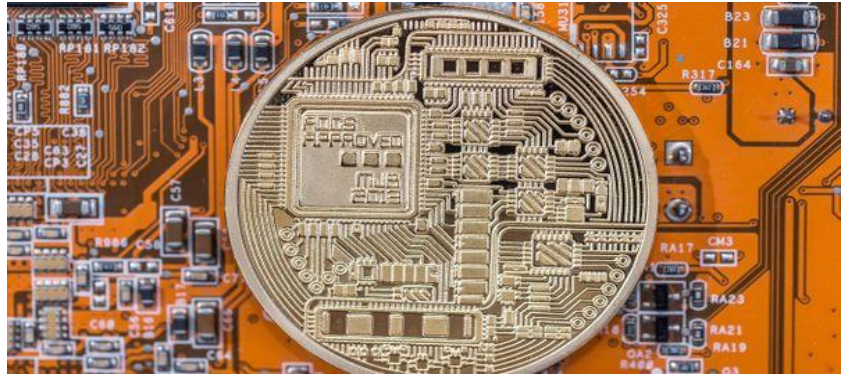




*R&R Weekly Column*  
*By Brunello Rosa*



### The Financial Stability Implications of Libra (And Private Sector Money in General)

Last week, Facebook unveiled its plan to introduce a new means of payment for small transactions, called [Libra](#). Although many of the details about it have yet to be revealed, some comments seem warranted based on what we know already. As far as we know, Libra, which will be backed by existing centralised payment systems such as Visa, Mastercard and PayPal, is not a crypto-currency. Facebook itself labelled it a “stable-coin” for this reason. Additionally, as persuasively argued by [Nouriel Roubini](#) and other leading economists, crypto-currencies are not currencies insofar as the volatility of their exchange rates with conventional currencies such as the US dollar does not make them a safe store of value, which is one of the key characteristics of money. At most, crypto-currencies can be considered as highly speculative, crypto assets.


It is unclear for now how “regular” money will be transferred into Libra wallets, at what rate of exchange such transfers will occur at, or whether consumers will be charged a fee whenever they do so. But let us assume that at some point all 1.7bn people on Facebook will have a Libra wallet. That would be a momentous feat, at least in terms of the scale of such an operation. And it would be just the latest arrival with in an increasingly crowded space, in which non-financial corporations are entering *en masse* into the traditional space occupied by financial companies. Other examples of this include [Apple Pay](#), [Ali-Pay](#), [We Chat Pay](#), and [Amazon’s loans to sellers](#) on its own platform.

It is now time to take stock of these developments, and assess some of the potential risks that could come along with some of the purported advantages for the consumer, such as reduced fees for small transactions. The fact that the private sector creates money is not cause for concern, nor is it anything new. Most of the money we use – which, incidentally, is already largely electronic, even if not “digital” – is created independently by commercial banks rather than by central banks, the latter of which maintain the monopoly to issue high-power money (the so-called monetary base).


Banks creating money via their loans are however subject to strict prudential regulations, which establish that there needs to be a relationship between the deposit held and money created. Banks have a lender of last resort, the central bank itself, which has its own international lender of last resort, the [Bank For International Settlements](#) (BIS). Deposits at commercial banks enjoy a public guarantee (in Europe, it is up to EUR 100,000 per current account), and banks enjoy an implicit backstop by their sovereign (hence the too-big-to-fail problem, when the individual financial institution is much larger than the sovereign that is supposed to provide the backstop for it). None of these implicit and explicit guarantees will be available for Libra and other forms of digital currency. Who is going to police against fraud, or against money laundering activities, for example? If something goes terribly bad, who will be the ultimate lender of last resort?


We are entering a dangerous territory here from the perspective of financial stability. For these reasons, leading regulators such as the [BIS itself](#) have started to give their warnings about the subject. As Mark Carney, Governor of the Bank of England and former President of the Financial Stability Board, [reportedly said](#), If Libra is successful in attracting users it would “instantly become systemic and will have to be subject to the highest standards of regulation.” We are registering here the dramatic increase of offers of new forms of money, means of payments, etc., by private-sector participants, more often than not from non-financial corporations, clearly aimed at disintermediating the traditional channels dominated by banks. This is nothing new: during the eighteenth and nineteenth centuries, plenty of corporations issued their own private forms of payment. That proliferation was at the origin of some of the worst scams and financial instability episodes (for a collection of which, read “[Manias, Panics, and Crashes](#)”, the masterpiece written by Charles Kindleberger). The final users of such products, excited by what seem to be “innovations,” should remember these historical precedents when embracing these newly offered means of payment.


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Looking Ahead

The Week Ahead: Turkish Elections Still To Be Decided And Stable Inflation

**In Turkey**, the CHP opposition candidate to mayor of Istanbul, Mr. Imamoglu, won against the AKP candidate, Mr. Yildirim. Following the elections, the government is likely to take measures to: *i)* support the ailing sectors of the economy; *ii)* improve fiscal performance; and *iii)* restore investor confidence.

**In the US**, inflation is expected to remain stable, and below the Fed target (2%), providing further justification for a rate cut (PCE May, c: 1.5% y-o-y; p: 1.5).

**In the EZ and Japan**, inflation is expected to slightly pick up (EZ CPI Jun., c: 1.3% y-o-y; p: 1.2; Tokyo CPI Jun., c: 1.3% y-o-y; p: 1.1) but remain below CB-target (2%).

The Quarter Ahead: Geopolitical Risks To Remain High

**In the US**, Fed will monitor economic developments and, due to a slowing global economy, is likely to adopt a dovish stance in H2-2019. Market expectations of 'one rate cut in July' rose to 68%.

**In the US**, the Trump administration is weighing new sanctions - that could be imposed as early as July - over Turkey's purchases over the S-400 missile-defense system.

To restart **trade talks**, US President Trump will meet **China's** General Secretary Xi at the G20 summit.

**In the EZ**, EU leaders will meet on June 30<sup>th</sup> to overcome the current gridlock on the candidates for the top positions in the bloc, including the ECB. President Draghi stated ECB's "readiness to cut interest rates or re-launch asset purchases if the economic outlook does not improve".

**In the UK**, the contest to succeed PM May has hardened the "Brexit" rhetoric: Mr. Boris Johnson, runner-up candidate, has declared that "the UK will leave the bloc on October 31 with or without a deal"; yet, a vote of 'no-confidence' in the government could lead to a general election. The BoE downgraded its growth forecast due to: *i)* Brexit prospects; and *ii)* the ongoing US-China trade war.

**In Iran**, over the next 10 days the country is set to surpass the 'uranium-stockpile limit' set by the nuclear deal, raising pressure on Europeans to save the accord, a year after the US withdrawal heightened tensions.

Last Week's Review

Real Economy: Rising Geopolitical Risks In The Middle East

**In the US**, the Fed held interest rates unchanged as expected (a: 2.50%) and prepared the grounds for a rate cut, by removing in its statement the previous pledge to be "patient", "given rising risks" (i.e. the ongoing US-China trade war).

**US** President Trump called off a military strike on Iran after a US drone was shot down over the Strait of Hormuz. The manufacturing (Markit PMI Manuf. Jun., a: 50.1; c: 50.4; p: 50.5) and services sectors (Markit PMI Serv. Jun., a: 50.7; c: 51.0; p: 50.9) weakened but remain above the 50-benchmark.

**In the EZ**, the manufacturing sector continues to contract (Markit PMI Manuf. Jun., a: 47.8; c: 48.0; p: 47.7).

**In Japan** and **the UK**, the BoJ and BoE left interest rates unchanged, as expected, at -0.1% and 0.75%, respectively.

Financial Markets: CB Stimuli Expectations Lifted The Markets

**Market drivers**: dovish guidance from the Fed and the ECB lifted both equities and bonds. In the short term, news narrative will remain the main driver.

**Stocks**: w-o-w, global stocks rose (MSCI ACWI, +2.4%), led by the US (S&P 500, +2.2%, hitting a record high) and the EZ (Eurostoxx, +2.6%).

**Bonds**: globally, indices rose w-o-w (BAML Global bond index, +0.4%). Yields fell across DMs, w-o-w: the 10Y UST yield fell by 3 bps to 2.07%, while German bund yields fell by 3 bps to -0.28%.

**FX**: the USD weakened against a basket of currencies (DXY, -1.4%) and the EUR rose (EUR/USD, +1.4% to 1.137). EM currencies strengthened (MSCI EMs, 1.2% at 1,642).

**Commodities**: Oil prices rose w-o-w (Brent, +5.1% to 65.2 USD/b) due to risings tensions in the strait of Hormuz. Further geopolitical escalation in the Middle East is an upside risk for oil prices. Driven by rising political tensions and lower bond yields, gold keeps rising a safe-haven asset (Gold, +4.3% w-o-w to 1,399 USD/t oz).



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## Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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