THE OUTLOOK | By Michael S. Derby

Digital-Currency Fever May Hit Fed

It is time to start thinking about Fedcoin.

For years central bankers have seen digital currencies as a curiosity to keep an eye on. But now they are increasingly looking at whether they should create their own.

"It's really very premature to be talking about the Federal Reserve offering digital currencies, but it is something we are thinking about," New York Fed President William Dudley said Wednesday.

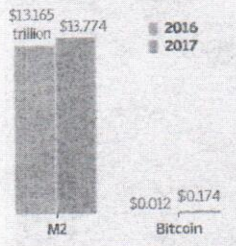
Mr. Dudley was speaking in the shadow of bitcoin, an electronic form of money that has soared in value this year, fueling an investment mania. Bitcoin is created privately, unlike national currencies such as the U.S. dollar and British pound that are issued by governments, typically through their central banks.

Since central banks rely on their control of the money supply to guide their economies and electronic payment methods are rising in popularity, officials have begun pondering whether they might need to get in the game.

The Fed and its foreign counterparts already create money electronically, working directly through private banks, which in turn loan money electronically to businesses, households and others. But the U.S. government also turns some of that into paper dollars and metal coins. The Fed issues no separate currency that exists only on the internet, without any tangible cash form.

No Comparison

The market value of bitcoin is a fraction of U.S. money supply, as measured by currency in circulation, time deposits and money funds.



Sources: Federal Reserve (M2); Coindesk (Bitcoin)

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Fed officials have long held that bitcoin is no rival for the dollar, and they don't see that changing. So far, it is neither stable in value nor universally accepted as a form of payment. Imagine trying to find a barber, for example, who accepts bitcoin and could reliably price the trim when the currency's value oscillated wildly.

But change is in the air. Some central banks, such as Sweden's Riksbank, are weighing the creation of their own versions of digital currencies.

San Francisco Fed President John Williams said last Wednesday the topic of a central bank digital currency would be "a very exciting area" of research over the next decade.

Academics have already been laying the intellectual groundwork for official digital money.

Central bank-issued digital money "can serve as a practically costless medium of exchange, secure store of value, and stable unit of account," wrote economics professors Michael Bordo of Rutgers University and Andrew Levin of Dartmouth College in a paper published this year.

They say central bank-issued digital money would be painless for those who want to use it. It could be accessed via accounts directly at the Fed, or more likely, from private banks in partnership with the central bank.

The accounts would earn interest, which would allow the Fed to conduct monetary policy through interest-rate changes right at the consumer level, replicating the tools the central bank now uses via banks and money managers.

Fed-issued digital money would also make payments fast and costless, removing the wait for money to clear into an account, or fees to move cash around.

"It's urgent for the Federal Reserve to move forward" on this matter, Mr. Levin said in an interview Friday. Given that it would, in many ways, be an extension of how the Fed already operates, implementation need not be that onerous, he said.

Key Fed officials don't share that urgency. Governor Jerome Powell, whom President Donald Trump has nominated to become Fed chairman, said in June about Fed-issued digital money: "My approach to that would be very, very cautious."

The Fed's regulatory leader, Randal Quarles, is on that same page. In remarks Thursday, he said there are a host of legal, technological and privacy issues that must be addressed before anything can move forward.

"I am particularly concerned that a central-bank-issued digital currency that's held widely around the globe could be the subject of serious cyberattacks and could be widely used in money laundering and terrorist financing," Mr. Quarles said. It is also possible a central bank system could complicate the ability of banks to make loans and upend private efforts to create more efficient payment systems, he said.

Mr. Quarles sees a more narrow path as likely. He called for more research into "limited-purpose" digital money that could, for example, be used to help settle transactions between banks.

There are also privacy worries. People and companies might not want to bank directly with a government arm such as the Fed if offered the chance.

There is also the fact that, for many Americans, cash remains king.

The rise of phone-based payment systems and merchants who are willing to take cards for small-scale purchases haven't made much of a dent, according to data compiled by several regional Fed banks. Cash remains popular for small transactions, and if there is anything moving people away from cash, it is the shift from brick-and-mortar shopping to online purchases, the report noted.

Mr. Dudley noted another impediment to U.S. government-backed digital dollars: compared with people in other developed economies, many Americans don't even have bank accounts.