**The Deputy Governor on the digital shekel: "The digital shekel could be a trust worthy catalyst for technology to enhance competition in the financial system."**

**The Deputy Governor of the Bank of Israel, Mr. Andrew Abir, spoke at the "Engines of the Israeli Ecosystem" conference of the Globes newspaper. Here are the main points of his speech.**

In the global debate about CBDCs, there are many who argue that CBDC is no more than a solution in search of a problem. Today I intend to talk about a problem that the digital shekel may assist in solving.

It will be no surprise to anyone if I say that in many countries around the world, including Israel, commercial banks do not win public popularity contests. The global financial crisis that erupted in 2008 and its impact on the economic situation of millions around the world was a major source of this anger. However, as is known, the banks in Israel functioned exceptionally well in comparison to their international peers, and their resilience was a central component in the way Israel overcame that crisis. In Israel, some of the anger directed at the banking system is the result of the need to increase the level of competition in some of the segments.

Over the years, legislators and regulators, the Bank of Israel included, have taken many steps to increase competition in the banking system. Some of the steps were regulatory, such as separating credit card companies from banks, easing regulation to encourage new banks, requiring banks to present customers with a uniform bank identity document, and more. Other steps involved adopting advanced technologies or significant technological projects: enabling remote account opening using video identification technologies, establishing a system for easy bank switching, establishing a national credit data registry at the Bank of Israel, all of which are already in operation. Among the projects still in process, for example, are open banking and the connection of non-banking entities to payment systems. Each of these steps has had an impact on improving the competitive situation. However, we still have a long way to go.

In the last two years, the public became aware of an area that was much less relevant when we at a low interest rate environment – bank deposits. The increase in the Bank of Israel's interest rate which was required to combat the rise in inflation was quite quickly and fully passed on to credit interest rates, but the transmission to interest rate on retail deposit - mainly short term - was partial and slow. This slow transmission was also observed in other countries, sometimes even more prominently than in Israel.

The Bank of Israel took measures to increase thee pass-through. Nevertheless, I must say up-front: This phenomena made parts of the public who were was very angry (at least as reported by financial journalists) but they did change their behavior. People who we often see spending hours on price comparison engines to save 40 shekels on a flight ticket do not always invest the time to compare the different interest rates that banks offer using valuable information that the Bank of Israel made available to them. The Bank of Israel and the media have done an essential job in responding to criticism of the deposits, for example, we published information about deposit and credit rates of different banks and by different segments on our website, and we launched an information campaign about an alternative product - money market funds. Unfortunately, we have not seen the results materialize in the way we would like and we will continue to work in this area.

Why is the public adoption of money market funds taking time? There could be several reasons, some technical. But in my opinion, one of the main reasons is the lack of a sense of security. Despite the feelings of anger I described at the beginning, the public knows the banks, trusts them, and feels safe to hold their money with them. This is of course a good situation, and it is the result of the quality management of the banks and the strict supervision over them. But it is also a situation that has negative effects on the public's willingness to deposit their money with other entities, and in turn has effects on the development of competition.

So the question arises - is there a winning combination? Can technology enable us to offer the public a product that is not a bank deposit, but enjoys a lower level of risk even than that of a bank account, and high public trust, thereby creating a game-changer for competition in the financial system?

The product I am talking about is, of course, the digital shekel. First, let's recall – a digital shekel is a liability of the Bank of Israel to the public - and in that sense, it is similar to cash, whose holding does not involve credit risk. This, unlike a bank deposit or a payments wallet, which involves a risk that may be small but not zero. On the other hand, the digital shekel is... digital, and in that sense, it is somewhat similar to the money we hold in a bank account.

It is important to clarify - despite the name, the digital shekel is very different from various products that in recent years have been called "digital currencies." In particular, it is very different from the most famous "digital currency" - Bitcoin. The digital shekel will not be developed by some anonymous Satoshi Nakamoto. Everyone will know who is behind the digital shekel and who is responsible for it - it will be the central bank, the same Bank of Israel that stands behind the cash we all know and trust. Another key difference is that unlike Bitcoin and its likes, whose value can variate by whole percentages and sometimes even tens of percentages in a few days - a shekel is always a shekel. A digital shekel will always be worth one cash shekel which is always worth one shekel in a bank account. The purchasing power of the digital shekel will always be preserved because over time the Bank of Israel maintains the inflation target – and if necessary, resolutely, as we have done in the last two years when inflation rose.

How could the digital shekel help us promote competition?

First of all, to the extent we progress to launching a digital shekel, it will bring the money that the Bank of Israel issues back to all areas of our lives. In recent years, the economy has become more and more digital, and there are many types of transactions that simply cannot be paid for with cash issued by the Bank of Israel - for example, e-commerce transactions. The cash of the Bank of Israel played a role in the competition between different payment methods, but its role has been eroded due to its technological inferiority. The digital shekel will allow us to pay with Bank of Israel money everywhere, and in any transaction we choose. This will enable the Bank of Israel to intensify the competition between different means of payment.

The digital shekel will be a platform for innovation. Currently, the only entities who have access to digital money at the Bank of Israel are the banks, although gradually we are opening access to accounts at the Bank of Israel to non-banking entities as well. The money available to the entire public - cash - is distributed to the public from the Bank of Israel's vaults first and foremost by the banks. The digital shekel will operate on a two-tier model, with a wide range of entities that can serve as Payment Service Providers or as Additional Services Providers on the digital shekel platform. In fact, the Bank of Israel will make the platform it builds available not only to banks, as it does today, but also to other payment companies, fintech companies, consumer clubs, and more. These entities will enable us to implement not only the simple payment operations we know today but will also be able to develop advanced and innovative use cases, for example in the world of Delivery vs. Payment that can reduce risk and create a wide range of new activities in the digital economy. These entities will need to be regulated, but the financial supervision over them will be lighter than over the existing entities, because they do not actually hold the public's money – it sits at the Bank of Israel. In this way, the digital shekel may be able to make a significant contribution to innovation and competition.

In this context, I am pleased to announce here today our intention to launch in the coming weeks another significant project as part of our ongoing analysis of a potential launch of a digital shekel. In this project, inspired by Project "Rosalind" carried out by the BIS Innovation Hub, we will build an API-based "sandbox" and invite you - financial entities, fintech companies, and indeed anyone who wants - to develop advanced and innovative use cases that will help us understand how to properly design the digital shekel system so that it can support such use cases. We are now building the system and intend to officially announce the project in the coming weeks, so **stay tuned**.

The possible contribution of the digital shekel to competition will not only be in the world of payments. The digital shekel can also have an impact on competition in the world of deposits, which I talked about at the beginning of the speech. Today, the public can largely only hold their money in banks. The public's ability to hold part of their money in the digital shekel may cause banks to want to incentivize the public to keep their money with them – whether by paying interest on the current account and higher interest on deposits, or through other added values such as better service, better technology, and the like. If that won't be enough, we could consider that the digital shekel, which will be built to be able to pay interest directly on the public's holdings, would actually do that. Of course, we will need to think about this carefully – for example, by setting it at a lower level than the Bank of Israel policy interest rate, and/or by limiting the types of users who will be eligible for it and the maximum amount on which interest would be paid. If today the Bank of Israel sets the interest rate in the economy and the competition between banks determines to what extent this rate is rolled over to the public, such a mechanism will be able to allow the Bank of Israel to also directly influence the degree of transmission, and further increase competition in the deposit market. Of course, things will need to be carefully considered and designed in light of their potential impact on the financial system. This is why we are conducting thorough analysis and consult with professionals in Israel and around the world in the thinking and design processes.

Let me sum up. Like the central banks of all developed economies, the Bank of Israel has not yet made a decision regarding the possible issuance of the digital shekel. The digital shekel project is an "action plan" – at this stage, its role is to enable us to be ready to issue the digital shekel if and when we find it to be right and necessary. My message to you today is that the issue of competition in the financial system, and the way technology can support it, is a central component in our thinking about the design of the digital shekel.