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Central bank report highlights risk in the race to digital currencies



David Hollerith · Senior Reporter

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Flags of the European Union flutter in front of the headquarters of the European Central Bank (ECB) in Frankfurt am Main, western Germany, on March 10, 2021.

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What could be more disruptive to the existing financial order than crypto?

Possibly, a central bank equivalent if not designed carefully, a new report says.

Three new reports from the [Bank of International Settlements](#) (BIS) and seven different central banks – including the Bank of England, Bank of Japan, European Central Bank and U.S. Federal Reserve – find that

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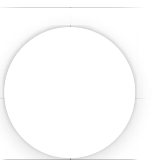
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while a groundbreaking innovation to monetary policy, central bank digital currency, or CBDC, pose many opportunities and uncertainties.

While the use cases for CBDCs – virtual money backed and issued by a central bank – range widely, central banks primarily want to use them as a tool to increase [financial inclusion](#), provide a backstop for all privately managed payment systems, enhance the efficiency of governments to collect taxes, among other benefits associated with moving to a cashless society.

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One risk highlighted in the new report is the heightened potential for systemic bank runs. During an economic crisis, "reduced transaction costs of a CBDC could exacerbate bank runs" because these digital currencies might be "perceived as a safe haven."

Eswar Prasad, senior professor of trade policy at Cornell University and author of a CBDC-focused book, "The Future of Money," said bank runs are just one of many risks central banks need to consider when issuing their own digital currency. "A low-cost digital payment system provided by a central bank not only risks disrupting the banking system but could also discourage private sector payment innovations," Prasad told Yahoo Finance.

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Exterior view taken on September 9, 2021 shows the European Central Bank (ECB) building in Frankfurt / Main, western Germany, prior to a meeting of the governing

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The risks of CBDCs

Nic Carter, Coin Metrics co-founder and current partner with Castle Island Ventures, said a digital dollar [issued by the Federal Reserve](#) could be used to effectively "nationalize the commercial banking sector."

"I think the biggest threat to Wall Street and banks, and the commercial bank sector is actually CBDCs," Carter told Yahoo Finance.

Prasad also warned that if nations move from cash to a digital currencies, "confidentiality in financial transactions and privacy could be compromised." On the other hand, the same low-cost efficiency that comes with digital cash would present the greater vulnerability of hacking and other cyber crime, he said.

"For central bank digital currencies (CBDC) to work effectively, public and private institutions need to cooperate to ensure integration with existing payments systems; to anticipate customers' future needs; and to support innovation while preserving public trust, privacy and stability in the broader financial system," the authors of the BIS report wrote.

While the race to issue CBDCs first heats up, the risks of doing so too quickly also



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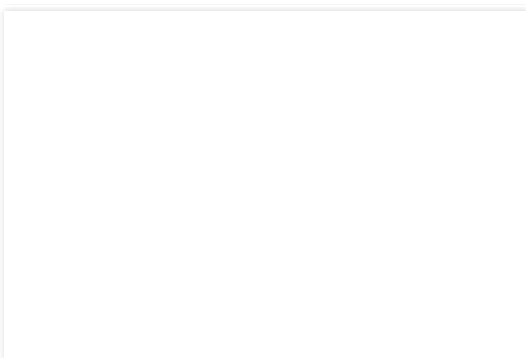


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comes with costs.

"This will require extensive research and analysis," Prasad said. "It is encouraging that major central banks are cooperating in undertaking extensive background research and experimentation before contemplating full-fledged rollouts of their CBDCs."



Federal Reserve Chairman Jerome Powell arrives for a House Financial Services Committee hearing Thursday, Sept. 30, 2021, on Capitol Hill in Washington. (Sarah Silbiger/Pool via

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More than 81 countries are exploring CBDCs, according to The Atlantic Council, a Washington-based think tank that [tracks](#) the progress of various CBDC projects worldwide. At least 5 nations, including the Bahamas, have already launched a digital currency. More than a dozen others are in the pilot phase, with China expected to roll out its digital yuan to foreigners at the upcoming Beijing Olympics in 2022.

In the near term, The Federal Reserve Bank of Boston is expected to come out with its own report on CBDCs as Fed Chair Jerome Powell has previously promoted the idea of a U.S. CBDC while condoning tighter regulation on their private sector alternative, stablecoins.

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