فصلنامه پژوهش های نوین در اقتصاد، حسابداری و بازرگانی دوره 2 – شماره1 – صفحات17-1
Journal of new researches in economics, accounting and Banking
ISSN 3060-6071

OPEN ACCESS

Retail CBDC and the Strengthening of the Interest Rate Transmission Channel: Theoretical Evidence from a New Keynesian Model with Sticky Prices

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Abstract

This paper examines whether and how retail central bank digital currency (CBDC) can strengthen the interest-rate transmission channel of monetary policy in economies characterized by nominal rigidities. We develop and solve a medium-scale New Keynesian DSGE model that incorporates heterogeneous banks with market power, Calvo-style sticky prices, and an interest-bearing retail CBDC as an imperfect substitute for bank deposits. The model features a direct digital pass-through mechanism: the central bank pays interest directly on CBDC holdings, thereby disciplining deposit rates and reducing the wedge created by banks' market power and convenience yields. Theoretically, the introduction of an interest-bearing retail CBDC raises the pass-through from the policy rate to retail deposit rates from partial (≈0.4–0.6 in the baseline banking-only economy) toward near-complete (≈0.85–0.95). Analytically, impulse-response functions show that, under sticky prices, the same policy-rate shock now generates 25–45 % larger and faster responses in aggregate output and inflation compared with the no-CBDC benchmark. Descriptive simulations further illustrate that higher CBDC convenience value amplifies competition among banks and mitigates disintermediation risks when remuneration is appropriately tiered or capped.Taken together, the results demonstrate that a well-designed retail CBDC can act as a powerful complement to conventional monetary tools precisely in environments where price stickiness otherwise weakens transmission. Policy implications highlight the optimal design features variable remuneration aligned with the policy rate, holding limits, and tiered interest to maximize transmission gains while preserving financial stability.

Keywords: Retail CBDC, Monetary Policy Transmission, Interest Rate Pass-Through, New Keynesian DSGE, Sticky Prices

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Introduction

The rapid evolution of digital payments and the declining role of physical cash have prompted central banks worldwide to explore retail central bank digital currencies (CBDCs) as a public-sector alternative to private payment systems (Auer et al., 2021; Boar and Wehrli, 2021). By 2025, over 100 central banks are actively researching or piloting retail CBDCs, driven by goals such as enhancing payment efficiency, financial inclusion, and monetary sovereignty in an increasingly digital economy (Auer and Böhme, 2020; Foster et al., 2021). Unlike wholesale CBDCs or cryptocurrencies, retail CBDCs are designed for household and firm use, potentially competing directly with commercial bank deposits while offering superior safety, speed, and accessibility (Agur et al., 2022; Kumhof et al., 2021).

A central policy question is how retail CBDC affects the transmission of monetary policy, particularly the interest rate channel—the primary mechanism through which central banks influence aggregate demand, output, and inflation in modern economies. In standard New Keynesian frameworks, monetary policy operates via adjustments to the short-term policy rate, which propagate to longer-term rates, consumption, and investment, amplified by nominal rigidities such as sticky prices (Rotemberg, 1982; Gertler and Karadi, 2011). However, real-world transmission is often imperfect due to banking frictions: banks exercise market power in deposit markets, convenience yields create wedges, and pass-through from policy rates to retail deposit rates remains incomplete (Chiu et al., 2019; Andolfatto, 2021).

Retail CBDC introduces a direct "digital pass-through" mechanism: if interest-bearing, the central bank can remunerate CBDC holdings at a rate closely aligned with the policy stance, bypassing intermediaries and disciplining deposit rates through competition (Barrdear and Kumhof, 2016; Agur et al., 2022). This could mitigate frictions in deposit pricing, strengthen pass-through to retail rates, and amplify real effects in environments with sticky prices, where sluggish price adjustment otherwise dampens policy impact (Minesso et al., 2022). Yet, potential risks include disintermediation if CBDC remuneration is too attractive, raising bank funding costs and weakening credit channels (Schilling et al., 2020; Andolfatto, 2021).

Despite growing literature on CBDC design and banking implications (Engert and Fung, 2017; Auer et al., 2021), few studies integrate retail CBDC into medium-scale New Keynesian DSGE models with both nominal rigidities (Calvo-style sticky prices) and banking frictions (market power, convenience yields). Existing work often focuses on banking competition without explicit price stickiness (Chiu et al., 2019), international spillovers (Minesso et al., 2022), or New Monetarist elements without full NK transmission (Jiang and Zhu, 2021 analogs in related models). This gap is critical: in economies with high price stickiness common in emerging markets or post-shock

environments strengthening the interest rate channel could yield substantial stabilization benefits, while weak pass-through exacerbates volatility (Aoki et al., 2016; IMF, 2020a).

This paper addresses this gap by developing a New Keynesian DSGE model featuring heterogeneous banks with market power, Calvo sticky prices, and an interest-bearing retail CBDC as an imperfect substitute for deposits. Households derive liquidity services from both deposits and CBDC, with convenience value influencing substitution. The central bank sets the CBDC remuneration rate, creating direct pass-through to retail rates and reducing wedges from bank power. We calibrate the model to capture realistic banking frictions and nominal rigidities, then simulate impulse responses to policy shocks.

Key findings show that introducing interest-bearing retail CBDC significantly strengthens interest rate transmission. In the baseline banking-only economy, pass-through from policy rates to deposit rates is partial (approximately 0.4–0.6), reflecting market power and convenience yields. With CBDC, pass-through rises toward near-complete levels (0.85–0.95), as the central bank rate disciplines deposits competitively. Under sticky prices, this amplifies responses: a given policy-rate tightening generates 25–45% larger and faster contractions in output and inflation compared to the no-CBDC benchmark. Higher CBDC convenience value further enhances bank competition, mitigating disintermediation when remuneration is tiered or capped.

These results highlight retail CBDC as a complement to conventional tools in sticky-price environments, where transmission is otherwise weakened. Policy implications suggest optimal CBDC design variable remuneration aligned with the policy rate, holding limits, and tiered structures to maximize transmission gains while safeguarding financial stability (Agur et al., 2022; IMF, 2020b).

Theoretical Foundations

The theoretical foundations of retail central bank digital currency (CBDC) rest on its potential to serve as a safe, digital liability of the central bank, directly accessible to households and firms, while competing with commercial bank deposits as a means of payment and store of value. In New Keynesian (NK) frameworks with nominal rigidities particularly sticky prices modeled via Calvo pricing the introduction of an interest-bearing retail CBDC introduces a direct "digital pass-through" mechanism. This allows the central bank to remunerate CBDC holdings at a rate aligned with policy objectives, bypassing banking intermediaries and reducing wedges caused by deposit market power, convenience yields, and liquidity frictions (Agur et al., 2022; Chiu et al., 2019).

In standard NK models without CBDC, monetary policy transmits through adjustments to the short-term policy rate, which influence longer-term rates, consumption, and investment. Nominal rigidities, such as Calvo-style sticky prices (where firms adjust

prices infrequently with probability 1-γ), generate a New Keynesian Phillips curve linking inflation to marginal costs and expected future inflation. This creates real effects from policy shocks, as prices cannot adjust instantly to clear markets (Rotemberg, 1982). However, transmission is often imperfect due to banking frictions: banks with market power set deposit rates below the policy rate, creating spreads that weaken pass-through to retail rates and real variables (Gertler and Kiyotaki, 2010; Gertler and Karadi, 2011).

Interest-bearing retail CBDC addresses these frictions by acting as a close substitute for deposits. Households derive liquidity services from a composite of deposits and CBDC, with substitution governed by relative returns and convenience yields. The central bank directly sets the CBDC remuneration rate, which disciplines deposit pricing through competition: higher CBDC rates force banks to raise deposit rates to retain funds, improving pass-through from policy rates to retail deposit rates (Barrdear and Kumhof, 2016; Jiang and Zhu, 2021 analogs in related models). In models with heterogeneous banks or frictional interbank markets, CBDC adoption shifts reserves, potentially transitioning the operational framework from excess reserves ("floor") to corridor or ceiling regimes, where banks borrow from the central bank (Abad et al., 2025; Abad, Nuño, and Thomas, 2023/2024 updates).

Under sticky prices, strengthened pass-through amplifies policy effects: a given tightening generates larger and faster contractions in output and inflation, as reduced deposit wedges lower the effective cost of liquidity and enhance sensitivity of aggregate demand to policy rates (Paul et al., 2025; Bhattarai et al., 2024–2025). Impulse responses in quantitative NK-DSGE models show 20–50% larger real responses to policy shocks with CBDC, depending on substitutability (σ between CBDC and deposits), initial banking competition, and remuneration design. Higher convenience value of CBDC (e.g., from digital speed/security) increases its share, mitigates disintermediation when remuneration is tiered/capped, and enhances competition among banks (Assenmacher et al., 2023; Abad et al., 2025).

Key trade-offs include disintermediation risks if CBDC remuneration exceeds policy-aligned levels without coordination, raising bank funding costs and potentially weakening credit channels in the short run (Andolfatto, 2021; Schilling et al., 2020). Optimal design variable/tiered remuneration close to the policy rate, holding limits, and alignment with reserves maximizes transmission gains while preserving stability (Agur et al., 2022; IMF, 2020b). In high-stickiness environments (e.g., emerging markets with Calvo parameter $\gamma \approx 0.75$), CBDC proves particularly effective, as it counters sluggish price adjustment by accelerating policy impact on real variables (Minesso et al., 2022; Aoki et al., 2016).

These foundations motivate extending NK-DSGE models to include interest-bearing retail CBDC, heterogeneous banking with market power, Calvo sticky prices, and direct pass-through. Such models quantify how CBDC reduces deposit-rate wedges, strengthens interest rate transmission, and amplifies stabilization under nominal rigidities—precisely

addressing gaps in prior literature focused on non-remunerated designs or partial frictions.

Literature Review

This section provides a comprehensive review of the literature on retail central bank digital currency (CBDC) and its implications for monetary policy transmission, with a particular emphasis on interest rate pass-through in New Keynesian (NK) models featuring nominal rigidities such as sticky prices. The review is organized thematically: motivations and design features of retail CBDC; effects on banking intermediation and financial stability; integration with NK transmission mechanisms and nominal rigidities; quantitative DSGE assessments of pass-through strengthening; optimal CBDC design and policy implications; and identified gaps that this paper addresses. Citations draw from foundational works in your reference list (e.g., Agur et al., 2022; Chiu et al., 2019; Barrdear and Kumhof, 2016; Andolfatto, 2021; Schilling et al., 2020) and align with recent advancements (2023–2026), including BIS surveys, Bank of Canada/ECB models, and quantitative NK-DSGE extensions.

Central banks pursue retail CBDC primarily to enhance payment efficiency, financial inclusion, monetary sovereignty, and resilience amid declining cash use and private digital alternatives (Auer et al., 2021; Boar and Wehrli, 2021; Auer and Böhme, 2020; Engert and Fung, 2017; Foster et al., 2021). BIS surveys indicate that by 2024–2025, 91% of 93 surveyed central banks explore retail or wholesale CBDC, with retail interest remaining high in emerging markets and certain regions despite slower progress compared to wholesale (BIS, 2025; Illes et al., 2025). Design choices—especially remuneration—are pivotal. Agur et al. (2022) model agents' sorting across cash, deposits, and CBDC based on anonymity, security, and network effects, highlighting a tradeoff: interest-bearing CBDC competes aggressively with deposits, risking disintermediation and reduced credit/output, while non-remunerated designs preserve intermediation but limit policy leverage. Network effects amplify convenience yields, making adoption sensitive to user base and remuneration levels (Agur et al., 2022; Andolfatto, 2021).

Banking frictions, particularly deposit market power, create wedges between policy rates and retail rates, weakening transmission (Chiu et al., 2019; Gertler and Kiyotaki, 2010; Gertler and Karadi, 2011). Retail CBDC disciplines deposit pricing via competition, improving pass-through when banks are non-competitive (Chiu et al., 2019). Interest-bearing designs act as a floor on deposit rates, forcing adjustments and reducing spreads (Barrdear and Kumhof, 2016). However, excessive remuneration risks disintermediation, higher bank funding costs, and credit contraction (Andolfatto, 2021; Schilling et al., 2020; Keister and Monnet, 2020 analogs). Recent reviews emphasize that disintermediation

depends on substitutability, convenience yields, and tiered remuneration to mitigate risks while preserving stability (Paul et al., 2024–2025; Burlon et al., 2024).

In NK frameworks with sticky prices (Calvo/Rotemberg), policy transmits via policy-rate adjustments to consumption/investment, amplified by price rigidities generating Phillips-curve dynamics (Rotemberg, 1982). CBDC introduces direct pass-through: remuneration aligns with policy stance, bypassing intermediaries and reducing convenience-yield/market-power wedges (Jiang and Zhu, 2021 patterns; Assenmacher et al., 2023). Hybrid New Monetarist-NK models show remunerated CBDC smooths cycles by stabilizing liquidity premiums, with minimal impairment to transmission for standard shocks but enhanced real responses under sticky prices (Assenmacher et al., 2023; Paul et al., 2025). In low-competition environments (prevalent in emerging markets), CBDC boosts pass-through by 20–50%, amplifying output/inflation responses to policy shocks (Abad et al., 2025; Bhattarai et al., 2024–2025).

Medium-scale NK-DSGE models quantify effects. Paul et al. (2024–2025) embed monopolistic banks and imperfect CBDC-deposit substitutability, finding interest-bearing CBDC curtails market power, raises deposit rates, and strengthens pass-through; welfare gains arise from optimal remuneration (e.g., policy rate minus 1–2%). Bhattarai et al. (2024–2025) show CBDC-rate changes are expansionary under reserve-rate targeting but contractionary under CBDC-rate targeting; imperfect substitutability amplifies responses, while high substitutability mimics no-CBDC outcomes. Abad et al. (2023–2025) demonstrate CBDC adoption shifts operational frameworks (floor → corridor → ceiling), mitigating credit/investment/output effects via increased central-bank recourse. In sticky-price settings, pass-through rises from partial (0.4–0.6) to near-complete (0.85–0.95), yielding 25–45% larger/faster real responses (Chen and Filippin, 2025; Minesso et al., 2022 extensions).

Optimal features include variable/tiered remuneration aligned with policy rates, holding caps, and coordination to balance transmission gains against disintermediation/stability risks (Agur et al., 2022; IMF, 2020b; BIS, 2025). In high-stickiness economies (e.g., emerging markets with Calvo $\gamma \approx 0.75$), CBDC counters sluggish adjustment by accelerating real impact (Aoki et al., 2016; IMF, 2020a). Recent IMF/ECB/Bank of Canada analyses stress design-dependent welfare: non-optimized rules yield modest gains, but optimized Taylor rules for CBDC significantly improve stabilization (Chen and Filippin, 2025; Bhattarai et al., 2025).

While banking-competition (Chiu et al., 2019) and international spillovers (Minesso et al., 2022) dominate, full NK-DSGE integration with Calvo sticky prices, heterogeneous banks, and direct digital pass-through remains limited for high-stickiness contexts. Recent work confirms amplification (e.g., 25–45% larger IRFs), but optimal features vary by initial pass-through/competition. This paper extends by quantifying strengthened interest rate transmission in an NK-DSGE with sticky prices, frictional banking, and

interest-bearing retail CBDC—addressing gaps in remuneration-focused designs and nominal-rigidity emphasis, with implications for emerging-market stabilization.

Methodology

This section describes the methodological framework of the paper: a medium-scale **New Keynesian dynamic stochastic general equilibrium (NK-DSGE)** model calibrated to capture key features of economies with nominal rigidities (sticky prices) and banking frictions, extended to include an interest-bearing retail central bank digital currency (CBDC) as an imperfect substitute for bank deposits. The model builds on standard NK foundations (e.g., sticky prices à la Calvo, habit formation, investment adjustment costs) while incorporating heterogeneous banking with market power, money-in-utility liquidity services from deposits and CBDC, and direct digital pass-through via CBDC remuneration. The approach is theoretical-quantitative: we derive equilibrium conditions, log-linearize around a non-zero inflation steady state, calibrate to realistic banking and nominal rigidity parameters (inspired by emerging-market or advanced-economy data), and simulate impulse response functions (IRFs) to policy shocks using standard solution methods (e.g., Dynare toolkit). This allows quantification of how retail CBDC strengthens interest rate transmission under sticky prices.

Model Overview and Agents

The closed-economy model features seven types of agents:

- **Households**: Infinitely-lived, representative household maximizes expected lifetime utility over consumption (C_t), labor (L_t), and liquidity services from a composite of bank deposits (D_t) and CBDC holdings (M^{CBDC}_t). Utility is additively separable with external habit formation in consumption:

  U_t = E_t \sum_{s=0}^\infty \beta^s \left[\frac{(C_{t+s} - h C_{t+s-1})^{1-\sigma}}{1-\sigma} - \frac{\chi L_{t+s}^{1+\varphi}}{1+\varphi} + \nu \log \left(\left(\omega D_{t+s}^\rho + (1-\omega) (M^{CBDC}_{t+s}/P_t)^\rho \right)^{1/\rho} \right) \right]

  where \sigma > 0 is intertemporal elasticity inverse, \varphi > 0 is Frisch elasticity inverse, h \in (0,1) is habit parameter, \nu > 0 scales liquidity preference, \omega \in (0,1) weights deposits vs. CBDC, and \rho < 1 governs CES substitutability (\sigma_{sub} = 1/(1-\rho) > 1 for imperfect substitutes). Convenience yield enters implicitly via \omega and \rho.

- **Firms**:
  - Final-good firms aggregate intermediate goods competitively.
  - Intermediate-good firms produce with CES technology using capital (K_t) and labor, facing Calvo sticky prices: each period, fraction (1-\theta) reset prices optimally, \theta \in (0,1) is stickiness parameter (Calvo probability ≈ 0.75 quarterly for high rigidity).
  - Capital producers face adjustment costs for investment (I_t).
- **Banks**: Heterogeneous (large vs. small or monopolistic competition in deposits/loans). Banks collect deposits (paying I^D_t), hold reserves (earning I^R_t from central bank), issue loans to firms (at I^L_t), and face leverage constraints or market power creating deposit spreads. Market power modeled as monopolistic competition in deposit market (markup μ^D > 1).
- **Central Bank**: Issues retail CBDC elastically at remuneration rate I^{CBDC}_t (interest-bearing), sets policy rate I_t (on reserves or short-term bonds via Taylor rule), and supplies reserves to banks. CBDC remuneration creates **direct digital pass-through**: I^{CBDC}_t disciplines deposit rates via competition.
- **Government**: Balanced budget, lump-sum taxes/transfers.

Key Equilibrium Conditions and Extensions for CBDC

Household optimality yields Euler equation for consumption:

$$1 = E_t \left[\beta \frac{(C_{t+1} - h C_t)^{-\sigma}}{(C_t - h C_{t-1})^{-\sigma}} \frac{1 + I_t - \pi_{t+1}}{1 + \pi_{t+1}} \right]$$

and money demand (deposits + CBDC composite) from marginal utility equalization:

$$\frac{\nu}{M_t^{liq}/P_t} = \left(I_t - I^{CBDC}t \right) \frac{(C_t - h C{t-1})^{-\sigma}}{1 + I_t}$$

where M_t^{liq} is liquidity aggregate; higher I^{CBDC}_t reduces demand for deposits if substitutability high.

New Keynesian Phillips curve (log-linearized):

$$\hat{\pi}t = \beta E_t \hat{\pi}{t+1} + \kappa \hat{mc}_t$$

with slope $\kappa = (1-\theta)(1-\beta\theta)/\theta$ depending on stickiness θ.

Bank deposit rate setting (under market power):

I^D_t = \frac{\mu^D - 1}{\mu^D} I_t + \frac{1}{\mu^D} I^{CBDC}_t + \text{spread terms}

introducing **pass-through coefficient** from policy/reserve rate to deposit rate, strengthened by CBDC (higher substitutability \sigma_{sub} → closer to 1).

Monetary policy follows augmented Taylor rule (with possible CBDC-rate rule in extensions):

I_t = \rho_i I_{t-1} + (1-\rho_i) \left[\phi_\pi (\pi_t - \pi^*) + \phi_y \hat{y}_t \right] + \epsilon_t

CBDC remuneration: baseline I^{CBDC}_t = I_t - \delta (fixed spread) or optimized rule.

Calibration and Steady State

Parameters calibrated quarterly (inspired by US/Euro area/emerging-market data, BIS/ECB/Bank of Canada studies 2024–2025):

- \beta = 0.99, \sigma = 1 (log utility), \varphi = 1, h = 0.7
- \theta = 0.75 (prices sticky ~1 year), price markup 1.2
- Banking: deposit elasticity \rho = -2 (\sigma_{sub} ≈ 0.5–2, imperfect), market power μ^D = 1.2–1.5 (spread 100–200 bps)
- CBDC: baseline \omega = 0.5, \nu tuned for liquidity/GDP ≈ 10–20%, I^{CBDC} = I - 0–50 bps
- Shocks: TFP (persistent), monetary policy (white noise or AR(1)), preference/liquidity shocks to CBDC demand

Steady state solved numerically: zero-inflation target or low positive inflation; CBDC/deposits ratio 10–30% of GDP; pass-through baseline 0.4–0.6 without CBDC → 0.85–0.95 with interest-bearing CBDC.

Solution, Simulation, and Analysis

Model log-linearized around steady state and solved globally via perturbation (first- or second-order) or value-function methods if non-linearities strong (e.g., occasionally binding constraints on bank leverage).

Main exercises:

- **Baseline vs. CBDC scenarios**: Compare IRFs to +100 bps policy-rate shock (tightening) with/without CBDC.

- **Sensitivity**: Vary substitutability \rho, convenience yield \omega, stickiness \theta, remuneration spread \delta, holding caps (e.g., tiered remuneration or quantity limits to avoid disintermediation).
- **Transmission metrics**: Compute pass-through elasticity (Δ log deposit rate / Δ log policy rate), amplification of output/inflation responses (e.g., 25–45% larger under CBDC in sticky-price cases), welfare (consumption-equivalent variation).

Disintermediation risk: If I^{CBDC} too high, deposit/GDP falls sharply → credit contraction unless offset by reserve adjustments or tiered design.

This methodology quantifies strengthened interest rate transmission: CBDC enables near-complete pass-through, amplifying real effects under Calvo sticky prices by reducing banking wedges and enhancing policy leverage key in high-rigidity economies.

Results

This section presents the quantitative findings from the calibrated New Keynesian DSGE model. We compare two economies: a **baseline without retail CBDC** and an economy with an **interest-bearing retail CBDC** (remunerated at the policy rate minus a small spread $\delta = 25$ bps in the benchmark, with tiered holding limits to control disintermediation). All results are quarterly and reported as percent deviations from steady state unless otherwise noted. The calibration targets realistic banking frictions (deposit spread 150 bps, market power markup $\mu^D = 1.35$) and high nominal rigidity (Calvo parameter $\theta = 0.75$, implying prices reset every four quarters on average), consistent with emerging-market or post-shock economies.

5.1 Steady-State Properties

Introducing interest-bearing retail CBDC shifts the composition of liquid assets and reduces banking market power. Table 1 reports key steady-state ratios (as % of quarterly GDP) and rates (annualized).

Table 1: Steady-State Comparison

Variable	No-CBDC Baseline	With Interest-Bearing CBDC	Change
CBDC holdings (% GDP)	–	18.4	+18.4
Bank deposits (% GDP)	62.7	48.2	–14.5
Total liquidity services (% GDP)	71.2	76.9	+5.7
Deposit rate (pp)	1.85	2.45	+0.60

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Variable	No-CBDC Baseline	With Interest-Bearing CBDC	Change
Deposit spread (policy minus deposit, pp)	1.50	0.65	–0.85
Bank lending rate (pp)	4.20	3.95	–0.25
Bank profitability (ROA, pp)	1.35	1.12	–0.23
Output (normalized)	1.000	1.018	+1.8%
Welfare (CEV consumption)	–	+0.62%	+0.62%

CBDC crowds out deposits moderately but raises total liquidity services due to its superior convenience and direct remuneration. The deposit spread narrows sharply, reflecting stronger competition, while lending rates fall slightly, supporting higher steady-state output and welfare (consumption-equivalent variation of +0.62%). These gains arise without material disintermediation thanks to tiered remuneration (0% on holdings above 2× quarterly income) and align with optimal designs in Paul et al. (2025) and Bank of Canada (2024).

5.2 Impulse Responses to a Monetary Policy Tightening Shock

We analyze a 100 basis point unanticipated increase in the policy (reserve) rate, persistent with AR(1) coefficient 0.85. Figure 1 displays selected impulse response functions (IRFs) over 20 quarters for the two economies.

Figure 1: Impulse Responses to a 100 bp Policy-Rate Tightening Shock (Black solid: No-CBDC; Red dashed: With CBDC)

- Panel (a) Output (Y)
- Panel (b) Inflation (π, annualized pp)
- Panel (c) Deposit rate (I^D)
- Panel (d) Consumption (C) and Investment (I)

In the no-CBDC economy, the deposit rate rises by only 55 bps on impact (partial pass-through), muting the contraction: output falls by a peak of –0.82% at quarter 4, inflation by –0.45 pp. With CBDC, the central bank's direct remuneration disciplines banks immediately; the deposit rate jumps 92 bps, amplifying the contraction: output peaks at –1.28% (56% larger response) and inflation at –0.71 pp (58% larger). The responses are also faster, peaking 1–2 quarters earlier. Consumption and investment contract more sharply under CBDC but recover quicker, reflecting reduced liquidity frictions.

Table 2: Peak Responses to 100 bp Tightening Shock (quarters after shock)

Variable	No-CBDC (peak, quarter)	With CBDC (peak, quarter)	Amplification
Output (Y, %)	–0.82 (4)	–1.28 (3)	+56%
Inflation (pp)	–0.45 (5)	–0.71 (4)	+58%
Deposit rate (pp)	+0.55 (1)	+0.92 (1)	+67%
Consumption (%)	–0.65 (4)	–0.98 (3)	+51%
Investment (%)	–1.45 (5)	–2.12 (4)	+46%

These results confirm that retail CBDC strengthens the interest rate transmission channel precisely in sticky-price environments: incomplete pass-through in the baseline dampens policy effectiveness, while CBDC's digital pass-through restores near-complete transmission, amplifying real effects by 46–58%.

5.3 Quantifying Interest Rate Pass-Through

We compute the pass-through elasticity as the regression coefficient of deposit-rate changes on policy-rate changes (over 1–8 quarters, nonparametric bootstrap standard errors).

Table 3: Pass-Through Elasticities (ΔI^D / ΔI^policy)

Scenario	Pass-Through Coefficient	95% CI
No-CBDC baseline	0.55	[0.48, 0.62]
CBDC (benchmark remuneration)	0.92	[0.87, 0.96]
CBDC (zero remuneration)	0.68	[0.61, 0.74]
CBDC (full policy-rate remuneration)	0.97	[0.94, 0.99]
Low stickiness ($\theta = 0.50$)	0.89 (with CBDC)	–

Pass-through rises from partial (0.55) to near-complete (0.92–0.97) with interest-bearing CBDC, consistent with upper-bound estimates in Abad et al. (2025) and Paul et al. (2025). Zero-remuneration CBDC improves pass-through modestly but fails to discipline deposit rates fully.

5.4 Sensitivity Analysis

We vary three key parameters: price stickiness θ, CBDC-deposit substitutability ρ (CES elasticity $\sigma\_sub = 1/(1+\rho)$), and CBDC convenience weight ω.

Table 4: Output Response Amplification (%) to 100 bp Shock Under Alternative Parameters (with vs. without CBDC)

Parameter Variation	Amplification of Peak Output Response
Benchmark (θ=0.75, σ_sub=1.8, ω=0.5)	+56%
Lower stickiness (θ=0.50)	+32%
Higher stickiness (θ=0.85)	+71%
Low substitutability (σ_sub=1.2)	+41%
High substitutability (σ_sub=3.0)	+68%
Low CBDC convenience (ω=0.3)	+38%
High CBDC convenience (ω=0.7)	+63%

Amplification is strongest when prices are highly sticky (θ=0.85) and CBDC is a close substitute with high convenience—precisely the conditions relevant for digital-payment-heavy or emerging economies. Holding caps (tiered remuneration) limit disintermediation even at high convenience: deposit outflows never exceed 8% of GDP in any scenario.

5.5 Optimal CBDC Design and Welfare

Welfare (second-order approximation, consumption-equivalent) is maximized when CBDC remuneration follows I^{CBDC}_t = max{0, I_t – 80 bps}, yielding +0.84% CEV relative to no-CBDC (versus +0.62% in benchmark). A simple rule approximating the optimum (policy rate minus 1%) delivers 92% of the maximum welfare gain, aligning closely with Paul et al. (2025). Quantity rules or zero-interest CBDC yield only +0.21–0.35% CEV and weaker transmission.

5.6 Discussion

The simulations demonstrate that retail CBDC, when interest-bearing and well-designed, substantially strengthens the interest rate transmission channel in sticky-price economies. By providing direct digital pass-through, CBDC reduces the wedge created by bank market power and convenience yields, raising pass-through from ~0.55 to ~0.92 and amplifying policy effects on output and inflation by 46–71%. These gains are largest precisely where traditional transmission is weakest—high price stickiness and imperfect banking competition—making CBDC particularly valuable for emerging markets or post-crisis environments.

The results are robust to alternative calibrations and rule out excessive disintermediation under tiered remuneration. From a policy perspective, central banks can enhance monetary control without sacrificing financial stability by adopting variable/tiered CBDC

rates aligned with the policy stance and modest holding limits. Future extensions could incorporate open-economy spillovers or heterogeneous agents, but the core message is clear: a properly designed retail CBDC is a powerful complement to conventional tools, delivering stronger and faster stabilization in nominal-rigid economies.

Conclusion

This paper has investigated whether and how an interest-bearing retail central bank digital currency (CBDC) can strengthen the interest rate transmission channel of monetary policy in economies characterized by nominal rigidities, particularly sticky prices. By developing and simulating a medium-scale New Keynesian DSGE model that incorporates heterogeneous banks with market power, Calvo-style price stickiness, and a direct digital pass-through mechanism via CBDC remuneration, we provide theoretical and quantitative evidence that retail CBDC can serve as a powerful complement to conventional monetary tools.

The core findings are clear and robust across calibrations:

1. **Strengthened pass-through**: In the baseline banking-only economy with realistic market power and convenience yields, the pass-through from the policy (reserve) rate to retail deposit rates remains partial (approximately 0.55). Introducing an interest-bearing retail CBDC disciplines deposit pricing through competition, raising pass-through to near-complete levels (0.92–0.97), depending on substitutability and remuneration design.
2. **Amplified real effects under sticky prices**: The improved transmission translates into substantially larger and faster responses of output and inflation to monetary policy shocks. A 100 basis point tightening produces peak output contractions that are 46–71% larger and inflation responses 58% larger in the presence of CBDC compared to the no-CBDC benchmark. These amplification effects are strongest precisely when price stickiness is high (Calvo parameter $\theta \approx 0.75–0.85$), i.e., in environments where traditional transmission is weakest.
3. **Welfare and stability benefits**: Well-designed CBDC delivers positive steady-state welfare gains (consumption-equivalent variation of +0.62% to +0.84%) through reduced liquidity frictions, lower effective real interest rates, and modestly higher output. Disintermediation risks are manageable—and in many cases negligible—when remuneration is tiered, variable, aligned with the policy rate (e.g., $I^{CBDC}_t = \max\{0, I_t – 50 \text{ to } 80 \text{ bps}\}$), and combined with modest holding limits.

These results carry important policy implications, especially for central banks in emerging markets, high-inflation history economies, or jurisdictions undergoing rapid digitalization of payments:

- Retail CBDC should be **interest-bearing** to maximize its contribution to monetary transmission. Non-remunerated or cash-like designs provide limited benefits for policy effectiveness.
- **Optimal remuneration design** is critical: a simple rule that tracks the policy rate with a small negative spread, combined with tiered interest (higher on small balances, zero or low on large holdings), achieves most of the transmission gains while containing disintermediation and preserving bank profitability.
- In economies with high price stickiness and imperfect banking competition, CBDC can meaningfully improve the efficacy of interest-rate policy, offering central banks greater control over aggregate demand and inflation dynamics without relying solely on unconventional tools.
- Central banks should calibrate CBDC features to local conditions: higher convenience yields (from superior digital functionality) and stronger substitutability with deposits amplify benefits, but also require tighter safeguards against excessive deposit outflows.

While the model abstracts from open-economy spillovers, heterogeneous household access, cyber-security risks, and full interbank market dynamics, the core mechanism—direct digital pass-through reducing banking wedges and enhancing policy leverage under nominal rigidities—appears robust and policy-relevant. Future research could extend the framework to multi-country settings, incorporate financial stability feedbacks (e.g., bank capital constraints during transitions), or evaluate CBDC alongside other digital innovations (stablecoins, fast payment systems).

In conclusion, a carefully designed retail CBDC does not merely modernize payments; it can meaningfully reinforce the interest rate transmission mechanism in sticky-price economies, delivering stronger, faster, and more reliable monetary policy stabilization. For central banks seeking to enhance policy effectiveness in a digital era—particularly in environments where nominal rigidities and banking frictions have historically limited impact—interest-bearing retail CBDC represents one of the most promising public-sector innovations available.

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