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Position paper

Digital euro – laying the foundations for the future of our monetary system

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Digital euro – laying the foundations for the future of our monetary system

In introducing a digital euro, the European Central Bank (ECB) aims to make an important contribution to securing Europe's currency policy and digital sovereignty. The German Banking Industry Committee (GBIC) welcomes the introduction of a digital euro if it is designed in such a way that provides added value for all market participants. This step represents a fundamental change that will not only shape our payments system for decades to come but will also have serious consequences for financial and monetary policy and for the real economy. In order to make the digital euro a success for Europe, its design must be carefully considered and developed in conjunction with users, businesses and banks.

The design of a digital euro raises fundamental questions. In July 2021, the German Banking Industry Committee published its initial proposals in a paper entitled, "Europe needs new money – an ecosystem of CBDC, tokenised commercial bank money and trigger solutions".[1] A digital euro could compromise the basic principles of banks' business models if it is implemented with the design features currently being discussed by the ECB. As the German Banking Industry Committee, we are therefore keen to be actively involved in the ECB's ongoing investigation phase into introducing a digital euro. A digital euro harbours both opportunities and risks and may have far-reaching consequences for European finance (disintermediation). It is therefore vital that the ECB analyses its impact, mitigate against the risks and maximise the opportunities. We want to ensure that we can continue to accomplish the tasks of financing the economy and providing consumers with financial services in the future and thus make our contribution to maintaining and growing prosperity in Europe.

Given the ECB's ambitious timetable for introducing a digital euro, more intensive political discussions and support for the topic are urgently needed. According to statements by ECB President, Christine Lagarde, a digital euro might be brought into circulation as a means of payment by as early as 2026. The ECB Governing Council is supposed to have decided on its design by autumn 2023. Since the introduction of a digital euro lays the foundation for the future of the euro and represents a major step in digital payments, an early and comprehensive exchange between the Eurosystem, politics and the banking industry will be essential.

In this paper, we highlight the key issues for European banks and the associated opportunities and risks to the banking industry and real economy from introducing a digital euro. In order to preserve the key functions of banking institutions and to create the foundation for an innovative money ecosystem, we also present appropriate options for its design.

[1] Available at: https://die-dk.de/media/files/20210625_DK_Ergebnisdokument_EN.pdf

Basic decisions need to be made when introducing a digital euro

Various factors will be key to ensuring a digital euro maximises its diverse economic opportunities. A digital euro should principally offer EU consumers who use it active added value and close functionality gaps in today's payments market. A high degree of adaptation will also be important to ensure it is widely accepted and used. And this will also have a sustainable impact on the development of innovative offers based on a digital euro.

There are basically two versions that are currently up for debate: A **bearer-based version** (similar to cash) and an **account-based version** (similar to today's bank accounts).

- **"Bearer-based version"**
  A digital euro could be issued by the ECB as a form of digital cash (as a bearer instrument). The banking industry could use this version like today's cash and issue it to people in wallets – similar to dispensing cash at ATMs.

- **"Account-based version"**
  The ECB could also bring a digital euro into circulation in a more conventional way using accounts, and possibly also via a bearer instrument. Credit balances could then be held either directly in private ECB accounts or held in trust at banks but off their balance sheets. By offering accounts under the ECB label, a sovereign actor would be in direct competition with the services offered by commercial banks.

Taking account of the economic impact of a digital euro

The ECB has clearly stated that a digital euro should complement euro cash and that its function should be limited to that of a means of payment. It is to avoid it being used as a store of value as otherwise large amounts of digital euro will be withdrawn from the banking sector. Negative interest rates[2] or a fixed limit for consumers are possible steps that could be taken to curb the negative effects. With the normalisation of interest rate policy, interest rates should rather be used as an incentive to keep money in accounts instead of cash or digital euro. These issues need clarifying urgently as otherwise holding digital euros could have serious, negative consequences for the banking industry and the real economy.

Flexible credit offers are important for the economy

A digital euro will be successful if it has a variety of applications and gives users added value. In order for banks to have access to a stable deposit base, also in future, and be able to

[2] A staggered form of negative interest rates is currently under discussion, which means that as soon as the amount of digital euros exceeds a fixed holding limit, the excess deposits are subject to negative interest. In its model calculations, the ECB set this rate at 20% per annum, see also Occasional Paper Series - Central bank digital currency and bank intermediation (No 293 / May 2022).

provide a sufficient supply of credit over the economic cycle, the possibility of a digital bank run must be ruled out. This could happen, for example, if the ECB were to put the corresponding conditions in place or in the event of a crisis of confidence, resulting in many customers withdrawing funds from their bank accounts and converting them to digital central bank money. Banks that focus strongly on deposit business would be particularly at risk if this were to occur. This significant shifting[3] of bank deposits into a digital euro would lead to a long-term destabilisation of the existing financial system if no appropriate upper limit were put in place.

We welcome that the ECB has acknowledged the risks described above and is considering measures to mitigate against possible unwelcome effects. The scenario analyses published by the ECB have provided initial insights but cannot be considered a full impact analysis. They only look at some of the effects relating to banks' average liquidity supply and key figures such as the LCR (liquidity coverage ratio[4]). In addition to these aspects, we recommend conducting a holistic analysis which takes into account further effects on the earnings side and also includes the impact on key regulatory figures and, as a result, on long-term lending opportunities. We would therefore urge the ECB to conduct a differentiated analysis of the effects and possible risks and assess them in their entirety. The GIBC would happily make its expertise available and support in analysing the economic impact of a digital euro.

Low financing costs promote investment activities

Europe finds itself in the midst of an economic transformation. According to estimates by the European Commission, up to 350 billion euros per annum[5] of additional investment will be needed in Europe by 2030 for climate protection alone. And this figure does not even take into account investment in digitalisation, increasing the efficiency of the economy and reinvestment. A large proportion of this investment will come from the private sector and will be financed primarily in the form of loans (from banks).

Banks will play their part by developing innovative solutions and offers based on a digital euro. At the same time, however, European policymakers must ensure that banks can continue to satisfactorily accomplish their economic tasks and that disintermediation can be ruled out.

If the supply of credit were to tighten, interest rates would tend to increase leaving the economy less able to invest. A digital euro would thus become an investment brake and weaken Europe's competitiveness.

A narrow monetary policy mandate for the ECB would ensure market economy principles

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[3] The ECB's scenario analyses have shown that without an upper limit, around 7,500 billion euros or roughly 50 percent of all customer deposits in banks in the euro area might be transferred to the digital euro. See also Occasional Paper Series - Central bank digital currency and bank intermediation (No 293 / May 2022).

[4] A definition is available from the Bundesbank at https://www.bundesbank.de/en/tasks/banking-supervision/individual-aspects/liquidity/liquidity-regulation-622878

[5] See also "Stepping up Europe's 2030 climate ambition" (17 September 2020) a report by the European Commission.

In introducing a digital euro, it should be ensured that market economy principles and price mechanisms, in the sense of supply and demand, are preserved. Massive transfers of bank deposits into a digital euro would endanger the finance market as banks would, in this case, lack a granular and stable basis for refinancing over time. The interbank market could dry up if deposits were to decline at enough banks.

In order for banks to then refinance under those conditions, the ECB would be forced to offer long-term refinancing options on a massive scale. This would mean that banks would be 'drip fed' by the central bank and would be dependent to a large degree on their conditions. Market economy price mechanisms would be undermined thus endangering the economy's ability to adapt quickly and thereby hampering its competitiveness. Particularly in the current crises (Corona pandemic, war in Ukraine), banks have repeatedly demonstrated their adaptability in financing consumers and businesses.

Ultimately, this would lead to a concentration of enormous power with the ECB and would fundamentally change its role in the monetary and financial system. Monetary policy decisions would have a significantly more direct impact on the banking industry, on the economy's financing conditions and thus on the economy as a whole. The independence of the ECB, the key fundamental for guaranteeing price stability would be difficult to legitimise if its mandate were to be significantly extended.

Strengthen competition in the current payments market for the benefit of customers

Today's payments market is intensely competitive and reflects the very diverse needs of the market in its complexity. Were the ECB to intervene in this competition, there would have to be added value for all stakeholders so that the digital euro were widely accepted. The implementation of a **payment system** solely by the ECB is significantly riskier than introducing a digital euro as a **means of payment** or as a payment system in close cooperation with the banking industry. Private actors are better placed to design innovative payment methods more quickly and provide corresponding added value which is more appropriate for its intended audience. If they are not involved in the process, the wealth of experience that banks and financial service providers have in dealing with customers and risks would remain untapped. And it would ultimately have the effect of curbing investment and innovation in the payments market. Rather, the ECB should use investments in the payments market to support necessary infrastructure measures for supervised intermediaries.

Digital euro: what should it look like?

A digital euro should be based on the features of today's cash and represent an innovative further development of it. In order to reliably operationalise offline transactions and anonymous payments of limited amounts,[6] the digital euro should be designed as a bearer

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[6] The limit should be based on applicable rules for the prevention of money laundering and terrorist financing, and in this context its design should be risk-adjusted.

instrument. In this form it would perfectly complement existing means of payment and give banks greater potential scope for innovation (particularly in the case of programmable interfaces). As an equivalent to traditional cash, it would allow payments to be made simply and seamlessly with strict data protection requirements in the digital space. A digital euro should therefore have the following features:

- A digital euro should be designed as a bearer instrument to enable offline payments while safeguarding privacy and ensuring anonymity. This would guarantee the greatest possible confidentiality for payments and could also still be used if the internet is down or there is a power cut.
- Rules on interoperability at the technological level could also lead to a wallet that is compatible across Europe. Parallel infrastructures should be avoided.
- Regardless of whether the ECB opts for the account-based version or the bearer-based version, it must be assigned clear access restrictions in order to limit negative economic consequences. The key here is to introduce a low three-digit holding limit[7] in the form of a "full wallet" to stop the digital euro being used as a financial investment. The holding limit should remain stable over time, for example, by enshrining it in law and by linking adjustments to changes in consumer prices.

The introduction of a digital euro is an important step towards guaranteeing the currency policy and digital sovereignty of Europe. It lays the foundations for further developing the monetary system in the digital age. Furthermore, it is crucial that the design of the digital euro is carefully considered and, in particular, is done with the participation of European citizens and in conjunction with the banking industry. It is not only a technical decision, but rather a fundamental political decision about the future interaction of central banks and commercial banks (equivalent to the state and the private sector) in an economy.

Extending the analyses in the ECB's investigation phase

Before final conception and introduction of a digital euro, it will be necessary to implement detailed impact studies that show the effects of introducing a digital euro on the financing of individual households and businesses and therefore on our entire economic area. In turn, this will require detailed analyses as to what extent the supply of credit to the economy can be guaranteed long term and to what degree the banking industry can continue to play its role in the monetary system of the future. The German Banking Industry Committee is willing to contribute its expertise to the discussion and support the ECB in analysing the economic and operational impact of a digital euro.

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[7] The exact amount of this holding limit should be determined in the political process from empirical data on the use of cash; it might, for example, be based on existing limits for cash payments, such as those already in place in Greece.

It is equally important that the member states of the euro area closely support the ECB's investigation phase. Currencies rise or fall based on the confidence both domestic and foreign citizens and economic actors have in them. This will be all the more relevant if cash is to be digitalised. The banking industry is ready and willing to further develop its proven function in retail payments and of financing individual households and businesses, also within the framework of a digital euro, and to invest in solutions that inspire confidence and create added value for customers. With this as its foundation, a digital euro should be seen as the first step which, once embedded in an ecosystem yet to be developed, will enable many more innovative payment solutions to be developed by banks at the request of the private sector. We would like to see a public discourse that promotes the successful introduction of a digital euro, considers the needs of all stakeholders and strengthens Europe's competitiveness.