

FX Viewpoint

Currencies
Global

e-CNY: After 'red packet' lottery trials, what's next?

- ◆ Beijing has become another major city to distribute digital 'red packets', as part of the 'e-CNY' pilot programme
- ◆ With wider trials in more cities, including Hong Kong and Macau, the official launch of e-CNY is on horizon, in our view
- ◆ We think e-CNY is unlikely to have exchange rate implications over the near term, but it could support RMB internationalisation

Mainland China is one of the frontrunners in the global race to launch central bank digital currencies. The People's Bank of China (PBOC) has made significant progress towards an eventual launch of 'e-CNY' – **more than 10,000 merchants participated in domestic trials in a handful of cities including Shenzhen, Suzhou, Shanghai, Chengdu, and Xiongan New Area in 2020**. In addition to offline payments, the e-CNY wallet supports online payments on an e-commerce platform, and one e-CNY is worth one renminbi.

The trial operation has also expanded from small-scale closed-loop testing to large-scale open testing. **The first mass-scale e-CNY trial was conducted in Shenzhen, China's technology hub, in October 2020, a total of 50,000 digital 'red packets', each containing CNY200, were first distributed to residents via a lottery.** Suzhou followed shortly in December, doubling the scale, with the offline payment feature revealed. Shenzhen also conducted two additional trials subsequently (in December 2020 and January 2021), each having the same scale as the Suzhou trial. Recently, Beijing has become another major city to do so, albeit on a scale that is similar to the first trial in Shenzhen. Apart from Beijing, wider trials in 27 other cities including Guangzhou will be conducted this year and possibly extended to two offshore renminbi hubs – Hong Kong and Macau – where pilots are focusing on cross-border payments for retail and tourism spending. We believe **the e-CNY could be ready for nationwide adoption in 2022 or 2023**.

Currently, the PBOC is only aiming for the e-CNY to partially replace physical currency in circulation domestically. Like cash, at least initially, it would not pay interest. It is intended for spending, not speculating. Unlike popular digital currencies whose values fluctuate or are fixed to a basket of currencies, it would not be traded on exchanges. Thus, there are basically no exchange rate implications over the near term.

However, in the long-term, it is possible that the e-CNY could become used outside of China – especially in those countries with weaker institutions, high inflation, and economic linkages with China. **Foreign demand for the e-CNY would then rise, supporting the RMB**, especially against the foreign currencies it is displacing. But this scenario of RMB internationalisation is not a foregone conclusion and we believe other conditions are necessary. The e-CNY must be at the forefront of digital currencies in user-friendliness, security, and settlement technology, but the Chinese authorities also have to relax capital restrictions further, in particular, allowing capital outflows more freely. International users need to have more confidence in the renminbi too. Ultimately, a currency's internationalisation depends on economic principles, not only technology.

The PBOC has made significant progress towards an eventual launch of e-CNY

With wider trials in more cities, possibly including the two offshore RMB hubs, the official launch of e-CNY is probably close, in our view

Since it is only meant to partially digitalise domestic currency in circulation during its initial phase, we believe the e-CNY is unlikely to have exchange rate implications over the near term

Yet, there could be important long-term implications for RMB internationalisation, especially if the e-CNY could eventually be transacted beyond China's borders and certain conditions are met

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