Libra 2.0 – What does it mean for monetary policy and financial stability?

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The views expressed here are those of the presenter and do not necessarily reflect those of the ECB.
Introduction

Adoption of crypto assets has raised concerns related to money laundering, illicit financing as well as consumer and investor protection.

Facebook’s Libra initiative has sparked reactions among regulators and policy makers to better understand the implications of privately issued stablecoins.

Extent of adoption is key for implications related to monetary policy though financial stability issues can arise already with more limited use.
Overview

1. Global stablecoins and Facebook’s Libra initiative
2. Potential implications for financial stability and monetary policy
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Global stablecoins and Facebook’s Libra initiative
Global stablecoins

A global **stablecoin** is digital asset that features a mechanism to **reduce price volatility** and with **global reach**.

Issued on a **distributed ledger** (blockchain).

**Value** of stablecoin is **collateralised by funds** that back up the issuer’s commitment to redeem them.

Existing stablecoins have **limited links** to traditional financial system as they are mainly used to move between and **store revenue** from **crypto-asset investments**.
The Libra proposal of June 2019

Libra announced as a **global stablecoin** and **financial infrastructure**:

- Built on **blockchain** technology;
- Backed by a **reserve** of stable and liquid assets, denominated in US dollars, euro, yen, the British pound and the Singapore dollar;
- Governed by the independent **Libra Association**;
- **Convertible** into a **local currency** based on an exchange rate.
G7 report on global stablecoins in October 2019

Need for innovation to support more competitive markets, financial inclusion and improved cross-border payments. Potential adverse effects on transmission of monetary policy, financial stability and the international monetary system. Same activities and same risks should face same regulation. Public authorities will continue efforts to improve payment systems. Central banks will assess relevance of issuing central bank digital currency (CBDC).
A stablecoin arrangement could fall under a number of different regulatory frameworks or, potentially, none of them.

Payment functions fall under the Eurosystem’s oversight framework if located in euro area or systemically relevant for euro payments.

The asset management function could qualify as issuer of e-money, investment fund or bank.
- Redeemable at par, claim on issuer, no credit => e-money.
- Risky financial assets, claim on share of issuer’s assets => investment fund.
- Redeemable at par, provision of credit => bank.

Stablecoin arrangement outside euro area without claim on issuer or reserve assets and not systemically relevant => none of above.
Libra 2.0 – What has changed?

Updated Libra Whitepaper of April 2020:

- Adding **single-currency** stablecoins,
- Stronger **protection for reserve** (e.g. capital buffer),
- **Permissioned blockchain** system only,
- Enhance **compliance framework** for prevention of illicit activity.

Potential future **touchpoints** with **central banks**:

- Place Libra **reserves** in **central bank accounts**.
- **Integrate** central bank digital currencies (**CBDC**).

**Concerns** related to public policies **persist**.
Potential implications for financial stability and monetary policy
Scenarios for potential take-up

Some benchmark figures:
- 286 million PayPal users hold €153 billion (€64 per capita).
- 588 million Yu’E Bao users (part of Alibaba Group) hold €135 billion (€231 per capita, market exchange rates).
- 2.4 billion Facebook users, of which 240 million (10%) located in euro area.

Euro share in Libra reserve exceeds share of euro area Facebook users, pointing to potential capital inflows.

Up to 30% of euro area safe short-term government bonds in reserve.

Moderate impact on euro area bank deposits.
- Outflow of household deposits into Libra of less than 3%.
- Bank deposits managed by Libra reserve about 0.5%.

(Source: ECB Macroprudential Bulletin May 2020)
A **stablecoin** arrangement is **exposed** to banks’ credit and liquidity **risks** and to credit, liquidity and market **risks of the government bonds** held.

Risks depend on whether the **value** of the coin is **fixed**. Users may misperceive risks of floating value. Fixed value creates solvency risk for the issuer.

Large redemption requests could trigger **sell-off of reserve assets** with ensuing contagion effects.

Single-currency stablecoins **not legally separated** with potential spill-overs of losses **across the reserves**.
Implications for policy interest rates

Zero remuneration of Libra could harden the effective lower bound on policy rates. Effect may be stronger for single-currency version of Libra. Low remuneration of reserve would challenge Libra’s business model.

Libra reserve could contribute to safe asset scarcity. Lowering the risk-free yield curve. Increasing money market fragmentation Affecting collateral quality and valuation among different member states.
Implications for monetary policy transmission

**Stability and cost of bank deposit funding** could be affected.

- **Shift** of deposits into Libra.
- Partial **reinvestment** into bank deposits through the **Libra reserve**. If Libra backed by **central bank reserves** a larger outflow of deposits without reinvestments could result.

**Bank disintermediation** could have consequences for **lending rates and credit provision**.

Use of **Libra** in **payments** could affect banks‘ income from **fees**.
Other effects with implications for monetary policy

Libra-induced **capital flows** could affect the exchange rate. Multi-currency version of Libra has higher euro share in reserve than potential users in euro area. Effects of single-currency version depends on take-up abroad.

If **prices** were to be **quoted in** multi-currency **Libra**, the **unit-of-account function** may become **impaired** with consequences for monetary policy transmission.

Banks’ **demand for central bank reserves** could decrease, with potential impact on operation of a corridor system for short-term rates.
Libra can fill gaps in cross-border payments that fail to satisfy user demands in terms of convenience, cost, access and speed.

Global stablecoins such as Libra could interfere with monetary policy transmission via various channels.

Concerns related to monetary policy and financial stability are not alleviated by the updated Libra proposal.

Under plausible scenarios for adoption, monetary policy impact would be contained though many unknowns remain.

Facebook’s Libra initiative has acted as a catalyst to advance work on central bank digital currency (CBDC).
Thank you