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Built to fall? As the CBDC sun rises, stablecoins may catch a shadow

Will central banks allow stablecoins to survive? Maybe as a financial instrument for the unbanked or they will be able to peacefully co-exist?

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There's a ferment brewing with regard to central bank digital currencies (CBDCs), and most people really don't know what to expect. Varied effects seem to be bubbling up in different parts of the world.

Consider: China's e-CNY has already been used by 200 million-plus of its citizens and a full rollout could happen as early as February — but will a digital yuan gain traction internationally? Europe's central bank has been exploring a digital euro for several years, and the European Union could introduce a digital euro bill in 2023. But, will it come with limitations, such as a ceiling on digital euros that can be held by a single party? A United States digital dollar could be the most awaited government digital currency given that the USD is the world's reserve currency, but when will it appear, if ever? Implementation could be at least five years away.

Amid all this uncertainty, one question has persisted, at least in the cryptoverse: What impact will large-economy digital currencies have on stablecoins? Would it leave them any oxygen to breathe?

On the positive side, some believe that most large-scale CBDCs will go the wholesale route, i.e., allowing direct access to digital money by a limited number of large financial institutions. If so, could this leave a "retail piece" for stablecoins in the payments sector?

"Their wallets or accounts might be held by intermediaries like commercial banks, who then have claims on the central bank. But effectively, most CBDCs will be used for retail payments," Gerard DiPippo, senior fellow at the Center for Strategic & International Studies, told Cointelegraph. "This includes China's e-CNY, which many

international studies, told Cointelegraph. This includes China's e-CNY, which many believe will be the first large-economy CBDC to be rolled out at scale."

"While it's still early to make a call, I would expect that CBDCs will be accessible by both retail and wholesale parties," Arvin Abraham, a United Kingdom-based partner at law firm McDermott Will and Emery, told Cointelegraph, adding that:

"Governments have a competitive imperative to allow for retail use of CBDCs to keep their currencies relevant in a world with stablecoins and other cryptocurrencies that are increasingly being accepted as means of payment."

A competition for users?

Assuming, then, a retail contest arises between stablecoins and CBDCs, which is likely to prevail?

"The obvious advantage of stablecoins is that they exist or are at least further along than most CBDCs. This is especially true in the U.S. context," said DiPippo. "I think a U.S. CBDC would take many years to deploy even if authorized by Congress today."

On the other hand, others believe that CBDCs, if and when they appear, will make stablecoins redundant. Consider that the two leading stablecoins, Tether (USDT) and USD Coin (USDC), are both linked to the U.S dollar and both aim for a 1-1 peg.

“In a world with a U.S. dollar CBDC, the need for these coins goes away, as there will be a crypto native alternative that is always backed 1-1 by the dollar and is effectively interchangeable with its fiat equivalent,” said Abraham.

But, maybe the outcome isn’t binary; a choice of one or the other. Perhaps they can peacefully coexist, a possibility that has been put forth by no less of an authority as the U.S. central bank’s second-highest-ranking official.

“If private monies — in the form of either stablecoins or cryptocurrencies — were to become widespread, we could see fragmentation of the U.S. payment system into so-called walled gardens,” Fed Vice Chair Lael Brainard testified in a May Congressional hearing, adding that: “CBDC could coexist with and be complementary to stablecoins and commercial bank money by providing a safe central bank liability in the digital financial ecosystem.”

Can stablecoins and CBDCs exist side by side?

Is this harmonious scenario realistic? “I see no reason why stablecoins and CBDCs cannot coexist,” DiPippo told Cointelegraph. “In practice, their degree of coexistence will depend in part on regulations, specifically whether some governments even allow stablecoins for payments — especially in the cross-border context.”

Much will depend on the user experiences, cost advantages, and general usability of each instrument, DiPippo added. “In general, I have more confidence in the private sector to succeed in these respects. I’m not so much worried about stablecoins being ‘crowded out’ as I am worried about them being banned.”

Coinbase cryptocurrency exchange not only believes in cohabitation but says CBDCs

Coinbase cryptocurrency exchange not only believes in competition, but says CBDCs may even boost stablecoins, according to a July white paper. “We strongly believe CBDCs will complement and encourage robust, inclusive, and safe innovation for stablecoins and the broader digital asset economy.”

Stablecoins are in a better position to innovate than CBDCs, Coinbase added. “In addition to having a first-mover advantage, stablecoins are expected to continue to rapidly evolve and innovate over the coming years, experimenting in ways CBDCs may not be able to due to differences in size and scope.”

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CBDCs, too, may come freighted with certain constraints from which stablecoins could be exempt. In its quest for a digital euro, the European Central Bank is “exploring a 3,000 euro limitation on the amount of digital euro that can be held by one party, based on various policy considerations,” the white paper noted. If that were to happen, stablecoins would arguably be able to serve those “needing a larger holdings of a digital fiat currency equivalent.” Stablecoins might also offer higher interest rates than CBDCs, the paper suggested.

“There could still be a role for stablecoins alongside CBDCs, although it would be more limited than today,” acknowledged Abraham. Stablecoins could have utility in providing a convenient means to have an interest in a basket of stocks, commodities and others. That is, “their function would be more akin to tracker funds where value is pegged to several assets.”

Then, too, a U.S. CBDC may not be ready for a full rollout for another five years, wrote Thomas Cowan, part of the team at the Boston Fed that in February released a

Thomas Cowan, part of the team at the Boston Fed that, in February, released a technical research paper on potential CBDC designs in a recent blog:

“By the time a U.S. CBDC is issued, regulated stablecoins could provide solutions that a CBDC may have been designed for—such as boosting financial inclusion, cutting transaction costs and settlement time, increasing access to USD, and even expanding the dollar’s role as the global reserve currency.”

MiCA darkens stablecoin prospects in Europe

In Europe, though, the outlook for stablecoins – or “so-called ‘stablecoins’” as some EU officials call them – could be more problematic. The Markets in Crypto-Assets (MiCA) regulation, expected to take effect in 2024, presents “a number of challenges for stablecoins,” said Abraham, most notably a ban on the paying of interest by stablecoin issuers.

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Such a prohibition would “deprive European citizens of an attractive investment option, particularly considering that financial stimuli instruments adopted to limit the economic impact of lockdowns are expected to result in historically high inflation rates,” noted Firat Cenzig, a senior lecturer in law at the University of Liverpool. Meanwhile, Nicolaes Tollenaar, partner at the Dutch law firm Resor, suggested in a *Financial Times* opinion piece in early August that such a ban “would force issuers to adopt a business model that is only sustainable with near-zero interest rates,” which are unlikely in the near future.

Wherefore China?

Elsewhere, China’s e-CNY has already been used by an estimated 250 million, and it remains a key part of any global CBDC discussion. What would a digital yuan mean for not only stablecoins but also the U.S. dollar?

In March, a Hoover Institution study noted that “over time, the spread of the e-CNY might diminish the role of the dollar as the world’s reserve currency and undermine the ability of the United States to deploy financial sanctions against rogue international actors.”

DiPippo, for one, doesn’t see much threat from an e-CNY on the international stage, however. “The e-CNY is unlikely to resolve the broader problems with renminbi internationalization, including China’s capital controls and geopolitical concerns.” The primary use of the e-CNY is for domestic retail transactions, though “experiments are underway to make the e-CNY usable across borders and interoperable with some regional CBDCs,” he added.

It is unlikely to do much to dent the USD's standing as a reserve currency per se, primarily because it is designed as a digital cash substitute that does not pay interest. "Central banks would not move a substantial share of their international reserves into a cash substitute with no yield; they'll continue to hold bonds. The e-CNY will not change that," DiPippo told Cointelegraph.

What about financial inclusion?

All in all, there are good reasons why CBDCs and stablecoins might be seen to be locked in a zero-sum game. They have the same design purpose, i.e., moving money more effectively, and a large-economy CBDC is not likely to be blockchain-based either because that would make it too slow, according to Cowan.

Elsewhere, Eswar Prasad, professor of economics at Cornell University and author of the book, *The Future of Money*, told Cointelegraph earlier this year: "A widely and easily accessible digital dollar would undercut the case for privately issued stablecoins," though stablecoins issued by major corporations "could still have traction, particularly within those corporations' own commercial or financial ecosystems."

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In the end, consumers may determine which instrument carries the day. In terms of market adoption, "the user experience will be key," added DiPippo. "So in that regard, I do not see stablecoins having an inherent advantage over CBDCs."

There is the matter, too, of financial inclusion, a goal to which both CBDC designers

and stablecoin issuers pay lip service. “Everyday people like you and me are unlikely to go to the Fed to get our CBDCs to transact with on a daily basis,” wrote Cowan. That is, customers will still get their digital dollars from commercial banks, just as they get cash today from local banks. That might not help those who don’t have bank accounts. According to Cowan:

“Regulated stablecoins could be better positioned to improve financial inclusion. This is because stablecoins are on numerous public chains and can be stored and moved easily without the need for a central party—just like cash today.”

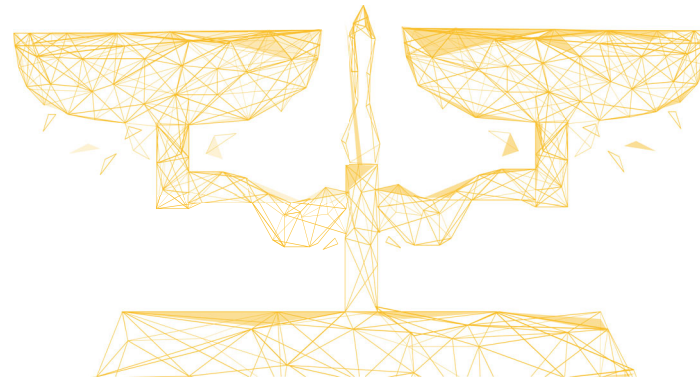
Cowan sees room for both financial instruments: “However value is stored and exchanged in the future, both stablecoins and CBDCs are likely to have a leading role in the upcoming transformation of finance.”

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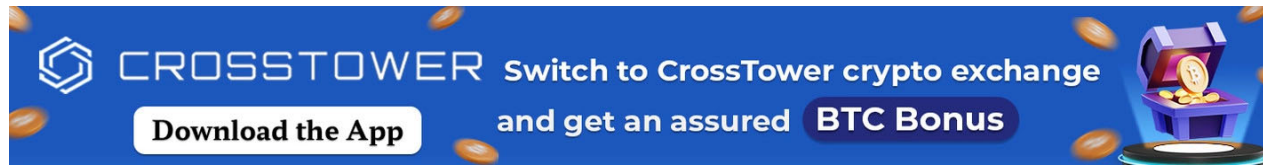
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