

Why central banks shouldn't ignore stablecoins

Rapid growth of stablecoins could impair monetary policy transmission



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For those who remember the 1970s, the recent growth of stablecoins may bring to mind the early, Wild West days of the Eurodollar market. Back then, the emergence of cheap offshore funding allowed US banks to circumvent domestic regulations and associated capital costs.

The Federal Reserve initially ignored the rise of this shadow currency system, which grew by more than tenfold in that turbulent decade. That proved to be a mistake. The explosion of Eurodollars fuelled a sharp rise in the velocity of money – albeit on a smaller base to now – and undermined the transmission of monetary policy at a time of rising inflation.

Like Eurodollars in the 1970s, stablecoins exist outside the official money supply and beyond the reach of regulators. They also possess inherent advantages, allowing for T0

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settlement of both digital and traditional assets. The fact that large commercial banks are contemplating tokenised deposits suggests they see value in the concept.

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Before the [FTX](#) and [Terra](#) debacles of 2022, the market for stablecoins was growing rapidly – at a rate of 500% per annum, as of September 2021, according to the Fed. There are presently around \$130 billion worth of stablecoins backed by high-quality liquid assets (HQLAs), such as US Treasuries primarily, and, in the near future perhaps, German Bunds, UK gilts and Japanese government bonds. The combined annualised payments volume of the top-three stablecoins – Tether, USDC and Binance USD – in the wholesale segment stands at around \$7.5 trillion on-chain, and almost \$11 trillion including on-exchange volumes (see table A, columns three and five). This is roughly equivalent to a velocity of around 80 to 100, compared with only 1.26 for traditional M1 money supply – essentially cash and current accounts.

A. Stablecoins on- and off-chain volumes and velocities (January 2, 2023)

Currency	Monetary base (\$ billions)	Annualised on-chain volume (\$ billions)	On-chain (M1) velocity	Annualised volume, including exchanges (\$ billions)	Total velocity
USDT (Tether)	\$70.3	\$3,841	55x	\$8,267	118x
USDC	\$41.6	\$3,397	82x	\$702	17x
Binance USD	\$16.4	\$290	18x	\$1,939	118x
Others (USDP, GUSD)	\$1.5	\$7	–	\$1	–
Totals	\$129.8 billion	\$7.5 trillion	–	\$10.9 trillion	–

Source: Coin Metrics for on-chain and supply data; CoinGecko for total volume; exchange volume not independently verifiable

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This alternative money supply currently exists outside the regulatory perimeter. If the growth of stablecoins resumes at anything close to pre-2022 levels, this could have severely adverse consequences for repo markets and other parts of traditional financial market plumbing, especially if the timeline for unwinding the Fed's balance sheet is extended. In other words, the rapid growth of stablecoins that silo HQLAs may have spillover effects for financial markets and monetary policy transmission. For this reason, we have [previously suggested](#) that stablecoins should be regulated and backed by central bank reserves.

That may be a bridge too far for supervisors. There are at least two other ways to bringing stablecoins within the regulator perimeter. One option is tokenised deposits – not a new concept, but a new name for electronic

liabilities. Some banks already offer these, but they will need to break their 'walled gardens' to increase the velocity of tokenised deposits. To replicate the utility of stablecoins, a JP Morgan token must be eligible for use at Barclays or Citi, and vice versa. One problem is that tokenised deposits, which are digital assets and settle T0, must still be ring-fenced from conventional T1 deposits. Allowing T0 and T1 assets to be fungible is a curveball that bank treasurers will find challenging to deal with. In the US, the Office of the Comptroller of the Currency has [signalled](#) that it is not keen on such fungibility.

Another alternative is currently being explored by USDC, one of the big three stablecoins, which is moving the bulk of its collateral – primarily US Treasury bills – to BlackRock. These assets will be held in a BlackRock money market fund with access to the Fed's reverse repo programme, essentially creating an explicit central bank liability without access to a Fed master account. This is an interesting development that suggests stablecoins can move inside the regulatory perimeter, but it is far from guaranteed that the Fed will permit this regulatory arbitrage from a lightly regulated non-bank entity.

It remains to be seen whether stablecoin innovations will be widely embraced by the market, or if legacy payment systems will be upgraded to make them redundant. But for any central bank that wishes to control money supply, ignoring stablecoins may create problems similar to those posed by Eurodollars in the 1970s.

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