Stablecoins and Monetary Policy

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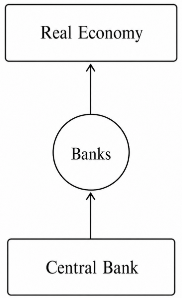
Standard Monetary Policy Transmission

- Central banks transmit monetary policy to the real economy by changing
  1. Interest on reserves
  2. Reserve quantity
  3. Crisis intervention

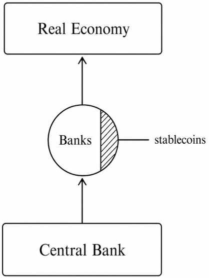
  for the banking system

- Efficient monetary policy transmission requires the banking system to "pass on" central bank rates and policies



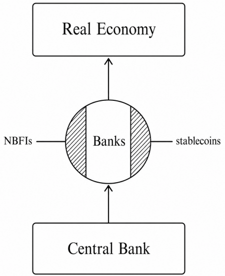
Monetary Policy Transmission with Stablecoins...

- Stablecoins as deposit substitutes
  - Issued outside of the banking sectors
  - Liability side: compete with deposits
  - Asset side: portfolio of fiat assets
- Banking sector and hence the effectiveness of monetary policy transmission shrinks
  - Unless central banks directly influence stablecoins



...Resembles Monetary Policy Transmission with NBFIs

- We can draw lessons from the rise of NBFIs because stablecoins are just like an NBFI
  - Combination of MMF + ETF
- Increase in market-based interventions by central banks in recent decades, e.g.,
  - March 2020 purchase of corporate bonds
  - Increased focus on repo rates influenced by hedge funds' leveraged Treasury holdings
- This trend will be further amplified by the growth of stablecoins



Splitting the Pie versus Changing the Size of the Pie

- So far, we considered "splitting of the pie"
  - Domestic deposits $\rightarrow$ stablecoins
- But, for a given country, stablecoins may also change the "size of the pie"
  - Foreign funds $\rightarrow$ stablecoins
- This is an important distinction
- Different implications for
  - Safe asset and reserve demand
  - Convenience yield
  - r^*