Chapter 22
Understanding the Impact of CBDCs on Financial Stability:
The Shift Towards a User-Centric Financial Ecosystem

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ABSTRACT

The development of digital banking and the introduction of cryptocurrencies have drawn considerable attention to central bank digital currencies (CBDCs) in the global financial system. Policymakers, economists, and business experts are debating the deployment of CBDCs and their effects on financial stability as central banks examine their potential. In order to investigate the possible risks and advantages of CBDCs for financial stability, this study presents a thorough narrative literature review that critically evaluates a wide range of academic publications, reports, and research studies. This study also highlights the necessity of a user-centric financial ecosystem that incorporates Web 3 concepts. It also explores the significance of carefully constructed CBDC frameworks by looking at the potential impacts of CBDC adoption on monetary policy, systemic risks, and banking intermediation.

1. INTRODUCTION

Central Bank Digital Currencies (CBDCs) have become a significant subject of debate and investigation in the international financial system. The idea of establishing CBDCs is a result of how the world of digital finance is changing and the popularity of cryptocurrencies like Bitcoin (BTC) and Ether (ETH). As a result, central banks have realized the need to investigate the possibilities of digital currencies they issue and regulate as technology advances continue to disrupt the financial sector (Coulter, 2023).

Policymakers, economists, and business professionals are all very interested in and debating the prospective implementation of CBDCs. Advocates claim that CBDCs can increase financial inclusion, simplify payment processes, lower transaction costs, and boost the efficacy of monetary policy (El Attar

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& ChaIoui, 2023). Given the complex interactions between digital currencies and the larger financial ecosystem, worries and uncertainty about the possible impact of CBDCs on financial stability still exist.

The purpose of this paper is to conduct a narrative literature review on how CBDCs affect financial stability. This research aims to offer insights into the potential risks and benefits connected with the use of CBDCs by critically analyzing and synthesizing a wide range of academic publications, reports, and research studies. For regulators and market actors to successfully manage the emerging world of digital currencies, it is critical that they have a thorough understanding of the implications of CBDCs for financial stability.

This narrative literature review aims to conduct a comprehensive analysis of the existing knowledge on central bank digital currencies. Additionally, it will assess the degree of agreement or disagreement among academics and point out any research holes that need to be filled. The review's conclusions will add to the continuing debates over CBDCs and their possible effects on financial stability. The findings offered by this review will be useful to policymakers, central banks, academics, and business experts who are attempting to evaluate the risks and advantages of CBDC adoption.

In the sections that follow, the researcher will examine the body of research on CBDCs, describe the review, present findings and analysis, talk about how CBDCs affect financial stability, and conclude with suggestions for future research.

2. LITERATURE REVIEW

Various significant variables have influenced the consideration of CBDCs, including technological innovation, a changing payment landscape, financial inclusion, greater control and visibility over monetary policy and financial stability, consumer protection, and the need to streamline cross-border transactions.

The emergence of distributed ledger systems and blockchain technology has demonstrated the promise of safe and effective digital transactions. To improve their monetary systems, central banks are eager to take advantage of these technological advancements (Gupta et al., 2023). Traditional payment methods have undergone substantial changes as a result of the emergence of digital payments, mobile banking, and fintech developments. CBDCs are viewed as a solution to update payment methods and provide customers with quicker, more secure, and more economical transactions.

By offering comprehensive and accessible digital payment alternatives, CBDCs have the ability to address concerns about financial exclusion. Making sure that everyone has access to a central bank-issued digital currency can promote financial inclusion (Ozili, 2023), regardless of their socioeconomic status or location. Furthermore, CBDCs give central banks more oversight and control over money flows, enhancing the efficiency of monetary policy. Real-time transaction tracking enables more accurate economic monitoring, assisting efforts to preserve financial stability and reduce risks.

Central banks could introduce CBDCs as a dependable and governed replacement for decentralized cryptocurrencies. Consumers can be safeguarded from potential risks associated with unregulated digital assets by providing secure and trustworthy digital money. Also, CBDCs have the ability to streamline and simplify cross-border transactions. With fewer middlemen and lower transaction costs, the use of digital currencies issued by central banks can promote quicker and more effective international transfers.

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