## ***Coping with current economic challenges for central banking***

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### *Opening remarks*

I am grateful for having been invited to participate in this Conference celebrating the Centennial of the Central Reserve Bank of Peru.

Amid this changing and complex environment, the topic of this session is directly related to one of the most traditional and fundamental functions of central banks: the provision of money.

### *Evolution of money: from precious metals to digital assets*

The exchange of money is what enables transactions to be carried out in the economy, providing a generally accepted unit of account and store of value which operates as a means of payment and facilitates the best use of competitive advantages.

Throughout history, money has evolved, perfecting its role. Common to the various transformations is the fact a better money or form of money always emerges to replace the previous one. For example, a metal may rust over time, but it does not decompose like wheat, so it can better preserve value. Coins are easier to transport than metals as are banknotes compared to coins, and electronic money is more efficient than banknotes.

In recent years, technological advances have substantially changed how payments are made and, therefore, what we use as money. Electronic money issued by private banks is replacing physical money issued by central banks in daily use, since it has reduced transaction costs and has attributes valued by people, such as greater security in the event of theft or loss. However, unlike banknotes and coins, it cannot be used anonymously, which is highly appreciated by some users, but at the same time is a concern for the authorities in charge of preventing money laundering and the financing of terrorism. The use of cash is more complex for paying large amounts, and the difficulties are exacerbated in cross-border payments.

This technological evolution has also allowed the emergence of a new class of digital assets, which combine characteristics of cash, such as anonymity, with those of electronic money, such as simplified transferences, even across borders, so they have the potential to be a good

[1] Organized by The Central Reserve Bank of Peru, The Reinventing Bretton Woods Committee and The Inter-American Development Bank.

substitute for current money. The possible massification of this type of asset certainly challenges central banks, as it poses various risks to the payment system or regulatory challenges that should be addressed.

Their massification could probably occur because their users value overcoming regulatory frameworks, facilitating money laundering, or simply because anonymity is desirable for them. On the other hand, these assets have additional factors that make them more similar to other financial assets, so that, alternatively, in a world of low interest rates, some of them emerge as an asset that promises unusual profitability, although in the past few weeks exactly the opposite has happened. The point is, however, that so far there has been a growing demand for these assets and, therefore, the question is the degree of substitution that it will achieve with respect to central bank money and the consequent loss of seigniorage, which may be the greater the weaker the currency of each country.

Options to respond to these concerns range from prohibition, regulation, and to one that is not exclusive and we well know that it attracts interest, i.e., the issuance of a Central Bank Digital Currency (CBDC).

*Implementing a CBDC*

Most central banks are exploring CBDCs, with some of them performing concrete experiments and, according to a BIS survey, several believe they will likely issue a retail CBDC in the short to medium term, and a few countries have already done so.[2]/ However, from our perspective there is a long way to go between the experimentation stage and the potential implementation of a CBDC.

A first motivation for issuing a CBDC could be to increase financial inclusion. For a country like Chile, with a relatively adequate —although perfectible— level of financial inclusion, it is not evident that the issuance of a CBDC is the best policy response to the challenges of the payment system, which are largely related to competition matters and for which an institutional framework exists that can address them. Thus, if bank e-money is widely available, why would public e-money be necessary? The answer does not seem so obvious.

Another reason to explore issuing a CBDC has to do with sovereignty, which can be a problem when central bank money is no longer used. Again, in Chile we are still far from such a scenario. Other arguments, such as strengthening the resilience of payment systems, or making the sending and receiving of remittances more efficient, can be addressed with other policies, regulation, and technological development. In fact, the CPMI is working on the implementation of 11 of the 19 "building blocks" of the G20 roadmap to make remittances

[2]/ https://www.bis.org/publ/bppdf/bispap125.pdf

faster, cheaper, and more transparent;[3]/ and in that roadmap CBDC is one of the building blocks, but not necessarily the first or the most important one.

In this scenario, one of the main reasons to explore the issuance of a Chilean peso CBDC is the possible response to the eventual massification of privately issued "non-bank" money, in the form of either decentralized cryptoassets, or stablecoins.

Two months ago, the Central Bank of Chile published a report with its preliminary vision of the possibility of issuing Chilean pesos in digital format, which generated great public interest. Said report outlines some principles that, from our perspective and given our reality, should be considered in the design of a possible digital peso.

Some of these principles include the fact that the CBDC should have the Chilean peso as the unit of account and be convertible at par value with coins and banknotes; and that the Central Bank would not have a direct relationship with CBDC users, so other entities would be in charge of account opening and management. Also, the CBDC should complement the existing supply of means of payment, fostering innovation and competition; and payments should be firm and irrevocable and low-cost for individuals. Finally, to mitigate disintermediation and financial stability risks, CBDC should probably be non-interest bearing and with limits to its holding; and it would be desirable for it to be able to operate both online and offline.

Considering that the issuance of CBDCs should lead to the development of new financial market infrastructures or to the adaptation of existing ones, it will also be important that they comply with the Principles for Financial Market Infrastructures (PFMIs), so as to limit risks in financial transactions carried out with this new instrument.

The document also notes that issuing a CBDC requires a more in-depth analysis of its costs and benefits, and that the eventual issuance of a CBDC should be contrasted with other policy alternatives. To this purpose, during the rest of the year the Central Bank of Chile will carry out a process of dialogue with the public and private sectors, in order to complement its vision and publish a new report towards the end of the year.

Preliminarily, the challenges would be multiple, and they include technological, legal, and potentially political aspects, such as those related to people's privacy. Among the former, in addition to the natural concerns about cybersecurity and operational risk, the absence of an international standard for the issuance of CBDC is important, as it may lead to a fragmentation that may hinder interoperability between countries. We understand that we are not the only country with these types of concerns and that, in this case, there is significant value in not being the pioneers and rather learning from experience and how other leading countries resolve these challenges.

[3]/ CPMI Cross-border payments programme (bis.org)

*Cross-border dimension*

Before concluding, I would like to touch on the cross-border dimension of CBDCs. From the standpoint of an emerging country. Should us be concerned about the potentially unrestricted availability of a CBDC in currencies such as the dollar, the euro, or the renminbi?

Certainly, if any of these currencies are eventually issued as a CBDC, it will be up to the respective central banks to define their characteristics and restrictions on their distribution and use, and it is not obvious that it is their interest to allow their CBDCs to be freely and universally used. However, if that were to happen, dollarization (or "eurorization") of emerging economies would be a much easier phenomenon to occur than it is at present, which would pose significant challenges for monetary policy transmission and financial stability in the affected countries. If this is the case, it may also be a factor that aligns macro stability policies to reduce this risk.

*Conclusion*

I have already referred to the history of money. It seems to me that we are currently going through a stage of change for the payment system. However, are we facing the end of payments as we know them? Will CBDCs be the predominant form of money in the future? Which promises will be fulfilled and which will not? I think uncertainty is still high, so at this point it is extremely difficult to anticipate what the history will say about them. All in all, I am sure that these new technologies will lead us to a more efficient payment system, and we need to be prepared and work to regulate it properly, leaving room for innovation but, at the same time, mitigating risks.