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Is the digital euro a solution in search of a problem?

The ECB is developing a central bank digital currency in response to changing digital payment demands, in contrast to the US strategy of pursuing privately issued stablecoins. The ECB hopes this will protect its monetary sovereignty while avoiding some of the risks associated with stablecoins. But it could crowd out private sector innovation while being insufficient to meet the ECB's goals.

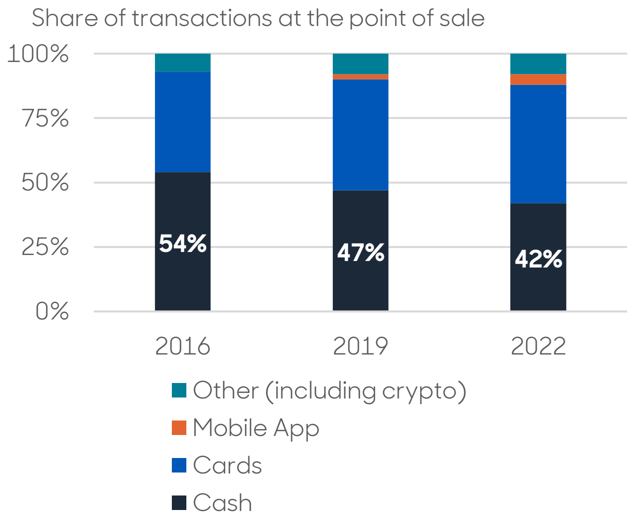
Key Takeaways

- In the Eurozone the usage of physical cash is steadily decreasing. Although digital money that is a liability of commercial banks is of course widely available, a digital liability of the central bank is not available to households and non-bank corporates.
- The ECB's proposed digital euro, a central bank digital currency (CBDC), is meant to fill this gap by providing a fully digital, central bank-issued medium of exchange. The ECB is targeting 2029 for full rollout.
- This approach is very different to that of the US, which is promoting privately issued stablecoins, and banned the Federal Reserve from issuing a CBDC.
- The potential global dominance of dollar stablecoins could pose a risk to the ECB's monetary sovereignty. But various institutional constraints and risks to the banking system could prevent the ECB from promoting stablecoins. So, it is pursuing a CBDC instead.
- But the digital euro could itself pose a financial stability risk. Depositors could withdraw funds from the banking system, preferring to store value in the form of digital euros. To avoid this, the digital euro will be non-interest-bearing and subject to holding limits.
- However, this leaves the ECB in the strange position of promoting widespread usage of the digital euro while simultaneously restricting holdings. This may limit its adoption, restricting the central bank's ability to stay at the frontier of changes to the payment system and global monetary order.

Is a digital euro really needed?

On the surface, the case for the issuance of the digital euro, a central bank digital currency (CBDC) issued by the European Central Bank (ECB), is not clear. Even though an increasing proportion of transactions are digital, rather than cash based (see Figure 1), buyers and sellers already have access to cash-like digital assets.

Figure 1: The usage of cash in the Eurozone economy is decreasing

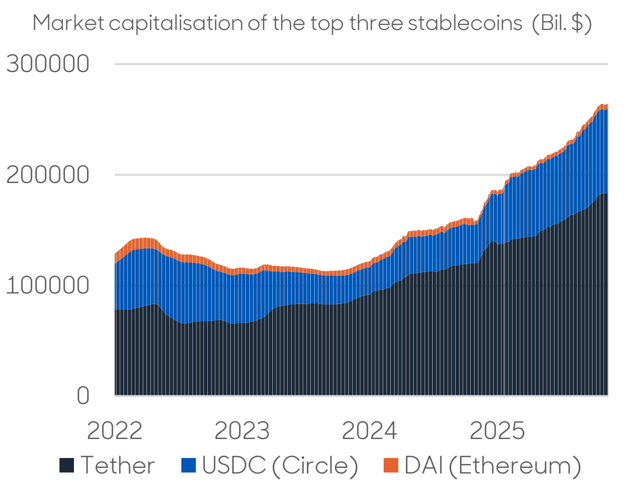


Source: Haver, Aberdeen, December 2025

For instance, commercial bank deposits, which make up the majority of narrow money, are widely accessible and accepted as a form of payment. They almost always trade at par with central bank-issued cash.

And, recently, stablecoins have emerged as another digital medium of exchange tied to state-backed safe assets, albeit in US dollars rather than euros (see Figure 2).

Figure 2: Stablecoins are on the rise, but not in euros



Source: Bloomberg, Aberdeen, December 2025

So, critics typically cite the availability of privately issued digital cash alternatives as a reason not to pursue the digital euro. After all, at a projected cost of €6bn, the introduction of the ECB's CBDC is not an inexpensive project.

But the ECB is pressing on with its plans; a pilot is slated for 2027, before the digital euro goes live in 2029.

Existing digital alternatives are only imperfect substitutes for cash

Proponents of the digital euro point out that commercial bank deposits are not direct liabilities of the ECB, but of private institutions. They are therefore inherently risky, because, if the bank fails, depositors could in principle lose their money.

Of course, a complex architecture of regulation, deposit insurance, and the central bank's lender-of-last-resort function ensures individuals rarely lose their deposits, but some residual risk remains.

Moreover, transactions in private digital money must be cleared through private payment systems, which can and have failed.

For example, payments cleared online with systems such as Visa, Mastercard, and PayPal are vulnerable to blackouts. And, as this space is dominated by non-EU corporations, the ECB has limited power to mitigate risks on this rail of Europe's payment architecture.

Stablecoins seem to have several advantages

In the US, regulators have responded to demand for a cash-like digital asset by encouraging the development of stablecoins rather than a CBDC.

Indeed, the US' GENIUS Act went so far as to make it illegal for the Fed to develop a CBDC.

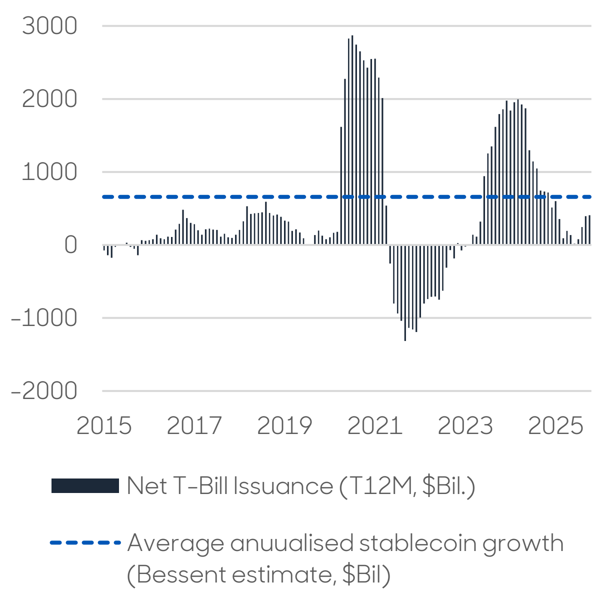
That's in part because stablecoins may be better placed to preserve the privacy of physical cash-based transactions. Critics are concerned that a state entity like the central back observing and facilitating all transaction is ripe for abuses of privacy and exertion of unwelcome state power, relative to a decentralised ledger like the blockchain.

Instead, the GENIUS Act set out a clear regulatory framework for stablecoins, which stipulates that issuers must back dollar-linked stablecoins one-for-one with Treasury bills (T-bills). It also does not allow the stablecoins to pay interest on deposits.

Such a framework comes with a number of benefits for the US.

First, the growth of stablecoins would boost the demand for sovereign paper, potentially lowering interest rates and giving the government more scope to pursue expansionary fiscal policy. That's why they form a key pillar of US Treasury Secretary Scott Bessent's fiscal strategy. He sees total circulation of dollar-linked stablecoins rising from \$300bn to \$3tn by the end of the decade, a rate of growth that could plausibly absorb total net issuance of T-bills (see Figure 3).

Figure 3: If they expand rapidly, dollar stablecoins could provide a significant source of demand for T-bills

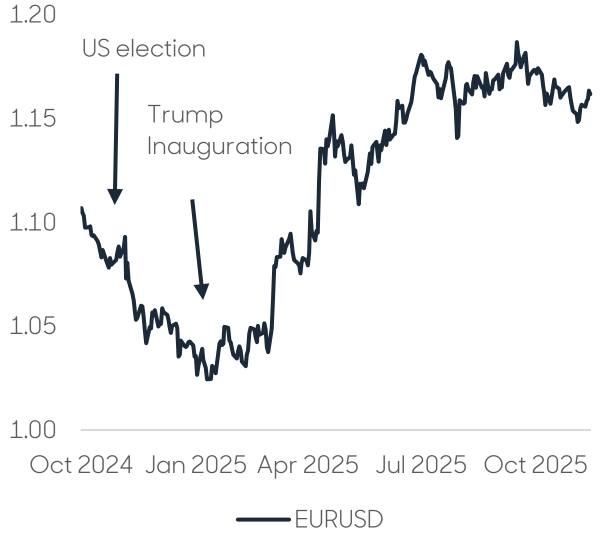


Source: Haver, Bloomberg, Aberdeen, December 2025

Second, as stablecoins are dominated by US-based issuers, their growth could support US corporate profitability.

Finally, dollar-stablecoins may reinforce dollar dominance, which has (arguably) come under threat over the course of Donald Trump's second presidency (see Figure 4).

Figure 4: The euro has risen against the dollar over Trump 2.0 so far



Source: Haver, Aberdeen, December 2025

But some of these advantages are specific to the US

It is precisely this dollar-dominance of the stablecoin ecosystem that has concerned European policymakers. They worry about a loss of control over both the European payment system and domestic financial conditions, as the growth of stablecoins could ultimately mean growth of dollar usage in Europe.

This raises the obvious question of why the Eurozone does not try to cultivate the development of euro-denominated stablecoins to compete with the US. After all, ECB President Christine Lagarde has repeatedly called for a "global euro moment".

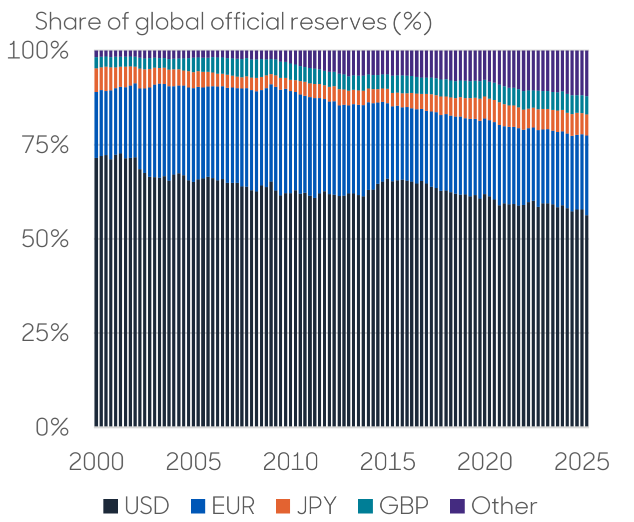
However, this is much easier said than done. First. the US already has considerable incumbency advantage as the issuer of the global reserve currency under the existing financial order *as well as* first-mover advantage, given the extent of existing dollar stablecoin development (see Figure 5).

Second, the Eurozone lacks a deep and liquid pool of safe sovereign debt. What EU-wide debt exists is much too limited to underpin a significant stablecoin presence. And adopting, say, German bunds as the linking asset for stablecoins would likely be politically unacceptable outside of Germany, even if it had the scale to support a deep stablecoin market.

Moreover, Europe's crypto industry is too small to provide a meaningful boost to corporate profits from a stablecoin boom.

Finally, European policymakers seem to be more concerned about some of the financial stability risks that stablecoins may present.

Figure 5: Though its share of the global total is falling, the dollar remains the dominant reserve currency



Source: Haver, Aberdeen, December 2025

For example, some versions of stablecoins have decoupled from the currency they intend to track. Such a decoupling could provoke a run on the stablecoin, in turn triggering selling pressure on short-term sovereign paper. In markets with relatively limited liquidity – such as those in the Eurozone – this selling could trigger big and unwelcome swings in financial conditions.

The digital euro may better suit the ECB's risk appetite

Indeed, the ECB as an institution seems to be quite risk-adverse, perhaps reflecting its experience of the euro crisis.

Meanwhile, its relative youth and the complex mix of European institutions may help explain why is wants to actively protect against perceived threats to its sovereignty.

And more generally, the ECB's scepticism of certain private sector financial innovations may reflect the different regulatory culture and political economy in Europe compared to the US.

However, Lagarde has argued that this caution towards stablecoins should not be seen as opposition to financial innovation *per se*. Rather, she views the ECB itself as an engine of innovation.

And from the ECB's perspective it is the introduction of the world's biggest CBDC that manifests that openness to innovation.

However, it is notable that the ECB is willing to use its institutional power to outcompete potential private innovations.

Indeed, many European banks have expressed their disapproval of the digital euro project, arguing that it threatens to crowd out their effort to disrupt Visa, Mastercard and PayPal's dominance with new European digital wallets.

Could the digital euro actually be a *source* of financial risk, rather than mitigate it?

Of course, the European banking industry may also have other reasons for resisting the introduction of at least certain forms of CBDC.

To the extent the deposits in private banks still maintain residual credit risk for depositors, then the provision of a state-backed liability that pays market interest rates would be a competitive threat to the banking system.

Indeed, its existence may cause deposit flight from the banking system, raising the cost of capital for banks, and, in the limit, creating a genuine liquidity and funding crisis for some banks.

Given the relative importance of banks versus capital markets as a source of credit provision within the Eurozone, the possibility of higher bank funding costs comes with significant risks for the economy, potentially adding yet another headwind to European growth.

The prospect of interest payments should keep deposits in the banking system

To avoid this problem, the digital euro will be non-interest-bearing, incentivising depositors to retain their private bank deposits. In this way, it replicates a key feature of the stablecoin legislation in the US.

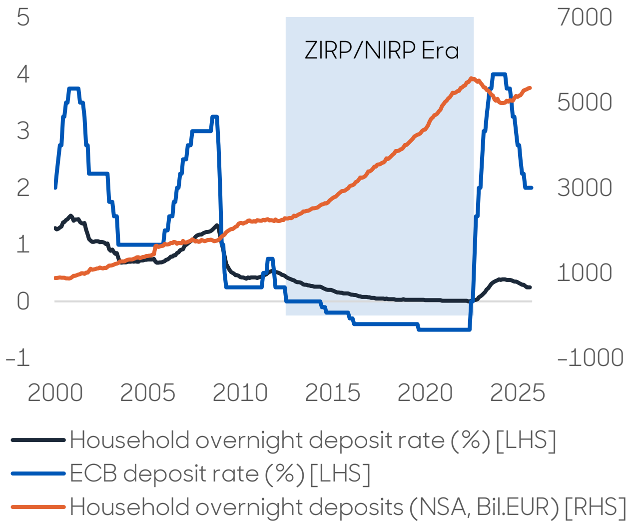
However, the widespread availability of a zero-interest bearing asset could potentially come with problems if the ECB ever decides it needs to set its policy rates negatively again.

Of course, euro cash notes are an example of an already existing zero-interest bearing liability of the state. But holding large cash deposits comes with costs (cash could be lost or stolen, for example) that holding large digital deposits does not.

So the presence of a digital, zero-yielding, asset might encourage households and businesses to wholesale switch from bank deposits to the digital asset in future negative rate episodes in a way that past negative rate episodes never caused a wholesale flight to cash (see Figure 6).

That means the digital euro could undermine both the ability of the ECB to administer negative rates and so affect financial conditions in a large negative demand shock and potentially risk bank deposit flight at precisely the time the economy is weakest.

Figure 6: Households value the convenience of digital assets a lot – even when they earn no interest



Source: Haver, Aberdeen, December 2025

Holding limits address financial stability concerns, but introduce a paradox

Of course, one solution to this problem would simply be to allow the digital euro to effectively charge negative interest rates when the ECB wants to set its policy rates negative.

But the asymmetry of an asset that pays no positive interest, but can charge negative interest, is likely to be politically and financially toxic.

So instead, the ECB's preferred solution to this problem is to introduce a holding limit on the digital euro, currently proposed to be €3,000 per person.

But this leaves the ECB in the strange position of promoting widespread use of its digital money while simultaneously placing restrictions on its uptake.

So, if the digital euro goes ahead – and we think it probably will – privately issued money will still remain the most important component of narrow money in the Eurozone.

Finally, we would argue that while the digital euro may help protect European monetary sovereignty, fostering a healthy ecosystem of financial innovation is likely to be more important in achieving this goal in the long run.

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