

Fight for Supremacy in the Digital Asset Space: Bitcoin and Digital Yuan have Vastly Different Risk Profiles

EXECUTIVE SUMMARY

In this research report, we are comparing the strengths and weaknesses of crypto assets (cryptocurrencies) and digital yuan by analysing their unique characteristics.

Cryptocurrencies are part of digital currencies (all electronic money) to which digital yuan belongs. Based on a distributed network composed of a large number of computers, a cryptocurrency's transactions are verified and their records are maintained by a decentralized system using cryptography rather than by a centralized authority such as a bank or a credit card company. Cryptography is the mathematical and computational practice of encoding and decoding data to make sure all transactions are processed with due diligence and authenticity so that financial intermediaries can be eliminated. This practice **enhances efficiency and lowers the costs of fund transfers among users, and it is inclusive because it covers the underprivileged unbanked population.** In accordance with a recent World Bank's report, almost 1.7 billion people are unbanked worldwide.

Although **cryptocurrencies have their merits, they possess several distinctively unfavorable attributes** such as without sovereign backing, extraordinary price volatility and limited supply. Due to these shortcomings, cryptocurrencies **should not be regarded as replacements for fiat currencies for "storing" value over time.**

- Cryptocurrencies are not issued by central banks, so they are not backed by national governments. As a result, cryptocurrencies usually experience great price fluctuations. Bitcoin volatility index has been within the 5% range most of the time for the 11-year period spanning from September 2010 to August 2021. This magnitude of volatility is much higher than the 1.2% for gold and 0.5%-1.0% for major currencies.
- The majority of the cryptocurrencies has a finite number of tokens to be mined by design. During incidence of crises when markets panics, cryptocurrencies most likely perform poorly, potentially letting the holders to incur notable losses.

Therefore, cryptocurrencies are more of an asset class sharing similar characteristics with and competing against precious metals as a tool for hedging inflation.

Bitcoin remains the undisputed leader in the cryptocurrency arena in terms of market capitalization. Its market capitalization stood at US\$883 billion as of 30 August 2021, higher than the runner-up Ethereum's by approximately US\$506 billion or nearly 135%. Nonetheless, the gap regarding the market capitalization between these two leaders has been narrowed from US\$937 billion or above 350% recorded in April 2021.

On the other hand, **a central bank digital currency (CBDC) uses an electronic record or digital token to represent the virtual form of a fiat currency of a particular nation.** Unlike cryptocurrencies, a CBDC is endorsed and issued by a sovereign government, offering significant stability in its price. In addition, a CBDC does not have any presumption of anonymity like cryptocurrencies and should be basically used for payments, while some people are using cryptocurrencies as outlets for personal wealth. Thus, they are quite different in nature and usage.

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