Are central digital bank currencies revolutionizing monetary policy in emerging markets?

- Binithi Sarah Holuwagoda Ruhunage

Ever since the first digital form of currency originated in the 20th century[1], financial systems have been revolutionized by technology. A CBDC (central digital bank currency) is a digital representation of a country's fiat[2] currency issued and controlled by its central bank. Now, more than 130 nations are currently investigating or testing CBDCs, especially in emerging markets, indicating a dramatic shift in technologically driven financial systems. A deeper question, however, is hidden beneath the progress and pilot programs: are these new digital currencies genuinely changing monetary policy, or are they just modernizing an already existing framework?

A CBDC is a digital representation of a country's fiat currency issued and controlled by its central bank. A CBDC has the legitimacy of state support, in contrast to stablecoins backed by private reserves or Bitcoin, whose value fluctuates due to speculation. The emergence of blockchain technology following the 2008 financial crisis is where the intellectual origins can be found. In an increasingly cashless world, central banks started looking into digital options to improve payment resilience, lessen reliance on cash, and make sure state money remained relevant.

According to studies, digital central bank currency may increase the effectiveness of payments, increase inclusion, and even provide new monetary control tools. In 1993, the Bank of Finland released the Avant Smart Card, which, though discontinued, was considered the world's first CBDC[3]. Pilot projects helped the concept develop, including Sweden's e-krona in developed nations and The Bahamas' Sand Dollar, the first fully operational retail CBDC in history, which debuted in 2020.

When combining the properties of cash, bank deposits and cryptocurrency, central bank digital currencies (CBDCs) offer significant advantages over other forms of money. As

[1] https://www.forbes.com/forbes/1999/1101/6411390a.html

[2] fiat currency: a form of government issued currency

[3] https://www.imf.org/en/Publications/fandd/issues/2022/09/Picture-this-The-ascent-of-CBDCs#:~:text=While%20some%20may%20assume%20that,considered%20the%20world's%20first%20CBDC.

regulated instruments, they allow central banks to retain control over the money supply, interest rates, borrowing conditions and overall financial stability. Their programmable nature further enhances policy flexibility by enabling transaction-level rules or conditions to be embedded directly into the currency itself. One important implication of this programmability is the ability to implement monetary stimulus more effectively through tools such as negative interest rates. In traditional systems reliant on physical cash, negative rates are difficult to enforce because individuals can simply hold banknotes outside the financial system to avoid the penalty, reducing the intended incentive to spend. By contrast, a CBDC can carry a negative interest rate on digital holdings, making it costly to hoard money and thereby encouraging consumption and investment during economic downturns. Research suggests that CBDCs can lower the effective lower bound on nominal interest rates, overcoming the constraint that cash imposes on how far rates can be pushed below zero and enhancing monetary stimulus when conventional tools are exhausted.

Problems only arise when non-interest-bearing CBDCs end up maintaining financial stability but limiting any creative policy options, while interest-bearing CBDCs increase the effectiveness of monetary policy but may result in a decline in commercial bank deposits. This difference is especially important in emerging markets, where central banks deal with the modernization challenge while maintaining fragile banking systems.

Some examples of CBDCs include China's e-CNY project, the largest Central Bank Digital Currency (CBDC) experiment in the world, at over 260 million active users or Brazil's Drex, which is currently focused on wholesale transactions, that has plans to tokenize financial assets and may eventually be consumer-facing, thus redefining the Central Bank's business operations while navigating through regulatory challenges.

These examples all show a similar pattern: CBDCs, although they are the ones that modernize payment systems and at the same time give better access to data, still are not the ones that change monetary policy at the core. Design being the decisive factor in impact, the need for solid infrastructure to support the implementation effectively and the role of regulatory cooperation were among the main points of the discussion. At the end, it is not the technology that will take the macroeconomic impact of CBDCs to the next level but rather the institutional preparedness and public trust.

Instead of bringing about a radical change in monetary policy, it can be said that CBDCs are causing an evolutionary shift in emerging markets. By giving central banks access to real-time data for evaluating spending and liquidity, they increase the accuracy of monetary policy; nevertheless, the ability of interest rate transmission is still dependent on banking practices. By allowing households to receive direct liquidity support without going through conventional financial channels, CBDCs could be an essential tool during emergencies. Furthermore, they could reinterpret the connection between fiscal and monetary policy, especially in countries where cash transfer programs are crucial. This could improve the efficiency of government spending, but it could also result in a politicization of central banking responsibilities.

As seen in the article, the theoretical investigation of data-driven monetary policy and real-world solutions to payment inefficiencies are driving the evolution of CBDCs (Central Bank Digital Currencies) in emerging markets. Both technological developments and the gradual development of trust are reflected in the progress. Legislators should concentrate on developing CBDCs that strengthen current banking structures while putting strong cybersecurity and legal safeguards in place. Creating monetary systems that are more intelligent, quick, and inclusive is the goal. Emerging market CBDCs seek to democratize access to money rather than reform interest-rate policy, which could increase the efficacy of monetary policy in a manner akin to how mobile technology enhanced communication.

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