Joachim Nagel: Central bank money in the 21st century

Speech by Dr Joachim Nagel, President of the Deutsche Bundesbank, at the DZ Bank Capital Markets Conference 2024, Berlin, 24 April 2024.

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1 Introduction

Good morning everybody,

It is my pleasure to open the third day of this year's DZ Bank Capital Markets Conference. Especially as the conference venue is located in the heart of the German capital.

The Pariser Platz has a mixed history. Originally built on the outskirts of the city, it became one of the grandest squares in Berlin, surrounded by important embassies and the finest hotel in town.

Later, it was almost completely destroyed during WWII, and following the construction of the Berlin Wall, it became part of the "death strip" that divided the city. In 1998, it was again filled with traffic before being converted into a pedestrian zone in 2002.

Thus, it is a symbol of transformation. And this is a good keyword for the topic of my talk today. However, I do not wish to talk about urban transformation, but about the transformation in payments and the central bank's response.

When the Brandenburg Gate was opened to cars in 1998, the payments landscape looked pretty different than today. Cash was king, one could say, and e-commerce was only in its infancy.

Today, banknotes and coins are still the preferred means of payment at the point of sale. But the share of cash payments in retail turnover has roughly halved.

In return, cashless payment methods have become increasingly important – a trend that is likely to continue. And a number of new digital payment solutions have been introduced.

The digital euro project aims to introduce a central bank digital currency (CBDC) for everyone.

Before I argue in more detail why I consider the step into the digital sphere useful and necessary for our central bank money, allow me to make a few comments on current monetary policy. I think this might also interest some of you.

2 Remarks on current monetary policy

The Eurosystem's response to the recent inflation surge was forceful and decisive. Starting in July 2022, we raised our key interest rates in ten consecutive steps by a total of 450 basis points. Moreover, we stopped purchasing assets and started to shrink our balance sheet.

The good news is that inflation has fallen significantly. From double-digit figures in the autumn of 2022 to 2.4 percent in March 2024. While this decline was due mainly to lower energy prices, monetary tightening is also bearing fruit.

According to the latest ECB staff projections, we expect the inflation rate to return to 2 percent on average in 2025. We are on a good path, but risks remain.

At present, I am not fully convinced yet that inflation will actually return to target in a timely and sustained manner. Core inflation remains high, especially inflation in the services sector. Driven by continued strong wage growth, it is more persistent than goods inflation.

By June, we will know a lot more, for example about wage growth in the first quarter. And this data will feed into new projections. If they help to increase our confidence in a timely and sustained return to 2 percent, I would be in favour of a rate cut in June.

However, such a step would not necessarily be followed by a series of rate cuts. Given the current uncertainty, we cannot pre-commit to a particular rate path.

The Governing Council will continue to decide – meeting by meeting and based on incoming data – how we proceed.

People trust us to soon restore price stability. We have to live up to this trust.

3 The digital euro – a matter of trust

Trust is also an important keyword when it comes to payments. Trust is the soul of money. [1] And in times of change, as we are currently experiencing, trust is particularly important.

Digital transformation has radically changed the payment landscape. We have seen many new players, including FinTech start-ups and BigTechs, who have successfully entered and established a prominent position in the payments market.

By offering innovative and convenient means of payment, they have challenged incumbent payment solution providers, even though they lack the same level of trust.

At the same time, cash is being used less and less. It cannot be used in digital payments, and it is also being used less at stores. In such an environment, the question arises as to the central bank's future role.

Cash is currently the only form of central bank money available to non-banks, including the general public. It is public money. All other means of payment for euro area citizens are provided by commercial issuers.

Public money is a cornerstone of our financial system. It does not only define the unit of account. In combination with regulation, it also ensures that a euro is (literally) equivalent to a euro, no matter who issued the means of payment.

In a digital world, it stands to reason that central banks are considering providing a digital alternative to cash. Not only the Eurosystem, but also many other central banks around the world are currently engaged in exploratory work regarding CBDC.

In November 2023, the digital euro project entered the preparation phase. This does not mean that a decision has already been taken as to whether a digital euro will actually be issued.

The ECB Governing Council will only be able to reach such a decision once the legislative process at the European level has been concluded. The introduction of a digital euro needs political backing and a solid legal framework.

A digital euro won't be introduced any time soon. It may take another four or five years before it is actually implemented.

4 The benefits of a digital euro

But how would a digital euro benefit consumers and merchants?

First, consumers would benefit from a European means of payment that is safe, convenient, fast, reliable, free of charge and usable throughout the entire euro area. As things currently stand, German bank cards, for example, don't always work in other euro area countries.

Consumers could use the digital euro for all kinds of payments: online shopping or in-store, for payments between individuals and even for transactions with public authorities. This is especially true if the digital euro acquires the status of legal tender, as it should.

Most people would pay with digital euro using either their existing online banking app (provided by their bank) or the digital euro app on their smartphone with baseline functionalities (provided by the Eurosystem).

But people who do not own a smartphone should also be able to make digital euro payments. One option currently under discussion by the legislators is the issuance of physical cards that would also be available to people without a bank account. The digital euro will be an inclusive means of payment.

Moreover, it is our intention to also make offline payments possible. This can be a useful functionality when there is no internet connection available (or in the event of a power failure).

Many people will appreciate the high level of privacy the digital euro will provide. There is no reason for anyone to be afraid of becoming a "see-through customer". While some critics argue that the digital euro would enable governments to monitor their citizens, the opposite is true.

In contrast to many commercial payment providers, the Eurosystem has no interest in monitoring people's payment patterns. The Eurosystem would not be able to identify people based on the payments they make. We would see only a minimal set of data necessary to fulfil Eurosystem tasks, such as settlement.

Banks and other payment service providers processing digital euro payments would not be allowed to use personal and transaction-related data for commercial purposes – unless users explicitly give their consent for them to do so. They would, however, have limited access to these data to the extent necessary in order for them to comply with anti-money laundering and counter-terrorism financing regulations. Offline payments would therefore be limited to low-value transactions.

Only cash offers a level of privacy comparable to the digital euro. And it won't be going anywhere. The digital euro would be a complement to cash, not a substitute.

Second, merchants would also benefit from a digital euro.

While they would have to compensate intermediaries for their services, legal safeguards should prevent them from being overcharged. The Eurosystem would bear its own costs as it does with cash today, and not charge merchants.

Today, retailers often feel obliged to offer their customers a variety of payment solutions, some of which are quite expensive. The digital euro would increase competition in the payments market. Merchants could negotiate lower transaction fees with private payment service providers.

Another advantage of the digital euro is that merchants would receive payments instantly, by means of instant settlement. Just like cash, this would allow goods and money to be exchanged simultaneously. There would be no outstanding claims.

That said, some people doubt whether we need a digital euro at all, as there are already enough payment methods available – at the point of sale, for online and for mobile-to-mobile payments. But I am confident that both consumers and retailers would appreciate the benefits of having a single payment instrument that ticks all the boxes – online and offline.

And what is more, banks could benefit from it, too. They could make use of a public European infrastructure as a vehicle for innovation, providing creative and new services to their customers.

The digital euro is not in competition with the European Payments Initiative, of which DZ Bank is a founding shareholder. Rather, they complement each other. The planned "Wero" wallet, for example, could integrate the digital euro.

Moreover, it can only be in the banks' interest for Europe to reduce its reliance on non-European payment infrastructures. Europe needs to become more resilient and independent.

Nevertheless, banks have their share of concerns when it comes to the digital euro. They are afraid that the digital euro might become an attractive substitute to bank deposits. Banks could lose an important source of funding. This could cause structural disintermediation and reduce banks' ability to provide credit.

Even if deposits remain attractive enough in normal times, a digital euro might facilitate a bank run if a bank's liquidity becomes questionable. Some critics even fear that a digital euro would become a source of financial instability.

The Eurosystem is aware of the potential risks and will take the necessary precautions to make sure that they do not materialise.[2]

First, the Eurosystem has no intention of remunerating digital euro holdings. And second, there will be a holding limit. Both measures underline that the digital euro is not meant to be a store of value.

As users could link their digital euro wallet to their commercial bank account, they could also conveniently settle transactions that exceed the holding limit. For example, when buying a used car.

The maximum amount will be low enough to ensure that banks will be able to cope with an additional demand for liquidity. Bundesbank analyses have shown that given present liquidity levels and the holding limits currently under discussion, any additional demand is likely to be manageable. [3]

We would see to it that people will not use the digital euro as a store of value, but as a means of payment, as intended. Rest assured that the Eurosystem has every intention of retaining the tried-and-tested two-tier banking system in the euro area.

5 Conclusion

Ladies and gentlemen,

Ken Olsen, the founder of Digital Equipment Corporation, said in 1977, There is no reason anyone would want a computer in their home. How wrong he was!

And when the Brandenburg Gate was opened to cars in 1998, few would have thought that almost everyone today would be using a smartphone.

I am sure that many people would have said that they neither need nor want a tiny computer in their pocket. But most of them changed their mind when they saw it in practice. The same may well happen with the digital euro.

The Pariser Platz has seen many transformations since it was built at the margins of Berlin (as I mentioned at the beginning). Today, it is one of the most central places in Berlin and one of the city's most visited landmarks.

The extension of central bank money into the digital sphere is also regarded by some as a marginal issue. And some are even afraid that it might do harm.

However, I am convinced that the digital euro will be a success and will deliver benefits to all. It will become a central place in the payments landscape. Like the Pariser Platz in the heart of Berlin.

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[1] Carstens, A. (2023), Digital Currencies and the Soul of Money, in: A. Dombret, P. S. Kenadjian (eds.), Data, Digitalization, Decentralized Finance and Central Bank Digital Currencies, Berlin / Boston.

[2] Bindseil, U., P. Cipollone and J. Schaaf, Digital euro: Debunking banks' fears about losing deposits, The ECB Blog, 19 February 2024.

[3] Deutsche Bundesbank, Financial Stability Review 2023, p. 76 and the subsequent box.