

Cryptocurrencies could eliminate banking's easiest moneymaker

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If the measure of a currency's importance is how much it's used to actually buy and sell things, digital currencies like Bitcoin and Ethereum have barely gotten off the ground. And Facebook's proposed entry,

Libra, has run into a wall of skepticism.

But don't be misled, says Darrell Duffie, professor of finance at Stanford GSB. Unless banks come up with much faster and cheaper ways to transfer money, he predicts, digital currencies in one form or another are likely to upend the industry's business model within the next decade.

"The future is coming, and it will be very disruptive to legacy banks that don't get with the program," Duffie says.

The disruption won't necessarily come from the likes of Bitcoin. It's more likely to come from a "stablecoin" that's pegged to the dollar or some other major currency. It could also come from a digital currency offered by a central bank—and most of them are looking at such possibilities. Or it might come from [tech companies](#), like Facebook, that find ways to circumvent the banks.

One way or another, Duffie says, banks are likely to lose their easy access to low-interest deposits—and easy profits—within 10 years. Banks also earn large profits on credit card interchange fees collected from vendors, who pass many of those costs on to customers.

"At some point, new payment methods will trigger greater competition for deposits," he says. "If consumers have faster ways of paying their bills, and merchants can get faster access to their sales revenue without needing a bank, they won't want to keep as much money in accounts that pay extremely low interest."

The Low-Interest Windfall

At the moment, consumers and businesses keep large sums—about \$14 trillion in the United States alone—in deposit accounts that pay an extremely low average rate of interest. Why? A key reason is that bank

customers still overwhelmingly rely on their deposit accounts to make and receive payments. Depositors are also notoriously slow to shop around for better deals from other banks.

As a result, banks reap huge profits. On average, banks currently pay less than 0.1% interest on checking and savings accounts, and only slightly more on one-year certificates of deposit. By contrast, the amount banks earn from routine overnight loans has climbed from 0.3% in 2015 to more than 2% today.

For the banks, that widening spread has meant billions in extra revenue at virtually no extra cost. Banks also earn large profits on credit card interchange fees collected from vendors, who pass many of those costs on to customers.

[Duffie notes that he has a potential personal stake in this issue: He is an unpaid board member of a proposed "narrow" bank, called TNB, that would take deposits but not offer any payment or credit card services. The firm's goal is to offer higher interest rates than normal banks, but it has yet to win regulatory approval or open for business.]

Cryptocurrency Transfers: Faster and Cheaper

Meanwhile, bank payment systems are slow and expensive compared with digital currencies and other new technologies. Checks take several days to clear, and vendors need to wait a long time to get paid when customers send their payments electronically. Wiring money can be faster, but it costs \$25 just to send \$200 from Cleveland to Cincinnati. International wire transfers routinely cost more than \$50. By contrast, transfers using the most efficient cryptocurrencies can be completed in a few seconds or less, at a tiny fraction of the cost.

Duffie says banks should not expect this state of affairs to last.

Central banks are acutely aware of the issue. According to a recent survey by the Bank for International Settlements, most of the world's [central banks](#) are doing research on digital currencies that they themselves could create or support.

Sweden's central bank, the Riksbank, recently floated the idea of an "e-krona." Any resident would be able to open a personal account at the Riksbank and make payments by directly transferring the "e-krona" to someone else's account. That would have cut commercial banks out of the process, which may be why the central bank has backed away from the idea.

But Duffie says that's just one approach. Banks already pay each other with a digital currency, in the form of electronic deposits that they hold at their central bank—in the U.S., that's the Federal Reserve. If non-bank payment companies were allowed to set up similar accounts at central banks, they would be able to bypass commercial banks for at least part of the payment process. Duffie notes that the central banks of both Canada and Singapore have tested this approach.

The Chicken, the Egg, and Libra

Meanwhile, Facebook has electrified both central banks and commercial bankers with its proposed cryptocurrency, Libra. To be sure, Facebook has run into a storm of skepticism tied to concerns about privacy and the potential for money-laundering and other illegal uses. Several big initial supporters, including Visa and Mastercard, have backed away.

But Duffie says Libra could have a huge impact, for better or worse, if regulators allow it to go forward, because it would immediately be available to the social network's 2.4 billion users.

"There's a chicken-and-egg problem with new currencies, because

nobody wants to use one until a lot of other people are using it as well," Duffie notes. "But as soon as Facebook releases Libra, it would start out with 2.4 billion potential users. There's nothing else coming along that can easily get those scale effects."

Even if Libra never launches, Duffie predicts that the combination of technology, economics, and public pressure will undermine the grip that conventional banks now have on the worldwide payment system.

The European Union recently ordered commercial banks to provide data to non-bank payment companies that would allow them to compete more directly. In the United States, the Federal Reserve is exploring the possibility of launching a fast-[payment](#) system of its own.

"The smartest [banks](#) will be on the front edge of this, but others will be reluctant to cannibalize their very profitable franchises," Duffie says. To the latter, he sends this warning: "The future is coming, and it's not good."

Provided by Stanford University

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