EUROPEAN CENTRAL BANK

EUROSYSTEM

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

SUERF Webinar

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Katrin Assenmacher
Monetary Policy Strategy Division

Disclaimer

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

1

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).

Regulatory considerations

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**.

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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)

Financial stability implications

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.

Conclusions

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