Digital euro

A wake-up call for banks to adapt and innovate

Analyst
Milya Safiullina, Frankfurt
m.safiullina@scoperatings.com

Team Leader
Marco Troiano, CFA, Milan
m.troiano@scopegroup.com

Media
Keith Mullin
k.mullin@scopegroup.com

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A digital euro can strengthen the resilience and autonomy of Europe's payment ecosystem and preserve the relevance of European banks and the euro in the global financial system. But it also has a potential to weaken bank profitability and increase costs, particularly in its initial phase. In the absence of circuit breakers, the higher velocity of money could accelerate runs on bank deposits in a crisis, triggering a liquidity crunch and leading to bank failures.

Banks must prepare for the challenges and opportunities emanating from moves to implement a digital euro. This means investing in digital infrastructure, adapting to new frameworks, and developing strategies that allow them to leverage the benefits while managing the risks effectively.

On the plus side, moves towards a digital euro will act as a catalyst for banks to accelerate their digital transition journeys, driving innovation and encouraging the shift to digitalised business models. This is positive for banks, as it will strengthen their offerings and enhance their overall competitiveness in the rapidly evolving digital global financial landscape.

1. A double-edged sword for banks – opportunities and risks

As a payment tool, the digital euro would directly compete with established options such as cash and electronic payments. This competition could diminish banks' ability to generate revenue from traditional services, like card issuance, payment processing and transaction fees. In a less supportive interest-rate environment, where banks are already under pressure to find new sources of income, a reduction in fee-based revenue could significantly impact profitability.

The digital euro has a potential to weaken banks' profitability

Banks are already facing increasing competitive pressure on payment fees, as non-bank payment service providers and fintechs have become integral to the payments ecosystem. The introduction of the digital euro could intensify this competition, further eroding banks' market share in payments and reducing the significant revenues they generate from providing payments services. Banks will need to develop new digital euro-related offerings and foster long-term customer relationships in an evolving market.

Digital euro poses funding challenge for banks and potential liquidity shortages

The digital euro could also pose a potential funding challenge for banks. As a potential store of value, a digital euro held in an ECB-guaranteed wallet could offer users a safer and more reliable alternative to traditional bank deposits. If people start holding more of their funds in digital euros instead of traditional bank deposits, banks could see deposit balances shrink.

This could affect their ability to lend money and will increase the cost of funding. Moreover, at times of financial crisis, individuals and companies would likely exchange significant amounts of their bank deposits into digital euros, leading to liquidity shortages and undermining the stability of the banking system.

For this reason, it is important for the banks that the digital euro is introduced with a narrow payment function, disincentivising its use as a savings and investment vehicle. Holding limits and the absence of remuneration would significantly reduce the incentive for users to store large amounts of money in a digital euro wallet. Limiting merchants' ability to hold digital euros and the 'reverse waterfall' mechanism'[1] could also work to contain any deposit outflows from the banking sector.

[1] The 'reverse waterfall' mechanism would enable users to make payments in digital euros, even if their digital euro balance is lower than the transaction amount. In such cases, the shortfall would be covered by funds from their private money account to complete the transaction. If the user lacks sufficient funds in their private money account, the payment would not be processed. This feature would be optional for end users but mandatory for business users, such as merchants. Merchants would be able to accept and process payments, but they would not be able to hold digital euros.

During the implementation of the digital euro (assuming it goes ahead), banks will have to make significant investments in digital infrastructure to ensure real-time processing, robust payment gateways, modern digital wallets, security and ensure scalability. Additionally, banks must ensure compliance with evolving regulatory frameworks while ensuring seamless compatibility with the ECB's digital euro architecture.

Higher costs for banks during the implementation stage of the digital euro

We see a clear advantage for early adopters and believe that larger banks, with their greater investment capacity are better positioned to tackle this challenge given the associated costs.

Banks will have to address privacy, data protection and cyber security concerns before adoption of the digital euro. As banks will act as intermediaries in the digital euro ecosystem, they must carefully balance the need for transaction anonymity while preventing fraud, money laundering, terrorism financing, and funding of sanctioned entities. Protecting the digital euro infrastructure from cybersecurity threats is critical for banks and the ECB, as any breaches will damage trust.

Security concerns must be addressed at earlier stages of development of the digital euro

But the digital euro could also provide opportunities for banks. Offering digital euro-related services such as wallet management, payment processing and integration with banking platforms could generate significant revenue streams, especially as digital payments continue to grow.

Digital euro opens banks opportunities for new revenue streams

Banks that are early adopters of digital euro services could streamline payment systems, reducing costs and improving transaction efficiency, thus gaining a competitive edge. The development and integration of the digital euro would also provide banks with valuable opportunities to accelerate their digital transformation, enhance their infrastructure and make it more sustainable and future ready.

Digital euro drives progress in banks’ digital transformation

2. Digital euro making progress

The ECB is more than halfway through the digital euro project preparation phase that was launched in November 2023. The decision on whether to proceed to the next phase is expected in October 2025. A final decision on the introduction of the digital euro is subject to the adoption of the legal framework. Finalisation would then be followed by an implementation phase, so actual issuance and roll-out of a digital euro is still years away.

The ECB will decide on the digital euro's next steps in October 2025

The ECB's second progress report on digital euro preparation, published in December 2024, highlights the significant strides made in crucial areas, including updates to the digital euro rulebook, collaboration on user-centric design, selection of potential providers for the digital euro service platform and proactive engagement with stakeholders.

Most countries exploring central bank digital currencies (CBDCs) are focused on enhancing payment systems, financial inclusion, and monetary policy effectiveness while also addressing challenges like privacy and regulatory frameworks. Countries are moving forward but they all have different priorities, from financial sovereignty to reducing reliance on foreign currencies to improving payment efficiency.

While the U.S. moves to ban a digital dollar, advanced pilots of CBDCs are forging ahead

More than 130 countries are exploring CBDCs and more than 60 are in advanced phases of development, pilot, or launch, although only four countries (Bahamas, Zimbabwe, Jamaica and Nigeria) have launched CBDCs. The digital yuan is in an advanced pilot phase. Other major economies are actively researching or testing CBDCs, though are at earlier stages.

The US government's latest stance on digital currencies reflects a strategic pivot away from CBDCs, opting instead to focus on the development and growth of lawful and legitimate dollar-backed stablecoins worldwide and issuance and operation of digital assets, including stablecoins. Federal agencies have been prohibited since January 2025 from taking any action to establish, issue, or promote CBDCs. This decision underscores the preference for leveraging private sector innovation while maintaining regulatory oversight, shaping the future of digital payments and financial system.

We do not expect any delays in the digital euro project due to the US stepping back. In fact, this could present a valuable opportunity for the ECB. While the US focuses on stablecoins, the ECB can continue to advance the digital euro as a more secure, state-backed digital currency that could offer a competitive edge in the global digital payments landscape.

3. The digital euro: ECB's vision for a secure, modern payment system

The digital euro is being designed as a modern, secure, efficient payment option available in the euro area, including for people without bank accounts. Unlike private digital payment methods or cryptocurrencies, the ECB would issue digital euros, making it a state-backed form of money. Once a final decision to issue the digital euro is made, and the legal framework and industry standards are established, the digital euro promises to streamline payments, enhance efficiency, increase financial inclusion and strengthen the overall payment system in the euro area.

Table 1: Digital euro vs cashless payments

	Digital euro (proposed)	Cashless payments (current form)
Definition	A central bank-backed digital currency issued by the ECB at par with cash	Electronic payments initiated using cards, apps, online transfers (backed by banks and private entities), or crypto assets (decentralised blockchain technology)
Purpose	To complement existing payment services with a modern, secure digital payment method, available and accepted in the euro area; to increase financial inclusion; designed as a means of payment rather than a store of value	Electronic payments, often for day-to-day transactions or as a store of value; varies for crypto assets: investment, online payments, remittances, or as a store of value
Issuer	The ECB	Electronic payments facilitated by private financial institutions (banks, payment companies); crypto assets issued by decentralised networks (e.g., Bitcoin, Ethereum)
Settlement time	Instant or near-instant	Instant or near-instant for electronic payments, depending on the method; varies on crypto assets
Availability	Euro area available online and offline for all electronic payments	Widely available online through various commercial platforms and financial institutions
Accessibility	Accessible directly from an ECB-issued digital wallet or associated platform, with or without a bank account	Relies on having funds in a bank account or digital wallet with a private institution or platforms
Costs for users	As a form of public money available free of charge for basic transactions within the euro area; rules in place to ensure that the fees merchants pay are fair	Users may incur transaction fees, service fees depending on the method they use; credit cards may charge interest or fees on unpaid balances
Regulation	Emerging legal frameworks, regulated and controlled by the ECB	Well established for electronic payments, governed by commercial banks, payment networks, and national regulations; the EU's markets in crypto-assets (MiCA) regulation for crypto assets
Privacy	A high level of privacy in everyday payments, transactions can be traceable for regulatory reasons	Varies depending on the platform or payment method used; often requires sharing personal data
Security	High security, with safeguards against fraud and cyber threats	Depends on the payment platform; often involves encryption; crypto assets secured by blockchain technology and consensus mechanisms, but risks of fraud remain for all payment tools

4. Growing shift away from cash towards digital transactions

The recent ECB study on the payment attitudes of consumers in the euro area indicates a significant shift in payment behaviour at point of sale (see Figure 1). The trend away from cash towards digital transactions underscores the need for the digital euro to ensure access to risk-free payments in an increasingly cashless environment.

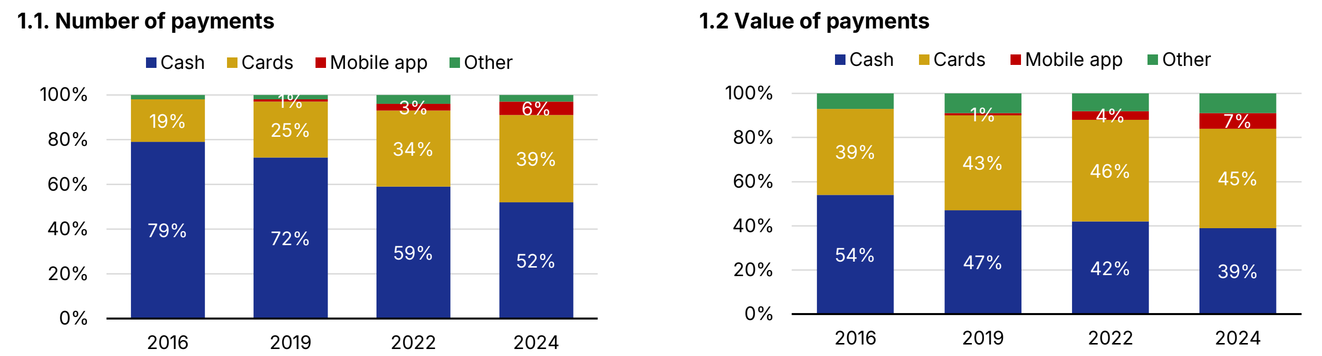
Digital payments gain momentum due to changes in payment habits

The number of cash transactions at point of sale fell to 52% in 2024 from 59% in 2022 (2019: 72%, 2016: 79%). Card payments rose to 39% from 34%, and mobile payments doubled to 6% over the past two years. Cards remain the dominant payment instrument in terms of value with a 45% share, followed by cash payments, albeit declining from 42% in 2022 to 39% in 2024. Mobile payments rose from 4% to 7% over the last two years.

Although cash is still the most frequently used means of payment in most euro area countries, the share of card and mobile payments is gaining momentum (Figure 2).

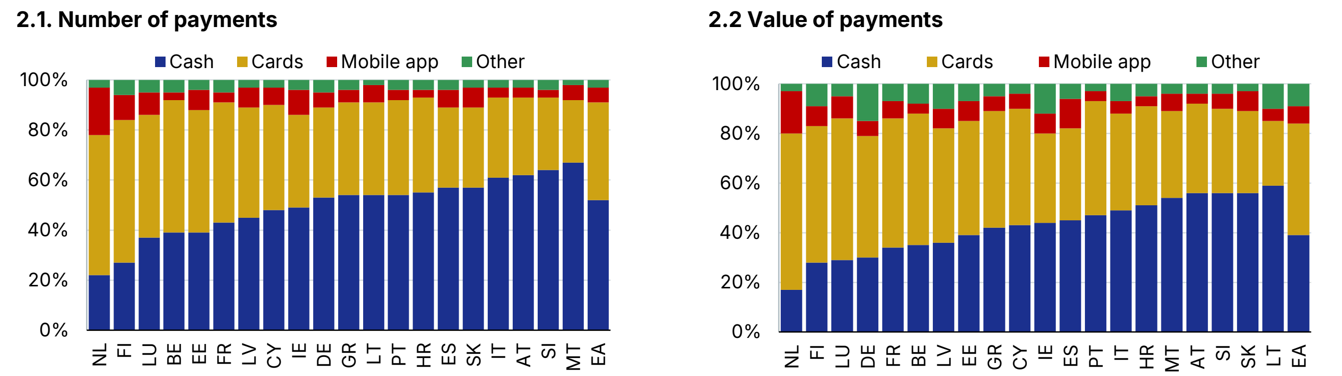
The shift from cash to digital transactions is driven by several key factors. Digital payments have become increasingly convenient, offering quicker and easier ways for consumers to make transactions without the need for physical cash. This trend accelerated during the Covid-19 pandemic, when contactless payments gained popularity because of their safety and convenience. As smartphones, mobile apps, and digital wallets have become more widespread, consumers now have a wide range of tools to complete transactions swiftly and securely. Moreover, digital payments often provide enhanced security features compared to cash, which can be lost or stolen.

Figure 1: Payment instruments used at the point of sale in euro area – historical



Source: Scope Ratings, ECB, De Nederlandsche Bank, the Dutch Payments Association, Deutsche Bundesbank

Figure 2: Payment instruments used at the point of sale, breakdown by country, euro area (EA), as of 2024



Source: Scope Ratings, ECB, De Nederlandsche Bank, the Dutch Payments Association, Deutsche Bundesbank

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Scope Ratings GmbH

Lennéstraße 5, D-10785 Berlin
Phone: +49 30 27891-0
Fax: +49 30 27891-100
info@scoperatings.com

Scope Ratings UK Limited

52 Grosvenor Gardens
London SW1W 0AU
Phone: +44 20 7824 5180
info@scoperatings.com

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Scope contacts
scoperatings.com

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