

Opinion **Markets Insight**

## CBDCs are set to transform how payments are made

Development of the digital currencies is gathering pace around the world

**OUSMÈNE JACQUES MANDENG**



In the early 19th century banknotes were seen by opponents as disruptive and prone to causing instability. The development of central bank digital currencies today is causing similar unease © Reinhold Thiele/ullstein bild via Getty Images

**Ousmène Jacques Mandeng** 9 HOURS AGO

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*The writer is a visiting fellow at the London School of Economics and Political Science and a senior adviser at Accenture. He has advised several CBDC projects.*

In the late 19th century, there was controversy in England over what some saw as a usurper to the established monetary order — paper banknotes. At the time, the use of paper currency to complement gold and silver coins was seen by opponents as unduly disruptive and prone to causing instability.

During 1891, the Financial Times reported that banknotes in England, unlike in Scotland, were met with such suspicion that it was difficult to use them in day-to-day payments.

A similar debate is under way on the development of central bank [digital currencies](#), which is gathering pace around the world. CBDCs are set to transform how payments can be conducted. About 11 countries have launched a CBDC, while 17 are running a pilot programme on them, according to a [tracker](#) from the Atlantic Council. A further 33 have one under development and 39 are carrying out research on CBDCs.

But some CBDC critics say they are not needed because the current system works, and they may bring unforeseen risks. This seems short-sighted, not taking into account

future payment needs.

The case for CBDC is a pragmatic one. They extend what central bank money can do, enhancing its utility to ensure it remains future proof. Part of a broader trend towards increasing diversification in payments, CBDCs support financial innovation and promote competition. That is a matter of fairness too. Since offering payment and settlement in central bank money is an advantage, alternative payment systems should have access to it.

Central banks currently issue banknotes for the general public and reserves for interbank high value payments. Banknotes are a physical token or bearer instrument and rely on the cash infrastructure including ATMs and cash registers. Reserves are book-entry or scriptural monies similar to a commercial bank deposit and live on account-based payments systems.

A CBDC is a digital token that typically circulates on blockchains or other platforms based on distributed ledgers to record ownership. In March, there will be key test for them — an EU pilot for market infrastructures based on digital ledger technology is scheduled to go live. It is meant to trial the adoption of trading and settlement of tokenised securities before regulation is amended to accommodate them.

DLT platforms offer many out-of-the-box capabilities and advantages. In the convoluted process of conventional securities trading, trade execution, clearing and settlement entail separate and multiple operations. These activities also often involve different entities.

In DLT-enabled securities trading, trade execution and settlement are one and the same. That is, the swap of a security token for a money token is the settlement.

Tokens can be exchanged on the basis of delivery versus payment instantly, meaning both legs of the transaction have to succeed, or neither do. Instant settlement would mean no open positions, no use of clearing, proceeds are immediately available and there would be no need for central counterparties and other risk mitigation measures.

CBDCs have also been instrumental in exploring new approaches to foreign exchange trading. In conventional foreign exchange transactions, the funding and settlement of trades are divorced. Processed through correspondent banks, long delays are common.

CBDCs outline an entirely new architecture, facilitating cross-border and offshore payments in an instant. They simplify, speed up and de-risk foreign exchange trading. This may allow CBDCs from smaller economies to play a more prominent role

This may allow CBDCs from smaller economies to play a more prominent role, leading towards more diversified international payments and reducing the reliance on the very narrow set of national currencies today. It may be one of the biggest contributions of CBDCs.

This may well be the year that will see the major adoption of CBDCs for securities settlements made real and important advances in the use of them for foreign exchange trading. The crypto world, a heavy user of blockchains, has seen difficult times lately. Central banks have remained undeterred to deploy the technology to facilitate CBDCs. It is an affirmation that cryptos and blockchain are two different things.

Central bank money has not seen many innovations since the adoption of modern banknotes. But now these institutions have a rare opportunity to shape the evolution of money itself.

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