

DIGITALIZATION OF (LEGAL TENDER) CURRENCIES: *OVERVIEW OF CURRENT MARKET INITIATIVES AND IMPLICATIONS FOR THE FX MARKET*

Presentation to the ECB FXCG

September 21, 2021

WIDER PRIVATE CRYPTOCURRENCY ADOPTION TAKES PLACE...



Bitcoin now introduced as official currency

EL SALVADOR TO START, PANAMA AND UKRAINE TO FOLLOW?

El Salvador

- officially enabled Bitcoin as legal tender and official currency on 7th September 2021.
- Connectivity takes place via an app, that offers citizens \$30 of free bitcoin.
- The government announced that it purchased additional 150 Bitcoins on the launch, bringing its total holdings to 550 Bitcoins (~\$25mio). The programme is backed by a \$150mio government fund that was approved at the end of August.
- The change means businesses should accept payment in bitcoin alongside the U.S. dollar, which has been El Salvador's official currency since 2001 and will remain legal tender.

Panama

- On 8th September 2021 Panamanian Congressman Gabriel Silva introduced a bill designed to provide "legal, regulatory, and fiscal certainty to the use, holding and issuance of digital value and crypto assets in the Republic of Panama.,,
- The bill, entitled "Crypto Law: Making Panama Compatible with the digital economy, blockchain, crypto assets, and the internet," was announced on Twitter by Silva.

Ukraine

- passed a draft law to legalize cryptocurrencies the day after El Salvador's Bitcoin Law came into effect, with a view to open up the crypto market to businesses and investors by next year.

...AS THE CRYPTOCURRENCY SPACE EVOLVES



Catering for different participants

STABLE COINS AND PRIVACY COINS SEE INCREASED DEMAND

Parallel trends that cater for investors searching for:

1. the benefits of cryptocurrencies but less volatility = **stable coins** (e.g. Tether, USD Coin, Binance USD etc.)
2. The benefits of privacy and disguise of origin = **privacy coins** (e.g. Monero, Zcash, DASH, Horizen, Verge etc.)

The introduction of CBDC's bring change to FX and could even become a regulatory tool, if pre-programmed against a conversion into private cryptocurrencies (something that can't be done with fiat cash that is in circulation).

COUNTRIES STEP UP REGULATION IN DIFFERENT WAYS



Approach of China vs. US

CHINA'S CRYPTO-REGULATION IS ACCOMPANIED BY THE LAUNCH OF A RETAIL CENTRAL BANK DIGITAL CURRENCY*

China

- In China regulators already drew the line early on. Crypto mining is banned and the ability of Chinese individuals and entities to participate in cryptocurrency is limited. As recent as May the Government issued warnings to the country's financial institutions to stop cryptocurrency activities.
- **Simultaneously China rolls out its own retail Central Bank Digital Currency (CBDC).** E-RMB tests first began in April of 2020 and as of July 2021 1.3million outlets use e-RMB, nearly 21million retail e-RMB wallets are opened and transactions of 5.3bn USD in value have been facilitated.
- A pilot for foreigners attending the Beijing Winter Olympics is planned.
- Moreover, the PBOC in its CBDC whitepaper stated it is exploring cross-border payments using the Digital Yuan and seeks to participate in discussions on setting Global CBDC standards (Multiple CBDC Bridge project with the BIS*).

US

- U.S. Securities and Exchange Commission Chair Gary Gensler put the cryptocurrency industry on notice of how far he'll go to bring it to heel. In threatening to sue Coinbase Global if the exchange lets customers earn interest on digital tokens, the regulator sent a warning to other firms offering similar products or even just thinking about it.
- Most recently treasury officials recommended stricter oversight of stable coins and Tether in particular.
- Federal Reserve Bank announced it will issue a discussion paper on the digital dollar – expected in September 2021.
- Federal Reserve Chair Jerome Powell has repeatedly said that the Fed is not eager to be first with a CBDC but wants to get it right, if it goes down that road at all.

* Retail central bank digital currency (CBDC) focuses specifically on the general public. A retail CBDC would therefore allow households and businesses to make payments directly and store value using an electronic form of central bank money.

Sources: Bloomberg, Reuters,* https://www.bis.org/about/bisih/topics/cbdc/mcbdc_bridge.htm

...WHAT IS NEXT?

What will the impact of CBDC's be on the FX market?

POTENTIAL IMPLICATIONS ON EXCHANGE RATES AND THE INFRASTRUCTURE OF THE FX MARKET

Therefore we should discuss with a forward looking angle:

What could be the impact of CBDC's:

A) on the FX market as it exists today and

B) on private cryptocurrencies, as they are added to the FX suite (and the sell- & buy side is embarking on trading it)?

How about:

WHAT WILL THE IMPACT OF CBDC'S BE ON THE FX MARKET?



Potential implications on exchange rates and the infrastructure of the FX market

RESERVE CURRENCY VALUATIONS TO CHANGE & RENEWED PRESSURES ON FX MARGINS WITH INCREASED EFFICIENCIES

Geostrategic:

- An overhaul of the composition of global FX reserves could take place
- The IMF defines foreign exchange reserves as “official public sector foreign assets that are readily available to and controlled by the monetary authorities” (IMF 2001). This definition lends itself to be extended to the best practices of reserve management, like prudent liquidity and credit risk management or the generation of a steady cash flow.
- Would a digital currency, or more generally a digital asset, qualify as a reserve instrument? So far, only a very limited subset of the existing asset universe enjoys reserve status.
- According to the IMF, worldwide allocated reserves amounted to \$11.9 trillion at the end of 2020, of which roughly 80% were denominated in either US dollars or euros.
- **Would a first movers advantage in launching a Central Bank Digital Currency result in substantial shifts in flow, changing that current composition?**

Valuations:

- If countries are able to build wholesale, cross-border CBDC mechanisms at scale, these payment systems could begin to replace SWIFT and other messaging systems as the preferred bank-to-bank transfer system. **This could reduce the share of international trade and capital flows denominated in USD?**

Infrastructure:

- Distributed ledger technology (DLT) could have numerous benefits when applied to clearing and settlement of FX (e.g. less counterparty risk, lower settlement fees, fewer intermediaries, higher level of transparency).
- DVP provided by clearing houses and t+2 trading to account for time differences in settlement in FX become obsolete. **Would a higher degree of standardization pave the way for an exchange traded model?**
- Efficiencies will most likely lead to continued pressure on margins (less ticket cost, less credit risk).

Sources: Bloomberg, Reuters, IMF

IMPORTANT INFORMATION



DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they operate their business activities. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively “DWS”) are communicating this document in good faith and on the following basis. This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

The document was not produced, reviewed or edited by any research department within DWS and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other legal entities of DWS or their departments including research departments.

The information contained in this document does not constitute a financial analysis but qualifies as marketing communication. This marketing communication is neither subject to all legal provisions ensuring the impartiality of financial analysis nor to any prohibition on trading prior to the publication of financial analyses. This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author’s judgment as of the date of this document. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/ or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained in this document. Past performance is not guarantee of future results.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information. All third party data are copyrighted by and proprietary to the provider. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of any investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to any transaction.

No liability for any error or omission is accepted by DWS. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. DWS or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document may not be reproduced or circulated without DWS written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

© 2021 DWS Investment GmbH

Issued in the UK by DWS Investments UK Limited which is authorised and regulated by the Financial Conduct Authority (Reference number 429806).

© 2021 DWS Investments UK Limited