and Facebook's yet-to-be-launched diem, formerly known as libra.

There's also pressure to keep up with digital currency projects launched by other central banks, before the ECB misses the boat and consumers end up putting their money elsewhere.

If people in the eurozone were to switch en masse to virtual currencies that operate outside the ECB's reach it could hamper the effectiveness of its monetary policy measures and undermine financial stability.

ECB president Christine Lagarde said the goal was "to ensure that in the digital age citizens and firms continue to have access to the safest form of money, central bank money".

The Chinese central bank has already started trials with a digital renminbi, while the Bank of England has created a task force to research a possible "bitcoin".

The US Federal Reserve and the Bank of Japan are also looking into so-called central bank digital currencies (CBDCs).

What are the risks?

Citizens might avoid traditional accounts in favour of going digital, weakening retail banks in the euro area.

The risk would be higher in times of crisis, when savers might be tempted to flee to the safety of a digital euro and trigger a run on banks.

To avoid this, the ECB could cap how many e-euros people could hold in digital wallets.

ECB executive board member Fabio Panetta on Wednesday gave the example of a threshold of around 3,000 euros (\$3,500), but said the final figure would be discussed over the next two years.

The ECB will also have to balance privacy demands with anti-money laundering regulations, with experts saying it's unlikely a digital euro can offer the same kind of anonymity as cash.

A key challenge that might emerge is that users "would have to be convinced to switch to a new payment method that is hardly different from existing ones", said Deutsche Bank analyst Heike Mai.

When can I spend mine?

Not anytime soon.

Having completed a preliminary research phase and a public consultation, the ECB's green light to move the project into higher gear will kick off a two-year "investigation phase" focused on the digital euro's design and distribution options.

Experts will also study the legislative changes that might be required. Germany and France said the introduction of a digital euro would be "conditional on a political decision, to be taken by member states".

Panetta said that if the digital currency is given the go-ahead after the investigation period, the implementation phase would take another three years—meaning the rollout is not expected before 2026.

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