

THE DIGITAL EURO AND ITS POTENTIAL IMPACT ON ITALIAN BANKS' FUNDING

The ECB and the euro-area national central banks have been examining the potential introduction of a digital euro since January 2020. This would be public money in digital format issued by the Eurosystem that would complement cash, not replace it.¹

A digital euro would enable people to make digital transactions using central bank money, therefore preserving the latter's role of monetary anchor² as the use of banknotes for payments gradually declines and the economy moves increasingly towards digitalization. The digital euro would strengthen the euro area's autonomy and monetary sovereignty – as other jurisdictions and private issuers introduce their own digital forms of money – while improving the European payment system's efficiency and competitiveness.³ The digital euro would also promote financial inclusion, as it would also be available to people without a bank account or with no access to electronic payment instruments.

The Eurosystem is working closely with other European authorities and institutions, EU Member States, the finance industry, and consumer and trade associations to explore the digital euro's design and distribution options. The technical infrastructure would be managed directly by the Eurosystem to ensure maximum resilience in the event of cyberattacks or if the system malfunctioned. The main use cases identified for the digital euro are retail payments in both online and physical stores or from person to person, and payments between public entities and citizens, i.e. a range of very common transactions which would encourage the adoption of the digital euro if the competent authorities decide to proceed with its issuance. In addition, the digital euro would provide the highest level of privacy among similar payment instruments while being compatible with public interest objectives, including compliance with anti-money laundering and counter-terrorist financing requirements.⁴ Supervised intermediaries would play a crucial role in

¹ Most central banks around the world have started analytical, research or development work on the possible issuance of a digital currency for retail payments. To find out more, see A. Kosse and I. Mattei, 'Gaining momentum. Results of the 2021 BIS survey on central bank digital currencies', BIS Papers, 125, 2022.

² The confidence that households and firms have in the forms of money issued by private entities (such as bank deposits) is a cornerstone of the stability of the financial system and hinges on the at par convertibility of these forms of private money with public money, i.e. money issued by the central bank. To find out more, see F. Panetta, 'Central bank digital currencies: a monetary anchor for digital innovation', Madrid, 5 November, 2021.

³ For more information, see ECB, *Report on a digital euro*, October, 2020.

⁴ The final decisions on the privacy aspects will be taken by the European Parliament and the Council of the European Union. The Eurosystem has nevertheless ruled out full anonymity when using the digital euro. For more information, see F. Panetta, 'A digital euro that serves the needs of the public: striking the right balance', Brussels, 30 March, 2022.

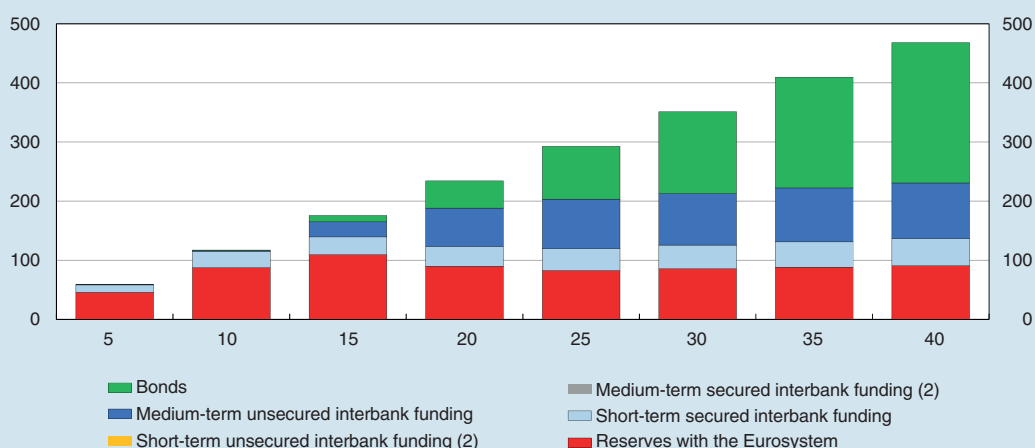
distributing the digital euro by providing any related services that require direct interaction with users.⁵

The digital euro could lead to changes in the composition of bank funding, if its features ended up encouraging people to hold it instead of deposits. The Eurosystem is assessing several options to mitigate the potential effects this substitution could have on the transmission of monetary policy and on financial stability.⁶

The results of a simulation exercise using data from the end of 2022 show that the effects of the introduction of the digital euro on the funding of the Italian banking system would, on the whole, be limited if demand for it led to a reduction in retail deposits of less than 15 per cent and it were issued when there was ample liquidity and stable funding for banks (see the figure).⁷ In this case, banks would in fact be able to offset most of the drop in retail funding by reducing the amount of excess reserves deposited with the Eurosystem and by increasing short-term secured funding (the least costly after retail deposits).

Figure

Potential impact of the digital euro on the composition of Italian banks' balance sheets (1)



Sources: Based on market data and banks' supervisory reporting at the end of 2022.

(1) For each potential deposit outflow percentage, the figure shows how banks could cover it by using the various funding instruments available. – (2) The results of the simulation exercise indicate very limited use of this source of funding.

⁵ The Governing Council of the ECB is also in the process of approving other decisions, including: (a) which settlement model to use for transactions; (b) which activities will be carried out by the Eurosystem and which will be carried out by financial intermediaries; (c) what form the 'payment scheme' distribution model, which will establish a common set of rules, standards and procedures to be followed by supervised intermediaries, will take; (d) who will have access to the digital euro; (e) whether or not it will be possible to make automated payments; and (f) how the compensation model for costs relating in particular to distribution and payment transfer operations will be set up. For more information, see the ECB's website, 'Publications on Digital euro'.

⁶ 'The implementation of CBDCs by central banks: challenges, risks and opportunities', speech by Piero Cipollone, Deputy Governor of the Bank of Italy, at the conference on 'Central Bank Digital Currencies: Threat or Opportunity?', London School of Economics, London, 28 October 2022.

⁷ In the simulation exercise, banks offset the dip in retail funding by reducing excess reserves and increasing their interbank funding and bond issuance. To find out more, see S. Auer, N. Branzoli, G. Ferrero, A. Ilari, F. Palazzo and E. Rainone, 'CBDC and the banking system', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming.

This coming autumn the ECB Governing Council will decide whether or not to proceed with the phase of the project devoted to developing the technical and commercial solutions required to issue and distribute a digital euro, which could take about three years. Moving on to the preparation phase would not involve the actual issuance of a digital euro. Any decision in this respect would be taken by the Governing Council at a later stage, and only after the adoption of the necessary regulatory framework by the European Parliament and the Council of the European Union.