

Stable coins, a bigger threat to banking

WHILE doing academic research on Bitcoin, I was struck by the "Global crypto adoption index," which measures the adoption of crypto currencies across 154 countries. What amazed me was the geographic locations of the top three countries (Vietnam at number one, India at two, and Pakistan at three). What makes them so unique is, like Bangladesh, they are lower-middle income countries and share somewhat similar economic circumstances like inflation and unemployment, among other activities.

Surprisingly, although Bangladesh has banned the usage of Bitcoin and other crypto currencies in 2017, Bangladesh ranks 29 in the index with an index score of 0.09, compared to 0.37 and 0.36 by India and Pakistan, respectively. The three elements of this index include total crypto currency received by a country, total transactions, and peer-to-peer trade volume-all weighted by purchasing power parity per capita. The fact that the index provider has this level of detail suggests the existence of unofficial crypto currency activities in Bangladesh that the authority may or may not be aware of. We must not forget that controlling money laundering is a perennial battle for Bangladesh, and until recently, we were not aware of the presence of casino gambling in our community. Hence, despite the banning, Bangladesh's position in the global crypto index is a matter of serious public concern.

Why is crypto currency growing so popular in neighbouring countries and Asia in general? As of 2021, Asia accounts for half of all crypto currency users globally. Unpredictable inflation, weakening of the domestic currency, and reduced transaction costs, are among the other factors making open-source crypto currencies increasingly popular among young consumers. Their very popularity has turned out to be a litmus test for emerging central banks who must regain public trust in the monetary policymaking of maintaining price stability and exchange rate stability.

There is an interesting parallel here. Just as citizens of emerging countries are quickly adopting crypto currencies in fear of weakening national currencies, their policymakers too are contemplating a digital version of their fiat currencies. For instance, of the nine countries that have launched a digital currency (the so-called central bank digital currency or CBDC), all are small developing countries. Among the 14 countries that are in the pilot stage, China and South Korea are the most prominent of them. The Indian parliament is expected to approve the legal framework for launching an e-rupee any day. The biggest worry for emerging central banks is that if they do not digitise their nation-

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al currencies, private crypto currencies will soon jeopardise their monetary sovereignty.

The case is somewhat different for advanced countries, which enjoy reserve status for their currencies. Therefore, unlike their emerging counterparts, central banks of developed countries are not worried that decentralised crypto currencies will impair their ability to set interest rates or control money supply to manage inflation. Developed central banks are not sure whether the benefits of CBDC outweigh the risk.

The hesitancy by developed central banks in issuing digital currencies can partly be explained by the rise of stable coins, which are digital currencies pegged to the major reserve currencies such as the euro or the US dollar. Just as the Saudi riyal is pegged to the US dollar, a stable coin is a digital currency that can be pegged to a major currency such as the dollar or against a basket of currencies. The holders of stable coins are promised that for every \$1 they put in, their money will remain worth

\$1. But unlike the Saudi riyal which is a government fiat currency, a stable coin can be issued by a global fintech company.

Stable coins are uninteresting as an investment asset since their values are fixed, but they have the potential to disrupt monetary transmission mechanisms in emerging and developing countries. Imagine that Google has floated a stable coin that can serve its billion clients. Many consumers would be willing to substitute their domestic currencies in favor of the stable coin simply because it will not erode their purchasing power due to high inflation at home. Imagine the plight of Turkish people whose currency has lost over 40 per cent against the US dollar, and as a result, inflation in Turkey has reached a 19-year high of 36 per cent. In fact, the inflation plight has cost Turkish statistical chief, Sait Erçal Dincer, lose his job as he refused to tamper inflation figures to please Turkey's president Recep Tayyip Erdoğan. It is not sur-

prising that many Turkish have turned to one of the most traded stable coins, Tether.

A headache for emerging central banks is that instead of regulating stable coins, major central banks such as the Federal Reserve or European Central Bank might actually support stable coins. This is an opportunity for developed central banks to further strengthen their currencies in the technology platforms without actually issuing digital currencies. This is why developed central banks are not in a hurry to adopt CBDCs because, unlike emerging markets, crypto currencies do not threaten their monetary sovereignty.

There is an interesting functional difference between crypto currencies and stable coins. As pointed out by Stephen Jen of Eurizon Capital, as hedge fund, stable coins are not an exciting asset because their values are fixed, but they have a great potential to become widespread digital currencies because unlike crypto currencies, they are stable. The wild price

swings will always undermine a crypto currency's potential as a currency. As Stephen Jen puts it, "what is a good asset is a bad currency (i.e., crypto currency), and a good currency is a bad asset (stable coins)." This schizophrenic conflict between assets and currencies will divide investors (retail and institutional alike) into two groups: one who prefers change and one who values legacy currency.

At a dinner in 2018, I told one of my friends, who was then the head of finance of a multinational bank, that people will not need to visit banks in a few decades as most of their needs will be served by advances in technology platforms. He disagreed and was surprised as to how I, as an economist, can make such a prediction when banks play such an outsized role, particularly in Bangladesh's economy. With the rise of stable coins, the possibility of "bank disintermediation" is not possible, but probable. If, for example, cross-border payments for trade and services such as tuition fees and medical expenses can be made through stable coins, commercial banks will face difficulty in raising the desired level of deposit. The higher cost of the deposit will drive up the cost of credit. This is a new risk to the financial stability of the banking system. Needless to say, the risk of bank disintermediation also stems from CBDCs, as many will shift their risk-carrying deposit in commercial banks to risk-free CBDCs. But with CBDCs, some of the adverse side effects can be mitigated by capping on the amount of CBDCs people can hold and what interest rates central banks can offer on digital currencies.

In addition to national currencies, the future payment landscape will include multiple CBDCs, stable coins, and perhaps a few successful crypto currencies like Bitcoin and Ethereum. Stable coins ought to enhance the dominance of major currencies such as the dollar, euro, pound, and yen. But the asset-backed stable coins will compete with and disintermediate currencies of emerging markets as an alternative to money. In an undergraduate course on money and banking that I have just finished teaching, I asked students whether, after graduation, they would like to receive their salary in taka or the dollar. Forty-four per cent of students answered in favour of the dollar, which gives us a hint to the degree of currency substitutability among the young generation. In the coming semester, I plan to repeat this question by adding two more options: stable coins and crypto currencies, simply to reflect the changing landscape of the global payment system.

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