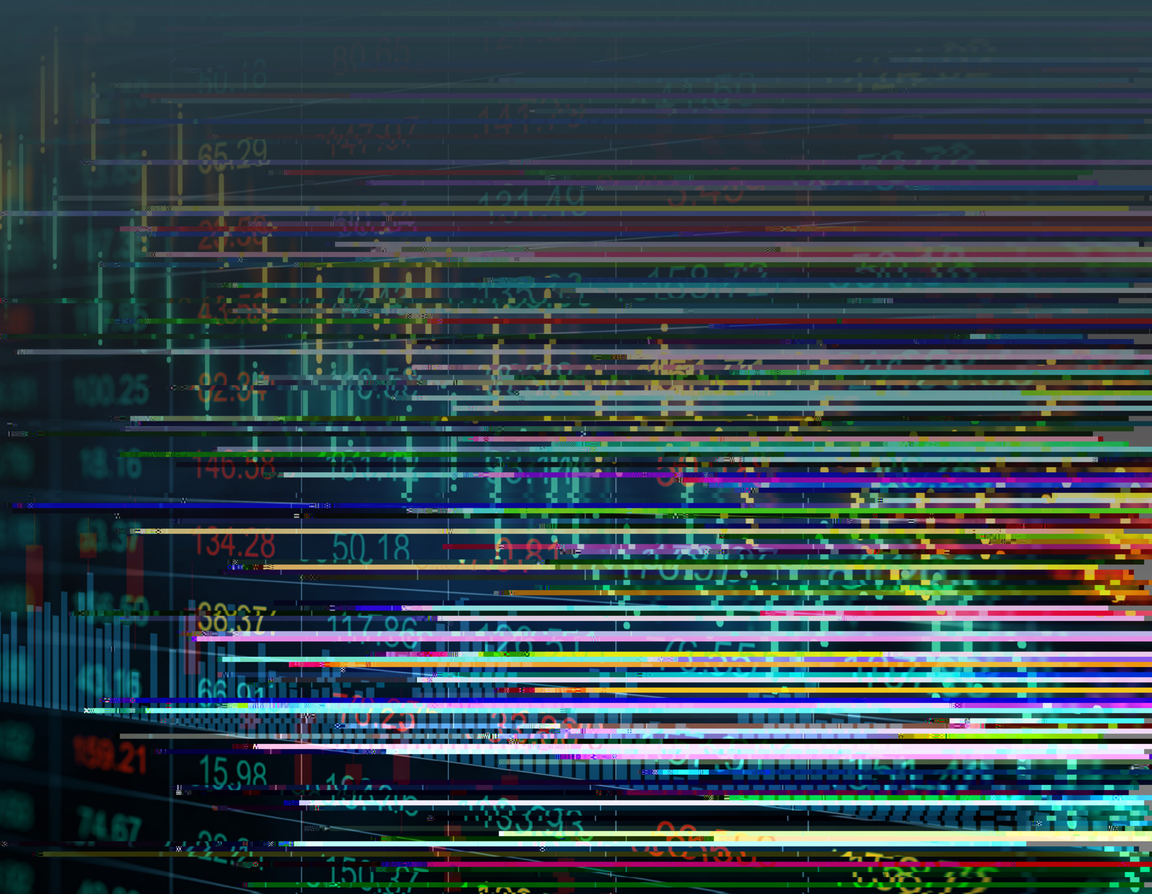

For decades, the U.S. dollar has been the world's preferred currency both for trade and nancial transactions. To date, it has been the predominant global reserve currency and its importance goes well beyond the size of the U.S. economy.[1] O entimes, the in uence of the U.S. dollar in international markets has been regarded as an unfair bene t to the United States both from an economic and geopolitical point of view.[2]

Two developments have emerged over the past 20 years to challenge the greenback's dominance, namely the Euro's launch and China's expansion. e launch of a common European currency uniting Europe in 1999

brought together a large economic area of countries with well-developed nancial markets. Meanwhile,as China overtook Japan as the world's second largest economy in 2010, imagining an increas0, imagi2P 036 Tw 1(s)0.5 (b)-5.5 (o currency to be a good form of domestic money. Money is a medium of exchange, and assets denominated in its unit of account need to be liquid and perceived to be safe.

on the attractiveness of a particular currency, as we are witnessing today with the sanctions associated to the Russia invasion of Ukraine. e control that the United States exercises over U.S. dollar-denominated transactions and the possibility of politically motivated sanctions can change the perception of liquidity of the U.S. dollar relative to other currencies. Russia has been increasing the share of the Chinese renminbi in its foreign reserves and recently it has started invoicing in rubles.[7]

Authoritarian regimes in particular are expected to continue looking for alternatives to diversify away from the U.S. dollar and the political constraints it poses. Assuming that is the case then the Euro is unlikely to be a good option , as Western Europe is likely to be in sync with the United Statesin future potential con icts. e Chinese renminbi, on the other hand, is a more natural candidate because it is more likely to deviate from U.S. sanctions, not to mention the fact that the Chinese economy's importance is growing stronger. . Yet there are several factors that hamper its growth. Chinese nancial markets do not yet provide the necessary liquidity that the world needs. In addition, the restrictions on capital ows are inconsistent with the notion of a global liquid asset pool. While the Chinese government has expressed its

Historically, central bankshave been managing a digital version of their currencies in the form of reserves of commercial banks at the central banks which are used to settle payments. Nonetheless, many central banks believe that they need to go beyond what they do today for several reasons. First, physical cash is disappearing worldwide. Should there be a point when electronic payments become the default and cash is no longer accepted , it would mean that there would be no public form of money available and that the private sector would be in total control of the payment system. At the same time, central banks feel the need to have an alternative to existing private forms of digital payments to improve on the e ciency of the system, provide resilience and avoid the possibility of monopoly power by big players (for example BigTech rms in China).

When it comes to complementing or improving the current payment infrastructure, central banks can focus on wholesale or retail CBDC. In wholesale CBDC, central banks open up access to their balance sheet to an increasing number of institutions. is can help make the payment market more competitive and e cient, but it would not address the rst concern, namely the need for a digital equivalent of cash. In order to do that they would need to create a *re ail CBDC* systemwhere there would be access for all including individuals.

Many central banks are either planning for or currently running projects for retail CBDC.[11] e Chinese central bank has already run a pilot for it, while the European Central Bank has produced a series of documents and is workk Br7s not yet ready for this fight, and they do not plan to replicate the full payment infrastructure. So far, most are thinking of relying on what is called the hybrid model of CBDC where private payment providers will facilitate access to the new digital currency.[13] In practice this means that while an individual will have access to the liability side of the central bank balance sheet, its use as a means of payment will still require the private payment infrastructure. In this environment, CBDC is unlikely to displace current forms of digital money. In addition, the central banks will have a hard time achieving other goals such as financial inclusion or resilience or improved competitiveness given the dependence on the private sector.[14]

Meanwhile, the future of CBDC taking off as a global currency will depend on a number of factors CBDC will need to be available to foreigners as a global currency, and most central banks have not made up their mind on this issue in part because issues such as privacy or regulatory conditions for CBDC have not been resolved . Today foreigners can have access to physical cash, but it is very difficult for them to have access to private digital versions of the currency held at bank accounts because in most countries regulations imposes residency requirements to open a bank account.

The real question is one of regulation. So long as the current regulatory environment remains unchanged, CBDC will do very little to increase the global use of a currency. It is possible that small CBDC balances are provided to foreigners in a way that resembles cash (anonymous, without KYC requirements and possibly available for offline use). This could be useful to help tourists execute certain payments, but it will have limited impact on the global use of a currency.

One other area where CBDC could make a substantial difference is

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border payments that is much more efficient than the current outdated, slow and expensive system. That in turn would make it easier for companies to price and operate in foreign currencies, boosting the importance of currencies such as the tenminbi that are likely to grow as trade increases. But this scenario is more about the regulatory and technology environment than about CBDC per se. In fact, some of these developments could involve private institutions and can take place without issuing a retail CBDC. For example, if central banks were to provide direct access to their balance sheet to institutions that specialize in cross-border payments and these institutions were allowed to manage large account balances, holdings of foreign currencies could be as frictionless as holdings of domestic currency. This is already happening in some jurisdictions but at a slow speed because of the conservative approach by central banks and regulators.[15]

Innovations in digital money, including the possibility of central banks issuing retail CBDCs, is seen by some as a potential inflection point in the competitive landscape among the largest currencies. That scenario, however, is unlikely. The historical dominance of the U.S. dollar is likely to remain in place and challenges to its position will come not from the rise of digital currencies, but elsewhere. The expansion of the Chinese economy in international trade will remain the biggest source of competition for the dollar's prominence. This combined with the additional cross-border payment systems that the Chinese

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