RBI to introduce Central Bank Digital Currency in phases: deputy governor

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The Reserve Bank of India (RBI) will introduce its own version of Central Bank Digital Currency (CBDC) in a phased manner and after carefully weighing its impact on various issues, including how it could hamper the deposit mobilisation abilities of banks, and its potential effect on the conduct of the monetary policy, deputy governor T Rabi Sankar said in a speech on Thursday.

“However, conducting pilots in wholesale and retail segments may be a possibility in near future,” the RBI deputy governor said.

The RBI is currently working towards a phased implementation strategy and examining use cases "which could be implemented with little or no disruption,” Rabi Sankar said in an online discussion on the issue, organised by Vidhi Centre for Legal Policy.

The RBI has been exploring the pros and cons of the introduction of CBDCs “since quite some time,” he said. The Indian central bank will also draw upon the lessons from other countries that are in various stages of introducing such a digital fiat currency.

In particular, the Indian central bank would evaluate the scope of CBDCs -- whether they should be used in retail payments or also in wholesale payments. The underlying technology, whether it should be a distributed ledger or a centralised ledger, is also being evaluated. Whether the underlying technology should vary based on use cases is being debated at the central bank.

Besides, other modalities such as token-based or account-based validation mechanism, distribution architecture (direct issuance by the RBI or through banks), and what would be the degree of anonymity granted for such CBDCs are also being determined at the RBI.

While the issue of CBDC has been touched upon by the RBI Governor himself, this is the first detailed discussion on the issue from a central bank official.

The issue of CBDC has crept up in the last few years with the advent of private virtual currencies, such as bitcoins. While these private currencies have their own benefits, they are not backed by any government and therefore do not follow any proper jurisdiction. The wide adoption of these currencies threatens to upend the established model of fiat currencies issued by countries within a border.

Besides, if the virtual currencies gain recognition, “national currencies with limited convertibility are likely to come under threat,” Rabi Sankar said, adding such private currencies can therefore have potentially damaging social and economic consequences.

Rabi Sankar noted that India is the leader in the world today in terms of digital payments systems, growing at 55 per cent compounded annual growth rate for the past five years. But Indians also prefer to use cash for small-value transactions up to Rs 500. This puts the nation in a unique position where both digital and cash transactions are practiced equally.

The introduction of CBDC would unlikely hamper the usage of cash, but if anonymity is ensured, then transactions can switch over from cash to digital means.

"India's high currency to GDP ratio holds out another benefit of CBDCs. To the extent large cash usage can be replaced by CBDCs, the cost of printing, transporting, storing, and distributing currency can be reduced," he said.

Nevertheless, it will take time for a wider adoption especially as most of the population are not tech-savvy enough, and the risk of cyber crime will continue to pose challenges in the case of CBDCs as well.

The adoption of CBDCs can also have important implications for the banking system. CBDCs can cause a reduction in the transaction demand for bank deposits and will reduce the intra-day liquidity for settlement of transactions. They could also cause a shift away from bank deposits.

"At the same time, reduced disintermediation of banks carries its own risks. If banks begin to lose deposits over time, their ability for credit creation gets constrained. Since central banks cannot provide credit to the private sector, the impact on the role of bank credit needs to be well understood," he said, adding losing deposits would mean the cost of credit would increase for banks.

The wider adoption of CBDC may also mean that the monetary policies have to be formed in a way to inject more liquidity in the system than needed to plug currency leakage from the banking system.

Therefore, the RBI will introduce the CBDC after careful consideration, and in any case, keeping India's leadership position in the global payment system in mind, the deputy governor said.