# AN INFLECTION POINT FOR DIGITAL CURRENCIES STARS THE E-YUAN

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Last week's *Behind the Markets* podcast featured a discussion with Grant Wilson, head of Asia Pacific for Exante Data, on macro research, digital assets and how China's entry into the digital currency ecosystem could play out over the coming years. Last year, Exante's data scientists were focused on virus developments in late January, all while the markets continued to rise through February—putting Exante's research team on the map.

Wilson, who lives in Australia, is focused on China. China is the largest consumer of Australian goods, and the U.S. is a strategic defense partner. Australia has a challenging relationship with China, as it was the first country to ban Huawei's 5G technology before that movement went global.

Wilson sees the relationship between the U.S. and China as permanently changed. While he thinks there will be some normalization in the trading relationships under President Biden's administration, any issue involving the transfer of technology will ultimately fall into a security domain that will remain tense.

But the focus of our conversation was more on developments in the digital world. Wilson's latest thought piece on China states that 2020 was an inflection point, when digital currencies became a mainstay in the global financial ecosystem.

The new digital currency world has implications for how monetary policy is conducted and the role of traditional banks in making loans. This new digital world could change from a fractional reserve banking system to one in which central banks can provide stimulus directly to households.

China experimented with such a currency "helicopter" air drop just last year—with a small token of $30 that could be spent on a peer-to-peer basis. This came with all the know-your-customer validation required to make this work—and all the tracking that governments could desire.

**What Is Bitcoin's Importance?**

Wilson believes that Bitcoin showed the world one can conduct peer-to-peer transactions at a large scale without the need for a commercial bank or other intermediary, such as PayPal.

**Are Banks Then out of Business?**

If you can put money on deposit with the central bank with no credit risk, why would you keep any money with a commercial bank? That is one of the key elements most central banks want to be careful not to disrupt with their digital currencies.

**China as a Hard-Money Economy Last Year**

While the U.S. had explosive growth in money supply during the pandemic, in many ways China stands out for its limited growth in money supply. Wilson sees huge interest in Chinese bonds for their higher real interest rates and a lot of flows to come from their inclusion in global bond indexes. There also is still a huge under-weight to Chinese yuan (CNY) reserves, with 60% of global reserves in U.S. dollars and only 2% in CNY. Wilson expects yuan reserves to increase, despite the global political tension.

Wilson first wrote about Bitcoin in 2013 and has been a long-term holder. His current view is a little weary and cautious, and he thinks some big moves can happen around year-end, perhaps around tax planning. This happened following the 2017 peak of Bitcoin.

One of the risks to Bitcoin could be government actions that make trading much more difficult. Currently, 77% of Bitcoin mining is taking place in China and perhaps as much as one-quarter of it in Xinjiang province, where the Uighur reeducation camps are located.

This was a really great conversation on the future of digitization and cryptocurrencies, and it was very topical in its assessment of China today. You can listen to our full conversation below.

Behind the Markets on Wharton Business Radio · Behind The Markets Podcast: Grant Wilson

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## DEFINITIONS

**Monetary policy** : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

**fractional reserve banking** : A banking system where only a fraction of deposits are backed by actual cash, and therefore available for withdrawal, at a point in time. This is meant to increase capital lending and expand the economy.

**Bitcoin (the currency)** : A digital currency (also called a cryptocurrency) created in 2009, which is operated by a decentralized authority as opposed to a traditional central bank or monetary authority.

**Credit risk** : The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

**M1** : refers to the M1 money supply that includes physical money, such as coins and currency, as well as demand deposits, checking accounts, and Negotiable Order of Withdrawal accounts.

**Mortgage Bonds** : A bond secured by a mortgage on one or more assets. These bonds are typically backed by real estate holdings or real property such as equipment. In a default situation, mortgage bondholders have a claim to the underlying property and could sell it off to compensate for the default.

**Real interest rate** : Interest rate accounting for the impact of inflation. From the nominal interest rate, which does not account for the impact of inflation, the rate of inflation is subtracted to get to the real interest rate.