

Opinion **Digital currencies**

Digital currencies carry threats as well as promises

The proliferation of new financial technologies calls for better cross-border regulation and supervision

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The cryptocurrency revolution unleashed new technologies that make cheaper and practically instantaneous payment feasible © Paul Yeung/Bloomberg

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The emergence of digital currencies, both private and official, is shaking up domestic and international finance. This will yield many benefits but some things will remain much the same. There are risks, too, with developing economies potentially finding themselves on the wrong side of a widening global financial divide.

Consider international payments, which are [inherently complicated](#). They involve multiple currencies, payment systems operating on diverse protocols and institutions governed by varying regulations. So, cross-border payments tend to be slow, expensive and difficult to track in real time.

[New technologies](#) spawned by the cryptocurrency revolution are making cheaper and practically instantaneous payment and settlement of transactions feasible. This will alleviate payment-related frictions in international trade. Economic migrants sending remittances back home will also benefit.

Changes are afoot in foreign exchange markets, too. For instance, transactions between pairs of emerging market currencies are becoming easier. China and India will no longer need to exchange their respective currencies for dollars to conduct trade. Rather, exchanging renminbi for rupees directly will become cheaper. Consequently, the reliance on [“vehicle currencies”](#), particularly the dollar, will decline.

The prospect of a digital renminbi being available worldwide has heightened [concerns](#) (or excitement) about the dollar finally receiving its comeuppance. The digital renminbi by itself will not, however, shift the balance of power among major currencies. After all, international payments are already digital. Rather, it is [China's Cross-Border Interbank Payment System](#), which can communicate directly with other countries' payment systems, that will enhance the renminbi's role as an international payment currency. The CIPS even has messaging capabilities that could sideline Swift, which currently monopolises messaging for all transactions between banks in different countries.

These changes have geopolitical implications. The dollar-dominated global financial system and American influence over Swift have long given US financial sanctions real bite. This has rankled rivals such as Russia and even [allies exposed to secondary sanctions](#). The efficacy of such sanctions will erode.

Still, digitisation by itself will hardly elevate the renminbi's status as a reserve currency, an international store of value. China has made progress on removing restrictions on cross-border capital flows, in addition to broadening foreign investors' access to its bond markets. But the government has resisted the institutional changes — including the establishment of an independent central bank and the rule of law — that are essential to garnering the trust of foreign investors.

The dollar's role as the dominant reserve currency is likely to persist, even if its status as a payment currency erodes. A likelier prospect, though, is a reshuffling of the relative importance of other currencies, while the dollar retains its primacy. Indeed, [private stablecoins](#) backed by US dollars might well gain more acceptance worldwide than those backed by other currencies, thereby bolstering the dollar's prominence.

[Developing countries will benefit](#) from new financial technologies that improve their access to global financial markets. However, the proliferation of channels for cross-border capital flows will exacerbate their vulnerability to the vagaries of major central banks' policies and the whims of international investors.

Moreover, small countries and those with central banks or currencies that lack credibility could be overrun by non-native digital currencies. The easy availability of digital versions of the major currencies, or even stablecoins issued by multinational corporations or global banks, would pose an existential threat to many national currencies. As [Turkey's recent experience](#) highlights, even a volatile cryptocurrency might be preferred to the local currency at times of economic turmoil.

The proliferation of digital currencies and new technologies calls for greater cross-border coordination of regulation and supervision. International institutions such as the IMF will have a crucial role in helping limit collateral damage inflicted on vulnerable economies.

These technologies are binding the world's economies and financial markets closer together. But left to itself, this brave new world could exacerbate global economic divides rather than bridge them.

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