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Reserve Bank of India Launches Digital Currency

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Summary

The Reserve Bank of India (RBI) launched a pilot project for the issuance and use of a central bank-backed digital currency on 1 November 2022. The present transactions, limited to nine selected banks, have been confined only to wholesale settlements. However, retaining digital currency is also expected to be launched in about a month. Digital currency is expected to reduce transaction costs, settlement risk and provide finality to settlements. It will also provide traceability to retail consumers and enable a more real-time, cost-effective, seamless integration of the cross-border payment system.

While presenting the Budget for 2022-2023, Finance Minister Nirmala Sitharaman declared that India's central bank, the Reserve Bank of India (RBI), will issue a digital rupee, or a central bank digital currency (CBDC), in early 2023. The CBDC has finally come to India with the start of the pilot phase of the digital rupee rollout from 1 November 2022. The RBI launched the first pilot of the digital rupee (symbol: e₹-W) for only the wholesale segment. The pilot programme permits nine selected participating banks to use the digital rupee to settle secondary-market transactions in government securities. The nine banks are State Bank of India, Bank of Baroda, Union Bank of India, HDFC Bank, ICICI Bank, Kotak Mahindra Bank, Yes Bank, IDFC First Bank and HSBC. Banks exchanged ₹275 crores (S$ 46.6 million) in bonds on the first day of the new currency, according to the Clearing Corporation of India Ltd.

The RBI has maintained that settlement in the central bank-backed currency would reduce transaction costs. Since it is a sovereign currency, it ensures finality and reduces risk in the financial system by pre-empting the need for settlement guarantee infrastructure or for collateral to mitigate settlement risk. As India moves into a new era of digital money, it is expected that the current rollout, would make the interbank market more efficient. The RBI has stated that the central bank's digital currencies will give consumers the same experience of trading in currency, in digital form, without the hazards associated with private cryptocurrencies. These currencies will also safeguard consumers by avoiding the negative social and economic effects of private virtual currencies.

The RBI proposes to test the e-rupee for retail use in selected locations in closed user groups within a month. The Retail CBDC, by definition, means that every individual will have a wallet with the RBI and, hence, it will be possible to know how and where people are using the currency. Through digital currency, the central bank aims to provide the public with a risk-free virtual currency that will provide them with legitimate benefits without the risks of dealing with cryptos. The CBDC for retail, rather than being based on the blockchain, would likely be on a Distributed Ledger Technology. It is also possible that the CBDC will be fungible with cash for retail. This feature would lend considerable trust to retail users as by easily opting in and out of the retail transactions, they would soon develop confidence in the currency. The significant feature of the CBDC is that it will be a legal tender like paper currency, with all the characteristics of the existing fiat currency. It is the digital form of fiat currency but, unlike other cryptocurrencies, it is issued and regulated by the central bank.

Presently, the total expenditure incurred on security printing from 1 April 2021 to 31 March 2022 was ₹4,984.80 crores (S$8.4 billion). This cost of printing money is predominantly borne by four stakeholders: the general public, businesses, banks and the Central Bank. The CBDC will reduce the operational costs, including costs related to printing, storage, transportation and replacement of banknotes and more.

The long-term objective of introducing the CBDC is to create an efficient and cheaper currency management system. The CBDC will be used alongside existing forms of money enabling financial inclusion and implementation of monetary and fiscal policies. The RBI has declared that based on the usage, the digital rupee will be demarcated into two broad types – general purpose (retail) and wholesale. The retail rupee will potentially be available for consumers and businesses, while the wholesale rupee is designed for restricted access by financial institutions. In the future, the digital rupee could also potentially enable a more real-time, cost-effective seamless integration of cross-border payment systems.

It is widely believed that CBDC is one of the biggest developments in the financial world, the full impact of which will be visible in the very near future. India has a rich legacy as an early adopter of technology with the rapid adoption of the Unified Payments Interface and QR-based payments across the country. With the CBDC, it is expected that India will take significant strides in the world, rapidly progressing towards the adoption of digital currencies. While direct benefit transfers have substantially reduced leakages in the purveying of government schemes to the public, the digital rupee is expected to play a bigger role in providing a safe and reliable means of payment for direct transfer programmes of government welfare programmes. Experts believe that with appropriate monitoring, the CBDC can help promote inclusive and innovative payments.

The digital rupee will enable payment means between consumer to consumer, consumer to business and business to business. However, digital currency is not expected to replace the current forms of currency which are in circulation. It will merely complement it. The digital rupee ideated by RBI will be generated through an advanced payment system which is affordable, accessible, convenient, efficient, safe, and secure. The big advantage of digital currency is that its transactions will be traceable.

Countries such as China and Hong Kong have commenced their pilots while many other countries are also developing their digital currency.

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