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Monetary Policy scenario for the ECB

The ECB increased the reference interest rates by 25 p in its July meeting, as expected. Additionally, it placed the remuneration of the minimum reserves at 0%, which was not anticipated, and therefore negatively and temporarily affected bank prices. Moreover, the wording regarding future decisions was slightly modified so as not to rule out a possible pause in the September decision.

Inflation continues to decline but is still expected to remain too high for too long. The euro area annual inflation rate was 5.3% in July 2023, down from 5.5% in June. A year earlier, the rate was 8.9%. The expectation is that inflation will drop further over the remainder of the year but will stay above target for an extended period. Having said that, underlying inflation remains high overall. The past rate increases continue to be transmitted forcefully: financing conditions have tightened again and are increasingly dampening demand, which is an important factor in bringing inflation back to target.

The Governing Council will continue to follow a data-dependent approach.

The case for a digital €

A digital euro could fix several market inefficiencies:

- Lack of cross-border payment services inside Eurozone
- Costs charged to businesses by payment services providers
- Lack of European payment services providers

There are several different motivations that could justify the issuance of a central bank digital currency. In our case, we believe a digital euro could address two developments we are observing in the payments market.

On the one hand, the increasing use of digital services imply that we are relying more and more on private digital means of payment. While these private solutions are very efficient, there is a need to ensure that citizens can still use central bank money, even in a digital world, since it is the anchor that underpins our trust in the currency and ensures the well-functioning of the financial system.

On the other hand, as you know, Europe has high dependencies on external providers for digital payments, and developments such as foreign CBDCs or stablecoins may just deepen this situation. In this context, a digital euro would provide a payment solution based on European infrastructure and accepted throughout the entire euro area, hence increasing the resilience of our economy and our society.

We, as supervisors, must always scrutinize the business and social trends that might have an impact on banking business models. It is a fact that the use of digital payments has increased in the last years and accelerated during the pandemic. Therefore, this is a reasonable rational for the ECB to explore the use of the digital euro as a new payment system. Nevertheless, the financial stability is the goal of our activity and our responsibility and commitment, and consequently, we need to identify and measure the impact of the digital euro on our banking system before any final decision is made.

The right holding limit for digital €

The issuance of a digital euro should not be in detriment to the stability of the financial system as I previously mentioned. Different tools may be implemented to avoid this unintended consequence, and at the Eurosystem we have concluded that setting a limit on the amount of digital euros that users may hold would be the most appropriate one. In fact, this conclusion is backed by the European Commission's legislative proposal. However, we also realize this limit cannot be so low that it renders the digital euro unappealing and, ultimately, ineffective to address the issues previously mentioned.

So, what is the right holding limit? Unfortunately, I cannot produce the magic number you are asking for, mainly for two reasons.

Firstly, we have only carried out preliminary analysis. These indicate that a 3,000 euro limit would be in line with retail user needs and avoid negative effects on the financial system. It seems this conclusion is shared by the European Commission, as per the report they published in conjunction with the legislative proposal. Nevertheless, as I said, our analysis is preliminary and this reference is just a working assumption for the moment.

The second reason for not having a figure yet is that we cannot really make such a decision so ahead in time. The determination of the holding limit will be strongly conditioned by the economic context at the time of issuance, so any further analysis and the corresponding decision on this matter need to take place closer to the issuing date.

That said, let me assure again that we are committed to finding the right balance between safeguarding our financial system and making sure the digital euro adequately covers the needs of the users. These two factors are guiding us in all our design decisions, including finding the right holding limit.

We are fully aware of our firm commitment with the financial stability. Despite the robustness of our banking sector, we cannot ignore the elements that might impact the competitiveness and profitability of the banks. Digital Euro is a project that has to be assessed from different angles:

1 impact on banking **business models** (given that payment systems are usually a recurrent source of income).

2 **liquidity:** it is important to gauge the overall impact of digital euro on bank´s liquidity situation as a result of the transfer of money from banking accounts to digital euro wallets.

3 financial stability: the 2 previous mentioned items might have an impact on financial stability. This need to be assessed not only from a macro but also micro perspective. We need to bear in mind that the micro supervision and viewpoint is the cornerstone of a strong banking supervision, complemented by a macro analysis.

Baking business is based on confidence and as we have experienced in the last months, it can be quite vulnerable to turmoils and unexpected events. This is the main reason why the potential issuance of the digital euro has to be underpinned by this previous assessment.

The interaction between private payment solutions and the digital €

The digital euro doesn't intend to displace private payment solutions, but rather to increase the number of options users have to make payments. In a dynamic and growing market such as the one we are in, <u>we believe there is enough space for a digital euro and private payment solutions to co-exist</u>.

We must remember, also, that our aim is to design a basic means of payment. It will be up to the intermediaries to add on it by building value-added services, if they so wish. In fact, <u>our expectation is that the digital euro enables the development of new pan-European payment and financial services by the private sector,</u> making it easier to compete with non-European solutions. Ultimately, a digital euro should stimulate innovation, foster competition and enhance resilience in the European payments market.

I personally support any initiative that might foster further European innovation and integration. I believe that the digital euro is one important step to improve the European payment system and as a consequence, the European financial system.

Users should be fully aware that the digital euro would be designed similarly to cash. In this sense, privacy is a key element on its definition. Likewise, the digital euro would not be covered by any common deposit protection scheme.

Having said that I would like to take this opportunity to stress the importance of fully supporting the set up of EDIS (European deposit insurance scheme) as a continuation of the European project, granting a common protection of European deposits once we have already achieved a common supervisory and resolution authority. I firmly believe that European banks are in a robust situation so there is no reasonable excuse to finish up the third pillar of the banking union.

Striking right balance between privacy and security

A fundamental premise of the digital euro is <u>to minimise the processing of personal data by both payment service providers and the ECB/NCBs</u> to the extent it is necessary to ensure its proper functioning. As a result, the ECB and the NCBs will neither be able to attribute data to a specific user nor be in a position to infer a given payment behaviour.

That said, security is, of course, of utmost importance. Hence, payment service providers should have similar levels of visibility as they have today with private payment solutions. As such, in their role as controllers, they will handle the required personal data so as to be able to fulfil certain public interest obligations (e.g. preventing fraud, combatting money laundering and tax avoidance) or, alternatively, with a view to enforcing various security and operational requirements such as the application of holding limits, the initiation of funding/defunding transactions or the management of local storage devices for off-line payments.

A peculiar scenario is that of off-line proximity payments which greatly resemble the experience of cash. As such, privacy levels become comparable to withdrawals of banknotes at ATMs meaning that Payment Service Providers (PSPs) are not involved, and hence do not have visibility, in transaction processing but rather only in the loading and unloading of funds into/from the registered local storage device.

In conclusion, <u>our citizens must be confident that their privacy will be ensured</u>. There is no intention or reason to scrutinise where or how much individuals spend their money. Data privacy is one pillar of the European regulation and we fully support it.

The digital € outside the Eurozone

Preserving the international role of the euro in a growingly digitalized world is one of the many dimensions the introduction of a digital euro can contribute to. As such the potential cross-border use of a digital euro has certainly been already addressed -although preliminarily- by both the Eurosystem and the European Commission.

<u>The Eurosystem favours first enabling access for euro area residents, merchants and governments</u>, thus facilitating the achievement of prioritised use cases within the euro area. It also supports extending those rights to non-resident euro area citizens that have an account with a euro area PSP. Furthermore, it foresees the possibility for merchants outside the euro area to accept digital euro payments indirectly, thus ultimately relying on private money as provided by a collecting PSP that is located in the euro area. Conversely, access for consumers in the EEA and selected third countries is seen as part of the future.

The final goal behind this step-based approach is twofold. On the one hand, consolidating the digital euro in its primary market before venturing into others. On the other hand, helping to minimize any potential distortions that a hasty foreign adoption of the digital euro might entail for those jurisdictions and for the Eurosystem's balance.

As it currently stands, the proposal for a Regulation on the establishment of a digital euro is pretty much aligned with the above roadmap in that it calls for an agreement and the fulfilment of a number of conditions ensuring a level-playing field across territories ahead of any potential distribution of the digital euro outside the confines of euro area.

As regards the possibility of making retail payments that entail a cross-currency conversion, the regulation remains silent. Yet, the Eurosystem is open to explore these functionalities where there are mutual interests with other jurisdictions. Obviously, making this work in practice implies a significant number of technical and business challenges featuring a wide range of costs and complexities.

The digital € as a mean to increase financial inclusivity

In our current world, being able to pay digitally is a basic need for people and so, it should be secured no matter what the particular circumstances of individuals might be. Thus, financial inclusion has certainly been addressed in the design decisions of the digital euro but given its complexities, this topic cannot be solved by merely introducing a digital euro.

As such, the Eurosystem has been vocal about the need of assigning the digital euro a legal tender status that would guarantee its wide acceptance. It has also called on regulators to act in order to require payment service providers to make the digital euro available to the broad population. Both these dimensions have been covered in the current regulatory proposal.

In more practical terms, the Eurosystem has been paying attention to not creating material barriers that could foster exclusion. In that respect, the Eurosystem is promoting an easy to use app which is compatible with the European Accessibility. It further requests offering a physical payment card for those who prefer so. In addition, it currently foresees an offline functionality that will support payments even in areas with poor network coverage.

Union co-legislators have picked up on these efforts and, for example, banned fees on natural persons for the provision of basic services. They further prevented PSPs from requesting the opening of a non-digital euro account or the signing of any other type of contractual agreement prior to being granted access to the digital euro. What's more, the proposed regulation asks PSPs to provide the necessary support to vulnerable groups, including the availability of human interaction to guide users through onboarding and transaction execution. Last but not least, regulation mandates Member States to designate authorities or post office giro institutions that can ultimately become access points to digital euro services to the unbanked as well as people with disabilities and/or low digital or financial skills.