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Analysis of today
Assessment of tomorrow

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Why Central Bank Digital Currencies Are Unnecessary and Dangerous?

The main central banks have been deliberating on the concept of introducing a digital currency. However, many citizens fail to grasp the rationale behind it when the majority of transactions in major global currencies are carried out electronically. Nevertheless, a central bank digital currency is much more than electronic money. I will explain why.

Central banks understand that inflation is primarily influenced by monetary factors, which is why they are increasing interest rates and implementing restrictive monetary policies as quickly as governmental regulations permit.

Central banks have recently lost credibility by initially disregarding the inflation danger, then attributing it to transitory factors, and finally responding belatedly and gradually.

In a world where there is an excess in money supply growth, there are mechanisms in place to prevent a significant rise in consumer prices caused by the destruction of the purchasing power of the issued currency.

Quantitative easing is subject to some constraints that partially prevent inflationary forces. As the banking channel serves as the transmission mechanism of monetary policy, credit demand acts as a constraint on inflationary pressures.

Now, consider if the transmission mechanism was direct and utilizing only one channel, the central bank. It is not the same to have a police officer walking down your street than to have a police officer in your kitchen watching your every move.

High inflation, government control, and financial repression

A central bank digital currency would be directly issued to your account held at the central bank. At best, it is surveillance masquerading as currency. The central bank would have precise information of your currency usage, savings, borrowing, spending, and transactions.

It can enhance the fungibility of money to prevent the common but unfounded problem of "excess savings." Moreover, as central banks become more politically involved, they might impose penalties on individuals who spend in a manner they consider unsuitable, while rewarding those who follow their recommendations. The entire privacy system and monetary limit mechanism would be removed.

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Moreover, if the central bank makes a mistake and creates an excess of money supply, as shown in 2020, it would immediately make consumer prices rocket. If the money supply increases dramatically in a year, we would experience massive inflation levels as the existing constraints of the transmission mechanism are eliminated.

Consider a scenario where you have a single account, a central bank, and the government. Guess what would happen? Full monetary financing of government spending leading to elevated inflation within a few years and the destruction of the private sector.

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Central banks have never prevented bubbles

Central bank digital currencies are unnecessary and dangerous. You cannot initiate an experiment of such magnitude when the autonomy of central banks has been questioned for years and there is abundant evidence of mistakes made with policy measures that do not acknowledge the danger of increased inflation and economic stagnation.

Central banks have never successfully prevented bubbles, high levels of risk-taking, excessive debt, or identified inflationary pressures. Given such history, no one should support a proposal that would grant them complete authority and control over the financial and monetary system.

What do central banks mean when they discuss a novel digital currency? It is a further advancement in the ongoing process of eroding the purchasing power of the currency, disguised under the objective of enhancing oversight of payments and facilitating the tracking of specific payment methods.

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The primary arguments for considering a central bank digital currency are efficiency and enhancing the transmission mechanism of monetary policy. However, none of them make sense.

Central banks often claim the need to enhance the transmission mechanism of monetary policy, but many of their statements are founded on an inaccurate belief that there is an excess of savings that requires a change in behaviour. By manipulating the cost and quantity of the currency issued, central banks aim to correct what they perceive as imbalances.

However, monetary policy rarely addresses the largest imbalances, which are the ones created by government deficits and debt accumulation. Disguising risk in sovereign debt leads to more imprudent fiscal policies and adds the risk of bubbles in financial markets as perception of risk is clouded by low rates and high liquidity.

A digital currency does not enhance the transmission mechanism of monetary policy unless the word “enhance” is used to hide a desire to boost the size of government in the economy through the erosion of the purchasing power of the currency and the constant monetary financing of public deficits.

A central bank digital currency is an oxymoron

Another aspect to consider is efficiency. Central banks appear to prioritize the regulation of monetary transactions and encourage spending regardless of the risks involved.

Creating a central bank digital money is not more efficient. It is another form of financial control. If negative interest rates are ineffective in stimulating economic agents, some believe that implementing negative rates and devaluing the currency faster using a digital currency may be more successful. They are wrong. The economy does not strengthen by making the currency a disappearing reserve of value.

Introducing a central bank digital currency is unlikely to reduce economic risks or stimulate productive investment, but encourage short-term malinvestment.

Central banks are unable to compel economic agents to spend and invest, especially when their strategies continually focus on encouraging debt and prolonging government imbalances.

Central banks should prioritize safeguarding the purchasing power of savings and salaries rather than seeking to destroy them - Daniel Lacalle

The process of any asset becoming a widely used currency is highly democratic. It is beyond the jurisdiction of governments and cannot be enforced.

When governments and central banks implement financial repression and devalue their currency, citizens may turn to other forms of payment that are considered genuine money.

Cryptocurrencies have emerged due to a lack of trust in fiat currencies and the ongoing efforts of central banks and governments to devalue currency in order to conceal underlying fiscal imbalances.

A central bank digital currency is a contradiction in terms, an oxymoron. Citizens demand cryptocurrencies because they are not controlled by central banks that seek to grow the money supply and induce currency depreciation through inflation.

Central banks should prioritize safeguarding the purchasing power of savings and salaries rather than seeking to destroy them. Using new means of financial repression may lead to a loss of confidence in the local currency. Once central banks acknowledge that they have exceeded the appropriate limits of their policy, it will already be too late.

Central bank digital currencies are unnecessary and dangerous

The benefits of technology, digitalization and ease of transactions are already there. There is no need to create a currency issued directly to an account at the central bank.

They are unnecessary as well because there is absolutely no need to compete with a digital yuan or bitcoin. China is moving closer to sound monetary policy and its central bank is purchasing more gold, not the opposite.

If central banks want to compete with other currencies or cryptocurrencies there is only one way: Make it absolutely clear that you will defend the reserve of value status of your currency.

> It looks like central banks want to behave like a monopoly that sells bad quality products but demands to remain the main supplier by eliminating the competition

There is no need for the euro or the US dollar to compete with bitcoin or a digital yuan if the Fed and the ECB truly defend their reserve of value and purchasing power.

However, it looks like central banks want to behave like a monopoly that sells bad quality products but demands to remain the main supplier by eliminating the competition.

The Fed and the ECB do not need to compete against cryptocurrencies if they show the world that they will defend the purchasing power of the US dollar and the euro.

The world's financial challenges are not solved by imposing total control implemented by a monetary monopoly whose independence is seriously questioned, but by increasing competition and independence.