
The Rise of Digital Currencies and Their Impact on Canadian Monetary Policy

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Abstract

The global shift toward digital currencies presents a pivotal challenge for Canada's monetary policy framework. As the Bank of Canada explores the potential introduction of a Central Bank Digital Currency (CBDC), critical questions arise regarding its impact on financial stability, banking structures, and monetary transmission mechanisms. This paper investigates these challenges, assessing whether a CBDC could enhance economic resilience or introduce new systemic risks.

Canada has long relied on a dual monetary system that accommodates both cash and digital transactions. However, as the use of physical currency declines and private digital payment systems expand, should Canada take the next step toward a fully cashless society? Drawing on Sweden's near-cashless model and China's digital yuan experiment, this paper evaluates the feasibility and implications of eliminating cash while addressing concerns over financial inclusion, security, and public trust.

The rise of decentralized cryptocurrencies and stablecoins introduces further complexity. Bitcoin, Ethereum, and other digital assets are increasingly used as alternative stores of value and mediums of exchange, potentially undermining the Bank of Canada's control over interest rates and inflation dynamics. This paper examines whether the proliferation of decentralized finance (DeFi) could weaken the central bank's ability to conduct monetary policy, leading to a fragmented and less predictable financial system.

Using a policy-oriented framework, this research integrates empirical data, theoretical monetary models, and international case studies to explore how Canada should navigate its digital currency future. It proposes a measured approach to CBDC adoption, ensuring that monetary sovereignty is preserved while fostering innovation and financial stability.

The findings contribute to the broader debate on the future of money, the role of central banks in a digital economy, the regulation of emerging digital financial ecosystems in Canada.

Keywords: Central Bank Digital Currency (CBDC), cryptocurrencies, monetary policy, financial stability, digital payments, decentralized finance (DeFi), Bank of Canada

Secondary Subject Area

Financial Economics